



*competition***commission**
south africa

POULTRY
MARKET INQUIRY
DRAFT TERMS OF REFERENCE

06 FEBRUARY 2024

1. INITIATION OF A MARKET INQUIRY

- 1.1. The Competition Commission (“Commission”) will conduct a market inquiry into the poultry industry value chain, the “Poultry Market Inquiry” (or “PMI”). The poultry industry (broiler chicken and egg production) is responsible for 65% of all animal protein consumed in South Africa, owing to the production of both chicken meat and eggs. The poultry industry is also the largest contributor to the agricultural sector with a total annual gross value of production of almost R72 billion in 2022, accounting for 17.1% of total agricultural gross value and 40.3% of total animal product gross value.¹
- 1.2. Poultry producers generally specialise in either broiler production, for the overall supply of chicken meat products, or the production of commercial egg products. The poultry value chain includes the production and supply of poultry feed, the supply and rearing of grandparent and parent stock, the production and supply of day-old broiler chicks and layer pullets (day-old chick reared for commercial egg production), the rearing of broilers to produce chicken meat products or the rearing of point-of-lay hens to produce commercial eggs, and processing (abattoirs) and marketing activities. Poultry products are sold through retail channels to consumers and wholesale channels to the restaurant and catering industry and other food companies (e.g., bakeries and processed foods).
- 1.3. In the broiler industry there are ongoing demands for bailouts through ever-increasing tariffs and the imposition of anti-dumping duties. Whilst acceding to these demands may protect the domestic industry, it may create negative consequences for consumers generally, and low-income consumers in particular which are dependent on chicken for protein. More recently, the industry has faced short-term challenges in the form of avian flu, impacting commercial egg production particularly, and load-shedding.
- 1.4. However, there are also market features of the poultry industry that are likely to impede, restrict or distort competition. Impediments to competition is itself a concern, as it prevents the benefits of dynamic competition and greater levels of participation, but even more so if it is contributing to the challenges with international competitiveness and higher consumer prices. These features include structural indicators, the outcomes in the industry and certain conduct along the value chain. At the very least, addressing

¹ Who Owns Whom (2023). “The Poultry and Egg Industry in South Africa, SIC codes 30111b and 61210a”.

these market features through a market inquiry can only benefit industry competitiveness and consumers through the improvement in competition.

