

Chinese Franchise Supermarkets : Future Development and Core Competence-Raising Measures

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Supermarket Franchising, as a relatively new mode of retail business, is often regarded as one of the two hallmarks of the "Modern Logistics Revolution". After more than ten years of development, franchise supermarkets have been a rising force in retail business in China. As a product of a highly-developed commercial economy, franchise supermarkets mainly deals in foodstuffs and other daily necessities, featuring low cost, high turnover rate, low prices and diversified inventory. Propelled by the conveniences that come with open shelves and self-service shopping, franchise supermarkets have been growing very rapidly and the rise of many franchise supermarket brands bears testimony to its growth potential and profitability. Meanwhile, in the backdrop of this boom, some franchise supermarkets are going bankrupt. This paper analyzes the current status of franchise supermarkets and some factors bearing on their core competencies, so as to close the competitiveness gap with international retail giants.

Key Word : Franchise Supermarket, Core Competence Innovative Strategy, Supply Chain Management, Corporate Image

1. Introduction

Since the full opening up of the Chinese retail sector, foreign retailers have hastened their steps in entering Chinese retail business. Big name foreign retailers like Wal-Mart and Carrefour have been at the forefront of expanding business in China. When their business

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in Chinese markets began saturating they started their entering into Korean, Japanese and German markets and ultimately failed. The Korean retailer E-mart has seized the "home turf" advantage and enhanced its competitiveness in the face of more fierce competition from foreign retailers. As of now, all international retail giants have entered China, which is surely poised to be the main battleground in the retailing business. If Chinese domestic franchise supermarkets are to survive in this severe business climate, they must have a clear self-understanding, recognize the competitiveness gap, formulate reasonable development strategies and open new channels of financing. In terms of logistical technology, information technology, overall marketing and management expertise, Chinese retailers have a long way to go towards improving their operational capability, innovating their strategic thinking and enhancing their core competences.

Since franchise businesses first emerged in China, the public's perception of franchise supermarkets has been one of low prices and large operational scale, which led to the wrong impression on the part of some people that the core competitiveness of franchise supermarkets lies in low prices and scale. Some people associated Wal-Mart's unparalleled competitive edge worldwide with its low prices and its sheer number of outlets; some people would even wrongly equate the core competence of franchise supermarkets with its unique and hard-to-replicate technology or product. The core competencies of a franchise supermarket business share many commonalities with that of businesses in general and differ in many ways as well. According to Li and Xie (2009), in terms of commonalities, supermarkets should have the common features of competencies such like being value-rich, unique, loyalty-bound and extendable; in terms of differences, the core competence of a franchise supermarket business has to reflect its particular features and the threshold it has to meet. Neither low price nor sheer scale lies at the heart of the core competence of franchise supermarkets. Low price as a most basic competing strategy can be easily learnt and replicated and therefore lacks uniqueness. In the long run, with the rise in incomes, consumers will have higher and higher standards against which to measure product quality and services and therefore be less concerned with price. As a result, low price cannot retain its attractiveness to people for long or generate lasting value for the company. Though franchise supermarkets need to meet a scale requirement in order to compete and survive, sheer scale expansion doesn't constitute a unique strength as it can be easily copied by competitors. Certain unique products or technologies don't qualify as core competencies for franchise supermarkets either.

The concept of corporate core competence was first advanced by Prahalad and Hamel

(1990). In academic fields, scholars still debate about the definition of “core competence”. Prahalad and Hamel (1994), focused on technology and product innovations, arguing that core competence is about diversified knowledge and customer knowledge and the intuitive creation of a harmonious entity. Leonard-Barton (1992) analyzed core competence from the perspective of knowledge, arguing that corporate core competence is the specialized knowledge and information accumulated from a continuous learning process. Academics in China have not agreed upon a satisfactory definition of core competence, but have already reached a consensus view on the defining characteristics of core competence: value-rich, non-imitable, non-tradable, dynamic and extendable. Xu, et al. (2004) concluded in his research that corporate cultural power, learning capacity and innovativeness all fit the five above-mentioned benchmarks. Yu and Meng (2004) argued that core competence varies according to business sectors. Some business sectors require high technology input, and therefore companies must invest heavily into research and development; while service sector businesses require more on corporate culture for competitiveness.

