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### Competition in Supermarkets: A South African perspective <sup>1</sup>

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#### **Abstract**

*Over the past two decades, southern African countries have experienced rapid growth in the number and spread of supermarkets. Several factors have been attributed to this growth, including urbanisation, increased per capita income, rise of the middle class as well as economies of scale, scope and transport. The format and location of supermarkets have also evolved over the years, moving away from serving the traditional high-end affluent consumers in urban areas to successfully penetrating new markets in low-income rural communities. Large supermarkets are able to offer lower prices due to economies of scale, and efficient procurement and distribution systems. This spread into rural areas, and rapid proliferation of supermarkets more generally, has given rise to important consequences for competitive rivalry between grocery retail outlets, as well as for local suppliers who want to participate in supermarket value chains.*

*This paper assesses the competitive landscape of the supermarket industry, the resurgence of independent grocery retailers as well as the implications on suppliers in South Africa. In doing so, it seeks to answer the following key questions: Do scale economies mean that only a few large supermarket chains can effectively operate in a given market? How important then is competition from niche retailers and small entrants? Is there a role for competition policy in the supermarkets industry?*

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## 1. Introduction

Southern African countries have experienced strong growth in the number and spread of supermarkets over the past two decades. This has largely been through the expansion of South African supermarket chains both within South Africa and in the region. In addition to increasing regional foreign direct investment, several demand-side factors have been attributed to this growth. These include urbanisation, the entry of women into the workforce, increased per capita income, rise of the middle class, lower unit costs due to economies of scale and scope as well as transport economies (Tshirley, 2010; Humphrey, 2007). Improved and modern infrastructure is also a key factor driving the rapid expansion of supermarkets in southern Africa. The surge in construction of shopping malls and centres provides retailers with the space to carry out their operations.

The format of supermarkets has also evolved over the years, moving away from serving just high-income, affluent consumers in urban areas to successfully penetrating new markets in low-income communities. Supermarkets have been able to do this, *inter alia*, by adapting their offerings and investing in more efficient procurement and distribution systems (Weatherspoon and Reardon, 2003).

Supermarkets and grocery retailers have distinctive characteristics. It is often precisely these characteristics that result in barriers to entry for new players. From a consumer point of view, supermarkets supply universal daily food products, including perishable food items. But beyond this, supermarkets offer the supplementary service of arranging a wide assortment of non-food products selling concurrently in a convenient setting and location focusing on quality, service, 'one-stop' shopping and an overall shopping experience (Basker and Noel, 2013). Supermarkets can provide a variety of products at relatively cheaper prices, given economies of scale and global sourcing strategies, compared to independent retailers (Haese and Van Huylenbroeck, 2005). Supermarkets also tend to invest more than other types of retailers in logistics, distribution centres and networks, as well as inventory maintenance. Moreover, big supermarket names bring in valuable footfall to shopping centres, making them key anchor tenants in almost every shopping centre in South Africa.

From the view of producers and manufacturers (suppliers more generally), supermarkets are an important source of demand and route to market and provide opportunities for suppliers to participate in lucrative retail value chains (Boselie, Henson and Weatherspoon, 2003).<sup>3</sup>

However, the strategic behaviour of supermarkets with market power, such as entering into exclusive supply agreements with suppliers and entering into exclusive leases with shopping malls, has competition implications on small suppliers, new entrants and independent retailers. There have indeed been competition concerns raised around the conduct of dominant supermarket chains in Australia, the UK and South Africa.

The growth and expansion of supermarkets therefore has important consequences for consumers, local suppliers and the competitive landscape. This paper seeks to answer the following key questions: *Do scale economies mean that only a few large supermarket chains can effectively operate in a given market? How important then is competition from niche retailers and small entrants? Is there a role for competition policy in the supermarkets industry?*

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<sup>3</sup> See also Emongor and Kirsten (2006 and 2009).

This paper is structured as follows. Section 2 highlights the trends in the growth and strategies of the major supermarket chains operating in South Africa. Section 3 describes the inherent characteristics of supermarkets which result in barriers to entry. Section 4 looks at a possible resurgence of independent grocery retailers in South Africa, an important alternative to supermarket chains in rural, peri-urban, central business district and township areas for low-income consumers. Section 5 assesses strategic conduct by dominant supermarkets which has the effect of dampening or distorting competition. Section 6 focuses on the impact on suppliers and Section 7 concludes.

## 2. Trends in the South African supermarket industry

The South African supermarket industry is concentrated with five main supermarket chains dominating the industry. Shoprite and Pick n Pay are the biggest players, while SPAR and Woolworths hold most of the remaining share. Fruit and Veg City (FVC), the fifth player, has within a relatively short period of time, entered the industry and grown considerably. All five supermarket chains have operations throughout southern Africa. Recently, Walmart-owned Game has ventured into grocery retail in competition with the incumbents. New entrant Choppies from Botswana has also grown rapidly in Botswana, Zimbabwe and South Africa in recent years.

**Shoprite Holdings**, the largest retailer in South Africa specialising in foodstuffs and household items, was the first supermarket to establish branches in Africa. Shoprite has a large network of over 1,500 corporate stores across Africa and almost 40 franchise stores in 14 African countries.<sup>4</sup> It has four core supermarket offerings<sup>5</sup>: Shoprite, Checkers, USave and OK. It caters for different demographic profiles and has different store formats to meet the needs of the full spectrum of different income groups/LSM categories.<sup>6</sup> Checkers and Checkers Hyper stores target the high-end affluent consumers whereas Shoprite focuses on the middle to lower market segments. Shoprite is extending its offering to low-income segments by penetrating into economically disadvantaged communities through its Usave format. Usave is also used as a tool to spearhead expansion into the rest of Africa.

**Pick n Pay Holdings**, the second largest retailer in South Africa specialises in groceries, clothing and general merchandise. Pick n Pay supports over 1,000 operations across Africa, also operating across multiple store formats, both franchised and corporate-owned. The retail chain has four main store formats: Pick n Pay Hypermarkets, Pick n Pay Supermarkets, Pick n Pay Family Franchise stores and Pick n Pay Butcheries. Pick n Pay also recently opened Pick n Pay Express franchise stores in collaboration with oil company, BP Southern Africa.<sup>7</sup> Like Shoprite, Pick n Pay is increasingly targeting lower income consumers, moving away from its traditional, upper income customer segment. As part of this strategy, Pick n Pay acquired Boxer stores in 2002. At the other end of the spectrum, Pick n Pay has recently started rolling out high-end, new store concept in different parts of the country.

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<sup>4</sup>[http://shopriteholdings.co.za/InvestorCentre/Documents/2014/IntergratedReport2014/5206\\_Integrated\\_Report.pdf](http://shopriteholdings.co.za/InvestorCentre/Documents/2014/IntergratedReport2014/5206_Integrated_Report.pdf), accessed 15/04/2015

<sup>5</sup> With regards to grocery and supermarket offerings. It has a range of other outlets that offer furniture, liquor, fast food and pharmacy services, amongst others.

<sup>6</sup> Living Standard Measures has become the most widely used marketing research tool in southern Africa. It divides the population into 10 LSM groups, 10 (highest) to 1 (lowest). LSMs segment the market according to their living standards using criteria such as degree of urbanization and ownership of cars and major appliances.

