

THE SPAR GROUP LIMITED
SUBMISSIONS ON THE SUBJECT MATTER OF THE GROCERY RETAIL SECTOR MARKET
INQUIRY
19 AUGUST 2016

The structure of Spar

1. As indicated in our comments on the draft statement of issues, it would be inaccurate for the grocery retail sector market inquiry (the "Inquiry") to classify Spar as a national supermarket chain. The Spar Group Limited is a wholesaler and distributor of groceries, which owns six distribution centres in South Africa. The independent retailers that trade under the Spar brands are a voluntary trading group (and are not franchisees).

2. There are different formats of Spar stores:¹
 - 2.1 SUPERSPAR stores are approximately 1, 700m² in size with a turnover of approximately R10 million per month. There are approximately 315 SUPERSPAR stores.²

 - 2.2 SPAR stores are approximately 900m² in size with a turnover of approximately R4,6 million per month. There are approximately 365 SPAR stores.

 - 2.3 KWIKSPAR stores are approximately 500m² in size with a turnover of approximately R2,9 million per month. There are approximately 130 KWIKSPAR stores.

 - 2.4 SAVEMOR stores are approximately 600m² in size with a turnover of approximately R1.3 million per month. There are approximately 20 SAVEMOR stores.

 - 2.5 Spar stores are divided into nine clusters and each cluster has a separate marketing campaign and merchandise mix to meet the demands of that cluster's customer profile. The clusters are as follows:

¹ References to "Spar stores" are to all stores that carry a Spar brand.

² Store numbers provided in this submission are approximates as the number of stores varies from month to month.

	LSM 1-5	LSM 6-8	LSM 9-10
KWIKSPAR	1	4	7
SPAR	2	5	8
SUPERSPAR	3	6	9
SAVEMOR	1	1	1

2.6 A particular store could be in more than one LSM cluster i.e. a KWIKSPAR store could be in clusters 1, 4 and 7. Stores are further segmented based on geographic location, such as rural or urban.

2.7 Spar stores are predominantly located in convenience centres, which are between 500 and 5, 000m², and serve part of a suburb.³ They are often small, free-standing stores. More than 75% of Spar stores are in such convenience centres, approximately 15% are in neighbourhood centres and approximately 5% are in community centres. Only 15 stores are in small regional centres, 2 are in regional centres and 1 is in a super-regional centre. Spar stores are therefore typically located in small retail developments with more limited space.

Table 1: Shopping centre core classifications

	Size of centre (m ²)	Description
Convenience centre	500 – 5, 000	Serves part of a suburb. Café / superette. Small free-standing store.
Neighbourhood centre	5, 000 – 12, 000	Centrally located for group of suburbs. Supermarket with small specialised stores.
Community centre	12, 000 – 25, 000	Large supermarket with small presence of clothing, services, restaurant, take-aways.
Small regional centre	25, 000 – 50, 000	Specific sub-region of city. 1 or 2 large clothing anchors and strong national tenant mix. Entertainment presence.
Regional centre	50, 000 – 100, 000	Service large region of a city / whole town. Large supermarket(s), national retailers, entertainment.
Super regional centre	>100, 000	As a regional centre, with more emphasis on variety and entertainment.

³ There are a range of means of classifying retail developments in South Africa. 'Core classifications' proposed by Dirk Prinsloo of Urban studies are shown in Table 1.

Source: Dirk Prinsloo, *Urban Studies*, available <http://www.urbanstudies.co.za/wp-content/uploads/2016/07/New-Retail-Classification-2010.pdf>.

3. The Panel has indicated in the final statement of issues that the Inquiry will evaluate the classification of the “SPAR Group and its franchisees” once it has obtained further information as regards:
 - 3.1 the nature of the franchise agreements between the Spar Group and its franchisees;
 - 3.2 the degree of independence of the franchisees;
 - 3.3 the degree of competition between the franchisees;
 - 3.4 the degree to which they make use of the Spar Group’s distribution centres; and
 - 3.5 other characteristics that will assist the Inquiry in appropriately classifying the Spar Group’s business model within the grocery retail sector supply chain.

The nature of the franchise agreements between the The Spar Group Limited and its franchisees

4. Spar is a voluntary trading group (not a franchise model as suggested by the Panel) that consists of independent retailers. All Spar stores, save for approximately 15 out of 830, are owned by independent retailers. The Spar Group Limited prefers not to own any Spar stores as it has found that stores are more successful if they are owned and managed by an independent retailer who has invested a significant amount of capital in the store.⁴
5. There are a number of benefits to being a member of the Spar voluntary trading group including being affiliated with the Spar name and having access to a range of support services offered by The Spar Group Limited including wholesale and delivery services, marketing services, information technology services, retailing services, expertise in setting up and managing stores and store development.
6. A prospective Spar retailer will be required to apply to the relevant regional Spar Guild for a Spar membership. The Spar Guild of Southern Africa NPC (“The Spar Guild”) is a separate company to The Spar Group Limited and has been established to facilitate, promote and

⁴ The Spar Group Limited may, for example, purchase a store when the retailer is in financial difficulty. It does so with the objective of selling the store to an independent retailer as soon as possible.

regulate the Spar voluntary trading group system. The Spar Guild consists of independent retailers and The Spar Group Limited through its distribution centres. Each independent retailer is a member of The Spar Guild and is required to pay █ of its monthly turnover which is used to market the brand. The board of The Spar Guild consists of an equal number of independent retailer directors and distribution centre directors who determine the policy for the Spar brand in South Africa.

7. If The Spar Guild decides to grant membership to the prospective Spar retailer, it will sign any required standard Spar documentation including The Spar Guild membership agreement.
8. The agreement between The Spar Guild, members of The Spar Guild and The Spar Group Limited is for an initial period of █.

The degree of independence of the independent retailers

9. Almost all Spar stores are separate businesses that are financially owned by independent retailers. As a result, The Spar Group Limited cannot conduct its business in the same way as a national supermarket chain.
10. Where a major retailer that owns its own stores can, for example, afford to subsidize a loss making store because it has lost footfall to a new entrant, this is not possible in the Spar model. The independent retailer, which in many instances has only the one Spar store as a source of revenue, may be forced to close its business.⁵
11. Although independent retailers are not permitted to belong to any other voluntary trading group without the prior written consent of the directors of the Spar Guild, as discussed in further detail below. Independent retailers are able to source from other suppliers, including wholesalers such as Makro.
12. Unlike national supermarket chains that are able to control retail prices, The Spar Group Limited may only recommend selling prices (“RSP”) for products available from its distribution centres and via dropshipment (but not for products sourced independently).