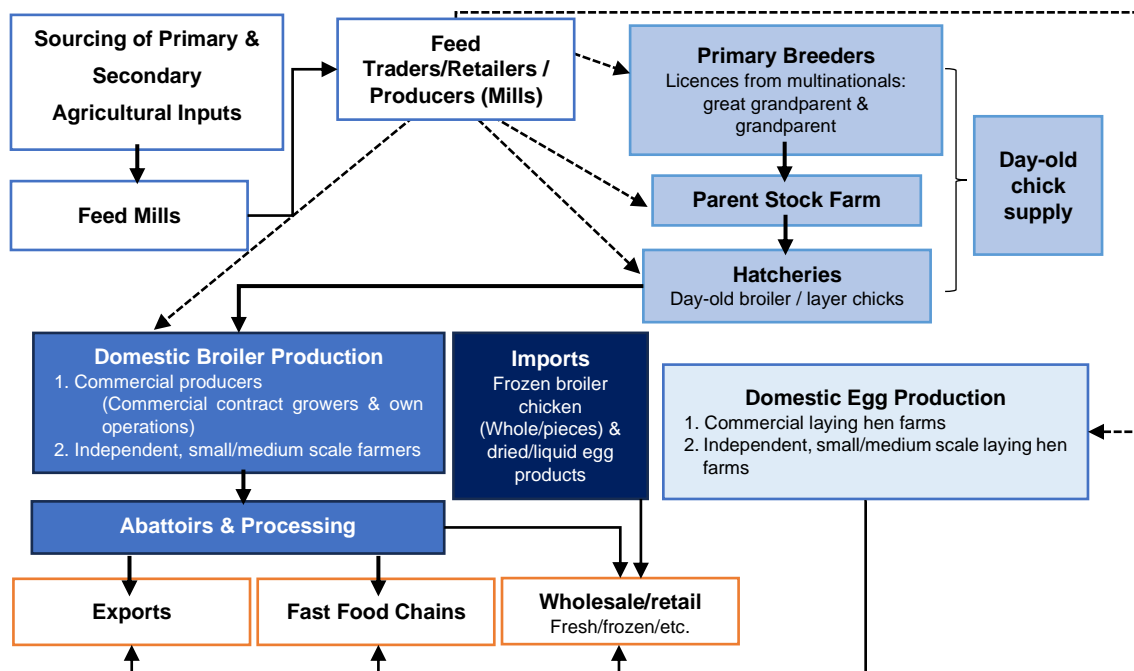
- 1.5. The South African poultry industry is dominated by few, large, vertically integrated companies. The Commission found in the 2021 Concentration Study that each value chain activity shows elevated levels of concentration. This applies from the production of important inputs to the end products that are sold through retailers or restaurants. Alongside concentration, there is vertical integration which makes independent producers customers of the larger players in terms of inputs such as feed and day-old chicks. Whilst contract farming has promoted entry, these are not independent competitors but rather form part of the integrated operations of the dominant companies, dependent on them for all aspects of their existence. The market structure poses material barriers to independent entry at scale and may enable conduct that raises those barriers further.
- 1.6. The South African Poultry Sector Master Plan (Master Plan) ², signed by all parties in November 2019, was designed to promote the development and transformation of the sector, including measures to expand and improve production, raise domestic and export demand, along with addressing certain trade related measures. As a negotiated agreement between the public sector and the industry, the Master Plan cannot and does not seek to address the structure, outcomes and conduct that are likely to be adversely affecting competition. It is complementary to a market inquiry.
- 1.7. The PMI will be initiated in terms of section 43B(1)(a) of the Competition Act 89 of 1998 (as amended) given that the Commission has reason to believe that there exist market features within several markets along the poultry market which may impede, distort or restrict competition, or undermine the purposes of the Act, and which have material implications for the poultry industry of South Africa, and ultimately consumers. These reasons are set out in more detail below along with the draft Scope of the Inquiry.
- 1.8. Public comments are invited on the Scope of the Inquiry by 16h00 on 15 March 2024.

² Department of Trade, Industry and Competition (DTIC) (2019). "The South African Poultry Sector Master Plan November 2019".

2. BACKGROUND TO THE POULTRY MARKET VALUE CHAIN

2.1. The poultry market is characterised by a complex value chain with high levels of vertical integration and concentration. Most of South Africa's broiler chicken and egg products are produced by large commercial firms that are generally vertically integrated from the genetics and day-old chicks through to animal feed and the slaughter, processing, and distribution level. The figure below provides a summary of the poultry value chain in South Africa.

Figure 1: Poultry industry value chain



Source: Commission's own summarised interpretation based on market research and previous cases.

2.2. Poultry production begins with sourcing genetic material from the global intellectual property holders of breeding stock. For broilers, the predominant breeds are Cobb 500 (owned by Cobb-Vantress), Ross 308 (owned by Aviagen) and Arbor Acres (owned by Aviagen). Lohmann and Hy-line are the two main commercial egg breeds available in South African market.

