Submission by Unitrade Management Services (UMS)

to the Grocery Retail Market Inquiry

Contact: Peter Draper

Managing Director

Tutwa Consulting Group

Peter.draper@tutwaconsulting.com

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1. Introduction/Background

The grocery retail sector is a key contributor for economic growth both internationally as well as domestically. As a result, authorities across various jurisdictions have placed much attention on ensuring an efficient and well-functioning grocery retail sector.

The issues sought to be canvassed in the current Inquiry are not exclusive to South Africa and in particular, competition authorities internationally have also focussed resources on tackling impediments to competition in the grocery retail sector. Notably, the United Kingdom Competition Commission (UKCC) and the Australian Consumer and Competition Commission (ACCC) have led similar Inquiry's in their respective jurisdictions.[1]

South Africa has not been immune to issues in the grocery retail sector and so the Competition Commission SA (Commission) has over the last decade, been required to assess numerous complaints in relation to it.[2] The issues in this sector are wide ranging, with the provision of exclusivity clauses in mall/shopping centre lease agreements receiving the most attention. The Commission, having previously considered these issues, found that there is insufficient evidence of any anticompetitive harm. The Commission did, however, take cognisance of the issues arising from exclusive leases which prompted an advocacy program to raise public awareness of the issue. This has led to a string of complaints being lodged at the Commission.[3]

Given the preponderance of issues in a key growth sector, and the potential for entrepreneurial opportunities in the sector, on the 13th of May, 2015, the Minister of Economic Development announced that a formal market Inquiry would look into tenancy agreements in malls as well as issues affecting the growth of township businesses such as spaza shops. More recently Minister Patel has highlighted the importance of the Competition Act as a lever for promoting inclusive growth in the economy[4], in light of which the current Inquiry provides an opportunity to break down the (perceived) barriers in the grocery retail sector thereby enabling a greater spread of ownership and participation by

[1] See Annexure A for a summary note on the United Kingdom and Australian Inquiries.
[2] In June 2009 the Competition Commission initiated a complaint against the major supermarket chains and wholesaler-retailers: Pick n Pay, Spar, Shoprite Checkers, Woolworths, Massmart and Mass Cash for alleged contraventions of sections 4(1)(a), 5(1), 8(c) and 8(d)(i) of the Act.
[3] See http://www.compcom.co.za/wp-content/uploads/2015/03/Competition-Commision-January-Newsletter-WEB.pdf
[4] See http://www.gov.za/speeches/minister-ebrahim-patel-economic-development-dept-budget-vote-201617-21-apr-2016-0000

South Africans in the wider economy. Broadly, the Inquiry seeks to understand and assess the nature of competition in the grocery retail sector, with a view to promoting inclusive growth.

On 30 October 2015, the Commission-led Inquiry gazetted the draft terms of reference (ToR) for the Market Inquiry. The Inquiry has requested interested parties to submit their views under six main areas[5] namely:

> *(1) The impact of the expansion, diversification and consolidation of national supermarket chains on small and independent retailers;*
>
> *(2) The impact of long term exclusive leases on competition in the sector;*
>
> *(3) The dynamics of competition between local and foreign owned small and independent retailers;*
>
> *(4) The impact of regulations, including inter alia municipal town planning and by-laws on small and independent retailers;*
>
> *(5) The impact of buyer groups on small and independent retailers; and*
>
> *(6) The impact of certain identified value chains on the operations of small and independent retailers.*

Given the interlinkages between various levels of the value chain, the grocery retail sector is susceptible to competition concerns. As noted prior, the issues that persist have been well documented by competition authorities internationally and the resources that have been expended in rectifying these concerns provides further indication that the grocery retail sector is a critical sector for growth and its impact on the broader economy as a whole (i.e. providing access to goods at reasonable prices, entrepreneurial opportunities for SMME's etc.)

