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GROWTH AND DEVELOPMENT IN THE SUGAR TO CONFECTIONERY VALUE CHAIN FOR SOUTH AFRICA AND ZAMBIA

Francis Ziba₁, Reena das Nair₂ and Maria Nkhonjera₃

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Abstract

The member states of the Southern African Development Community (SADC) have placed industrial development at the core of the region's integrated development agenda. This paper seeks to assess the regional competitiveness and opportunities in the sugar to confectionery value chain in Zambia and South Africa. Agro-processing, specifically in the sugar to confectionery value chain, is an important area in which industrial development can be pursued in both countries. This study aims to develop a shared understanding of the challenges impeding the expansion of downstream industrial activity in the sugar confectionery sector in the two countries, and to identify the potential for firms to upgrade. This research offers concrete proposals that will inform cross-country policy initiatives to address these challenges at a regional level.

Keywords: Industrial development, Regional Value Chains, Competition, Capabilities upgrading, Supermarkets, Sugar

JEL classification: L10, 66, L81

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¹ The in-depth study on the Growth and Development in the Sugar to Confectionery Value Chain for South Africa and Zambia is available on <http://www.competition.org.za/>.

1 - Ziba is a research fellow at the Zambia Institute for Policy Analysis and Research (ZIPAR) fziba@zipar.org.zm; 2 - Das Nair is a senior researcher at the Centre for Competition Regulation and Economic Development (CCRED) reenad@uj.ac.za; and 3 - Nkhonjera is a junior researcher at CCRED mnkhonjera@uj.ac.za.

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Abbreviations

ABF	Associated British Foods plc
ACF	African Competition Forum
AFDB	Africa Development Bank
ASASI	Association of Southern African Sugar Importers
BRICS	Brazil, Russia, India, China, and South Africa
CAGR	Compound Annual Growth Rate
CCPC	Competition and Consumer Protection Commission of Zambia
CCRED	Centre for Competition, Regulation and Economic Development
DoP	Division of Proceeds
Dti	Department of Trade and Industry
EU	European Union
FSSC	Food Safety System Certification
GVC	Global Value Chain
HACCP	Hazard Analysis and Critical Control Points
ICUMSA	International Commission for Uniform Methods of Sugar Analysis
IDCS	Industrial Development Corporation of South Africa
IDCZ	Industrial Development Corporation of Zambia
ISO	International Organisation for Standardisation
ITAC	International Trade Administration Commission
MCEP	Manufacturing Competitiveness Enhancement Programme
NTBs	Non-tariff Barriers
NTE	Non-traditional exports
RVC	Regional Value Chain
SABS	South African Bureau of Standards
SACU	Southern Africa Customs Union
SADC	Southern African Development Community
SASA	South African Sugar Association
SSA	Swaziland Sugar Association
UAE	United Arab Emirates

UNZA	University of Zambia
USD	United States Dollar
WTO	World Trade Organisation
ZABS	Zambian Bureau of Standards
ZDA	Zambia Development Agency
ZIPAR	Zambia Institute for Policy Analysis and Research



1. Introduction

The member states of the Southern African Development Community (SADC) have placed industrial development at the core of the region's development integration approach. In pursuit of this important common objective, this study looks at the sugar to confectionery value chain in Zambia and South Africa. Sugar confectionery products include sweets (hard boiled candy, lollipops, chews, chocolate etc.) while baked confectionery goods include sweet biscuits. The research was undertaken to build a shared understanding of the opportunities and main bottlenecks found in the value chain.

The research is motivated by two key factors. First, both South Africa and Zambia are large net exporters of sugar, with Zambia being the lowest cost producer of sugar in the region (Ellis, Singh and Musonda, 2010) and amongst the lowest cost producers in the world. Yet, there is a large trade deficit in both these countries as well as in the SADC region in downstream sugar confectionery products which is a substantial category of processed food. Given the cost advantages, South Africa and Zambia are well placed to exploit opportunities from low cost sugar to develop relatively low-to-medium technology value added products in the sugar and baked confectionery industries. Despite low costs of production, Zambia and South Africa's domestic sugar price exceeds the world sugar price which results in relatively higher input costs for local producers in downstream confectionery markets (Chisanga et. al, 2014a and 2016).

Second, the same firms that operate in South Africa also operate at two key stages of the sugar to confectionery value chain in Zambia, namely in the sugar production (until recently) and formal retail levels. The largest producer of sugar in Zambia, Zambia Sugar, was until recently a subsidiary of South African firm Illovo Sugar. It is now owned by Associated British Foods. Similarly, the largest retailers in Zambia, Shoprite and Pick and Pay, are also the two largest supermarket chains in South Africa with a large regional footprint. This has interesting implications for understanding the regional nature of the value chain and the role of these key firms in determining the structure and developments in the value chain both within each country and between South Africa and Zambia.

The role of retailers is particularly important in understanding the sugar to confectionery value chain as they play a key, and growing, role in local producers accessing final markets. From a national perspective, supermarkets are an important route to the domestic market, particularly to urban consumers, for local suppliers. But importantly, from a regional perspective, supermarket chains are an avenue to wider regional markets in SADC.

A global value chains framework was utilised, adapted for regional dynamics to understand opportunities and constraints to regional industrialisation. Data from both primary and secondary sources were used. The dataset of primary information was obtained through in-depth interviews with key stakeholders throughout the value chain in both Zambia and South Africa, as well as from the annual reports of listed companies. The interviews were mainly conducted using detailed structured questionnaires during face-to-face interviews. Overall, data was collated from 29 interviewees. This included five sugar millers and twelve confectionery producers in addition to data from the other targeted entities in each country. This information was further augmented by secondary data collected from various sources.

The overarching objective of this study is to highlight the potential for mutually beneficial growth and development opportunities for both countries. The specific objectives of the study are as follows:

- To develop a shared understanding of the challenges impeding the expansion of industrial activities in South Africa and Zambia;
- To analyse the performance and competitiveness of the sugar to confectionery regional value chain and the potential for upgrading;
- To identify concrete plans at the sectoral level for mutually beneficial and collaborative industrialisation strategies for the sugar and confectionery value chains across the two countries.

South Africa and Zambia are significant as far as regional industrialisation is concerned. On one hand, South Africa is largely deemed to be the 'gateway to the region', given its level of industrialisation, relatively sophisticated markets and proximity to the rest of the region. However, South Africa has recently seen structural shifts with sharp increases in contributions of the services industry to GDP while the manufacturing industry contribution to GDP and employment has significantly decreased over time. On the other hand, Zambia's export profile has remained largely dominated by metal commodities, primarily copper, that are susceptible to international commodity price shocks. Zambia's economy has also seen a shift towards the services industry, with the sectoral composition of the economy largely comprising services but without achieving the industrial development required for sustainable economic growth and employment creation. As such, it is important to understand why there is value addition in some agro-processing sectors and not in the sugar to confectionery value chain, where there are clear natural advantages in sugar production.

Both South Africa and Zambia are therefore faced with a challenge to increase their manufacturing base as employment and industrialisation are on their respective development agendas. Agro-processing, specifically in the sugar to confectionery value chain, is an important area in which industrial development can be pursued in both countries if there is a better understanding of the linkages and the constraints faced.

This report is structured as follows: Section 2 provides a literature review on value chains and Section 3 descriptively maps the sugar to confectionery value chain in South Africa and Zambia, highlighting the key players at each level of the value chain. Sections 4, 5, and 6 then assesses the dynamics within the value chain including the growth and performance of main players, the pricing of sugar as an input into confectionery production and the major constraints faced including accessing routes to market. Section 7 concludes and provides recommendations for mutually beneficial policy interventions for Zambia and South Africa.

2. Literature Review: Global value chains, regional value chains and agro-processing

Global value chain (GVC) theory helps to explain how patterns of international trade and production have shaped prospects for development and increased competitiveness (Gereffi, 2014). GVC perspectives are often used to analyse international trade and production networks (Gereffi, 1999). Due to the increased globalisation of processes involved in the manufacturing of various products, it has become important to understand the inter-firm linkages found in these trade networks. These international trade networks are generally characterised by unequal distribution of economic rents (Gereffi et al. 2001. and a GVC framework allows for an understanding of how the distribution of rents can be changed for firms to receive more equitable shares of these rents through mechanisms such as upgrading.