Franchise supermarkets specialize in the retail sector and perform the function of commodity distribution. Only by providing customers with the products and services they want can franchise supermarkets win over customers, which requires them to grasp home-turf advantages and build a market-oriented corporate culture. Huo and Han (2009) pointed out in their paper, *Study on Chinese Supermarket Chains' Path Choice to Enhance the Core Competitiveness: A Case Study of E-Mart in Korea*, Huo and Han (2009) pointed out in their paper, *Study on Chinese Supermarket Chains' Path Choice to Enhance the Core Competitiveness: A Case Study of E-Mart in Korea*, that core competence includes corporate culture, product management expertise, service management expertise, supply chain management expertise, marketing ability, innovative ability, and brand management expertise. In contrast with manufacturing businesses, retail sector businesses should focus more on corporate culture, brand management, product management expertise and the ability of retail outlets to respond to supply chains. In their paper, they constructed the large franchise supermarkets core competency diamond model (see in Figure1). They summarized the core competencies of E-mart as follows: a successful localization strategy, supply chain management that gives consumer demand as feedback to the supply chain, "Korean Standard" customer services, and active assumption of corporate social responsibilities to build a good public image.

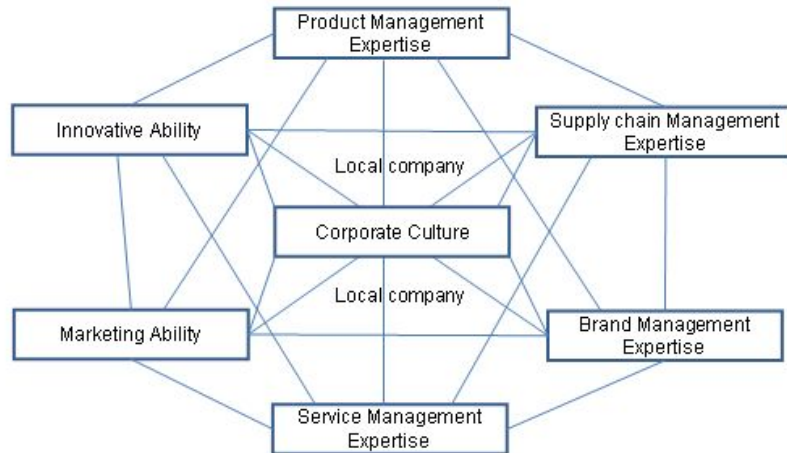


Figure 1. The large franchise supermarkets core competency diamond model

In conclusion, the core competence of franchise supermarkets means the ability owned by supermarket chains to exceed other retail business formats or other enterprises and can keep the long term competitive advantage and stable development. Therefore, Chinese franchise supermarket must improve their core competencies as soon as possible if they want to survive and develop with the competition of other supermarket chains and the attack of foreign capital supermarkets in the post WTO era. Core competence is the basis of survival and development for franchise supermarket chains. Accordingly, Chinese franchise supermarket managers must analyze the factors which affect their core competencies and make correct decisions based on the analysis to improve their competitive ability. Hence, this paper aims to analyze the current status of the development of supermarkets in China, upcoming opportunities in an environment of changing economic patterns, the effect factors of core competence, and how to improve the core competencies of supermarkets in the current situation. In addition, innovative practices in the retail sector in 2010 have been stated in the conclusion.

