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## **AN EX-POST REVIEW OF THE WAL-MART / MASSMART MERGER**

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### **Abstract**

This paper evaluates the impact of the Massmart Supplier Development Fund which was established as a condition to the Wal-Mart // Massmart merger in 2012. The purpose of the Fund is to response to the threat of loss of employment and sales by local suppliers as a result of potential displacement by way of imports. To address this concern, financial and non-financial support is provided to new and existing enterprises which can benefit from capacity development as well as improved market access by integrating into Massmart's supply chain. The analysis involved assessing the performance of the SDF to date in terms of number of enterprises supported, value of disbursement and procurement and jobs created. It is found that the SDF has facilitated the entry and expansion of SMMEs in the agriculture and manufacturing sectors. It has also positively contributed to job creation and local procurement. It is concluded that the Fund has contributed to the achievement of both competition and industrial policy objectives, as contained in the public interest provisions of the Competition Act.

**Keywords:** Mergers & Acquisitions; Event Study Analysis

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## INTRODUCTION

The *Wal-Mart/Massmart*<sup>1</sup> merger brought to the fore the public interest issues arising from mergers. This merger also raised the profile of competition law and stimulated debate on how competition law may intersect with broader government policy such as industrial policy as well general foreign direct investment policies.

Prior to this merger, a limited number of cases had been approved by the Competition Tribunal (“Tribunal”) with conditions that addressed public interest concerns, over and above employment conditions. The *Iscor Limited/ Saldanha Steel*<sup>2</sup> (2002) merger was approved on failing-firm grounds as well as on public interest grounds whereby the prohibition of the transaction would result in the closure of a steel processing plant with adverse effects on the Saldanha region. In *Metropolitan Holdings/ Momentum Group*<sup>3</sup> (2010) the Tribunal found that whilst the merger presented no competition concerns, it did raise significant public interest concerns in terms of negative effects on employment.<sup>4</sup> In the *Kansai/ Freeworld*<sup>5</sup> (2012) merger, the Competition Commission (“Commission”) raised concerns relating to the concentration of the industry, whilst the Department of Trade and Industry (“the dti”) noted the transactions potential adverse effects on localisation initiatives, employment levels, particularly black empowerment, and innovation and investment into the sector.<sup>6</sup>

The *Wal-Mart/Massmart* merger provides a suitable case study in which to assess the potential interaction between competition law and industrial policy. This is because while previous merger assessments have been decided on public interest grounds, these concerns were acknowledged, and recommendations put forward, by the Commission. The *Wal-Mart/Massmart* case, however, saw numerous government departments presenting opinions and recommendations to the Competition Appeal Court (“CAC”) on the appropriate merger conditions. These recommendations were mainly based on broader government policy that was in place at that point in time.

The assessment will consider the Tribunal CAC decisions, as well as the studies commissioned through the CAC’s March 2012 order. In order to assess the SDF, information was sourced from the Massmart Supplier Development Fund 2013 Annual Report, as well as the requested information from Massmart on the Fund’s performance from September 2013 onwards.

The report will be structured as follows: **Section I** below provides an overview of the literature review discussing the potential intersection between competition and industrial policy objectives. **Section II** then

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<sup>1</sup> Commission case number: 2010Nov5445; Tribunal case number: 73/LM/Nov10 (29 June 2011); Competition Appeal Court: 110/CAC/Jun11 and 111/CAC/Jun11 (9 March and 9 October 2012)

<sup>2</sup> Competition Tribunal of South Africa, *ISCOR Limited and Saldanha Steel (Pty) Ltd*, 67/LM/Dec01, 4 April 2002.

<sup>3</sup> Competition Tribunal of South Africa, *Metropolitan Holdings Limited and Momentum Group Limited*, 41/LM/Jul10, 9 December 2010.

<sup>4</sup> The merger was approved subject to a limited moratorium on retrenchments for two years.

<sup>5</sup> Competition Tribunal of South Africa, *Kansai Paint Co Ltd and Freeworld Coatings Ltd*, 53/AM/Jul11, 20 January 2012.

