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**STREAM 1, POLICY BRIEF 7**

# **THE ROLE OF SOUTH AFRICAN SUPERMARKET CHAINS IN DEVELOPING CAPABILITIES AND DRIVING GREATER INTRA- REGIONAL TRADE**

Policy brief prepared for the Labour Caucus in the Jobs Summit Economic Sector Interventions working group by the Institute for Economic Justice (IEJ).

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**Note:** This policy brief highlights the role that South African businesses can play in developing the capabilities of farmers, agro-processors and light manufacturers in southern Africa, using the example of the growing store network of South African supermarket chains in the region. This has the potential to contribute to industrialising the region and contribute to job creation.

The brief draws from extensive research undertaken by the Centre for Competition, Regulation and Economic Development (CCRED) at the University of Johannesburg on the implications of the spread of supermarkets in the region.<sup>1</sup>

## **1. THE POTENTIAL OF SUPERMARKET CHAINS TO SPUR REGIONAL DEVELOPMENT**

Countries in the SADC region have experienced strong growth in the number and spread of modern retailers, supermarkets in particular, over the past two decades. As supermarket chains expand their networks within and across countries, they are increasingly penetrating rural and peri-urban areas, moving away from just serving the traditional, affluent consumers in urban areas.

This spread of supermarkets is important for consumers and suppliers alike. Competition between supermarkets impacts on the pricing, quality, access and choice of products and services to consumers. The conduct of supermarkets also has a crucial impact on suppliers as key and growing routes to market for them. For suppliers in the region, such as farmers, agro-processors and light manufacturers, the growing network of supermarkets provides opportunities for greater participation in regional value chains. This, in turn, allows suppliers to build scale and develop capabilities, contributing to the industrialisation objectives of many African countries to produce more value-added products. It also provides a stepping stone for suppliers to upgrade and potentially participate in global value chains, with important implications for jobs in the agriculture and manufacturing sectors.

The growth and spread of supermarket chains has further driven the trade of processed and packaged foods and household consumable products in the SADC region. However, majority of the products on supermarket shelves in the region are imported from South Africa or from deep-sea sources, with little intra-regional trade. South African supermarket chains can therefore be a strong catalyst to stimulate local food processing and light manufacturing industries in the region, replacing deep-sea imports, stimulating greater intra-regional trade and creating employment opportunities.

## **2. WHAT LIMITS THIS POTENTIAL?**

Competition between supermarkets therefore matters for its own sake and because of the far-reaching implications for regional economic development. The concentrated nature of many formal grocery retail markets in southern Africa, however, limits the options that suppliers have in selling their products. Two or three South African

supermarket chains hold most of the market share in many formal markets in the region. These high levels of concentration mean that they have considerable buyer power and are often able to control pricing and trading terms with suppliers.

The research has shown that this power includes being able to charge a range of fees such as listing or support fees to suppliers to stock their products on shelves. Suppliers further pay for early settlement of their invoices, and for advertising, promotions, transport and wastage, in addition to a range of rebates and discounts. Cumulatively, the various charges can add up to 10-15% off the price of the product sold to supermarkets, placing considerable strain on supplier margins. It is also critical for successful sales that products are displayed where shoppers can easily see them. Eye-level shelf space is often taken up by dominant, multinational suppliers. Similarly, access to refrigeration space is important for suppliers of perishable or cold products, and this is also often controlled by large multinationals.

Over and above legal requirements such as compliance with national standards, food safety, labelling and packaging requirements, suppliers have to incur costs to adhere to private standards imposed by supermarkets. Non-harmonised standards in different countries in the region further limits intra-regional trade. For instance, products accredited by the Zambia Bureau of Standards are not accepted/recognised in South Africa. Supplying supermarket chains also means that suppliers need to meet supermarket requirements in terms of costs, quality, packaging, consistency, delivery schedules and quantities. These require significant investments in plants and capabilities.

Unequal bargaining power, strong buyer power and the demanding requirements of supermarket chains therefore mean that small and medium-sized suppliers in the region struggle to supply them. As a result, the supplier base continues to be dominated by a few large, often multinational, suppliers who can meet these requirements and by deep-sea imports. This hinders the participation and growth of suppliers in the region.