2.3. The process for rearing day-old chicks from genetic material is similar for broilers and egg layers:

- 2.3.1. Genetic stock is imported into South Africa for breeders to rear grandparent or parent stock birds that produce fertilised eggs. These fertilised eggs are transferred to hatcheries to be incubated and hatched to produce day-old chicks.
- 2.3.2. In the case of broilers, day-old chicks are reared for up to 38 days until they are ready for slaughter. For eggs, day-old chicks (also known as pullets) are reared for 21 weeks when they begin laying commercial eggs.
- 2.4. The affordability and quality of day-old chicks are imperative for efficient production and cost management. South Africa is an importer of genetics, specifically at the grandparent level,³ which enables local producers with access to quality genetic pools globally. Due to imports occurring at the grandparent level, higher feed costs are also incurred at this level which raises the cost of the supply of day-old chicks.⁴ In addition, exchange rates are another component of the cost of day-old chicks from the importation of genetic material.⁵ Variations in the price of day-old chicks is also determined by the supply arrangement with day-old chick suppliers. That is, some integrated companies may supply day-old chicks at cost whilst others may supply at market value.
- 2.5. Feed is another crucial input alongside genetics and day-old chicks. It is estimated that feed accounts for approximately 70% of the industry's variable costs. Feed is manufactured by feed mills from a range of inputs that are combined by mills according to specifications for the type of chicken (broiler or layer) and its age:
- 2.5.1. *Primary agricultural inputs:* Several grains are used in the feed manufacturing process with the most important being maize, the dominant energy source for animals. Other grains may include barley, wheat, oats, and sorghum.
- 2.5.2. *Manufacturing by-products:* By-products from other agro-processing activities are also important maize ingredients. These include oilcakes which provide a

³ Broiler breeder genetics are imported into South Africa at great-grandparent and grandparent level with limited imports at the parent stock level. Currently, imports of fertile eggs at any level of the breeding cycle are prohibited in South Africa. As a result, the complete biological cycle includes the breeding and rearing of grandparent and parent stock prior to the rearing of commercial day-old chicks where the complete production process requires 12 to 22 months. Hence, feed costs also play a major role at these levels of the value chain, impacting on the overall price of day-old chicks for broiler and egg production.

⁴ BFAP (2023). Evaluating the competitiveness of the South African broiler value chain.

⁵ Ibid. For example, a depreciation in the Rand (ZAR) increases the cost of genetic material relative to the rest of the world.

protein source. Other by-products may include wheat bran, flour, maize chop, gluten meal, germ, and straw.

2.5.3. *Vitamins, minerals, and medicines:* These are imported or sourced from the mining industry to supplement grains and oilseeds used to make feed.

2.6. Feed prices are the most significant cost driver in the production of chicken meat and commercial eggs. Preliminary observations show that broiler producers have had periods where they could not recover the cost of feed through prices when feed costs have increased. However, producers have also not transmitted lower feed prices to the price of chicken meat. Similarly, egg producers have not been able to fully pass on feed price increases.

2.7. Broiler and egg production takes place on farms owned by large commercial players or contract growers.

2.7.1. The 4 largest chicken producers – Astral, RCL, Country Bird, and Sovereign - account for nearly 63% of South Africa's chicken production. When broilers are fully grown, they are slaughtered at an abattoir and processed for sale in the retail market and hospitality sector. However, since South Africa does not produce enough chicken to meet consumption, imports of frozen chicken play a vital role. In 2022, 359 000 tonnes of chicken were imported into the country. Most of these imports (53%) were of mechanically deboned chicken used in processed meat production; 43% were of frozen pieces and offal; and 2% were of fresh and chilled pieces and offal. South Africa uses an active trade policy regime to manage the price at which imports come into the country. This regime includes quotas, import duties, and anti-dumping duties. All of these are subject to change as market conditions evolve.