<sup>7</sup> <http://www.picknpay.co.za/news/smallformat-stores-on-their-way>, accessed 25/09/2015

The **SPAR Group**, the third largest mass grocery retailer specialising in foodstuffs and general merchandise in South Africa, operates in over ten African countries. Through primarily a franchise model, SPAR supports over 1500 stores in South Africa and over 150 stores in the rest of sub-Saharan Africa. Like Shoprite and Pick n Pay, SPAR expanded into four store formats designed to meet the needs of different customer groupings. SPAR's traditional target consumer was typically the higher income, older population, but it is moving towards middle-class, younger customers and also entering more rural communities. The four SPAR Brands are Superspar, SPAR, Kwikspar and SaveMor. SaveMor is exclusively focused on rural and township markets. It gives the option to existing small store owners/independent retailers to convert their stores into a SaveMor store. SPAR also opened a forecourt convenience store in 2013, SPAR Express, in collaboration with Shell.

**Woolworths Holdings**, the fourth largest retail chain in South Africa targets high income consumers. Woolworths has over 1,000 corporate and franchise stores in a number of African countries.<sup>8</sup> Unlike the other supermarkets, it only has a single format, which emphasises providing superior quality grocery products to high-end, affluent customers. Like the other supermarkets however, Woolworths has ventured into convenience stores at fuel forecourts. Partnering with Engen, Woolworths has a number of Woolworths Foodstop stores.

The fifth largest grocery retailer in South Africa, **Fruit and Veg City Holdings (FVC)** entered in 1993 with a single store in Kenilworth, Cape Town. It expanded rapidly and by 2006 had around 80 stores nationally. In 2007, Pick n Pay sought to merge with FVC. The Competition Commission of South Africa recommended that the Tribunal prohibit the merger between the two on grounds that it would result in the removal of an effective competitor in the retail market for fresh food. The Commission found that FVC was a growing effective competitor to Pick n Pay and would provide an even greater product offering in the future. Allowing the merger would therefore stifle both current and future competition.

It appears that the Commission was accurate in its prediction of FVC's growth. FVC showed impressive growth particularly between 2006 and 2015. Turnover increased sharply from R1.6 billion in 2006 to R15 billion in 2015, with a growth rate per year well ahead of the major listed food retailers.<sup>9</sup> There are now over 100 FVC stores throughout southern Africa. FVC also targets customers across different LSM groups, including through its more up-market Food Lover's Market format. FVC, like the major supermarkets, has expanded into franchised convenience stores (Fresh Stop stores) through a joint venture with fuel company Caltex.<sup>10</sup> FVC initially focused on a niche area - fresh produce - and procuring daily from local municipal fresh produce markets significantly cut its costs. Further, they operate low margin distribution centres, allowing them to offer lower prices than the major supermarkets. Estimates are that these cost savings allow FVC to charge prices that are between 20% and

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<sup>8</sup> Zambia, Zimbabwe, Botswana, Namibia, Swaziland, Kenya, Ghana, Mauritius, and Mozambique. Recently Woolworths closed down its operations in Nigeria so that it could better focus on growing its operations in the southern African countries.

[http://www.woolworthsholdings.co.za/investor/annual\\_reports/ar2014/whl\\_2014\\_integrated\\_reprt1.pdf](http://www.woolworthsholdings.co.za/investor/annual_reports/ar2014/whl_2014_integrated_reprt1.pdf) accessed 01/06/2015

<sup>9</sup> Growth rates of the major listed supermarket chains were reported at about 15% per year between 2006 and 2012, while that of FVC was 20% per year. <http://www.financialmail.co.za/business/2012/07/18/fruit-veg-city-grows-market-share>, accessed 15/01/2015.

<sup>10</sup> FVC also has an in-house fast food brand, a profitable international fruit export JV business and liquor and soft drink outlets.

25% lower than the other major supermarkets, in addition to being able to offer good quality and a wide range of fresh produce.<sup>11</sup>

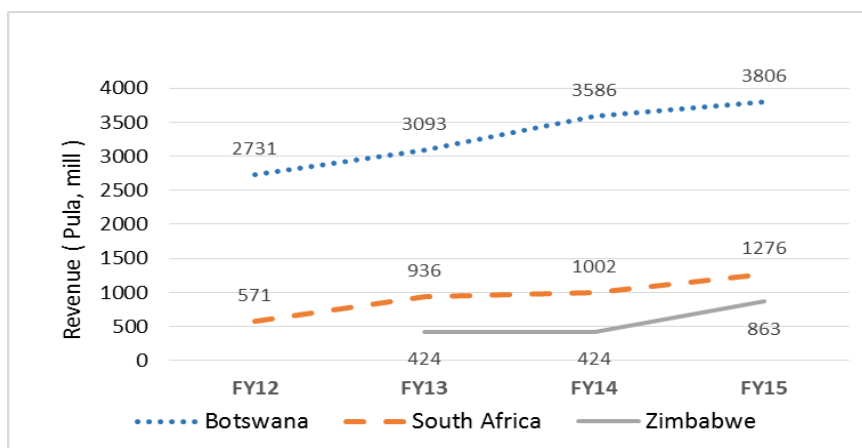
Much more recently, Walmart-owned **Game** has branched into food products (branding itself as a non-perishable groceries retailer). This is the typical Walmart format in other countries. There have however been competition concerns raised by Game to the Competition Commission as discussed in Section 5.

While the past trend in southern Africa has been that South African supermarkets have aggressively spread in the region, this trend is now changing with supermarkets from other SADC countries entering the region. The most successful example of such entry is by **Choppies Enterprises**. A grocery and general merchandise retailer from Botswana, Choppies has over the last 15 years grown from two stores in Botswana to over 125 stores in Botswana, Zimbabwe and South Africa, with plans to enter Zambia, Kenya<sup>12</sup> and Tanzania in 2016. Choppies plans to almost double its stores to close to 200 by the end of 2016.<sup>13</sup> In 2015, Choppies listed on the Johannesburg Stock Exchange and is already listed on the Botswana Stock Exchange.

Choppies' target market is low-to middle-income consumers (LSM 3-6), but it is attempting to attract middle to upper income consumers. It targets value-conscious, high frequency, small basket size, cash paying shoppers. Until recently, in South Africa Choppies store locations have mainly been in semi-urban and rural areas, locating near transport nodes such as taxi ranks. Choppies stores in South Africa are found in mining regions, such as Rustenburg and other towns in the North West province. Only recently has it started locating in shopping malls, with its entry in the newly developed Carletonville shopping centre in late 2015 and in a mall in Maheking.

In the past 5 years, Choppies has seen rapid growth in the number of stores and revenue in Botswana and Zimbabwe. Revenue growth in South Africa however saw a dip in 2014, attributed to the platinum sector strike given the location of Choppies' stores (Table 1 and Figure 1).

