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A Recipe for Success in Southeast Asia's Food and Beverage Market

Corporate and investor interest in Southeast Asia's food and beverage (F&B) industry is more intense than ever. Consumer demand in the region is being driven by rising populations, income levels and evolving tastes.

A wealth of new products and the increasing penetration of modern retailing have led to double-digit growth rates for numerous F&B categories across the region. In Vietnam, retail sales of frozen processed food, cheese and chocolate confectionary grew by 24%, 15% and 13% respectively in 2013[1].

Whilst opportunities are aplenty in the region, the landscape is highly competitive, and varies widely across geographies and market segments. It is important for brands looking at entering the Southeast Asia market to identify unique and lucrative opportunities, and to apply an appropriate methodology for entry. For example, although Cambodia is a relatively small market, it can pay large dividends to category leaders with the right strategic approach.

L.E.K. Consulting has been advising strategic operators and private equity investors on Southeast Asia for 15 years, and have identified three key factors or 'ingredients' for success (Figure 1).

Figure 1

Key factors for entry into the Southeast Asia F&B market

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[1] Euromonitor 2013

One Cup Of Taste and Innovation

In any market, products need to align to consumer tastes to succeed. The best operators in Southeast Asia F&B are constantly innovating, introducing new products and modifying established ones to keep up with varied and changing consumer preferences.

Across the region, globalization and increasing global interconnectedness of the urban middle class have turned consumers towards Western diets. The rapid spread of global supermarket chains and fast food restaurants is also reinforcing these trends.[2] And as a consequence, traditional F&B products are being "Westernised" or enhanced. For example in Vietnam, chrysanthemum tea, a traditional drink has been repackaged into ready-to-drink designs and has been a major source of growth for beverage brands. Similarly brands in many categories have freshened up established products by introducing new flavours, new package sizes and package formats.

Two Cups of Marketing and Pricing

The arrival of foreign brands combined with dynamic local players; make the Southeast Asia F&B market highly competitive. Brand owners must be prepared to invest substantially in branding and marketing to gain consumer attention, particularly in certain product categories. For instance, Otsuka's Pocari Sweat has long dominated Indonesia's isotonic drink market with roughly 80% market share in 2005. However, Danone was able to make a strong entry through successful campaigns leveraging its Mizone brand – capturing over 40% of the market by 2010.

Brand owners entering the market also need to be aware of the extensive use of social media and consumer reliance on mobile communications in Southeast Asia. Whilst this is a common trend around the world, three Southeast Asian countries form part of the top ten users of Facebook (Indonesia, the Philippines and Thailand), making this a valuable communication channel between brands and consumers.

The competitive landscape also has implications for how brands target and price their products. The existence of 'Magic Sales Price' (MSP) in several countries is a key issue. MSP is a psychological price limit that consumers associate with a unit of most typical consumer goods -from a bottle of shampoo to a packet of potato chips. In some Southeast Asian countries, it can be a relatively small amount making pricing a challenge for F&B brands. In Indonesia approximately 1,000 Indonesian Rupiah (IDR) or roughly $USD0.10 is considered the MSP that consumers expect to pay for common household items. This pricing makes margin management especially difficult in a rising input cost environment.

Distribution challenges can further complicate a brand's ability to price products. The challenge stems from a need to maintain similar retail price across various channels despite significantly

[2] Pingali, Prabhu, "Westernization of Asian diets and the transformation of food systems: Implications for research and policy", Food Policy Volume 32 Issue 3, June 2007

[3] Socialbakers.com 2014

different costs. In order to mitigate this issue, many successful Southeast Asian brand owners offer different Stock Keeping Unit (SKUs), product sizes and even different brands, for use in different channels and regions.

> *New brand entrants are often daunted by these challenges and focus initially on large, dense markets such as Jakarta, causing them to miss out on potentially higher-margin opportunities elsewhere*

Three Cups of Distribution

Getting products to shelves is perhaps the most challenging part of operating in Southeast Asia. This is a result of three factors:

1. The geographical complexity of certain countries e. g. Indonesia and the Philippines.
2. The lack of modern transportation and storage infrastructure in various locations.
3. The relatively low share of products sold through modern trade.

In addition, the distribution strategy a brand selects will also have a direct impact on the scale and number of manufacturing sites required. For example, a distribution strategy that aims to serve all of Indonesia will generally require production on several islands in order to be cost competitive or maintain similar pricing across the country.

