The Rapid Rise of Supermarkets in Central and Eastern Europe: Implications for the Agrifood Sector and Rural Development

Liesbeth Dries, Thomas Reardon and Johan F. M. Swinnen

During the 1990s transition period in Central and Eastern Europe, the retail sector was privatised and some domestic-capital supermarket chains gradually emerged. Massive inflows of foreign direct investment followed and competitive domestic investments drove a rapid take-off of large-format modern retail sector development from a tiny ‘luxury’ niche of around 5% of food retail in the mid-1990s to 40-50% by 2003 in ‘first-wave’ and 20-40% in ‘second-wave’ countries. In ‘third-wave’ countries like Russia, it is still only 5% but growing very fast elsewhere. In most countries there is rapid multi-nationalisation and consolidation of the supermarket sector, with profound changes in procurement systems affecting the conditions facing farmers, and creating important opportunities and challenges. The article ends with a review of policy options and a research agenda.

1 Introduction

Recent studies have shown a meteoric rise of supermarkets in Latin America in the past decade (Reardon and Berdegué, 2002; Reardon et al., 2003a), with profound effects on agrifood systems via important changes in organisation and institutions, including centralisation of procurement from farmers, decline of traditional wholesale systems, and demanding private standards on product quality and safety. The supply-side implications of these changes took a heavy toll of smaller and under-capitalised producers unable to meet the new requirements, with the resultant exclusion of many small producers, in addition to the creation of new dynamic markets for local farmers (Reardon and Berdegué, 2002).

This leads to the question of whether Central and Eastern Europe (CEE) might be experiencing a profound and rapid retail transformation similar in scope and speed to
that of Latin America, but perhaps different in its path, nature, and implications for suppliers and rural development. There is growing evidence of such a revolution recently in Poland, Hungary, and the Czech Republic, which is rapidly spreading East and South. The trade press, such as the CIES Food Business News, which is the news arm of the largest retailer and food supplier association in the world (CIES Food Business Forum), in the past few years has been reporting intense activity of major international retailers setting up shop in the CEE region.

Little research has been undertaken to date, however, on this, or its consequences for the agrifood sector. For the past decade, there has been considerable research on how various supply-side aspects (such as land reform, farm restructuring, rural credit problems, and market institutions) have affected the post-transition path of agricultural development in CEE (see Lerman et al., 2004; and Rozelle and Swinnen, 2004 for an overview). There have also been several studies of how pre-transition conditions, combined with land and factor market transitions, affected the development of the processing sector in a number of countries (Gow and Swinnen, 1998; Walkenhorst, 2000; Dries and Swinnen, 2004a). However, there has been very little analysis of the retail system, and no analysis at all of how pre-transition conditions in the retail sector (the ‘tail that wags the dog’ of the agrifood system) conditioned the development path of the sector after the transition, and in turn how the latter, combined with the post-transition conditions of factor markets plus change in the processing sector, determined the conditions now faced by farmers in the region.

To address this gap, this article explores: (i) the extent, speed, and nature of the retail transformation in the CEE region; this includes diffusion of ‘modern, large-scale format stores’ such as supermarkets, hypermarkets, cash & carry, and discount stores, all of which we group for simplicity under the term ‘supermarkets’, unless distinction is needed; (ii) the organisational and institutional changes in the food product procurement systems of supermarkets in the region, with a particular focus on horticultural products; (iii) hypothesised implications of this change in the procurement system, which represents a change in the wholesale sector faced by farmers, on farmers and food firms in the region.

We expect the latter to be important, which makes this subject important to policymakers engaged in farm and food policy as well as rural development programmes. Governments in the region are developing new rural strategies to help farmers and food processors cope with the profound change on the factor market side as well as with increased competition in an integrated European and global market. Yet a rapid transformation of the domestic retail sector – and thus the buyers these farms and firms face – including the profound organisational and institutional change this brings, is likely to reinforce this process through a consolidation of buyers demanding large volumes and consistent deliveries over the year, and imposing very demanding quality and safety standards. While much of the policy debate has focused on trade issues, the impact of international forces may be stronger and more radical through the rapid rise in the CEE itself of supermarket chains that tend to set the conditions in the agrifood system internationally. To put this in perspective, we should note that, in Latin America, supermarkets already buy 2.5 times more fresh fruits and vegetables (FFV) than the region exports! In other words, research is showing that, in other developing regions, the effect of local supermarkets on local producers far exceeds the effects of trade
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regime changes on farmers (Reardon et al. 2003a). This might be the case in CEE as well.

Three stages appear to structure the path of change in the retail sector in the region, and we structure the article accordingly. The first stage is the pre-transition, or ‘communist’, period, roughly pre-1990, when in most of the countries the state played an important role in the retail sector, combined in some countries with a significant parallel retail sector that was private, informal, and small-scale. The second stage is the early transition period when the earlier system was changed, often via privatisation (ownership change) without fundamental change in the distribution (concentration of ownership or location pattern) and format (small versus large) of the retail stores. The third stage is the ‘globalisation period’ that started in some CEE countries in the second half of the 1990s with major investments by multinationals, and is strong today. In this stage, supermarkets emerged or rose rapidly relative to their earlier development, with a proliferation of formats (large-format stores, including hypermarkets, discount stores, cash & carry, as well as small-format convenience chain stores), in addition to deep changes in their procurement systems (such as the establishment of centralised buying and distribution centres, shifts from traditional brokers to new, specialised/dedicated wholesalers, to use of private standards, and generally the decline of traditional wholesale systems).

The article proceeds as follows. Section 2 discusses retail system change over the three stages. Section 3 analyses procurement system changes associated with the retail changes. The final section discusses implications for the supply side (farms and firms), with policy implications and an agenda for extending this preliminary research.

The sources of information used for this study were limited by the fact that governments in the region have not yet put in place systematic tracking systems for the retail sector or its procurement systems. At most, there are counts of numbers of stores, which is rather like counting the number of farms in order to be able to describe an agricultural system. The reason for the dearth of official data is doubtless the suddenness of the change in the sector, and a lack of appreciation (which we note around the world) of the centrality of retail sector decisions for the conditions of the entire agrifood system. Hence, we have had to rely on articles in the retail trade press and several private sector consultant analyses, as well as rapid reconnaissance work in several countries selected as ‘polar cases’ from which to construct an image of the potential spectrum of answers to our questions. These cases include Croatia, the Czech Republic, Slovakia, and Poland, in May-July 2003.

2 The transformation of retail systems in CEE

2.1 Stages and waves

Table 1 summarises the key characteristics of the retail system in the three stages outlined above in Section 1. In the following sub-sections we discuss these characteristics in more detail. However, at the outset, it may be important to emphasise that all CEE countries have gone through the same three stages, but that they have varied significantly in the speed with which they have moved from one stage to the next. There is considerable documentation on when various countries implemented certain reforms, although it is much less specific on the retail sector. However, all CEE
countries started the transition stage between 1989 and 1991. There is much more variation in the next stages; as explained below, some countries entered the globalisation stage in 1996, while others did not do so until 2002 or later. Below, we document a number of ‘waves’ of countries progressing more or less simultaneously in the transformation stages. For example, countries such as the Czech Republic, Hungary, and Poland are ‘first-wave countries’, starting the globalisation period around 1996. Balkan countries such as Croatia, Romania, and Bulgaria are part of a second wave, where retail globalisation started in the late 1990s. In a third wave of countries, including Russia and Ukraine, retail globalisation did not really start until 2002 (see Table 2).

**Table 1: Key characteristics of the three stages of retail transformation**

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Communism</th>
<th>Transition</th>
<th>Globalisation</th>
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<tbody>
<tr>
<td>Concentration in retail sector</td>
<td>High</td>
<td>Low</td>
<td>High</td>
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<tr>
<td>Dominant source of capital</td>
<td>Domestic</td>
<td>Domestic</td>
<td>Foreign</td>
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<tr>
<td>Foreign investment</td>
<td>-</td>
<td>Brownfield</td>
<td>Greenfield</td>
</tr>
<tr>
<td>Share of modern retail</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Share of large multinationals</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Location of modern retail outlets</td>
<td>-</td>
<td>Cities</td>
<td>Everywhere</td>
</tr>
</tbody>
</table>

### 2.2 Retail systems before the transition

The retail system before the transition varies among the CEE countries. Two distinctly different models, illustrated in Figure 1, are the ‘centralised/state’ approach and the ‘decentralised/state-private mixed’ approach. Most countries followed the former approach where retail and wholesale entities were mainly state-owned or co-operatives organised as geographic monopolies, with little or no competition among them (Nowak, 1991; Seitz, 1992). Privately owned companies played only a minor role (Seitz, 1992; Henry and Voltaire, 1995).