It is against this background that Unitrade Management Services (Pty) Ltd (UMS) makes its submission to the Inquiry. As will be evidenced in the following section, UMS is a key player in the grocery retail sector and the issues as noted in the ToR have a direct impact on our business, as well as affect our members, many of whom service spaza shops and the township economy more broadly. UMS hopes that through its submission it can assist the Inquiry in eradicating anti-competitive harm which UMS feels to be restricting the ability of smaller players, including our members, to grow and compete effectively in the grocery retail sector.

[5] See http://www.compcom.co.za/retail-market-inquiry/

The rest of the report is structured as follows. Section 2 provides a background to the UMS business as well as its areas of focus. Section 3 shares the concerns and issues from UMS's experience in the sector, including concerns expressed by some of our members. Section 4 offers recommendations to the Inquiry. Section 5 concludes.

2. Background to the UMS business

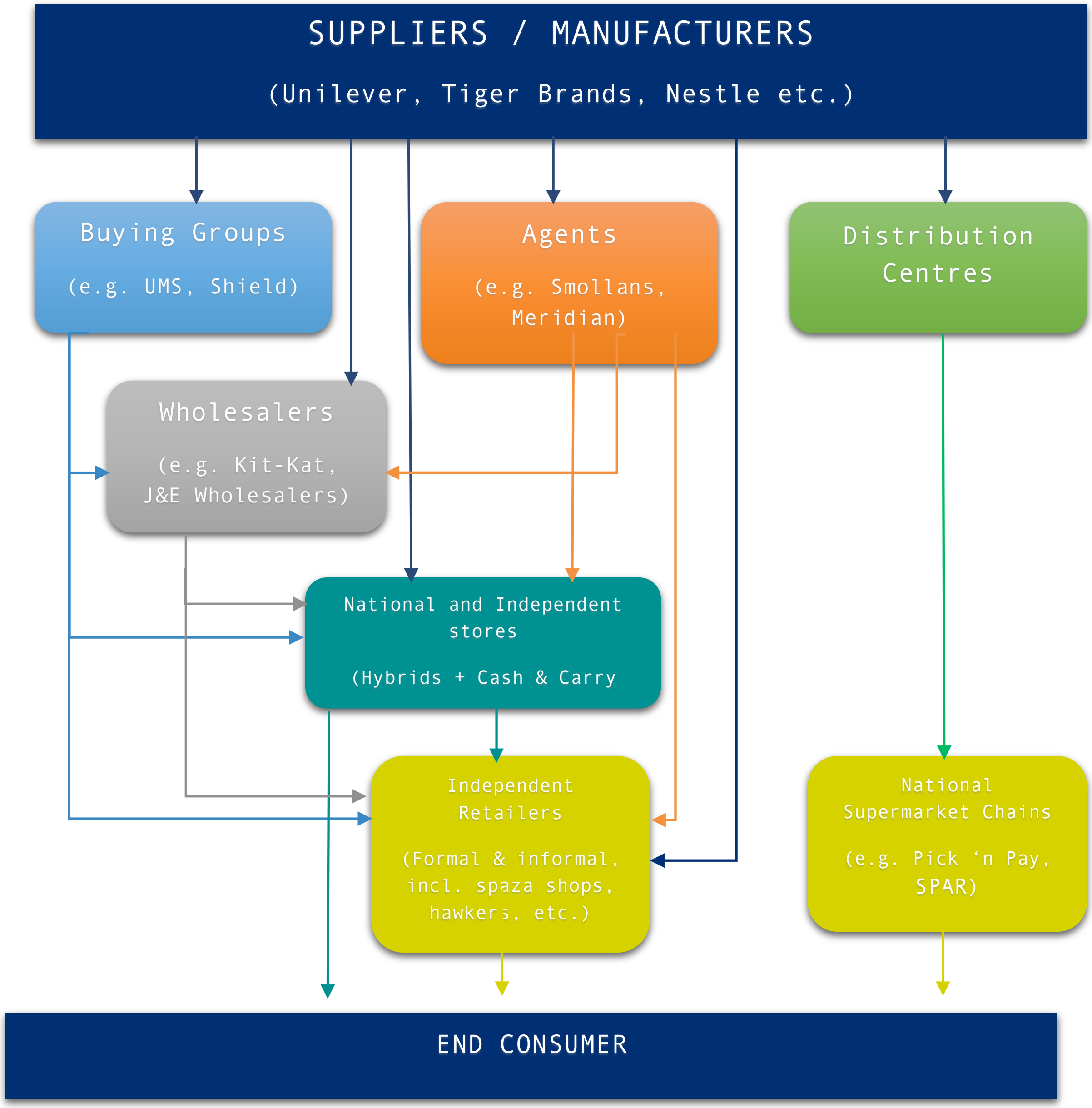
UMS is predominantly owned by previously disadvantaged individuals and is a voluntary buying association. Since 2006 UMS has grown successfully and is a substantial player in the grocery retail market, reflected in part by the 150 store owners that, working as members with UMS, are now able to provide goods and services around the country, and employ total staff of approximately 10 thousand.

