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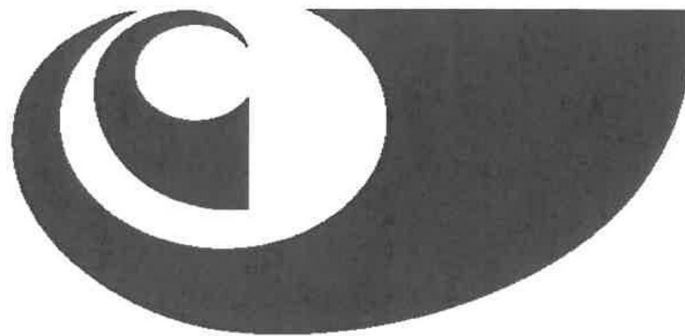
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GOVERNMENT NOTICES • GOEWERMENTSKENNISGEWINGS

ECONOMIC DEVELOPMENT DEPARTMENT

NO. 1553

28 NOVEMBER 2019



***competition*commission**
south africa

**COMPLETION OF THE GROCERY RETAIL MARKET
INQUIRY**

November 2019

1. BACKGROUND

The Competition Commission ("the Commission") initiated a market inquiry into the grocery retail sector in South Africa in terms of Chapter 4A of the Competition Act, No. 89 of 1998 (as amended) ("the Act") because it had reason to believe that there are features of the sector that prevent, distort or restrict competition.

The Commission gave notice in the Government Gazette¹ on 30 October 2015 announcing the establishment of the Grocery Retail Market Inquiry ("the Inquiry") in terms of Section 43B(2) of the Act. In terms of the Notice, the Inquiry was expected to be completed by 29 May 2017. On 26 May 2017, the Commission gave notice in the Government Gazette² amending the timeline for completion of the Inquiry to 31 March 2018. The timeline for completion was further extended to 28 September 2018 as published in the Government Gazette³ on 23 March 2018. Furthermore, on 26 September 2018, the Commission gave notice in the Government Gazette⁴ to amend the timeline for the Inquiry to 30 September 2019. Another amendment to the completion date of the Inquiry to 31 October 2019 was published in the Government Gazette⁵ on 27 September 2019. Lastly, an amendment to the completion date of the Inquiry was published in the Government Gazette⁶ on 31 October 2019, extending its completion to 29 November 2019.

2. COMPLETION OF THE MARKET INQUIRY

In terms of section 43B(6) of the Act, the Commission must complete a market inquiry by publishing a report contemplated in section 43C, within the time set out in the terms of reference contemplated in subsection (2). In addition, section 43C(1) of the Act requires that the Commission must, upon completion of a market inquiry, publish a report in the government gazette.

The Inquiry published its final findings and recommendations on 25 November 2019. A summary of the report is contained below, and a non-confidential version of the report is published on the Commission's website, at <http://www.compcom.co.za/retail-market-inquiry/>.

¹ Gazette No. 39347

² Gazette No. 40860

³ Gazette No. 41512

⁴ Gazette No. 41932

⁵ Gazette No. 42730

⁶ Gazette No. 42817

THE GROCERY RETAIL MARKET INQUIRY FINAL REPORT

SUMMARY OF THE FINDINGS AND RECOMMENDATIONS

25 NOVEMBER 2019

competition regulation for a growing and inclusive economy



SUMMARY OF THE FINAL FINDINGS AND RECOMMENDATIONS OF THE GROCERY RETAIL MARKET INQUIRY

1. On 30 October 2015, the Competition Commission ("the Commission") gave notice in the Government Gazette ("Gazette") announcing the establishment of the Grocery Retail Sector Market Inquiry ("the Inquiry") in terms of Section 43B(2) of the Competition Act no 89 of 1998 (as amended) ("the Act"). The Gazette set out the Terms of Reference ("ToR") which would guide the work of the Inquiry.
2. The Commission initiated the Inquiry in order:
 - 2.1 to understand how the grocery retail sector operates because the Commission had reason to believe that there exist features, or a combination of features, in the sector that may prevent, distort or restrict competition; and
 - 2.2 to achieve the purpose of the Act.
3. The Inquiry was conducted in four phases:
 - 3.1 phase one involved the publication of the ToR, initial background consultations, literature review and the publication of the Statement of Issues ("SOI"), Guidelines for Participation and Administrative Timelines;
 - 3.2 phase two involved information gathering through site visits and re-visits, surveys, targeted consultations, information requests and public hearings;
 - 3.3 phase three, involved the processing and analysing of information, identifying information gaps, follow up consultations, targeted consultations, and information requests to address any identified gaps, culminating in the publication of the Preliminary Report; and
 - 3.4 phase four involved the formulation and testing of recommendations, drafting and publication of the Final Report.
4. The SOI contained the Inquiry's envisaged framework to assist the participants in the Inquiry to focus on issues that the Inquiry envisaged to be the most relevant in answering questions arising from the ToR. In line with the scope of the Inquiry, and as set out in the ToR, the SOI proposed to assess competition in the grocery retail sector according to these stated objectives.
 - 4.1 Objective 1: The impact of the expansion, diversification and consolidation of national supermarket chains on small and independent retailers in townships, peri-urban and rural areas and the informal economy.
 - 4.2 Objective 2: The impact of long-term exclusive lease agreements entered into between property developers and national supermarket chains, and the role of financiers in these agreements on local competition in the grocery retail sector.
 - 4.3 Objective 3: The impact of the dynamics of competition between local and foreign national operated small and independent retailers in townships, peri-urban and rural areas and the informal economy on competition.
 - 4.4 Objective 4: The impact of regulations, including, among others, municipal town planning and by-laws on small and independent retailers in townships, peri-urban and rural areas and the informal economy.