An example of the ‘centralised/state’ model is the former Czechoslovakia, where, before the transition, the state operated a centralised retail and procurement system. The retail sector was fully formal, with no informal retail allowed. Most food sales took place in state enterprises (zdroj) whose shops were either broad-line food shops or fresh fruits and vegetables (FFV) shops. In addition to the state enterprises, an important share of food distribution was done via consumer co-operatives (jednota) and state-owned department stores (prior). The consumer co-operatives were mainly in urban marginal or rural areas and thus were concentrated in what would become Slovakia rather than in what would become the Czech Republic. The retail sector consisted of a mix of small supermarkets and small shops in urban areas, and small shops and co-operatives’ sales outlets in rural areas.
Table 2: Waves of retail transformation in CEE

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<tr>
<td><strong>Retail development</strong></td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>% modern retail in total</td>
<td>1998</td>
<td>54</td>
<td>46</td>
<td>27</td>
<td>34</td>
<td>19</td>
<td>3</td>
<td>5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>55</td>
<td>48</td>
<td>44</td>
<td>49</td>
<td>42</td>
<td>8</td>
<td>23</td>
<td>1-2</td>
<td>&lt;1</td>
</tr>
<tr>
<td>Foreign food retail sales per urban resident (US$)</td>
<td>2002</td>
<td>808</td>
<td>503</td>
<td>302</td>
<td>377</td>
<td>93</td>
<td>64</td>
<td>148</td>
<td>4</td>
<td>2</td>
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<tr>
<td>% income spent in foreign food retailers</td>
<td>2002</td>
<td>14</td>
<td>10</td>
<td>7</td>
<td>8</td>
<td>2</td>
<td>3</td>
<td>8</td>
<td>0.2</td>
<td>0.3</td>
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<td><strong>Reform and development</strong></td>
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<tr>
<td>Reform progress EBRD</td>
<td>1998</td>
<td>3.5</td>
<td>3.7</td>
<td>3.5</td>
<td>3.3</td>
<td>3.0</td>
<td>2.7</td>
<td>2.8</td>
<td>2.5</td>
<td>2.5</td>
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<tr>
<td>GDP/capital (US$)</td>
<td>1998</td>
<td>5500</td>
<td>4600</td>
<td>4100</td>
<td>4000</td>
<td>4800</td>
<td>1900</td>
<td>1550</td>
<td>1800</td>
<td>800</td>
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<tr>
<td></td>
<td>2002</td>
<td>6700</td>
<td>6600</td>
<td>4900</td>
<td>4400</td>
<td>5000</td>
<td>2100</td>
<td>2000</td>
<td>2400</td>
<td>850</td>
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<tr>
<td>Income category</td>
<td></td>
<td>Upper middle</td>
<td>Upper middle</td>
<td>Upper middle</td>
<td>Upper middle</td>
<td>Lower middle</td>
<td>Lower middle</td>
<td>Lower middle</td>
<td>Lower middle</td>
<td>Lower middle</td>
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<tr>
<td><strong>Demography</strong></td>
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<td></td>
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<td></td>
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<tr>
<td>% urban population</td>
<td>2002</td>
<td>75</td>
<td>65</td>
<td>63</td>
<td>58</td>
<td>59</td>
<td>56</td>
<td>68</td>
<td>73</td>
<td>68</td>
</tr>
<tr>
<td>% females in workforce</td>
<td>2002</td>
<td>64</td>
<td>52</td>
<td>60</td>
<td>63</td>
<td>60</td>
<td>62</td>
<td>71</td>
<td>64</td>
<td>62</td>
</tr>
<tr>
<td>Male/female labour force</td>
<td>2002</td>
<td>1.2</td>
<td>1.3</td>
<td>1.2</td>
<td>1.2</td>
<td>1.2</td>
<td>1.2</td>
<td>1.1</td>
<td>1.2</td>
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Note: a) expected.

Countries with an important private or at least mixed component in the retail system were Hungary, Poland, and the former Yugoslavia. For example, Croatia, as part of the latter, represented the ‘decentralised/state-private mixed’ system before the transition. The state-owned chains of small-format stores, based in the various regions, sold mainly dry/processed products with only very small sections of FFV (and other fresh food). Private small shops operated in a parallel retail market. FFV were mainly retailed via green-markets in city, town and village squares.

2.3 The transition stage: privatisation and domestic restructuring

In the early stages of transition, there was an initial privatisation of the retail sector, generally associated with the breakdown of the highly concentrated state system into separate units that soon started to merge and form many small private retail chains. For example, in Bulgaria, the number of retail outlets tripled between 1990 and 2003, with the fastest proliferation in the early transition phase, when the number leapt from 15,000 in 1990 to 44,000 in 1995. In the ensuing seven years the number rose by only 3,000 to 47,000 in 2002 (a few years into the globalisation phase) (Bushnakova, 2003).

Almost all of the above was carried out with domestic capital; there were very limited retail FDI inflows during this period. Foreign investors encountered obstacles to entering the market due to unclear ownership structures, a ban on participating in privatisation auctions, unclear privatisation of state enterprises, unstable macroeconomic situations, and in some cases (such as Croatia) civil strife and political instability.

The few foreign retail chains that did enter the market managed to do so by buying existing, newly privatised chains; for example, in 1991, in the Czech retail sector, Ahold (Netherlands) entered by buying the Mana chain and Delvita (Belgium) by buying the
Sama chain of small supermarkets, and Tesco (UK) entered the Czech Republic and Slovakia in 1996 by buying the former Prior department stores. There was as yet no move in this incipient multinational presence to diversify formats beyond supermarkets into hypermarkets or discount stores (as would happen in the next stage), or to move beyond the main cities into smaller cities or rural towns, again as would happen in the next stage; non-metropolitan areas were still served by small shops, small new private chains, consumer co-operatives, and public plaza markets/bazaars, depending on the country.

This is not to say that the emergent domestic-capital chains did not begin to invest and grow; they merely did so on a very limited scale relative to what they would do, in competition with foreigners, in the next stage. For example, Konzum, one among many privatised chains in the early 1990s, quickly outstripped its fellow chains during this period, moving from only small shops to add a small supermarket format by the mid-1990s and several large supermarkets by the end of the 1990s in Zagreb, forming a capitalisation base from which it then jumped to nationwide coverage in the globalisation stage in the early 2000s.

2.4 The globalisation stage

The globalisation stage started at various times (from the mid/late 1990s to the present) depending on the country (categorised by income level and stage of reform), but showed several characteristics in common across the countries: (i) extensive investments by foreign retail chains and the rapid rise of the modern retail sector, hence multinationalisation; (ii) the application in developing regions of the global ‘retail transformation model’ (Reardon et al., 2003a); (iii) a dramatic rise in the share of supermarkets (in the broad sense of the term); (iv) inter-country as well as intra-country supermarket diffusion; (v) concentration in the supermarket sector; and (vi) important changes in procurement systems that then affect farmers. We discuss i-v further in this section and then vi in Section 3.

The rise of the modern retail sector

Figure 2 illustrates how the share of the modern retail sector (supermarkets, hypermarkets and discount stores) in total retail grew rapidly in the Czech Republic, Slovakia, and Croatia, although starting at different times. Data in Table 2 and Figure 3 show how the average share of modern retail in total retail went from 40% to 49% in first-wave countries from 1999 to 2002, a mere three years; in second-wave countries it jumped from 9% to 24% in the same period, and from negligible to 1-2% in the third-wave countries. This demonstrates that the modern retail sector in first-wave and second-wave countries is already approaching one-half (converging with South America which had been at about this stage for the whole of the 1990s) and one-third respectively of total retail after only a few years of blindingly fast transformation.
Multinationalisation

A striking characteristic of the supermarket sector in most CEE countries is its rapid multinationalisation in only the past five years. Several indices illustrate this. First, using 2002 data, we calculate that foreign supermarkets make $22 billion of sales per

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1. We used data on the number and type of large-format stores belonging to foreign chains in the Balkans and CEE, from CIES Food Business Forum (2003) for 2002, and made rough calculations of their approximate sales (using representative per-store sales figures for the different formats, taken from data sources for several CEE countries).
year in the region ($20 bn of the $22 bn were in the countries in Table 2, the rest was mainly in Latvia/Estonia/Lithuania). To give an idea of what this magnitude represents, it is roughly the equivalent of the sales of 550 hypermarkets at $40 million a year each in sales, or of 11,000 small/medium supermarkets at $2m. of sales each. Typically about 70% of a supermarket’s sales are of food, so this means that foreign retailers sell about $15 bn of food products, much of this from farms and firms in the region, to local consumers, constituting a large impact on the food system solely from foreign retailers.