<sup>6</sup> The merger was approved subject to conditions which addressed the above-mentioned concerns, including a commitment to establish an automotive coatings manufacturing facility in South Africa.

discusses the background to the merger and unpacks the public interest implications of the *Wal-Mart/Massmart* merger as presented by the Commission in their assessment. Shortcomings in the Commission's analysis are highlighted as well. The Commission's analysis is then compared to the public interest considerations raised by the intervenors in their preliminary studies. **Section III** provides an overview of the achievements of the SDF in terms of the programmes developed, sectors and enterprises supported, and the integration of beneficiaries into the Massmart and Wal-Mart supply chains. The report concludes in **Section IV** with an assessment of whether the SDF has addressed the potential competition policy concerns

## **SECTION I: LITERATURE REVIEW: THE INTERSECTION BETWEEN INDUSTRIAL AND COMPETITION POLICY**

Industrial policy can be broadly understood as government measures, typically policy instruments, which are applied to selected sectors or industries and through which resources are directed in order to afford industry participants some advantage. The intended outcome of industrial policy interventions is to overcome market failures and facilitate structural change, thereby inducing economic activity and creating the platform/foundation which leads to economic development<sup>7, 8</sup>

South Africa's Industrial Policy Action Plan ("IPAP") is a mid-term plan aimed at strengthening the country's industrial capacity by identifying key sectors to develop. These sectors are selected based largely on their potential for growth and employment creation, and for the diversification and growth of exports. On a broad level, the main objective of the IPAP is to address market failures in sectors of the economy which have the potential to stifle economic growth.

The IPAP identifies competition policy as one of its transversal programmes through which to achieve some of government's industrial policy goals. Of particular concern in this regard are low levels of competition in sectors with high levels of concentration, as well as the adverse effect of anti-competitive conduct on employment and low income households through the charging of unnecessarily high prices. It further calls for monitoring the conduct of dominant firms and facilitating the entry and growth of new firms into the economy<sup>9</sup>.

Qobo<sup>10</sup> (2013) suggests that the competition related proposals contained in IPAP indicate "a move towards greater state intervention in markets, both in the form of increased regulation in support of socio-economic goals and in terms of increased direct state economic activity"<sup>11</sup>. One mechanism through which this is achieved is through enforcing policies which are designed to restructure or distort markets in order to

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<sup>7</sup> UNCTAD, (2009). The relationship between competition and industrial policies in promoting economic development.

<sup>8</sup> IPAP 2014/15 – 2016/17

<sup>9</sup> Ibid.

<sup>10</sup> Qobo, K. (2013) *Competition Policy Response to State Intervention: A Competition Practitioner's Perspective on IPAP5*.

<sup>11</sup> Ibid.

realise industrial policy objectives. It is here that competition concerns – and a potential conflict between competition law and industrial policy – may arise.

Industrial policy measures could have the effect of harming competition where its interventions prompt anti-competitive outcomes in the market, or facilitates anti-competitive conduct amongst firms<sup>12</sup>. For example, the protection of priority sectors or large domestic firms, whilst perhaps intended to improve international competitiveness or create national champions may have the effect of displacing competitors as well as possible adverse implications on consumer welfare.

That said industrial policy can also facilitate competition in markets and amongst institutions<sup>13</sup>, thereby sharing a common purpose with competition policy. For instance, policies which encourage the promotion of SMMEs, facilitate the growth and expansion of key industries, or promote international competitiveness resonate with competition policy ideals.

The issue therefore becomes how to navigate the landscape to ensure congruency between industrial and competition policy. One of the mechanisms currently employed to ameliorate potential tensions are the public interest provisions, as contained in the Competition Act. Public interest considerations are employed by the Commission in merger assessments, where the effect of the proposed transactions on employment, small business, industrial sectors or regions, and the ability of national industries to compete internationally are examined. The inclusion of these provisions in the Act bares testament to a competition policy framework which seeks to address broader industrial and public policy issues, as opposed to only competition-specific considerations<sup>14</sup>.

These public interest considerations are also present in the Commission's prioritisation framework, through which particular industries are identified as requiring proactive dedication of the Commission's resources based on (i) the impact on the consumer welfare for the low-income earners; (ii) the prevalence of anti-competitive conduct or outcomes in that sector or industry; and (iii) government's economic priorities.

However, caution needs to be applied in the Commission's assessment of public interest conditions in merger assessments. This is because remedies should address only merger-specific public interest concerns, and not wider policy objectives. The nett effect of a transaction must be considered, as opposed to focussing on the public interest factor, whether positive or negative. From a competition policy perspective, the potential impact of structuring a remedy based on public interest considerations must be considered, particularly if the proposed remedy seeks to address a wide range of factors, which may include elements of industrial policy.

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<sup>12</sup> UNCTAD, (2009). The relationship between competition and industrial policies in promoting economic development.

<sup>13</sup> Qobo, K. (2013) *Competition Policy Response to State Intervention: A Competition Practitioner's Perspective on IPAP5*.

<sup>14</sup> Qobo, K. (2013) *Competition Policy Response to State Intervention: A Competition Practitioner's Perspective on IPAP5*.

