

GROCERY RETAIL SECTOR MARKET INQUIRY

TERMS OF REFERENCE

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1 INTRODUCTION

- 1.1 The Competition Commission (“the Commission”) will conduct a market inquiry to understand the general state of competition in the grocery retail sector (“the Grocery Retail Sector Inquiry”).
- 1.2 The purpose of the market inquiry is to examine whether there are features or a combination of features in the grocery retail sector which prevents, distorts or restricts competition and/or to achieve the purposes of the Competition Act, No. 89 of 1998 (as amended) (“the Act”).
- 1.3 This Terms of Reference (“ToR”) is published in terms of section 43B(2) of the Act read together with section 43B(4). In terms of section 43B(2) of the Act, the Commission must publish a notice in the Government Gazette announcing the establishment of the market inquiry at least 20 business days before the inquiry commences, “*setting out the terms of reference for the market inquiry and inviting members of the public to provide information to the market inquiry*”. In terms of section 43B(4) of the Act, the ToR “*must include, at minimum, a statement of the scope of the inquiry, and the time within which it is expected to be completed*”. In accordance with these provisions, this ToR sets out the scope of the Grocery Retail Sector Inquiry, as well as the expected timeline for the inquiry.
- 1.4 The ToR proceeds as follows: section 2 outlines the legal basis for the market inquiry; section 3 provides the background to the market inquiry; section 4 sets out the scope of the market inquiry; and section 5 outlines the market inquiry process and timelines.

2 LEGAL BASIS FOR THE MARKET INQUIRY

- 2.1 This market inquiry is initiated in terms of Chapter 4A¹ of the Act and in keeping with the purpose and functions of the Commission as set out in sections 2 and 21 of the Act respectively. Section 21 of the Act calls on the Commission to *inter alia*, “*implement measures to increase market transparency.*”
- 2.2 In order to fulfil these functions, and in line with the purpose of the Act, Chapter 4A of the Act enables the Commission to conduct market inquiries in respect of the “*general state of*

¹ Chapter 4A of the Act, which introduces the powers to conduct market inquiries, came into effect on 01 April 2013.

*competition in a market for particular goods or services, without necessarily referring to the conduct or activities of any particular named firm”.*² A market inquiry is thus a general investigation into the state, nature and form of competition in a market, rather than a narrow investigation of specific conduct by any particular firm.

2.3 The Commission is conducting the Grocery Retail Sector Inquiry because it has reason to believe that there are features or a combination of features in the sector that may prevent, distort or restrict competition within that market, and/or to achieve the purposes of the Act.

2.4 The purpose of the Act, as set out in Section 2 of the Act is to “*promote and maintain competition in the Republic in order –*

- (a) *to promote the efficiency, adaptability and development of the economy;*
- (b) *to provide consumers with competitive prices and product choices;*
- (c) *to promote employment and advance the social and economic welfare of South Africans;*
- (d) *to expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic;*
- (e) *to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy;*
- (f) *to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.*
- (g) *to detect and address conditions in the market for any particular goods or services, or any behaviour within such a market, that tends to prevent, restrict or distort competition in connection with the supply or acquisition of those goods or services within the Republic; and*
- (h) *to provide for consistent application of common standards and policies affecting competition within all markets and sectors of the economy.”*

2.5 Although the ToR delimits the scope of the market inquiry as currently envisaged, additional and related matters not identified herein may arise during the conduct of the inquiry. If the

² According to section 43B (1)(i) of the Act, the Commission may conduct a market inquiry if (i) it has reason to believe that any feature or combination of features of a market for any goods and services prevents, distorts or restricts competition within the market and/or (ii) to achieve the purposes of the Act.

Commission believes that the ToR should be amended in any way, either through the addition of new matters or exclusion of matters currently identified herein, the ToR may be amended in terms of section 43B (5) of the Act.