⁵ The independent retailer may still be obliged to make rental payments and may face a damages claim for failing to trade as required by the lease.

- 12.1 The vast majority of RSPs are determined regionally by each distribution centre and are based on the overall competitive landscape experienced within that region. There are a limited number of RSPs determined nationally which largely relate to products that are advertised on television.⁶
- 12.2 The RSP is only a recommendation. The nature of the relationship between The Spar Group Limited and its voluntary retail members is such that the members have the discretion to determine the selling prices in their individual stores. Independent retailers who wish to set prices lower or higher than the RSP are therefore at liberty to do so.
- 12.3 In fact, individual stores operate in different markets and often choose not to follow the RSP where the circumstances faced by that store differ from the region as a whole (for example remote stores which may have additional transport and delivery costs).

The degree of competition between independent retailers

13. While locations for new Spar stores are selected so as not to impact on the success of existing stores, the determination of the geographic market is more complex than a radius consideration as consumers may shop at their place of residence, place of employment or in transport hubs during their commute to or from their place of employment.
14. Therefore Spar stores may compete with each other.
15. In addition, after an initial three year period, a retailer is entitled to terminate his membership agreement with Spar on [REDACTED] and may then trade under his own name or the brand of another major retailer. The Spar Group Limited has a right of first refusal if the retailer decides to sell its business while it bears a Spar brand. However, it is possible for a retailer to give [REDACTED] of termination and convert the store to another major retailer on [REDACTED]. Spar stores have converted to a variety of different brands, including Pick 'n Pay, Shoprite and Choppies. A number of Spar retailers join and leave Spar each year.

⁶ This advertised price becomes a maximum price because consumers would complain if it was higher than the advertised price.

16. Spar retailers typically locate their stores in smaller, convenience or neighbourhood retail centres, as discussed in paragraph 2.7 above. These centres are often developed by smaller landlords, individuals or consortia of individuals. In some cases, the retailer owns the centre in which the Spar store operates, or has a shareholding in the centre.

The degree to which independent retailers make use of the The Spar Group Limited's distribution centres

17. There are three avenues for an independent retailer to purchase products:

17.1 The first is through Spar's distribution centres.

17.1.1 The Spar Group Limited operates a decentralised distribution model, in which the management of each of the six Spar distribution centres have a considerable amount of autonomy in the region in which they operate. For example, each distribution centre has its own managers (including a divisional managing director) as well as a team of buyers who are mainly responsible for setting recommended retail prices in the region. Each distribution centre therefore functions in the market as a wholesaler to the Spar retailers in the region.

17.1.2 The Spar Group Limited encourages its independent retailer members to source products either from its distribution centres or via dropshipments.

[REDACTED]

As indicated, the retailers that trade under the Spar brands are a voluntary trading group. After [REDACTED] they are free to resign their membership at any time on [REDACTED]. Through the board of The Spar Guild, retailers have an equal say to The Spar Group Limited in relation to important issues affecting the group. As a result The Spar Group Limited is not in a position to dictate to retailers or to operate in an autocratic or high handed manner in its dealings with retailers.

- 17.2 The second is through the dropshipment system which includes suppliers that are listed with The Spar Group Limited. The retailer orders from the supplier who supplies directly to the retail store. The Spar Group Limited effects payment to the supplier and collects payment from the retailer.⁷
- 17.3 The third is directly from suppliers of choice (provided they comply with relevant food safety legislation requirements and standards). Independent retailers are especially encouraged to keep the value chain as short as possible (which is important for security of supply) and to support local suppliers, including local farmers.
18. Overall, independent retailers purchase on average ████ of their general merchandise from Spar's distribution centres or via dropshipments but only approximately ██████ of their fresh produce. This is difficult to estimate accurately since Spar does not control purchases by retailers, and Spar relies on turnover information provided by retailers.
19. The Spar Group Limited therefore competes at the wholesale level with other grocery wholesalers and retailers for sales to independent Spar retailers.

Other characteristics

20. Even though Spar has a category management system (in which participation is voluntary), only around 580 stores out of 830 participate in it. The category management system is a means by which The Spar Group Limited supports its retailers in ensuring that retailers carry the optimal mix of products in their stores. Many Spar retailers believe that they are in a better position to do this themselves, and so do not participate in the category management system.
21. While Spar retailers must submit their turnover to The Spar Group Limited, they are not required to submit any other financial information to The Spar Group Limited (such as on store expenses, profitability etc.). The Spar Group Limited therefore does not typically actively participate in the financial management of Spar retailers.

⁷ This concept is described in more detail in paragraph 34.1 below.

Barriers to entry

22. The Panel notes various barriers to entry and expansion. They outline that these may result from the following:
- 22.1 the nature of supermarkets;
 - 22.2 the product offerings and significant investments required by national supermarket chains;
 - 22.3 economies of scale which allow stores to negotiate discounts with suppliers;
 - 22.4 economies of scale which allow stores to secure the most suitable location for their business;
 - 22.5 regulatory and related barriers to entry.

Retail in South Africa

23. There are three trends worth noting in the grocery retail sector. First, there is significant growth in the sector generally. This means that the market is not yet mature, and that there is scope for new entry. Second, consumers are increasingly shopping at independent supermarkets and at wholesalers. Third, alternative distribution channels used by small and independent retailers to procure groceries are growing, and these alternative channels enable independent retailers to compete with larger grocery retail groups.
24. Growth in retail has been seen both across listed and independent retail groups.
25. *Listed food retailers:* Listed food retailers have been expanding significantly in South Africa. The results from the 2015 financial reports show the following:
- 25.1 *Pick 'n Pay:* In the 2015 financial year, Pick 'n Pay opened a net of 45 Pick 'n Pay stores in South Africa, 17 of which were supermarkets (with the remainder a combination of clothing, liquor and pharmacy) and 14 Boxer stores in South Africa of which five were superstores and six were Punch stores (the remainder being hardware and

liquor). In addition, 14 Pick 'n Pay franchise supermarkets and 21 Pick 'n Pay Express franchises were opened.⁸

25.2 *Shoprite*: Shoprite opened a net of 28 new stores across its three supermarket chains in South Africa in the 2015 financial year. It now has 915 outlets in South Africa. This includes 419 Shoprite stores, 191 Usave, 191 Checkers, 33 Checkers Hyper, and 321 OK franchises. The number of corporate stores (including outside of South Africa) has risen from 864 in 2007 to 1,751 in 2015.