New brand entrants are often daunted by these challenges and focus initially on large, dense markets such as Jakarta, Manila or Bangkok, causing them to miss out on potentially higher-margin opportunities elsewhere. For example, L.E.K.'s research of the non-alcoholic beverages market in Indonesia found that realised pricing in second-tier cities like Medan, North Sumatra could be materially higher than in highly competitive Jakarta.

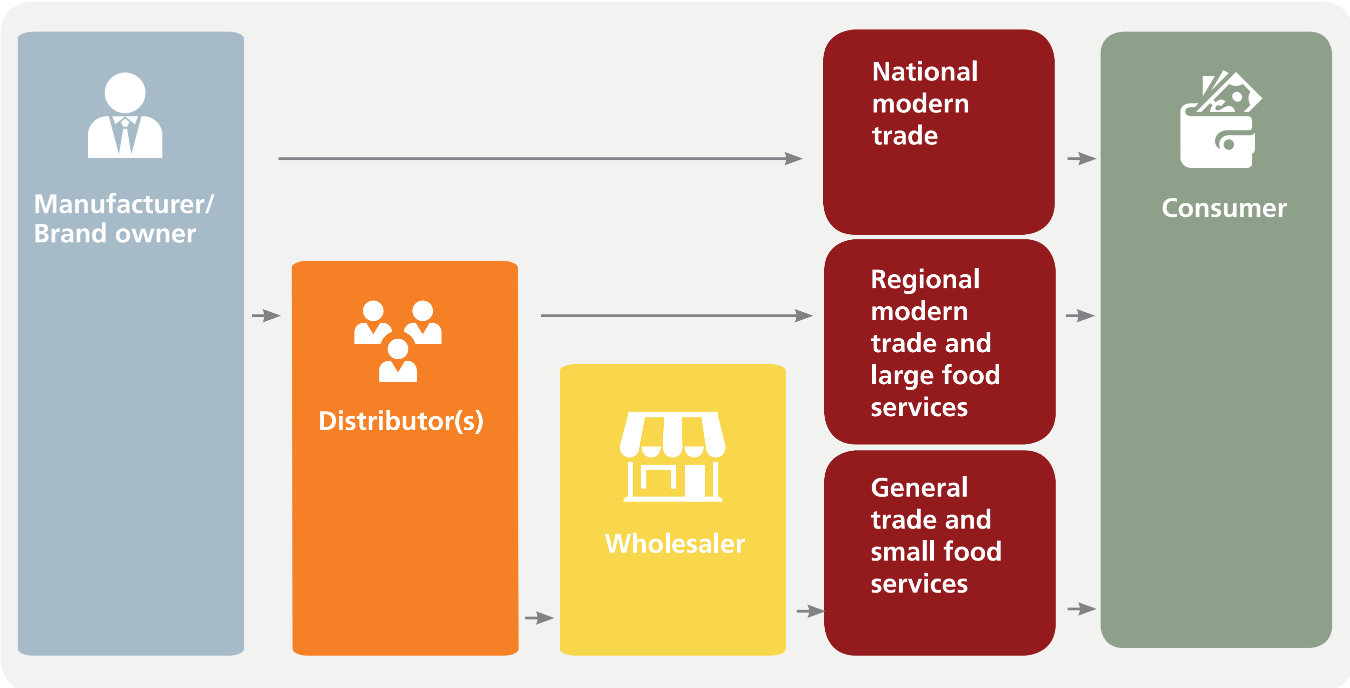
Therefore understanding and overcoming impediments such as complex distribution value chains, varying coverage quality and challenging commercial terms, are vital to increasing sales volume, achieving long-term success and profitability.

1. Distribution chains

There can be a large number of players in the distribution value chain: direct customers, national distributors, regional distributors, wholesalers, larger retailers and traditional trade outlets. Many new entrants will use distributors as their primary agents, giving them full control of pricing and negotiations to the various channels. However more established players, will negotiate with and supply direct to modern retail chains, only employing distributors for general trade. This model of mixed trade channels was the optimal solution for one packaged F&B manufacturer in Thailand (Figure 2), as it provided a number of effective penetration points to the consumer, allowing them to achieve optimal sales volumes and profitability.

Figure 2

Distribution chain of packaged F&B manufacturer in Thailand



The importance of different trade channels to brand owners can vary depending on the product category. For instance, a significant majority of chocolate confectionary in Thailand is sold via modern trade outlets such as supermarkets and convenience stores, while baked goods are predominantly sold via small "Mum and Dad" stores. Therefore brand owners should emphasise on building direct sales capabilities or distributor relationships, depending on their product offering.