2. The Enterprise Environment and Current Situation of Chinese Franchise Supermarkets

Franchise businesses first emerged in China in the mid-80s, and after 30 years of development, franchise supermarkets have been the driving force of franchise business in China. In 1993, the Chinese government laid emphasis on franchise businesses as the focus of logistical system reform and put it on its agenda. Since 1994, the annual growth rate of

Chinese franchise supermarkets has been a steady 50%. Statistics show that the annual increase in sales volume at large and medium franchise supermarkets has contributed to activating domestic demand, and the role it plays is more and more significant. At the end of 2006, there were already 123,690 supermarkets, with a total floor space of 95.497 million square meters, employing 1.765 million workers, generating an annual sales volume of 1,554.89 billion Yuan.

According to the statistics in the franchise retail sales report released by the Business Survey arm of the Franchise Association after analyzing the data on more than 300 companies, in 2009, the biggest 100 retail franchises that mainly dealt in foodstuffs, sundries, clothing and home appliances reached a sales volume of 1.36 trillion Yuan, representing a 13.5% annual increase. The top 100 franchises had a total outlet of 137 thousand, representing an 18.9% increase. By the end of 2009, registered retail members of the Franchise Association represented 12.5% of total social retail sales and employed 5 million workers. In a time of changing economic growth patterns, domestic consumption in general and franchise sales in particular have been playing an increasing important role. Franchise retailers are not only the direct drivers of domestic consumption, but also the medium that carried out such initiatives such as "community commerce", "Thousand Village", and "Subsidized Appliances for the Countryside". As the main channel for delivering necessities of life in emergencies, retail outlets ensure the stable supply of goods and the smooth running of the market.

Now the franchise retail sector has several new developmental trends: diversifying business scope to include fresh foodstuffs and enlarging the capacity of logistical systems; emphasizing and applying retail technologies; establishing incentives systems for the coming of age of new managers; developing online retail sales and so on. Large-scale supermarkets are one of the fastest growing parts of franchise businesses. By analyzing results in the perspective of each region in China, we can see that large-scale supermarkets in first-tiered and second-tiered cities have almost reached saturation and therefore are reaching into tier three and tier four cities. In this drive to cover tier-three and tier-four cities, foreign retailers hold some important advantages. In the mean time, supermarkets are all trying to formulate strategies that fit their business portfolio, which include innovative and diversified business operations, getting prime lots, locating near residential communities, servicing communities, and intensifying management. The rise and steady development of convenience stores is a prominent phenomenon and include constraints such as low-level overcapacity, logistical weaknesses and inadequate stock of seasonal food.

3. Upcoming Opportunities for Franchise Supermarkets in Changing Economic Patterns

In the next five years, the process of urbanization is bound to accelerate, and household incomes will surely rise. With further reforms in income distribution systems and the improvement of social security, China will gradually transition from a big producer to a big consumer by entering a period when consumer markets develop rapidly. Purchasing power and purchasing are likely to be on the rise, with improvement in consumption structure and consumption environment further opening up consuming capacities. The 12th Five Year Plan¹⁾ period will see new opportunities for the development of franchise businesses, of which franchise supermarkets are an indispensable part.

3.1 The Domestic Demand Expanding Strategy Paving New Ways for Franchise Supermarkets

The 12th Five Year Plan stipulates clearly that domestic demand will be ceaselessly stimulated, and a long-term mechanism for increasing consumer demand will be established. With the 12th Five Year Plan being implemented phase by phase, with ongoing urbanization and continuous improvement in income distribution systems, and with a more balanced social security & welfare system being set up, potential demand will effectively be turned into real consumer demand. In addition, the role of logistics in bringing together production and consumption will be strengthened, which in turn means greater opportunities for franchise businesses. According to 2009 statistics data of Ministry of Commerce of China, a one percentage rise in consumption rate would release 335.3 billion worth of demand. Assuming an annual grow rate of 8 percent in 2015, China's per capita GDP will reach 5 thousand dollars, further foregrounding the role of consumption in stimulating the economy and ushering in a new era of consumption-dominant economic development. All these taken together mean a greater impetus to the development of franchise supermarkets in China and new challenges as well.