**Figure 1: Growth in Choppies' Revenue in southern Africa**



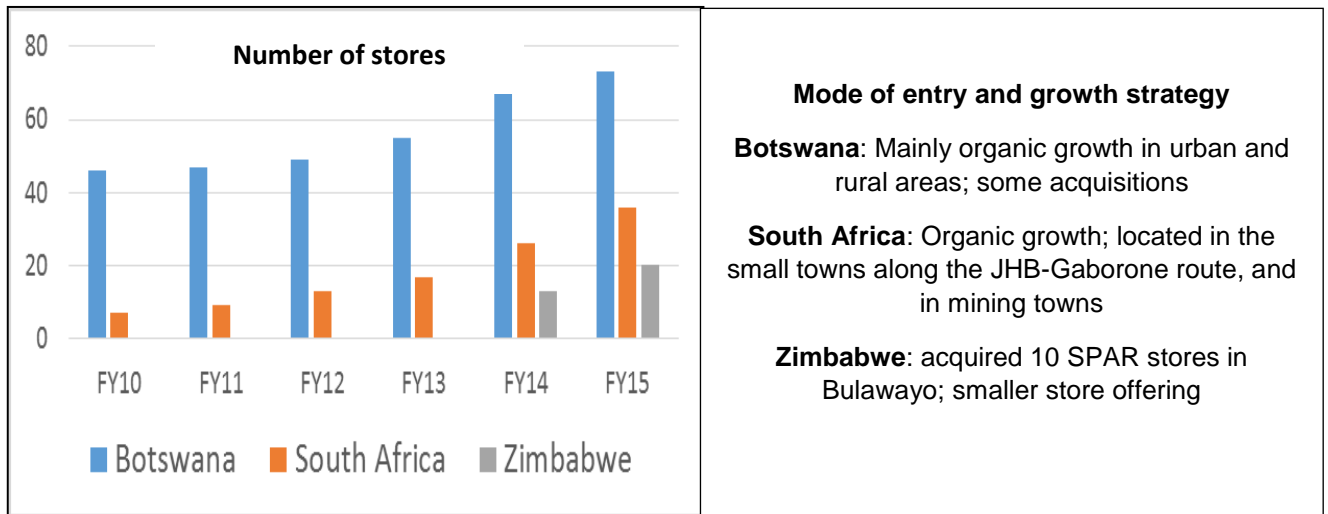
Source: Choppies Interim Results, 2015

<sup>11</sup> <http://www.entrepreneurmag.co.za/advice/success-stories/entrepreneur-profiles/fruit-and-veg-city-michael-and-brian-coppin/>, accessed 25/08/2015

<sup>12</sup> <http://www.howwemadeitinafrica.com/why-botswanas-largest-retailer-ventured-into-risky-zimbabwe/45858/>, accessed on 07/01/2015

<sup>13</sup> According to Choppies' CEO, [http://www.iol.co.za/business/international/botswana-s-choppies-to-seek-sa-listing-1.1854541#.VU3Ha\\_mqgko](http://www.iol.co.za/business/international/botswana-s-choppies-to-seek-sa-listing-1.1854541#.VU3Ha_mqgko), accessed on 09/05/ 2015

**Figure 2: Growth of Choppies store numbers and mode of entry**



Source: Choppies Interim Results, 2015; Annual Report, 2014 and Pre-listing statement, 2015

**Preliminary observations of trends**

Certain observations can be drawn from the above narrative on the spread of supermarket chains in southern Africa. All the supermarket chains, except for Woolworths, have extended their offering to target customers across the full range of incomes/LSMs. There has been a focus on targeting low-income consumers, either by opening new stores (like Shoprite’s Usave) or by acquiring existing stores (like Pick n Pay’s Boxer and SPAR’s SaveMor). This has raised concerns for independent retailers traditionally serving these areas, as discussed in Section 4.

Most of the supermarket chains have also diversified their formats to include hypermarkets, convenience stores, express stores at fuel forecourts and fast food offerings amongst others. The mode of expansion differs between supermarkets, but expansion has generally been through increasing the number of corporate stores or franchise stores, or a combination of both, organically or through mergers. At one extreme, Choppies only has corporate stores. At the other extreme, SPAR mainly operates through a franchise model. In between, the other supermarkets operate both corporate and franchise models, although Woolworths and FVC are moving away from franchises to fully corporatised stores. Often quality and risk management are key reasons for this.

The entry and growth of Choppies in the southern African provides an interesting counterfactual to the trend of South African supermarkets in the southern African region. The competitive reaction in the future by the incumbent supermarkets to its growing presence in South Africa will be interesting to observe, especially as it starts to locate in shopping malls given the concerns described in Section 5.

Importantly, in seeking to answer one of the key questions of this paper, both FVC and Choppies have brought substantial benefits to consumers in South Africa - FVC in the form of lower prices for fresh fruit and vegetables and Choppies in the form of low-cost supermarket products in easily accessible locations previously underserved. Both are continuously increasing their offerings, providing important alternatives to the incumbents for consumers. There is therefore an important role for niche players and new entrants in this industry.

### 3. Characteristics of supermarkets and associated barriers to entry

A number of structural barriers to entry and expansion exist because of inherent characteristics of supermarkets as well as the significant investments made by large chains.

The fact that supermarkets sell perishable foods affects the organisation of firms and consumer buying patterns. Consumers tend to shop regularly from supermarkets located within very short distances from their residential or work locations. This typically creates competition between supermarkets at a very local level in terms of **physical location**.<sup>14</sup> Supermarkets and independent retailers often therefore compete for space in close proximity to residential locations (Basker and Noel, 2013), in central business districts (CBD), near the workplace or in townships near dense housing areas. The physical location limitations for modern retailers in dense urban neighbourhoods or in CBDs is therefore a form of a structural barrier to entry. This barrier is further heightened by strategic behaviour through supermarkets insisting on exclusivity clauses in shopping centre leases as discussed in Section 5.

The perishable nature of food requires supermarkets to make large investments in logistics, distribution and inventory maintenance such as refrigeration, backup generators, refrigerated trucks and distribution centers. Supermarkets are increasingly switching to own centralised **distribution centres** (DCs) instead of store-to-store procurement (Reardon and Hopkins, 2006). This reduces coordination costs and congestion diseconomies which can outweigh the transport costs to and from DCs that are located in more remote parts of the city (Reardon and Hopkins, 2006). It however also has the effect of substantially raising barriers to entry for small scale operators who cannot afford to make such large investments (Basker and Noel, 2013; Marion, 1984).

Investments in DCs are costly and appear to be necessary for chains with multiple stores to effectively compete. DCs are important as it is cheaper for stores within the group (whether franchise or corporate) to procure their goods from DCs than individually negotiating and buying directly from suppliers. This is because of the scale economies and associated discounts and rebates that can be secured from suppliers when the DC buys in bulk. DCs also support the uninterrupted, timely supply of goods to stores. Stores place orders with the DC periodically based on each store's individual supply requirements.<sup>15</sup> DCs are typically run as independent business units with profit targets within the supermarket group.

In South Africa, all the major supermarket chains have invested significantly in DCs. SPAR has a number of DCs which serve stores throughout the region. SPAR franchisees are free to source independently from suppliers, but given the cost savings from sourcing from DCs, franchisees often opt to go this route. Shoprite's financial reports highlight a significant increase in capital expenditure between December 2013 (ZAR 137m) and December 2014 (ZAR 228m) in DCs, as well as contracted capital commitments in December 2014 for future investments (of ZAR 241m).<sup>16</sup> Shoprite's Centurion DC has doubled in size from 80,000 m<sup>2</sup> to 180,000 m<sup>2</sup> and is the largest DC under one roof on the continent. The facility serves as the distribution point for about 90% of ambient products delivered to stores in the Gauteng area and in southern Africa.<sup>17</sup>

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<sup>14</sup> For instance, the UK Competition Commission in its inquiry into the grocery retail market, defined local geographic markets as being limited to within 5 to 15 minutes-drive time depending on whether they were categorised as large, mid-sized or convenience grocery stores (UK Competition Commission 2008).

