Journal of Business; ISSN: 2233-369X; e-ISSN: 2346-8297; Volume 10, Issue 2, 2021

Does the Increase of Organized Retail Share, over Traditional Trade in FMCG Sector, Negatively Affect the Competition and Limit Local Manufacturers to Access Final Customer Market? The Case Study of Snacks Industry

*** Irakli KHVTISIASHVILI**

**** Nino JOJUA**

Abstract

This study aims to identify factors that limit local manufacturers to access B2C channel customers, that is caused by Organized trade and Traditional trade market ratio changes in retailing industry. The increased pressure from Organized trade affects commercial cost structure to reach customers and position product on the retail shelf. Research deploys direct interview method from field experts to identify obstacles on the market and evaluate their quantitative affects through the desk research.

Keywords: commercial costs, market concentration, organized trade, retailing, traditional trade

JEL: F10

Introduction

From the global practice, due to the strong consumer demand or product perishability, fast moving consumer goods (FMCG) have a limited shelf life. These commodities are frequently acquired, quickly eaten, inexpensively priced, and marketed in vast quantities. When they are on the store shelves, they also have a high turnover. Examples include non-durable goods such as packaged foods, beverages, toiletries, over-the-counter drugs, and other consumables.

Based on Kondawar's (2020) research FMCGs constitute a large part of consumers' budgets in all countries. Generally, the benefits resulting from the sale of FMCG are fairly low. Nonetheless, relatively high benefits can be achieved given the large volumes sold. In addition, it is known from economic theory that the structure of a highly concentrated market leads to a high profit margin.

This market is characterized by a high level of competition, the seasonality of sales in certain product categories, as well as the constant appearance of new brands and types of goods. A common precondition for success in this market is: broad presentation of product, availability, wide range of products and standards of placement and display of goods (Wood L, 2020).

FMCG Industry is characterized by a well-established distribution network, low penetration levels, low operating cost, intense competition between the organized and unorganized segments.

However, According to TBC capital (2018) organized trade is prevailing over traditional trade through regional penetration with increased commercial cost pressure over FMCG product manufacturers, that factor becomes market driver for next five-year industry's perspective.

CFI (2021) argues that the main features displayed by FMCG for consumers are as follows: Frequent purchasing; Low engagement (little or no effort) / Quick buying decision; low price; Quick consumption; Short lifespan.

Key features of FMCG from a marketing point of view are: High production volumes; Low margins for distributors; High stock rotation; Large distribution network.

Among the trends and innovations of the modern FMCG industry, the following should be highlighted: FMCG e-Commerce; Direct Distribution; Customer Experience; Big Data & Analytics; Retail format changes (increase in the share of retail chains); Acceleration of the growth rate while introducing new products and reducing the life cycle of goods (Aggrawal M, 2022).

* *Assoc. Prof., Faculty of Business and Technologies, International Black See University, Tbilisi, Georgia. Email: ikhvtisiashvili@ibsu.edu.ge*

** *Assoc. Prof. Dr., Faculty of Business and Technologies, International Black See University, Tbilisi, Georgia. Email: njojua@ibsu.edu.ge*

Journal of Business; ISSN: 2233-369X; e-ISSN: 2346-8297; Volume 10, Issue 2, 2021

It is important for market participants and investors to have information about the sector. Accordingly, the aim of the research is to show companies and potential investors the current market situation and the development potential of the sector.

Based on TBC capital (2019), The fast-moving consumer goods sector in Georgia will increase up to 11 billion GEL in the next six years from 9.4 billion GEL in 2019, with a compound annual growth rate of 5.6 percent. Meanwhile, the number of branded network merchants will increase by a factor of two. In addition, the tourism expenditure is expanding in the food and fast consumption industries.

According to the Geo Stats (2020) the main revenue of 86 percent of FMCG is generated from domestic expenditure done by Georgian citizens, while 7.4 percent comes from tourism expenditure and 6.2 percent respectively is created by restaurant expenditure.

According to Galt & Taggart (2020) import of FMCG and production inputs for the same industry reached 3.8 billion GEL that has generated 5.5 billion GEL revenue in the sector. Hence, industry is import dependent by 62 percent.

Total FMCG retail chain in Georgia for year 2021 consists of active 5800 stores, from where 69 percent is traditional trade shops and 31 percent is organized trade shops.

