



## **The Situation and Problems of Japan's Wholesale Market**

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### Explanatory Note for Translation

This report describes the situation and problems of Japan's wholesale market. The report was written in 2009 by the study group set up by the Ministry of Agriculture, Forestry and Fisheries. Recommendations made by the report are reflected in the "Basic Policy for Wholesale Market 2010" which is renewed every five years.

The wholesale market is at the core of Japan's fresh food distribution system. The basic mechanism of the wholesale market is that wholesale traders accept products from fresh food suppliers and then sell them by auction to middle traders and large retailers. Wholesale traders are paid a commission from suppliers.

This translation covers only the first two chapters of the report, and omits the remaining sections concerning policy proposals.

(Translation)

Report by the study group on the future of Japan's wholesale market

March, 2010

### **I. Preface**

Wholesale markets are part of the basic infrastructure of Japan's system of food distribution. A large part of perishable food is traded via wholesale markets. The wholesale market has played an important role in securing the stable supply of perishable food to consumers.

The Central Wholesale Market Law was enacted in 1923, which was the starting point of Japan's wholesale market policy. The current wholesale market framework was started in 1971, and reformed in 1999 and 2004. These reforms aimed to improve trading efficiency and quality control. At the same time, they aimed to reorganize the structure of existing wholesale market. Even after the final reform in 2004, various efforts have been made to create a safe, reliable and efficient food distribution system to meet the expectations of both

producers and consumers.

However, the conditions surrounding Japan's food distribution system have continued to change significantly even after the 2004 reform. The social structure has changed due to the falling birth rate and the aging of the population. The domestic farming and fisheries sector have downsized their production capacity. People have become more conscious of food safety. There is more demand to commit to social interests such as those of the environment.

Wholesale markets, on the other hand, are in a difficult situation. Due to reduced consumption and production of food as well as the increase of imported food, both the fraction and the absolute quantity of food distributed through wholesale markets have decreased. Business conditions of both wholesale traders and middle traders have become increasingly unfavorable.

This study group was created in October 2009 in order to discuss the possible role and direction of, and related policy towards the wholesale market, based on awareness of the above issues.

To date, the group has held 12 meetings, including hearings from wholesale traders, middle traders, farmers, producers' groups, food retailers, food processing industries, catering industries, consumers, operators of wholesale markets and academic experts.

This report is based on the discussions of the study group and shows the status, problems and the possible future directions and related policies of the wholesale market.

## **II. Status and problems of the wholesale market**

### **1. Changes in the conditions surrounding the wholesale market**

The conditions surrounding the wholesale market have changed significantly in recent years.

#### **(1) Reduction of food consumption due to the falling birth rate and the aging population**

Japan's population is decreasing after peaking at 127.79 million in 2004. The percentage of people aged 65 and over is expected to rise to 33.7% in 2035 from 20.2% in 2005. Certainly, Japan's population will have more elderly and less young people.

Based on this, both the total food consumption and food consumption per person are decreasing, and this trend will increase even further in the future.

#### **(2) Changes in food consumption and food retailing and the diversifying food needs of consumers**

The structure of households in Japan has changed towards having more single-person households and less two or more person households. Another social change phenomenon is that nowadays, more women have jobs or are engaged in activities outside of their houses.

These changes have resulted in the increase use of processed food and more eating out (including take out). The share of processed food and eating out as a share of total food consumption in Japan has risen rapidly from 74.2% in 1980 to 81.6% in 2005 while that of fresh food has declined to 18.4%.

Different needs have developed for food. One example is the increase of food purchases in convenience stores or through the internet, which was rare in the past. Another example is

that there is increasing interest in food-quality and health issues related to the food that one eats.

### **(3) Increased concern on food safety**

Several food related scandals have occurred in recent years, such as the deceptive labeling and processing by food companies, and undercutting consumers' confidence in food. These have resulted in increased interest in food safety and food quality by the consumers. Some studies have shown that more people care about "food safety" and "freshness of food" rather than "food price".

### **(4) More commitment to solve social and environment problems**

Global warming is progressing due to effects of increasing greenhouse gases, i.e. carbon dioxide. The average world temperature has increased by 0.7C in the past 100 years. This will affect the ecosystem, farming, social structure and human health in a large way.