Figure 1 overleaf provides a rough schematic for how the grocery retail value chain works. To further note, we have subsumed UMS under the heading of buying group, even though we are not a buying group per se – yet we do have a buying group function.

A typical **buying group** may offer the following business model:

- Trading terms based on volumes
- Negotiation of deals
- Very limited business to business activity
- Very limited business to consumer activity
- Value: central account and administration
- Major capabilities: MOVING VOLUME

Figure 1: Grocery Retail Value Chain



Buying groups give independents (including hybrid, cash and carry, independent retailers and other store formats) critical mass, and also offer small spaza shops and stokvel stores more choices at lower prices, since independent wholesalers and distributors generally sell at lower margins than the large chains.

UMS's **business model** is somewhere between a full Franchise Operation and Buying Group. UMS offers our members all of the advantages of franchising without the associated costs; in short we consider ourselves to be a **Voluntary Trading Association**,[6] and not a Buying Group per se. We also offer the benefits of a franchise to our suppliers, similar to the benefits one would receive from full franchise groups. Whilst UMS may be viewed as a typical franchisor, no fees are charged to the independent store owner(s). UMS makes a clear distinction between itself and typical buying groups. Whereas the latter solely provides the benefit of increased buyer power, UMS provides additional benefits to independent stores at no additional charge. These added benefits include:

- Skills development and training[7]
- Marketing that is uniquely tailored to community dynamics
- Administrative support including a buying team
- Credit facilities
- Sales and operational support
- Store development
- Private label programmes
- Business development plans
- Customised promotional plans

For UMS it is not just about buying and rebates, our belief is that the model of a buying group is short term and too restrictive in the main. Which is not to say that there is no place for these typical buying groups in the future, rather that we believe in partnerships (with both suppliers and members), through providing brands, training, support structures, and sustainability - essentially building a better business for both suppliers and members.

The approach adopted by UMS is to ensure that the independent has access to wholesale and retail opportunities in the groceries sector. By creating an accessible platform, smaller store owners or potential entrants have a relaxed environment within which to operate and, critically, obtain goods at prices that they would not otherwise have access to. Members can participate at the wholesale or retail level, or a hybrid of the two, through the UMS brands: Powertrade, Foodtown and Best Buy.

As a result of these efforts and initiatives, UMS has been able to grow significantly over the past ten years, providing direct opportunities for many entrepreneurs. This is even more pronounced when one considers the importance of the grocery retail sector in providing access to goods and services to the

[6] The Spar Group is another example of a Voluntary Trading Association.

[7] UMS has developed and launched a state of the art classroom based training facility at the UMS Academy. This initiative aims to address the lack of formal, focussed skills development initiatives for independent retailers and wholesalers, their staff and management. The UMS Academy seeks, through training for business growth, to uplift the community through the development of people.

lower income population of the country. Organisations such as UMS that operate at both the middle layer of the economy and at the bottom of the pyramid have fostered an approach that involves partnering with independent retailers and wholesalers to innovate and sustain diversity of businesses. This diversity helps to ensure healthy competition, and creates value for poor consumers. The diversity of retailers helps to create a more inclusive market-based economy as opposed to one characterised by the dominance of the major corporate retailers, who seem to engage in anti-competitive practices. It begs, in our view, the question as to how much greater the growth effect would be if the perceived distortions were not in place.