The consideration of regional value chains is particularly important because these chains may be more amenable to upgrading than GVCs as they are likely to be less tightly controlled than the latter (Keane, 2015). Issues such as harmonisation of standards or border controls may further be easier to negotiate between countries that share borders than between those that

do not. Thus, understanding firm and state strategies in the formation of regional value chains is important to understand their operation and potential for regional industrialisation.

Until recently, there has been limited literature on regional value chains in Africa. Apart from the case studies on various African agricultural and mining commodities feeding into GVCs², the GVC literature on African value chains either focused on the effect of Asian firms on African producers or on the demand patterns driven by BRICS countries (Brazil, Russia, India, China, and South Africa) (Keane, 2015). However, more recently, regional value chains studies have either had a regional focus assessing the potential or existence of regional value chains (Farole, 2015 and Keane, 2015 in their assessment of the SACU region), or as case studies looking at specific value chains (e.g. Fessehaie, et al., 2015).

Two key insights emerge from the limited research on regional value chain. First, most regional value chain studies are conducted with the view to develop regional value chains as preparation for entry into GVCs (Keane, 2015). For instance, Kaplinsky and Morris (2015) find that regional value chains can play an important role as a learning ground for African suppliers ultimately destined for global markets. This is because African markets generally have far less stringent standards and requirements than global markets (largely found in developed countries).

The second key insight is that, as highlighted by Farole (2015), regional value chains in southern Africa remain largely underdeveloped. This underdevelopment extends to the agro-processing sector where it is suggested that regional value chain development should be the greatest given the level of agricultural production in southern African countries (Farole, 2015).

The development of regional value chains depends on both structural and policy factors. Structural factors include the southern African region having difficulty in achieving scale and having large intra-regional imbalances as it is characterised by relatively small regional markets (Farole, 2015). Policy factors are especially important in the context of regional communities' integration, an avenue by which countries could improve their trade-competitiveness through upscaling in value chains. The upscaling can be facilitated by enacting regional policies which reduce excessive protectionist trade measures, as well as increased tax incentives for attracting new technology (AFDB *et al.*, 2014).

Regional integration has long been a goal for SADC countries. However, despite the regional integration agenda, national policies are often in opposition to the regional integration initiatives in SADC (Hartzenberg and Kalenga, 2015). Although countries have ostensibly implemented a number of trade liberalisation measures, they have also found ways to circumvent the effects of application of tariff liberalisation by implementing non-tariff barriers (NTBs) (Hartzenberg and Kalenga, 2015). Particularly for agro-processing, trade policies undermine the potential for the development of downstream activities (Farole, 2015). As such, the concept of unlocking the development of regional value chains is directly affected by issues of trade cooperation between neighbours in the region.

A key participant and the last link to end consumers in many agro-processing and industrial value chains is the retailer. The rapid growth and spread of modern retailing in southern Africa is an important dynamic in shaping regional food value chains. Modern retailers, supermarkets in particular, are becoming a growing route to market for consumer goods in southern Africa, providing opportunities for suppliers to participate both within and outside their home countries (Boselie, Henson and Weatherspoon, 2003; Reardon and Hopkins, 2006). Past studies have shown that as a result of the spread of supermarkets, suppliers have had to invest in their

² See for example Cramer (1999), Dolan and Humphrey (2000) and Gibbon (2003)

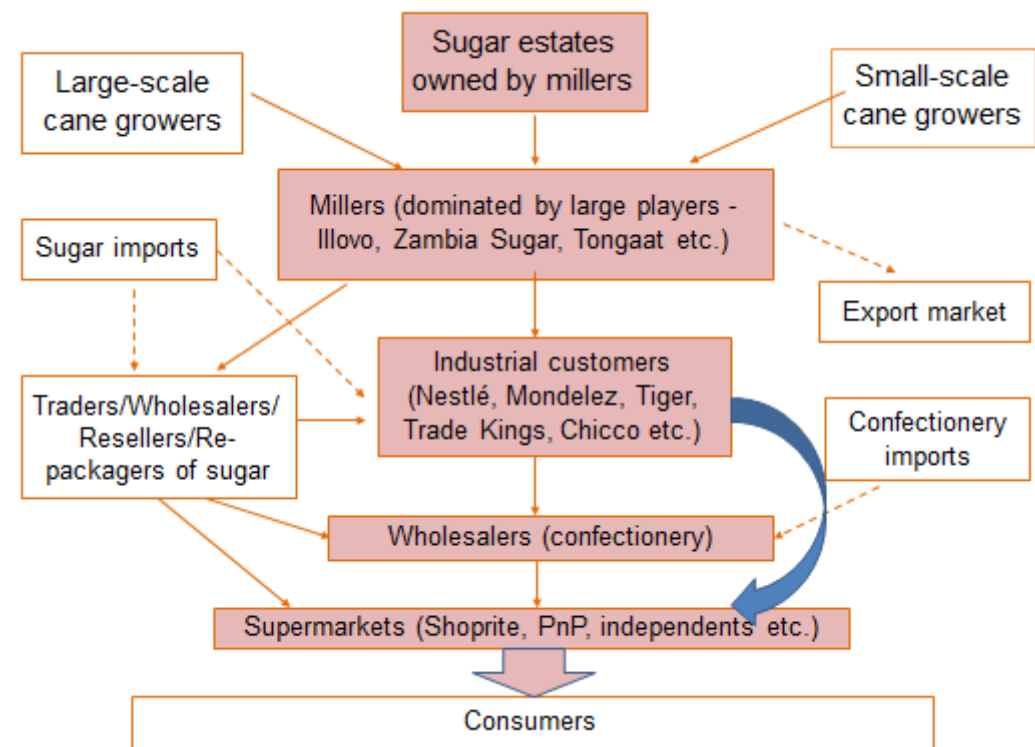
capabilities to ensure that products sell off shelves as fast as possible. This presents a barrier to small and medium-sized suppliers. However, the biggest concern is the ability for dominant supermarket chains to abuse their buyer power. Supermarkets often impose a range of other costs on suppliers through their trading terms. This is reflective of their buyer power and affects the ability of suppliers to sustainably supply supermarkets, in turn affecting their development (see das Nair and Chisoro, 2015, 2016 and 2017).

3. Mapping the sugar to confectionery value chain in South Africa and Zambia

The figure below represents the sugar to confectionery value chains in South Africa and Zambia (Figure 1Figure 1). The upstream level is the agricultural component, where sugarcane is grown. The next level involves the milling of sugarcane into sugar. This is followed by the downstream manufacture of confectionery producers who use sugar as a key input. In both countries, there is a degree of vertical integration between sugar growing and milling (discussed below). The sugarcane growing level is not focused on in detail in this study.

Generally, sugar from millers is of two grades: household grade (HH) which is sold from the millers directly to distributors, wholesalers and retailers or industrial grade which is largely used by industrial customers to produce confectioneries, biscuits, cereals, and beverages among other products. Both grades are also exported (from SA and Zambia).