2.7.2. Egg producers rear their own point of lay hens since the quality of the rearing process has a direct bearing on the efficiency with which the hen will produce eggs. The final stage is marketing where the outputs are eggs and spent hens. Eggs are bought and sold by the major retailers, the hospitality sector, and

informal traders. Three large firms account for estimated 51% of total egg production as of 2022/3.⁶

- 2.8. Contract growing has become a popular trend in poultry industry with more and more production taking place outside of the operations of large integrated players. The reliance on contract growers is not unique to South Africa and is global model by which large producers manage and transfer risk to smaller independent growers. It is estimated that there are 450 contract growers in South Africa. Broiler production by contract farmers accounted for an estimated 60 – 80% of broiler production in 2022 compared to 51% in 2009.⁷
- 2.9. The price paid to the contract farmers is determined by the contractor, after which the cost of supplied inputs like feed is deducted. While contractors use the same basic system, minor differences in compensation relate mainly to the system used for payment of bonuses. Compensation consists of three components a fixed margin per kg, a cost recovery component based on the tournament pricing structure, and an optimal bonus payment based on a fixed performance standard. The margin and cost components are used by all contractors with small differences in the size of the margin as well as the formula used to adjust the margin over time. The bonus payment is not available to all producers as some contractors' base compensation only on fixed margin and Cost recovery component.⁸
- 2.10. The entry of contract growers has been partly enabled by the sale of poultry farms by major poultry producers to new contract farmers (e.g., Daybreak Farms sold off seven of its farms to black poultry producers).⁹ Given the advantages of being part of an integrated value chain in this industry, there are benefits to independent farmers becoming contract growers. Contract growers cover the most crucial broiler production stage and allows these farmers and large corporates to potentially increase efficiencies within the integrated value chain. The contract grower model also allows for the spread of broiler production at any given cycle over several farms which may impede the pursuit

⁶ Who Owns Whom (2023). "The Poultry and Egg Industry in South Africa, SIC codes 30111b and 61210a".

⁷ Competition Commission (2021). "Measuring Concentration and Participation in the South African Economy: Levels and Trends," main report, November 2021.

⁸ Davids, T & Meyer, F (2017). "Price formation and competitiveness of the South African broiler industry in the global context"

⁹ Competition Commission (2021). "Measuring Concentration and Participation in the South African Economy: Levels and Trends," main report, November 2021.

of scale economies but may provide protection with respect to biosecurity considerations given that disease outbreaks and appropriate quarantine measures can be adopted on a smaller or less disruptive scale.

2.11. Across the poultry industry value chain, transport logistics is an important aspect for the transport of feed, other input supplies, fertilised eggs, day-old chicks, live birds, and processed broiler meat. Domestically, road transport is used for all poultry activities from suppliers to producers and from producers to wholesale and retail markets. Processed or commercial eggs have a short shelf life, and distribution activities are a critical element of the overall marketing process. As such, the distribution activities are often handled by the producing companies or closely tied contractors. On the other hand, processed broiler meat logistics involves specialised cold chain logistics where the meat is transported in strict temperature controlled refrigerated vehicles to storage facilities and then to point-of-sale or customers. In some cases, large commercial growers may undertake their own cold storage and cold chain logistics or utilise third-party distribution and cold storage services companies (especially for long-distance and interprovincial movements of chicken meat).

3. MARKET FEATURES OF THE POULTRY VALUE CHAIN

3.1. Section 43A sets out firstly that a market inquiry means '*a formal inquiry in respect of the general state of competition, the levels of concentration in and the structure of a market*'. It continues to identify that the focus is not necessarily on the conduct of a single named firm, but rather whether any market feature impedes, restricts, or distorts competition within that market. In section 43A (3), market features are identified as including the structure of the market, the outcomes observed in the market and conduct by firms in the market or that supply to or acquire from the market. These different categories of market features are used to structure the identification of features that the Commission has reasonable belief are having an adverse effect on competition in the poultry industry.