We reiterate at this juncture that independents typically have lower cost structures and UMS assists in further lowering product procurement costs. This is in addition to the support services provided by UMS which allow independents to compete with the corporate supermarket chains. In a nutshell we facilitate entrepreneurship, allow for independence in business operations and contribute to sustainable, inclusive economic growth.

Finally, GG Alcock in his book Kasinomics, has shed further light on the dynamics that exist with the informal township economy. Of particular interest to the Inquiry is the growth of the informal economy. First, it is noted that informal retailers are on average 7% cheaper than the corporate supermarket chains. Secondly Alcock alludes to figures from an AC Nilsen study which suggest that 20% of consumer spending takes place in the informal economy - which sells goods to the value of R46 billion.

Alcock also highlights the growth of foreign owned spazas and attributes this growth trend to the decline of the spaza business undertaken by South Africans, a gap which has been exploited by foreigners. Over and above the price benefit that these foreign owned spazas bring, they allow for interest free credit and extended store hours. In essence catering for the demographics in the townships has enabled this growth. Figures by AC Nilsen also indicate that the informal sector is growing at 7% whilst the formal sector is growing at 4%.

If one considers these dynamics it provides further clarity as to why we observe the corporate chains now entering spaces previously occupied by informal traders and independent retailers.

3. UMS issues/observations

As noted in section 1, the concerns in the grocery retail sector have received widespread attention from competition authorities internationally as well as domestically. UMS, as a key stakeholder in the sector, has not been immune from these issues. However, it is important to note that smaller players in the market – both manufacturers and retailers – face the possibility of reprisals from the big retailers and manufacturers, meaning that providing actual evidence of wrongdoing on the large players' part is an intimidating proposition. Consequently, our submission is based on our years of operation/experience in the sector. In this light we have identified several impediments to competition. These concerns are raised in conjunction with the 6 areas the Inquiry seeks to assess.

UMS contends that the following issues impact negatively on the success of independents in the sector, and the sector as a whole:

3.1. The buying power of the big 5[8] supermarket chains has implications for independents which manifests itself through the "waterbed effect".[9]

3.2. There is a lack of support by suppliers/manufacturers for independents generally, and in terms of loyalty programmes specifically, whereas such support is provided to the big 5.

3.3. There is a lack of funding provided by manufacturers to independents for new store openings or store refurbishments, whereas such funding is made available to the big 5.

3.4. Onerous trading terms are being imposed on independents, with hurdles to meet obligations being too high relative to those provided to the big 5.

3.5. Some of the big manufacturers appoint exclusive agents/distributors to deal with the independents on pricing and other trading terms, with these exclusive agents/distributors having the power to set these terms, whereas some of those agents also compete directly with the independents they are supposed to service. (Mondelez and P&G are cases in point) Such arrangements are not imposed on the big 5, rather manufacturers deal directly with them.

3.6. The big 5 collectively constitutes an unfair percentage of manufacturers' total output, which does influence manufacturers trading terms, and other pricing policies, with independents.

[8] These are the Shoprite Checkers, Spar, Pick n Pay, Woolworths and Massmart.

[9] Subject to levels of concentration amongst buyers in a market, certain buyers may possess greater market power over suppliers than their rivals and are able to exercise this in the form of obtaining much lower prices. These prices may be excessively low so as to render the supplier unprofitable over this portion of sales. As a means to recoup the margins lost to the dominant buyer the supplier is forced to raise prices to smaller buyers to levels that would not have necessarily existed absent the abuse of market power by the dominant buyer(s).

3.7. Independents are being foreclosed entry into new mall developments, in essence offers are rarely made to independents to participate.

As evidenced above, the issues raised by UMS are broadly in relation to market dominance, a fragmented independent sector, a lack of equity and the existence of unfair competition in the sector. We set out below further context to the issues raised by UMS in line with the points above.