Figure 1: Sugar to confectionery value chain in Zambia and South Africa



Source: Authors' own

3.1. Sugar production

The sugar industry in South Africa generates approximately R12 billion (USD806 million)³, and creates 79,000 direct jobs and 35,000 indirect jobs (SASA, 2016). There are approximately 22,500 registered sugarcane growers, with sugar being produced by 6 milling companies

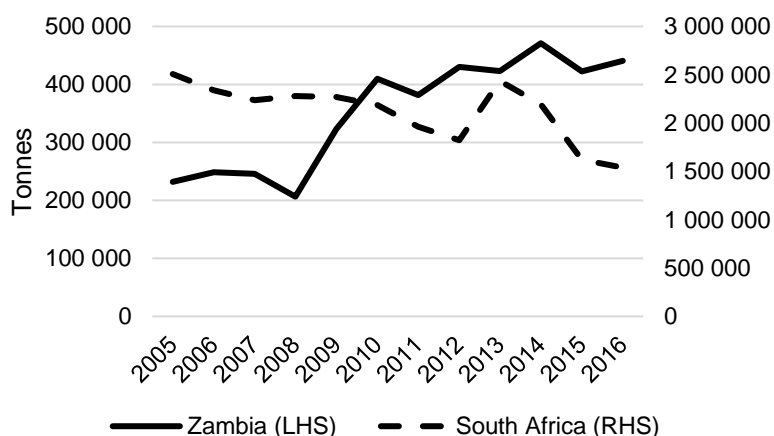
³ This figure is based on revenue/ income generated through sugar sales in both SACU and world export markets.

operating 14 sugar mills (SASA, 2015). Just over 21,000 of these sugarcane growers are small-scale growers (95% of the population of sugar growing establishments). However, 83% of the sugarcane produced in South Africa by volume is produced by large scale growers. The milling companies are also involved in upstream activities, albeit at a relatively small-scale, accounting for approximately 8% of the sugarcane grown in the country (SASA, 2015).

In contrast, the Zambian sugar industry is relatively smaller than that of South Africa in terms of revenue and employment. In terms of revenue, it generated over USD200 million in 2015. This is based on the revenue generated by Zambia Sugar, which accounts for approximately 90% of the sugar market in Zambia. The Zambian sugar industry employs approximately 10,000 people (based on the numbers of people employed at the sugar producers, including the seasonal agricultural workers) (Zambia Sugar, 2015; Sable Transport, 2016). Like South Africa, smallholders in Zambia supply a much lower proportion of sugarcane than largescale growers to millers.

Production volumes of sugar in South Africa have been relatively consistent, on average about 2.1 million tonnes between 2005 and 2016 (Figure 2). The drought reduced sugar production in South Africa to approximately 1.6 million tonnes in the 2015/16 season (SASA, 2016). In contrast, Zambia’s production has increased over the years, particularly between 2008 and 2010 (Figure 2). The average production between 2010 and 2014 is almost double that of the period between 2005 and 2008. However, Zambia’s production still lags far behind that of South Africa.

Figure 2: Sugar production (tonnes/annum) in Zambia and South Africa



Source: Compiled from SASA; FAOSTAT and CSO

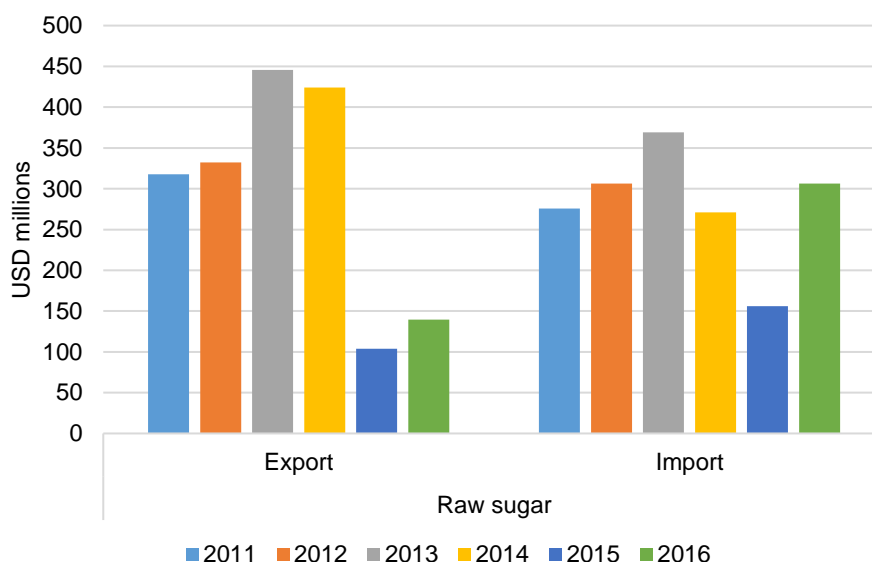
3.2. Trade of sugar

South Africa and Zambia are both net exporters of raw sugar products, as Figure 3 and Figure 4 show. South Africa has however imported significant amounts of sugar between 2011 and 2013, after which there was a decline before increasing again in 2016. Between 2013 and 2015, sugar imports into South Africa decreased by 51% (Figure 3). This is primarily because of the import tariff which kicked in around this time. Although data for 2017 is not yet available, industry experts suggest that imports again started increasing particularly in January 2017 given the strengthening of the Rand.

Exports of raw sugar decreased between 2013 and 2015, with a steep decrease in 2015. Between 2014 and 2015, sugar exports decreased by USD320 million. Namibia, Mozambique and Botswana are key export markets for South African sugar, while Swaziland and Brazil are

key sources for South Africa's sugar imports. This decrease in exports can be attributed to the drought and lower production given less investment in sugarcane growing by farmers. Furthermore, small scale growers lack the capital to invest in planting, management and equipment and they do not have the collateral to borrow funds, affecting their yields. Exports however picked up (by 34%) in 2016.

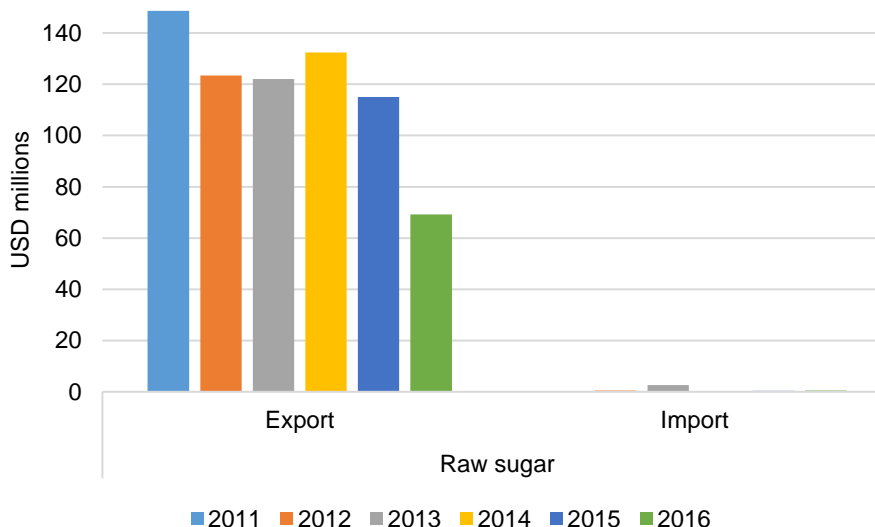
Figure 3: Sugar trade, SA (USD millions)



Source: Comtrade

The extent of Zambia's net exports is a reflection of its position as a low-cost producer of sugar. The largest export destination was the DRC, a very significant market for Zambian exports, followed by Mauritius (although this sugar is actually destined for Europe, with importing company domiciled in Mauritius), Kenya and South Africa. The value of exports to South Africa increased significantly between 2011 and 2014 (approximately USD5 million in 2011 to USD25 million in 2015).

Figure 4: Sugar trade, Zambia (USD millions)



Source: Comtrade.

Zambia has had almost no imports of sugar over the 6-year period considered (Figure 4 above). This is because the production levels of the three main players can more than meet local demand. Furthermore, the vitamin A fortification legislation which requires that all domestic and imported sugar meet the fortification requirement acts as an entry barrier for imports into the country. This legislation is seen by some industry participants as an NTB on imported sugar from other countries (Kalinda and Chisanga, 2013).

3.3. Trade agreements and protection in the sugar sector in the southern African region

The above import trends raise questions about why regional sugar producers such as those in Zambia and South Africa (and even Mauritius) do not meet the regional demand. Not only is there limited trade in sugar confectionery products in the region for sweet and baked confectionery (see Section 3.5), there is also limited trade in actual sugar in the region. These are questions that have previously been raised by a study undertaken by the African Competition Forum (Chisanga et al, 2016). This is despite there being regional agreements in place which are meant to encourage regional trade. However, regional and international agreements appear to have a limiting effect on intra-regional trade, and that serve to protect incumbent millers within national markets as we discuss below.