Structure

3.2. As mentioned, the South African poultry value chain is highly concentrated and characterised by vertical integration. The largest producers of broilers and eggs have a

presence from essential inputs through to retail brands sold through retailers. These integrated firms sell inputs to their internal operations and contract growers as well as to independent and emerging farmers and producers in the value chain, creating a reliance on a larger competitor by emerging players:

3.2.1. *Genetic material:* Genetic material is concentrated globally with 90% of all broiler production coming from breed owned by Aviagen Inc. and Cobb-Vantress LLC. Only four South African companies have distribution rights for these breeds in the South African market. Ross 308 is supplied by Astral; Cobb 500 is supplied by RCL and Quantum; Arbor Acres is supplied by Country Bird. For egg laying hens, Lohmann and Hy-line are the two main commercial egg breeds available in the South African. Quantum owns the rights to import the grandparent stock of the Lohmann chicken breed to South Africa¹⁰ The Hy-line breed is imported at the grandparent stock level by Hy-line South Africa (Pty) Ltd (Hy-line SA).¹¹ The Dekalb Amberlink breed is also used for egg production and the genetic distribution is owned by Serfontein Poultry.

3.2.2. *Day old chick supply:* Local distributors for the broiler and egg-laying hen breeds all control the value chain from the import of breeding stock to the supply of day-old chicks. The distributors supply parent stock to their own integrated breeding operations and to unintegrated companies which are typically contracted breed rearing farmers to enable the distributor to retain control over the supply. Parent birds are reared until they can produce fertilised eggs. Fertilised eggs are transferred to hatcheries (either integrated, contracted, or independent) where they are hatched to produce day-old broiler chicks, which are either sold to independent farmers, supplied to contract growers or to the integrated producers on rearing facilities.

3.2.3. *Feed:* In 2020, there were 30 feed companies where 75% of feed production is produced by three companies that are owned by the vertically integrated

¹⁰ Quantum Annual Report 2022.

¹¹ Hy-line SA is an independent breeding stock provider that is the South African distribution subsidiary of Hy-line International and unaffiliated to any downstream entities.

companies - Meadow Feeds - part of Astral, Epol – part of RCL Foods and Afagri.¹² Another prominent feed manufacturer is Nova, which is part of Quantum Foods. Independent millers make up approximately 25% of the industry.

3.2.4. *Egg supply:* Large players similarly dominate egg production with three firms (Quantum Foods, Sovereign Foods, Kuipers) supplying 51% of the market. Most eggs, 75%, end up in the formal sector through major retailers and the hospitality sector.

3.2.5. *Broiler production and supply:* Two companies, RCL and Astral, dominate local production and have enjoyed a joint market share above 35% since 2015. Excluding exports, the market share has been closer to 50%. Participation by emerging players has not affected the leading positions of these players.

3.3. Not only is the poultry value chain concentrated at every level, but vertical integration means that it is typically the same large companies that dominate at each level. Access to the breeding stock enables those companies to dominate the process of developing day-old chicks and the use of those chicks in broiler or egg production. The companies have made use of contracted parties to increase capacity but still retain control of inputs and markets. The table below presents a summary of some of the large integrated poultry producers in South Africa.

