

MEDIA ADDRESS ON THE PRELIMINARY REPORT OF THE GROCERY RETAIL MARKET INQUIRY

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29 MAY 2019

The Grocery Retail Sector Market Inquiry was established on 30 October 2015. The purpose of the Inquiry, as set out in the Terms of Reference, was to assess:

- the impact of the expansion, diversification and consolidation of national supermarket chains on small and independent retailers in townships, peri-urban areas and rural areas and the informal economy. This is dealt with in Objective 1;
- 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 local competition in the grocery retail sector. This is dealt with in Objective 2;
- the impact of the dynamics of competition between local and foreign national operated small and independent retailers in townships, peri-urban areas, rural areas and the informal economy on competition. This is dealt with in Objective 3;
- the impact of regulations, including, inter alia, municipal town planning and by-laws on small and independent retailers in townships, peri-urban areas, rural areas and the informal economy. This is dealt with in Objective 4;
- the impact of buyer groups and buyer power of the national retail chains on small and independent retailers in townships, peri-urban areas, rural areas and the informal economy. This is dealt with in Objective 5; and
- the impact of certain identified value chains on the operations of small and independent retailers in townships, peri-urban areas, rural areas and the informal economy.

Overview of Our findings

Broadly, the Inquiry found that there are features in the South African grocery retail sector that may prevent, distort or restrict competition. There are three principal areas of concern that warrant remedial action. These relate to:

- the use of long-term exclusive lease agreements and the exercise of buyer power by the national supermarket chains;
- the inability of small and independent retailers, particularly spaza shops to adapt to a changing competitive environment; and
- the lack of a pro-competitive regulatory regime that is aligned with the convenience model associated with small and independent retailers.

The Inquiry found that these factors were prohibitive to the realisation of the objectives of the Competition Act, which seek, amongst others, to realise inclusive economic participation.

The Inquiry is particularly concerned that the factors identified above have effectively excluded widespread participation in the retail sector in South Africa where barriers to entry should be low and participation possible.

This fundamentally undermines the objectives of the Competition Act and the broader national economic policy aimed at facilitating transformation and economic inclusion.

The need for the facilitation of new and sustainable entry, particularly that of smaller players, into markets such as the South African grocery retail sector is not only underscored by the broader public interest imperatives I have outlined above, it is also premised on the positive welfare enhancing outcomes such as consumer choice, convenience, innovation and competitive pricing, that accrue to the entry of such players.

Participation in the Inquiry

Before setting out the detail of the Inquiry's findings, it is important that I acknowledge the widespread participation by various stakeholders including the national supermarket chains, small and independent retailers, spaza shop owners, suppliers, consumers, government departments and some local authorities.

The Inquiry received more than 500 submissions, held over 80 round-table discussions, as well as public hearings held in the Western Cape, KwaZulu Natal, and Gauteng, six mini-public hearings in Limpopo, Mpumalanga, Northern Cape, Eastern Cape and the North West as well as targeted site visits. The extensive input received from these stakeholders informed the preliminary findings and proposed recommendations set out in the Preliminary Report and presented here today.

On behalf of the Inquiry, I would like to thank these stakeholders for their participation and look forward to further positive engagements until the conclusion of this Inquiry.

Scope of analysis and key elements of the South African grocery retail sector

The Inquiry conducted its analysis on the broad South African grocery retail sector.

It is also important to set out some key aspects of the South African grocery retail sector that underscore the findings of the Inquiry:

- small and independent retailers, including spaza shops, serve a useful convenience role akin to that of convenience stores in the garages located in the urban areas.
- the formal retail segment is characterised by high levels of concentration, with the incumbent national supermarket chains namely, Shoprite, Pick n Pay, Spar and Woolworths, accounting for a market share of 72%.
- there are significantly high barriers to entry in the formal retail segment for both challenger supermarket chains and specialist stores. In addition to these high barriers to entry, market conduct and regulatory constraints further raise barriers to entry and expansion in this sector.

Findings

With these structural considerations in mind, I now turn to the findings of the Inquiry.

Long-term exclusive lease agreements, buyer power and their distortions on competition between grocery retailers

The enormous bargaining power that the national supermarket chains have over property developers and suppliers enables them to demand exclusive leases, low rentals from property developers and rebates from suppliers for which only they qualify.