3.3.1 Policy and Regulatory Framework in South Africa

The protection for the sugar industry in South Africa by the government comes in the form of:

(i) Tariff protection

Tariff protection on sugar imports into SACU member states kicks in when the long-term average world price of sugar (adjusted for distortions in global markets like subsidies and cheap loans) drops below a given dollar-based reference price.⁴ Global increases in the sugar price since 2009 meant that this tariff did not kick in until around 2014 when the reference price was raised by the South African International Trade Administration Commission (ITAC) by 58%. This meant that importers had to start paying tariffs for the first time in over 4 years in 2014.⁵ In January 2017, the reference price was USD 566/t. The increase in the reference price was a result of heavy lobbying since 2008 of ITAC by SASA (South African Sugar Association) and the Swaziland Sugar Association (SSA). A concern with this type of tariff protection is that it only holds for a point in time. Changes in global production and exchange rate fluctuations in theory would require more frequent adjustments. A key point of contention is that tariff just serves to protect and benefit the millers upstream who continued to report robust profits.

(ii) The SADC Sugar Co-operation Agreement

This agreement attempts to facilitate a more integrated regional market for sugar and a higher level of co-operation between member states, with the stated aim of improving the competitiveness of the region's sugar producers, as well as promoting sugar containing products. The agreement allows for partial access of the SACU market for SADC surplus sugar producers. This partial access is in the form of import quotas governed by a formula that allocates access based on the size of each country's surplus sugar production, and the level of market growth in SACU (see below for SA). The rationale is to offer non-SACU surplus

⁴ http://www.sasa.org.za/sugar_industry/MarketCompetitiveness.aspx; Wood, 2013;

⁵ <https://www.bloomberg.com/news/articles/2014-04-08/south-africa-sugar-fee-raise-means-first-import-duty-in-4-years>

producers (Malawi, Mauritius, Mozambique, Tanzania, Zambia and Zimbabwe) the chance to export some level of duty-free sugar to the region at higher prices than what they can get in global markets. In effect, the agreement limits the volume of sugar that SADC countries can send to South Africa duty free. Exports over this volume would attract duties.

Despite the SADC Sugar Co-operation Agreement, and other agreements, it appears that sugar-containing products or downstream confectionery producers may not be benefiting from their stated objectives, although the promotion of such industries also appears to be an explicit objective of the agreement. This is seen in the limited intra-regional trade in confectionery products.

(iii) Local and Export Quotas and Equitable Export Obligations

South African sugar exports to world markets are priced substantially below the domestic sugar price. This pricing dynamic is common in most surplus sugar producing countries. To distribute exposure to the world market equitably amongst growers and millers, a redistribution of proceeds is effected via SASA. The Sugar Act (1978) and the Sugar Industry Agreement (2000) provide regulatory support for this redistribution of proceeds.

Export quotas are managed by Sasexcor - SA Sugar Export Corporation (Proprietary) Limited. It is noted in the Sugar Industry Agreement that there is no obligation on any mill, including a sugar beet mill, to export or provide for export that quantity of sugar that is represented by its export quota allocated. However, any export volumes, over and above the local sales quotas, have to go through Sasexcor. It appears therefore that the millers cannot export independently of Sasexcor. Further, exports have to be of bulk raw sugar unless if special permission is obtained from SASA. Sasexcor is then obliged to buy the full export quota from millers at prices determined by SASA.

3.3.2 Policy and Regulatory Framework in Zambia

The regulations and strategies pertaining to the sugar sector in Zambia include:

(i) Vitamin A Fortification legislation

The Zambian government through the Ministry of Health and with the help of the U.S Agency for International Development (USAID) enacted this piece of legislation. As noted, this legislation mandates that all sugar in Zambia that is meant for direct consumption has to be fortified with Vitamin A supplements. This legislation was motivated by the need to enhance Vitamin A availability to Zambians. However, since this legislation is not universal, it makes Zambian sugar expensive compared to sugar coming from the region despite the low production costs. The legislation therefore acts as structural barrier to entry and in effect allows Zambia Sugar Plc. to maintain its quasi monopoly status by reducing competition from cheap imports (Serlemistos and Fuso, 2010).

Potential importers of sugar are also required to obtain import permits from government. However, the process is not transparent and this often leads into delays since the process has to be cleared by at least three ministries (Chisanga et al., 2016). The effect of these non-tariff barriers is evident in the negligible sugar imports as shown in Figure 4.

(ii) Zambia National Sugar Strategy (ZNSS)

Recognising the importance of the sugar industry, the Government formulated the Zambia National Sugar Strategy (ZNSS) in which the main objective was to adapt the sugar sector in response to European Union's sugar trade regime which came into effect in June 2006. The EU together with the World Trade Organisation (WTO) implemented reforms aimed at

removing artificialities in the EU sugar market that reduced sugar production and that also slashed prices by 36% over a four-year period beginning 2006/07. Owing to the sugar reforms, Zambia Sugar as of 2016 saw exports to EU reduce from 22% to 14% as it continued to focus on African regional markets, both traditional and new markets. The reforms have impacted on the sugar regimes and resulted in prices in the EU converging into global prices.

The strategy does not appear to speak to downstream sugar-containing industries at all. It is also not clear how this strategy speaks to the SADC Sugar Co-operation Agreement, if it does speak to it at all.

Other regulatory frameworks directly impacting Zambia's sugar industry include the Zambia National Export Strategy (ZNES) and the National Agricultural Policy (NAP) as well regional best practices i.e. trade guideline as stipulated in the COMESA and SADC frameworks.

There are therefore numerous agreements, policies and strategies in place in both countries to protect and grow the sugar industry as a whole. However, it needs to be questioned whether these policies benefit downstream sugar confectionery industries or if they only protect sugar millers who wield considerable market power and are strong lobbyists. Further, there is a challenge of policy harmonisation both within countries and among SADC member countries given a complex matrix of national and regional policies.

3.4. Sugar confectionery production

Key overall trends in sugar confectionery production in South Africa

The sugar confectionery industry in South Africa generated R5.6 billion (USD414 million) in 2016 up 6% from the previous year. The categories which generated the most revenue are pastilles, gums and jellies. Boiled sweets are however a singular category, i.e. does not have a number of different types of sugar confectioneries combined into one category. As such, among singular categories, boiled sweets bring in the highest revenue.

The production volumes of sweets by category yield similar results with pastilles, gums and jellies yielding the highest production volumes in 2016 (22 000 tonnes), followed by boiled sweets (15 000 tonnes) (Euromonitor International, 2016). The growth in the pastilles, gums and jellies category could be explained by investments into that category. For instance, Tiger Consumer Brands opened a R160 million gums and jellies plant in Durban in 2014 (Euromonitor International, 2015a).