In comparison with the global FMCG sector, organized trade ratio in Georgia is much below the industry average of 80 percent OT share and has further growth potential, with compound annual growth rate of 20%, based on high rural penetration possibilities (TBC capital 2019).

Accordingly, the FMCG market has a possibility to grow by 7% CAGR for next five years, while the organized market penetration will achieve 41% by year 2024.

Research identifies challenges of the given changes on the market and evaluates negative factors of such high market concentration in favor of Organized trade.

Research Methodology

The approach for conducting a specific retailing market concentration and commercial term analysis is based on a multi-level system that uses a various methodological tool to search for quantitative and qualitative data and translate it into useful information. The following diagrams depict crucial phases and points out numerous features and approaches employed at various competition levels, including company-specific and industry-wide challenges, as well as examples of related product category engagement and commercialization factors.

At the outset, the research interest area is narrowed down with the actual problem generated through the Georgian FMCG Retailing industry framework analysis and concerning its structural composition, as well as the effect of market compound growth rate and concentration ratio on the industry's competitive advantage on the rural and urban arena.

Hereafter, the research problem is to understand the implication of the industry's composition on internal rivalry forces and analyze individual variables which build up market concentration, supply chain challenges and competitive advantage on organizing trade portion of the market that can possibly limit rivalry and excess to final customer market for the manufacturers. Accordingly, the research question is narrowed down as follows: Does organized retail share increase, over traditional trade in the FMCG sector, negatively affect the competition and limit local manufacturers to excess in the final customer market?

Firstly, research deploys compound annual growth rate methodology to research market trend developed by Anson *et al* (2010) and Herfindahl–Hirschman Index, a commonly accepted measure of market concentration to understand competitive level of the industry (The United States Department of Justice, 2021).

Research creates commercial cost ratio analysis to valuate sales proportion and commercial cost pressure for the whole industry. Formula identifies commercial cost value from organized trade ratio and divides it on total FMCG sector sales.

Research identifies relationship through leaner regression tool, between commercial cost ratio as dependent variable over organized trade share. To understand how much of given factor is explained by organized trade market share increases.

Journal of Business; ISSN: 2233-369X; e-ISSN: 2346-8297; Volume 10, Issue 2, 2021

According to Osborne W. (2017) Linear regression attempts to show the relationship between two variables by using a linear equation to observed data. One variable is supposed to be an independent variable - organized trade market share, and the other is to be a dependent variable – commercial cost ratio. Research deploys Excel data analytical tool to calculate relationship between those two variables.

On the next level, research deploys supply chain analysis to understand market structure and underline main industry players affecting the whole value and price generation framework (Hugos, 2018).

Research collects essential information through face-to-face interviews, that are structured interviews conducted by trained interviewers who use a standardized interview protocol and a standardized set of responses for recording participants' responses (Jennings, 2005).

Research conducts face to face two-hour interviews, with commercial directors of three main distributor companies in Georgia that control 70 percent of distribution chain of local market. interviews are formulated based on open ended questions. The list of questions is presented in bellow table:

Question	Timing
Can you list down detailed commercial costs for each organized trade chain in Georgia for FMCG year 2021?	30 minutes
Can you list down detailed commercial cost for traditional trade in Georgia for FMCG year 2021?	30 minutes
What are the main challenges while negotiating commercial terms and payment terms with organized trade chains?	30 minutes
How is price margin formulated through the supply chain of FMCG in Georgia year 2021?	30 minutes

The epistemology of the research is designed (Smith et al, 2012) at the third stage when representing the problem, research area, topic, and scientific paradigm. The epistemological position of the given research can be formulated as follows: data are contained within the practical knowledge of industry players, suppliers and FMCG retailing sector specialists involved in day-to-day operation of Georgian FMCG distribution and trading sectors; because of information endowment in those three parts of the public, it should be collected through personal and face to face interviews.

To sum up, research integrated desk analysis and observation tools within the quantitative data collection process (Saunders, 1997).

Because of information sensitivity the distributor company names and interviewed personal names stay confidential in the research paper.

FMCG Sectoral Analysis

Research identified from table 1 that the total FMCG sector is growing by an annual compound growth rate of 7 percent and customers tend to buy more commodity products in the retailing chain. However, within the industry, organized trade revenue share is growing by 22 percent, while traditional trade revenue share grows only by 2 percent.