<sup>15</sup> Choppies pre-listing statement, 2015

<sup>16</sup> Shoprite February 2015 Financial Highlights

<sup>17</sup> <http://www.shopriteholdings.co.za/GroupServices/Pages/Supply-Chain-Management.aspx>, accessed 11/09/15

Pick n Pay invested ZAR 628m in 2010 in its DC in Longmeadow, Gauteng. It has ten DCs around the country, in addition to a perishables inland DC. The total investment in all its DCs were estimated to be over ZAR 2b. According to Pick n Pay, these investments in 2010 were essential to maintain competitiveness - *“Our decision to move to centralised distribution was motivated by changes in South Africa’s retail landscape which had seen us fall behind our competitors, who were investing significantly in their supply chains and in improved service to their stores through centralised distribution systems. Throughout the world, the most successful retail groups have unlocked massive value from their supply chains, and most of them have moved away from direct-to-store delivery distribution”* (Former CEO Nick Badminton).<sup>18</sup>

Woolworths and Fruit and Veg City have also invested in DCs. Choppies too has seven DCs, two of which are in Rustenburg, South Africa, and the rest of which are in Botswana and Zimbabwe.<sup>19</sup>

Aside from the large capital investment required to set up DCs, the cost benefits (**scale and scope economies**) offered by large DCs confer a competitive advantage and present a barrier to entry for new retailers who enter the market without DCs. Economies of scale and scope create natural barriers to entry as entrants need sufficient scale and product range, including number of outlets, to benefit from the cost savings that large incumbents have (Basker and Noel, 2013). This often means that there are only a few large players and concerns of abuse of dominance and coordinated conduct arise.

With regards to **logistics**, supermarkets either own their vehicle fleet (including refrigerated trucks) or outsource this function. Shoprite for instance has its own fleet under the Freshmark name. Choppies also owns their transport fleet of over 500 vehicles. Pick n Pay on the other hand outsources its logistics to Imperial Logistics<sup>20</sup> with dedicated trucks. Either way, an efficient transport network appears crucial to successfully compete.

Another feature of supermarkets is the extensive investment in **advertising and promotions** used to create loyalty and attract footfall with the aim of converting this into sales. Advertising costs can be a significant barrier to entry for new players in the market. Incumbents may make it even more difficult for new entrants by strategically spending excessively on advertising. To gain market share, new entrants have to match this spend out of a much smaller revenue base, putting entrants at a cost disadvantage (Marion, 1984). It is easier for incumbent supermarket chains with many outlets to spread advertising costs, again putting new entrants with single stores at a disadvantage. New methods of advertising however, such as social media, may be cheaper and supermarkets are increasingly employing such methods.

Aside from cost savings due to scale and scope, modern retailers greatly reduce the consumers’ overall cost of acquiring a typical basket of food and household products. Supermarkets offer the convenience of a **‘one stop shop’** that traditional ‘mom and pop’ stores or independent retailers are often not able to. This includes a wider variety of products, easier access, longer opening hours, consumer credit and other services, which reduces search and transport costs for customers.

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<sup>18</sup> <http://www.moneyweb.co.za/archive/r628m-distribution-centre-for-pick-n-pay/>, accessed 25/08/2015

<sup>19</sup> Choppies prelisting statement (2015)

<sup>20</sup> <http://www.imperiallogistics.co.za/imperial-news/509/imperial-reduces-costs-and-boosts-service-pick-n-pay>, accessed 11/09/15



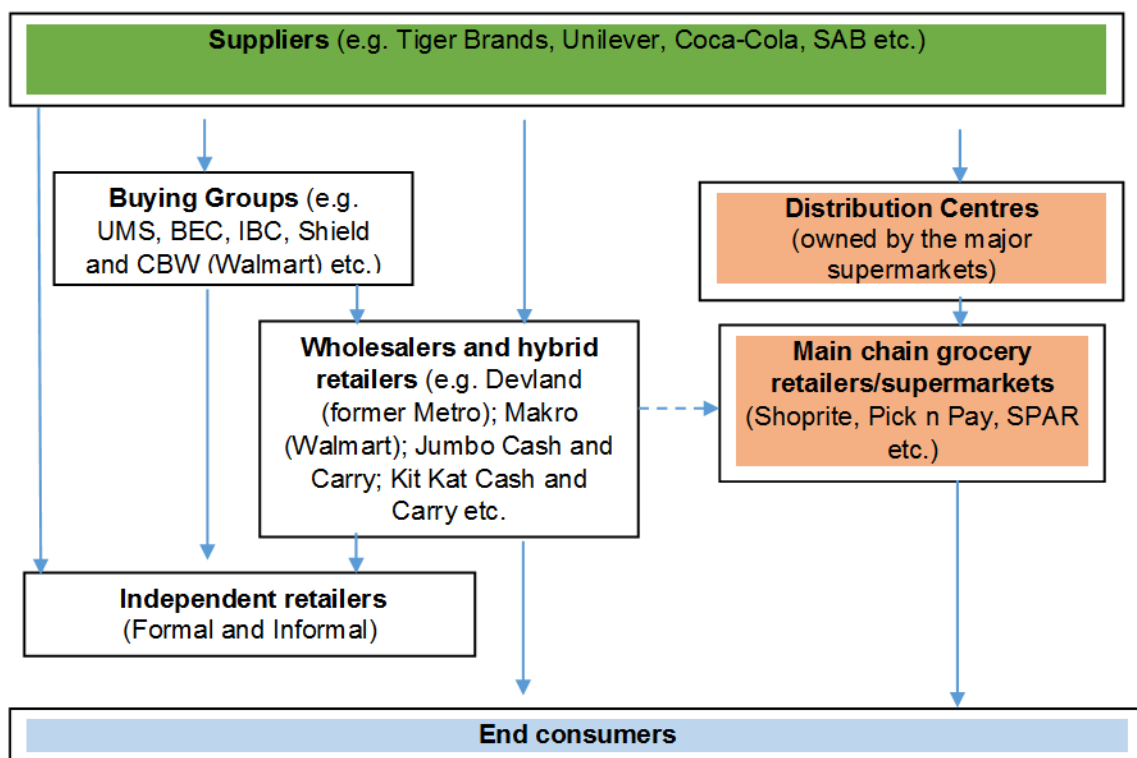
A number of business-related barriers to entry also exist for supermarket chains and independent retailers alike. These include lack of skills and capabilities to produce **sustainable business models/plans** and to manage **cash flow** effectively. Small retailers need substantial equity on hand as it usually takes 2-3 years to become profitable and retailers often incur large losses in the first couple of years. Poor planning and inadequate stocking of shelves can have devastating effects on entrants.

#### 4. The possible resurgence of independent retailers in South Africa?

The previous section highlighted inherent characteristics of supermarkets that result in barriers to entry. This section assesses evidence of a possible resurgence of independent retailers in South Africa, which suggests that their evolving models of retailing may be successful in alleviating some of these barriers.

Independent retailers are a means by which consumers, particularly low income consumers in South Africa, can access groceries. The characteristics of independent retailers that appeal to consumers include lower prices, personalised customer service, credit facilities, availability of specialist products, location advantages and convenience. Independent retailers are usually low-margin businesses that have to closely manage overheads and other expenses (such as wastage and stock shrinkage). Figure 2 below illustrates the different routes through which consumers can buy consumer goods in South Africa.

**Figure 3: Supply chain of grocery retail products in South Africa**



Source: Adapted from Ravhugoni and Ngobese (2010) and Masscash/Finro Tribunal decision Case No: 04/LM/Jan09

As can be seen, buying groups occupy a similar space for independent retailers in the supply chain as distribution centres do for the major supermarkets.<sup>21</sup> Buying groups are therefore a way for a new entrant to derive some, although not necessarily all, of the benefits of DCs without the costly investment.

There have been concerns that independent retailers are declining in South Africa. Around 2009/2010, the Competition Commission evaluated a number of mergers in the independent wholesalers space (which affects independent retailers), reflecting the degree of consolidation.<sup>22</sup> A concern raised through these mergers was that the independent food sector was under immense pressure from large supermarkets, leading to their closure. The Tribunal found that it was essential for independent wholesalers to procure products from suppliers at competitive prices if they wanted to remain competitive against supermarkets. As reflected in Section 2, major supermarkets are indeed moving into the townships and rural areas.