Second, there is a great diversity of multinational retailers that have undertaken FDI in the region, for 13 countries (foremost among which are Germany, France, the UK, and the Netherlands in terms of weight of FDI). Figures 4 and 5 give an overview of the number of supermarket and hypermarket outlets of the main foreign retail chains. The motives for entry include the fact that Western Europe offers fairly saturated, low-growth markets in which most countries have planning restrictions on further out-of-town retail development, while the CEE retail sectors initially offered soft local competition, higher mark-ups on food, less constraining local planning, and growing markets (see, for example, Dawson, 2001).

### Figure 4: Number of foreign-owned supermarket outlets in CEE, 2002

![Bar chart showing the number of supermarkets in CEE by retail chain]


Third, M&M Planet Retail (2001) presents a list of the ‘top 35 countries’ in terms of multinationals’ presence in their retail sectors. All four of the ‘first-wave’ countries figure in this list. For reference, France is number 1 with 14 international retailers

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2. The foreign chains include: (1) Julius Meinl, Spar (Austria); (2) Delhaize (Belgium); (3) Kesko (Finland); (4) Ahold (Netherlands); (5) Auchan, Carrefour, Casino, Cora, Intermarché, Lidl, Metro AG, Rewe, Tengelmann (Germany); (7) Dansk (Denmark); (8) ICA (Sweden); (9) IGA (US); (10) Migros Turk (Turkey); (11) Reitan (Norway); (12) Tesco (UK); (13) IperCo-op (Italy).
present; Poland number 2 with 13 international chains; UK number 7; the Czech Republic number 12 with 10 foreign chains; Hungary and Slovakia tie at 18 with 7 foreign chains. It should be noted that several other foreign chains have entered these countries since 2001, so these are now underestimates.

**Figure 5: Number of foreign-owned hypermarket outlets in CEE, 2002**

![Bar chart showing the number of hypermarket outlets per country.](chart.png)

Source: Ibid.

Figures 6 and 7 give an idea of the degree of multinationalisation in Slovakia and the Czech Republic. The share of foreign-owned chains in the 50 main companies in the retail sector is 80% in the Czech Republic. As with the sudden shift in the concentration index, we again find that multinationalisation really took off in 1997 in the Czech Republic, while this happened only in 2000 in Slovakia and 2001 in Croatia. In 2001, foreign-owned retailers accounted for slightly more than 40% of total turnover of the 50 biggest retail companies in Slovakia. The share of foreign-owned companies in total retail is about 35% in the Czech Republic, while it is only 10% in Slovakia. Given that supermarkets account for about 40% of retail, and FDI is practically solely in the supermarket sector, this means that about 70% and 20% of the supermarket sectors in the Czech Republic and Slovakia respectively are multinationalised, implying that further multinationalisation can be expected in Slovakia, but only consolidation in the Czech Republic.

This does not mean, however, that all the major retail players are foreign in the CEE. While foreign chains tend to be the top players in the first-wave countries, in others, such as Slovakia (perched between first and second waves in terms of entering globalisation), Croatia, and Russia, domestic chains are at the top.

Moreover, underlying the 2002 patterns of FDI-based sales across countries, shown in Table 2, is a dynamic of diffusion of FDI over CEE countries during the past five-seven years that is interesting and relatively consistent. At the beginning of each
round of FDI, firms (that are not global multinationals) from neighbouring first-wave or developed countries’ retail chains move into a country because of their advantage over domestic chains (usually) and initial lack of global multinationals. Examples include

Figure 6: Share of foreign ownership in top 50 retail trade companies (%)

Source: Own calculations based on Shopping Monitor CE (INCOMA Research).

Figure 7: Share of foreign companies in total retail

Source: Ibid.
Finnish and Turkish retailers moving into Estonia and Russia, Slovenian and Austrian into Croatia, Czech into Slovakia, and Hungarian into Romania, and so on. After that, the global multinationals move in, first into the first-wave countries, such as Ahold, then Carrefour, then Tesco into Poland, the Czech Republic, and then Hungary; then they move into second-wave countries (recently Metro into Croatia), and finally establish (only this year or last) footholds in the third-wave countries (Metro into Russia). Foreign retailers tended to find a relative ‘saturation point’ that provided an impulse to spread regionally, while at the same time in a more competitive environment they started to acquire domestic firms and push out weaker foreign competitors. Hence, retailers have an ‘anchor’ strategy in which they implant first and deepest in the best prospect first-wave country and then set up their procurement systems for the region as a whole and move into other countries, as discussed in Section 3. These patterns are similar to those in the mid/late 1990s in Latin America (Reardon and Berdegué, 2002).

Spread to secondary cities and then small towns
In the way that foreign chains extend from ‘heated up competition’ in relatively modern-retail-saturated countries to less-saturated countries in the region, the same is now occurring within countries, both from large cities to smaller cities and towns, and from richer neighbourhoods to middle- to lower-income neighbourhoods. Again, this was happening first and fastest in first-wave countries 2-3 years ago, and second-wave countries in the past year or so, and is just starting in third-wave countries, thus extending the effect of the supermarket revolution into the food markets of the poor, and into the countryside. This clashes with the conventional view in the region that supermarkets are just a ‘big-city phenomenon’ and a middle-class trend. Many retail chains want to be the first hypermarket in a small town, effectively locking out competition as there is only a market for one major store.

Several examples are telling. In Croatia, Konzum started in Zagreb and then in 2001 moved to Split on the coast (acquiring Euroviba) and in 2003 extended to Osijek in the eastern interior (acquiring Alastor). Alastor itself, a dominant chain in the Osijek grain-belt, had expanded over Osijek in the late 1990s and then into intermediate cities and smaller towns around it in the first few years of the 2000s, the penetration going as far as relatively small towns such as Dakovo (20,000 population). In the Czech Republic, Delvita has entered a relatively small town of 15,000, which contrasts with the pre-transition policy of locating supermarkets only in large towns. Summing up the motivation for such moves, Ahold-Poland was cited as explaining: ‘Given the strong international competition in the Polish market, Ahold is now planning to target smaller towns with populations of 50,000-70,000’ (CIES, 2001).

Emerging consolidation
While the retail sector was very concentrated, but mainly public sector, before the transition, and then highly de-concentrated with privatisation and the proliferation of retailers in the 1990s, there is emerging evidence of a reconcentration, but this time private-sector and multinationalised. This is thus a ‘U’-shaped pattern of concentration over time.

The degree of concentration in the supermarket sector is not clearly correlated with the degree of development of the sector as a whole (share in total retail). In Poland, in 2001, the top 5 chains had 48% of the supermarket sector; this is doubtless higher today,
following Tesco’s acquisition of the Hit chain in 2002 (Business Analysts and Advisers, 2003). In the Czech Republic, the figure is 70%, in Bulgaria, around 90%, in Croatia, around 60% in 2002, but only 25% in Slovakia. There are several reasons for the ambiguity in the correlation between the supermarket market share in retail and the top 5 share in the supermarket sector. (i) In some second-wave countries, the investments of a few chains in the past few years suddenly swamped the emerging supermarket sector; these can be foreign chains, such as Metro, Billa, and Bonjour (Cyprus) in Bulgaria, or mainly domestic chains, such as Konzum’s spectacular increase in share in the Croatian market in the past 2-3 years, or Perekriostok, Metro, and Ramstor in Russia. (ii) In some countries, such as Poland and Slovakia, a relatively large number of foreign competitors (most of them with ‘deep pockets’) entered in the past few years and the ‘shake-out’ is only now beginning, with large-scale acquisitions among them. We expect a series of acquisitions and mergers that will concentrate these supermarket sectors quickly over the next 3-4 years and there are signs that this is already proceeding apace. PolandRetail.com (2003) notes that, in November, Ahold sold two hypermarkets to Carrefour. This is one of many recent examples in the region of internecine struggle and acquisition among global retailers and between global and regional retailers in the past few years.

There are several weapons in the competition, among the most important being the organisational and institutional changes in procurement which we discuss in the next section. The other is format diversification – away from small to large supermarkets, and into hypermarkets, discount stores, hard discounts, and convenience stores, in order to increase a chain’s coverage of the market, drive down prices and drive up product diversity (itself an opportunity for food suppliers), and thus increase market share. Format diversification is in fact usually a sign that a supermarket sector is maturing. It takes ‘deep pockets’ to be able to make investments in giant hypermarkets, and these have been mainly the reserve of foreign chains. Figure 8 shows how the number of hypermarkets in the Czech Republic has increased rapidly from 2 to over 100 since 1996. Figure 9 shows that the share of hypermarkets in the total modern retail sector (including also supermarkets and discount stores) is almost 45% in the Czech Republic and near to 30% in Slovakia. First-wave countries tend to be already, over the past 2-3 years, heavily ‘hypermarketised’, but this is only just beginning in second-wave countries. Given the relative homogeneity of urban share across the CEE region, we expect this trend to continue.