Table 1. Made by author (2021)

FMCG SECTOR REVENUE AND CAGR BY SHOP TYPE MLN GEL								
YEAR	2016	2017	2018	2019	2020	2021	E2022	**CAGR**
TT REVENUE	5,802 ₾	6,165 ₾	6,707 ₾	6,450 ₾	5,950 ₾	6,107 ₾	6,514 ₾	**2%**
OT REVENUE	1,286 ₾	1,631 ₾	2,085 ₾	2,720 ₾	3,285 ₾	3,778 ₾	4,344 ₾	**22%**
TOTAL	**7,088 ₾**	**7,796 ₾**	**8,792 ₾**	**9,170 ₾**	**9,235 ₾**	**9,885 ₾**	**10,858 ₾**	**7%**

Journal of Business; ISSN: 2233-369X; e-ISSN: 2346-8297; Volume 10, Issue 2, 2021

From Figure 1 research identified that annually FMCG industry revenue stream transfers from traditional trade shops to the organized trade shops. To compare with, in 2016, 82 percent of revenue was distributed to traditional trade shops and only 18 percent of total revenue was generated by organized trade shops. While in 2020 given ratio changes radically and organized trade generates 36 percent of total revenue that reduces traditional trade shops revenue generation to 64 percent.

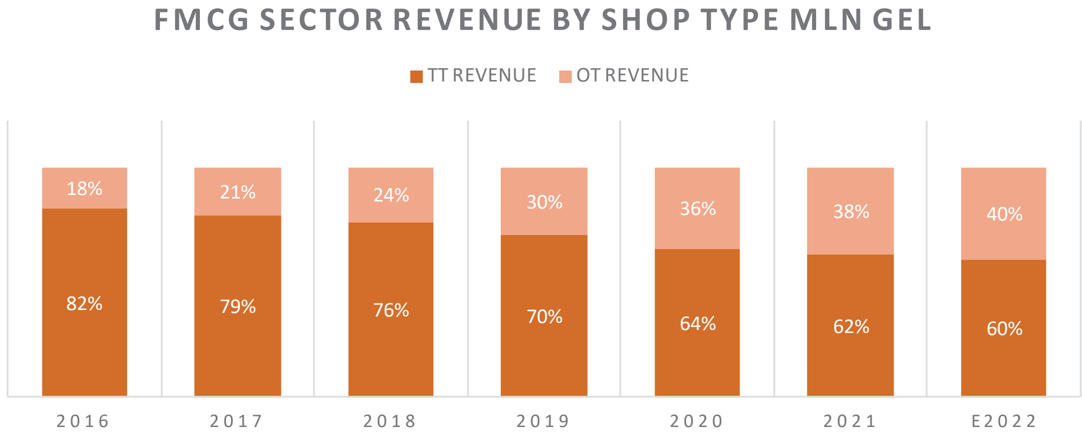

Figure 1. Made by author (2021)

To conclude, organized trade revenue is growing 15 percent faster than total FMCG sector, given growth is fueled by direct acquisition of traditional trade shop revenue streams.

In more details, during the year 2021 Georgian market consisted of 1800 organized trade shops and 4000 traditional trade shops. On average one organized trade shop for FMCG products per month generated 175 000 Gel revenue while a traditional shop creates sales of 127 000 Gel on average per month. Research evaluated that FMCG product consumption per organized trade shop is 37 percent hire that in traditional trade shops.

Organized Trade by Market Share

As Figure 2 presents, the organized trade retail sector is dominated by five main players of the market: Nikora Trade, Carrefour, Ori Nabiji, Spar and Retail Group. Above mentioned players in 2020 control 74 percent of the total sales in the sector.