However, new trends are emerging which hint at a 'rebirth' of profitable and sustainable independent outlets in South Africa.<sup>23</sup> Buying groups appear to be growing, indicating that the independent retailers they supply are also growing. Sector research suggests that the 'share of basket' for independent retailers is growing as is their turnover.<sup>24</sup> Recognised to be driven by foreign owners and young South African business owners, independent retailers are allegedly becoming more profitable and sustainable.<sup>25</sup> Rough estimates are that they account for around 30-40% of the total grocery retail market, while formal supermarket chains account for the balance in South Africa. The outlook by buying groups currently is that the segment is growing given the large collective base of lower LSM consumers.<sup>26</sup> The Competition Commission has concerns around this segment nonetheless, and has recently announced a retail market inquiry looking into issues of foreign ownership amongst other concerns of competition and participation.<sup>27</sup>

Buying groups like Unitrade Management Services (UMS) Limited operate in South Africa and in neighbouring countries such as Botswana and Namibia. Active in Gauteng, Cape Town and Kwa-Zulu Natal, UMS supports independent stores that are 'housed' under one of three brands: Powertrade, Food Town and BestBuy. According to UMS, many of their members are foreign (mainly Indian, Chinese and Pakistani-owned) and are largely run as family businesses. All the three brands cater for low-income consumers (mainly LSM 2-6), and on-sell to retailers. There are over 90 stores under the three brands collectively. UMS negotiates with big suppliers on behalf of all its members to secure keener pricing through buying in bulk. Large suppliers are often reluctant to deal directly with small, independent retailers. Given that UMS' business is a volume-driven business, it has an incentive to upskill and enhance capabilities of independent retailers so that they in turn sell greater volumes. This is precisely what UMS and the other buying groups do.

Buying groups typically provide marketing assistance, IT, human resource assistance, training, merchandising and branding, knock-and-drop advertising, direct marketing and credit support to the independent retailers. They also advertise and promote on behalf of the

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<sup>21</sup> This was also highlighted by the Competition Tribunal in the Masscash/Finro merger.

<sup>22</sup> Masscash/Finro large merger, Tribunal Case NO: 04/LM/Jan09. See also

<http://www.tradeintelligence.co.za/TradeProfiles/independentdirect.aspx>

<sup>23</sup> <http://www.shoppingandretail.co.za/2014/June/IndependentOutlets.php>, accessed 10/09/2015

<sup>24</sup> <http://www.tradeintelligence.co.za/TradeProfiles/independentdirect.aspx>

<sup>25</sup> Ibid

<sup>26</sup> This is also known as the 'Base of the pyramid' in developing countries.

<sup>27</sup> <http://www.bdlive.co.za/business/retail/2015/05/13/patel-gives-go-ahead-for-probe-of-fairness-in-retail-sector>

retailers, including through printing leaflets and pamphlets. As highlighted in Section 3, advertising and promotions costs are barriers for new entrants.

Similar to the role that UMS plays, the Buying Exchange Company (BEC) Limited trades under two separate trading divisions – Food Zone<sup>28</sup> catering for the retail market and Trade Zone catering for the wholesale market.<sup>29</sup> These operate in all the main hubs in South Africa as well as in Namibia and Botswana. The company aims to increase numbers ‘*rapidly in all provinces of South Africa.*’<sup>30</sup> BEC provides a range of services to the store such as centralised buying and access to all major suppliers; centralised accounts; assistance with store layouts; radio, television advertising, monthly promotions and on-going point of sale material etc.

Elite Star Trading, like the above buying groups offers a range of services to their franchised independent retailers. They have around 149 stores in South Africa, as well as stores in Botswana and Namibia. Their bigger stores have their own warehousing facilities. Offering similar support to independent retailers is the ICC Buying Group, a division of the Independent Cash & Carry Group. ICC is estimated to be one of the biggest buying groups in South Africa. ICC supports independent retailers under the Lifestyle brand, with stores including Lifestyle Supermarket, Lifestyle Express, Lifestyle Liquor and Lifestyle Hardware & Building Supplies. However, unlike the other buying groups, ICC has its own DC, in addition to a transport fleet. ICC highlights that it has been growing at around 38% in the past few years.

For suppliers, particularly small food processors and household consumable manufacturers, independent retailers offer an important alternative route to market to chain supermarkets. Supermarkets are increasingly imposing escalating standards and conditions on suppliers (see section 6), while independent retailers’ requirements are less onerous than those of supermarkets, allowing small suppliers to get a foothold into the value chain.

Another emerging trend is the move into retail by established wholesalers through the development of ‘**Hybrid**’ formats. This enables wholesalers to compete for lower LSM customers with supermarkets and independent retailers.<sup>31</sup> As shown in Figure 2 above, wholesalers can sell directly to the end consumer through a hybrid offering or through independent retailers. In recent years in South Africa, wholesalers have been re-positioning their businesses to target end customers directly. They have added offerings that were typically only seen in supermarkets, such as butcheries, bakeries, delis and fresh produce sections. This is a move away from their traditional focus on independent retailers only, creating some tension and potential competition concerns as they now compete with their customers. Cash and Carry’s have hybrid stores selling mainly to independent retailers.

Notwithstanding the benefits of buyer groups for independent retailing, the lack of centralised warehousing and logistics systems still appears to place independent retailers at a disadvantage compared to supermarket chains. This is highlighted in Table 2 below in an illustrative comparison of buying group-derived price benefits for independent retailers versus wholesale buying through a warehouse system (or DC equivalent). For the same volume of product from the same supplier, a wholesaler can get around a 10% greater discount off the price than an independent retailer gets through a buying group. This is purely because of the additional allowances and discounts given to supermarkets that have

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<sup>28</sup> <http://www.foodzone.co.za/background.html>

<sup>29</sup> Although this is no longer operational

<sup>30</sup> [http://www.foodzone.co.za/company\\_overview.html](http://www.foodzone.co.za/company_overview.html)

<sup>31</sup> <http://www.tradeintelligence.co.za/TradeProfiles/independentredirect.aspx>

DCs, which independent retailers do not have. Further, large suppliers tend to favour formal supermarkets, and often give them better terms and prices than they give the buying groups, even for the same volume of product.<sup>32</sup>

**Table 1: Cost benefits to an independent retailer vs a DC**

Typical trade agreement with suppliers for <b>independent retailers</b> (direct store delivery/own transport)	Typical trade agreement with suppliers for <b>DC</b> (delivery to DC)
Rebates (e.g. 6%)	Rebates (e.g. 6%)
+ Advertising allowance (e.g. 2%)	+ Advertising allowance (e.g. 2%)
+ Additional add spend (e.g. 1.5%)	+ Additional add spend (e.g. 1.5%)
+ Other incentives (loyalty/volume rebates)	+ Other incentives (loyalty/volume rebates)
	+ Distribution allowance
	+ Warehousing allowance
	+ Other discounts, like pallet discounts
<b>TOTAL discount off price: around 20%</b>	<b>TOTAL discount off price: 20% plus around 10% = 30%</b>

*Source: Authors own, constructed with information from a buying group*

Although there are still challenges, this section has shown that some of the structural barriers to entry in the supermarket industry can be overcome by independent retailers through buying groups. Buying groups in recent years appear to be growing and expanding into southern Africa from South Africa and this is reflective of the growth of the independent retailers which they manage.

## 5. Strategic behaviour of supermarkets with market power

The strategic behaviour of incumbents can limit participation of new entrants and niche players in the supermarket industry. A common competition concern in South Africa is that of incumbents entering into leases with property owners in shopping malls that contain exclusivity clauses (referred to as **exclusive leases** henceforth).<sup>33</sup> This prevents new entrants from locating in lucrative retail spaces, limiting their ability to enter or expand. Attractive store sites are necessary if a new entrant is to become an effective competitor. Property developers provide supermarkets with store sites, with the most desirable sites being located inside a shopping mall where customer traffic is dense. Exclusivity clauses in leases signed between property developers and supermarkets (anchor tenants) grant them exclusive rights to operate as the sole supermarket in the mall. Property owners would then require permission from the incumbent if they wanted to rent to other ancillary tenants who overlapped with the incumbent supermarket's offering.