The long-run effects of supermarket buyer power can include regional suppliers exiting the market, which ultimately could lead to higher prices for consumers. Abuse of buyer power can also have damaging effects in that it can reduce investment and innovation amongst suppliers, leading to poorer product quality and less choice, in addition to higher prices.

### 3. POLICY RECOMMENDATIONS

A number of policy recommendations have emerged from the studies to address concerns of concentration, buyer power, barriers to entry and regional supplier development.

**First**, the possibility of a voluntary or mandatory regional code of conduct which governs the relationships between suppliers and supermarkets has been motivated for. The international experience has shown that codes of conduct are a useful way to control the exertion of buyer power and have been identified as a practical and effective approach to level the playing field and reduce information asymmetries between suppliers and supermarkets.<sup>2</sup> Such codes as applied in other countries regulate the conduct of supermarkets towards suppliers by setting minimum standards and obligations for supermarkets with regards to supply agreements and various fees included in the trading terms. For instance, the code can include provisions for prompt payment to suppliers; what proportion, if any, of advertising and promotion costs of supermarkets suppliers are responsible for; whether suppliers are liable for wastage costs; if there should be listing fees; rules about payments for specific shelf and fridge space etc.

Closer to home, Namibia adopted the Retail Sector Charter of 2016. Established by the Namibia Trade Forum, the Charter aims to bring structural transformation in the retail sector by exploring ways in which more Namibian producers can access retail shelves. It has measures through which supermarkets can support local businesses, especially SMEs, in supplying to their stores including through local sourcing commitments. The Charter also advocates for enterprise development programmes to assist local suppliers, including through skills development, and labelling and packaging upgrading investments to conform to retail specifications. Namibia is the only country in Africa to have a formalised voluntary retail sector charter. South Africa could adopt a similar retail industry code of conduct for supermarkets, which could be extended to a regional code given that it is the same (mainly South African) chains that operate in the SADC region. Like the Namibian Retail Charter, a code of conduct can include concrete measures of support by retail chains for regional SME suppliers through investing in formal supplier development programmes.

A long-term, commercially oriented approach by supermarkets in partnership with government can yield sustainable outcomes to build supplier capabilities in the

region. Co-funding for such programmes can come from fines levied by the competition authorities in abuse of dominance or cartel matters, or from existing pockets of funding reserved for black industrialists and small businesses. The critical point is that this funding needs to be channelled appropriately to commercially sustainable business that are mutually beneficial for both the supermarket and the supplier in the long term. For this to happen, the supermarket sector has to be intimately involved in designing and structuring the programmes and in identifying and developing the suppliers qualifying for the support. It cannot purely be financial support without any capability development.

The Department of Trade and Industry (The dti), through a process facilitated by an independent consultant<sup>3</sup> and coordinated by CCRED, has started engagements with the major supermarket chains in South Africa in this regard. The dti commissioned the project with the objective of creating mutually beneficial economic relationships between South African retailers and manufacturers in the region. Following extensive consultations with stakeholders, a Retailers Workshop was held on the 11 June 2018 in Cape Town, co-hosted by the Consumer Goods Council and Nepad Business Foundation. A number of initiatives were agreed upon in terms of the way forward. One initiative included the retailers producing a list of products that can be sourced from countries in the region for their store networks; and the policy support, regulatory changes and supply side assistance that would be required to develop and build these product value chains. The initiative was re-iterated at a conference held for the 3rd annual SADC Industrialisation Week in August 2018 in Windhoek, Namibia.

The process has however been slow, and the discussions have mainly been around supplier development programmes that retail chains could support in the region. More concrete steps forward would involve signing voluntary codes of conduct governing supermarket behaviour towards suppliers, in addition to the supplier development programmes, in the region. This requires solid commitment from government as custodians of the code of conduct, as co-partners in the supplier development initiatives, and as facilitators to get buy-in from other governments in the region. While the amendments to the South African Competition Act, if legislated, will strengthen the provisions to address issues of abuse of buyer power in South Africa, this will not necessarily benefit suppliers in the region. Therefore, a regional code of conduct is a more concrete and wide-

reaching way forward with respect to regional supplier development.

Developing and growing the supplier base in the region also involves addressing the high levels of concentration and anti-competitive behaviour along food and manufacturing value chains in the region. Support, including funding, needs to be given for a more regional focus in competition enforcement, with closer collaboration between competition agencies in the different countries in the region.