3.1. The Waterbed effect. This issue regards the relative volumes purchased by the big 5 supermarkets. UMS accepts this is a reflection of relative purchasing power which in itself confers some advantage to the corporate groups. However, we contend that this purchasing power advantage is being abused by the larger corporates. In effect, given the downward pressure being placed on prices by larger players, manufacturers may be forced to recoup lost margins through charging independents higher prices, or offering them smaller price discounts – amounting to the same thing.

Some of UMS members have shared the concern that suppliers are being “bullied” by the larger corporate groups. In some instances, a UMS member would find employees of the larger corporate groups walking through their stores and noting the prices of many primary line items. Pursuant to this UMS members receive calls from suppliers requesting that they cease advertising the specials they were afforded by the respective supplier and in some cases the prices of those very products are then reduced drastically by the larger corporate groups. Whilst UMS acknowledges that lower prices are to the benefit of the consumer, the reluctance of suppliers to offer preferable/lower prices to independents (under the fear of reprisal from the corporate supermarket chains) creates further distortions in the grocery retail sector.

Further to this is the differential distribution allowances that are offered to the larger corporate groups by suppliers/manufacturers. These allowances favour the larger corporate groups viz-a viz the independents as it enables them to lower their prices even further or alternatively raise the relative price at which independents are able to sell their goods.

3.2. & 3.3. Loyalty programmes and new store openings/refurbishments. Manufacturers have shown little or no appetite to engage with independents on either the creation of loyalty programmes or funding new store openings and product lines. By contrast, larger corporates will charge suppliers/manufacturers to participate in new store openings and product promotions, in effect padding their profits at the manufacturers’ expense, whereas independents have to pay suppliers/manufacturers for the same services. This places independents at a significant cost disadvantage, yet it is the independents that provide better access to stokvels and spaza shops, avenues which the larger supermarkets may not necessarily reach. Furthermore, consumers in townships and outer lying regions were historically not well serviced by larger corporate groups so the independent traders have positioned themselves to serve this end of the market. However, this relative advantage appears to be under threat from the current practices of the larger corporate groups.

Relatedly, we contend that the current manner in which these programmes are offered, i.e., manufacturers paying the corporate chains to promote products, is discriminatory. Even if UMS were to be presented with such options, they will in no way receive the same cost benefit from the manufacturer. To us these arrangements merely exacerbate the cost pressures we currently are subjected to. Overall, therefore, these practices also prejudice the competitiveness of township-based traders.

3.4. Onerous trading terms. UMS contends here that it is extremely difficult to meet the obligations set by suppliers/manufacturers. This may be a consequence of the large corporate groups dictating the trading terms on which suppliers/manufacturers deal with independents. The larger supermarket groups will penalise suppliers for non-delivery, service levels, and stock availability and in virtually all cases suppliers/manufacturers are liable for a penalty. Independents are unable to exercise the same level of market power and the supplier would refuse to sign such agreements, yet this is willingly done with the large corporate groups. In other words, independents by virtue of their size are unable to exercise such market power and reach agreements such as those entered into between the large corporate groups and suppliers.

3.5. Purchasing power dominance. The larger corporate groups account for 70-80% of the total grocery retail sector (per revenue measure), as such it is reasonable to assume that they procure a large volume of a supplier/manufacturer's output. Furthermore, the large corporates have their own buyers' groups which, in our view, is a direct conflict of interest. Considering the lofty positions currently held by corporate supermarket chains, having their own buying groups provides them with an additional avenue to control and manipulate market outcomes to their favour - which further entrenches their positions. Given this countervailing power that large corporate groups possess and exercise, independents face undue pressures from the respective supplier/manufacturer, i.e. unfair trading terms.

3.6. Exclusive agents/distributors. One concern here is the additional margins that are added on by the distributors; in effect introducing an extra layer increases costs. UMS members estimate that this could add up to an additional 10% to costs. This, in combination with the strict trading terms, places UMS members at a further price disadvantage. Furthermore, dealing with a distributor that is also a competitor has quite obvious disadvantages. UMS contends that having to deal with the distributor is unjustified given that efforts have been made to set up an efficient supply chain thereby reducing distribution costs for the supplier/manufacturer. In addition to this UMS contends that stock availability always seems to favour the large supermarkets.