SUMMARY OF THE FINAL FINDINGS AND RECOMMENDATIONS



- 4.5 Objective 5: The impact of buyer groups and buyer power of the national retail chains on small and independent retailers in townships, peri-urban and rural areas and the informal economy.
- 4.6 Objective 6: The impact of certain identified value chains on the operations of small and independent retailers in townships, peri-urban and rural areas and the informal economy.
- 5 In conducting this Inquiry due regard was given to ensuring that the processes followed were both thorough and fair. The Inquiry reached out to numerous stakeholders operating at different levels of the grocery retail value chain across South Africa and received both written and oral submissions. The stakeholders that participated included the national supermarket chains, small and independent retailers, spaza shop owners, FMCG suppliers, consumers, local authorities, provincial and national government departments, and industry regulators. The Inquiry received more than 500 submissions from the main parties, held over 80 round-table discussions as well as public hearings in the Western Cape, KwaZulu Natal, and Gauteng. These public hearings were supplemented with six mini-public hearings in Limpopo, Mpumalanga, the Northern Cape, the Eastern Cape and the North West. In addition, the Inquiry also conducted site visits to spaza shop owners, grocery retailers, wholesalers and other stakeholders at a number of sites in towns and cities where local grocery retailing issues had been brought to its attention.
- 6 On the basis of these submissions, the Inquiry published its Preliminary Report on 29 May 2019 setting out its initial findings and proposed recommendations, and invited stakeholders to make submissions in response. Having considered the views and submissions from stakeholders arising from the Preliminary Report, this report reflects the Inquiry's final findings and recommendations ("the Final Report").
- 7 The Inquiry received numerous submissions from stakeholders in response to its Preliminary Report. These included various national and provincial government departments, industry regulators, industry associations, the national supermarket chains and emerging challenger retailers, small and independent retailers, buyer groups, property owners or developers and managers, banking institutions, FMCG suppliers, spaza shop owners, and academic research institutions. These submissions and comments added to the substantial body of information, evidence and data gathered in the period leading to the publication of the Preliminary Report. The combination of these submissions provides the basis for the Inquiry's final findings and recommendations as set out in this Final Report.
- 8 Broadly, the Inquiry found that a combination of features in the grocery retail sector may prevent, distort or restrict competition. In particular, three principal areas of concern warrant remedial action: 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*
- 9 By way of context, the grocery retail sector is characterised by low levels of economic regulation and openness of markets. The openness of the sector has enabled the increased expansion of corporate retailers to the displacement of small and independent businesses. This displacement has been further exacerbated by the ease of entry in the informal segment, leading to the replacement of small and independent retailers, which were primarily family operated and mainly serviced rural and non-urban communities, before the boom of shopping malls in these areas. It is within this context that the Inquiry has considered the competitive dynamics in the grocery retail sector.
- 10 There are low barriers to starting survivalist informal spaza shops. However, there are significant challenges to building them into thriving, competitive businesses that

- can enter the higher value segments within grocery retail, such as tenancy in formal shopping malls. The Inquiry believes that there is a need to remove impediments to the increased and effective participation of SMMEs and operations owned by HDIs in the grocery retail sector. Making markets more inclusive, as anticipated by the provisions on the purpose of the Act, not only addresses social imperatives but also provides a platform for more competitive markets, which benefit consumers.
- 11 The Inquiry considered the market structure of the grocery retail sector, and found that it is complex, consisting of numerous players including manufacturers or suppliers of grocery retail products, buyer groups and distributors, wholesalers, hybrid wholesalers (i.e. wholesalers that also have retail supermarket offerings), national supermarket chains, speciality stores, emerging challenger retailers, independent retailers (formal and informal) and consumers.
- 12 At the supplier level, there are a number of firms who manufacture and supply various FMCG products to different retail platforms. These suppliers are of varying size, with a limited number of large multi-product firms. Similarly, the wholesale level comprises a number of formal players such as buyer groups and cash and carries, who primarily supply the independent and informal retailers such as spaza shops.
- 13 The retail level of the value chain is segmented between the formal and informal channels. The formal retail segment is characterised by the presence of the incumbent national supermarket chains, speciality stores and the emerging challenger retailers, while the informal segment mostly has an active presence of small and independent retailers including general dealers and spaza shops. The sale of grocery products takes place through both the formal and informal retail channels. The formal channel is the larger and more important distribution segment. Within the formal channel, a large proportion of grocery product sales takes place in

