Competition Commission South Africa: Grocery Retail Sector Market Inquiry

Submissions on the substantive points contained within the Terms of Reference and Statement of Issues

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This note is in response to the call for submissions on the substantive points contained within the Terms of Reference and Statement of Issues for the Grocery Retail Market Inquiry. These are my personal views based on research I have undertaken and do not necessarily reflect the views of CCRED or the University of Johannesburg. This note draws from on-going research and publicly available studies that have been attached as part of this submission.

Barriers to entry and expansion for grocery retailers

Barriers to entry and how they can be overcome are particularly relevant in the South African context where there are significant challenges to opening up the economy to wider participation.[1]

Certain structural barriers to entry in this sector are a function of the inherent characteristics of supermarket chains. Some of the biggest structural barriers are the substantial investments required in distribution centres and logistics networks, as well as scale and scope economies in having multiple stores. All the major supermarket chains have invested in distribution centres. Certain newer chains, like Fruit and Veg City, started by focusing only in a niche area (fresh produce), procuring directly from local municipal fresh produce markets. Once it established a footprint, Fruit and Veg City was able to extend it offerings to other grocery products and expand to support investments in distribution centres and logistics networks.

While buying groups offer some of the benefits of distribution centres to independent retailers in terms of economies of scale, the lack of direct access to distribution centres and logistics networks still appears to place independent retailers and new entrants at a competitive disadvantage. For instance, suppliers may provide additional discounts (such as distribution, warehouse and pallet discounts) for sales to distribution centres compared to sales to independent retailers via buying groups, even for the same volume of product.[2]

Other barriers to entry and expansion include advertising costs, lack of business management skills, retail capabilities and access to finance (including for cash flow and working capital purposes). Providing financial assistance may help new entrants get past initial loss-making phases, but any financial assistance provided without upskilling retail capabilities is not sufficient to attain sustainable outcomes. While it may be argued that there is significant government funding available for small businesses, lack of awareness of such programmes as well as the red tape involved in accessing these funds appears to limit the potential of such pockets of funding.

[1] Understanding barriers to entry forms part of the key objectives of the Inquiry (See, *inter alia*, paras 36, 40.1 and 65.2 of the Statement of Issues).

[2] Whether these differences are cost related would have to be further investigated.

A prevalent strategic barrier to entry in South Africa, and an area that the Inquiry is looking into[3], is the practice of exclusivity clauses in long-term lease agreements entered into by incumbent supermarkets and property developers in shopping malls or retail centres. These clauses stipulate on the insistence of the anchor tenant (the supermarket) that no rival supermarket, specialist retailer or single-line store (like butcheries and bakeries) that is seen to be competing with the offerings of the supermarket can operate in the same mall. If they are allowed to operate, they may be subject to certain restrictions.[4] The exclusivity requirements can span decades (given renewals), creating a barrier to entry or expansion for rival retailers in that space. Access to prime retail space is important to allow these new entrants to grow and become effective competitors to the incumbent supermarkets. The existence of such leases can therefore have the effect of preventing, restricting or distorting competition. Entrants into shopping centres in rural areas appear to be particularly negatively affected by such leases.

It is important to note that while there has been new entry, notably by Fruit and Veg City and Choppies, this has taken considerable time. Fruit and Veg City began operations in 1993 and took close to a decade to gain traction. It, and other similar businesses, may have had a much greater effect, had some of the above-mentioned barriers been lessened.

In other countries, measures have been put in place to deal with such barriers largely under the competition regime. In the UK, the Competition Commission made an order to phase out exclusivity clauses in its Groceries Market Investigation Order of 2010 following recommendations for an investigation from the former Office of Fair Trading. In Australia, following the inquiry by the ACCC, the major supermarket chains, a wholesaler and other retailers voluntarily provided court-enforceable undertakings which phased out exclusive lease provisions over a number of years. Encompassing open and flexible retail spaces in urban planning to ensure a mix of formats and addressing exclusivity through planning policies can also assist in opening up the sector. This requires municipalities to play a role, possibly under guidance from national government and the competition authorities.