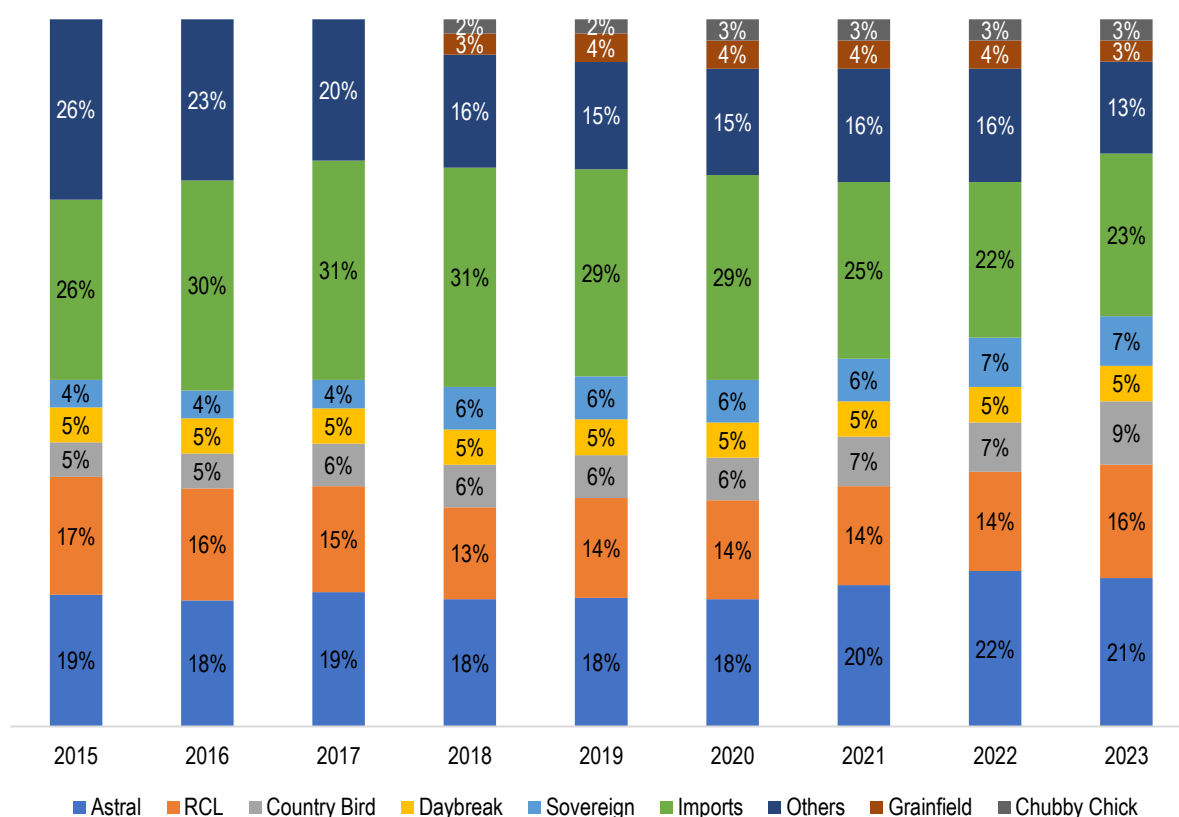
Table 1: Integrated poultry producers in South Africa.

	Feed	Breeder / Parent Stock / Hatchery	Day-old chick (broiler) / pullet supplier	Reared live broilers / layers	Abattoirs	Broiler Processing & Supply	Egg Production
Astral Foods	X	X	Broiler	X	X	X	
Country Bird Holdings	X	X			X	X	
RCL Foods	X	X	Broiler	X	X	X	
Quantum Foods	X	X	Broiler & layer pullets	Broilers (contract) & layers			X
Sovereign Foods			Broilers	Broilers	X	X	
Kuipers Group	X		Broilers	Broilers & layers	X		X

¹² DALRRD. "A Profile of the South African Broiler Market Value Chain 2021". Available at: <http://webapps1.daff.gov.za/AmisAdmin/upload/Broiler%20Market%20Value%20Chain%20Profile%202021.pdf> [Accessed on 18 October 2023]

3.4. The structure of the poultry industry has not changed materially in recent years, despite the governments' industrial policy interventions and active trade policies. The figure below shows that the largest broiler producers' market shares have all grown since 2015 while those of other players has shrunk. As such, concentration levels remain high raising the risk of anti-competitive conduct and imbalanced relationships that impede participation by emerging producers.

Figure 2: Market shares in the South African broiler market



Source: Astral Annual Results Presentations, 2015-2023.

Outcomes

3.5. The concentration levels and vertical integration in poultry production have limited the scope for new players to enter the market and compete with established producers. Consequently, transformation in the poultry industry remains slow. Contract growers, while an important part of the value chain, remain highly dependent on the integrated producers for inputs such as a feed and day-old chicks. This dependence also deprives them of an independent route to market through retail or the fast-food industry.