2.5 Determinants of the waves of retail transformation

What drove this ‘supermarket revolution’ and why has it occurred at different rates in the different sets of CEE countries? Reardon et al. (2003a) present a model of the diffusion of supermarkets in developing countries as a system of demand (for supermarket services by consumers), and supply of these services. Demand is driven by consumers’ incentives and capacities. Demand-side incentives include: (i) urbanisation, with the concomitant increase in the opportunity cost of women’s time, and (ii) reduction of effective food prices for consumers because of the mass procurement and efficient merchandising of supermarket chains. Demand-side capacity variables include: (i) per capita income growth increasing the demand for processed foods which is the usual entry point for supermarkets, and (ii) growing access to refrigerators, cars, and
bus transport. The supply side of supermarket diffusion in developing countries was driven very substantially by an avalanche of European and US retail investment driven by FDI liberalisation plus the above factors, in the 1990s and 2000s.

**Figure 8: Change in number of hypermarkets in the Czech Republic**

![Graph showing the change in number of hypermarkets in the Czech Republic from IV 1996 to II 2001.](image)

Source: Ibid.

**Figure 9: Change in the share of hypermarkets in the modern retail sector**

![Graph showing the share of hypermarkets in modern retail in the Czech Republic and Slovakia from 1998 to 2003.](image)

These factors also determine supermarket diffusion and multinationalisation in CEE countries, as can be inferred from the data in Table 2. Table 2 presents, for countries in the CEE region, country characteristics, the share of supermarket
(supermarkets, hypermarkets, and large-format discount stores) sales in total retail, and an indicator of the importance of foreign investment in food retail (proxied by the food sales of foreign retailers in those countries in 2002). Several points stand out.

Table 2 suggests a pattern of three ‘waves’ of sets of countries in the march of supermarket diffusion, mirroring the three levels of supermarket penetration in retail noted above. The patterns follow the above ‘supermarket diffusion model’ from both demand and supply sides of services; in other words, to a large extent there is a general correlation between, on the one hand, the level and rise in the share of supermarkets in total retail, the multinationalisation/globalisation of the retail sector of a country, and, on the other hand, the per capita income and the ‘reform index’ as calculated by the European Bank for Reconstruction and Development.

The reform index measures the extent of institutional and economic reforms and market liberalisation in the process of transition from a centrally planned economy to a market economy, with the index between 0 and 4 and increasing in the extent of the reforms. As illustrated by Figure 10, there is a strong positive correlation between the extent of reforms and the growth of the modern retail sector. Moreover, the figure suggests that there appears to be a minimum level of reform which is needed before retail investments are made, but that, once beyond this, the modern retail sector grows exponentially with further reforms. Figure 11 indicates a strong positive relationship with the income level of the country. In combination, both factors explain why there are important differences between the countries’ domestic and foreign investment in supermarkets. With reforms and income levels differing between countries, the starting point of retail FDI, and hence the beginning of the globalisation phase of the retail sector, thus differed significantly among countries – mid/late 1990s in first-wave countries, circa 2000 in second-wave countries, and only in 2002 in third-wave countries.
countries. The average income and the transition index decline as one goes from the first- to the third-wave sets of countries. These retail-side findings go along with the fact that the great bulk of overall FDI in the CEE region has concentrated in the first-wave countries (EBRD, 2003).

Figure 11: Share of the modern retail sector in total and GDP per capita

Note: 1998 and 2000 data for Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia, Ukraine.
Source: Own calculations based on EBRD (2003) and Incoma Research.

Note that a weak link to the diffusion model is the role of extra-income socio-economic determinants. Most of the countries, regardless of ‘wave’ category, are relatively highly urbanised (the second-wave countries slightly less so than the first-wave), with a high proportion of women in the workforce (not very different from the male participation). These two expected determinants do not have much explanatory power in this region simply because they vary very little.

Moreover, particularly striking is the impact of liberalisation reforms on supermarket diffusion in situations where the socio-economic context (such as incomes and urbanisation) had created latent demand for supermarkets but where they only ‘took off’ once the reforms (and accompanying general economic climate) favoured such investments. One sees this, for example, in Croatia, which had no supermarkets until 1996, then very slow domestic supermarket development until the denouement of the political crisis and instability by the late 1990s, then retail foreign investment starting only in 2001, and a rapid rise in domestic as well as foreign chains thereafter in intense competition. This moved the Croatian supermarket sector from lagging far behind the front-runners in the first wave to a point of essential convergence with them at around 45% of food retailing. Another example is Slovakia, which lagged behind other first-
wave countries until the end of the 1990s when the fall of the Mečiar government led to important policy changes and improvements in the investment climate.

The speed and extent of reforms are not the only extra-socio-economic factors that can delay or speed supermarket diffusion, other things being equal. Beliakov and Noble (2003: 10) noted a number of other site-specific constraints to retail in Russia at present: shortage of suitable retail properties; ‘the difficulty of getting access to land and necessary permits; unavailability of long-term leases; underdeveloped supply infrastructure; huge distances between major urban centers; shortage of qualified retail staff’.

2.6 The future: convergence?

The convergence of reforms and the spread of FDI (and competitive domestic investment), in particular among the first- and second-wave countries and starting in the third, give rise to the observed tendency towards convergence of retail systems among countries reflected in the ‘catching up’ by lagging first-wave (Slovakia) and second-wave (Croatia) countries in supermarket growth so that the share of supermarkets in food retail is beginning to reach the 40-50% range in half the study countries by now. For example, within Central Europe, there was greater divergence in patterns at the start of the globalisation period than there is now, indicating that there has been a convergence over the period. For instance, Figure 2 shows how the market share of the modern retail sector has changed since 1998 in the Czech Republic and Slovakia, followed by Croatia. It is evident that the changes started in the Czech Republic earlier than in Slovakia but, as can be seen, a remarkable convergence has occurred in the past few years.

There is considerable evidence emerging that forces are afoot for third-wave countries to move towards convergence with the retail structures of the other parts of the region in the near future. At present only 10% of the Russian retail sector is dominated by supermarkets (split equally between Russian and foreign operators) (RetailPoland.com, 4 January, 2004). But there is impetus for rapid future growth in the sector, evidenced by the entry of a global multinational retailer (Metro) and regional multinationals (for example, Ramenka of Turkey) into Russia in the past 1-2 years, and the major investments being undertaken at present by the main domestic chains (such as Perestriostok and Sedmoi Kontinent). 3

3. CIES (2004b) notes: ‘Metro said on Thursday that it would invest US$70m. in building two hypermarkets in Moscow ... with a view to opening them at the end of this year or at the beginning of 2005. The group operates seven cash and carry stores in Moscow and St Petersburg and is due to add a further eight this year.’

4. Namnews (2002): ‘Turkish Ramenka, which owns the Ramstore supermarket chain, plans to invest US$100m. in 2003 in 10 more stores in Russia, bringing the total number of Ramstore shops in Russia to 30’, Prime Tass reports.

5. CIES (2004a) notes: ‘Leading Russian supermarket operators Perekriostok and Sedmoi Kontinent have announced plans to invest further in their store networks... Perekriostok has agreed on a US$75m. credit facility from a group of foreign banks. ... Perekriostok currently operates 46 outlets in Moscow and St Petersburg. Sedmoi, meanwhile, said that it would open 25 stores this year, including its first hypermarket. The retailer reported a 48% rise in sales to US$445m. for 2003.’
3 Evolution of food retail procurement system

Over the decade between the start of transition in CEE and the thick of food industry globalisation in the early 2000s, there were major changes in the product procurement systems of the retail sector. Together, these constitute a major transformation of the wholesale sector, and thus the market conditions facing farmers. In this section we discuss these changes. The scope of this article does not permit a full treatment across countries and products; illustrations will therefore be given mainly from the case countries discussed above in order to have a parallel structure in our discussion of retail and retail procurement systems – namely Croatia, the Czech Republic, Poland and Slovakia. Moreover, we mainly focus on FFV (fresh fruits and vegetables).