Buyer power of large supermarket chains

Supermarket chains are an important route to market for suppliers of fast moving consumer goods. Without a consistent route to market, suppliers of processed food and manufacturers of household consumable products are restricted in their ability to expand and develop their capabilities.

Large supermarket chains have considerable buyer power.[5] They often control negotiations of trading terms, particularly over smaller suppliers, and can impose a range costs on suppliers. These costs include listing fees or ‘support’ fees to get onto supermarket supplier lists, advertising and promotional discounts/allowances, slotting allowances (to get onto shelves or till points), discounts off the list price, fixed or variable rebates based on sales volumes, swell or wastage allowances and settlement discounts amongst other costs. Listing fees are typically a once-off payment[6] that have to be paid for each product line or stock

[3] See for instance, paras 45.2 and 68-77 of the Statement of Issues.
[4] Such as size and range of offerings.
[5] The Inquiry seeks to assess concerns around buyer power as stated in, *inter alia*, paras 96 and 105-109 of the Statement of Issues.
[6] Although in some cases, these fees have to be paid on a more regular basis (for example, 6 monthly).

keeping unit (SKU) that the supplier wants to supply the supermarket, but can also be charged as a percentage off the product price. The listing can apply to all outlets of the supermarket chain or just to certain stores or certain areas. While these fees vary widely across products, suppliers and supermarkets, they can be prohibitive for smaller suppliers. Suppliers are also often required to offer supermarkets settlement discounts for paying them within the number of days stipulated in their trading terms, which varies depending on the supplier. Long payment periods negotiated by supermarkets can put considerable pressure on a supplier's cash flow and working capital which is problematic for smaller suppliers. This is more so when there is pressure on the supplier to in turn make payments to its input suppliers further up the value chain.

Over and above the basic legal or regulatory requirements such as South African Bureau of Standards (SABS) accreditations, food safety[7], bar coding, labelling and packaging requirements, suppliers also have to adhere to private standards imposed by supermarkets. These can include higher accreditation requirements such as Food Safety System Certification (FSSC 22000), or additional quality, labelling and packaging requirements, all of which are at the supplier's cost.

The impact of these costs on suppliers, and whether it negatively affects the trading terms with independent retailers as compensation for these higher costs, would need to be assessed as part of the Inquiry. Preliminary research suggests that it is often difficult for independent retailers, wholesalers or buying groups to get similar trading terms to what the large supermarket chains get for equivalent transactions.

International experiences have shown that voluntary codes of conduct between suppliers, wholesalers, independent retailers and supermarkets have been a useful way to control the exertion of buyer power and have been identified as a practical and effective approach in developing countries. This is similar to what has been done in the UK, through the Groceries Supply Code of Practice which stipulates that retailers are required to comply with the Groceries Market Investigation Order of the former Office of Fair Trading. This Code is enforced in the UK by an independent Groceries Code Adjudicator, set up specifically to oversee the relationship between supermarkets and their suppliers and housed within the former OFT. In Ireland, there are plans to institute a mandatory Code of Conduct in the grocery sector, to be overseen by the Department of Enterprise, Trade and Employment. In Spain, a new act focusing on measures to improve the functioning of the food chain was promulgated in 2013 which uses a mixed model of regulation and self-regulation (through voluntary codes of conduct) to govern commercial relations between the agents in the food chain. In South Africa, such codes could potentially be administered through the Economic Development Department through the appointment of a similar independent adjudicating body.

[7]The Foodstuffs, Cosmetics and Disinfectants Act, 1972 (Act No 54 of 1972) and the Health Act, 1977 (Act No 63 of 1977) deal with issues of hygiene at the point of production, general consumer protection and food safety. They also include the conditions under which food is stored, transported, maintained, and consumed. Supermarkets also require that suppliers meet the minimum Hazard Analysis and Critical Control Points (HACCP) accreditation.