25.3 *Woolworths*: In the 2015 financial year Woolworths opened two large format stores and seven stores in Engen forecourts, to add to the 297 Woolworths food stores (including outside South Africa).

25.4 *Choppies*: Choppies opened its first store in South Africa in 2008. In the last eight years it has opened 38 stores in South Africa and two distribution centres. It is targeting Mpumulanga, Limpopo, Northern Free State and North West provinces.⁹ In addition, in December 2015 Choppies filed a merger notification to purchase an additional 21 Jwayelani stores in Kwazulu Natal and the Eastern Cape.¹⁰

26. This suggests that the market is not mature and that there is scope for growth and expansion.

27. In addition, market research by AC Nielsen shows that retail supermarkets have grown significantly in the last few years (see

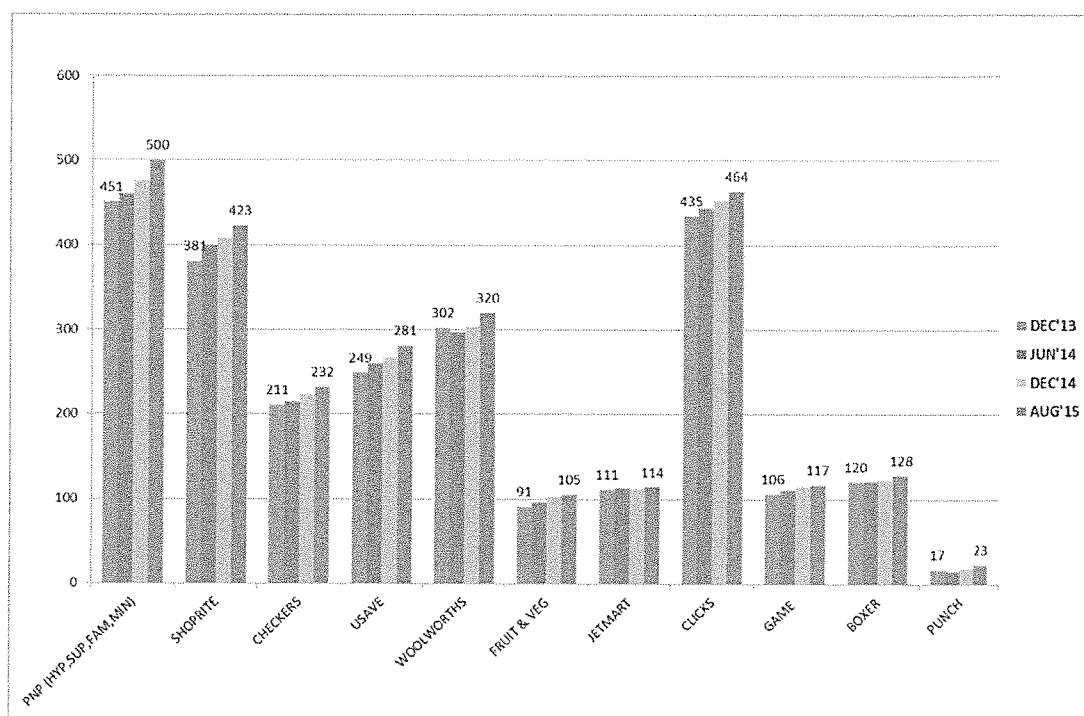
28. Figure 1). This suggests that at least the availability of sites is not a significant barrier to new entry.

⁸ Pick n Pay Integrated Annual Report 2015.

⁹ Choppies Enterprises Limited 2015 Integrated Annual Report.

¹⁰ See: <http://www.bdlive.co.za/business/retail/2015/12/22/botswana-based-retailer-targets-south-african-expansion>

Figure 1: Growth in selected retail outlets (AC Nielsen, 2016)



29. Spar stores have also grown in number over time (see Table 2). While net store growth fluctuates over time in South Africa and in some years this is negative, there are typically more than 20 new stores opened each year. The store numbers set out on Table 2 include stores in other Southern African countries served by the relevant Spar distribution centre in South Africa. Note that the total number of stores shown on Table 2 includes store closures and retailers that have left Spar.

Table 2: Spar retailers, 2011 – 2015 (including neighbouring countries)

Distribution Centre	2011	2012	2013	2014	2015
Eastern Cape	98	100	104	106	108
KwaZulu Natal	166	172	171	171	178
Lowveld	41	54	59	57	56
North Rand	143	146	151	154	157
South Rand	255	255	256	252	253
Western Cape	156	158	160	163	165
Total	859	885	901	903	917
Stores opened	26	23	18	20	25

30. *Growth in independent stores:* Though there is less data available on independent stores, there is evidence that suggests that there has been growth in independent chains. Furthermore, as explained above, the sector more broadly appears to be growing.
- 30.1 For example, Fruit and Veg City has grown from one store 23 years ago to over 100 stores in 2012. Growth between 2006 and 2012 has been at 20% per year.¹¹ In addition, it has opened over 100 Fresh Stop stores in Caltex forecourts. While concern has been raised about the pace of growth relative to major retailers the following can be noted:
- 30.1.1 Fruit and Veg City, by percentage terms grew more in turnover than major listed supermarket chains (21%, in comparison to 15% for major chains).¹²
- 30.1.2 In the abandoned merger between Pick 'n Pay and Fruit and Veg City the Competition Commission found that Fruit and Veg was "*a significant competitive constraint to PnP*" as it had captured market share from Pick 'n Pay in various markets in which it had entered.¹³ This implies that Fruit and Veg City is a competitively significant entrant.
- 30.2 The Checkout group (based in KwaZulu-Natal) has grown from 6 stores in 1995 to over 55 stores and a distribution centre in 2016.
- 30.3 In addition, there has been an increase overall in the number of independent stores.¹⁴ This is supported by the fact that buying groups, which cater to independent stores, appear to be growing.
31. *Increased use of independent stores:* In addition to increased growth in independent stores, market research suggests increased use of independent stores. For example, 74% of Spar

¹¹ See: <http://www.financialmail.co.za/business/2012/07/18/fruit-veg-city-grows-market-share>

¹² Das Nair, R and Chisoro, S, "The expansion of regional supermarket chains", WIDER Working Paper 2015/114, November 2015, available at <http://www.saiia.org.za/value-chains-in-southern-africa/1056-009-wp2015-114/file>