Key overall trends in baked confectionery (biscuits) production in South Africa

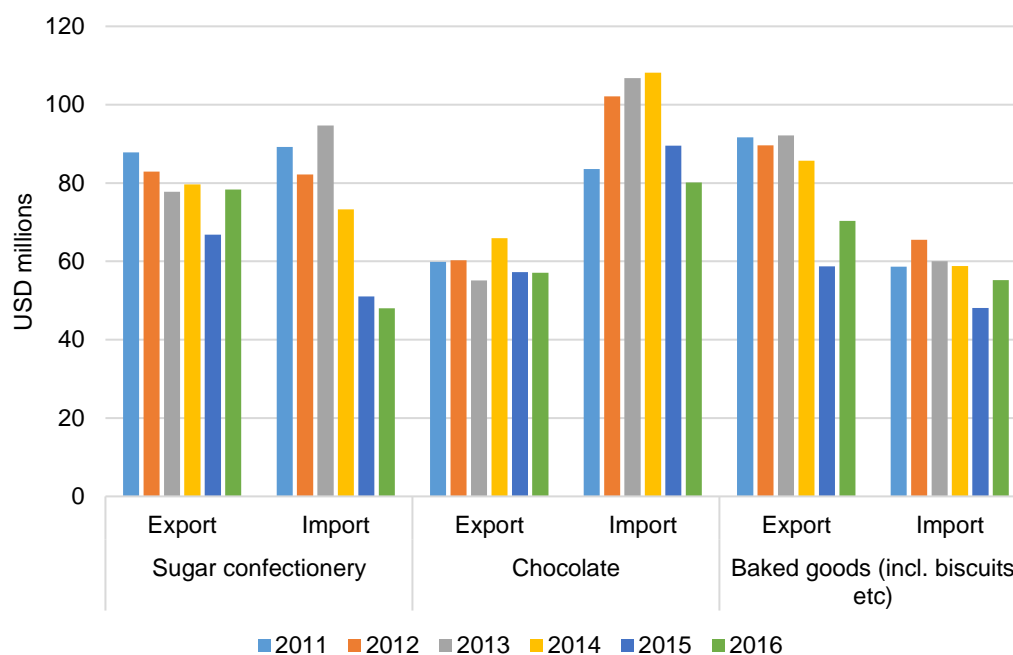
Biscuit revenue has almost doubled between 2010 and 2015, with an increase of just over R2.5 billion to R4.8 billion (USD330 million). Biscuits are split between sweet and savoury biscuits, with the former making up over three-quarters of revenue in the biscuits segment. Of the sweet biscuits, the largest category by far is the plain biscuits category, which makes up just over 75% of the sweet biscuits category. Similar trends are found when assessing the various biscuit categories in terms of volumes. Sweet biscuits (78 000 tonnes), particularly plain biscuits, make up the bulk of the biscuit volumes produced, compared to 7 000 tonnes for savoury biscuits (Euromonitor International 2016).

3.5. Trade of sugar and baked confectioneries

Trade data for sugar and baked confectionery products indicate that South Africa has almost balanced trade in sugar confectionery, a trade deficit in chocolate, and a trade surplus in baked goods (Figure 5). Traded sugar confectionery products include sweet and chewing gum, while traded baked goods encompass bread and biscuits. Trade of baked goods for South Africa

show that the top 8 export destinations are all in southern Africa, with Namibia and Botswana making up just under 40% of all exports. Most of these exports are of sweet biscuits.

Figure 5: Sugar and baked confectionery trade, SA (USD millions)

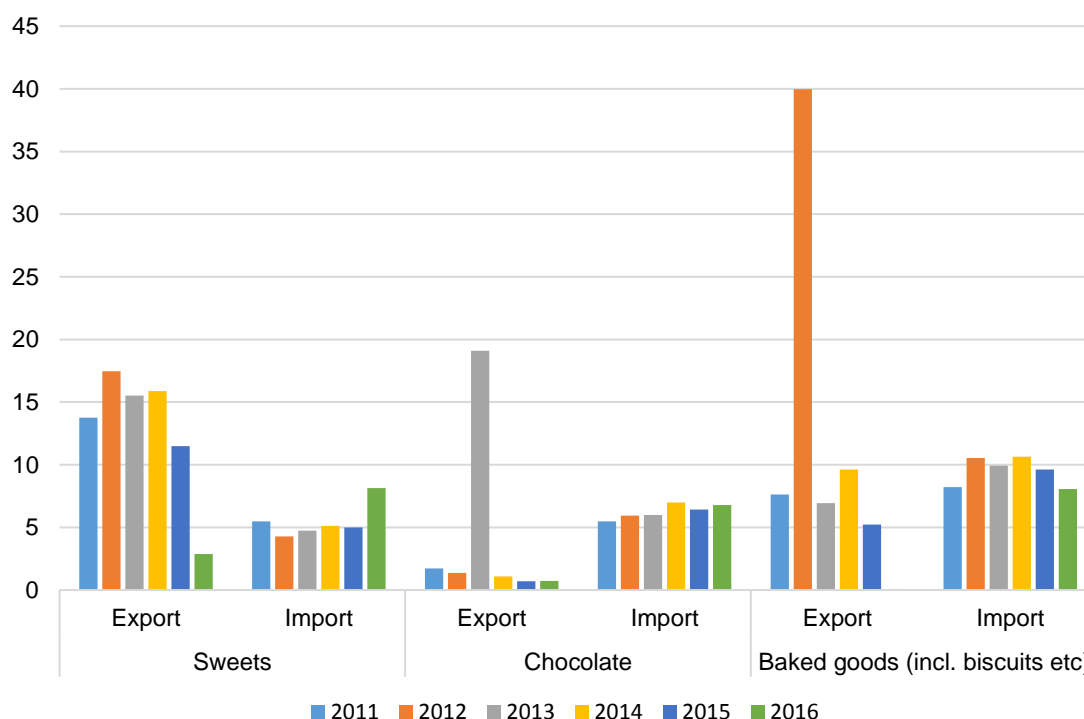


Source: Comtrade

South Africa's main import sources for sugar confectionery products are Switzerland and Swaziland as reflected in the extensive imports of chewing gum from Switzerland and of both chewing gum and sweets from Swaziland between 2011 and 2015. As with baked confectionery goods, South Africa's main destination for sugar confectionery exports is within the region.

On the other hand, Zambia's confectionery trade is at far lower levels than that of South Africa, although there are net exports of sugar confectionery (Figure 6). Zambia has been a net exporter of sugar confectionery products throughout the period 2011 to 2014. For baked goods, barring the outlier in 2012, Zambia is a net importer. It is unclear at this stage what the 2012 once-off spike in exports of baked goods and the 2013 once-off spike in chocolates are attributed to, or whether these are data errors.

Figure 6: Sugar and baked confectionery trade, Zambia (USD millions)



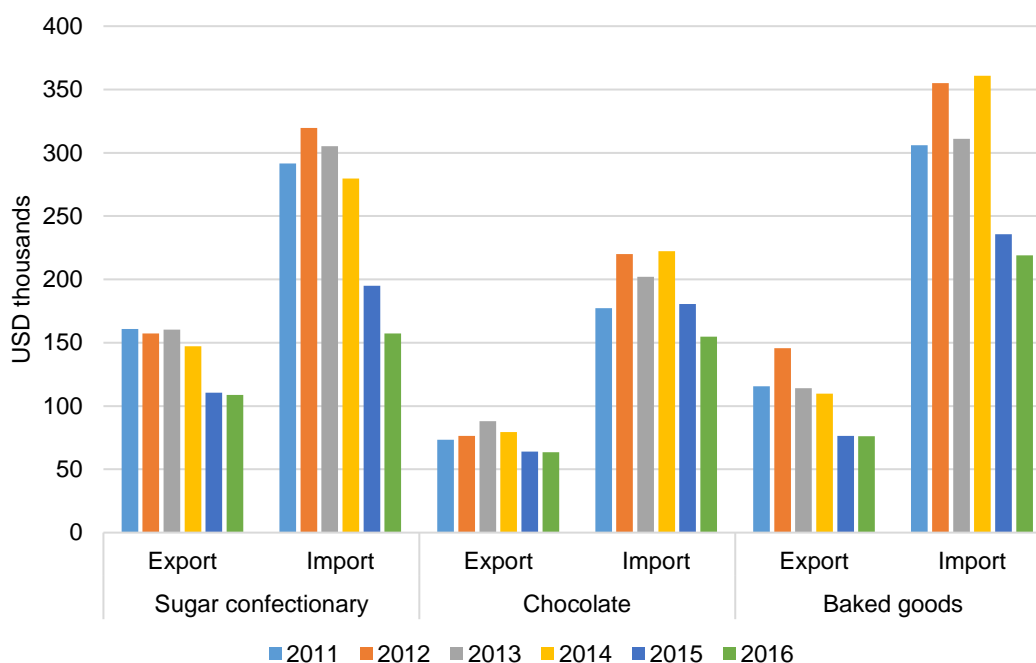
Source: Comtrade.