The *Wal-Mart/Massmart* merger provides a unique example of a case where the Tribunal's public interest decisions with respect to the merger conditions were found wanting by the intervenors with respect to industrial policy imperatives

## **SECTION II: BACKGROUND**

The preamble to the Competition Act (1998) ("the Act") recognises that the South African economy must be open to greater ownership by a greater number of South Africans, and that an efficient, competitive economic environment, balancing the interests of workers, owners and consumers and focussed on development, will benefit all South Africans<sup>15</sup>.

This is espoused in Section 12A of the Act which requires that the Commission and Tribunal consider both the impact that a proposed merger will have on competition in a relevant market, and whether a proposed merger can or cannot be justified on public interest grounds. The Act specifically identifies four public interest areas that competition authorities must consider when evaluating a proposed merger, namely:

- (a) a particular industrial sector or region;
- (b) employment;
- (c) the ability of *small businesses*, or *firms* controlled or owned by historically disadvantaged persons, to become competitive; and
- (d) the ability of national industries to compete in international markets<sup>16</sup>.

The *Wal-Mart/Massmart* merger raised various public interest concerns which were considered by the Commission in its investigation, and the Tribunal and the CAC in their assessment and ruling on the merger. The Commission and Tribunal's assessment of the public interest considerations, as well as the interveners and ultimately the CAC's evaluation of the Commission's recommendations, are outlined below.

### ***Background to the Wal-Mart/Massmart merger and Tribunal & CAC decisions***

In September 2010, the announcement was made that Wal-Mart intended to acquire a controlling interest in Massmart through the acquisition of 51% of the target firms' ordinary share capital<sup>17</sup>. Walmart is the largest retailer in the world as evidenced by the scale and size of its operations; it has over 11 000 retail outlets in 27 countries and recorded sales of US\$473.1 billion in the financial year ended 31 January 2014<sup>18</sup>. Massmart<sup>19</sup> is a wholesaler and retailer of general merchandise, liquor, home improvement equipment and basic food in South Africa.

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<sup>15</sup> Preamble to the Competition Act, No.89 of 1998.

<sup>16</sup> Section 12(A)(3) of the Competition Act, No.89 of 1998.

<sup>17</sup> 110/CAC/Jun11 and 111/CAC/Jun11 (9 March 2012), page 4

<sup>18</sup> <http://news.walmart.com/walmart-facts/corporate-financial-fact-sheet>

<sup>19</sup> Massmart has four divisions which trade under the names of 10 subsidiaries as follows: *Massdiscounters*: Game and Dion Wired; *Masswarehouse*: Makro; *Massbuild*: Builders Warehouse, Builders Express and Builders Trade Depot, and *Masscash*: Buy-Rite, Sunshine, Mikeva, Cambridge, DF Astor, Savemore and Score.

On 2 February 2011, the Commission finalised its investigation of the proposed merger. It found that the merger was not likely to lead to a substantial prevention or lessening of competition. The Commission considered the public interest issues arising from the merger, specifically (i) the effect on employment, (ii) the effect on a particular industrial sector or region, and (iii) the effect of the merger on small business suppliers. On the issue of *employment*, the Commission investigated the unions<sup>20</sup> concerns regarding the potential casualisation of labour by the merged entity, as had been observed in other jurisdictions. The Commission found that apart from these concerns not being merger-specific, the merged entity would be constrained by South African labour laws in terms of the Labour Relations Act (“LRA”). In particular, section 189 of the LRA prohibits the merged entity from changing the terms and conditions of employment to the detriment of employees. The Commission therefore concluded that the merger would not result in any changes on employment.

With regard to the impact of the merger on a *particular industry or region*, the Commission acknowledged that Massmart (i) likely has sufficient funds such that it can reduce margins thereby driving wholesale and retail competitors out of the market, (ii) has significant buyer power such that it is able to source large volumes from suppliers at discounted rates compared to competitors, and (iii) may result in increased concentration through the erection of wholesale and retail stores in remote areas.

In considering these concerns, the Commission found that cutting margins would potentially have a net welfare gain as consumers could benefit in the short-run, and possibly in the long-run, from possible price wars between Massmart and its competitors. Further, the establishment of wholesale and retail outlets in remote areas could result in employment creation, and may provide some relief to small businesses in that they need not travel to urban areas to purchase stock. The Commission did, however, concede that the customers may bypass small businesses and purchase directly from the merged entity.

