

THE GROCERY RETAIL MARKET INQUIRY

PRELIMINARY FINDINGS AND RECOMMENDATIONS

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PRELIMINARY FINDINGS AND RECOMMENDATIONS OF THE GROCERY RETAIL MARKET INQUIRY

1. Broadly, the Inquiry found that there is a combination of features in the South African grocery retail sector that may prevent, distort or restrict competition. In particular, there are three principal areas of concern that warrant remedial action, namely long term exclusive lease agreements and buyer power; competitiveness of small and independent retailers; and the regulatory landscape.

Market structure and the Inquiry's scope of analysis

2. The Inquiry considered the market structure of the South African grocery retail sector and found that it is broadly split between formal and informal segments. In the formal segment, the Inquiry found that there are a number of suppliers of FMCGs and a few national supermarket chains, hybrid wholesalers as well as emerging challenger retailers. In the informal segment, the Inquiry found that there are a number of independent wholesalers and retailers (e.g. general dealers, spaza shops and hawkers).
3. At the supplier level of the South African grocery retail sector, there are a number of firms who manufacture and supply various FMCGs to different retail platforms. These suppliers are of varying size, with a limited number of large multi-product firms.
4. In the formal retail channel, there are about seven national supermarket chains comprised of four incumbent firms and about three emerging challenger retail operations. The incumbents generally have a retail presence across the country whilst the emerging challenger retailers are present in specific parts of South Africa. The broader wholesale and independent retail channel is made up of a number of independent firms including wholesalers, general dealers, buyer groups (who represent wholesalers, among others), right down to spaza shops.
5. There is very limited information regarding the levels of concentration in the broader South African grocery retail sector. However, what is clear is that the supplier level of the value chain is characterised by the presence of a large number of players active in the various sub-sectors with a few large multi-product firms. Data from StatsSA indicates high levels of concentration in the formal retail channel, the national supermarket chains, namely, Shoprite, Pick n Pay, Spar and Woolworths collectively have a market share of 72%.
6. The levels of concentration in the formal retail channel, in particular, are also reinforced by the high levels of barriers to entry that seem to exist at this level of the value chain. It is common cause that entry at this level requires the acquisition of land and buildings which necessitates significant capital expenditure in order to make entry, the realisation of significant economies of scale and scope, the establishment of an extensive distribution network in order to be competitive, and compliance with stringent regulatory requirements in order to remain operational. The Inquiry also found that the formal segment is characterised by high barriers to entry and expansion at the supplier level of the value chain.
7. The Inquiry also established that the national supermarket chains are vertically integrated in that they act as both distributor and retailer of groceries.

This vertical integration appears to confer some competitive advantage as there is recognition that such strategies yield efficiencies in the distribution system and savings for suppliers. This vertical integration does not appear altogether unique to the national supermarket chains as there are some buyer groups that have also adopted this strategy and established their own central distribution centres while some of the buyer groups have members who also own distribution centres.

8. The above entry and competitive conditions are applicable to all players that are active in the formal retail channel. Similarly, the conditions of entry and competition that prevail in the informal retail channel are also similar irrespective of where these players are located.
9. It is the view of the Inquiry that the market structure of the South African grocery retail sector, as alluded to above, creates a conducive environment for a significantly altered bargaining framework between the national supermarket chains and their suppliers (be it suppliers of FMCG products or property developers). This altered bargaining framework leads to distortions in competition between the national supermarket chains, emerging challenger retailers and those firms that are active in the wholesale, independent retail channel.
10. From a customer perspective, the purchasing decisions (underpinned by demand-side considerations) made by consumers across LSM groups tend to be informed by the same factors, namely price, availability, convenience or quality. It is for this reason that low income households, for example, appear to rely on both spaza shops and the national supermarket chains for their grocery needs. For those customers that reside in non-urban areas, the national supermarket chains and spaza shops serve a useful substitutable and complementary purpose. It seems that consumers shop at spaza shops (where they generally spend less than 40% of their budget) for the convenience of location and trading hours relevant mostly for day-to-day items, whilst they shop at the national supermarket chains for weekly and

monthly shopping where price, variety, quality and packaging size matter. In non-urban areas, spaza shops serve a useful convenience role (akin to that of convenience stores in the garages located in the urban areas).

11. This consumer dynamic is expected given that there is acknowledgement that asymmetrical competition dynamics exist between large national supermarket chains and independent grocery retailers in the informal retail channel. Consumers may find that large national supermarket chains are substitutes for independent grocery retailers under certain conditions, particularly where a large national supermarket chain is able to service the convenience aspect that spaza shops, for example, have traditionally filled.
12. With this background in mind, the scope of analysis adopted by the Inquiry was premised on the view that the products and services provided by grocery retailers (both formal and informal, in their respective categories) are provided under similar entry and competitive conditions in South Africa. As a result of these considerations, the scope of analysis for the Inquiry is the broad grocery retail sector in South Africa.
13. We now turn to the findings of the Inquiry in light of its objectives.