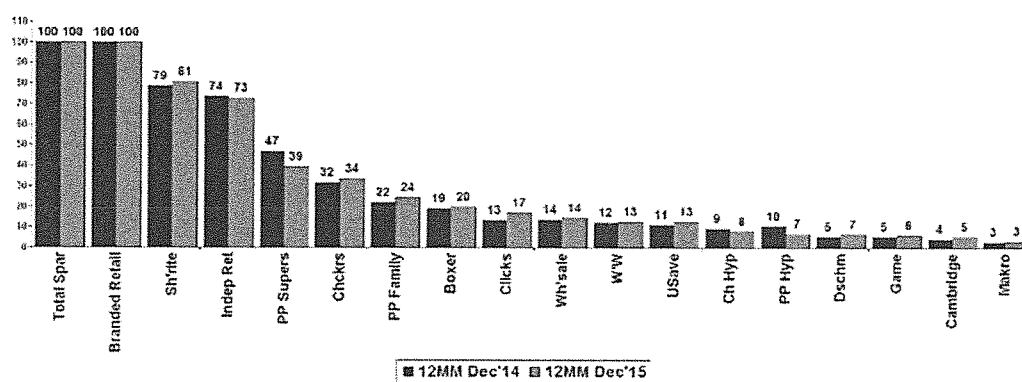
¹³ OECD, Annual report on Competition Policy Developments in South Africa April 2006-31 March 2007, 4 October 2007, DAF/COMP(2007)27 available at: [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP\(2007\)27&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2007)27&docLanguage=En)

¹⁴ A recent study stated that "*trends are emerging which hint at the rebirth of profitable and sustainable independent outlets in South Africa.*" See Das Nair (2015), cited above, at p. 12.

customers use independent retail.¹⁵ Furthermore, independent stores are used by over 80% of South Africans.¹⁶ The use of independent stores has been increasing over the last few years in terms of loyalty, penetration, spend per buyer and packs per buyer (though spend and packs per occasion have fallen slightly). This has been particularly pronounced in certain LSMs. In addition, the share of basket and turnover of independent stores has been increasing.¹⁷

32. As such, the sector in South Africa is one in which there is a lot of expansion and growth by existing stores with simultaneous increases in use of independent stores.

Figure 2: Spar - % of buyers shopping at other retailers (Nielsen)



Barriers to entry in the supermarket sector

33. The Panel notes that economies of scale allow retailers to negotiate with suppliers, and this may create barriers to entry. It is important for the Panel to note that The Spar Group Limited does not have exclusive arrangements with grocery suppliers (including grocery suppliers that produce products that are sold under the Spar brand).
34. Retailers in South Africa have various channels through which they can purchase their stock from manufacturers:
- 34.1 **Direct supply by grocery manufacturers to independent grocery retailers (direct-to-store delivery, or 'drop-shipment')**: Independent stores and chains may be supplied directly from manufacturers with direct-to-store deliveries, bypassing wholesale. This

¹⁵ See Nielsen report, December 2014.

¹⁶ See Nielsen report, Q4:2015.

¹⁷ Supermarket and Retailer, "Rebirth of independent outlets in South Africa", 28 May 2014, available at http://www.supermarket.co.za/news-article.asp?ID=4606&CatTags=15-Innovation%20and%20technology,%209-Supplier%20news&zoom_highlight=independent+

option is sometimes sub-optimal as it may be difficult or expensive for very small volumes, and may entail co-ordination of different deliveries. However many stores (including corporate-owned stores) still use direct-to-store.

34.2 **Procurement of grocery products by independent grocery wholesalers and independent grocery retailers through buying associations or buying groups:** In order to benefit from economies of scale, some independent stores group together to benefit from bulk discounting or purchase through a buying group. These groups have varying offerings but generally allow independent retailers to leverage off the power of group negotiations and bulk purchase discounts. In addition, some groups offer additional services including branding, advertising, assistance with layouts and systems and training. Some examples of buying groups are set out on Table 3 below.¹⁸

Table 3: Buying groups in South Africa

	Trading names	Members and / or Branded Stores	Purchase assistance	Other assistance	Business model
UMS	Powertrade, Food Town and Best Buy Can retain own branding.	90	Centralised buying and bulk pricing.	Advertising and marketing, technology, training.	Voluntary trading group. UMS makes their money from rebates.
BEC	Food Zone and Trade Zone. Also, buying partners without using image.	170 (incl. Botswana and Namibia).	Centralised buying (drop shipment from manufacturer) and access to suppliers.	Centralised accounts, advertising, assistance with layouts and design, training.	Franchise model with a R120,000 once-off fee.
Elite Star Trading		149	Centralised buying		
ICC Buying groups	Lifestyle Supermarket, Lifestyle Express,		Centralised buying but with warehousing		

¹⁸ Das Nair and Chisoro (2015), cited above.

	Trading names	Members and / or Branded Stores	Purchase assistance	Other assistance	Business model
	Lifestyle Liquor, Lifestyle Hardware and Building Supplies		and distribution.		
Shield (Massmart owned)		431 (incl. Botswana and Swaziland).	Bulk product purchase.		Voluntary buying association.

34.3 **Procurement of goods by independent retailers through wholesalers:** Wholesalers rely on the purchase of large volumes and therefore benefit from a discounted unit price. They then on-sell to independent retailers at a lower price than the retailer would face if it purchased directly. Some wholesalers may also sell directly to the public (such as in a hybrid model). Examples include CBW, Jumbo, Devland, Metro, Rhino, Africa Cash 'n Carry and a range of regional brands. These include corporate-owned wholesalers. For example, Masscash has several wholesale brands including CBW, Jumbo and Shield, focused on building and maintaining a supply chain to independent low-end retailers that is as competitive as the distribution centre models of large retailers.¹⁹ In addition, in respect of fresh produce, independent retailers may purchase directly from local municipal markets without requiring access to a distribution centre. This is a strategy adopted by Fruit and Veg City, for example, which sources 40-60% of its fresh produce from municipal markets. Rather than placing it at a disadvantage, some evidence suggests that sourcing from municipal markets allows it to charge prices between 20-25% less than other major retailers (although it is not clear if it benefits from volume discounts).²⁰

34.4 **Procurement through distribution centres:** Various retail groups have distribution centres that purchase from manufacturers and then distribute products to individual stores. These stores can be: (i) corporate owned; (ii) independently owned franchises; or (iii) independently owned stores that have the option to purchase through a voluntary trade agreement (as is the case for Spar retailers).

¹⁹ See: Competition Tribunal, In the Matter between Masscash Holdings Pty (Ltd) and Finro Enterprises Pty (Ltd), 04LMJan09.

²⁰ See: <http://www.bdlive.co.za/business/retail/2012/11/11/fruit-veg-city-looks-healthy>, and Das Nair (2015), p. 15).