Finally, on the issue of *small business*, the Commission found that Walmart, by committing to continue sourcing products locally, would benefit local suppliers in South Africa. Furthermore, Massmart had indicated that it did not intend on reducing the number of local SMME suppliers. On engaging with some of Massmart’s SMME suppliers, the Commission learnt that most of the products distributed or supplied through the SMMEs were imported and not manufactured locally. Furthermore, Massmart suppliers were able to supply these products to other local retailers or wholesalers.

Based on these considerations, the Commission found that the merger was unlikely to have a significant negative impact on employment, small business or a particular industry or sector. The Commission therefore recommended that the proposed transaction be approved without conditions.<sup>21</sup>

On 31 May 2011, the Tribunal conditionally approved the merger. As per the Commission’s analysis, the Tribunal found that the merger did not raise any competition concerns as Wal-Mart did not compete with

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<sup>20</sup> Specifically, the South African Commercial, Catering and Allied Workers Union (SACCAWU) and the Food and Allied Workers Union (FAWU).

<sup>21</sup> Competition Commission, 3 November 2010, Final merger report on *Wal-Mart/Massmart* merger, Case number 2010Nov5445.

Massmart in South Africa, and that its only presence in the country was through its procurement arm which purchased South African produce for the export market. The Tribunal did, however, acknowledge that the merger raised public interest concerns related to employment and the potential displacement of small businesses in markets underserved by large retailers.

During the hearing, the merging parties offered various undertakings which they agreed could be imposed as conditions for the approval of the merger<sup>22</sup>. One of these was an '*investment remedy*' which would see the establishment of a R100 million programme aimed exclusively at the development of local South African suppliers, including SMMEs. In addition, the merged entity would establish a training programme to train local South African suppliers on how to do business with the merged entity and Wal-Mart<sup>23</sup>. The Tribunal considered the undertakings and converted them into conditions.

### ***Reflections on the Commission's and Tribunal's evaluation of public interest***

Whilst the Commission did interrogate the relevant merger-specific public interest concerns, it failed to amply consider all of the effects of the merger on particular industrial sectors or regions and on small business. In terms of the effect on a particular industrial sector or region, the Commission failed to sufficiently examine the implications of the merger on the value-chain. In particular, the overall effect of the transaction on domestic production, consideration of potential import substitution given Wal-Mart's significant global purchasing power, and the implication of the transaction on both large and smaller wholesalers and retailers was not adequately dealt with.

Similarly, with regard to the implications of the merger on small businesses, the issue of raised barriers to entry for existing and potential Massmart suppliers was not sufficiently interrogated in the Commission's assessment. The Commission did not provide an in-depth analysis as to whether the merger would limit the growth and expansion of SMMEs and HDIs in the relevant or adjacent sectors, nor were the potential repercussions on employment, related sectors or regions thoroughly examined.

The shortcomings of the Commission's evaluation of the public interest concerns were identified by the interveners, which appealed the Tribunal's decision and sought a review application requesting that the CAC review the Tribunal's decision and refer the matter back to the Tribunal for reconsideration. The public interest concerns raised by the interveners and the CAC are discussed below.

### ***Public interest concerns as raised by government departments***

During the merger investigation, and in the run-up to the Tribunal hearing, a study commissioned by the government departments<sup>24</sup> examined the public interest implications of the merger. This study provided the impetus behind the review applications which raised concerns relating to (i) the impact of the merger

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<sup>22</sup> Tribunal case number: 73/LM/Nov10, 29 June 2011

<sup>23</sup> 110/CAC/Jun11 and 111/CAC/Jun11 (9 March 2012), page 4

<sup>24</sup> Genesis. 19 April 2011. '*Assessment of the Public Interest impact of the WalMart-Massmart merger; confidential version*'.

on current domestic Massmart suppliers, and (ii) the impact of the merger on employment in relation to current and future Massmart employees.

The government departments' were apprehensive that the merged entity would switch some of its procurement away from domestic suppliers to imports post-merger. Such import substitution would likely compromise the sustainability and participation SMMEs and HDI manufacturing and assembly firms in productive sector activities. The knock-on effect would be an adverse impact on domestic employment and a reduction in output in sectors which economic policy is aimed at developing,<sup>25</sup> both of which would affect broader economic development goals.

Government departments submitted that these concerns were plausible given the enormous global purchasing power of Wal-Mart, which enables it to source and distribute products globally at low prices. Post-merger, Massmart would have incentive to tend towards import substitution as its access to international imports at cheaper prices would improve through its affiliation with Wal-Mart. It was suggested that given the substantial size of Massmart's purchases (total procurement value of R42.2 billion<sup>26</sup>) even a small reduction in domestic procurement could have significant effects<sup>27</sup> on both domestic suppliers and employment. In this regard, it was suggested that a form of quota on mandatory domestic purchases be imposed on the merged entity<sup>28</sup>.