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

14. First, when viewed within a bargaining framework, there appears to be a sustained pattern of behaviour by the national supermarket chains and their counterparts (whether property developers or suppliers of FMCG products) that:
 - 14.1 enables or results in the exercise of market power by the national supermarket chains to the exclusion of smaller, independent stores as well as emerging challenger retailers such as OBC, Choppies, Fruit and Veg and Food Lovers Market; and

- 14.2 creates a conducive environment for the exercise of buyer power, with its concomitant distortion of competition between the national supermarket chains, wholesalers and independent retailers.
 15. This pattern manifests itself in respect of long-term exclusive leases in shopping centres and the payment of rebates by suppliers to the national supermarket chains, both of which have the effect of:
 - 15.1 reinforcing the levels of concentration in the formal retail segment;
 - 15.2 entrenching incumbency by the national supermarket chains; and
 - 15.3 raising barriers to entry for small and independent retailers and thus removing a crucial element for competition in the retail ecosystem i.e. emerging challenger retailers.
 16. Cumulatively, the exclusionary effects arising from this pattern have resulted in restricted consumer choice.
- The impact of long-term exclusive lease agreements on competition in the grocery retail sector*
17. The bargaining power possessed by the national supermarket chains (as anchor tenants) manifests itself in the requirement for exclusivity in lease agreements. For example, while some of the national supermarket chains alleged that the financiers of property developments required such exclusivity, the Inquiry established that this is not the case.
 18. The Inquiry established that financiers typically require property developers to secure national supermarket chains as anchor tenants that will remain operational in the development for the duration of the loan repayment period, which is usually 10 years before they are willing to finance a development.
 19. The Inquiry found that national supermarket chains (as anchor tenants) exploited this requirement by requiring exclusivity, claiming that this is to protect their investment and compensate them for accepting the risk of paying rent for 10 years, irrespective of the success of the mall.
 20. The Inquiry established that there is a pattern of sustained use of long-term exclusive lease agreements by the national supermarket chains in shopping centres across South Africa. The pattern of these long-term exclusive lease agreements appears to have persisted over long periods of time with the initial lease period being generally 10 years. When regard is given to the renewal clauses in these lease agreements, some of these contracts could endure for a period of at least 30 years.
 21. The Inquiry found that given the high levels of concentration in the formal retail channel, which the incumbent national supermarket chains account for a significant portion thereof, the foreclosure effects that arise as a result are significant. Whilst the historic focus of the effect of exclusive leases was on competition between the national chains, the Inquiry has focused on the effect of such leases on the entry and expansion of smaller challenger retail chains and independent stores, including specialist retailers. The Inquiry has found that exclusive leases have substantially hindered the emergence of challenger retail chains to the main four national retailers, and also served to prevent economic participation by small independent retailers, including specialist retailers. This was confirmed by the evidence gathered by the Inquiry.
 22. The Inquiry established that the vast majority of Shoprite and Spar leases, and a majority of Pick n Pay leases, contain exclusivity provisions. Woolworths leases do not contain explicit exclusivity provisions. However, the Inquiry found that its leases do incorporate aspects that the Inquiry considers to have similar effects to exclusivity provisions. A number of small independent retailers and the emerging challenger retailers brought forth evidence of their inability to

access the shopping centre environment across the country as a result of the long-term exclusive lease agreements. Property developers also affirmed the view that these long-term exclusive lease agreements foreclose the would-be entrants from entering the shopping centre environment in competition with the national supermarket chains. Woolworths also acceded to the foreclosure effects that arise as a result of these exclusive lease agreements.

23. Much has been made, by the national supermarket chains, of the fact that the emerging challenger retailers or small specialist stores could and are able to grow outside of the shopping centre environment. The Inquiry also established that these emerging challenger retailers and independent stores have been forced to seek alternative avenues in order to compete in the South African grocery retail sector. The Inquiry finds it concerning that their growth and competitive ability has been substantially limited because of exclusion from the shopping malls. Notably, the Inquiry established that consumers generally spend a significant portion of their grocery expenditure in shopping centres. It is this custom that small and independent retailers and the emerging challenger retailers are deprived of as a result of being foreclosed from shopping centres.
24. The Inquiry is concerned that the observed pattern of the use of long-term exclusive lease agreements serves to sustain and entrench incumbency and the current levels of concentration in the South African grocery retail sector. In essence, current exclusive leases prevent emerging chains from developing to the point that they can suitably play the anchor tenant role in new developments, which means the same four retail chains are the only candidates, perpetuating and entrenching their cumulatively dominant position. Furthermore, given the slightly different LSM or consumer targeting of these chains, there would typically only be a couple that might be appropriate for any single new development given its location and target market.
25. The Inquiry found that the foreclosure effects arising from the use of exclusive long-term lease

agreements are also aided and abetted by the presence of usage clauses stipulating the purpose of the space that is being leased and limitations to the landlord's right of letting the rental space. In this regard, the Inquiry established that the usage clauses essentially stipulate not only its current business activities but also the national supermarket chains could potentially engage in at the shopping centre. For example, this goes as far as including the sale and hire of video recorders and accessories, electronics and communications, for example.

