Regional supermarket value chains: is there a role for local suppliers?

The spread of large supermarket groups across the Southern and East African region raises important questions about local supplier capabilities, the ability of local suppliers to access supermarket group value chains, and the competitive landscape that the entry of large multinational retail groups creates. Over the past two decades, there has been a rapid expansion of South African supermarket chains into Southern Africa. However, recently we have also seen the growth into South Africa and Zimbabwe of Choppies, a supermarket chain from Botswana, which plans to open a further 31 new stores in Botswana, South Africa and Zimbabwe, to list on the Johannesburg Stock Exchange (JSE) by the end of May 2015, and to grow into the Kenyan market by the end of 2015.

In many countries, particularly South Africa and Kenya, the main factors driving the expansion of supermarket groups include increased urbanisation, rising incomes and a growing middle class, more efficient transport systems, and the ability of supermarkets to adapt their format and adopt efficient procurement systems tailored to the needs of the poor. Supermarkets are moving away from serving the traditional high-end affluent consumers in urban areas and are successfully penetrating new markets in low income, geographically isolated rural areas.

While the growth of supermarket groups in the region has introduced competitive rivalry and accessibility to a broader range of products and services in the different countries, it can also impose some challenges for local suppliers (specifically small farmers, and food processing and manufacturing firms) in terms of entering the supply chains of supermarkets at different levels. This stems from the fact that retail chains may adopt certain business models, sourcing and procurement strategies and practices that marginalise or exclude small, often indigenous, producers and manufacturers from their supply chains, as we discuss below.

Why does the inclusion of local suppliers matter?

Why does the development of the capabilities of small-scale local suppliers and their inclusion into the supermarkets’ supply chains matter? Small-scale suppliers matter for economic development within the context of inclusive growth and participation. These producers typically constitute a large proportion of the total number of agricultural producers in many African countries where agriculture is the economic pillar, and are often key providers of employment especially in the agricultural sector in rural areas. They also employ a significant proportion of informal, unskilled, female and part-time workers.

Light manufacturing industries are also typically labour-intensive and have useful linkages with other sectors of the economy. These industries often allow low income countries to compete by leveraging their low labour costs. It is also important to develop these industries as they allow for the creation of value-added industries leveraging off competitive input industries. Participation of small-scale producers in sophisticated value chains, is likely to grow their capabilities through learning-by-doing, thus enhancing their productivity and innovation in the medium- to long-term. This is especially important for small- to medium-sized farmers and food processing firms that are likely to benefit from the adoption of modern distribution channels and procurement systems that lower transactions costs and encourage market exchanges.

Concerns arising from the expansion of multinational supermarket groups

South African supermarkets trading in southern Africa source the vast majority of their products from their home country. This is mainly due to the proximity of Zambia, Zimbabwe, Botswana and Mozambique to South Africa which makes importing from South Africa economically feasible. Through moving away from spot purchases and adopting specialised procurement agents and preferred suppliers for supplying the region, supermarket groups gain direct influence over quantities, product quality and delivery. This has the adverse effect of shrinking the supply base because only preferred suppliers are included.

Large retail chains are also increasingly using their own centralised distribution centres in supplying a broad range of stores and are shifting away from the traditional store-by-store procurement and supply practice. For instance, Shoprite uses Freshmark as its centralised buying and distribution arm in Africa for fruit and vegetables and has a number of distribution centres in several countries in SADC. Nakumatt has set up regional distribution centres responsible for carrying out the wholesale function for all of their outlets. Centralised procurement through the use of distribution centres saves on transport costs and gives supermarkets stronger bargaining power with suppliers. Supermarket groups make use of preferred suppliers such as specialised dedicated wholesalers who increase efficiency in the supply chain and offer huge discounts on bulk purchases. This has the effect of excluding from supermarket supply chains small-scale producers who cannot match these huge discounts and level of sophistication in supply chains.

Supermarket groups also place stringent demands that small producers find difficult to fulfil including imposing escalating private quality and safety standards on suppliers. Quality standards are important because they are the object of liability laws, product expiry regulations and other regulations that
focus on the conduct of supermarkets towards consumers. Meeting these requirements means suppliers are required to make substantial threshold investments in packing houses, cold chains, and standards and certification processes.

On the other hand, it is important for local suppliers to develop the capabilities to supply retail value chains, which in turn is likely to increase their competitiveness, the quality of their output and the efficiency of their production. As a way of responding to the above issues and maintaining competitiveness, policymakers and regulators have developed different frameworks for bridging this gap. For example, when European supermarkets sourcing produce from Zimbabwe were increasingly imposing tighter standards throughout the value chain, local suppliers responded by restructuring their operations, upgrading facilities, processes and logistics handling. The local upgrading processes were made possible through the effective cooperation between government and the local suppliers which was key in designing and implementing appropriate policies targeting local upgrading. Government extended subsidies to local suppliers to enable them to increase production, invested in infrastructure to reduce lead times and set up farmer support schemes to reduce costs.

This suggests that policymakers, in order to facilitate the participation of small-scale producers in the supply chains of supermarket groups, need to encourage and where possible facilitate substantial investments in institutional, as well as public and private, physical and financial infrastructure support systems. This clearly requires substantial involvement of supermarket groups as the main players in the supply chain with insight on the levels of capabilities required and standards necessary to meet customer and regulatory requirements. CCRED’s current research on regional value chains, changing supermarket retail patterns and local supplier capabilities will explore the implications of these trends through in-depth country studies conducted by CCRED in South Africa and Botswana, and regional research partners in Zambia, Zimbabwe and Mozambique. In particular, the research will consider the various interventions required to develop more opportunities for the participation of local suppliers in these complex supply chains.

Notes

2. ‘Supermarkets in Africa: The grocers’ great trek’ (21 September 2013). The Economist; and Nleya, L. ‘Reading between the aisles: The bigger picture on leases in grocery retail’, CCRED Quarterly Competition Review (June 2014).
5. See note 4.
10. See note 2.
13. Freshmark website.
17. See note 4.
18. See note 15.
19. See note 15.
22. See note 20.