The merging parties' submission that the transaction would accrue public interest benefits was interrogated. Of particular interest was the extent to which consumer benefits in the form of lower prices and employment creation, as well as potential supplier benefits through the development and integration of local SME suppliers into the Massmart and Wal-Mart procurement network, would be achieved. With regard to the proposed merger conditions on local procurement, the merging parties argued that apart from being impractical to implement, issues of local procurement provisions should be dealt with through industrial policy. They further maintained that the conditions would be asymmetric, thereby resulting in harm to competition.

The departments' opposed this argument based on their findings that Massmart's pre-merger local content purchases did not compromise its competitiveness against other retailers. It was also argued that without local procurement conditions there would be asymmetry post-merger given the merging parties' global procurement potential compared to its domestic competitors.

The government departments' concluded that the public interest benefits claimed by the merging parties were insufficient to offset the concerns raised with regard to domestic procurement, and called for either

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<sup>25</sup> See above discussion on IPAP, NDP and NGP

<sup>26</sup> Genesis, 2011, Assessment of the Public Interest Impact of the *Wal-Mart/Massmart* Merger.

<sup>27</sup> The estimated impact of a 1% change in Massmart sales switching away from domestic procurement to imports would reduce total domestic procurement by R422 million and would result in a loss of 4 000 jobs.

<sup>28</sup> Competition Tribunal of South Africa, *Wal-Mart/Massmart*, 73/LM/Nov10, 29 June 2011.

the prohibition of the merger or the development of effective merger conditions that would ameliorate the public interest concerns.

The Tribunal approved the *Wal-Mart/Massmart* merger and incorporated the parties' proposed undertakings as conditions. However, its decision was met with resistance from organised labour<sup>29</sup> and government departments<sup>30</sup> ("the interveners"). This led to the matter being brought to the CAC for adjudication on the grounds that the effect of the merger on employment and local procurement had not been adequately addressed through the proposed remedies.

### ***Public interest concerns as raised by CAC commissioned studies***

Based on the CAC's consideration of the review application sought by the interveners, it directed that separate studies be commissioned to determine "the most appropriate means together with the mechanism by which local South African suppliers may be empowered to respond to the challenges posed by the merger and thus benefit thereby"<sup>31</sup>.

At the outset of the CAC's evaluation of public interest as applied to the merger, it noted that this provision raises questions on the relationship between industrial policy and competition law. In particular, it alluded to the perceived failure of the free market and the role of government intervention in the economy – in the form of industrial policy – which finds itself juxtaposed against the competition regulatory framework. The CAC's interpretation of the landscape between industrial and competition policy, as well as the recommendations contained in the expert reports, is likely to have informed its sculpting of the merger conditions, particularly those requirements relating to local procurement concerns.

Industrial policy typically involves both horizontal and vertical policy interventions; horizontal policies strive to influence the entire economy and usually complement macroeconomic agendas, whilst vertical policies aim to support specific sectors, industries or companies. It is in terms of the vertical interventions – through the application of monetary instruments such as tax breaks, subsidies, debt write-offs, and structural measures including trade barriers, regulatory measures and policy – that competition could be distorted in favour selected firms and sectors. It is in this context that clashes between industrial policy and competition law may arise.

The merger brought attention to the issue of globalisation within the context of industrial policy and the need for an adequate response to the potential consequences for South African suppliers as a result of global value chains. The report submitted by the merging parties describes both the positive and negative impacts of globalisation, i.e. rapid growth in output and employment contrasted with threats to the sustainability of domestic producers which are unable to compete with imports. The report points to the need for economic specialisation in order to reap the potential gains of globalisation. However, it is

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<sup>29</sup> South African Commercial, Catering and Allied Workers Union (SACCAWU)

<sup>30</sup> Namely, the Department of Trade and Industry, the Economic Development Department, and the Department of Agriculture, Forestry and Fisheries, along with the South African Small, Medium and Micro Enterprise Forum.

<sup>31</sup> 110/CAC/Jun11 and 111/CAC/Jun11 (9 March 2012), Page 109

acknowledged that this specialisation will not be realised by all existing firms in the supply chain, but will be reserved for those enterprises that are able to reorient their operations to feed into larger value chains.

In order to realise the opportunities presented through globalisation, a country's participation in the global economy needs to be structured such that it can maximise growth and development gains. This requires, amongst other things, appropriate industrial policy, institutional capacity and resource allocation. In the South African context – where exclusion and unemployment are prevalent – the gains of participation in the global economy should accrue benefits across the economy.