26. The Inquiry found that this conduct is akin to the national supermarket chains carving out potential product markets they wished to enter into in the future without explicitly prohibiting property developers from leasing out rental space to suppliers of these particular products. The Inquiry was provided with evidence of instances where retailers in these carved out potential product markets would be allowed to operate in the shopping centre environment. However, their tenancy would be immediately terminated by the property developers once the national supermarket chain decided to expand into these carved out product markets. Some of the limitations to the landlord's right to let included the requirement that property developers must consult the national supermarket chains on the tenant mix and any future developments that may impact on same by a property developer. The usage clauses further stipulate the location and size of potentially competing stores that could be allowed in a shopping centre.
27. The national supermarket chains provided a number of reasons in justification of long-term exclusive lease agreements. These justifications ranged from the view that exclusivity is aimed at compensating the national supermarket chains for having committed to a long-term agreement with its concomitant success risk factors, to compensation for the investments made.
28. The Inquiry found that the justifications provided by the national supermarket chains are not compelling for a number of reasons. For one,

this is because, although historically the national supermarket chains did not possess sufficient information and tools to gauge the economic viability of the areas they were entering into and thus relied on exclusivity as a means of protecting themselves, this is no longer the case. With the proliferation of information and the sophistication of economic tools, national supermarket chains are not only able to assess realistically the viability of opening a store in a particular location, evidence before the Inquiry indicates that a detailed and intensive viability assessment is made by these national supermarket chains before entering into a lease. Furthermore, risk is also reduced for these chains through negotiating low rental rates and transferring more of the development costs onto other tenants, reducing the need for exclusivity clauses. However, most importantly, all businesses take on investment risk as part of doing business and the ability of the national retail chains to transfer this risk to property developers and other tenants simply reflects their considerable market power. After all, other tenants are not able to mitigate such risks in the same manner.

29. The Inquiry found evidence showing instances in which the national supermarket chains waived exclusivity provisions in order to allow competitors (including other national supermarket chains, specialty stores and in limited instances, the emerging challenger retailers) to access the shopping centre environment. Whilst some national supermarket chains are becoming more lenient regarding the enforcement of exclusivity against small and specialist stores, the Inquiry remains concerned that they still require limitations on the size of these competing line tenants. The Inquiry found that the restrictions on size have the effect that these competing line tenants cannot effectively compete and grow their businesses beyond the required floor space imposed by the national supermarkets.
30. Similarly, while in some large shopping centres there has been a relaxation of the enforcement of exclusivity provisions, such that competing anchor tenants may be present, there is very

limited evidence of the emerging challenger retailers such as OBC, Fruit and Veg City, Liquor City and Choppies, being allowed to enter shopping centres. This may be because they lack the negotiating power to force entry into larger malls in competition with the anchor tenant, or a more deliberate strategy by the current dominant chains to keep such emerging challengers small by denying them entry specifically. Entry by these emerging challenger retailers into the formal grocery retail segment in South Africa has largely been outside shopping centres and with time, for a very few such as Food Lovers Market and Fruit and Veg City, into the shopping centres. The Inquiry found that this conduct effectively maintains the incumbency of the national supermarket chains in the shopping centres and retail supermarket trade more generally given the importance of shopping centres for consumer shopping expeditions.

31. The national supermarket chains tendered undertakings to the Inquiry in terms of which they sought to waive the enforcement of exclusivity provisions in their lease agreements. These waivers had conditions ranging from the type of products sold (in the case of speciality stores) to the size (both in terms of revenue and lease space) and location of the potential competitors concerned. The Inquiry found it challenging to establish consensus between the national supermarket chains in respect of the conditionalities for the waiver of exclusivity provisions.
32. In summary, the Inquiry found that the pattern of the sustained use of exclusive long-term contracts has not only restricted competition and given rise to consumer harm, but it also goes against the objectives of the Act which seek to, amongst others, to realise inclusive economic participation. The Inquiry is particularly concerned that these practices 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 broader national economic policy aimed at facilitating transformation and economic inclusion.

33. In addition, the Inquiry was made aware of allegations that line tenants are not only affected by exclusive lease agreement clauses but by other terms that property developers enforce on them such as high rental costs. In this regard, it was argued that property developers are forced to transfer costs for managing the shopping centre onto the line tenants to appease the requirements of the anchor tenants for low rental rates. This is akin to the waterbed effect identified in academic literature. The Inquiry is concerned that the high cost of rental for the smaller tenants limits their ability to effectively compete and grow their businesses. This applies to existing tenants that are not direct competitors to the national retail chains due to the exclusive leases, but would also apply to smaller specialist stores or challenger chains in the event that they gained entry in future. The Inquiry is therefore concerned that simply eliminating exclusive leases may still not achieve greater levels of competition and economic participation if these businesses are saddled with high rental costs relative to the national chains.

Buyer power and its impact on competition in the South African grocery retail sector

34. The Inquiry found that the presence of buyer groups in the South African grocery retail sector has beneficial competition outcomes for members (generally traditional and hybrid wholesalers as well as independent grocery retailers), who largely operate in the informal retail trade segment. In particular, buyer groups enable wholesalers and independent retailers that lack scale economies to be able to amass their purchasing power in bargaining with suppliers. The Inquiry established that buyer groups play a pivotal role in improving the competitiveness of wholesalers and independent retailers.

35. It is against this finding that the Inquiry assessed the bargaining dynamics between the suppliers of FMCG products and the national supermarket chains as well as the buyer groups. The Inquiry sought to determine whether the exercise of buyer power by the national supermarket relative to that of buyer groups and wholesalers serving

smaller retailers had an effect on competition at the grocery retail level of the value chain.

