his article draws insights from the study of Fruit and Veg City Ltd (FVC), as a successful entrant into the formal grocery retail market, and further considers the growth of independent retailers. The study is part of a programme of work to understand Barriers to Entry in the South African economy, supported by National Treasury.

The supermarket industry in South Africa remains concentrated, with four large supermarket chains Shoprite, Pick n Pay, SPAR and Woolworths holding the largest shares of the grocery retail market. These supermarket chains have a wide geographical presence in all provinces of the country accumulated over several decades. High levels of concentration in grocery retail potentially limit gains to consumers resulting in high prices, poor quality or limited choice.

Fruit and Veg City has achieved tremendous growth since its inception in 1994 with over 100 stores to date. It has grown to be an effective competitor in the retail industry, entering originally as a part-line retailer focused primarily on fruits and vegetables. Independent retailers on the other hand, have successfully entered the retail market through the use of buying groups. Independent retailing represents an alternative model of entry for small players as opposed to the traditional supermarket chain model. The independent retail market is growing and accounts for approximately 30% of the total retail market. Although national retail chains account for the larger share (70%) of the total retail market, some estimates suggest that their share is declining every year.

The growth of Fruit and Veg City and independent retailers provides innovative insights regarding how local supermarkets have devised ways to become and remain competitive and overcome the high barriers to entry in the supermarket industry. These insights provide policy makers with a framework for developing institutional support to facilitate the entry of new players.

Key barriers to entry

Direct procurement is crucial in retail through cost savings derived through avoiding marked-up retail prices. The national chains have the financial strength and buying power to source directly from suppliers and manufacturers affording them significant cost advantages due to economies of scale and scope.

The Fruit and Veg City case study provides useful lessons regarding cost savings through direct procurement strategies. Fruit and Veg City sources its fresh produce directly from municipal markets which aids in cutting costs and allows the firm to charge competitive prices between 20% - 25% lower than major retailers. As Fruit and Veg City gradually expanded its footprint in the market, it could support further investments in distribution centres and logistics networks.

Independent supermarkets have also found alternative ways of procuring products with significant cost savings. They have adopted the use of buying groups to achieve cost savings in procuring their stock. Buying groups negotiate better pricing deals with suppliers and manufacturers and purchase in bulk on behalf of small supermarkets. Although buying groups reduce the barriers faced by local supermarkets in terms of achieving efficiency in their buying, lack of access to distribution centres and procurement logistics reduces their ability to store and distribute products, manage cash flows, and ultimately compete.

A majority of retailers interviewed as part of the study confirmed that the inability to make extensive investment in advertising and promotions used to create loyalty and attract greater footfall is one of the primary challenges for small supermarkets and suppliers. Incumbent supermarkets spend significant resources on advertising. To gain market share, new entrants have to match this expenditure out of a much smaller revenue base. This puts new entrants wishing to compete directly with large supermarkets at a huge cost disadvantage. Access to finance for the investments required at the start-up is an additional challenge.

Advertising costs place a significant burden on small local supermarkets with single outlets. However, small supermarkets have found ways of overcoming advertising barriers through the use of buying groups. Buying groups assist small supermarkets with advertising and promotions through the use of knock and drop advertising, direct marketing and credit support. For example, Unitrade Management Services organises and promotes store competitions for retailers which increases footfall and sales.

Lack of business management skills and retail capabilities in a highly competitive retail environment increases the rate of exit among small local supermarkets. Management skills and experience are crucial for successful retailing. Buying groups continue to play a crucial role in skills training and development of local supermarkets by providing training to small retailers at little or no cost.

Similarly, retail experience and management skills are critical aspects of successful models. Fruit and Veg City’s retail experience means that it developed a greater understanding of the retail industry and could easily identify opportunities for entry and growth. For example, FVC was able to identify a gap in the market for fresh fruits and vegetables, quickly differentiating itself from other supermarkets by focusing on an area where the major supermarkets traditionally did not have
a strong focus. The firm successfully adopted a flexible business model which allowed it to diversify into other formats and markets. This flexibility appears to have allowed it to seize new opportunities and to adapt its format quickly from its initial niche advantage in fresh fruit and vegetables as demonstrated through its full-line Food Lovers Market offering.

A lack of access to prime retail locations in shopping malls and retail centres is a major barrier to entry for small local supermarkets. Location is obviously a critical issue in supermarkets’ attractiveness to consumers. Customers consider location when choosing a store and location provides the firm with strategic advantages.

Property developers interviewed as part of the study confirmed that the practice of long term exclusive lease agreements entered into by incumbent supermarkets and property developers in shopping malls heightened barriers to entry for small local supermarkets. This practice denies new entrants and specialist retailers such as butcheries and bakeries access to retail space in prime locations with greater footfall. Fruit and Veg City in 2009, lodged a complaint with the Competition Commission of South Africa regarding the conduct which prevented it from locating in certain retail centres. This problem is acute in smaller shopping centres located in rural areas.

**Recommendations**

The entry of Fruit and Veg City and the growth of independent retailers demonstrates the competitive value of a diversity of retail business models for consumers and for suppliers and emphasises the importance of keeping the retail space open to entrants. Entry and rivalry between retail groups not only benefits consumers across all income groups through improved pricing, quality and choice but ensures economic participation of local farmers, producers and manufacturers or suppliers in supermarket supply chains. This is especially relevant in South Africa where there are significant challenges to economic participation of local entrepreneurs. The invisible matrix is an opportunity to provide training subsidies to firms, for instance buying groups, to assist small suppliers and independent retailers with skills training and development.

In addition to financial assistance, skills training and development through fostering long-term, public-private partnerships between key suppliers, wholesalers, buying groups and independent retailers would ensure successful transfer of knowledge and skills (in advertising, marketing, cash flow management, inventory and waste management etc.). There is also an opportunity to provide training subsidies to firms, for instance buying groups, to assist small suppliers and independent retailers with skills training and development.

It is important to level the playing field for smaller firms and new entrants by encouraging suppliers to offer fair prices and terms of supply (comparable to what is offered to large supermarkets, based on fair commercial considerations). This could be done through obligatory codes of conduct between producers, wholesalers and retailers enforced by government ministries or competition authorities. For example in Australia retailers and wholesalers sign a written notice to the competition authority which binds them to write down their supply agreements, act in good faith and prohibit retailers from threatening suppliers with termination of contracts without reasonable grounds. The code sets guidelines with regard to how retailers and suppliers ought to conduct business and stipulates that this information should be made available to all suppliers at all times.

**Notes**

4. See note 1.