1) Its full name called "Twelfth National Economic and Social Development Five-Year Plan (2011-2015)". China starts the country's short-term planning since 1953 and the "First-Year Plan (1953-1957)"

3.2 Changing Growth Pattern bringing New Opportunities

Further staying off the effects of the global financial crisis and consolidating the gains of economic development are the main tasks of the 12th Five Year Plan period. In the post-crisis period, with changing demand structure at home and abroad and with the upgrading of manufacturing industries, logistical and franchise businesses will see unprecedented opportunities. On the other hand, an economic shift away from high-input, high energy consumption to a more intensive development mode requires that logistical and franchise businesses cut emissions and energy use and work towards the goals of “going green and conservationism”. According to a survey, water and electricity bills represent the third largest categories of cost after labor and rent costs at large retail outlets in China, accounting for 10-30 percent of total costs. That is 2-3 times higher than when compared to the same outlets in advanced economies. Therefore, cutting emission and energy consumption doesn't only cut costs and raise profits, but contributes to changing economic patterns and enhancing competitiveness.

3.3 The Upward Shift in Consumption Pattern bring Opportunities for Franchise Businesses

With the rise in living standards and changing consumption patterns, franchise businesses will not only provide products but also services for consumption as well. In 2009, the urbanization rate in China stood at 46.6%, and it is predicted to exceed 50% at the end of the 12th Five Year Plan, when over half of the population will live in cities. Taking migrant workers into consideration, the vast majority of consumers will be living in cities and towns. The Post-1980 generation and the Post-1990 generation, along with the Silver-haired generation will be the main drivers of consumer demand (According to estimates, 420 million Chinese are born after 1980, accounting for 31.4 percent of the population, while 65-and-above seniors number around 113 million, accounting for 8.5 percent, which is projected to rise to 10 percent). On top of that, service consumption, car consumption, digital & credit consumption, online consumption, personalized products consumption will be the new hot spots of consumption. All these factors will prompt franchise businesses, including franchise supermarkets, to improve their sales networks and provide urban dwellers with more convenient and more wide-ranging shopping services.

4. Factoring Influencing Core Competence of Chinese Supermarket Franchises and Recommended Measures

4.1 Scale of Operation : Calling for New Modes of Expansion

When supermarkets first came into beings, they were designed to meet the demand for the one-stop purchase of foodstuffs. In order to satisfy housewives' demand that all daily necessities could be bought in a one-stop purchase, supermarkets have been expanding and diversifying their inventory ever since. As of today, supermarkets have evolved into big public places where food, clothing, sundries, hotels and ticket services can be found. In the past ten years, though the Chinese retail business as a whole is growing at 9.7% annually, it is still under unprecedented pressure from facing the fierce head-on competition from foreign retail giants (Li and Xie, 2009). In comparison with other types of businesses, franchise retail businesses' advantage lies in economies of scale. Only by achieving economies of scale can franchise retail businesses expect to lower costs and attract consumers and clients with competitive prices. On facing competition from foreign retailers, domestic franchise supermarkets chose to expand their scale of operation by franchising domestic outlets, or by leasing, buying and building new outlets, while the internationally prevalent practices of merger and acquisition face hurdles in China because of institutional constraints and unfamiliarity. Domestic retailers need to change their mindset, actively engage in merger, acquisition and combining and reach across trade and regional boundaries, so that domestic large-scale competitive franchise supermarkets can take shape.

4.2 Information and Logistics Technology : Establishing Advanced Franchise Information Support Systems and Supply Chain Technology

Since the products that franchise supermarkets deal in are all everyday necessities that price-sensitive consumers buy in large quantities, franchise supermarkets must adopt low-cost, low-price tactics. In order to lower costs, franchised supermarkets generally have common suppliers and channels of distribution, which rely on logistics information systems. The headquarters, outlets and distribution centers should be connected on a digital network system, which would enable the digital integration of purchasing, sorting, processing, packaging, storage, transportation and distribution. Logistical systems are fundamental to the

competitiveness of franchise supermarkets and franchise supermarkets should try to raise the efficiency and effectiveness of logistical systems to raise their core competencies. Without modern management expertise, franchise supermarket cannot conduct effective cost control, and raising core competence and competitive edge over competitors would be a joke.