36. The Inquiry found that the structure of the South African formal grocery retail segment is characterised by factors that are conducive to the existence of an unequal bargaining framework between the national super market chains and suppliers, especially relative to wholesalers and buyer groups. The Inquiry established that the national supermarket chains are a critical route to market for the suppliers of FMCG products, based on revenue and volume contributions. With few exceptions, there was evidence in relation to the inability of FMCG suppliers to walk away from negotiations with national supermarket chains and the rigidity of trading terms, particularly as it relates to the composition and quantum of same. In this context, the national supermarket chains are able to extract more favourable trading terms than those customers in the informal segment (i.e. buyer groups, wholesalers, independent retailers etc.).

37. The findings of the Inquiry suggest that there is no clear rationale that explains the difference in the quantum of the rebates paid to the national supermarket chains in comparison to those obtained by those customers in the informal segment other than simply differential buyer power. In some instances, even where the national supermarket chains were not the largest customers, they were still able to extract better and more favourable trading terms than buyer groups, who would be the larger customers in those particular instances. This differential treatment is indicative of the exercise of buyer power.

38. In particular, the national retail chains have moved to demanding rebates to cover the costs of certain retail store level activities, such as merchandising, store openings and refurbishment, advertising and promotion, access to shelf space and category management, etc. The primary discriminatory effect of these rebates is that they are by their very nature not made available to wholesalers and buying groups servicing the independent

retailers, because the wholesalers do not serve the retail store function given their lack of vertical integration. The implication is that independent retailers, which also incur these self-same costs as the national retail chains, do not benefit from similar rebate categories and therefore are placed at a material disadvantage to the national chains.

39. The Inquiry is thus of the view that these rebates are more favourably offered to the national supermarket chains, which resultantly reduce their costs of offering FMCGs and thereby maintain their market positions and providing an unfair competitive advantage over the independent retailers. The costs of the independent retailers, owing to their lack of vertical integration with wholesalers, are not reduced to the same extent. The independent retailers incur all these costs with no rebates, even in instances where they otherwise qualify for the rebates by virtue of conducting the activities to ultimately place product on shelf like the national supermarket chains. This ultimately impedes these independent retailers' ability to compete and grow.
40. Furthermore, whilst some of these rebates paid by FMCG suppliers appeared to be underpinned by productive efficiencies (such as in the case of distribution allowances, for example), there were some which did not appear to have any efficiency or beneficial justification other than simply a reflection of buyer power by the national chains. In this context, the Inquiry found mixed evidence about the pass-through of rebates to the final prices paid by consumers. This is particularly concerning given that some suppliers factor in the cost of these rebates onto the price paid by the national supermarket chains for the products. This could potentially have a price-raising effect on the cost of products to the detriment of consumer welfare where such rebates are not passed through. Further to this, there is a lack of transparency regarding back-end margins.
41. The Inquiry is of the view that cumulatively, the South African grocery retail sector possesses features and characteristics that are conducive

to the exercise of buyer power and the indicative evidence obtained through the rebate analysis attests to the exercise of such power to the detriment of independent retailers and smaller retail chains, and potentially to consumers too.

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

42. The Inquiry noted that spaza shops and independent retailers in peri-urban areas developed at a point in time where, as a result of the apartheid regime's spatial policies and construction of the economic landscape, there was no closer competition to contend with both from national supermarket chains nor foreign nationals in the immediate vicinity. Subsequent to democracy, this economic landscape has been slowly changing in these areas.
43. In particular, the Inquiry found that the entry of the national supermarket chains into township areas has shifted the competitive landscape in those areas such that the observed decline or exit of spaza shops and independent retailers can partly be attributed to this phenomenon. The Inquiry also found that as spaza shops and independent retailers were grappling with this changing competitive dynamic, there was, simultaneously, increasing competitive pressure from foreign-owned spaza shops that have displaced locals in some cases.
44. The Inquiry found that spaza shops and independent retailers serve a critical role in the grocery retail ecosystem, particularly for those that reside in peri- and non-urban areas. Despite the lower prices offered by supermarket chains, spaza shops offer convenience in terms of longer trading hours, proximity of location and also offer products in smaller quantities making them affordable to poor consumers who would not otherwise afford to purchase bulk products from supermarket chains. This convenience role is akin to smaller convenience stores of the national chains and petrol station forecourts that have proliferated in wealthier areas. As a result, there continues

to be a role for spaza shops despite the entry of supermarket chains into these peri-urban and non-urban areas.

45. Further, and most importantly, the Inquiry is of the view that spaza shops and independent retailers are a crucial tool for the realisation of the objectives of the Competition Act. Specifically, spaza shops and independent retail operations are part of the suite of avenues available for the achievement of broader and inclusive economic participation given the lower entry barriers into these types of businesses. This also provides the potential to build one's own business and accumulate capital rather than simply engage in salaried employment.
46. It is the view of the Inquiry that the entry of national supermarket chains into townships and rural areas has had both negative and positive effects. From a consumer perspective, their entry has provided closer proximity to the source of weekly and/or monthly shopping activities given the range and lower pricing of larger supermarket chains. Historically consumers from township areas would have travelled greater distances to frequent these chains for such shopping expeditions, incurring greater costs in terms of time and transport money.
47. From a small and independent business perspective the evidence is often mixed. The more convenient location of the national supermarket chains means that some convenience shopping which would have occurred at the spaza shops has now shifted to the larger retail chains, negatively affecting the spaza shops. The Inquiry established that overall, there has been a decline in the number of small independent grocery retailers operating in non-urban areas following the entry of national supermarket chains in these areas. However, the shorter shopping hours, single location on the periphery of the peri-urban areas and big box format means that these supermarket chains have not displaced all convenience shopping, especially for smaller daily top-up shopping by commuters that may leave and return outside of shopping hours or those located further from the supermarket store.