35. As such, while larger retail groups have economies of scale which allow them to negotiate with grocery suppliers, independent retailers also have recourse to various routes to market which allow them to benefit from volume discounting.
36. The Panel also discusses barriers to entry that emerge from economies of scale which allow stores to secure the most suitable locations for their businesses. As property developers often require tenants that will attract footfall, a brand with a history of attracting customers may have some advantages in securing premises.
37. However, the increase in the number of stores owned by independent retailers and the significant and rapid growth of new entrants (such as Choppies) shows that there are suitable locations for business that can be secured.
38. Furthermore, as the market is not mature and expansion in underserved areas is a key trend there are substantial differences between the barriers to expansion in South Africa as compared to more mature markets. For example, in the Sebokeng and Umlazi case studies referred to in paragraphs 57.2 and 57.3 below it was possible for rival stores to set up on the adjacent property.
39. The Panel also sought input on regulatory barriers to entry. Regulatory requirements and delays in the installation of bulk infrastructure, particularly in underserved areas, are problems experienced by Spar retailers. These problems likely affect the growth of other independent retailers. For example, building permits are required from local municipalities, liquor licences²¹ must be applied for and approved, and electricity, water and sewerage connections must be put in place in order for a retailer to start trading. Where there are delays in the provision of these services and in the issuing of the various permits required, the establishment of new stores is delayed and may be made more costly. As a consequence of this, rental charges per square metre paid by Spar retailers outside of urban areas are often similar to those paid by Spar retailers in urban areas. If permits were approved more rapidly, and infrastructure (water, electricity, sewerage connections) put in place more quickly, this would reduce costs and facilitate entry.

²¹ Further detail on the specific concerns with applying for and maintaining liquor licences is set out below.

Objective 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

Spar has facilitated the entry and expansion of independent retailers in townships, peri-urban and rural areas

40. Spar has facilitated the entry and expansion of independent retailers in townships, peri-urban and rural areas with over 100 stores in these areas, creating more than 20, 000 jobs.²²

The entry of independent Spar retailers in townships, peri-urban and rural areas has a positive impact

41. The opening of a significant retail store in a township, peri-urban or rural area, like a Spar store, formalises the retail sector in these areas:

41.1 employment conditions comply with labour regulations; and

41.2 taxes are paid in terms of relevant tax legislation.

42. There are additional benefits that arise from a Spar store entering townships, peri-urban and rural areas:

42.1 An independent retailer opening a new store in these areas brings (i) the benefit of access to a significantly greater product range which will be favoured by consumers; and (ii) wholesale price benefits which will be passed on to consumers.

42.2 All SUPERSPAR stores offer a Standard Bank money transfer system which allows customers to transfer money from one SUPERSPAR to another. Some SPAR and KWIKSPAR stores also offer this service.

42.3 Customers are also able to collect their pension at certain Spar stores, generally in rural areas, through NET1's system. The South African Social Security Agency (SASSA) system will be implemented in around March 2017.

43. There are instances where an independent Spar retailer supplies spaza shops or hawkers who are in proximity to the Spar store.

²² 97 Spar stores are black owned.

43.1 In these instances, the Spar store and spaza shops or hawkers co-exist (often with the spaza shop or hawker located on the pavement of the Spar store). This likely illustrates that they do not compete.

43.2 It is up to the Spar retailer to decide whether it would like to work together with the spaza shop or hawker (which emphasizes the independence of the Spar retailers).

*Case study: Spar Umlazi*²³

44. Background

44.1 Umlazi Mega City ("UMC") is a centre in Umlazi, a large and densely populated township in KwaZulu-Natal.

44.2 [Redacted]

44.3 [Redacted]²⁴

44.4 [Redacted]

44.5 [Redacted]

²³ [Redacted]

²⁴ [Redacted]

[Redacted]

44.6 [Redacted]

[Redacted]

45.1 [Redacted]

45.1.1 [Redacted]

45.1.2 [Redacted]

45.1.3 [Redacted]

45.2 [Redacted]

45.3 [Redacted]

45.4 [Redacted]

45.5 [Redacted]

46. Pro-competitive impact of Spar Umlazi's entry

46.1 [Redacted]

46.2 [Redacted]

46.3 [Redacted]

46.4 [Redacted]²⁵

Competitive constraints in townships, peri-urban and rural areas

47. The Panel should also bear in mind that small retailers in townships, peri-urban and rural areas are strong competitors and therefore affect how Spar stores operate in these areas.

48. To the extent that new entry into townships, peri-urban and rural areas results in greater concentration in these areas, which is not clear, consumers in these areas are also able to purchase goods from retailers at places of employment or transport hubs which serve as competitive constraints.

²⁵ Further information on Spar Umlazi appears at paragraph 57.3 below.

Procurement

49. Spar encourages independent retailers to support local procurement and tends to use smaller suppliers for Spar branded products. Further detail in relation to Spar's procurement policy and practice are dealt with in more detail in objective 5 below.

Objective 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

Spar stores with exclusive leases

50. It is important to note that because The Spar Group Limited does not own the vast majority of the Spar branded retail outlets, it has only a limited ability to collect information on Spar stores, including on leases. The information provided here is therefore The Spar Group Limited's best estimate.
51. There are approximately 830 Spar stores. The Spar Group Limited does not have copies of all the lease agreements. Approximately 20% of the stores are on land owned by independent retailers and approximately 25% of the head leases are held by The Spar Group Limited. The remainder are held by the independent retailers.
52. The lease agreements are on average for an initial period of 10 years, often including an option to renew. The duration is negotiated to protect the independent retailer's investment in the Spar store and compensate the retailer for accepting the risk of paying rental for 10 years, regardless of the success of the store. As set out above in paragraph 2.7 above, most Spar retailers are located in small developments, very often developed by smaller property developers that require long term leases in order to raise financing for the property development. A developer may request a longer period, for example 15 years, as it will need to demonstrate that it has leases in place in order to obtain finance.
53. Approximately 30%²⁶ of Spar stores have leases containing exclusivity clauses. Many of these (Spar estimates that over half) contain varying degrees of partial exclusivity, including for example allowing for a Woolworths store or existing tenants.

²⁶ Independent retailers are not obliged to provide copies of their lease agreements to Spar and Spar therefore does not have copies of all the lease agreements.