The CAC agreed that the merger had brought attention to the challenges posed by global value chains on the South African economy, and in its judgement promoted a comprehensive national response to address the consequent risks and opportunities. However, the CAC prompted “caution in respect of competition law being employed as a surrogate for a coherent industrial policy”,<sup>32</sup> and as such found that the concerns relating to global value chains lay beyond the scope and purpose of the public interest provision contained in s 12A(3) of the Act. The CAC's considerations of the conditions were therefore confined to identifying a solution to counteract the merger-specific risks of the transaction, particularly the impact on local producer SMMEs and their interactions with the global value chain of the merged entity.

The studies submitted by the merging parties and intervenors concurred that the most appropriate mechanism through which to empower local suppliers to participate in the Massmart supply chains was by means of a supplier development fund. It is against this backdrop that the CAC contemplated the purpose, scope and functions of the Massmart Supplier Development Fund.

### ***The CAC's application of the public interest findings to the SDF***

In terms of the *purpose and scope* of the SDF, the CAC found that it should be designed to respond to the threat of loss of employment and sales by local suppliers, including SMMEs, as a result of their potential displacement by way of imported goods<sup>33</sup>. In particular, the Fund should incentivise the merged entity to purchase products from South African producers and manufacturers over and above the types of products that would in any event be so purchased. In this way, domestic suppliers will be integrated into Massmart's local, and potentially Wal-Mart's global, supply chain.

The Fund's *target market* would include new and existing suppliers which could benefit from improved market access and capacity development. It was envisaged that these enterprises would supply niche products to Massmart in the areas of horticulture, and fresh and perishable foods. The projects and programmes supported under the Fund should take cognisance of developmental factors such as the labour-intensity of the suppliers operations, whether the business is owned by a historically disadvantaged person(s), and whether the enterprises falls into the SMME classification.

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<sup>32</sup> 110/CAC/Jun11 and 111/CAC/Jun11 (9 October 2012), page 7

<sup>33</sup> 110/CAC/Jun11 and 111/CAC/Jun11 (9 March 2012), page 4

The CAC ruled that the *type of assistance* provided should include financial assistance as well as skills development. This will ensure that suppliers that struggle to become competitive stand to benefit from support including, amongst others, quality upgrading and implementing retailer standards; product re-design to meet demand; upgrading of equipment; marketing support; and financial support in the form of low interest loans, interest rate support or credit, amongst others. This would be bolstered by the assurance that participation in the programme would be rewarded with sustained transactions in Massmart's supply chain.

Regarding the *value of the Fund*, the CAC ordered that a maximum amount of R200 million be allocated by Massmart over a 5 year period. This amount is over and above the R40 million already spent by Massmart.<sup>34</sup> Whilst this figure differed from the merging parties' and the intervenors' proposed capitalisations amounts,<sup>35</sup> the CAC importantly noted that "the quantum is not the sole touchstone; integration of local SMME's into the global value chain of Walmart is the core objective".<sup>36</sup>

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<sup>34</sup> Following the Tribunal's Decision in May 2011, the merged entity initiated the development of a Massmart supply development fund. The focus of the initiative was on support for small enterprises from disadvantaged communities. At the time of the hearing before the CAC, the fund had committed R40.4 million to four substantial projects and two small training and auditing projects had already been initiated.

<sup>35</sup> The merging parties proposed R100 million whilst the state proposed R500 million to R2 billion over a 5 to 10 year period.

<sup>36</sup> 110/CAC/Jun11 and 111/CAC/Jun11 (9 March 2012), page 28

### SECTION III: IMPACT OF THE MASSMART SUPPLIER DEVELOPMENT FUND<sup>37</sup>

In this section the achievements of the Massmart Supplier Development Fund will be discussed, based on information submitted by Massmart. First, the overall performance of the Fund is discussed, following which the achievements of the specific programmes are provided.

#### **Overall fund performance**

Since the establishment of the SDF in 2012 until end December 2015, funding to the value of close to R79 million (33% of total Fund value) has been disbursed to qualifying enterprises.<sup>38</sup> Funding assistance takes the form of zero-interest recoverable grants as well as loan guarantees.<sup>39</sup> The Fund has assisted 34 small and medium enterprises in the agriculture (fresh produce and livestock) and manufacturing sectors. In terms of access to global value chains, the developing wine brands programme has seen 14 wine brands, which represent over 24 varietals, integrated into the Massmart supply chain of which two brands have been introduced into Walmart stores internationally.