Note: Trade values for 2016 in USD millions for Zambia are mirror data.

In 2014, over 98% of Zambia's exports of sugar confectionery products were to Zimbabwe, DRC and Malawi, with Zimbabwe alone accounting for over 50% of these exports. This indicates strong demand for Zambian sugar confectionery products in the region.

The SADC region as a whole however is a net importer of confectionery goods. In 2016, the trade deficit was USD48 million (see Figure 7). Although this is a decrease from USD162 million in 2012, there is a potential opportunity for the region to replace deep sea imports, particularly those from China and Brazil (highlighted in Table 1), which have been key import markets for SADC, even relative to countries like Zambia. On average between 2011 and 2016, top export markets for trade in sugar confectionery for the SADC region were South Africa, Namibia, the Congo, Angola and Botswana, further emphasising the existence of a large market for sugar confectionery products within the region. Exports to these countries have however decreased particularly between 2014 and 2015.

Figure 7: SADC sugar confectionery trade (USD thousands)



Source: Trademap

Note: SADC trade value for 2016 in USD thousands includes mirror data for The Congo, Namibia, Angola, Tanzania, Swaziland, Zambia, Malawi, Seychelles and Lesotho.

Table 1: SADC, top non-SADC import sources for sugar confectionery

Country	Average (USD) value (2011-2015)
South Africa	79,323,000
Swaziland	29,215,000
China	24,195,000
Brazil	18,029,000
Kenya	17,848,000
Botswana	13,322,000
Zambia	13,141,000

Source: Trademap

However, there are challenges which exist in trading of confectionery within the SADC region. High duties are an obstacle for trade in exports to Zimbabwe, Mozambique and Malawi, and despite SADC trade agreements, these countries have national protectionist measures in place. For instance, import duties on sweet products can be up to 40% in Zimbabwe.

4. Assessment of the growth and development of sugar and confectionery producers

In the in-depth study, we assessed the growth and performance of both sugar millers and confectionery producers in each country. The details of the growth and performance of the sugar millers are not discussed further in this paper given that the focus for present purposes is on downstream confectionery producers. However, it is important to note that the large sugar millers in both countries have made significant investments in refining and storage

capacity suggesting that they are benefiting from the protection offered nationally and in the region despite the drought, imports and other negative economic and global conditions. Large millers like Zambia Sugar continue to contribute strongly to group profits and concerns arise whether this is at the expense of downstream industry.

The growth and performance of downstream confectionery producers in both countries is evaluated below from the primary data collected through interviews and from secondary data from public sources.

As previously noted, the South African confectionery production industry is mostly made up of large local and international multinational firms. The biscuits sector is dominated by one single player - AVI's National Brands which in the last 5 years has controlled over 45% market share (Euromonitor International, 2016). The company's baker biscuit brand has the highest market share of about 22%. The second largest player is the Pioneer Foods group which has seen significant declines in its market share since 2015. This is as a result of Pioneer selling off its biscuit brand. Recently, the industry has also seen significant new investments from three international players - Mondelez International, Trade Kings and Aldor. These firms have subsequently set up a production plants in South Africa and have seen their market share rise marginally in comparison to the other players. This is a clear indication of their capabilities to compete in foreign markets.

However, in the case for Zambia, sweets and confectionery industry has for a long time been dominated by imports from South Africa and the sub-region. With the slowing of the manufacturing industry in the 80s and 90s, most firms which were producing sweets and confectionery products either relocated to other countries in the region or closed down due to high production costs which ensued after the collapse of the Zambian economy in the 80s. As a result, the gap created by these manufacturing firms was filled up by imports mainly coming through regional supermarkets which had started expanding into Zambia. In addition, a good number of sweets and confectionery products found themselves on the market through direct imports by small Zambian firms that wanted to take advantage of the void. Nonetheless, the last two decades has again seen the rise of local firms expanding in this sector predominantly led by Trade Kings and a few others small to medium-sized firms. As noted, these firms exhibit strong capabilities and are able to export products into the region and most of their products are 'retail ready' in terms of meeting supermarket standards

Most medium to large regional confectionery producers are investing in South Africa which is seen as a gateway for most regional players and this has subsequently encouraged investment in the country. Investments have been made in plant and machinery, new flavours, packaging, accreditations such as HACCP and FSSC 22000 to signal quality and gain acceptance by supermarkets, and training, amongst others. Likewise, most if not all of these producers have also invested in barcodes which is an additional demand by retailers.

However, confectionery producers in both South Africa and Zambia face a range of barriers to expansion. The industry in both countries has seen considerable competition in cheap, hard candy which is the main product for most of the producers in the industry. Cheap imports from South America and Spain in the case for South Africa make it very difficult for local suppliers to compete favourably due to high production costs. Gums and jellies from India and Turkey are also imported into South Africa at increasing rates. It was also alleged that imported sweets from Colombia, Brazil and Thailand did not have to comply with local packaging regulations.

In Zambia, the large constraint facing producers in the confectionery sector is the constant electricity supply power cuts which affect all players in the sugar to confectionery value chain.

This has contributed to the high sweets and confectionery costs in Zambia. Other constraints include high transport and distribution costs. Related to this is the difficulty in running double shifts given the lack of public transport in both countries. The costs of advertising to build brand awareness and high labour costs/inflexible labour are also significant.

5. Concerns around pricing of sugar and relationship with sugar millers

The pricing of sugar is a contentious issue in both South Africa and Zambia. In Zambia, the concerns around pricing stem from allegations of excessive pricing by the quasi-monopoly supplier of sugar – Zambia Sugar. In South Africa, the concerns around pricing stem from the complex regulatory framework governed broadly by the Sugar Act in conjunction with the trade agreements discussed above.

(i) Pricing in South Africa and relationship with suppliers

The Sugar Act of 1978 in South Africa provides for setting of the sugarcane price, and not directly for the setting of the sugar price. While the Sugar Act provides for the general structure and principles, and the general framework, it is the Sugar Industry Agreement of 2000 that provides details on pricing mechanisms.

The cane price is jointly determined through the Division of Proceeds (DoP) formula. The DoP is essentially a pool of proceeds made up of the weighted average of revenues from local sales of white, brown and exported sugar. These proceeds are pooled and shared between millers and growers in a predetermined (roughly 64:36) ratio split between growers and millers, with growers entitled to the 64%. The justification for the DoP method is to protect growers, who otherwise would be subjected to very low global sugar prices forcing down the price of their cane. The funds for growers/farmers from the DoP allocation go through the Sugar Farmers' Association. The operation of the DoP requires a considerable amount of current and future projected information to be exchanged through SASA.

The individual millers then set sugar prices to industrial customers based on average industry costs⁶ at their own discretion, allowing for rebates, discounts and different packaging formats for different customers (retail and big industrial customers). The local price is allegedly typically around 5-8% above prices of imports according to one interview source.

The final sugar price to industrial users is therefore not legislated and, in theory, is open to competition. However, given a regulated cane price and a well understood framework, the regulatory mechanism appears to inadvertently enable the millers to collectively set the final selling price for sugar around a range. This is exacerbated by a provision in the Sugar Industry Agreement of 2000 which allows for a more direct mechanism for millers to coordinate around a focal point called the 'notional price'.⁷ The notional local market price⁸ refers to the notional price attributed to local market brown sugar, refined sugar and molasses, respectively, determined by SASA for the purpose of backwardly determining the DoP. A study by the African Competition Forum (ACF) describes this notional price as being set given input from producers and growers (Chisanga et al., 2016). While millers are not obligated to their own final prices at this value, prices tend to fluctuate around this.

⁶ Including the cane price, which is the most significant component.

⁷ Sugar Industry Agreement, Chapter 6: Determination and Distribution of Proceeds and cane prices

⁸ 'Local market' means the geographical area falling within the borders of the Republic of South Africa and the states of Swaziland, Namibia, Lesotho and Botswana.