Japan declared a national target in January 2010 to cut 25% of greenhouse gas emissions by 2020 compared to 1990, with the condition that a fair and viable international framework should be established and that all the main participating countries should agree to ambitious targets. Private companies will be required to take action to meet these targets.

Several food distribution scandals, such as cases of false food labeling and ingredients, have raised the demand to improve compliance and the ethics of food companies.

### **(5) Domestic farming and fisheries production is going down**

Japan's farming sector has faced some tough circumstances. The amount of farmland has decreased and abandoned farmland has increased. The farming population has decreased and they are also getting older. The total sales of the industry has been in decline since 1984.

The domestic fishery sector has faced similar problems. The number of fishermen has decreased and they are also getting older. The fish catch from the surrounding sea has also been low. The production of the fishery sector in recent years is less than half of the peak year in 1984.

In this way, the structure and capacity of the domestic farming and fishery sector, which is the base of the perishable food supply, has been weakened.

### **(6) Production organizations are becoming bigger, and food retailers are changing**

Agricultural cooperatives and fisheries cooperatives are the main suppliers of perishable food to the wholesale markets. These cooperatives have decreased by 20% in number through mergers over the last 5 years, while the average sales of each cooperative has increased. Consequently, the size of suppliers has been getting bigger.

Food retailers, the customers of wholesale markets, have changed as well. Sales of smaller food retailers have decreased while the sales from supermarkets and convenience stores have increased. From 1994 to 2007, supermarket sales increased from 13 trillion Yen to 17 trillion Yen, and convenience store sales increased from 4 trillion Yen to 7 trillion Yen.

## **2. The current state of wholesale market**

### **(1) Transaction volume and business conditions of the wholesale market**

Wholesale markets have not adjusted quickly enough to changes resulting in the current state as follows:

a) Decrease in wholesale market trading share.

The portion of perishable food traded via the wholesale market is fairly high. It is over 60% for fruit, vegetables, fish and fish products. The portion would be over 90% if only the domestic products were counted. This shows that the wholesale market maintains its importance as a main pathway of the food distribution system. However, due to the increase in demand for imported food and processed food, these shares are decreasing in all products apart from flowers (Table 1).

Table 1. Trading ratios of the wholesale market

	FY2006 (rate of change)	FY1996
Fruit and vegetables [All]	64.6% (-10.0)	74.6%
Fruit and vegetables [Domestic products only]	[91.9%]	
Fish and fish products	62.1% (-7.3)	69.4%
Meat	10.1% (-4.8)	14.9%
Flowers	85.4% (+1.3)	84.1%

Source: Ministry of Agriculture, Forestry and Fisheries' own data

b) Decrease in trading volume and value

The volume and value of trade through the wholesale market has decreased. The value of trade decreased by over 20% for fruit and vegetables and by 30% for fish and fish products over the last 10 years. The percentage decrease in the value of trade is higher than that of the volume of trade for both fruit and vegetables and fish and fish products (Table2, Table3).

If you compare the biggest wholesale markets to the smallest in each area, (Japan can be divided into 8 areas, namely, Hokkaido, Tohoku, Kanto, Hokuriku, Tokai, Kinki, Chugoku and Shikoku, and Kyushu and Okinawa), in terms of trade volumes, the differences between them have expanded. This implies that polarization between wholesale markets is occurring.

Table 2. Changes in the volume of trade through the wholesale market

(thousand tonnes)

	FY2006 (2006/1996)	FY1996
Fruit and vegetables	16,163 (-19%)	19,961
Fish and fish products	4,105 (-25%)	5,459
Meat	365 (-29%)	512

Source : Ministry of Agriculture, Forestry and Fisheries' own data

Table 3. Changes in the value of trade through the wholesale market

(billion yen)

	FY2006 (2006/1996)	FY1996
Fruit and vegetables	3,464.2 (-22%)	4,452.6
Fish and fish products	3,043.6 (-30%)	4,327.1
Meat	372.4 (-23%)	485.2
Flowers	452.2 (-17%)	544.9

Source : Ministry of Agriculture, Forestry and Fisheries' own data

c) The worsening business of wholesale traders and middle traders

Wholesale trading companies based at the central wholesale markets have decreased by a little less than 20% for the fruit and vegetables sectors, and decreased by 10% for the fish and fish products sectors in the last 10 years. The number of wholesale trade companies in the meat and flower sectors has remained at the same level (Table 4).