<sup>32</sup> Whether this is reflective of differences in cost to serve the different groups is unclear at this stage.

<sup>33</sup> Information for the assessment of exclusive leases in this section was largely gathered through interviews with property developers, retail service providers and supermarkets in South Africa.

Exclusivity can either be 'blanket' exclusion on all grocery retail offerings or on particular product lines (butchery, bakery etc.). Exclusivity clauses can also mandate that rival product lines cannot be greater than a stipulated size, for instance, a specialist independent butchery cannot be in excess of 300-400m<sup>2</sup> in size. With fewer competing supermarkets in a given location, customers are ultimately left with reduced choice in terms of product range, pricing and quality.

From the property owners' point of view, dominant incumbent supermarkets are 'must have' tenants to secure financing from the banks given the high footfall they attract. Therefore they often accede to the demands of supermarkets, which can include exclusive leases. From the anchor supermarket's point of view, the typical argument for exclusive leases is that they are crucial to the development of the mall and contribute to investments in the mall. Therefore the counterfactual is that property developers would not construct a mall in the first place without commitments from the supermarket. Supermarkets argue that exclusivity is needed to protect their investments. This highlights the strong bargaining position of anchor supermarkets.

Internationally, the Australian Competition and Consumer Commission's (ACCC) grocery inquiry found exclusive leases to be an impediment to competition. It found that the major supermarkets in Australia entered into such leases to ensure that they maintained exclusive access to prime sites. The ACCC found that such leases hindered entry of new and small supermarkets into local areas. The supermarket chains argued that exclusivity was necessary to foster investment in densely populated urban areas. The ACCC however took the view that it was still possible to enter and invest in metropolitan areas without exclusive leases. Given the possible procompetitive benefits of exclusive leases in terms of encouraging investments, the ACCC through advocacy efforts set out certain conditions under which exclusive leases could be entered into, such as in areas where there was still room for future growth and not in larger urban areas.<sup>34</sup> After the ACCC's intervention, some of the major supermarkets voluntarily undertook to phase out these provisions over a few years, and these undertakings were enforceable by law (OECD, 2013). Furthermore, all future lease agreements entered into would no longer have exclusivity clauses. Similarly, the UK authorities investigated the potential anticompetitive impacts of exclusive leases. Out of 384 stores operating in highly concentrated markets during the time of the inquiry, the Commission found that 30 existing exclusivity arrangements created barriers to entry. The Commission proposed a five year exclusivity limit for new shopping centres and the annulment of existing exclusivity arrangements after five years of their report being published.<sup>35</sup>

### ***Concerns around exclusive agreements in South Africa***

The Competition Commission of South Africa in June 2009 initiated an investigation against the major supermarket chains, Shoprite, Pick n Pay, Woolworths and SPAR as well as wholesalers - former Massmart and Metcash. In addition to allegations of abuse of buyer power, engaging in category management practices and information sharing, the Commission looked into long term exclusive leases. Subsequent allegations around exclusive lease agreements between the major retailers and property developers were made by Fruit and Veg City, the A&M Hirsch Family Trust and Mr Ismail Ganchi of Aquarella Investments 437 (Pty) Limited.<sup>36</sup>

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<sup>34</sup> <http://www.compcom.co.za/wp-content/uploads/2015/03/Competition-Commision-January-Newsletter-WEB.pdf>

<sup>35</sup> Ibid

<sup>36</sup> <http://www.compcom.co.za/wp-content/uploads/2015/03/Competition-Commision-January-Newsletter-WEB.pdf>

The Commission's investigations revealed the widespread existence of long-term exclusive lease agreements between supermarkets and landlords. The Commission found that these had the potential of dampening competition because the anchor tenant was unlikely to approve entry of a competing supermarket or specialist stores like bakeries and butcheries. This leaves the anchor tenant as the only grocery retailer in the premises free from effective competition and customers are left with limited choice.

However, after the investigation, the Commission concluded that there was insufficient evidence to conclusively prove that exclusive leases had the effect of *substantially lessening competition*. The Commission therefore non-referred the allegations. This reflects the high threshold or burden of proof in the South African competition regime. Conduct that clearly has an exclusionary effect on competitors, and a distortionary effect on competition, is not sufficient to make a finding given the high standard of proof of anti-competitive *effects* that is required by the Act (or the prevailing interpretation of the Act).

The Commission instead engaged in softer advocacy measures with supermarkets, property developers and banks, recommending the use of long term exclusive lease agreements only in cases where the supermarkets can prove that they undertook substantial investments in certain shopping centres and limiting the duration of exclusivity. The Banks Association undertook that the major banks would no longer require exclusivity clauses in agreements between developers and anchor tenants before accessing funding.<sup>37</sup> However, as discussed below, it appears that the banks do not insist on exclusivity clauses in any case and that it is the supermarkets who insist on this.

Notwithstanding these undertakings, new complaints were lodged at the Commission from October 2013 onwards. These led to the Commission announcing that it would be re-opening investigations into such practices. In October 2013, Masstores lodged a complaint against the exclusive lease agreement between Shoprite Checkers and Hyprop Investments for the Cape Gate Regional Centre in Cape Town. In September 2014, the South African Property Owners Association (SAPOA), filed complaints against Pick n Pay, Shoprite and SPAR for exclusive leases in a number of shopping malls. In October 2014, Massmart made the same complaint against the major retailers Pick n Pay, Shoprite and SPAR, following the difficulties that its subsidiary, Game, is facing in locating in certain centres.<sup>38</sup>

Given these extensive complaints and other concerns in the industry, following authorisation by the Economic Development Department Minister, the Commission on 13 May 2015 announced that it would undertake a market inquiry into the retail sector. Minister Patel announced that the inquiry would examine the tenancy arrangements in shopping malls, the growth of township enterprises such as spaza shops in order to ascertain whether the retail sector is competitive and inclusive.<sup>39</sup> The terms of reference and appointment of the panel has since been finalised.<sup>40</sup>

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<sup>37</sup> <http://www.compcom.co.za/wp-content/uploads/2015/03/Competition-Commission-January-Newsletter-WEB.pdf>

<sup>38</sup> In the same period, Mr. SA Mahwiliri, a franchisee of Pick n Pay, laid a complaint against the manager of Kwa-Mhlanga Shopping Complex after he was refused retail space, allegedly following an order from Shoprite, the anchor tenant. Similarly in December 2014, Mr Hlope, a businessman operating a liquor store filed a complaint against the major retailers after he was also denied lettable space in malls.

<sup>39</sup> <http://www.bdlive.co.za/business/retail/2015/05/13/patel-gives-go-ahead-for-probe-of-fairness-in-retail-sector>

<sup>40</sup> <http://www.compcom.co.za/wp-content/uploads/2016/01/Commission-appoints-panel-for-the-Grocery-Retail-Sector-Market-Inquiry.pdf> and [http://www.gpwonline.co.za/Gazettes/Gazettes/39347\\_30-10\\_NationalGazette.pdf](http://www.gpwonline.co.za/Gazettes/Gazettes/39347_30-10_NationalGazette.pdf)

According to SAPOA (one of the complainants) in a survey undertaken in 2012,<sup>41</sup> 94% of the respondents (property owners) were of the view that they would prefer not to have exclusivity clauses in their leases for a range of reasons, including that it prevents the landlord from placing free-standing bakeries, butcheries or green grocers; it prevents the landlord from optimising the best tenant mix suited for the shopper coming to the centre and for the growth of the centre; it reduces the option of having specialist retailers that offer greater product ranges; it limits opportunity to expand etc. 56% of the respondents agreed that exclusivity clauses had no benefit (presumably to property owners) and were actually detrimental to the management of their assets.