The supply of sugar (and glucose, another key input) is either directly from millers or from traders/distributors who buy from millers and on-sell to manufacturers. However, given the relatively small volumes of sugar required by smaller producers, these producers procure their sugar requirements from sugar distributors such as Sugar on Tap, Royal Rice and Akila group.

Negotiations on contractual agreements with suppliers are generally skewed towards the sugar mills as they have more leverage, especially against the smaller producers. It is typically difficult to secure discounts. The payment terms are generally very strictly within 7 days, although some players have been able to negotiate payment terms up to 15 days or even a month, depending on the supplier. Large sweets and confectionery producers with more negotiating power and large offtake commitments typically have fixed price annual contracts.

In terms of local sugar price increases to industrial customers, ordinarily, there is an annual sugar price increase around February/March, which in 2016 was approximately between 12 and 14%. However, given the global shortage of sugar and the drought, there was a further price increase in June/July in 2016 which brought the total price increase for the year to approximately 30%, placing considerable strain on producers.

(ii) Pricing in Zambia and relationship with suppliers

Although Zambia is a low-cost producer of sugar according to LMC International rankings, domestic sugar prices are still very high (CUTS, 2014) and rising, and are above other African countries with higher costs as shown in the ACF study. Various reasons have been suggested including high internal marketing costs, the requirement to fortify sugar with Vitamin A creating barriers to cheaper imports and the exercise of market power by Zambia Sugar (Chisanga et al., 2014a). While country-specific factors such as high transport costs may affect prices in Zambia, the prevailing high domestic prices of sugar given the country's relatively low production cost signals potential competition concerns (Ellis et al., 2010).

Despite some market entry in the past two decades by two small millers, Zambia Sugar continues to dominate the production of sugar. The entry of Kafue and Kalungwishi sugar have not affected the dominance of Zambia Sugar given their much smaller sizes and quality and capacity constraints (even with the support to Kafue Sugar from Shoprite). This dominance is exacerbated by protection from outside competition by NTBs (Vit. A fortification and import permits through a bureaucratic and non-transparent system).

Confectionery producers highlight the extent of the concern around the pricing of sugar from Zambia Sugar. As previously noted, the high cost of sugar in Zambia led Trade Kings Zambia considering relocating some of their sweets production facilities to Zimbabwe where the cost of Brazilian imported sugar is said to be three times cheaper than the cost in Zambia. As a result, the company is able to produce its products in Zimbabwe at a lower cost and then ship the goods into Zambia for sale. The price of sugar in Zambia also contributed to the lack of profitability for Zambian products in South African motivating setting up the plant in South Africa, in addition to wanting better access to regional markets. Trade Kings is also of the view that the fortification requirement is a way to further protect the market in favour of Zambia Sugar.⁹ Also as noted above, the high costs of sugar were also a concern to the other main confectionery producers in Zambia who highlighted the difficulty in negotiating with Zambia Sugar and the lack of profitability in selling to other countries in the region due to the high sugar price from Zambia Sugar. According to one producer, Zambia Sugar has high overhead costs and this is passed on to customers.

⁹ They also cited Guatemala as the only other country to have adopted such a policy.

The high profitability of Zambia Sugar¹⁰ further raises questions about whether its pricing is exploitative of downstream customers. Currently, sugar pricing is the subject of an investigation by the Competition and Consumer Protection Commission of Zambia (CCPC).

6. Routes to market and relationship with wholesalers and retailers

6.1 Routes to Market - South Africa

The distribution of sugar confectionery products in South Africa is largely through store-based retailing, with grocery retailers, mainly supermarkets followed by independent retailers being the main route to market for sugar confectionery products (Table 2 below). The distribution profile has not changed much between 2010 and 2015, with each channel maintaining similar shares during the period. It is important to note that independent small grocers, convenience stores and other grocery retailers are all, collectively, independent retailers. As such, when assessed collectively, they are a significant route to market.

Table 2: Distribution of sugar confectionery by type of retailer (% shares)

Outlets	2010	2011	2012	2013	2014	2015
Store-Based Retailing	98.60	98.60	98.70	98.60	98.60	98.50
(1) Grocery Retailers	83.70	83.70	83.30	83.20	83.10	82.60
<i>Supermarkets</i>	46.00	46.40	46.00	46.00	46.00	45.50
<i>Independent Small Grocers</i>	14.80	14.80	14.80	14.80	14.60	14.50
<i>Convenience Stores</i>	5.00	5.00	5.00	5.10	5.20	5.30
<i>Forecourt Retailers</i>	6.10	6.00	5.90	5.80	5.80	5.80
<i>Other grocery retailers</i>	11.8	11.5	11.6	11.5	11.5	11.5
(2) Non-Grocery Specialists	3.90	3.70	4.10	4.00	4.00	4.20
Mixed Retailers	11.00	11.20	11.30	11.50	11.50	11.80
Non-Store Retailing	1.40	1.40	1.40	1.40	1.40	1.50
Total	100.00	100.00	100.00	100.00	100.00	100.00

Source: Euromonitor International (2015b)

In South Africa, sweets produced by small and medium-sized producers (hard candy such as lollipops and hard boiled sweets) are mainly sold to wholesalers (around 90%) who on-sell to the informal market either via independent retailers, spaza shops, or hawkers. This is the dominant route to market for small to medium-sized sweets producers in South Africa, with only large producers accessing markets via formal supermarkets.

Producers are constantly making efforts to penetrate the retail market. However, the requirements to get into the retail channel have generally been too onerous for small to medium-sized producers. For example, these can include rebates (ranging between 12% to 20% on average off the price suppliers can get), stock and merchandising costs (around 4%), promotion fees (around 3%), returns given their perishable nature (around 10%) and listing or support fees (can be approximately R100,000 to R200,000 for a single stock keeping unit). Listing fees for lollipops can range from R250,000 to R300,000 for till positions for 6 months for inland supermarkets only. Other fees include advertising and promotional rebates. Long payment periods to small suppliers also negatively affect their cash flow.

It appears easier for suppliers to supply franchise stores such as SPAR stores because the franchisees have more leeway regarding the manner in which they run their businesses, including the choice of products on their shelves. Non-standardised private standards across supermarkets further make it difficult for suppliers to invest in equipment that can supply all supermarket chains. One producer estimated that the costs of accreditations can be up to

¹⁰ This is assessed in the in-depth study using Zambia Sugar annual reports

R2million, with R100,000 per annum to maintain. As noted previously, some producers have nonetheless invested in HACCP (food safety) certification (and a further investment into ISO quality standards by one producer) knowing that this given them greater opportunity to enter the retail space and to export. It was noted though that HACCP is not a legal requirement but a voluntary standard although supermarkets sometimes insist on suppliers having this certification. Larger confectionery producers also agree that retail chains have onerous requirements. As with the sweets, store-based retailing is the main route to market for biscuits in South Africa.

Confined-label or house brands (where the retailer does not own the brand, unlike a private label) offer opportunities for local producers of sweets and biscuits. However, it appears from our fieldwork that supermarkets are not loyal when it comes to these agreements. For example, it was reported that supermarkets can unilaterally decide that they no longer want the product, or they can switch suppliers at short notice. As such supermarkets tend not to enter into long-term agreements where house brands are concerned.

6.2 Routes to Market – Zambia

Aside from supermarkets and wholesale distribution networks, most small to medium Zambian suppliers use alternative routes to markets through independent groceries, convenience grocers and other retailers.

Among the challenges local suppliers face in integrating into the supermarket value chains is the level at which procurement decisions are made in Zambia. Store managers do not have the discretion in selecting local suppliers for corporate stores. This is almost exclusively the decision of top management at head office, often located in South Africa. In contrast, supermarkets operating as franchises have more flexibility regarding decisions on suppliers. Therefore, like in South Africa, it is easier to start supplying chains like SPAR which operate several franchise shops in Zambia.