54. Spar does not believe that exclusivity enables a retailer to raise prices for a number of reasons including that:
- 54.1 most shoppers (i) shop at their place of residence, place of employment and transport hubs on their way to or from work and are therefore able to compare prices and shop at alternative stores; and (ii) are aware of what the prices for staple products ought to be and would therefore not support a store that was more expensive.
- 54.2 barriers to entry are not sufficiently high for higher prices to be sustained.
55. In any event, exclusive leases do not come into play in a large part of the grocery retail sector. It is clear that grocery retail in malls is merely one facet of the grocery retail sector. Another significant part of the sector is grocery retail in stand-alone stores, or in small centres (such as convenience centres and neighbourhood centres referred to in Table 1 above which only have one premises available for occupation by a grocery retailer. In addition, grocery retail in rural towns takes place within the commercial hub of that town, in close proximity to other commercial premises which are available to new entrant grocery retailers.

Exclusive leases encourage and protect investment

56. A Spar store is typically owned by an individual, or a small number of individuals (possibly through the vehicle of a corporate entity) who invest their own capital into the store. Independent retailers face significant risks and costs in opening up a Spar store.
- 56.1 An individual Spar store requires start-up capital of up to R5 million for a KWIKSPAR and R18 million for a SUPERSPAR, depending on the store format, which is a substantial capital investment for many individuals and may require equity and/or loan capital. The Spar Group Limited does not have precise information regarding profitability of the Spar stores owned by independent retailers as independent retailers are not obliged to submit this data. The Spar Group Limited estimates that most retailers take approximately three years to break even (though this varies) and would thereafter need to earn a return on their investment.
- 56.2 The business of an independent Spar retailer is riskier than that of a corporate retailer as independent Spar retailers do not have the same diverse sources of income. In addition, as mentioned above, a major retail chain that owns its own stores can, for example, afford to subsidize a loss making store because it has lost footfall to a new

entrant. This is not possible in the Spar model. The independent retailer may be forced to close its business (with potentially serious financial consequences as a result of the rental and other obligations imposed in terms of the lease).

56.3 Independent retailers are likely to face more difficulties in accessing capital and are likely to have higher costs of capital. The lower the risk of a new store, including if the store is protected by an exclusive lease, the more likely that the independent Spar retailer will be able to raise funding, and the lower the financing cost is likely to be.

56.4 As set out above, independent retailers typically commit to leases of 10 years. This means that the retailers must pay rent at the premises regardless of the success of the store. Furthermore, the rental agreements, which often contain personal suretyships, have performance clauses which require the retailer to continue trading, regardless of the profitability of the store. The rental commitment can add substantially to the risk that the retailer takes on when opening the store. The net present value of the rental repayments can easily equal or exceed the other set up costs associated with the store.

56.5 Rent accounts for between 15% and 20% of total expenses (after cost of sales, see Table 2). As mentioned above, independent retailers are not required to submit profitability information to Spar (retailers must only submit turnover information). The Spar Group Limited has purchased stores that are loss-making and unsustainable, such as Sebokeng and Limpopo, and accordingly The Spar Group Limited has some experience at the retail level. The net present value of rental payments varies depending on the independent retailer, the rental agreement period, and the independent retailer's discount rate (cost of capital). Using the annual rentals set out in Table 4, and applying a discount rate of 8% and a lease period of 10 years (and no annual rent escalation), the net present value of rentals ranges between approximately ██████ in the case of Limpopo and ██████ in the case of Sebokeng. These rental commitments are therefore high relative to the approximate set-up costs of between R5 million and R20 million for a Spar retailer.

Table 4: Sebokeng SUPERSPAR and Limpopo SPAR: Rent as a % of gross profit

	Sebokeng SUPERSPAR		Limpopo SPAR	
	Oct 2015 - May 2016	May-16	Oct 2015 - May 2016	May-16
Sales	██████	██████	██████	██████
Gross profit, after adjustments	██████	██████	██████	██████
Total expenses	██████	██████	██████	██████

57.2 In Sebokeng, Spar enforced its lease exclusivity for the centre in which Sebokeng SUPERSPAR was located. The landlord built a store for Pick 'n Pay on a piece of adjacent land not covered by the exclusivity provision. The two stores share the same parking lot. [REDACTED]

Table 5: Sebokeng SUPERSPAR profitability before and after entry in close proximity

	Oct 2014 – Feb 2015	Oct 2015 – Feb 2016
Sales	[REDACTED]	[REDACTED]
Gross profit	[REDACTED]	[REDACTED]
Expenses	[REDACTED]	[REDACTED]
Net profit before investment	[REDACTED]	[REDACTED]

57.3 Another example of a store opening in the vicinity of a Spar store relates to Spar Umlazi.

57.3.1 [REDACTED]

57.3.2 [REDACTED]

²⁷ This information is recorded in the transcript of the interrogation of Mr. Ulrich Geyser by the Competition Commission on 27 March 2013.

58. These examples illustrate why certain leases for Spar branded stores contain exclusivity provisions, which are in place so as to reduce the risk of opening a new store. These examples also show that the investments at risk are not only investments in shop fittings and funding losses during the first few years of being in business but also include the commitment to pay rent over a 10 year period, regardless of the success of the store.

Exclusive leases do not create barriers to entry

59. New malls are constantly being developed. This provides opportunities for retailers, including new entrants, to trade in malls and the land adjacent to the malls as was the case in Sebokeng and Umlazi.
60. In any event, as mentioned in paragraph 30 above, there has been significant new entry in the grocery retail sector despite the existence of exclusive leases. In the case of Sebokeng SUPERSPAR, Spar's landlord developed a property for Pick 'n Pay next to the Spar store.

Objective 3: the impact of the dynamics of competition between local and foreign national operated small and independent retailers in townships, peri-urban and rural areas and the informal economy

61. It is difficult to determine the actual effect that foreign national operated small independent retailers have on local independent retailers including independent Spar retailers in townships, peri-urban and rural areas.
62. The Spar Group Limited understands that many foreign national retailers are not regulated in townships, peri-urban and rural areas, for example, do not pay tax or charge VAT, which impacts on local independent retailers including independent Spar retailers that do comply with these obligations.
63. The way in which foreign national retailers operate in these townships, peri-urban and rural areas may impact local independent retailers, including independent Spar retailers, for instance:
- 63.1 staff may not be paid in accordance with labour legislation (i.e. paid less than the minimum wage);
- 63.2 electricity may be used through illegal means which reduces their operating costs; and

63.3 customers may be attracted through non-conventional methods, for example, customers may be allowed to purchase groceries on credit and are required to leave their identity document or credit card as security until the end of the month when they are able to pay for their groceries.