48. This shift in the competitive landscape has required that local spaza shops respond by adapting their own business models and even locations within peri-urban areas in order to continue to be relevant to consumers in those areas. This may include longer opening hours or a change in products stocked in order to fulfil the convenience role more appropriately. Location also becomes more important. This may involve moving further from the new supermarket location, but the Inquiry also found that those spaza shops and independent retailers that are located closer to the shopping centres have sometimes benefitted from the increased foot traffic in that area.
49. The challenges from a changed competitive environment due to large supermarket chains entering peri-urban areas for local spaza shops are compounded by the additional challenge of new entry by foreign-owned nationals into these same areas. The Inquiry found that local spaza shops also face competition from a growing number of foreign owned spaza shops and independent retailers that are generally perceived to be cheaper than most local-owned spaza shops by consumers. As a result, foreign owned shops often perform better in comparison to local-owned small businesses, especially in the context of the broadening footprint of national supermarket chain stores in these areas where changes to business models are required.
50. The Inquiry found that there are numerous factors that are perceived to contribute to the success of foreign owned spaza shops, based on consumer surveys, targeted engagements and public forum discussions. These factors, amongst others, included efficiencies in the procurement of goods from cooperative arrangements (both horizontal and vertical), greater convenience through longer trading hours, stock diversity and product packaging, but also greater price competition from trading in counterfeit goods.
51. The Inquiry found that foreign owned spaza shops and independent retailers in many instances employ horizontal (operational ties) and vertical

- (spaza shops linked to wholesalers) cooperative strategies to compete. At a horizontal level, the Inquiry established that separate but allied retail outlets share opportunities for bulk purchasing and synergizing deliveries as well maintaining 'multiple retail outlets' under central control. From a vertical perspective, the Inquiry found that foreign owned spaza shops may in some cases be linked to specific wholesalers, some of which are also foreign owned. This provides these spaza shops with the opportunity for preferential pricing. In contrast, most local-owned spaza shops and small grocery retailers are family owned and operate on a standalone basis. This approach to conducting business not only inhibits local-owned businesses from raising capital for expansion but also deprives them of the ability to realise economies of scale in respect of purchasing and transport costs.
52. In relation to stock diversity, product choice and packaging, the Inquiry found that foreign owned spaza shops offer customers a wider variety of products and volumes whilst local spaza shop owners admitted that their shops have less stock in comparison. This effectively means that local owned spaza shops are not able to fully cater to the demand from customers as opposed to the foreign owned spaza shops.
 53. The Inquiry found that trade in counterfeit goods confers some form of price advantage to those that engage in the sale of such goods as opposed to those competitors that do not. Further to the unfair competitive advantage, there are broader negative ramifications for the fiscus in terms of lost tax revenue and the increased burden that is likely to be placed on the public healthcare sector. The Inquiry found that while local-owned spaza shops also traded in counterfeit products, the sale of such goods appeared to be more prevalent in foreign owned spaza shops. This unfair competitive advantage was also confirmed by the observed trends in consumer preferences as they appear to prefer foreign owned spaza shops due to, amongst others, lower prices.
 54. Having regard to the emerging competitive pressures from both the national supermarket chains and the foreign nationals faced by small and independent retailers, the Inquiry noted that South African spaza shops and independent retailers have struggled to adapt to the changes in the competition dynamics. The Inquiry found that the challenges facing spaza shops in particular, and which are said to have contributed to the difficulty to adapt to changes in competition, include amongst others:
 - 54.1 The inability to adequately tap into the economies of scale and scope in procurement offered by buyer groups and larger wholesalers due to the smaller and informal nature of these retailers relative to even independent retail stores that make use of buyer groups. The lack of cooperation amongst South African spaza shops unlike those of foreign nationals also prevents them from taking advantage of the opportunities for bulk buying at more competitive prices.
 - 54.2 The inability to tap into credit markets due to again the small and informal nature of these businesses. This feature means there is typically a lack of verifiable performance information and systems in place which result in information asymmetries with potential providers of credit, including the buyer groups but also financial institutions and development finance providers. The lack of credit limits the ability to ensure greater stock levels and variety to meet the convenience requirements of customers. The lack of social networks of cooperation as an alternative such as those used by foreign-owned shop owners also closes out this alternative.
 - 54.3 The need for greater levels of professionalisation and improved business management skills in the context of more sophisticated competitors entering these areas of operation and the need to adapt the businesses to such competition.