3.7. New mall developments. We contend that independents are rarely offered participation in any mall developments. Taken in conjunction with the notion that the larger supermarket groups are now entering the geographic spaces typically serviced by independents, notably townships, and peripheral urban areas, UMS members are being disadvantaged further. UMS members have in the past attempted to engage in new malls and shopping centre developments and were denied outright on the premise that large supermarket groups bring greater foot traffic.

4. Recommendations to the Inquiry

UMS offers the following recommendations to the Inquiry to assist in assessing the aforementioned concerns.

3.1. The Inquiry should obtain pricing and discount schedules offered by the suppliers/manufacturers to the big 5. This would enable the Inquiry to assess if there is unfair price discrimination being targeted against independents. In other words, for the same level of purchases for example by Pick n' Pay, are the same prices being charged by the supplier/manufacturer (holding all other factors constant, *i.e.* transport costs)?

A further aspect is to assess the general prices that are offered to independents to ascertain if there is in fact a waterbed effect in the absence of any clear volume based discounts.

3.2. The Inquiry should look into the current terms on which loyalty programmes and store promotions etc. are being premised. Is it such that the requirements to qualify for loyalty programmes and store promotions are set too high and may never be reached by an independent?

3.3. The Inquiry should seek to understand the role of distributors in relation to independents, and if there are any efficiency justifications being advanced for this practice. It would also serve the Inquiry well to compare the pricing and other terms offered to the distributors and the prices that are charged by distributors to independents.

3.4. Furthermore, the Inquiry should compare the trading terms being offered to large supermarket groups and compare these to the terms being offered to independents. What are the requirements that are being imposed on independents viz-a-viz the large supermarket groups? Are these differences (if identified) justified?

3.5. The Inquiry should obtain a list of the top 5 products that are sold and ascertain which retailers are responsible for the largest purchases. If it is the case that manufacturers could expand output and service more purchasers at fair terms, why aren't they? A further and related aspect to the volume benefit that large retailers are obtaining is whether the cost savings are being passed on in anyway, absent which these benefits, albeit subject to further consideration, should be offered to smaller players. One possible solution would be to offer similar discounts to all players where it is found that a single retailer is accountable for, say, 30% (or more) of a manufacturers output.

3.6. On the aspect of exclusivity of shopping mall leases, the Inquiry should establish whether exclusivity is justified and how so? If so, one remedial measure could be to require that major developers should be at least 5kms from a large independent. In instances whereby a large supermarket group has more than 35% market share in a certain locality, the supermarket could be forced to divest or sell so as to encourage diversity in the market place.

3.7 Further, while the rationale for having exclusive leases in new mall developments might, in certain instances, be justifiable (where without such leases a proposed development would not receive financial backing from banks etc.), this practice is open to abuse and has indeed been abused as evidenced by the flurry of complaints filed with the Commission in the last few years. To remedy this, a complete phase out of exclusive leases in shopping malls may be the way to go in South Africa. However, due regard must be taken of the economic dynamics in this sector which may make long leases desirable in some cases. As such, independent economic analysis should be undertaken to identify the period required by "anchor" tenants to recoup any investments in new mall developments in South Africa and a term limit needs to be imposed on exclusivity, for example 5 years per the UK case (see Annexure A), to apply in cases where exclusive leases are desirable. Any exclusive leases in already existing malls should also be subjected to a phase-out period.

We further propose that the Inquiry seek to assess the implementation of a quota system in order to govern the level of ownership in various localities and store formats by the corporate supermarket chains. In addition to this we implore the Inquiry to assess the possible cross shareholdings that the corporate chains have in other stores, which in our view may also have an influence on a property developers' incentives to allow or disallow the presence of an independent retailer in a mall or shopping centre.

3.8. Finally, it is our view that independent retailers and wholesalers are an important contributor to the economy. They are the engine of the township economy as they service spaza shops, and offer diversity. A retail sector that is dominated by large players is not healthy for competition and inclusivity in the long run. Developing small and medium-sized businesses, and supporting the township economy, are some of the major objectives of government aimed at boosting growth, and making it more inclusive.