Property developers claim that while the banks insist on an anchor tenant (which is often a large supermarket group) to provide funding, they do not insist on exclusivity clauses in leases with these anchor tenants. It is the main supermarkets who hold the bargaining power that insist on them. In other words, banks only really care about the number and types of lessees (for instance, they check how many key national retailers are present in a centre).

A range of other factors appear to affect whether exclusive clauses in leases are insisted upon. These include shopping centre size, whether the centre is a new or existing centre, whether the centre is in a rural or urban area or whether it is a corporate or franchise store.

With regards to shopping centre size, in larger malls, there is usually space for more than one anchor tenant at different ends of the mall. Shopping centres of 12,000m<sup>2</sup> can usually only support one anchor tenant; centres of >25,000m<sup>2</sup> can support two and centres of >40,000m<sup>2</sup> can support up to three supermarkets. Exclusive leases are more likely to be insisted upon when the size of the centre is between 12,000 and 12,500m<sup>2</sup>.<sup>42</sup>

Negotiating leases is difficult in new centres as the anchor tenant is important in obtaining finance from banks as explained above. Property developers often end up allowing or giving in to demands of exclusivity by major supermarkets just to kick-start the development process. Subsequently, they struggle to re-negotiate the terms of the leases. Exclusive leases therefore may be more prevalent in new centres where there is risk and uncertainty and where the anchor tenant seeks to protect his investment from competition. However, property owners and supermarkets also suggest that exclusive leases were more prevalent historically, and that it was common practice in South Africa for many years. Potentially given the increased attention by the Competition Commission around this practice recently, there is greater sensitivity in new centres, while in existing centres the problem persists given that the leases were signed many years ago. In practice, leases usually last for 10 years, but anchor tenants can have up to five options for renewal resulting in exclusivity that spans for several decades. While exclusive leases might arguably be justified in the initial phases of the investment to allow the anchor supermarket to recoup its investment, gain footfall and establish a market, it is hard to see how such justifications can be reasonable for such extended periods of time. This is especially the case if supermarkets are able to recoup their investments within a few years of establishment, which appears to be the case typically in South Africa.

It also appears that small property developers, particularly for developments in **rural areas**, who do not have bargaining power against major supermarkets are more inclined to

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<sup>41</sup> 15 respondents were surveyed. SAPOA members control the bulk of South Africa's private sector commercial land and building stock, as well as managing the majority of property funds listed on the JSE.

<sup>42</sup> Other estimates are that shopping centres between 14,000 and 20,000m<sup>2</sup> are where there are typically still fights around exclusivity.

succumb to entering into leases with exclusivity clauses to kick-start developments. Lack of competition has far-reaching consequences in rural areas where pricing is a key factor for low-income consumers. Further, small specialised businesses in rural areas like grocers, bakers, butchers and delicatessens are prevented from locating in centres if there is exclusivity. A specialised butchery in South Africa, Roots Butchery, has allegedly encountered such problems in rural areas.

Models of retailing, whether franchise or corporate, also appear to impact on whether the anchor supermarket insists on exclusive leases. It appears that in the case of franchise stores, individual store owners typically insist on exclusivity clauses in leases to protect his/her individually-liable investment.

While it may be so that the practice is less common in recent years, and this is visible in many new centres where there are multiple supermarkets in the same centre, there is little doubt that new entrants, independent retailers and specialist stores are disadvantaged in entering shopping centres. In addition to being riskier, smaller new entrants are uncertain traffic builders, resulting in landlords charging them higher rental rates even if they do manage to secure a lease in the premises. Moreover, securing a strong anchor tenant in the shopping centre determines the types of line stores<sup>43</sup> that will populate the centre and the rental that the landlord can extract from them. It is easier to extract higher rentals from ancillary line stores if the anchor store is a Shoprite for example, as opposed to a smaller supermarket like a Choppies. Generally, prices charged per m<sup>2</sup> to all line tenants depend on the position of the store, the size of the mall, and its proximity to the anchor tenant. Therefore the incentive is to secure large incumbents as anchor tenants, and this results in the exclusionary effects on new entrants.

## **6. Impact on suppliers**

The procurement and sourcing strategies of large supermarkets have a significant impact on local suppliers with regards to participation in the value chain and development of their capabilities (Brown and Sander, 2007). Reardon, Timmer and Berdegue (2004) and Humphrey (2007) show that large supermarket chains have indeed drastically transformed food supply chains. Supermarkets have moved away from spot purchases to adopting specialised procurement agents and dedicated wholesalers, or procuring directly from farmers and processors, giving them direct influence over pricing, quantities, terms of delivery and product quality. This has the adverse effect of shrinking the supply base by using only preferred suppliers (see Altenburg et al, 2016) and bypassing traditional wholesale markets (Humphrey, 2007). Several multinational supermarket chains like Ahold, Tesco and Metro have preferred supplier lists (Reardon and Gulati, 2008).

Large supermarkets are also imposing escalating private quality and processing standards on suppliers (Humphrey 2005; Boselie, Henson and Weatherspoon, 2003). The capabilities of local suppliers (particularly small-scale farmers, small food processors and producers of household consumable goods) to meet these standards and reach the required scale to enter into the supply chains and compete with imports is of importance for their sustainability. Marketing of fresh food produce to supermarkets has been difficult for suppliers in developing countries as often the institutional, physical and financial infrastructure support systems are weak (including bar coding, packing houses, cold chains,

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<sup>43</sup> For instance, clothing stores like Edgars and Foschini



shipping equipment, credit facilities, standards and certification processes etc.). Producers are usually responsible for all post-harvest activities up until the product is delivered to a distribution centre or a supermarket. Particularly for fresh fruits and vegetables, Sanitary and Phytosanitary (SPS) protocols are important (Tshirley, 2010). But over and above these minimum standards as well as Global GAP standards, multinational retailers may further impose food standards like Hazard Analysis and Critical Control Point (HACCP) (Altenburg et al, 2016). In South Africa, even higher international standards like Food Safety System Certification (FSSC 22000) are being required in certain instances.

The modernisation of procurement systems has therefore placed considerable pressure on suppliers with regards to their costs, the volumes they are able to supply, the consistency and quality of their products (Dakora, 2012). Supermarket chains generally have a dual objective - to reduce costs and to increase quality (including improving safety standards). This dual objective directly translates to the requirements imposed on suppliers and therefore on supplier capabilities. This means that local suppliers require significant investment in capital, technological, managerial, organisational and financial upgrades to meet requirements of supermarkets.

Over and above demanding lower costs and higher standards from suppliers, supermarkets often impose a range of other costs on suppliers through their trading terms. This is reflective of the **buyer power** of large supermarkets. Dominant supermarkets can exert buyer power by suppressing the price they pay to suppliers of products. At first glance, it may appear that this serves to reduce the price paid by supermarkets to suppliers, thereby reducing costs. If such cost reductions are passed on to consumers, then consumer welfare is increased. Therefore buyer power may not be considered harmful to the end consumer. However, buyer power can be harmful to the competition process if the intention of the dominant supermarket is to exclude its rivals from the industry. Several jurisdictions, such as Canada, the UK and Germany, view buyer power as a competition concern only if this is the intention (OECD, 2013). This could occur for instance, if the dominant supermarket uses its buyer power to enter into exclusive agreements with key suppliers, preventing them from supplying 'must-have' products to rival supermarkets.