As for middle trading companies based in central wholesale markets, these have decreased by 25% for the fruit and vegetables, fish and fish products and meat sectors. Companies trading flowers were the exception and they have increased slightly (Table 5).

The total amount of transactions of all the wholesale companies based in central wholesale markets has decreased in every sector other than meat (Table 6).

For these, the average transaction amount per wholesale trading company in the central wholesale markets has decreased by 10% for the fruit and vegetable sector, and by 30% for fish and fish products sector. As for the middle trading companies, the average transaction amount per company has decreased by more than 30% for fish and fish products sector (Table 7 and Table 8).

As a consequence, 30% of wholesale companies trading fruit and vegetables, and more than 50% of those trading fish and fish products, meat, and flowers have posted operating losses. The percentage of middle trading companies posting ordinary losses are 40% for fruit and vegetables, 50% for fish and fish products, 20% for meat and 30% for flowers. Trading companies have faced very difficult financial conditions.

Similarly, the financial conditions of companies operating the central wholesale markets have been very severe. As for their accounts, to which the Local Public Enterprise Act applies, 6 out of 13 accounts have posted a net deficit. As for other accounts, 35% of income has been compensation received from the local government.

Table 4. Number of wholesale trading companies based at the central wholesale markets

	FY2006 (2006/1998)	FY1998
Fruit and vegetables	91 (-19%)	112
Fish and fish products	87 (-10%)	96
Meat	10 (0%)	10
Flowers	31 (0%)	31

Source : Ministry of Agriculture, Forestry and Fisheries' own data

Table 5. Number of middle trading companies based at the central wholesale markets

	FY2006 (2006/1998)	FY1998
Fruit and vegetables	1,763 (-24%)	2,309
Fish and fish products	2,625 (-23%)	3,398
Meat	82 (-23%)	107
Flowers	106 (+6%)	100

Source : Ministry of Agriculture, Forestry and Fisheries' own data

Table 6. Total transaction amount of all the wholesale trading companies based at the central wholesale markets (billion yen)

	FY2006 (2006/1998)	FY1998

Fruit and vegetables	2,029.4	(-25%)	2,714.3
Fish and fish products	2,110.7	(-28%)	2,929.2
Meat	251.6	(+5%)	239.4
Flowers	155.9	(-0%)	156.2

Source : Ministry of Agriculture, Forestry and Fisheries' own data

Table 7. Average transaction amount per wholesale trading company based at the central wholesale markets (billion yen)

	FY2006 (2006/1998)	FY1998
Fruit and vegetables	22.3 (-8%)	24.2
Fish and fish products	24.3 (-20%)	30.5
Meat	25.2 (+5%)	23.9
Flowers	5 (0%)	5

Source : Ministry of Agriculture, Forestry and Fisheries' own data

Table 8. Average transaction amount per middle trading company based at the central wholesale markets (billion yen)

	FY2006 (2006/1998)	FY1998
Fruit and vegetables	1.20 (-1%)	1.21
Fish and fish products	0.77 (-31%)	1.12
Meat	2.51 (+26%)	1.99
Flowers	0.64 (+16%)	0.55

Source : Ministry of Agriculture, Forestry and Fisheries' own data

## (2) Function and role of the wholesale market: current situation

### a) Function to collect and disperse products:

Wholesale markets collect sizable amounts of various products from the main production areas all over Japan. Also they collect a large variety of products from nearby producers to have a wide range of products. The function of the wholesale market is to distribute both a variety and volume of products to users such as food retailers and supermarkets that have their own needs for product variety and quantity. Wholesale markets can do this with both speed and efficiency.

In this function of the wholesale market, it is very important to supply perishable food both smoothly and stably to the population, the majority of whom are living in the large consuming regions. Both producers and distributors of food expect the wholesale markets to carry on this function of collecting and dispersing products into the future.

Several problems, however, can be pointed out about this function of the wholesale market.