Two things should be noted with respect to the analysis and the illustrations. First, supermarkets tend to penetrate FFV retail markets and make changes in their FFV procurement systems more slowly than for other products such as processed/packaged products that lend themselves more easily to the kinds of changes discussed below; thus, our examples from the FFV sector are the ‘floor’ of change, in the sense that one can be certain that the procurement systems for other products have gone through similar changes but more quickly and earlier. Second, our discussion is centred on the actions of the leading supermarket/hypermarket chains in ‘first-wave’ countries, such as the Czech Republic and Poland, that experienced the earliest and/or fastest retail transformation, and ‘second-wave’ countries such as Slovakia and Croatia. ‘Third-wave countries’ such as the poorer Central and East European countries are only now entering the globalisation phase of retailing and we argue that they can expect to see similar changes in retail procurement. One tends to find that the front-runners set the pace for procurement system change and we observe that the medium and small chains, and retail systems in countries lagging behind the front-runners, follow suit as their capacity permits, as the retail transformation occurs.

3.1 Procurement systems under communism

The procurement systems for food products before the transition reflected the degree of centralisation, collectivisation, and formality of the retail sector in each CEE country (see Figure 1). Hence, for example in Czechoslovakia, where retail was centralised (in urban areas, in state enterprises), collectivised (in rural areas in consumer co-operatives), and formal (no informal retailing was allowed in urban or rural areas) – the procurement system was the mirror reflection of these characteristics. There was a centralised procurement company managed by the state, which operated distribution centres (DCs) in the different regions of the country, distributing to urban state retail enterprises and rural retail co-operatives alike.

In contrast, Croatia, for example, had a retail system that combined elements of the above centralised/collectivised/formal system with a quite large parallel private market.

6. The distinction in the food retail chain between Czechoslovakia (Czech Republic; Slovakia) and former Yugoslavia (Croatia) can be further extended to the farm level. In Czechoslovakia the vast majority of food was produced on large-scale collective and state farms, while in former Yugoslavia farming was mostly on small-scale private farms. Small-scale private farming continues to dominate agricultural production in Croatia, while in the Czech Republic and Slovakia agriculture is now dominated by large-scale private farms.
The procurement system of the retail sector was three-pronged. First, since the early 1950s, state chains had regional DCs, as the chains themselves were for the most part regionalised. The DCs were mainly for processed products. Second, since the early 1980s, agrokombinats (large agricultural production and marketing SOEs) had opened retail outlets that relied primarily on procurement from their own production (such as Podravka with processed vegetables, or Voce and Dona, vegetable production agrokombinats). Third, state retail chains had very little if any fresh produce; most of this was sold through private green markets (trznice) and small shops; these private entities plus the state stores procured FFV from informal ‘truck markets’, run by traditional wholesalers who brought produce from surrounding rural areas and directly from farmers delivering and selling in the green markets. Some brokers brought in a limited quantity and assortment of imported products such as tropical produce and apples from other socialist countries.

3.2 Procurement systems during transition

The first half of the 1990s saw the dismantlement of the state-run and collectivised components of the retail procurement system in the region. This happened most rapidly and completely in centralised retailing systems in the more developed economies of the region, such as in Czechoslovakia, where privatisation meant the immediate sale of the centralised procurement system to private wholesalers at the same time as the break-up of state retailing. The dismantlement occurred with a lag in the second- and third-wave countries.

Hence, during the 1990s there was a proliferation of private food product general-line (by which we mean here not dedicated to one type of client or market niche, but potentially with product specialisation) wholesalers in the region to replace progressively the state-managed – and collective – wholesale functions. By 1999 in Poland, for example, there were 5 nationwide wholesale networks (exclusively owned either by foreign capital or by partnerships of foreign and domestic companies), 5 purchasing groups, 60 regional wholesale networks (holding a 30% share of the wholesale market), and 14,000 local wholesale company warehouses (mainly family businesses).

The new general-line wholesalers bulked produce bought from a variety of sources, including co-operatives and individual farmers. In countries such as Poland or Croatia, this meant aggregating over many small farmers. These new private wholesalers established DCs and truck fleets, and collected from farms and delivered to the remaining state-owned chains, the new private chains, and even to the green markets and small shops, beginning to displace the truck markets. Because the FFV production base in many of the countries was narrow in terms of product diversity and seasonality, and with low productivity and quality and high transaction costs and risk, many of the new wholesalers placed great emphasis on importing FFV to supply the local market – in particular, bananas and citrus and stone fruit from international markets. At the same time, some started small outgrower schemes to ensure a domestic production base. Gradually, towards the middle to end of the 1990s, many of these wholesalers began including the emerging supermarkets among their clients.

For example, in Croatia, general-line wholesalers Bili Commerce and Vrni, both based in the coastal FFV production zone, began to serve the newly privatised chains
such as Diona and also provided FFV to the military. Bili, for example, focused mainly on the newly privatised Diona and Konzum chains of small stores, and on importing for UN peace-keeping forces. Moreover, some regional wholesalers cum outgrower schemes emerged to supply mainly green markets and small store chains, such as Vesna in Osijek, which started as a small wholesaler and then grew into a major wholesaler in that region, gradually shifting from a general FFV wholesaler supplying the whole gamut of retailers to becoming a specialised/dedicated wholesaler focused on the Alastor and later the Konzum chain; Vesna was thus an early entrant into the new breed of wholesalers that would become dominant in the globalisation period. Finally, several major FFV suppliers themselves became wholesalers as well, as in the case of Fragaria, an apple supplier that gradually increased its wholesaler and outgrower management functions. An important role also began to be played by the newly privatised or emergent processing firms, some of which created their own distribution channels.

3.3 Evolution under globalisation

The transformation of the retail sector in this phase was facilitated by a profound transformation of the procurement systems of retail chains. The changes were determined, on the one hand, by the incentives of the increased competition in the retail sector with the emergence of chains of large-format stores and substantial FDI. This created the need to reduce costs and produce consistent volumes and standardised products, and to improve quality and product differentiation in order to gain merchandising advantage. On the other hand, it enhanced the capacity to change the organisation and technology of the procurement system based on the greater volumes moved, and the technology transfer from foreign retail chains.

Important for the initiation of the changes was a widespread feeling among retailers interviewed that the new general-line wholesalers emerging in the early/mid-1990s did not add up to an adequate procurement system for the supermarket chains, in particular once retail competition increased sharply with globalisation. They felt that the ‘old system’ even after transition was not able to deliver the required quality, and there were high transaction costs when supermarkets had to rely on it.

In order to respond to the chains’ need for alternatives to the existing wholesale system, and to pursue competitive strategies of lowering costs while raising quality, leading supermarket/hypermarket chains in the CEE region have been shifting during the past few years towards the use of a new procurement system characterised by six key shifts towards: (i) centralised procurement systems; (ii) cross-border procurement systems; (iii) specialised/dedicated wholesalers; (iv) the use of global logistics multinationals to improve procurement systems quickly; (v) preferred supplier systems; and (vi) adding private standards.

We note that these shifts have been undertaken by the ‘leading chains’ both within a given country and across countries. One finds these six shifts earliest in the ‘first-wave’ countries, and therein among the leading chains, but with a clear tendency observed for the second-wave countries and smaller chains to follow suit as soon as they are able, driven by the same incentives.
Shift towards centralised procurement systems

There has been a marked and recent tendency to shift from per-store procurement to a centralised system (usually a central buying office for a general category like FFV and then from one to several distribution centres (DCs) across the country to handle product movement). This is done in order to reduce co-ordination costs, generate economies of scale by buying in larger volumes, work with fewer wholesalers and suppliers per unit merchandised, and have tighter control over product consistency in meeting standards. Typically chains make this move when they reach a certain volume threshold where it becomes markedly more efficient to shift to DC(s). Moreover, typically a chain moves from a DC for a zone to a DC or set of linked DCs for a whole country in order to source across the country and obtain the cheapest and best quality products by having a larger pool of suppliers from which to choose.

Several cases illustrate this development. Ahold Poland operates over 180 outlets in Poland, in two store formats – Hypernova (hypermarkets) and Albert (supermarkets) – all of which are supplied via 5 DCs (in Bielsko-Biała, Poznań, Tarnów, Będzin and Piotrków Trybunalski) (www.ahold.com.pl). The latter, built in 2002, covers 22,000 square metres and was the largest in the country in 2002 (Supermarket News, No 74, 13 June 2002). Also, Tesco opened a 40,000 m² DC in Teresin for the distribution of all processed/packaged food for all its Poland stores on 6 January 2004. As it sells about $1.5 bn of products, about half, say $750m., of which is food, this means that roughly $0.5 bn of processed/packaged food products are centralised in procurement and distribution in this new large DC. It is now building a second, for fresh food (Retailpoland.com, 12 January 2004).