shopping centres which are primarily occupied by national supermarket chains as the anchor tenants.

- 14 Following the publication of the Preliminary Report, stakeholders submitted that in order for the Inquiry to conduct a competition assessment and make findings, it must define relevant product and geographic markets, in accordance with international standards and previous decisions of the Competition Tribunal ("Tribunal"). Stakeholders also submitted that the Inquiry was inconsistent and contradictory in the use of its 'market definition' in that in some instances it considered a broad national grocery retail market, and in others a narrower segment, for formal retailers.
- 15 The Inquiry sets out below its responses to these stakeholder submissions and sets out a legal framework for the conduct of this market inquiry and the approach adopted in respect of market definition and the appropriate framework to consider in defining the grocery retail market.
- 16 All the stakeholders that raised concerns regarding the issue of market definition appear to have conflated Chapter 2 and Chapter 4A of the Act. An aspect of importance in making a distinction between the Commission embarking on an investigation that is conducted under Chapter 2 of the Act and conducting a market inquiry, in terms of Chapter 4A, is noting that the Inquiry is much more widely focused. The former is only concerned with prohibited conduct by an individual firm (or group of firms) while the latter is much broader in its reach and is concerned with features of markets that may hinder competition, consumer choice or effective participation, often not ascribed to a single firm.
- 17 Section 43B of the Act, which deals with the initiation of market inquiries, contemplates that some notion of a market is relevant in the conduct of a market inquiry. However, this is not in the context of establishing dominance for Section 2 abuse of dominance cases.

disadvantaged individuals' perspective. It is thus the view of the Inquiry, that for the legislature not only to employ different tests, but also to distinguish the nature of the conduct that these two processes are concerned with, points to the clear intention by the legislature to have these processes distinguished from each other.

18. It is important to note that the use of the word 'features' in the wording of this provision allows for a consideration and inclusion of factors that may or may not warrant a market definition. By way of example, the identification of regulatory constraints as a feature that hinders or distorts competition does not, in and of itself, warrant the definition of a market in respect of that issue. It is for this reason that the Inquiry, in its Preliminary Report, identified grocery retailing as the scope for its analysis. This broad approach to its analytical framework allowed the Inquiry to engage with the issues or features within the grocery sector that may have an impact on competition.

19. It is also open for the Inquiry to define a product market with certain features, even if this product market is characterised by numerous local markets, as is the case in grocery retail. It is our view that where a feature of the product market, such as exclusive leases, repeats itself across these local geographic markets, it is valid to consider such a feature broadly, and not local market-by-local market.

20. The second aspect of section 43B is that the basis for the Commission to embark on a market inquiry is to achieve the purposes of the Act which are more broadly defined than pure price competition. This is of relevance to this Inquiry in general and exclusive leases in particular. The purposes of the Act are also emphasized in the preamble to the Act which states that the Act exists to "provide for markets in which consumers have access to, and can freely select, the quality and variety of goods and services they desire".

21. A market inquiry investigating market features which impact on the purposes of the Act clearly is broader in scope than simply abuse of dominance provisions under section 2. Even within a market inquiry, certain market features may be assessed from the perspective of multiple purposes of the Act. For instance, exclusive leases may be viewed from a hindering of competition perspective (noting this is a lesser test to those in section 2 of the Act), a consumer choice perspective and a participation of SMEs and historically

22. The Inquiry believes that the point of defining markets is to allow for the identification of competitive constraints on specific firms, and to be able to estimate the size and position of a firm in a specific market. The market definition process is essentially an analytical tool which assists in identifying these constraints and thus is used where appropriate. The Inquiry further believes that what is more telling in the conduct of a competition analysis is the presence and level of competitive constraints that firms face. Developments in economic literature show that in instances of differentiated product and service markets, such as we have in retail markets, a strict and traditional approach to market definition is not always possible due to the difficulty of determining how close a potential substitute must be in order to be included in the market.

a single product range but typically with complementary products. These specialist stores will also interact competitively with the supermarket and convenience stores in various ways.