- 3.6. The South African Poultry Association (SAPA) has found several challenges affecting subsistence and small-scale broiler producers through its surveys of the market.¹³ Aside from the more generic challenges all businesses face in the current economic environment, the following factors are seen to have the effect of impeding the growth of new producers in competing with large existing producers:
- 3.6.1. Difficulties in sourcing fertile hatching eggs and good quality day-old chicks as well as late delivery of day-old chicks and substandard quality of delivered day-old chicks.
 - 3.6.2. Difficulties in sourcing reasonably priced feed and vaccines, poor or erratic water and electricity supply, and access to abattoir services which can be in part due to remoteness of some producers.
 - 3.6.3. The lack of working capital (for feed, chicks, and medications), access to finance (maintaining or upgrading facilities), cashflow problems (as a result of customers defaulting on payment) and low or no profits due to high input costs and other production challenges.
 - 3.6.4. Other challenges noted by SAPA include unstable or poor market conditions, high mortality rates due to inclement weather and disease, and a lack of training and skills in poultry husbandry and abattoir management.
 - 3.6.5. Other concerns that affect small and independent firms include the lack of independent abattoirs to market and sell dressed chicken meat into the formal sectors. These producers often cannot enforce tractability measures such as bar-codes which relegates them to supplying the informal sector.
- 3.7. As mentioned, South Africa imports significant amount of chicken to meet the domestic production gap. These imports are subject to a tariff regime that is actively managed and intended to protect South African producers from unfair import competition. Whilst there are aspects to global trade which can result in unfair competition, such as feed subsidies and a limited market for brown meat in industrial countries, other domestic

¹³ SAPA Annual Report 2022. Available at: <https://www.sapoultry.co.za/wp-content/uploads/2023/06/SAPA-AR-2022.pdf>

factors may be contributing to the local industry being uncompetitive in international markets, including a market structure that may impede competition.

Conduct

3.8. Contract growing has been coming under more scrutiny by regulators and policymakers in other jurisdictions, where there are concerns about the power imbalances that manifest themselves through information asymmetry and tournament systems in contracts. Authorities in the United States of America, the Department of Agriculture (USDA) along with the Federal Trade Commission (FTC), have over several years, raised concerns and received a range of complaints about tournament systems used to remunerate growers and the ways in which they enable contractors to exercise market power over growers. Researchers have noted that grower contracts in the United States and South Africa for broiler production share similar characteristics.¹⁴

3.8.1. One concern is transparency regarding what contract growers could potentially earn, especially where integrators have a high-level of discretion that can adversely affect growers. To remedy these concerns, the USDA recently amended regulations under the Packers and Stockyards Act to add a series of disclosures to enhance transparency in the relationship between growers and integrators.¹⁵

3.8.2. The FTC has raised concerns about the wide discretion that contractors have when they evaluate fully-grown chickens and determine the prices to be paid to contract growers under the tournament system. Specifically, there are concerns that prices are subject to wide and often inexplicable variations from year to year. Another concern that has been raised is the lack of a regulations or standards to ensure that the quality of chicks and feed that contract growers receive is the

¹⁴ Davids, T & Meyer, F (2017). "Price formation and competitiveness of the South African broiler industry in the global context"

¹⁵ USDA. (2023). Transparency in Poultry Grower Contracting and Tournaments – A Rule by the Agricultural Marketing Service. Available online: <https://www.federalregister.gov/documents/2023/11/28/2023-24922/transparency-in-poultry-grower-contracting-and-tournaments>

same across all growers, which are the key determinants of success under the tournament system.¹⁶

3.8.3. Contracts used in the USA require growers to carry the costs of production capital including land, buildings, and equipment much like in SA. However, they include mandatory requirements that are specific to or tailored for a contractor. These specifications cover square footage, ventilation capacity, water systems, among others.¹⁷ It has been reported that the effect of specifications is to tie contract growers into exclusive relationships with a particular contractor making switching more expensive.