55. In addition to the challenges above, the Inquiry found that the regulatory environment is not conducive to supporting the sustainable competitiveness of these micro-enterprises in competition to supermarket chains, and in many cases actively undermines their ability to respond to the changing competitive environment.
 56. For example, the Inquiry found that local authorities impose restrictive apartheid-era trading times that are at odds with the convenience role that spaza shops and independent traders are best positioned to target. This is especially important in the context of the entry of supermarket chains as the spaza shops need to position themselves firmly as convenience options in order to survive and thrive. This also creates an asymmetry between those shops willing to not comply with the trading hours and/or pay enforcement officials to ignore the lack of compliance. Such shops are able to gain an advantage in servicing consumer demand to the detriment of those that comply, which also undermines the transition of these businesses from informal to formal enterprises.
 57. Similarly, in relation to liquor regulation, the Inquiry found that there is differential treatment of small and independent traders relative to the national supermarket chains for which longer trading hours are provided for. This enables the national supermarket chains to be able to service demand in those periods in which the small and independent traders are not able to trade. This confers upon the national supermarkets a level of competitive advantage that is not available to the small and independent traders.
 58. In addition, the Inquiry found that the regulatory processes for trading are burdensome for small traders, particularly in relation to zoning and land use. The Inquiry found that the cost and time constraints associated with rezoning of property, depending on the location of the land, are onerous for micro-enterprises and could have a negative impact on potential entrepreneurs. This is especially in the context where shop owners may need to relocate in response to the entry of supermarket chains and would require new sites zoned for business use.
 59. More generally on zoning and trading hours, the Inquiry found that many municipalities seek to use these laws to push out informal traders in favour of the supermarket chains and formal independent stores which they favour because they see them as contributing to municipal taxes. However, the Inquiry notes that the informal businesses also contribute to municipal development and the welfare of their residents in terms of providing economic participation for their owners and convenient shopping for their customers. In addition, these businesses can only be developed into formal tax-paying operations if they are provided with the necessary support from municipalities to develop and grow.
- Recommended remedial action*
60. Having regard to the foregoing, the Inquiry recommends a number of remedial actions that may rectify the circumstances identified above that have the effect of preventing and distorting competition in the South African grocery retail sector, and inhibiting the effective participation of South African spaza shops and independent retailers in this sector.
 61. Broadly, the required remedial actions comprise a suite of interventions ranging from (i) changes in firm behaviour in order to ameliorate the distortions in competition in relation to long-term exclusive lease agreements and buyer power; (ii) support mechanisms to bolster the sustainable competitiveness of small and independent retailers; and (iii) modernisation of the regulatory landscape in order to create a conducive environment for the optimal functioning of competition.
 62. Exclusive leases. In order to remedy the distortions to competition as a result of the use of long-term exclusive lease agreements, the Inquiry recommends the following:

- 62.1 As of the date of publication of this 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 center for speciality stores.
- 62.2 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 center.
- 62.3 The enforcement of exclusivity by the incumbent national supermarket chains (Shoprite, Pick n Pay, Woolworths, Spar (including their subsidiaries)) and their successors 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 Inquiry report.
63. These recommendations permit the phase 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.
- 63.1 The immediate cessation of exclusivity as against speciality stores is warranted given that these restrictions have serious detrimental effects on broadening participation in the economy by SMEs and firms owned by historically disadvantaged persons. The elimination of such exclusivity is also unlikely to severely impact on the operational viability of national supermarket chains given their small and specialist nature.
- 63.2 Regarding existing lease agreements, the Inquiry was careful to avoid any commercial upheaval (for both the national retail chains and property developers) that could result from an immediate cessation of such conduct. This alignment with the contracting between anchor tenants and property developers also means there is likely to be less disruption to those contractual arrangements.
- 63.3 Moving forward, the Inquiry sees no possible efficiency rationale that outweighs the exclusionary effect of exclusive leases. South Africa is already endowed with ample shopping mall complexes, and there are plenty of potential anchor tenants willing to take on the risk of new developments if they add value to the community without having to require exclusivity.
64. Having regard to the foregoing, the Inquiry sought to provide a comprehensive package of remedial actions to facilitate the implementation of the recommendations set out in paragraph 62 above. These remedial actions include the development of a mandatory code of conduct as well as the establishment of an Ombudsman to oversee the implementation thereto. This approach is ideal as opposed to dealing with such conduct on an ad hoc case by case basis.
65. As such, the recommendations set out in paragraph 62 above must form the basis for an agreed industry code of conduct in order to ensure that they apply equally to all national chains. This will provide each national chain the comfort that they will not be disadvantaged by signing up to the code because their competitors cannot then gain an unfair advantage through non-compliance.
- 65.1 Whilst a voluntary industry code is desirable from an expediency perspective, and

some progress has already been made in this regard, the Inquiry also recommends legislative or enforcement action if this is not feasible.