**Table 1: Programme disbursements from inception until December 2015**

Disbursements per project stream		As % of total	Disbursements per year		As % of total
Manufacturing projects	R 49 313 695	6%	2013	R 4 689 843	2%
Direct Farming	R 14 590 774	6%	2014	R 40 841 576	17%
Services to suppliers/ Capacity Building	R 14 986 778	20%	2015	R 33 359 828	14%
<b>Total</b>	<b>R 78 891 247</b>	<b>33%</b>	<b>Total</b>	<b>R 78 891 247</b>	<b>33%</b>

Source: Massmart

Table 1 above shows the value of disbursements to enterprises through the SDF since its inception in 2012. The Manufacturing SMME's programme has received the largest portion (almost R50 million) of the funding to date, followed by capacity building projects and the Ezemvelo Direct Farm programme which received R15 million and R14.6 million respectively. The performance of the specific programmes is provided below.

#### **Manufacturing SMMEs**

The manufacturing SMMEs programme includes projects with suppliers of value-added general merchandise and processed food products. The support offered through this programme includes grants (e.g. for production materials and equipment, working capital, etc.) as well as assistance to manufacturers to expand their supply network to regional, provincial, national or even international base.

<sup>37</sup> Information sourced from the Massmart Supplier Development Fund 2013 Annual Report as well as information submitted by Massmart, at the Commission's request, on the Fund's performance from September 2013<sup>37</sup> onwards.

<sup>38</sup> The CAC order stipulates that Massmart should spend up to R242 million over a period of five years (9 February 2013 to 9 February 2018) to develop its suppliers. The annual amount to be spent is at the discretion of the fund committee which will consult with the advisory board on the annual expenditure.

<sup>39</sup> These guarantees lower the cost of credit for beneficiaries and help them become fundable by reducing the lender's risk exposure via surety to a defined threshold. This service encourages lenders to increase advantages to SMMEs needing access to working capital or debt to expand or acquire their SME business.

Massmart has identified the following clusters for funding and development: building material, bricks, general merchandise, clothing and textiles, and processed food. The table below lists the products which are manufactured by beneficiaries within each cluster.

**Table 2: Products supplier by beneficiaries of the Manufacturing SMME programme**

Cluster	Products produced
Building materials	Mosaic stone, hollow-core doors, nails, ladders, freestanding baths, glue and adhesives, paint, and window and door frames
Bricks	Clay and cement bricks
General Merchandise	Pot plants, charcoal and briquettes, cooking gel, plumbing thread tape, packaging, cooler boxes, lamp shades and bases, and detergents
Clothing and Textiles	Towelling, chef's jackets, underwear and socks
Processed Food	Instant noodles, maize meal, baked goods, and fruit juice

Source: Massmart

Since 2012 close to R50 million has been disbursed to 34<sup>40</sup> manufacturing SMMEs, of which 12 are black-owned and 17 are woman-owned. Over R162 million in sales to Massmart have been realised and 1 421 job created. The clothing and textiles cluster has provided the best investment return based on total procurement. Of the manufacturing enterprises supported, five are import substitution projects; products in this regard include plumbers tape, nails, cooking gel, plastic pot plants and noodles.

**Table 3: Manufacturing SMME programme performance since inception until December 2015**

Cluster	Total active projects	Total disbursements	Total procurement	No. of jobs created	Black-owned	Woman-owned
Building materials	8	R 9 952 904	R 26 777 875	145	5	3
Bricks	5	R 15 762 364	R 44 875 555	256	2	1
General Merchandise	12	R 11 541 062	R 32 906 939	173	3	8
Clothing and Textiles	3	R 1 521 839	R 42 568 023	668	1	1
Processed Food	6	R 10 535 526	R 14 884 350	179	1	4
<b>Total</b>	<b>34</b>	<b>R 49 313 695</b>	<b>R 162 012 742</b>	<b>1 421</b>	<b>12</b>	<b>17</b>

Source: Massmart

The developing wine brands programme, which is housed within Manufacturing SMMEs programme, was established to create opportunities and assist emerging black-owned and black-empowered wine brands with market access by supplying their wines through Massmart liquor chains. Since the programme was launched in 2012, Massmart has disbursed R1 900 730 to 10 wine brands representing 20 wines (2 varietals each) which received marketing and distribution support, and a further 4 wine brands which received marketing support only. Sales over the period totalled R2 700 684 of which R2 571 981 was procured by Massmart. Two brands, namely Seven Sisters and Bayede, have been introduced into Walmart stores in the United States, China and Brazil.

<sup>40</sup> Of the 34 enterprises supported, seven have either graduated from the programme (i.e. no longer require SDF support) or have been removed from the SDF project list due to proving commercially unviable. The specifics are as follows: **Bricks cluster**: 1 discontinued; **General merchandise**: 3 graduated and 1 discontinued; **Processed Food**: 2 graduated.