3.9. In addition to entrenching asymmetrical bargaining dynamics between large producers and emerging farmers, the current market structure may serve as a barrier to accessing retail and/or end-user customers for emerging producers. Large producers have established commercial relationships that an emerging player is unlikely to replicate. This issue may also be exacerbated by dumped imports that constrain producer prices and limit their ability to sustainably recover production costs and may be a determining factor behind consolidation.

3.10. The large integrated producers in SA also make use of contracting at other levels of the value chain, such as for parent stock breeding and the hatcheries for one-day old chicks. Contract relationships at these levels of the value chain are generally likely to create dependency as the contractors will be similarly reliant on the large integrated firms for both inputs and for market access. This situation is likely to result in an imbalance of power in their design and execution, placing the contracted producers in adverse market circumstances.

¹⁶ FTC (2023). "Poultry Growing Tournament Systems: Fairness and Related Concerns – Written Submission of Federal Trade Commission Chair Lina M. Kahn" Available online: https://www.ftc.gov/system/files/ftc_gov/pdf/Comment%20of%20Lina%20M.%20Khan%20on%20USDA%20ANPR%20re%20Poultry%20Growing%20Tournament%20Systems.pdf

¹⁷ FTC (2023). "Poultry Growing Tournament Systems: Fairness and Related Concerns – Written Submission of Federal Trade Commission Chair Lina M. Kahn" Available online: https://www.ftc.gov/system/files/ftc_gov/pdf/Comment%20of%20Lina%20M.%20Khan%20on%20USDA%20ANPR%20re%20Poultry%20Growing%20Tournament%20Systems.pdf

4. SCOPE OF INQUIRY

- 4.1. Consistent with section 43B of the Act, the PMI will focus on whether there are any market features in South African poultry industry which impede, restrict, or distort competition, or undermine the purposes of the Act. The poultry market incorporates all components from genetics through to retail and wholesale customers, including all suppliers to each stage of the value chain, from feed to logistics.
- 4.2. The main objectives of the inquiry into Poultry Market value chain, in respect of both chicken meat and egg value chains, are to:
 - 4.2.1. Evaluate whether market features distort competition throughout the value chain including the pricing and access to quality key inputs such as genetic stock, parent stock, feed, eggs, day-old chicks of pullets (for both broiler and egg-laying hen rearing), abattoirs and cold chain logistics.
 - 4.2.2. Evaluate the impact of large integrated producers as gatekeepers of key inputs, particularly feed and day-old chicks, on the production of small and medium-size enterprises (“SMEs”) and/or businesses owned by historically disadvantaged persons (“HDPs”), but also genetic stock and parent stock for both broiler and egg production.
 - 4.2.3. Evaluate whether the commercial relationship between contract growers and integrated producers at all levels of the value chain is characterised by imbalances in bargaining power and information asymmetry and understand the impact of such imbalances on competitive outcomes affecting the growth and sustainability of small-scale producers in the industry, including the emergence of independent competitors with access to markets.
 - 4.2.4. Evaluate the role of retailers, quick-service restaurants, and processed food companies in facilitating new entry and access to markets by independent producers, including SMEs and HDPs, along with the availability and pricing of cold chain storage and logistics, whether private or communal.

4.2.5. Determine appropriate remedies where an adverse effect on competition or the purposes of the Act are found as set out in section 43C (3) of the Act.

5. MARKET INQUIRY TIMELINES AND PROCESS

5.1. The public is invited to submit comments on these draft Terms of Reference by 16h00 on 15 March 2024. Written submissions can be sent to pmi@compcom.co.za. All submissions will be reviewed, and a final Terms of Reference published by the Commission.

5.2. The PMI will commence 20 business days after the publication of the final Terms of Reference and the final report will be completed within 18 months, as per the statutory requirements of sections 43B (2) and 43B(4)(a) of the Act respectively. Details on the administrative phases of the inquiry along with Guidelines for Participation will be made available on the Commission's website once the final Terms of Reference are published. At that point, members of the public and businesses will be invited to provide written representations and information to the inquiry.