- 1) A strong cold-chain-system is necessary for the distribution of perishable food in order to secure the quality, safety and freshness of the products. However, in the central wholesale markets, the low-temperature areas comprise only about 10%. Thus, the cold-chain is often interrupted at the wholesale markets.

- 2) There is an increased demand from supermarkets and the food industry for pre-cut products or products in smaller pack sizes, instead of buying fruits, vegetables and fish as they are. The other move is that supermarkets and food retailers have increased their demand for fresh food from local areas, or from specific producers as well as for some less common products in order to increase the variety of goods. Wholesale markets, however, have not coped well enough with these demands.
- 3) The food processing and catering industries and also supermarkets prefer to obtain their food materials on a pre-negotiated contract basis so that they can then produce their products with a stable volume, price and quality. Wholesale markets, however, have not been quick enough to cope with their needs.
- 4) Existing regulation on transactions at wholesale markets forces real products to be physically brought to the marketplace as it is important to properly assess and determine a price for the products. But there are cases when it is not necessary to check the actual goods. Besides, these restrictions go against the needs of suppliers and users of wholesale markets who want to get fresh products quickly using efficient transactions.
- 5) Areas covered by each production groups are getting bigger. Consequently, these groups are inclined to ship their products to large markets that can handle and trade large volumes of products. As a result, bigger markets collect more products while trading volumes at smaller markets has decreased. These smaller markets are more reliant on products forwarded from other markets in order to get the necessary volume for their customers. This is not an efficient way of operating a market.

#### b) Function of price setting

A wholesale market is expected to set the price on a volume of products, based on the demand and supply situation with rapidity, fairness and transparency. Above all, central wholesale markets, the marketing hubs of perishable food, are expected to play a role in the setting of fair reference prices. Prices set at large central wholesale markets influence the pricing of food elsewhere.

This price setting function of wholesale markets, however, has faced several problems:

- 1) The increase in users trading large volumes of products, such as supermarkets, has resulted in a change of trading style. There is more negotiation based trading, which can efficiently trade a volume of products. The share of trade by auction has decreased. The share of trades decided through negotiation is 80% for fruit and vegetables, and fish and fish products, and is 60% for flowers. This means that the influence of large users such as supermarkets on price setting has been increased.

When trades are based on negotiation, the details of each transaction (i.e. price and quantity) are not disclosed. In this way, the transparency of price setting at wholesale markets has been reduced.

- 2) As for local small and middle sized wholesale markets, their trading volume has been reduced, and their price setting is influenced more by prices set at large wholesale markets. Small and middle sized wholesale markets have a reduced role in price setting.

#### c) Functions of payment systems

A large number of transactions are executed everyday at wholesale markets. Wholesale markets are trusted for quick and secure payments from wholesale trade companies to the suppliers of products. By rule, wholesale traders have to pay their suppliers on the day following a transaction. The payment from the middle trader to the wholesale trader has to be simultaneous to the acquisition of the products.

As for payments from middle traders to wholesale traders, some wholesale traders use their own credit exposure management system to collect payment, but many are executed by payment facilities setup by middle traders and/or retailer associations.

Quick and secured payment systems at wholesale markets play an important part of the stable production and shipment of perishable food, and producers expect wholesale markets to continue this function.

However, there are the following problems with the payment systems at wholesale markets.

- 1) As the financial situation of wholesale traders and middle traders gets worse, it is becoming harder to maintain the present payment system. The risk of a failure to pay has increased.
- 2) Apart from the institutional payment systems of wholesale markets, some wholesale traders have to pay a deposit to producers groups, and this has also become a burden.

d) Function of providing information

The wholesale market exists between suppliers and users of food. One of the functions of the wholesale market is to convey the information of users to suppliers and vice versa.