2.6 Upon completing the market inquiry, and in accordance with section 43C of the Act, the Commission:

“(1).....must publish a report of the inquiry in the Gazette, and must submit the report to the Minister³ with or without recommendations, which may include, but not limited to -

- (a) recommendations for new or amended policy, legislation or regulations; and*
- (b) recommendations to other regulatory authorities in respect of competition matters.*

(2) Section 21(3), read with the changes required by the context, applies to a report to the Minister in terms of subsection (1)⁴.

(3) On the basis of the information obtained during a market inquiry, the Competition Commission may -

- (a) initiate a complaint and enter into a consent order with any respondent, in accordance with section 49D, with or without conducting any further investigation;*
- (b) initiate a complaint against any firm for further investigation, in accordance with Part C of Chapter 5;*
- (c) initiate and refer a complaint directly to the Competition Tribunal without further investigation;*
- (d) take any other action within its powers in terms of this Act recommended in the report of the market inquiry; or*
- (e) take no further action.”*

3 BRIEF BACKGROUND TO THE MARKET INQUIRY

3.1 The four largest supermarket chains operating in South Africa, collectively account for more than 90% of the market.⁵ These firms are able to operate as grocery anchor tenants in shopping centres and malls of various sizes. Mergers and acquisitions and expansion

³ The Minister of Economic Development

⁴ Section 21(3) of the Competition Act requires the Minister to table the report in the National Assembly.

⁵ Who Owns Whom Wholesale and Retail of Food Report 2014 page 3. These estimates are also in line with market share estimates in the Barclays South African food and general retail report dated 16 July 2014, page 10.

through greenfields development of the national chains have seen greater consolidation and growth of the formal sector.

- 3.2 Since the 1990s, one of the more prominent features of the South African economy has been the evolution of the townships, peri-urban and rural areas into centres of business activity. The main driver of such a development is the burgeoning of retailers to tap into the growing low to middle income households. The increasing movement of large retailer chains into previously untapped low to middle income segments has resulted in an increase in shopping centre development in these areas.⁶
- 3.3 The movement of national supermarket chains into the townships, peri-urban and rural areas mainly through the construction of shopping centres has affected small, informal and independent retailers in a number of ways. Studies carried out in different townships in South Africa have confirmed that the number of informal businesses decreased immediately after the national supermarket chains moved into townships. For example, in a study by the Bureau of Market Research, in Soshanguve (north of Pretoria), a significant proportion of informal businesses interviewed confirmed a decrease in their business activities during the 6 month period since the opening of a shopping centre in the Soshanguve area. The study found that 75% of informal businesses located less than 1 km from the centre (or about 15 minutes walking time) reported a decline in their profits while only 36,8 % of those located between 4 and 5 km (approximately 1 hour's walk) from the centre experienced a drop in their profitability.⁷
- 3.4 Prior to 1994, small informal businesses supplied residents in these areas with groceries. Despite the importance of small informal businesses in townships, peri-urban and rural areas, they show relatively high attrition rates.⁸ A potential decline in the number of small

⁶ Ligthelm, A. (2008) The Impact of Shopping Mall Development in Township Areas on Small Township Retailers, *Bureau of Market Research, University of South Africa, SAJEMS NS 11*. Accessed at <http://www.scielo.org.za/pdf/sajems/v11n4/04.pdf> on 11/02/2015 at 21h40.

⁷ Ligthelm, A. (2008) The Impact of Shopping Mall Development in Township Areas on Small Township Retailers, *Bureau of Market Research, University of South Africa, SAJEMS NS 11*. Accessed at <http://www.scielo.org.za/pdf/sajems/v11n4/04.pdf> on 11/02/2015 at 21h40.