Objective 4: the impact of regulations, including, amongst others, municipal town planning and by-laws on small and independent retailers in townships, peri-urban and rural areas and the informal economy

64. As mentioned above, almost all Spar stores and TOPS stores are owned by independent retailers. The restrictions imposed by regulations, particularly legislation relating to liquor, raise costs faced by retailers, which many independent retailers are unable to afford.

65. Small independent retailers rely heavily on cost efficiencies. The introduction of liquor into these small businesses assists independent retailers to run financially viable businesses which employ a number of people. The financial burden and the onerous requirements of liquor regulation are therefore likely to place a number of people at risk of becoming unemployed.

66. Spar has recently responded to multiple legislative instruments drafted at the national and provincial levels which relate to the regulation of liquor.²⁸ Set out below are some of the concerns raised.

Premises and Zoning

Liquor premises

67. The National Liquor Policy attempts to reduce the harmful use of alcohol by restricting the sale of liquor to zoned areas.²⁹ The suggested methods to enforce this are through (i) pre-inspections; and (ii) requiring zoning certificates to be submitted with an application for a

²⁸ The Department of Trade and Industry (the "DTI") "Liquor Policy Review: A discussion document for public consultation (the "National Liquor Policy") published for comment on 20 May 2015 under Government Notice 446 in *Government Gazette* 38808; the Department of Economic Development, Environment, Conservation and Tourism: North West Liquor Policy: White Paper (the "NW Liquor Policy") published for comment on 21 January 2014 under Provincial Notice 33 in *Provincial Gazette* 7217; and the North West Liquor Licensing Bill, 2015 (the "NW Liquor Bill") published for comment on 1 September 2015 under Provincial Notice 65 in *Provincial Gazette* 7528.

²⁹ National Liquor Policy, para 1.6.3.

liquor license or registration.³⁰ Requiring businesses to submit proof of zoning to the liquor licencing authorities is unnecessary and burdensome. The correct forum for challenging zoning is in the offices of the municipality.

68. The National Liquor Policy proposes that liquor premises ought not to be located within 500 metres from schools, places of worship, recreational facilities, rehabilitation or treatment centres, residential areas and public institutions. It further proposes that no liquor license shall be issued to petrol service stations, premises attached to petrol service stations, premises near public transport and areas not classified for entertainment or zoned by municipalities for purposes of trading in liquor. ³¹

68.1 These proposals are likely to cripple the industry. Many shopping centres are located close to residential areas, public institutions and schools. A shopping centre may also be near, or even encompass, recreational facilities, premises attached to petrol stations or premises near public transport.

68.2 It may be that there are no premises on which liquor may be sold due to the proliferation of schools, places of worship, recreational facilities, rehabilitation or treatment centres, residential areas, public institutions, petrol service stations and public transport ranks or stations.

68.3 In all cases where businesses trade in shopping centres, agreements of lease or other rights of occupation have been negotiated and signed. Some of these may be for a period of five years, 10 years or even longer. Landlords will have no interest in terminating the right of occupation and will proceed against the tenants for recovery of rental and other costs regardless of whether the business is trading or not.

69. In some provincial bills, it is proposed that a liquor licensing officer be a designated employee in the employment of a municipality.³² While such relationship between the municipalities and liquor licensing authorities is to a certain extent welcomed, it is likely to slow down the consideration and issue of liquor licences causing delays in the opening of a business.

³⁰ National Liquor Policy at para 4.3.9.3

³¹ National Liquor Policy, para 1.6.6.

³² Section 27 of the NW Liquor Bill.

Distributors and wholesalers

70. The Liquor Act 59 of 2003 (the “National Liquor Act”) provides for registrations as a manufacturer or distributor of liquor. As it is currently, it is possible for an applicant, who may be a retailer, to hold both types of registrations.
71. The National Liquor Policy suggests that distribution should only take place in “industrial zoned areas” and proposes that premises in retail areas in which wholesale distribution takes place should be relocated to these areas within a fixed period.³³
72. The zoning of the property should govern the use of the property. If the Town Planning Scheme allows both wholesale and retail activities to take place on the same premises by way of a special or particular zoning, there is no reason why this should not be allowed in terms of the Liquor Act.

Onerous application process for a retail liquor licence

Public interest considerations

73. In certain provincial policies, the granting of the application is not only subject to the premises being correctly zoned and suitable for use but it must also be in the public interest.³⁴ This increases the complexity of the application process as applicants would be required to motivate the effect on public interest including the potential negative impact on residents and property owners as well as property values, schools and religious institutions as well as other liquor establishments in close proximity.

Engagement with communities

74. Certain provincial policies requires consultation with communities within a specified radius of the proposed premises which is time consuming and costly, especially in rural areas.³⁵ The method ordinarily used to object to applications or call meetings to discuss applications is through advertisements or the Provincial Gazette. An applicant should therefore not be required to consult with each community member.

³³ National Liquor Policy, para 4.3.7.

³⁴ Section 40 of the NW Liquor Bill.

³⁵ Item 5 of the NW Liquor Policy provides at 5.8 that “Communities within one kilometre (1km) radius of the proposed premises must be consulted during the consideration of the license or registration.”

75. Provincial policies sometimes require notice to be given to all residents within a certain radius of the business.³⁶ This is particularly difficult in areas where there is a high residential component such as in a block of flats or townhouse development. This provision is probably intended for a rural operation or the establishment of a shebeen but should not apply to the establishment of a supermarket or a liquor store.

Supporting documentation

76. The supporting documentation required for retail liquor licences place an enormous burden on applicants.

76.1 Original tax certificates³⁷

- 76.1.1 Certain provincial liquor policies require an original income tax certificate to be furnished to the liquor authorities each time a liquor licence is applied for or renewed (in some provinces, liquor licence may only be valid for a period of one year).³⁸

- 76.1.2 While all Spar and TOPS business are registered for income tax and VAT, to obtain a tax clearance is costly and administratively burdensome. The services of an auditor are required and, in many cases, it is impossible to obtain because of outstanding trivial matters. The cause of delays is often beyond the control of the tax payer.

76.2 Detailed sketch plans and photographs³⁹

- 76.2.1 The nature of plans required to be submitted by certain provincial liquor bills are such that services of an architect are required. There is no reason to reflect material on a plan as this can be done in a description of the premises. Although in the case of Spar and TOPS, these requirements are generally met, it will raise the costs for independent retailers considerably.

- 76.2.2 Photographs should be limited to premises that are already constructed.

³⁶ Section 34 of the NW Liquor Bill.

³⁷ Section 33(2)(h) of the NW Liquor Bill.

³⁸ Item 8 of the NW Liquor Policy.