There is no doubt that the major South African supermarkets have considerable buyer power. For many local suppliers, supermarkets are the main route to market. Supermarkets are able to influence pricing and trading terms such as listing fees, rebates, advertising and slotting allowances, promotion fees, payment terms, settlement discounts, new store openings fees etc. (Reardon and Gulati, 2008). In South Africa for instance, it appears that suppliers face numerous costs just to participate in a supermarket value chain, even before a single unit of their product is sold. If a new product is to be launched, suppliers may need to pay the supermarket a marketing budget. In addition, many suppliers pay listing fees or slotting allowances to get shelf space. Suppliers of perishables also have to pay a swell allowance.<sup>44</sup>

Supermarkets in both developed and developing countries are increasingly producing their own/house brands of food and household products.<sup>45</sup> These **private label** brands are proving to be highly successful and fast sellers for supermarkets as they compete with branded alternatives on price, value and quality, particularly for cost-conscious customers. Given the lack of branding and advertising for these products, their costs of sales are often

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<sup>44</sup> This is a payment that compensates for damaged or spoiled products that would be too cumbersome to be physically returned to the supplier (or in the case of perishable products, not practical to be returned at all).

<sup>45</sup> See OECD (2013) for the growth of private labels in European supermarkets

lower than other well-known branded products. The increase in the number of private labels may also be an indicator of increased competition between supermarket chains.

Private labels however have raised concerns for suppliers of branded products in instances where supermarkets favour private labels at the expense of branded products. It has also raised concerns around the bargaining power of retailers against branded manufacturers. Suppliers are sometimes 'forced' into supplying house brands at lower margins than their branded products and this can be used as a tool to negotiate down prices for branded products. However the competitive impact of private labels is ambiguous. Mills (1995) suggests that private labels are welfare-enhancing as double mark-ups are eliminated and that the additional competition created between the brand and private label could lead to lower prices. But other studies suggest that private labels actually result in an increase in price of the branded product given a core base of loyal customers for the branded product (Gabrielsen and Sørsgard, 2007, as cited in OECD, 2013).

There has indeed been growth in private label products in supermarket shelves in South Africa. Every major supermarket chain has their own brand/private label product. Shoprite has its 'Ritebrand' and 'Housebrand' ranges in Checkers, which covers around 300 products. Pick n Pay has its 'No Name' brand and are looking to further expand their own label range. Food Lover's Market produces its own house brands 'Freshers' and 'Food Lovers Signature'. SPAR also has its own branded products. SPAR does not allow major suppliers like Tiger Brands to manufacture its own private label products, thus allowing new smaller players to enter the supermarket supply chain. Choppies also has 50 of its own branded products, in food, beverages, household cleaning products and cosmetics. Many suppliers of branded products in South Africa also manufacture and sell house brands and some of the concerns mentioned above were expressed. On the other hand, private labels confer some bargaining power to supermarkets over large suppliers which may assist new entrants that have access to manufacturers. In some instances, brands are developed explicitly by the supermarket to provide it with leverage and buyer power against dominant suppliers.

Increased competition between supermarkets benefits suppliers as it reduces incumbent supermarkets' buyer power given the alternatives available for suppliers. The entry of Fruit and Veg City has indeed provided an alternative route to market for farmers, and Choppies' growth means that suppliers have a new avenue to play off against incumbents in negotiating trading terms.

Local suppliers that are able to supply supermarkets with products of desired quality, volumes and consistency obviously benefit supermarkets and so it is in their interest that suppliers upgrade their capabilities. Internationally and in South Africa, supermarkets have invested in different degrees in **supplier development programmes**. In South Africa, part of the conditions imposed by the Competition Appeal Court in the Walmart/Massmart merger required the merged firm to set up a supplier development fund and make available ZAR 240 million over a period of five years (Morris, 2014). One beneficiary of this fund was Lethabo Milling<sup>46</sup>, a new entrant producing super maize meal and other products. Lethabo Milling supplies Massmart stores with these products and has received additional support such as training, waived listing fees, fast-track payments, and assistance with pricing models from Massmart. Another similar fund, the Agro-Processing Competitiveness Fund, was set up from the Pioneer cartel settlement. This fund of ZAR 250 million, with substantial co-funding from the Industrial Development Corporation, offers support to non-dominant agro-processing players in the form of investment support, business support and research grants.

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<sup>46</sup> Lethabo Milling received ZAR1.6mn from Massmart and ZAR8.2mn loan from ABSA

## 7. Some conclusions

This paper has highlighted the strategy of supermarket chains in Southern Africa extending their offering across different formats to target customers across the full range of incomes. There has been an increased focus by supermarkets in targeting low-income consumers. The paper has also highlighted a reversal in the trend of only South African supermarkets spreading into the region, with the recent rapid growth of Botswana-owned Choppies. The future competitive reaction of incumbent supermarkets to Choppies' entry will be of interest given that it is beginning to enter shopping centres in South Africa.

A range of structural and strategic barriers to entry that affect the competitive landscape in South Africa were evaluated. The structural barriers to entry are largely a function of the inherent characteristics of supermarkets. The biggest of these barriers are the substantial investments required in distribution centres (and the associated economies of scale benefits) and significant advertising/promotions costs. This gave rise to key questions being asked: do scale economies mean that only a few large supermarket chains can effectively operate in a given market? If so, is competition from niche retailers and small entrants important at all? While the paper highlights that economies of scale and scope are indeed major barriers to entry, the benefits brought by new entrants in South Africa - Fruit and Veg City and Choppies, as well as independent retailers - have been clearly shown, both in terms of lower priced products for consumers and alternative routes to market for suppliers.

Therefore reducing barriers to entry, including the strategic behaviour of incumbents, and allowing increased participation is important. The most prevalent strategic barrier appears to be the practice of incumbent supermarkets entering into exclusive leases with property owners. Reducing such barriers would entail allowing open and flexible retail space in urban planning to ensure a mix of formats (niche players, specialised stores etc.) It would also require undertakings by the incumbent supermarkets to either not enter into such agreements at all, or to reduce the duration of the exclusivity clauses. In turn, this may require stronger enforcement by the competition authorities (as opposed to just advocacy, which has evidently not worked in the past) grounded in a view that such conduct has a distortionary effect on competition. This might even suggest that the abuse of dominance provisions of the Competition Act require rewording to cover conduct that 'distorts' competition, lowering the very high current threshold in practice of needing to prove a substantial lessening of competition.

The paper also highlighted a resurgence of independent retailers, either on the back of strong buying groups or offshoots from wholesalers through hybrid models. This is an alternative model to traditional supermarket chains in South Africa for low-income consumers, new entrants and local suppliers alike. One way to encourage entry and participation is to therefore support and grow independent retailers. Although barriers they face can be reduced through buying groups, the benefits of accessing distribution centres and logistics infrastructure are clear. Access to finance to construct such facilities would afford them significant cost benefits from suppliers. Further, encouraging suppliers to offer fair prices and terms of supply to independent retailers would benefit them. The competition authorities have an important role to play in this regard.

The significant buyer power of supermarkets can result in small and medium-sized suppliers being marginalised. Again, competition authorities have an important role to play in ensuring that supermarkets with market power do not abuse this position. While the competition authorities in South Africa have been active in promoting supplier development programmes linked to conditions or settlements in cases, it would require a greater coordinated effort

between different relevant government departments to roll out such initiatives on a much larger scale.

This paper has shown that the growth of supermarkets and independent retailers has important implications for both consumers and suppliers to supermarkets. Promoting competitive outcomes in this sector, including through the competition regime, is therefore vital.

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