The international retail sales giant Wal-Mart uses the most advanced Electronic Data Interchange(EDI) that digitally connects suppliers, outlets and distribution centers, which enables it to send its suppliers the latest 100 week sales record of any commodity and track the sales on a global level. In contrast, the management systems in use at Chinese domestic franchise businesses are backward and low in automation, while the franchise supermarket sector, unlike traditional retailing, requires modern technology for its operation.

4.3 Corporate Image : Raising Customer Satisfaction and Build Retail Brand

Corporate image is the total sum of the recognition on the part of the public of a company's principles, guidelines and performances, and therefore is the mirror image of the public's perception of the company. Corporate image has a direct bearing on the popularity of the company among the public and consists of corporate philosophy recognition, behavioral recognition and visual recognition. Many franchise supermarkets we see today lack differentiating characteristics. More specifically, they don't have distinct traits that set them apart from each other in terms of operation, inventory, outlet layout, promotion techniques and services. The image that consumers hold of a franchised supermarket is all about its business scale and size. In other words, the image of most franchise supermarkets is still at the stage of visual recognition and most franchise supermarkets have not fully and thoroughly worked on fostering its corporate image, due to a lack of understanding of the importance of corporate image.

By building an appealing corporate image, franchise businesses can foster in the public a brand loyalty and trust. As we all know, the main means of expanding sales for franchise supermarkets is to cultivate customer loyalty and trust, thereby raising profitability. If the corporate image is tarnished or bad and the services are not of a high standard, customers would simply go to other supermarkets to do their shopping for the same products, with the end result being that the competitiveness of the former is compromised. Cultivating a positive corporate image requires that products and services be taken as a whole, and further requires the building of corporate culture on the fronts of corporate ethics,

institutional culture and the more visible material front. The situation of customers and competitors needs to be carefully analyzed and corporate values and guiding principles should be in place to steer concrete management decisions. Management of the business should be done in accordance with modern and fitting rules. Brand-building strategy should be carried out on certain products. And a brand building strategy that focuses on quality services should be brought to bear on enhancing the name recognition of franchise supermarkets. Such measures as membership options should be taken to enhance customer loyalty so that the number of customer entries could go up and new products could be added to the inventory, thereby raising the core competence of the business.

4.4 Effective Management : Improving Operation and Raising Competent Managers

Franchise supermarkets have been doing business in China for more than 10 years and their management philosophy and management methods still lag behind. Judging from realities on the ground in China, supermarket development has focused narrowly on hardware, such like outdoor decoration and the decor of showcases. In these regards, they have caught up with the West and maintained a uniform outlook among franchised outlets. But many franchise supermarkets lack a set of coherent, consistent and scientific management methods and philosophies. In order to raise competitiveness, supermarkets should employ a business strategy that strives for low costs, low prices, high quality and satisfying services, so that customers can find satisfaction and benefit in shopping. Pure economic gains should not be the goal of franchise supermarkets. Every measure needs to be taken into account to ensure that customers spend the least amount in the most convenient way and get the highest quality in both products and services. Effective management of supermarkets requires competent and innovative talents. Competence in management is an important factor in the development of franchise supermarkets. Therefore domestic franchise supermarkets should emphasize the training of their staff, the training of the management in particular, so that they can catch up with international retail giants with their own team of competent management.