Regarding the practice of long-term exclusive lease agreements, the Inquiry found that this is widely prevalent across the country and that the exclusionary effects that arise endure for significant periods, some up to forty-five years. The justifications put forth by the national supermarket chains were not compelling for a number of reasons, including that the risk factor presented in justification for the necessity of such contracts is now significantly reduced.

What is even more concerning for the Inquiry was the overwhelming evidence pointing to a number of specialist stores and the emerging challenger retailers being foreclosed from the shopping centre environment, a crucial aspect for effective competition in South African grocery retail sector, as customers spend more than half of their grocery shopping expenditure in shopping centres.

Further, the Inquiry found that the foreclosure effects arising from the use of exclusive long-term lease agreements are aided and abetted by clauses stipulating the purpose of the space that is being leased and limitations to the landlord's right of letting the rental space.

Regarding buyer power and rebates, the Inquiry has found that:

- buyer groups have beneficial competition outcomes for their members (generally traditional and hybrid wholesalers as well as independent grocery retailers but generally do not include informal spaza shops;
- the national supermarket chains are a critical route to market for the suppliers of FMCG products;
- rebates are more favourably offered to the national supermarket chains, which resultantly reduce their costs, give them an unfair competitive advantage over the independent retailers and thereby entrench their market positions; and
- there is no clear rationale that explains the difference in the quantum of some of the rebates paid to the national supermarket chains when compared to those obtained by customers in the informal segment, other than simply differential buyer power.

Shifts in the competitive landscape and the impact on small and independent retailers

The Inquiry also found that small and independent retailers, particularly spaza shops, have struggled to adapt to a changing competitive environment as a result of the entry of the national supermarket chains in non-urban areas. The inability to adapt was also exacerbated by the presence of a regulatory regime that is not aligned with the convenience offering associated with small and independent retailers.

In this regard, the Inquiry determined that:

- the entry of the national supermarket chains has shifted the competitive landscape in non-urban areas in relation to price, product variety and consumer expectations;
- the entry of the national supermarket chains in non-urban areas has resulted in diversion of some of the customer demand previously serviced and the convenience factor offered by the small and independent retailers;
- this has led to a decline in the number of small independent grocery retailers in these areas;
- in addition to the competitive pressure that local-owned spaza shops face from the entry of the national supermarket chains, there appears to be increased competition from and displacement of local owned spaza shops by spaza shops owned by foreign nationals;

- the entry of national supermarket chains into townships and rural areas has helped to provide more choice and cheaper pricing for weekly and monthly shopping in closer proximity to consumers;
- However, the spaza shops will continue to play a critical convenience role for daily top-up shopping; and
- the regulatory environment is not conducive to supporting the sustainable competitiveness of these micro-enterprises in competing with supermarket chains, and, in many cases, it actively undermines their ability to respond to the changing competitive environment.

Proposed remedial actions

Broadly, the required remedial actions comprise a suite of interventions ranging from:

- changes in firm behaviour in order to ameliorate the distortions in competition in relation to long-term exclusive lease agreements and buyer power;
- support mechanisms to bolster the sustainable competitiveness of small and independent retailers; and
- modernisation of the regulatory landscape in order to create a conducive environment for the optimal functioning of competition.

Further, in order to ensure a streamlined and focussed implementation process of the proposed remedial actions, the Inquiry found it appropriate that a single implementing government department be tasked with the role of overseer and coordinator of the required interventions.

This single implementing government department must work with an inter-governmental committee that will coordinate and direct the work to be conducted by the various government departments in terms of the regulatory and other actions recommended by this Inquiry.

On **exclusive leases**, the Inquiry recommends the following:

- As of the date of publication of the final report, the incumbent national supermarket chains (Shoprite, Pick n Pay, Woolworths, Spar (including their subsidiaries) and their successors must, with immediate effect, cease from enforcing exclusivity provisions, or provisions that have a substantially similar effect, in their lease agreements against speciality stores.
- This also applies to other provisions which serve to restrict the product lines, store size and location within the shopping centre for speciality stores.