Furthermore, in addition to legal requirements stipulated by ZABS and other regulatory bodies, supermarkets impose additional private standards not mandated by law that domestic firms are expected to fulfil in order to be able to supply them. This calls upon the local firms to invest in modern machinery and new production techniques in order to access supermarket chains. In Zambia, other demands by supermarkets include: possession of barcodes for goods supplied for inventory and sales records purposes; allocation of a marketing budget for the promotion of the firm's goods; hire of merchandisers to man the firm's shelf space in the store; arrangement of firm's own transport logistics when supplying goods; and for some supermarkets, ability to supply a certain minimum number of stores in the country. These demands impose costs on local firms and they require capital injections to invest in these requirements.

Evidence from Zambian's small-to-medium confectionery firms revealed that the most common reasons for not supplying were the long credit period imposed by supermarkets for payments of their products supplied (an average of 30 – 45 days p). This poses a cashflow challenge as their working capital is held up by the supermarket chains. The conditions of selling to wholesalers is often much less onerous. The growing popularity of private labels, which are often imported, are also crowding out local suppliers.

7. Conclusions and policy recommendations

It is clear that despite having a clear advantage in sugar production, Zambia, South Africa and the SADC region as a whole are net importers of sugar confectionery products (sweets and biscuits). There are opportunities to develop confectionery producers in the region to reduce the trade deficit and recent investments in both Zambia and South Africa highlight these opportunities. However, the research has revealed several challenges faced by confectionery producers in each country, particularly small to medium-sized producers. Therefore, we propose the following policy interventions to increase the levels of production and exports in the sugar confectionery sector in both countries.¹¹

(i) Pricing of input sugar

While both South Africa and Zambia enjoy an advantage in sugar production, the price of sugar remains relatively high in both countries which make it difficult for local confectionery producers to compete with finished imports of confectionery products. The upstream level of the value chain in both South Africa and Zambia is highly concentrated, particularly in the production of industrial sugar. In Zambia, the sugar price is essentially set by monopoly player, Zambia Sugar Plc. There is no regulation that governs the setting of the sugar price. However, regulation in place in terms of vitamin A fortification and onerous import permit requirements serve to maintain the dominant position of Zambia Sugar. Of serious concern is the impact on downstream confectionery industry of uncompetitively priced input sugar.

On the contrary, the setting of sugar prices in South Africa is more complex than in Zambia given the regulatory framework that sets the sugarcane price. The combined result of the regulation is that the sugar price downstream is in effect 'controlled'. The time-to-time setting of the 'notional local market price' for sugar for purposes of backwardly deriving the cane price through the Division of Proceeds mechanism creates a focal point for millers to coordinate prices around.

While the legislation offers protection to sugar millers and sugar cane growers, it appears that its impact on downstream industries in the region has never been evaluated. It is therefore recommended that a cost-benefit analysis be undertaken to evaluate the overall impact of the legislation and regulations in the region throughout the value chain, including the downstream industry. This needs to be done to see if they collectively speak to a common goal for the region. While it is accepted that sugar cane growers and millers in the region are vulnerable to low world sugar prices that result from the heavy subsidies given to producers in countries like Brazil and India (and this is often the ostensible rationale for the significant protection afforded to the sugar industry by respective national governments) the combined impact of such protection on downstream industry needs to be assessed.

(ii) Access to markets/routes to market

Another area for intervention is with respect to access to markets for confectionery producers. As shown, store-based retailing is an important route to market for producers of sweets and biscuits. Particularly for small and medium-sized producers, the large supermarket chains are currently not a sustainable route to market and majority of their sales are to wholesalers who on-sell to independent retailers. This research revealed several reasons for this, but the overarching, unanimous sentiment is that the large supermarket chains are very difficult to

¹¹ For recommendations pertaining to the sugar milling level of the value chain, see the in-depth study. These include recommendations around alternative uses for sugar cane, such as in the co-generation of electricity or ethanol production. Other recommendations around general concerns raised and that require country-specific responses can be found in the in-depth study.

access and deal with. Given their considerable buyer power over small and medium sized producers, it is hard to negotiate favourable terms for producers. Supplying supermarkets also comes at additional costs which squeeze supplier margins and make them uncompetitive against imports.

We recommend that a regional code of conduct be implemented at SADC level. Such a code would govern the relationship between suppliers and supermarkets given that it is essentially the same supermarkets that operate in the region, a common code could be developed and adopted for SADC. This could be a voluntary or mandatory code of conduct. If mandatory, further considerations of which body would oversee and enforce this code would need to be had.

While a code of conduct could assist in reducing abuses in buyer power, it cannot ensure that suppliers with potential in the region can easily access supermarket shelves, especially that of South African supermarkets. Our research has shown that confectionery producers in Zambia show clear potential to sell to supermarkets in the region. Indeed, a few Zambian firms are already 'retail ready', and perhaps with some support in marketing, packaging and merchandising, these firms will be ready to supply regional supermarket chains. An agreement with South African supermarkets to 'open up' a jointly determined proportion of shelf space on sustainable terms to these producers in stores in the region would provide a much larger route to market for these suppliers. From a SADC perspective, this could reduce the trade deficit for confectionery products while stimulating industrial development in the region. This requires a mind-shift by supermarkets. While growing current sales is often a supermarket's primary objective, encouraging the growth of local suppliers, even if their products are not initially the fastest selling products in the category, has long-term benefits and positive spillovers even for the supermarket industry.

(iii) Developing capabilities and capacity

From the supermarkets' perspective, smaller producers and producers in countries outside South Africa have limited capability and capacity to sustainably supply all stores in a chain. Given the importance of maintaining availability and consistency across stores, as well as the reputation of the chain, this is a valid concern.

Policy intervention in this regard requires commitment from both government and supermarket chains to build capacity of suppliers. For instance, a bilateral agreement could be reached between the South African and Zambian government to create a centre of excellence in Zambia to assist small to medium confectionery producers to develop their packaging, branding, marketing and merchandising capabilities. Supermarkets, with the assistance and possible matching of funding from government, could embark on targeted supplier development programmes to build these capabilities for small to medium-sized confectionery producers in both countries.

(iv) Harmonisation of standards in the region

A major stumbling block for non-South African producers in supplying supermarket chains with confectionery products in South Africa (and in other countries outside their home country) is the non-harmonisation of standards across the region. National standards such as South African Bureau of Standards (SABS) and the Zambia Bureau of Standards (ZABS) are not harmonised, and this means that South African supermarkets don't see Zambian products bearing a ZABS stamp as being of the same quality as products bearing the SABS stamp. As highlighted, there are problems faced by ZABS in terms of management and the costs and delays in obtaining standards. These costs, and the perception that ZABS and SABS are not

on par, result in difficulties for Zambian confectionery producers to get their products on supermarket shelves in South Africa.

We propose a harmonisation of standards across the region. In Zambia, ZABS sets the barest international minimum standards to accommodate the profile of domestic firms in Zambia that cannot afford to meet higher standards. Therefore, ZABS needs to enhance the mandatory standards in order to bring them to par with regional and international standards. This can be done in a phased manner for different categories of supermarket products over time, focusing first on products in which non-South African producers are exhibiting capabilities and in which there is growing intra-regional trade. This will increase the competitiveness of Zambian products and ease entry into supermarkets regionally.¹²

(v) Access to development finance

In Zambia, in particular, access to finance for growth and development is severe with commercial banks not being a viable source of finance for businesses. This is the case given the high interest rates of between 30 to 40% charged by these banks and the lack of collateral demanded by the financial organisations.

While the Zambian Development Agency (ZDA) has funding available for export promotion and enterprise development, the impact of the use of funds in the recent past has not been very positive. The Industrial Development Corporation of Zambia (IDCZ) can also potentially provide development finance to the sugar value chain in Zambia. However, it is still relatively new (incorporated in 2014) and is yet to build a strong portfolio of investments and expertise. There is potential for the IDC of South Africa to collaborate with the IDCZ (and potentially the ZDA) to build capacity. This could mean collaborating in pooling resources and seeking of funds from potential investors for the sugar value chain.

¹² The East African Community provides a good benchmark in this regard. It has harmonised standards across for six of the top 20 most traded products in the region, and is pushing for the harmonisation of the most traded products.

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