### ***Ezemvelo Direct Farm Programme***

The Ezemvelo Direct Farm Programme was designed to assist small to medium-sized farmers enter the Massfresh and Fruitspot fresh produce supply chains. The programme was targeted at historically disadvantaged farmers that would be new suppliers to Massmart, and which typically would not have been able to access to the fresh produce supply chain due to their size, location and trading history. Support through the programme included input loans, technical support, basic financial management skills, logistics, and food safety training.

As at December 2015, financial support to the value of over R14.6 million had been provided to farming projects. At the programmes peak in 2013, 164 smallholder farmers were linked to the supply chain through cooperative structures. This decreased to 139 farmers in 2014 due to the discontinuation of some projects and cooperative membership fluctuation. Total sales to Massmart and other retailers totalled R13.1 million with Massmart accounting for 62 percent (or R8.1 million). More than 700 smallholder farmers have received training since the start of the programme.

During 2015 Massmart started the process of discontinuing the direct farming projects. The company is not a market leader in the fresh produce category, and the decision was made to focus the SDF resources on supporting enterprises in the manufacturing sector which would assist Massmart in meeting demand created by structural manufacturing shortages in the supply chain.

Three pack houses (two in KwaZulu Natal and one in Limpopo) which were established through the programme have been handed over to former cooperative beneficiaries for future use. Further, the Fund's first red meat smallholder sourcing project which was implemented in the Eastern Cape is set to continue under the management of Masscash outside of any further SDF support.

The only farm project that will remain in the Direct Farm Programme is Korema Farm. This farming entity is located in Winterveld, Gauteng, and grows cucumber and pepper crops under hydroponic tunnels. The company operates in a cooperative structure and has created 15 jobs. Grant funding support to the value of R78 000 has been provided through the Fund. Since supplying produce into Massmart (Fruitspot) in 2012, Korema Farm has managed to expand its business from 7 to 21 tunnels.

### ***Services to suppliers***

In addition to project specific disbursements, the SDF invests in pre- and post-listing services that assist suppliers to meet retail requirements. These services are informed by specific supplier needs and include food safety compliance, SABS certification, facility and product technical assistance, merchandising and accounting services, as well as business management training through the Gordon Institute of Business Sciences (GIBS). As at December 2015, the Services to Suppliers programme had disbursed close to R15 million to service providers and over 50 beneficiaries have benefitted through the programme.

## ***Projections for 2016***

The 2016 project disbursements are forecasted to be R34 million for the period January 2016 to December 2016. Three new businesses have been included in the project pipeline: (i) office furniture manufacturer and supplier that is anticipated to create an estimated 15 jobs and will provide Massmart with an import substitution opportunity; (ii) partial import substitution opportunity in the supply of wrapping paper and Christmas crackers with an estimated 25 temporary jobs to be converted to permanent employment; and (iii) manufacture of toilet seats with an estimated 18 jobs to be created.

## **SECTION IV: CONCLUSION**

This paper assessed whether the Massmart SDF has had the intended effect in terms of addressing the competition and industrial policy concerns which arose from the *Wal-Mart/Massmart* merger.

The principal merger-specific concern identified by the CAC was the threat of loss of employment and sales by local suppliers as a result of import substitution. This would potentially arise from the merged entity switching some of its procurement away from domestic suppliers to import post-merger. The anticipated effects of this shift in procurement range from an adverse impact on employment to a reduction in output in sectors earmarked for development.

It is observed that the SDF's focus on particular sectors and activities, its attention to supporting the entry and expansion of SMMEs, as well as its commitment to encouraging local procurement resonates with both competition and industrial policy objectives. The Ezemvelo Direct Farm Programme for example, has provided financial and non-financial support to numerous small farmers, including farmer co-operatives, thereby contributing to employment and rural development objectives. Similarly, through the Manufacturing SMME's programme, enterprises have entered the Massmart supply chain in value-add activities, specifically enterprises active in the building materials, brick, general merchandise, clothing and textiles, and processed food industries. Finally, Massmart has procured over R162 million worth of products from the enterprises supported through the SDF.

Based on the observations above, we find that the SDF has addressed both competition and industrial policy concerns; specifically, attention to vulnerable sectors, encouraging entry and expansion of SMMEs into the Massmart's supply chain, as well as adhering to local procurement commitments. From the analysis of its performance, it appears that the SDF has addressed the merger-specific concerns raised. The Fund has contributed to the achievement of industrial policy objectives, each of these which are contained in the public interest provisions of the Competition Act.