According to the data provided by the China Franchise Business Association, the innovative practices in the retail sector in 2010 are as follows :

Table 1. 2010 Year Innovative Practices in Retailing

Categories of Initiatives	Franchise Brand	Themes
Social Responsibility (Conservation, environmental Protection, food safety)	Auchan	Sustainable Development Initiative
	CR Vanguard	Three Hundreds ¹ Project
	CR Vanguard Suguo	Scientific Food Safety Verification
	Carrefour	Speedy Food Safety Verification
	Metro AG	Product Origin Tracing System
	Tianhong	Energy Efficiency, low-carbon outlets?
	Lianhua-Danfoss	Digitally Controlled cooling systems
	Leili	Low-carbon emission seaweed fertilizer vanguard
	Wal-Mart	“Wal-Mart” Youth Technology Innovation Contest
	Wal-Mart	The Earth Month Movement
	Wal-Mart	Conservation Model Movement
	Wal-Mart	Supplier Energy Efficiency Movement
Classification	Suning	“ELITE boutique”
	Chaoshifa	Improving the sales of farm produce in communities
	Kids King	Innovation in infant, mother and child product service
	Yongwang	“ten for fun” 10 RMB store
	Jinluo	Fresh Products leading the business
	Tencent Tech	Innovator of IT product sales
	Jinxiu Thousand Village	Innovative Farm-Sales Model
Technology (IT, Logistics and damage prevention)	Tianmu	Smart delivery of fresh produce plan
	Shanghai Shitian	Bottomless paper price tag and bottomless label
	Liqun	Voice recognition raises efficiency by 4-5 times
	Huashi Delivery	Third-party standardized delivery
	Wal-mart P&G	Standardized Delivery
	IBM	Business Cloud Platform
	Jibao Logistics	Tray-carried Supply Chain Innovation
	Wal-Mart	Video Facial Recognition System
	Ronghua Electric.	Digital Products & Premium Product Protection
	Haikang Weishi	Headquarters & Outlet Monitoring: damage prevention
Marketing	Honghaizi	Focusing on customer demand to raise profitability
	Chengdu Red Flag	Innovative service platform, maximum convenience
	Hebei Guoda	Delicious Northern Style Breakfast

Categories of Initiatives	Franchise Brand	Themes
Marketing	Carrefour	Happiness to the home
	Chaoshifa	Healthy cuisine, year-round healthy, fresh food
	Zhengdafutong	Three major innovations put us in the lead
	Jingkelong	“Love Card” Propels harmonious development
	RT-MART	D plan-exquisite decoration and lighting
	Gome	Expo co-opt Gome, making life better
	Jingong Supermarket	Household electricity sales agent
	Wushang	All cooling system of processed vegetables
	Bestbite	Co-brand Credit card
	Lining	Online sales
	Tencent Tech	Easy Technology
Management	Wuhan Zhongbai	Innovative Management of Equipment Maintenance
	Xinghan	Convenience Store Collocation Model
	Zhongbai Convenience	Innovative Performance Management
	Zhen Gongfu	Rice University
	Xinglong Big Family	Strategic Partnerships make sales more friendly
	Meiyijia	Cultivating “sales assistants”
	Wal-Mart	Farm-Supermarket Direct Supply Chain

5. Conclusion

Economic globalization has brought both opportunities and challenges for Chinese franchise businesses. The opportunity side lies in the integration of major economies and global logistics in particular. The challenges lie in the frenzied influx of foreign competitors scrambling for fewer and fewer remaining business prime lots. A common problem with local supermarkets is their small scale and low profitability, along with their competitive disadvantage in terms of their services and management against foreign competitors. Therefore, at the macro-economic level, China needs to carry out institutional reform and institutional streamlining, formulate broad development blueprints, strengthen the rule of law and develop intermediary agencies. At the business level, market positioning strategy is key factor to the success of franchise businesses; therefore expanding scale, diversifying business, and instituting people-oriented inventory stocking, up-to-date management and brand-building strategy should be

seriously considered options. Finally, Chinese domestic supermarkets should focus on building a "people first" corporate culture, build positive corporate images in customers and improve shopping environment. Only in this way could Chinese domestic supermarkets enhance their strengths and achieve future success.

- 논문접수일 : 2011. 5. 7
- 게재확정일 : 2011.5. 20

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