In the Czech Republic, Ahold opened its first DC for FFV in 2001 and a second one in 2002. Delvita was already operating a DC in 1995, and recently opened a second. Tesco was building its first DC in the Czech Republic at the end of 2003. Kaufland has a DC. However, not all leading chains have enough stores yet to warrant DCs: for example, Carrefour has its suppliers deliver directly to the hypermarkets, and Globus (Germany) relies on specialised/dedicated wholesalers (Hortim, Vis, and Ceroz) to deliver to its stores. This new type of wholesaler, dedicated to supermarkets, is discussed further below. Slovakia is a few years behind in these developments but is moving in the same direction. Whereas Ahold and Delvita have no DCs yet in Slovakia, Tesco opened its first DC there at the end of 2003, as will Kaufland in 2004.

Croatia is a ‘second-wave’ country in supermarket development, but chains are now moving very rapidly towards DCs induced by the competition introduced by heavy FDI by foreign retailers starting in 2000/01. Konzum, the leading chain and with domestic capital, opened the largest DC in the former Yugoslav region in 2000, and has since rapidly abandoned its system of small warehouses and per-store deliveries to use a set of DCs across the main regions with co-ordinated, centralised procurement from Zagreb. Metro (Germany) built a large DC in October 2003. Billa had planned to wait until it had 20 stores in Croatia before building a DC, but because of competitors’ moves it has halved this waiting time and built a large DC in 2003. In contrast – and this illustrates the mechanisms that increasingly differentiate the competitiveness of dominant and secondary chains – CBA (a consortium of small, independent supermarket chains) has noted that it is at a severe competitive disadvantage by not yet having a system of DCs.
Finally, this shift to DCs is even beginning in third-wave countries like Russia. An example is Perekriostok, with 46 stores in St Petersburg and Moscow (www.perekriostok.com.ru). Pyatyorochka, Russia’s largest supermarket chain, founded in 1999 and with 150 stores in St Petersburg and Moscow and 20 franchisees in smaller cities, has also moved in the past year to use a DC in St Petersburg (and soon in Moscow) in order to drive down costs, in particular against the informal market and in the context of suddenly escalating foreign competition from Turkish, German, and French chains that have entered in the past year or two (www.e5.ru).

Shift towards cross-border procurement systems

The logical extension now being undertaken by various chains in the CEE region is to move to cross-border sourcing – co-ordinating procurement over a chain’s DCs in the set of countries where it operates. These systems allow the procurement of the cheapest and best quality products from the various countries. This extends the set of suppliers available to the chain, and magnifies the advantages of a DC system noted above. The process is related to accession to the European Union, which increases opportunities for post-accession cross-border procurement.

Central Europe, home of the ‘first wave’ of retail transformation, is also the cradle of the regionalisation of procurement. Ahold announced in October 2002 the formation of Ahold Central Europe (ACE), an integration of its operations in Poland, the Czech Republic, and Slovakia undertaken during 2003. ACE is based in the Czech Republic, and merges ‘backroom functions’ such as product procurement and administration for 400 Albert supermarkets and Hypernova hypermarkets in Central Europe with combined sales in 2001 of approximately €1.3 bn. Daily merchandising operations are managed by the local units (Ahold Newsletter, 2002). This integration is organised by category, so that there is an ‘ACE Fresh’ for FFV procurement. Tesco, now the leading retailer in Central Europe, with 153 stores (53 in Hungary, 66 in Poland, 17 in the Czech Republic, 17 in Slovakia), has its administrative headquarters in Prague, although FFV procurement is still organised on a national level. Kaufland is building DCs in Slovakia and Poland (and already has one in the Czech Republic). Once the DCs are operational, importing products from Poland into Slovakia, for example, will also be simplified and suppliers that are delivering to the DC in Poland will also be used to supply the Slovakian market.

Moreover, to facilitate this integration, wholesalers from a given country are ‘expanding with’ the expanding retailer in order to continue to service it across the countries in a region, as has also been observed in Latin America and Asia (Reardon et al., 2003b). For example, some wholesalers that had agreements with retail chains in the Czech Republic expanded their businesses to Slovakia once the supermarkets they serviced in the Czech Republic entered Slovakia. Ceroz – established in 1991 and now the biggest Czech wholesaler in FFV, owning 8 DCs in that country – has built three DCs in Slovakia since 1998 because the foreign retail chains that were expanding their operations from the Czech Republic into Slovakia wanted to deal with the same suppliers with whom they already had a business relationship.

The first glimmers of such regionalisation of procurement are starting in the ‘second-wave’ countries. In South-eastern Europe (the Balkans), Metro is setting up a Southeast Europe Business Unit that will serve the Metro stores in the Balkans sourcing
from several countries (pers. comm., Robert Kuhta, FFV Purchaser Metro, Croatia, July 2003).

**Shift towards specialised/dedicated wholesalers**

The leading chains are shifting from traditional wholesalers and even from new general-line wholesalers to ‘specialised/dedicated wholesalers’ that are specialised in a product category and dedicated to supplying supermarkets. This means that the wholesaler is more responsive to the quality, safety and consistency requirements of supermarkets than are traditional wholesalers that aggregate products across many producers and qualities with little capacity for segregation.

These new firms are sometimes external to the retail company, but sometimes they are in the same holding company. There appears to be a tendency for the former to shift to the latter in the following sequence. First, a private wholesaler emerges in the early transition period, and increasingly augments the share of its business from supermarket chains. Second, the wholesaler shifts to having the majority of its business from a handful of chains; at the same time, it adds services such as packaging and quality control that it did not carry out as a ‘traditional wholesaler’. Sometimes these services are merely transport for purchases made directly by the supermarket chain; in our interviews we found that these were considered to be ‘entry fees’ to obtain the business of the retailer. Third, the now specialised/dedicated wholesaler moves from mainly buying on the spot market or from a list of customary suppliers, to starting outgrower schemes where it contracts production that meets the specific grades and standards of the retail chain. It does this both to forestall the retailer entering into direct relations with producers and bypassing it, and because it needs to undertake these schemes to meet product quality and safety requirements (more on that below). Fourth, the retail chain acquires, or enters into a joint venture with, the wholesale firm. Acquisition has the advantage of control, exclusivity so that it also ‘captures’ a supplier base, and turning the wholesaler into a profit centre. These steps are illustrated below in the case of Croatia.

In Croatia after the transition, newly formed wholesalers, with outgrower schemes (that also ended up with imports off-season or of products not available in Croatia or available but not in sufficient quantity), expanded rapidly and shifted their focus from other markets to the supermarket market. Sometimes these were already dedicated to one or more chains; the wholesaler/outgrower then shifted in the past few years from selling mainly to green markets and chains of small stores, to selling to supermarket chains. This was the case with the outgrower schemes Vesna in Osijek (focused on Alastor), and DAD in Neretva (focused on Konzum), and to a certain extent also with the ‘new wholesalers’ which had emerged in earlier eras (Bili). The first two, Vesna and DAD (in the two main vegetable production zones of Croatia), were mainly outgrower schemes which then added wholesale schemes in order to provide ‘one-stop-shopping’ for the chains. In the case of both, the leading chain (Konzum) acquired them (in 2003 and 2002 respectively). Moreover, there was rapid expansion of suppliers such as Fragaria or Vrni or Lipovac which mainly had their own production and who had then recently added a substantial number of outgrowers to increase volume, as well as further

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7. For example, bananas from Latin America that are delivered in the port of Antwerp and have to be transported to the Czech Republic.
wholesaling functions and value-added operations. Hence, these supplier-wholesalers moved towards specialising in supermarkets and adding volume and assortment so that they could provide one-stop shopping at least in several categories per wholesaler. All three of these grew very quickly; the largest of them, Lipovac with a farm near Osijek and a distribution centre near Zagreb, extended from 300 to 3,000 ha of outgrowers in only the past 3 years. Vrni started in 1996 with 3 ha of its own production, 10% of the output of which it sold to supermarkets. Over the past 6 years it then added 68 ha of outgrowers, and it now sells 70% of its output to supermarkets.