However, the following problems have been observed concerning the provision of information by wholesale markets:

- 1) Users of food are looking for some qualitative information about products in addition to the quantitative information of price and place of production, For example, information about the production methods used may add extra value to the products. Producers, on the other hand, are looking for information about the demand trends of end-users. Wholesale traders and middle traders, however, do not supply enough information about these issues.
- 2) Information of producers owned by wholesale traders and information of users owned by middle traders are not well shared among them.

e) Other functions

Other functions and roles in which wholesale markets are expected to participate:

- 1) Wholesale markets are expected to play a positive role in ensuring food safety and credibility for the benefit of consumers. Examples of ways this can be done are, to make sure there is adequate food labeling, conveying production information to users, and proper food handling to ensure its safety.
- 2) Wholesale markets have a public role to supply food smoothly and stably. Good corporate ethics are important to obtain the social credibility of the wholesale markets. At the same time, wholesale markets are also expected to contribute to the local society.
- 3) Wholesale markets often use vast amounts of electricity and water running large refrigeration units and other such equipment. They discharge large amounts of waste food as well as used containers and packaging. All of these put a large burden on the environment. Wholesale markets are required to alleviate their environmental burden.

f) There are other problems related to the functions of wholesale market in general:

- 1) Revisions to the Wholesale Market Law in 1999 and 2004 have eased some of the existing regulations, but the effect has not been entirely satisfactory. Besides, there is insufficient verification of existing regulations for wholesale markets.
- 2) Pre-approval procedures and the paperwork required by the operating institution of wholesale markets are a large burden for wholesale traders and middle traders.



- 3) Each wholesale market has a market-trade-committee, comprising of operators, wholesale traders, middle traders, and large retailers. The market-trade-committee fixes the trading rules and the ways that these should be applied in the market according to the conditions of the wholesale market. However, these market-trade-committees haven't functioned well enough to promptly adjust to eased regulations and other reform procedures.

### **(3) Management system of the wholesale markets: current situation**

The management system of wholesale markets provides the base to implement the above functions. There are several problems, however, with the current management system of wholesale markets:

- a) As mentioned before, the management conditions of wholesale traders and middle traders have deteriorated.
- b) There is not enough interaction between operators, wholesale traders, middle traders, and large retailers to plan and implement a strategic action plan for the future of the wholesale market. There are various possible ways to strengthen the market functions, such as to equip the cold-chain system, to introduce more efficient logistics, and to supply better information. Overall, the key is to operate the market in line with the trends of the food chain from producers to consumers. However, this kind of idea is not well shared between the relevant parties. If they cannot cope with the diversifying needs of the suppliers and users of wholesale markets, they may lose their own function and role.

### **3. Possible solutions/directions of the wholesale market**

As mentioned above, there are a number of problems with current wholesale markets. The following are necessary points that needs to be taken into consideration when tackling these problems.

#### **(1) Issues to maintain and strengthen the functions of the wholesale market**

- a) Cope with the diversifying needs of suppliers and users

It is necessary to improve the function of the wholesale market to cope with the various demands of both suppliers and users. This would include accomodation of cold-chain-systems, to have facilities for food processing and packing, to have better storage and delivery systems, and to have more stable transaction systems such as introduction of pre-contracted transactions.

- b) Ensure the fairness and efficiency of transaction systems

Both basic structures of wholesale markets, namely having wholesale traders as sellers and middle traders and large retailers as buyers, and basic regulations for wholesale markets are necessary and should be maintained in order to ensure transaction fairness and the price settings functions of wholesale markets. However, there are some regulations which are no longer necessary. Present regulations should be verified and reviewed to reduce the burden on wholesale traders and middle traders.

- c) Meet the demand from the public

The wholesale market has a public role to supply food smoothly and stably. The wholesale market has to obtain the support of the public by assuring food safety and reliability, improve corporate ethics, and tackle environment problems.

#### **(2) Issues on the management system and restructuring of wholesale markets.**

a) Promoting the restructuring of wholesale markets

Trading volume of central wholesale markets has become polarized to large ones and small/medium ones. It is necessary to clarify and differentiate the role and function between large markets and small markets in order to obtain an efficient food distribution network. At the same time, it is necessary to continue the present effort of restructuring the wholesale markets in which performance is not good enough.

b) Reinforce the management practices of wholesale traders and middle traders

Wholesale traders and middle traders are the main players in wholesale markets. It is necessary to improve their management performance by strengthening the functions of the wholesale market.

c) Managing the wholesale markets with a proper business strategy

It is necessary that operators of wholesale markets, wholesale traders, middle traders, and large retailers work together to manage the wholesale market with a business strategy that includes the future prospects of wholesale markets.

(Remaining sections, concerning the policy proposal, have been omitted.)

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