- 65.2 Failing a voluntary code, the Commission should initiate and investigate the collective exclusionary effect of exclusive leases nationally by the supermarket chains on emerging retail chains and the participation of SMEs and firms owned by historically disadvantaged persons.
- 65.3 In addition, the Inquiry also recommends that the Department of Trade and Industry establish a regulatory framework to oversee the grocery retail sector, including the appointment of an ombudsman to act as arbitrator in disputes, in order to deal with the full range of issues highlighted in this Inquiry including that of exclusive leases. This is because the Commission itself is unlikely to be able to respond timeously to the sheer volume of likely disputes. The regulatory framework should cover all discriminatory conduct in favour of the national retail chains including exclusionary lease practices, differential rental rates and escalations, as well as store location within shopping malls. Specifically, the ombudsman will act as an arbiter in disputes between retailers and property developers on such matters. The ombudsman will also be responsible for ensuring that all customers or suppliers are treated in a fair and transparent manner.
66. Buyer power and rebates. Rebates are an entrenched business practice that may be difficult to move away from without material commercial upheaval for both supermarket chains as well as certain suppliers. The Inquiry thus invites further submissions on potential solutions that might enable a movement towards a more non-discriminatory outcome but which also recognizes the current business model reliance on such rebates. Possibilities may include:
- 66.1 A more immediate move towards non-discrimination in terms of rebates that are common across retail and wholesale customers;
- 66.2 The gradual removal, rationalization or limitation in size of those rebates only provided to the national supermarket chains and not wholesalers and a shift of such rebate values to rebates common across the two groups where non-discrimination principles would apply; or alternatively
- 66.3 The gradual extension of some of those rebates currently only provided to the national supermarket chains to wholesalers or buyer groups (or directly to their members) as well.
67. The remedial action that is ultimately identified must form part of a mandatory Code of Conduct for Stakeholders in the grocery retail sector that will fall within the scope of a single government implementing department and Ombudsman.
68. The Code of Conduct will provide guidelines in line with any ultimate remedial actions identified to ensure a non-discriminatory and fair treatment on rebates.
69. The Ombudsman will be responsible for:
- 69.1 monitoring compliance with the code of conduct and handling disputes between the suppliers and retailers.
- 69.2 Notifying the Commission of any cases it believes there to have been an abuse of buyer power or discriminatory treatment which violates the Competition Act.
70. It must be noted 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 objective justification between national supermarket chains and small and independent retailers.

71. Once more, the Inquiry is of the view that an agreed industry code of practice on rebates is desirable because it can be implemented quickly and provide comfort to each single competitor that it will not be put to a competitive disadvantage by agreeing whilst others do not. It also more easily facilitates action across different market participants such as suppliers and retailers.
72. 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. For this reason, changes 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.
73. However, the Inquiry is also mindful that bringing about changes in the rental models of shopping mall developments is likely to result in substantial commercial upheaval for both the national retail chains as well as the property developers in the short term. This suggests that if change is to occur then a suitable transition model will need to be developed whereby, there is a glide path to a more equitable rental model. The Inquiry also recognises that this too will require industry level buy-in or regulation in order to ensure that no single developer or supermarket chain gains a competitive advantage through non-compliance, threatening the compliance of others in the process.
74. Given these difficulties, 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. In addition, the Inquiry will also engage with the Department of Trade and Industry as to how such a transition model may fit within the regulatory framework for grocery retail envisaged above. If these discussions fail to be constructive, the Inquiry recommends that the Commission initiate and investigate the exclusionary effects of such rental differentials as against the larger property developers whose practices have a more widespread impact on the market. This may be under the new section 9(1)(a)(ii) or the existing section 5(1) of the Competition Act no 89 of 1998 (as amended) (the “Competition Act”) where the amendments now waive the yellow card for offences. Alternatively, this may be explored under the indirect effect of buyer power as against the national retail chains under the new section 8(4) of the Competition Act.
75. Competitiveness support for spaza shops and small independent retailers. In order to foster and ensure inclusive economic participation as envisaged in the objectives of the Competition Act, the Inquiry is of the view that there is a need for a suite of interventions aimed at improving the competitiveness of spaza shops and independent retailers beyond the improvement in pricing of supply to wholesalers and access to trading areas as outlined above.
76. The Inquiry has identified a number of areas of improvement which are necessary in order to achieve this. These range from (i) the need for improved bargaining and procurement processes; (ii) removal of information asymmetries in order to improve access to credit finance; and (iii) providing support for the enhancement of business skills.
77. The Inquiry is of the view that there already exist numerous market driven initiatives and business models that already provide greater purchasing power and credit to certain independent retailers, and which could form the basis for support for smaller and informal businesses if given the necessary support for innovation around their business models.
 - 77.1 The Inquiry has determined the success and beneficial outcomes of buyer groups in aggregating the purchasing power of small and independent retailers as well as providing credit finance. However, these groups rarely reach down to the smaller informal spaza shops due to their size

and informal nature. There is a need to strengthen such platforms and expand the scope of their operations to include spaza shops.

77.2 The Inquiry has also noted various initiatives to improve the business skills and incorporate spaza shops into existing formal networks to enhance their viability. These include the partnerships between the Free State Department of Economic Development, Small Business Development, Tourism and Environmental Affairs and BiBi Cash and Carry; the eSpaza Sum and Big Save initiative, and the Gauteng Department of Economic Development initiative along with Pick n Pay. Whilst many of these have faced challenges and created some unintended consequences, the process of exploring different models has provided important lessons as to what may or may not work.

77.3 Lastly, there are also emerging logistics and distribution businesses seeking to find a niche in providing stocking and support services to spaza shops. These businesses too are innovating in order to find workable commercial models that might support such efficiency-enhancing services.

78. Accordingly, the Inquiry recommends that the best approach is for the single implementing department (as the lead) together with development finance institutions (“DFIs”) such as the Industrial Development Corporation (“IDC”), Khula Enterprise Finance (“Khula”), the National Empowerment Fund (“NEF”) and industry participants (retailers and suppliers) to support the development of viable commercial models which may provide the necessary support for smaller informal businesses rather than seeking to provide such services itself. This is because there is already fertile ground for such models, and if entrepreneurs can find means to generate revenues out of such initiatives such that it is self-sustaining and the rollout incentivised,

then the impact is likely to be more widespread and sustainable than any government led programme reliant on continual funding.