Use of global logistics multinationals

Furthermore, a related trend is for leading chains, in particular in the ‘first-wave’ countries, to use the services (either in a joint venture or a business alliance) of global multinational logistics firms. Thus large retailers induce a rapid transfer of world-class logistics technology into the local wholesale sector – basically suddenly creating a dualistic system between the haves and have-nots of these services. This allows the leading chains to bring down their costs, become yet more competitive, further distance themselves from weaker local chains, and accelerate the consolidation process. This is similar to what leading chains are doing in Latin America and Asia (Reardon et al., 2003b). In December 1999, the UK’s Tibbett & Britten-Hungary entered into a logistics partnership with Tesco (Hungary’s biggest hypermarket chain operator). In April 2003, Tesco signed an agreement with the US-based global multinational ProLogis for the lease of a large (26,000 m²) ProLogis DC in the Czech Republic. The press release is revealing of the symbiosis between multinational retail and logistics firms in entering emerging markets, and of the role played by the advantage of regional presence:

We were looking for a very quick solution to achieve our distribution goals. ProLogis provided a well-suited facility in a very timely and professional manner’, said Mark Champagne, supply chain and distribution director for Tesco. ‘We look forward to working with ProLogis in the Czech Republic and throughout Central Europe.’ ‘ProLogis is pleased to be working with Tesco as the company builds its presence in the Czech Republic,’ said Hans van Luijken, first vice-president of Central Europe for ProLogis. ‘ProLogis Park Prague is a prime example of our goal to establish a presence in the key distribution hubs throughout Europe … as we continue to serve our local and global customers in Central Europe.’ … ProLogis is a leading provider of distribution facilities and services with 226.7m. square feet (21.1m. square meters) in 1,728 distribution facilities owned, managed and under development in 67 markets in North America, Europe and Japan. (PR Newswire, 2003)

Shift towards preferred supplier systems

The leading chains are shifting towards ‘direct’ purchase from growers. We qualify ‘direct’ here in that most often this procurement channel is managed by the specialised/dedicated wholesaler as a ‘preferred supplier programme’. As noted above, however, most of these wholesalers have been absorbed into the retail firms or are in joint ventures.

This is done in order to select producers capable of meeting the quality and safety standards of the supermarkets and thus reduce transaction costs for the chain both by lower search costs and by reducing the number of suppliers per unit sold. The retailer, or the wholesaler acting on its behalf, then provides incentives (negative and positive) –
for example via implicit or explicit contracts, lower risk, and sometimes price premia, as well as the resolution of certain idiosyncratic factor market failures facing the producers – to meet the retailer’s requirements, such as the chain’s providing evidence to banks of the existence of a contract so as to serve as a substitute collateral for producers.

In Croatia, the largest chains recently began to acquire specialised wholesalers in order to have their own ‘preferred supplier’ programme and to accomplish three goals. (i) They cut out the margins of the middleman (this was emphasised as a key goal by retailers such as Konzum and Metro). In the past year Konzum has acquired DAD (by far the largest outgrower scheme in the coastal fruit and vegetable areas) and then Vesna (ditto, but in the Slavonia area) in order to gain control of supply channels. (ii) They sought to obtain the desired quality and began to cut procurement costs in order to increase profit rates and also enhance year-round consistency so that there are fewer breaks in supply over the year. (iii) They wanted to increase the volume of throughput substantially and, via outgrower schemes under their control, vastly increase local production. This was needed to fuel the immense increase in FFV sales that they sought and succeeded in accomplishing. For example, Konzum went from $11m. to $64m. of FFV sales in the past two years! The dominant retail chains also began to supply FFV to food service companies such as restaurants and hotels that formerly were almost exclusively supplied by the specialised wholesalers.

The preferred supplier programmes of Konzum (DAD, Vesna/Fructus) emphasised grower upgrading, with greenhouses and irrigation as key inputs. The chain is seeking to reduce the sharp seasonality of production (a major problem revealed in all our interviews) and enhance product quality. Konzum and Metro have the deep pockets needed to guarantee loans for the capital investment of their outgrowers, to acquire greenhouses and irrigation. This is an example of a retailer resolving idiosyncratic market failure, since most growers lack the collateral needed to obtain bank loans. Competitors such as Bili and Vrni emphasised that this puts other wholesalers at a steep disadvantage in the present situation of strong competition for good local growers and market share.

The upshot is that the leading chains in Croatia (Konzum, Metro) are rapidly shifting, or have already shifted, towards a preferred supplier system managed by their specialised/dedicated wholesalers, and have drastically reduced their use of the types of general-line wholesalers that had emerged during the transition. By so doing, their procurement organisation now has many elements in common with a number of leading chains in Western Europe and the US. Smaller chains are obliged to follow suit (hence there is a diffusion of procurement technology change across the retail sector), with small chains such as Tommy Supermarkets on the coast now embarking on preferred supplier systems with dedicated wholesalers managing them.

**Shift towards private safety and quality standards**

Leading chains are shifting towards higher quality and increasingly safe products by means of private standards imposed on suppliers. There are several reasons for this, as revealed in our interviews: (i) higher product quality and safety are being used to woo consumers, as competitive tools against the remaining small shops and markets; (ii) standardisation reduces costs and allows more efficiency of product flow in the procurement system; (iii) an important reason is to bring the attributes of local supply
into conformity with the private standards of European retailers, several of which are also the leading chains in CEE (such as Tesco, Ahold, Carrefour, Metro); (iv) centralised purchase (with better monitoring ability), qualified specialised wholesalers, and preferred supplier programmes of selected producers, raise the capacity of retailers to apply higher standards than is possible when purchasing from general-line wholesalers who buy from and sell to a wide variety of firms; \(^8\) (v) in general, public food regulations for the domestic market, whether they exist or not, are not easily enforced by governments in the region, so private standards and private enforcement are the main way that food safety at retail outlets is imposed, at least at present. In turn, large retailers are easy targets for liability, should a problem be experienced by a consumer.

Food safety requirements for FFV production for the domestic market differ from country to country, with little variation between different retail chains. In the Czech Republic, public requirements are stricter than they are in Slovakia; for example, HACCP certification is officially obligatory for producers of FFV and storage facilities. In Slovakia this is not yet the case and the private retail chains do not require it either. Also private initiatives concerning food safety requirements are more advanced in the Czech Republic than in Slovakia, as we found some evidence that retail chains are trying to communicate food safety issues to their customers. For example, there is an integrated fruit production label (SISPO) that was introduced by the Czech Union of Fruit Growers. Almost all supermarket chains interviewed indicated that they prefer to buy SISPO labelled fruit and the label is clearly identifiable on the shelves. At the moment integrated fruit production is still only a small proportion of total Czech fruit production, but retail chains made it clear that in the future they will move to buying only SISPO-labelled fruit on the domestic market. This could have important consequences at the production level, because certain investments are necessary to become SISPO certified and for the moment it is mainly the larger and better producers which have switched from conventional to integrated production. However, apart from the controls carried out on SISPO producers by experts of the Union of Fruit Growers, and random sample checks by the public food agency on products in storage rooms and on the shelves of supermarkets, there are no controls on production practices and pesticide residues for the local products that are sold in supermarkets. Both in the Czech Republic and in Slovakia there is a public BIO label for organically grown FFV. However, in neither country do the supermarkets adopt this label because customers are not willing to pay a higher price for these types of products.

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8. The shift to DCs often also intensifies the control on quality and sometimes even increases quality requirements. For example, for the moment Tesco employs one person who performs quality controls in all Tesco stores in Slovakia. Once the DC is open at the end of the year, Tesco will employ 6 people charged with quality control. Kaufland Slovakia will reverse its quality policy completely once the DC is established. At the moment, Kaufland puts all (even non-calibrated) delivered products on the shelves. Products that are not sold at the end of the day, for example because they are of too low quality, are simply returned to the supplier. In the DC, all products delivered will have to be first-class, sorted and calibrated, and low-quality products will be returned immediately.
4 Implications for agricultural producers, rural development, and policy

Supermarkets and strong foreign retail chains are rapidly entering and taking over food retailing in Central and Eastern Europe. Supermarkets’ procurement practices and requirements are an important challenge for farmers and supply chains in the region. As this process has started only relatively recently, there are no studies on the impact so far, and the discussion here is to some extent speculative. Our analysis draws on insights from other regions, while identifying a series of specific CEE characteristics which will affect the impact.

A key concern is that the supermarket revolution will push a large proportion of farmers, and in particular small farmers, out of the market, as they may find it hard to ‘make the grade’ and sell to supermarkets. While at this point there is no systematic evidence on this, studies from other parts of the world, in particular emerging markets in Latin America, suggest that these pressures may be real and important (Reardon and Berdegué, 2002; Berdegué et al. 2003). The reasons why small farmers in particular are said to lose out are twofold. First, there is an important fixed transaction cost component in the costs of exchanges between farms and retailers, making it more costly for retailers to deal with a large number of small farmers than with a few bigger suppliers. Second, small farmers are often more constrained in their means for making necessary investments, either because they do not possess sufficient own resources or because they have problems accessing external funds in imperfect rural financial markets.