³⁹ Section 33(2)(e) of the NW Liquor Bill requires "detailed sketch plan of the premises showing the rooms, services, buildings, construction material and other pertinent information together with colour photographs of the external and internal features of the premises".

There is no value in submitting photographs of a building site.

76.3 Proof of business trading licence

76.3.1 Proof of a business or trading licence issued by the relevant municipality is required to be submitted with an application for a liquor licence by certain provincial liquor bills.⁴⁰

76.3.2 In most cases, a Spar or TOPS store is opened in a shopping centre or strip mall which is under construction. The application for a liquor licence is generally lodged at an early stage, sometimes even prior to the ground being broken, and it is therefore impossible for a trading licence to be furnished at this stage.

76.3.3 A practical solution which has been used in other provinces, particularly Gauteng, is for a liquor licence to be conditionally granted subject to the lodgement of a trading licence.

76.4 Proof of lawful occupation

76.4.1 In many cases, a Spar or TOPS store is a tenant in a shopping centre which is only built on the basis of the tenancy of the Spar or TOPS store. Therefore, to require a title deed or a lease agreement in the name of the applicant by certain provincial liquor bills may not be possible.⁴¹

76.4.2 An application for a liquor licence is often lodged at a stage where there are only heads of agreement in place or possibly when only an exchange of letters has taken place. The lease agreement may only be signed after the premises is opened.

76.4.3 A verbal agreement or a simple letter from the letting agent or the owner of the property confirming the right of occupation should be considered satisfactory for the liquor authority to verify lawful occupation.

⁴⁰ Section 33(2)(f) of the NW Liquor Bill.

⁴¹ Section 33(2)(i) of the NW Liquor Bill.

- 76.5 Written consent to conduct the intended business⁴²
- 76.5.1 The written consent required is either from the owner of the premises or the relevant authority, where applicable, by certain provincial liquor bills.
- 76.5.2 Written consent from the owner is not problematic as it can be incorporated into the right of occupation that governs the premises or the owner can easily provide a letter in this regard.
- 76.5.3 The consent of the relevant authority, on the other hand, is impractical. It is also unnecessary as the premises will be zoned to allow a business such as a supermarket or a liquor store. Therefore there should be no obligation on the applicant to obtain any written consent from the relevant authority, especially considering that it is costly and time consuming. It also creates an opportunity for corruption as a municipal official may be left with a discretion to allow a liquor store on premises A or premises B when both premises are legally authorised in terms of the Town Planning Scheme to conduct a liquor store business.

Licence conditions

77. Liquor licences issued in terms of certain liquor policies are only valid for a period of one year. This significantly raises legal costs for an applicant or licence holder.
78. There are proposals that an on-consumption licenced premises be “weapon free” which may require a safe to be made available in case persons in possession of guns or sharp objects enter the premises. The cost of implementing this will be high as, amongst other things, a separate member of staff would need to control this.
79. Off consumption licenced premises licensees are required to provide ablution facilities.⁴³ At best liquor stores have a small toilet and wash hand basin for their own staff which is located in a secure area behind the counters. To allow the members of the public into these private areas creates safety risks.

⁴² Section 33(2)(j) of the NW Liquor Policy requires written consent from either the owner of the premises or the relevant authority.

⁴³ NW Liquor Policy, item 11(b).

80. Restricting the sale of liquor on Sunday in either liquor stores or grocers wine outlets and supermarkets adversely affects businesses as it limits the number of days on which sales can be made.⁴⁴ Restrictions on trading hours should be governed nationally.
81. Liability and responsibility for all land pollution and littering outside the liquor premises is often placed on the licence holder. In addition, the licence holder is often expected to ensure that there is no loitering by patrons outside the on-consumption liquor premises.⁴⁵ This is an area of municipal competence and this responsibility is policed on a regular basis. It should not become the responsibility of a manager to keep the area surrounding the licenced premises clean as this would result in additional costs for the licence holder and shift responsibilities which should fall on either the municipal authorities or the owner of a shopping centre or strip mall onto a manager.
82. Some provincial liquor bills propose that a licence holder keep a record of all sales of 25 litres or more to any unlicensed person.⁴⁶ This threshold is too low. These provisions may be intending to control the on-sale of liquor to “shebeens”, however, it is submitted that this is not the method which should be used. Instead of shifting policing obligations onto a licensee, policing should be more robust and effective.

Objective 5: (i) the impact of buyer groups on small and independent retailers in townships, peri-urban and rural areas and the informal economy; and (ii) the impact of buyer power of large purchasers of FMCG products, relative to their suppliers on small and independent retailers in townships, peri-urban and rural areas and the informal economy

83. Buyer groups place small retailers in a similar position to larger retailers in the sense that they can secure lower prices through bulk discounts. Buyer groups therefore have a positive impact on small and independent retailers in townships, peri-urban and rural areas and the informal economy.
84. Although The Spar Group Limited is a significant purchaser of groceries, it operates differently to other large buyers.
- 84.1 It has six distribution centres which operate independently under separate management teams, each headed by a separate divisional managing director. The distribution centres therefore operate with a degree of autonomy.

⁴⁴ Item 13 of the NW Liquor Policy.

⁴⁵ Item 14 of the NW Liquor Policy.

⁴⁶ Item 17 of the NW Licence Policy.

- 84.2 Even if The Spar Group Limited negotiates a national trade term, an individual distribution centre is able to negotiate its own deal.
- 84.3 Each distribution centre negotiates with suppliers for its own volumes only.
- 84.4 The distribution centres do not have exclusive agreements with suppliers including in relation to Spar branded products.
- 84.5 The distribution centres predominantly procure from South African suppliers. Less than 5% of merchandise is imported.
- 84.6 In respect of Spar branded products, the preference is to use small suppliers (i.e. a smaller milk processor such as Woodlands Dairy).
- 84.7 As mentioned above, independent retailers are not obliged to procure products from the distribution centres or via dropshipment.
- 84.8 Independent retailers may procure from their preferred suppliers and are encouraged to procure from small local suppliers and to keep the value chain as short as possible especially in relation to fresh produce.
- 84.9 As the majority of Spar stores are owned by independent retailers, The Spar Group Limited does not have detailed information on the independent suppliers from which its retailers procure. Approximately [REDACTED] of goods on average are purchased from the distribution centres and via dropshipment, so [REDACTED] in value) is procured from independent suppliers.

Objective 6: the impact of certain identified value chains on the operations of small and independent retailers in townships, peri-urban and rural areas and the informal economy

85. It is not clear what the Panel is concerned about in relation to this objective 6. Once this is clarified, Spar will consider if any further submissions are required.