- No new leases or extensions to leases by the incumbent national supermarket chains may incorporate exclusivity clauses (or clauses that have substantially the same effect) or clauses that may serve to restrict the product lines, store size and location of other stores selling grocery items within the shopping centre.
- The enforcement of exclusivity by the incumbent national supermarket chains (including their subsidiaries) and their successors in title as against other grocery retailers (including the emerging challenger retailers) must be phased out within three years from the date of the publication of the final Inquiry report.

These recommendations permit the phasing out of existing exclusive agreements where appropriate, whilst setting the platform for a future where such agreements do not exist to restrict entry and expansion by specialist and emerging retail chains into shopping malls nationally.

Further, these recommendations must be contained within an agreed Industry Code of Conduct in order to ensure that they apply equally to all national chains.

Failing a voluntary or regulatory code, the Commission has the option to initiate enforcement action against the incumbent national supermarket chains. As outlined above, the Inquiry finds that the effect on these competitors has been substantial.

Regarding **buyer power and rebates**, the Inquiry recognises that this is an entrenched business practice that may be difficult to move away from without causing commercial upheaval. Thus, this necessitates a joint effort in finding potential solutions that might enable a movement towards a more non-discriminatory outcome, but which also recognizes the value of the current business model's reliance on such rebates. Some of the possibilities may include:

- a more immediate move towards non-discrimination in terms of rebates that are common across retail and wholesale customers;
- a gradual removal, rationalization or limitation in size of those rebates only provided to the national supermarket chains and not to wholesalers; and a shift of such rebate values to rebates that are common across the two groups where non-discrimination principles would apply; or alternatively;
- a gradual extension of some of those rebates currently only provided to the national supermarket chains to wholesalers/buyer groups (or directly to their members).

It is important to note that this is not an outright prohibition of rebates as the Inquiry is only concerned about those rebates that give rise to differential treatment without any objective

justification between national supermarket chains, on one hand, and small and independent retailers, on the other hand.

The Inquiry is of the view that the remedial action that is ultimately identified must also form part of a mandatory Industry Code of Conduct that will fall within the scope of a single government implementing department.

On **lease rental rate differentials**, the Inquiry is mindful that the elimination of exclusive leases may still not have the desired effect of enhancing competition and economic participation if rental rates are highly discriminatory in favour of the national retail chains. Changes ideally need to occur to the manner in which rental rates are set and the extent of differentials that currently exist in shopping malls across the country.

The Inquiry intends to embark on further consultations with property developers, supermarket chains, emerging retail chains and independent stores in the next phase in order to identify a workable transition model.

Regarding **support for spaza shops and small independent retailers in order to remain competitive**, the Inquiry believes that there is a need for:

- improved bargaining and procurement processes;
- the removal of information asymmetries in order to improve access to credit finance; and
- providing support for the enhancement of business skills.

The Inquiry acknowledges that there are numerous market driven initiatives and business models that already provide greater purchasing power and credit to certain independent retailers.

Accordingly, the Inquiry recommends that the single implementing department coordinates seed finance for innovative commercial models of private businesses that aim to offer the following support for spaza shops:

- The effective incorporation of spaza shops into buyer groups and larger wholesale operations to assist them to realise economies of scale and scope in purchasing;
- The generation of key business information on individual spaza shop operations such that the risks of extending credit finance to these shops can be more accurately assessed; and

- The development of consumer and business information to assist in the improvement of such businesses, including business and financial management training to lead to the professionalisation of this class of grocery convenience store.

On the **removal of regulatory obstacles to meeting competitive challenges**, the Inquiry recommends that:

- municipalities must review the by-laws and regulations in relation to spaza shops and street traders with the view to abolish the regulation of trading times for these businesses. This is with the exception of liquor trade;
- municipalities must fastrack the approval of any existing re-zoning requests for spaza shops in township areas;
- the single implementing department must coordinate the determination of preferred zoning processes and practices that facilitate ease of entry for small businesses in non-urban areas;
- municipalities must proactively rezone areas and erect infrastructure for informal traders to enable them to carry on business in a more effective and formalised manner;
- municipalities must develop and implement a framework for the registration of informal businesses particularly spaza shops, within the municipal jurisdiction;
- there must be increased coordination between the South African Revenue Services (“SARS”) and the South African Police Services (“SAPS”) to facilitate proactive policing against widespread trade in counterfeit goods; and
- there must be improved coordination by government in addressing the regulatory challenges which affect small businesses.