79. 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 small informal spaza shops:

79.1 The effective incorporation of spaza shops into buyer groups and larger wholesale operations in order to assist them to realise economies of scale and scope in purchasing. This would include finding effective means to pool the purchasing of numerous spaza shops in the same area such that the distribution costs are also reduced;

79.2 The generation of key information on individual spaza shop operations such that the risks of extending credit finance to these shops can be more accurately assessed in order to facilitate credit access for the purchase of stock. This would include means to link the suppliers of credit to the spaza shops; and

79.3 The development of consumer and business information to assist in the improvement of such businesses, including business and financial management training in order to improve the skills of spaza shop owners, and thus lead to the professionalisation of this class of grocery convenience store.

80. The Inquiry notes that such an incentive programme must be open to and target initiatives established by, inter alia, buyer groups, and spaza shop associations. The Inquiry would like to caution that the initiatives to be considered in respect of the incentive programme must be premised on developmental, rather than pure commercial, objectives insofar as the development of spaza shops is concerned.

81. The Inquiry notes that the initiatives that can be considered under such an incentive programme may, inter alia, include the establishment of distribution centres to be located in peri- and non-urban areas. The development of such distribution centres could follow a similar approach as that adopted for the automotive hubs established by the Automotive Industry Development Centre in conjunction with the Gauteng Provincial Government, wherein supporting infrastructure was put in place to support entrepreneurs in the townships. This is in the context where warehouses may not operate in proximity to particular areas and the visible success of similar models such as the municipal fresh produce markets.
82. The Inquiry also recommends that the single implementing department seek to draw in funding from the large national retail chains in support of the seed funding initiative in order to bolster the funds available.
83. Removal of regulatory obstacles to meeting competitive challenges. In order to remedy the regulatory obstacles faced by small informal and independent retailers in peri-urban and non-urban areas, the Inquiry makes the following recommendations to remove regulatory constraints and improved enforcement of other regulations in order to equalise the playing field:
- 83.1 With regard to trading times, municipalities must review the by-laws and regulations in relation to spaza shops and street traders. This must be done with the view to abolish the regulation of trading times for these businesses. The Inquiry notes that the regulation of trading times should continue to apply to the retailing of liquor given the social impact of such economic activities. However, where asymmetries exist in the regulation of trading times for liquor trade which favour the national supermarket chains, such asymmetries need to be removed.
- 83.2 With regard to zoning, municipalities must fast-track the approval of any existing re-zoning requests for spaza shops in township areas within three months from the date of the publication of the final report of the Inquiry.
- 83.3 The Department of Cooperative Governance and Traditional Affairs must coordinate the determination of preferred zoning processes and practices that facilitate ease of entry for small businesses in non-urban areas and which can be adopted by municipalities nationally.
- 83.4 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. Such initiatives must be done ensuring that due consideration is given to the following:
- 83.4.1 the location of the informal trading market should be in close proximity to economic and transport hubs, such as malls and taxi ranks. This is crucial as it will generate a high volume of foot-traffic which is necessary for the viability of these businesses;
- 83.4.2 consumer movements and demand by business;
- 83.4.3 proper lighting, security and sanitation is provided within the infrastructure to ensure improved health and safety conditions for these businesses;
- 83.5 Municipalities must develop and implement a framework for the registration of informal businesses particularly spaza shops, within the municipal jurisdiction. The process must be simplified and should not require the type of registration that is conducted through the Companies and Intellectual Property Commission. Rather, the registration process should aim to develop a simple

register which will track, inter alia, the details of the spaza shop owner, the location and basic data relating to the turnover of each spaza shop.

83.6 There must be increased coordination between the South African Revenue Services and the South African Police Services to facilitate proactive policing against counterfeit goods.

83.7 There must be improved coordination by government on addressing the regulatory challenges which affect small businesses. The Department of Trade and Industry must establish a committee that will involve the different spheres of government. This committee will be tasked with the review of existing regulations, using government regulatory impact assessment tools in order to recommend relevant changes that will improve the overall competitiveness of small businesses.

84. The purpose of these recommendations is to provide some immediate regulatory relief to spaza shops seeking to contend with a changing competitive environment and ensure that such regulations do not restrict their activities and adaptation to competition. These go to some of the core issues faced by such shops, including the unfavourable trading hours and re-zoning requirements. The recommendations envisage some immediate relief from suspending regulations or fast-tracking existing applications, whilst more sensible policies are developed for municipalities nationally through the coordinating role of the Department of Cooperative Governance and Traditional Affairs.

85. However, the recommendations also seek to achieve a mindset shift at a municipal level to one that is supportive of informal businesses in peri-urban and non-urban areas such that these businesses may be able to grow and compete more effectively in support of their owners and consumers served. This will also enable the

ultimate transition of these businesses to more formal operations that can contribute to municipal tax. As a result, the Inquiry envisages a deliberate focus on removing regulatory red tape for such businesses and integrating their needs into local economic planning in much the same manner as is done for formal businesses. The collection of information on businesses in the township areas would assist in the development of such local economic policies.

85.1 The additional focus on enforcement around counterfeit products is there to ensure that stores have an incentive to comply with broader legal requirements even if they are informal, by removing the advantage gained by some businesses from price undercutting due to the illicit trade in counterfeit goods. This initiative is also in line with other current initiatives in government to remove such illicit trade given its negative impact on tax collection too.



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