**Second**, harmonising standards, both legal requirements and certain private standards of South African supermarket chains across the region, can open up wider regional markets for suppliers. This requires harmonising processes and testing requirements in national bureaus of standards and/ or investments in regional testing and accreditation facilities which will facilitate regional acceptance of products.

**Third**, barriers to the growth and development of the retail sector that affect competition need to be addressed. The Competition Commission of South Africa, through its Grocery Retail Market Inquiry, has heard testimony in its public hearings that historical practices like exclusive leases in shopping malls in South Africa prevent participation of independent retailers and new entrants. The recommendations of the inquiry and how it will deal with this issue are expected to be released in September 2018. For effective competition in the retail space, it is essential to encompass open and flexible retail spaces in urban planning to ensure a mix of formats, and to address exclusivity through planning policies. In countries like Australia and the UK, urban planning has played a key role in opening up markets in retail to wider participation and ensuring competition to incumbents. This requires engagement of competition authorities with local government/municipalities to ensure that planning policies allow a diversity of retail offerings and that practices that create barriers to entry and participation are removed.

**Fourth**, support to new entrants and independent retailers is needed through facilitating access to distribution centres and logistics networks. For instance, Pick n Pay in an initiative with Gauteng Department of Economic Development opened up some of its distribution channels to township spaza shops, giving them access to stock at competitive pricing. Other similar partnerships between supermarkets, small independent retailers and government are possible to implement in a short space of time.

**Fifth**, access to development finance for new entrants and independent retailers is critical. The research has shown that cash flow issues and access to finance from commercial banks are major hindrances to new entrants and small players. While it may be argued that there is significant government funding available for small businesses, lack of awareness of such programmes as well as the red tape and bureaucracy involved in accessing these funds limits their potential. Development funding for such entrepreneurs is also not 'patient' enough, expecting unrealistic returns in too short a time frame.

**Finally**, providing funding without upskilling capabilities is not in itself sufficient to attain sustainable inclusive outcomes. Over and above support to suppliers, government needs to be more involved in providing training or training subsidies to new entrants and buying groups that assist independent retailers to build retail capabilities (including in advertising, marketing, cash flow management, and inventory and waste management).

1. das Nair, R., Chisoro-Dube, S., and F. Ziba (2018). The implications for suppliers of the spread of supermarkets in southern Africa. *Development Southern Africa*. <https://www.tandfonline.com/doi/full/10.1080/0376835X.2018.1452715>;

das Nair, R. (2017). The internationalisation of supermarkets and the nature of competitive rivalry in retailing in southern Africa. *Development Southern Africa*. <https://www.tandfonline.com/doi/abs/10.1080/0376835X.2017.1390440>;

das Nair, R. and Dube, S.C. (2015), 'Competition, barriers to entry and inclusive growth: Case study on Fruit and Veg City, CCRED Working Paper 2015/9; UNU-WIDER working papers: das Nair, R. and Chisoro, S. (2017), 'The expansion of regional supermarket chains: Implications on suppliers in Botswana and South Africa'; das Nair, R. and Chisoro, S. (2016) 'The expansion of regional supermarket chains and implications for local suppliers', available at <https://www.competition.org.za/regional-value-chains/>

2. E.g. the Groceries Supply Code of Practice (GSCOP) in the UK, overseen by an independent groceries ombudsman, the Grocery Code Adjudicator (GCA), was set up following a competition inquiry to ensure supermarkets treat their suppliers lawfully and fairly. In Australia, supermarkets are not allowed to request suppliers to pay listing fees, shrinkage fees, wastage fees, promotion fees or payment for better positioning of products on the supermarket shelves (enforced by the Australian Competition and Consumer Commission). In Ireland, there are plans to institute a mandatory Code of Conduct in the grocery sector, to be overseen by the Department of Jobs, Enterprise and Innovation. In Spain, a new act focusing on measures to improve the functioning of the food chain was promulgated in 2013; it uses a mixed model of regulation and self-regulation (through voluntary codes of conduct) to govern commercial relations between the agents in the food chain.

3. Dr Faizel Ismail (currently Adjunct Professor at the University of Cape Town), the former Ambassador of South Africa to the World Trade Organization, and trade negotiator of South Africa.