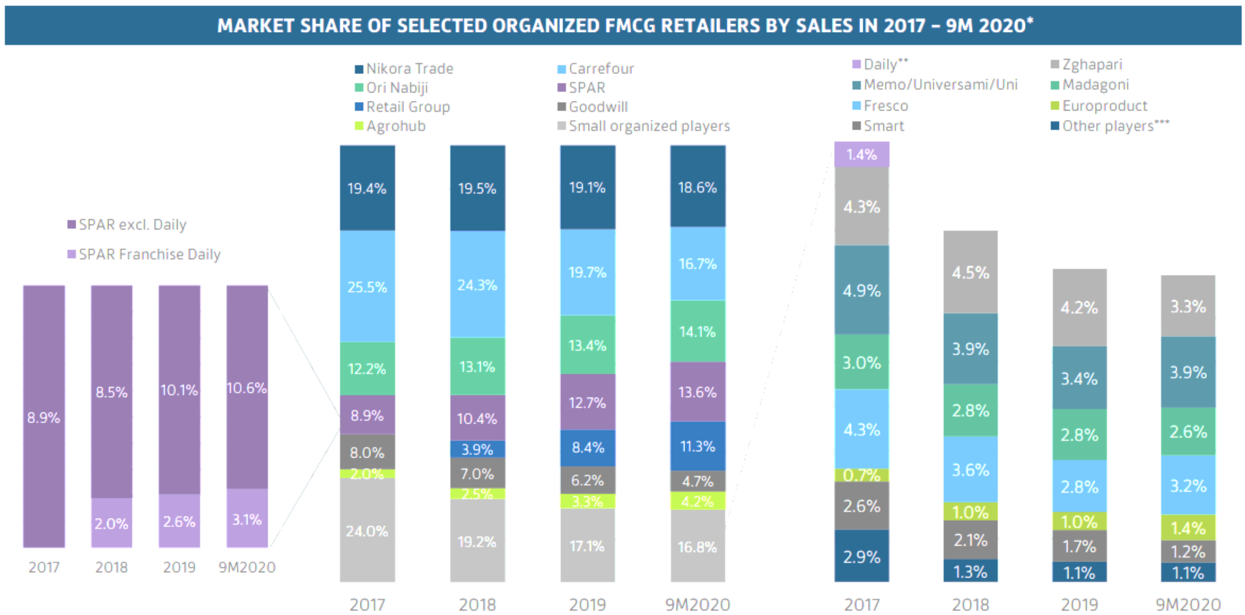

Figure 2. TBC CAPITAL (2021)

Journal of Business; ISSN: 2233-369X; e-ISSN: 2346-8297; Volume 10, Issue 2, 2021

At the same time, in 2019 and 2020 market share of big players has an increasing trend in comparison to the smaller organized trade players, due to extra rapid expansion of several FMCG retailers. Moreover, competing among each other is not only an option, but there is also still a big opportunity to capture market share of unorganized trade retailers, especially outside the capital Tbilisi.

Decreasing Herfindahl-Hirschman index (HHI) explains higher competition among the select organized retail market players. While the organized market is growing and FMCG retailers are opening new spaces, HHI index dropped to 1,192 in 2019 and is bottoming to 1,152 in 2020. Given circumstances indicates that competition in the organized FMCG sector is growing and parallelly cannibalizing traditional market shop share.

Commercial Cost Structure

Research identifies five main types of commercial costs in organized trade chain, according to the table 3 it is: cashback paid on monthly basis, bonus on sales plan execution paid annually at the end of the year, primary shelf positioning has a nature of monthly payment, sales promotion discount executed six times per year for two weeks every time and listing fee per newly opened shop is onetime payment, given commercial costs are calculated from product's sellout price. Also, research investigates the hidden cost of stretched payment terms that can go up to 70 days per individual chain.

Extended payment terms have negative implications on the backward supply chain players. Manufacturers and distributors face higher cost of capital and inflated working capital problems that indirectly are represented in product retail price on the shelf.

Table 2. Made by author (2021)

COMMERTIAL COST SNACK CATEGORY	CASHBACK	BONUS ON PLAN EXECUTION	PRIMARY POSITIONING	SALES DISCOUNT	LISTING FEE	COMMERCIAL COST TOTAL Y 2020
OT CHAINS	**%**	**%**	**%**	**%**	**%**	**%**
NIKORA	16%	3%	1%	4%	1%	**25%**
SPAR	17%	3%	-	4%	1%	**25%**
MAGNITI	20%	1%	2%	4%	-	**27%**
JIBE	15%	1%	-	-	-	**16%**
CARREFOUR	18%	1%	4%	4%	-	**27%**
FRESKO	10%	-	-	-	-	**10%**
MEMO	20%	-	-	-	-	**20%**
MADAGONI	13%	-	-	-	-	**13%**
GOODWILI	15%	-	-	-	-	**15%**
EVROPRODUCT	15%	2%	-	-	-	**17%**
VEJINI	10%	-	-	-	-	**10%**
ORI NABIJI	24%	-	-	6%	-	**30%**

Research observed that given commercial terms tend to grow annually by 2 percent during the last five-year period. With the increase of bargaining power of the organized trade and reduction of the traditional trade shops that doesn't have commercial cost structure or is represented to as low as 1 percent benchmark, chains power increase and request further average annual 2 percent expansion of commercial costs.