Clearly the above are important challenges, which should be taken seriously. For example, Reardon et al. (2003c) found in several case studies in Croatia that specialised wholesalers and supermarkets’ preferred supplier programmes tend to work with the (relatively) large FFV producers in the main produce regions, and to eschew smaller producers if they have alternatives, for the reasons noted above.

However, one can also identify several factors which suggest that the impact of the supermarket revolution on farmers, including small farmers, may be less dramatic in some contexts, and may even have positive effects in Central and Eastern Europe; and even more so for rural development.

First, the effects documented in this article are especially relevant for suppliers of FFV. This is an important group of producers, but most farm produce, including milk, grains, sugar, etc., is processed before it reaches the retail sector. The impact of the supermarket revolution on these farms will be indirect in the sense that supermarket development is affecting the food processing/manufacturing sector, which in turn affects farmers. The results of this ‘chain rule’ set of effects may be more similar to

9. The fruit and vegetables (incl. potatoes) sector accounted for 15% of total crop output in the Czech Republic (CSU, 2004) and 4% of total agricultural area in Hungary in 2001, where sales of F&V made up 18% of total agricultural sales (Kopint-Datorg Rt, 2004). Market shares of F&V overall are not available for Poland, but 50% of agricultural holdings grow potatoes, 20% field vegetables and 7% strawberries, and orchards account for 1.4% of total agricultural area (GUS, 2004). In Croatia, 70% of agricultural households have orchards; 22% have potato production; and 5% grow other vegetables (CROstat, 2004).
10. A potentially important effect of supermarkets which is not analysed here is the impact on the food processing sector. In early transition, many CEE countries had food processing companies which produced low quality output, and were undercapitalised and in need of investment and consolidation to survive in a
that of foreign investors taking over dairy or sugar processing plants (see Dries and Swinnen, 2004a, 2004b; and Gow et al., 2001, for case studies).

Second, in several countries farm output is dominated by larger farming companies – typically privatised state and collective farms. This holds in particular for countries such as Slovakia and the Czech Republic where the vast majority of agricultural land is used by large farming companies. In other countries, such as Poland or Croatia, small farms predominate. Moreover, within a country the importance of farm organisations typically differs significantly among subsectors (for example, grains versus dairy), reflecting economies of scale. Hence the impact of retail changes on suppliers is likely to differ significantly between countries and sectors.

Third, the CEE farming sectors have undergone a dramatic restructuring over the past fifteen years. Besides privatisation and the restructuring of the farms, this included a massive outflow of labour from the agricultural sector. In some countries, such as the Czech and Slovak Republics and Hungary, more than 50% of (officially registered) workers in agriculture left the country early on in the transition. In other countries this adjustment process has been more gradual, but the effect has also been a strong outflow of farmers and farm workers (Swinnen et al., 2004). This process has continued as investments in the food industry and preparations for EU accession, with the need to enhance the competitiveness of domestic farms, have kept up the pressure for restructuring. In this perspective, the impact of the retail revolution may thus be a continuation of the important agrifood chain restructuring which started fifteen years ago.\(^\text{11}\)

Fourth, the farm sector in Central and Eastern Europe is most in need of finance for investments, quality improvements, and access to high value markets. Interestingly, investments by modern retailers and vertical co-ordination with suppliers may well be of significant assistance in this process. Examples from Central America (Berdegué et al., 2003) and Croatia (Reardon et al., 2003c) document how modern retailers assist their suppliers with credits, inputs, extension services, and even bank loan guarantees to upgrade their capacities to produce and deliver products of high quality and, increasingly, food safety standards.

Preliminary evidence indicates that these assistance packages are especially likely to be provided in markets where there is a shortage of high quality suppliers.\(^\text{12}\) This is often the case in transition countries, because: (i) there has traditionally been a serious problem with product quality, (ii) financial constraints have limited farms’ ability to invest in quality, and (iii) farm restructuring – and in particular the shift from collective to individual farms – implied loss of managerial capacity, especially for quality output. Hence, such assistance programmes may be more likely to be provided in transition countries, and in particular in those where the market is dominated by small/medium-sized farms – at least when retailers want to source commodities locally. Evidence

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11. The average annual decline in agricultural employment in the first-wave countries Hungary, Czech Republic and Poland was -12% in 1989-92, -6% in 1993-7, and -4% in 1998-2001 (ILO, 2003).

12. Studies on vertical co-ordination between food processors and supplying farms find similar strategies and effects (eg. Gow and Swinnen, 2001; Dries and Swinnen, 2004a).
presented in this article, and in other studies, suggests that modern retailers do invest in important local sourcing especially of fresh products such as FFV.

Such assistance packages tend to be introduced by multinational retailers. However, competition between retailers for quality suppliers forces other retailers, including local companies, to follow this path as well in order to maintain a sufficiently large supply base; an example of a lead domestic chain doing this is the action of Konzum in Croatia. This is especially important in transition countries where there is typically a shortage of quality supplies.

An important impact of these strategies is on the international competitiveness of the supply chains and, hence, the farms that are able to upgrade to meet the demands of modern retailers. This is a major factor in the current process of EU accession and wider international integration. Many experts have pointed out the continuing weaknesses of the CEE agrifood supply chains which have caused the net agrifood trade balance between the EU and the CEE to shift dramatically in favour of the EU over the past 15 years (Swinnen, 2002). The retail investments and the associated supply chain effects could have an important impact on improving the competitiveness of CEE suppliers vis-à-vis their EU competitors in more integrated markets.

As mentioned earlier, there is little systematic evidence so far and this points to an important need for research in this area. The only study in existence on supply chain investments, quality upgrading and small farmers in Eastern Europe is that of Dries and Swinnen (2004a, b) on Polish dairy farmers. Their analysis shows that the impact is generally positive for farmers, even for small farmers, as processors assist them with quality upgrading and investments. The only farmers to lose out are those close to retirement who would have gone out of business anyway. Most studies of modern supermarket investments in other regions tend to point to opportunities for farmers, but often emphasise the major challenges facing small farmers and the highly significant exclusion of under-capitalised small farmers (Reardon and Berdegué, 2002). However, even these studies show that small and medium-sized farmers – who have the necessary human, physical, financial, and organisational capital assets – can have a future in modern retail chains. For example, a 2003 report on Central America (Berdegué et al. 2003) documents that 70% of the suppliers for Hortifruti, a highly developed specialised retail FFV supplier in Costa Rica, are small farmers (who passed the selection process and benefited from extended supplier assistance), working via intermediate packers who aggregate supplies, and that this suppliers’ group has been very stable over the past five years. Very often, however, the small farmers have stayed ‘in the game’ because of heavy subsidies from NGO and donor projects to capitalise them sufficiently.

Finally, modern retail investments will not only affect rural suppliers, but will also have a wider impact on rural development. This includes improved access to better quality and a wider variety of foods and other products for rural households; and the creation of off-farm employment, directly or indirectly, in the supply chain. Investments in packaging, quality control, extension services, etc. are likely to create new jobs in the rural areas, while at the same time the competition from the retail chains will cause traditional shops and retail outlets to close. The supermarkets, as motors of market development, will also generate opportunities for differentiation of products and value added.

In summary, the above arguments lead to the conclusion that retail investments are likely to have important implications for supply chains and rural households in Central
and Eastern Europe. It appears that these investments may bring very significant benefits to the region, but could also pose significant threats where inefficient or undercapitalised farmers cannot ‘make the grade’.

It is important for a policy debate to begin on the most effective and appropriate methods for developing ‘win-win’ solutions for retailers and for agrifood producers in the region. The specifics of this debate will vary country by country, determined by the agrarian structure, the condition of supply chains, the status of current regulations, whether the country is on the accession list, and so on.

One policy issue that will, however, cross-cut many of the countries is the need to address the challenges that the retail transformation poses for small/medium-sized producers. In situations where small and undercapitalised farms are prevalent, such as in Croatia, Bulgaria, and Poland, governments should be keenly aware that the survival of these farms will be challenged very rapidly by the development of supermarkets. This transition may well be inevitable in the longer run, but a case can be made for the need to assist these small farms to meet the requirements of the transformed retail sector in order to make the impacts on the rural sector more gradual, and even to harness the market development power of the supermarkets to create opportunities for small farms. This will be challenging in a situation of limited rural credit markets and poor extension services. When upgrading is carried out of these latter services, attention should be paid to gearing the upgrading to the requirements of the modern retail sector as the dominant client, rather than to the requirements of the declining traditional wholesale and retail sectors.

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