⁸ Ligthelm, A. (2008) The Impact of Shopping Mall Development in Township Areas on Small Township Retailers, *Bureau of Market Research, University of South Africa, SAJEMS NS 11*. Accessed at <http://www.scielo.org.za/pdf/sajems/v11n4/04.pdf> on 11/02/2015 at 21h40. In addition, a more recent article by Charman, Petersen and Piper in *Transformation* 78 (2012) ISSN 0258 – 7696 acknowledges that: “*Although no accurate data on the survival of spaza business is available, it is thought that up to 50% of new entrants are unable to sustain their businesses for longer than five years, though those that do survive have great longevity.*”

informal businesses is likely to have an adverse effect on employment, income levels and the spread of ownership in this sector.⁹

- 3.5 In addition, the Commission previously investigated the issue of long term exclusive leases and has recently noted increasing concerns relating thereto from market participants as evidenced by further complaints it received since the previous investigations.¹⁰ The complaints are broadly about the use of long term exclusive lease agreements entered into between property developers and national supermarket chains, and the role of financiers in these exclusive lease agreements as a barrier to entry and expansion. The exclusive clauses in the lease agreements may be causing distortions in the grocery retail sector. In general, the exclusive clauses restrict the landlord from leasing out space in the same shopping centre to potentially competing retailers, whether it is a retailer whose primary business is the sale of foodstuffs, a café or delicatessen which sells fresh fish or meat, grocery, fresh fish shop, butchery, bakery, liquor store or a fruit and vegetable shop. These restrictions tend to mostly affect small and independent retailers who may not be in a position to attract customers if located outside the shopping centre or mall.
- 3.6 Since the previous investigations, the Commission had embarked on advocacy efforts and has imposed conditions to the approval of mergers in the sector to persuade participants in the sector to change the practice of entering into exclusive lease agreements as by default for each new development. However, despite the Commission's efforts, the conduct persists. The Commission has identified this market inquiry as the appropriate route to address the issue of long term exclusive leases, given that these efforts have failed.
- 3.7 In general, clauses in the exclusive lease agreements may affect customers' choice in terms of product range and quality, and ultimately affect competition. Better product range and the

⁹ See Statistics South Africa (2013), Rise in informal businesses accessed at <http://www.polity.org.za/article/rise-in-informal-businesses-stats-sa-2014-08-14>. In terms of the informal sector's contribution to employment, out of the 15-million employed nationally, the informal sector employs about 1.5-million, which is 10% of the total. The number of persons running informal businesses declined from 2.3-million in 2001, to 1.1-million in 2009, and increased to 1.5m in 2013. The survey found that the main reason people started informal businesses was due to unemployment.

¹⁰(i) Mass Stores Proprietary Limited ("MassStores") vs. Shoprite Checkers Proprietary Limited ("Shoprite") and Hyprop Investments Limited ("Hyprop"); (ii) Massmart Holdings Limited vs. Shoprite Checkers (Pty) Ltd, Pick n Pay Retailers (Pty) Ltd, Spar Group; (iii) Mr SA Mahwiliri (Pick n Pay Franchisee) vs. Mr Isaac Kriel (Shopping Centre Manager); (iii) South African Property Owners Association NPC vs. Pick 'n Pay Group, Shoprite Group, Spar Group; (iv) Charles Mathebula vs. Walmart; and (v) Walter Vusimuzi Hlophe vs. Pick n Pay, Game, Shoprite Checkers, Spar.

quality of service (including pricing and promotions) can be expected to be better where there are competing retailers at the same shopping centre.

3.8 Some national supermarket chains also offer opportunities for independent businesses to participate in the grocery retail sector through franchising arrangements. Some trading conditions such as pricing, packaging and branding are largely determined by the franchisor. Most franchisees do not source supplies on their own but operate as branches of the franchisor and may also enjoy assistance in sourcing funding. They thus appear to operate at an advantage against local and independent retailers. The Commission has also noted that some of the national supermarket chains are buying back their franchised stores leading to further consolidation in the grocery retail sector.

3.9 There has also been varied performance of local and foreign national operated small informal retailers across the country – some, in particular foreign national operated retailers, have been perceived to be more successful than the others and the reasons therefore are unclear. This has led to tensions that have sparked into violence in some instances. Given the importance of the informal sector, it is important to make a deliberate effort to examine the dynamics of competition between local and foreign national operated small and independent retailers and to understand whether this may contribute to the decline in small and independent retailers in townships, peri-urban areas, rural areas and the informal economy.