For manufacturers and distributors sales stream is shifting to the direction of organized trade shops. In year 2016 OT / TT proportion is represented by 18% / 82% industry split, however in year 2021 OT / TT proportion achieved a new level of 40% / 60 %. Accordingly, manufacturers and distributors must pay on average 27% more per sold one Lari that is transferred from traditional trade to the organized trade.

Main drivers of the commercial costs are cashbacks and sales discounts that generate 90 percent of total commercial costs in the organized trade chains. Plan execution bonuses are paid at the end of the year based on annual sales results planned in conservative way to be executed with high probability by chains.

Journal of Business; ISSN: 2233-369X; e-ISSN: 2346-8297; Volume 10, Issue 2, 2021

Commercial Cost Ratio

Research valuates the total commercial cost on the annual bases and compares it to the total fast moving consumer goods value to identify the commercial cost pressure on the market and product manufacturer in general, who is the final payer of the above-mentioned cost.

To compare with commercial cost ratio in 2017 is only 4 percent of total FMCG sales, while in year 2021 given ration increases and archives 11 percent from annual FMCG sales.

Table 3. Made by author (2021)

FMCG SECTORREVENUE ANALYSIS MLN GEL							
YEAR	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**E2022**
TOTAL SALES	7,088.00 ₾	7,796.00 ₾	8,792.00 ₾	9,170.00 ₾	9,235.00 ₾	9,885.00 ₾	10,858.00 ₾
OT SHARE	18%	21%	24%	30%	36%	38%	40%
OT SALES VALUE	1,286.00 ₾	1,631.00 ₾	2,085.00 ₾	2,720.00 ₾	3,285.00 ₾	3,778.00 ₾	4,344.00 ₾
Commercial Cost	N/A	18%	20%	25%	28%	30%	31%
Commercial Cost Value	N/A	293.58 ₾	417.00 ₾	680.00 ₾	919.80 ₾	1,133.40 ₾	1,346.64 ₾
Commercial cost ratio	**N/A**	**4%**	**5%**	**7%**	**10%**	**11%**	**12%**

Such gradual increase of commercial cost ratio finally affects the supply chain price structure and transfers price margin from manufacturer to the retailer.

Regression Analysis

Research identifies that between commercial cost ratio and organized trade market share is strong relationship, accordingly R square is equal to 0.9975. Hence increase of commercial cost ratio is fully explained by Organized Trade market penetration strategy and increase of number of supermarkets all over the country. Such high penetration rate is directly corelated with relative increase of commercial cost ratio of total FMCG market.

Below Figure 3 shows the leaner regression results:

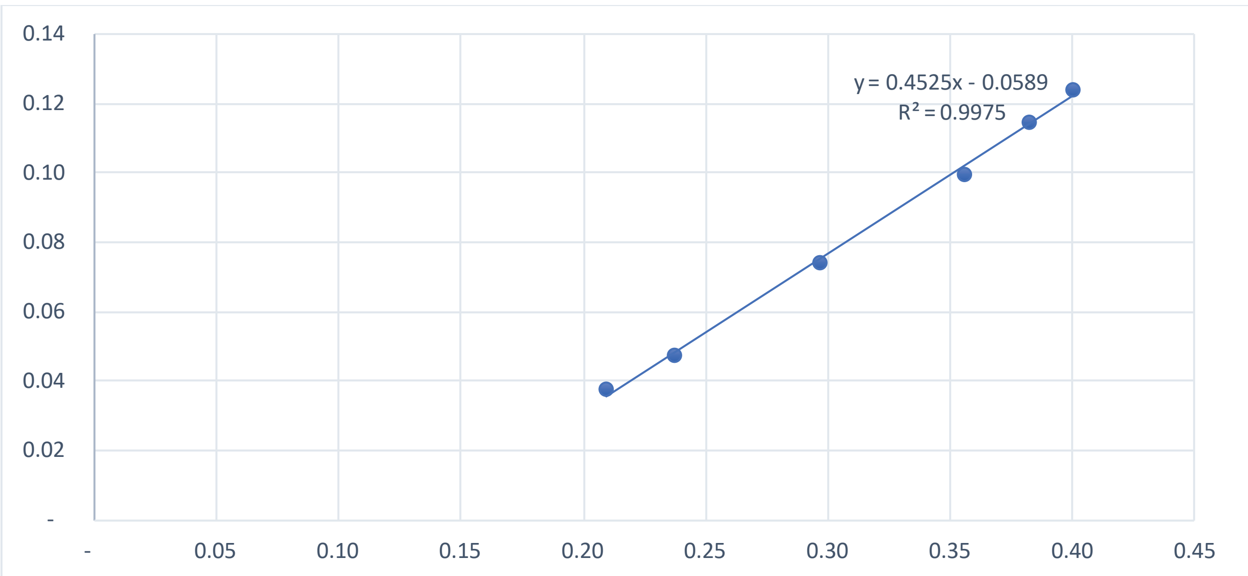

Figure 3. Made by author (2021)

Journal of Business; ISSN: 2233-369X; e-ISSN: 2346-8297; Volume 10, Issue 2, 2021

Accordingly, further increase of OT shop number will simultaneously escalate commercial cost ratio and increase pressure on local manufacturers to split their price margins in favor of supermarket chains. That has negative affect on FMCG supply chain structure that is presented below.

The FMCG Market Structure

Fast moving consumer goods industry mainly consists of three main output producers: Agricultural goods producer companies, Georgian FMCG producer companies and Imported FMCG producer companies totally delivering to the market products worth 6.4 billion GEL.

Second ring in the supply chain as indicated in Figure 4 is presented by FMCG distribution companies adding 24 percent gross margin on the manufacturers price and simultaneously sharing 50 percent of commercial costs with the product manufacturers that are dictated by retail chains, research identified that on average given commercial costs contribute 9 percent in total 24 percent gross margin.

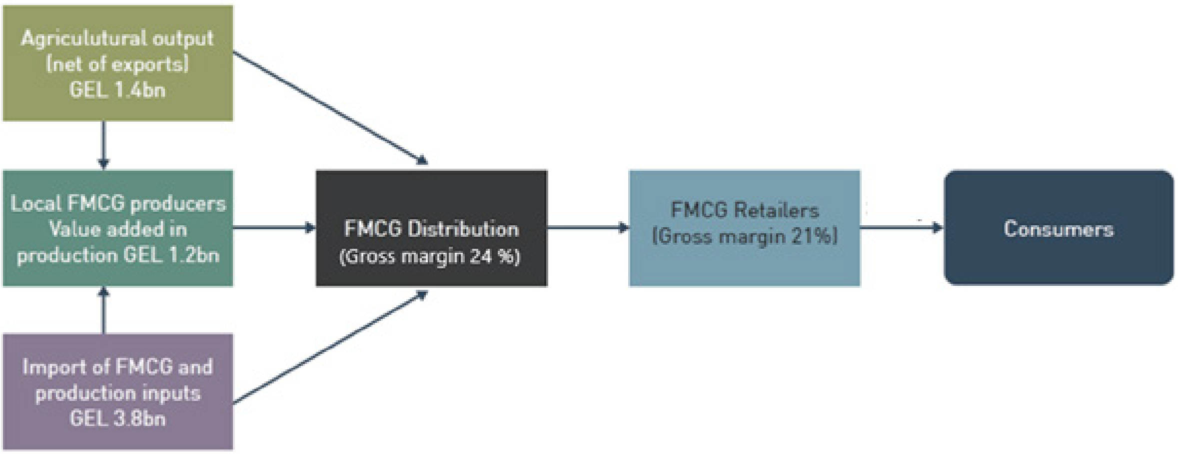

Figure 4. Made by author (2021)

Distributors have strong bargaining power with the retail chains, because they manage diversified product portfolios with several assortment and product variety. Also, distributors allocate high logistics costs on product portfolio and create economy of scale value in the chain for manufacturers.

Strongest players in the chain are FMCG retailers, who charge 21 percent gross margin on distributors invoice price and benefit from commercial costs that add up to an extra 18 percent margin on their side. Hence, the given structure creates on average 39 percent of gross margin on the side of retailers.