2. Distributor coverage

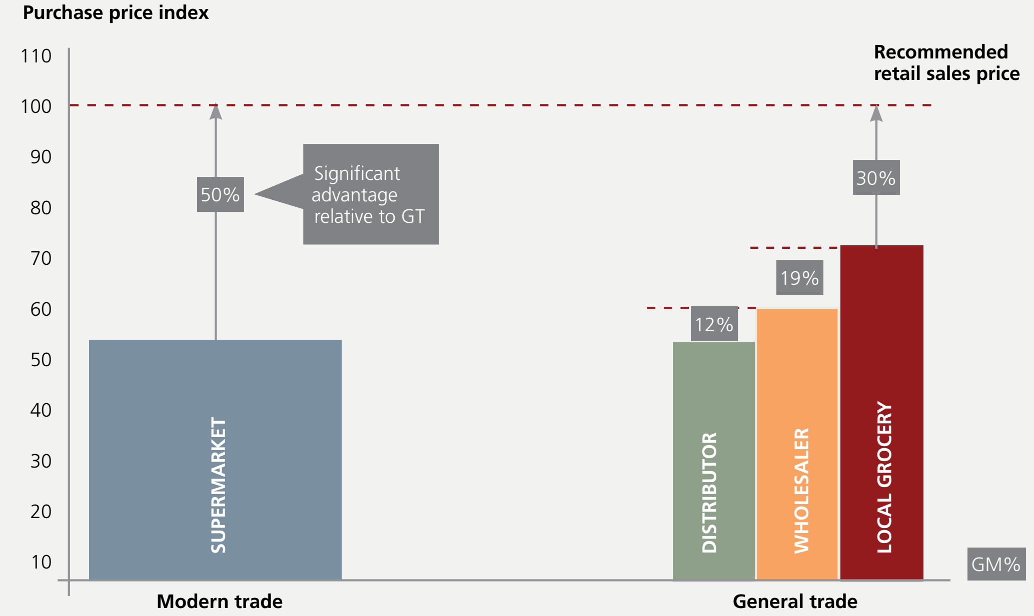
Administratively, it is easier for brands and manufacturers to deal with only one distributor. In some Southeast Asian markets, a national distributor can be appointed and relied on to make products available to consumers. This is a logical decision as it allows brands to focus on production and marketing. However, it makes choosing the right distributor a critical decision and requires an extensive evaluation of not only of the distributor's breadth but also their depth. For example, Indonesia has over two million traditional trade outlets[4] and national distributors can provide coverage of many of these channels but their ability to comprehensively cover a specific or select market may be limited. Thus brand owners can be giving up greater margins through these mass market approaches. The best brand owners in Southeast Asia typically work with multiple distributors selected on the strength of their networks and assets, in distinct and profitable geographic regions.

3. Commercial terms

Southeast Asian Modern trade retailers typically possess strong negotiating positions through their ability to move large product volumes. As a result, they can extract significant concessions from brand owners in the form of discounts, off-invoice marketing support, and in some cases, slotting fees to guarantee shelf space. Nevertheless, dealing with modern retailers can be relatively straightforward compared with the complexities of general trade channels (Figure 3).

Figure 3

Illustrative purchase price index for a carbonated beverage in Indonesia



Source: L.E.K. Consulting research 2014

General trade channels require brands to provide consistent price parity to consumers yet there needs to be enough room in pricing to allow for the various tiers of distributors, wholesalers, and retailers to earn reasonable returns.

In addition, maintaining pricing discipline in a fragmented distribution value chain can be highly challenging. Many brands manage their direct distributors well but struggle to control consumer pricing, particularly in indirect general trade channels. The most successful brands use the strength of their name to exert control far down the distribution chain, sometimes going as far as mandating prices at every point. Other strategies involve setting selling prices (and monitoring them closely) throughout the distribution chain in order to provide consumers a consistent price experience regardless of the channel. Also, aggressive advertisements of retail prices to end consumers can be undertaken to ensure pricing discipline in the value chain.

Non-price trade terms can be complex but it can also provide brand owners interesting opportunities if they think innovatively. For example, unsold stock is a major concern for Southeast Asian distributors and they often demand rich terms for products in new, unproven markets. Recognising this, a new snack brand in Indonesia allowed returns of unsold stock from its distributors in order to obtain favourable pricing.

It is hard to argue with the fundamental attractiveness of Southeast Asia and the growth potential offered by its component countries. However, the region is a complex and competitive market where success is defined not only by product quality or marketing efforts but also by a brand's ability to get its product to consumers using an optimal distribution strategy. It is essential for brands and investors looking at the Southeast Asian market to have a sound understanding of local distribution structures, coverage, and commercial terms.

[4] Nielsen 2014

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