4 SCOPE OF THE MARKET INQUIRY

4.1 For the purposes of this inquiry, the grocery retail sector includes all shops that predominantly sell fast-moving consumer goods (for example food, toiletries and/or liquor), whether as a wholesaler, retailer, or both. It encompasses all kinds of shops, from small informal businesses such as street traders/hawkers, spaza shops and small independent grocery stores to supermarket chains and wholesale groups/outlets.

4.2 The scope of the market inquiry will include the following:

4.2.1 The impact of the expansion, diversification and consolidation of national supermarket chains on small and independent retailers in townships, peri-urban and rural areas and the informal economy.

- 4.2.2 The impact of long term exclusive lease agreements entered into between property developers and national supermarket chains, and the role of financiers in these agreements on competition in the grocery retail sector.
 - 4.2.3 The dynamics of competition between local and foreign national operated small and independent retailers in townships, peri-urban areas, rural areas and the informal economy.
 - 4.2.4 The impact of regulations, including *inter alia* municipal town planning and by-laws on small and independent retailers in townships, peri-urban areas, rural areas and the informal economy.
 - 4.2.5 The impact of buyer groups on small and independent retailers in townships, peri-urban areas, rural areas and the informal economy.¹¹
 - 4.2.6 The impact of certain identified value chains on the operations of small and independent retailers in townships, peri-urban areas, rural areas and the informal economy.¹²
- 4.3 The market inquiry may probe, among other things, the following:
- 4.3.1 The competition dynamics in the grocery retail sector, including pricing practices, extent of consumer choice and innovation.
 - 4.3.2 The impact of franchise retailers on small and independent retailers in townships, peri-urban areas, rural areas and the informal economy.
 - 4.3.3 The causes and impact of the decline in small and independent retailers in townships, peri-urban areas, rural areas, and the informal economy.
 - 4.3.4 Other issues of public interest and consumer harm in the grocery retail sector.

¹¹ For the purposes of this inquiry, buyer groups refer to the cooperation between buyers upon price, product diversity, quality, technological improvement or other factors. This definition is in line with the definition of buyer groups used by the Office of Fair Trading ("OFT") in a 2007 economic discussion paper entitled "*The competitive effects of buyer groups*", prepared for the OFT by RBB Economics LLP, available at www.of.gov.uk

¹² The specific value chains to be assessed will be identified during the course of the inquiry.

5 MARKET INQUIRY PROCESS AND TIMELINES

- 5.1 The inquiry will be carried out by a panel of experts in the subject matter assisted by a technical team made up mostly by the staff of the Commission and/or consultants as required.
- 5.2 Without limiting the inquiry panel's methodology, the methods that may be used for gathering information may include the following:
 - 5.2.1 Questionnaires and surveys to identified participants and/or to the general public.
 - 5.2.2 Information requests to particular market participants.
 - 5.2.3 Calls for submissions on issues relevant to the market inquiry.
 - 5.2.4 Targeted meetings with key industry stakeholders.
 - 5.2.5 Public hearings.
- 5.3 The participants in the market inquiry process will include firms directly or indirectly involved in the grocery retail sector, as well as those that have an impact on competition in the sector. These include firms in the property market, finance institutions and suppliers. The inquiry will also include participation by business and trade associations, government departments, public entities, regulatory authorities, consumers and consumer groups, and any other stakeholder that may be able to provide information relevant to the market inquiry. Members of the public are encouraged to participate fully in the inquiry process.
- 5.4 The Commission will publish a report at the conclusion of the market inquiry.
- 5.5 The Commission is committed to the principles of fairness, transparency and integrity and will conduct the inquiry in accordance with these principles. The Commission will allow stakeholders fair and reasonable opportunity to provide input into the inquiry process and its outcomes. For this reason the Commission may release interim reports throughout the market inquiry for public consideration and comment at its discretion.

6 Timelines

- 6.1 The inquiry will commence on 27 November 2015, and is likely to be completed by 29 May 2017.