Annexure A: Key Findings from the UK and Australian Inquiries

United Kingdom Competition Commission

In 2005, the UKCC led an inquiry into the grocery sector, considering amongst others, issues of coordination between supermarkets as well as competition issues in the grocery retail supply chain. A previous market investigation as well as two prior merger notifications in the grocery retail sector had prompted the UKCC's market Inquiry. The issues traversed by the UKCC included an understanding of pricing dynamics at various levels of the supply chain, and exclusive leases were considered under a barrier to entry or expansion assessment.

The UKCC had also identified the potential for exclusive leases to cause harm, more so in certain geographic areas that were found to be highly concentrated amongst grocery retailers. Specifically, the UKCC Inquiry identified 30 out of 384 stores wherein exclusive leases in highly concentrated local markets were found to be a barrier to entry. In remedying the issue, the UKCC imposed a 5-year exclusivity limit on all new shopping centres being built, with the further abolishment of existing exclusive clauses 5 years after the publication of the UKCC report.

In addition, the UKCC introduced a series of regulatory reforms which broadly sought to introduce more stringent competition measures into the planning process for new store developments; requiring that grocery retailers give up control over land sites in highly concentrated markets, tightening the provisions of the Supermarkets Code of Practice (which was subsequently replaced by the Grocery Supply Code of Practice and further obtaining legally binding commitments from retailers- commitments which would be further used in establishing an Ombudsman to oversee the Supermarket Code of Practice. In this regard the UKCC adopted a voluntary approach by requesting that stakeholders provided binding commitments to enable the formulation of an Ombudsman. However, the UKCC's efforts were unsuccessful in reaching a binding agreement with supermarkets on the respective commitments. In August 2009, the UKCC engaged with government, advocating for the Ombudsman to function on a statutory basis. As it currently stands the role of the Ombudsman has been incorporated into in various Bills with the broad aim of ensuring the proper functioning of the supermarket sector and preventing further abuses of power. To further note as at May 2012, the Groceries Code Adjudicator Bill was introduced in the House of Lords and received Royal Assent on 25 April 2013.

Through the introduction of the various regulatory reforms the UKCC has been provided with a platform to assess compliance in the grocery retail sector.

The Australian Consumer and Competition Commission

In 2008, following concerns of high levels of concentration in the grocery retail sector, as well as rapidly rising grocery food prices precipitated in part by the global food price rises that year, the ACCC led a market Inquiry to assess the state of competition in the grocery retail sector. The ACCC-led Inquiry was broad in scope and considered amongst others: the state of competition amongst supermarkets, supply chain issues, buyer power and restrictive constraints. The ACCC approach entailed constructing several price indices, then testing and measuring the effect of several causal factors on those prices. When conducting the price analyses the ACCC was able to determine whether competition diminished in relation to the several factors as well as exclusive lease agreements.

Similar to the UKCC, the ACCC found that exclusive leases, through their restrictive nature, created barriers to entry in local areas which were entrenched by the dominance of larger players. The ACCC further stated that these outcomes must be considered with caution, and that the findings may only be applicable in certain instances, i.e. where supermarket concentration issues persisted in certain localities. Interestingly, the ACCC further noted that exclusive leases are not always necessary to induce investment (which was the premise for exclusivity stated by incumbent supermarkets), with the only plausible reason being to restrict entry. Nonetheless, the ACCC did not prohibit exclusive leases outright as these arrangements in their view may have both pro-competitive and anticompetitive effects. Specifically, the ACCC found that exclusivity provisions may be justified in the regions where growth potential has been identified, whilst conversely in metropolitan areas exclusive leases are not permissible.

Pursuant to their findings the ACCC adopted an advocacy programme approach by engaging with various relevant stakeholders. Ultimately an agreement was reached between the various stakeholders, whereby incumbent supermarkets agreed to phase out all exclusivity clauses in existing lease agreements to the effect that all new lease agreements would no longer have exclusivity clauses.