In a competitive price creation structure local manufacturer must benchmark retail shelf price with importer's retail shelf price. Based on what should compensate backward FMCG retailer's gross margin and commercial costs, Distributors gross margin and finally end up with difference between its sell in price and total costs. To sum up, heavy commercial cost structure disables manufacturers to be profitable and future growth oriented.

Conclusion

To conclude, the fast-moving customer goods market has a potential of high growth in Georgia represented by a compound annual growth rate of 5.6 percent. However, within the growth structure Organized trade cannibalizes the market share of Traditional trade shops. Explained by HHI index changes within the industry simultaneously with CAGR allocation.

Based on supply chain analysis, research calculated that such market development trend negatively affects the final local manufacturers in the snack industry, commercial cost in organized trade achieves up to 30 percent of sellout price that absorbs the manufacturers price margin and reduces the suppliers power to the minimum in the industry.

At the same time commercial cost ratio in 2021 achieved 12% from the total FMCG sales that has transferred price margin from manufacturer to the retailer and weakened financial sustainability of the backward supply chain.

Because of limited regional market size and customer population, local manufacturers have smaller economies of scale in comparison to the international snack importers. Hence, such market structure negatively affects the competition and creates market entry barriers for existing and new local players on native Georgian market.

To sum up, local manufacturers are at the risk of gradual price margin reduction, because of high commercial cost structure and OT/TT ratio saturation that causes sales value transfer from Traditional trade to Organized trade.

References

Adeishvili G. (2019) *FMCG sector analysis: moving fast*, TBC Capital, Tbilisi, Georgia

Adeishvili G. (2018) FMCG sector analysis: moving fast, TBC Capital, Tbilisi, Georgia

Aggrawal M. (2022) *The Future of E-Commerce in Penetrating Sales of FMCG*. Retrieved from https://www.indianretailer.com/article/technology/digital-trends/the-future-of-e-commerce-in-penetrating-sales-of-fmcg.a7757/

Bochorishvili E. et al (2020) *Georgian Economy - need for a new economic model in the context of global change*, Galt & Taggart, Tbilisi, Georgia

Chachanidze M. et al (2020) *FMCG sector analysis 2019-2020*, TBC Capital, Tbilisi, Georgia

CFI (2021) *Fast-Moving Consumer Goods (FMCG), Products that are highly in-demand, sold quickly, and affordable.* Retrieved from https://corporatefinanceinstitute.com/resources/knowledge/other/fast-moving-consumer-goods-fmcg/

Easterby-Smith, M., Thorpe, R. and Jackson, P.R., (2012) Management Research. SAGE Publications [Accessed 14 Jul. 2020], Retrieved from https://books.google.co.uk/books/about/Management_Research.html?id=ahbhMb-R7MQC&pgis=1>

Hugos, M (2018) *Essentials of supply chain management*, 4th edition, Wiley, United States of America pp 30-50, ISBN-10: 9781119461104

Jennings, G.R. (2005) *In Encyclopedia of Social Measurement*, Elsevier Inc., ISBN 978-0-12-369398-3

Kondawar A. (2020) *FMCG – Everything you need to know about this sector and the FY20 roundup for the listed companies.* Retrieved from https://jstinvestments.com/fmcg-everything-you-need-to-know-about-this-sector-and-the-fy20-roundup-for-the-listed-companies/

Mark J. P. Anson; Frank J. Fabozzi; et al (2010). *The Handbook of Traditional and Alternative Investment Vehicles: Investment Characteristics and Strategies*. John Wiley & Sons. pp. 489–. ISBN 978-1-118-00869-0.

Osborne W. (2017) *Regression and linear modeling, best practices and modern methods, SAGE*, New Delhi, pp: 201-2018

Saunders M. et al (1997). Research methods of business studies, Pitman publishing, pp. 30-60

The United States Department of Justice (2021) *HERFINDAHL-HIRSCHMAN INDEX*, U.S. Department of Justice, 950 Pennsylvania Avenue, NW, Washington, DC 20530-0001. Retrieved from https://www.justice.gov/atr/herfindahl-hirschman-index

Wood L. (2020) Global FMCG Market Opportunity Analysis, 2018-2019 & 2025 - A Billion New Consumers in Emerging Markets, Research and Markets. pp: 100-115