25. The Inquiry believes that what is most relevant is that there is likely to be a greater closeness of competition between stores located within the same shopping mall for the same product lines. It is less convenient for a consumer to purchase some products at one store then move to another store in the same mall for some additional items, than the alternative of visiting numerous different locations. In the same way, shops within a strip mall would also compete more closely if they sold the same product. The rationale here is also convenience.

26. This conclusion has relevance to both grocery competition and to the interaction with specialty stores. The use of exclusivity provisions to keep out specialist stores which only compete with certain product lines, is a recognition that supermarkets do interact competitively with these in a mall and would impact on sales of their own product lines. In considering the importance of shopping malls as destinations for consumers, access to such malls also impacts on other objectives of the Act such as participation in the economy.

27. From a geographic market perspective, the most common approach is to consider localised markets because consumers tend to shop within the vicinity of where they live or work, or on the route to and from work. This focus is reinforced by the fact that shopping malls and strip malls consider the catchment area around their location when determining what their likely footfall will be. However, as much as there is product differentiation, there is also spatial differentiation which impacts on the closeness of competition and competitive constraints imposed by different outlets.

28. The local nature of markets does not eliminate the fact that there are several competitive variables which may be set nationally due to head office purchasing

deals. For example, products may be listed nationally, have common retail prices within the supermarket groups, and have coordinated promotions due to national advertising policy. However, some (if not most) aspects of competition are also determined locally. The size of the store, its product range, local promotions and range selection, and store layout are all likely to be impacted by local competition dynamics. While these may not always relate to price (except through promotions), they go to other demand-related variables which affect consumer welfare such as product range, variety and innovation, as well as the overall shopping experience.

29. The Inquiry is of the view that both local and national competition is important. While many aspects of grocery retailing markets may be localised, the nature of the issues under consideration (such as exclusive leases and buyer power) are replicated across the country and thus create a national phenomenon which provides a further reason for the Inquiry's assessment to be conducted on the basis of the broader retailing of grocery products, taking into account the possible narrower markets that may exist. The adoption of such a broad approach to its assessment has also allowed the Inquiry to assess the multifaceted nature of the competition dynamics that underscore the issues raised in the ToRs.

Market concentration

30. Following the publication of the Preliminary Report, the national supermarket chains submitted that the Inquiry had overestimated their market shares and the resultant levels of concentration in the grocery retailing sector. They attributed this mistake to the inclusion of revenue realised from the sales of non-grocery products and out of country sales.

31. The Inquiry accepted the submissions by the national supermarket chains and revised its concentration ratio estimate for grocery retailing. It is important to note that, as in the Preliminary Report, the concentration ratio estimate relied upon by the Inquiry

only considered the formal grocery retail segment, including specialist stores. Informal stores are rightly excluded as they do not exert a strong competitive constraint on supermarket chains. Where there is competitive interaction, it is asymmetric; namely supermarkets on spaza shops. In this regard, the Inquiry maintains its view that the grocery retail sector is characterised by high levels of concentration, with the top five retailers accounting for approximately 64% of the market.

32. The levels of concentration in the formal retail channel are 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, 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 finds that the formal segment is characterised by high barriers to entry and expansion at the supplier level of the value chain.

33. The Inquiry 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 unique to the national supermarket chains as some buyer groups 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.

34. The above entry and competitive conditions are applicable to all players that are active in the formal retail channel.

35. It is the view of the Inquiry that the market structure of the grocery retail sector creates a conducive environment for a significantly altered bargaining framework between the national supermarket chains and their suppliers (whether suppliers of FMCG products or property developers). This altered bargaining framework leads to distortions in competition between the national supermarket chains, emerging challenger retailers, specialist stores and those firms that are serviced by the wholesalers and buyer groups, i.e. independent stores and spaza shops.

36. 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 and quality. Low income households, for example, appear to rely on both spaza shops and the national supermarket chains for their grocery needs. For 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, 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).

37. 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 have traditionally filled.

38. 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

39. 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:

39.1 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

39.2 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.

40. This pattern is demonstrated in 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:

40.1 reinforcing the levels of concentration in the formal retail segment;

40.2 entrenching incumbency by the national supermarket chains; and

40.3 raising barriers to entry for small and independent retailers and thus removing a crucial element for competition in the retail ecosystem.

41. Cumulatively, the distortions to competition 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

42. The bargaining power possessed by the national supermarket chains (as anchor tenants) manifests itself in the requirement for exclusivity in lease agreements. 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.

43. 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 ten years, before they are willing to finance a development.

44. The Inquiry finds that national supermarket chains (as anchor tenants) took advantage of this requirement by requiring exclusivity, claiming that this is to protect their investment and compensate them for accepting the risk of paying rent for ten years, irrespective of the success of the mall.

45. 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 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 at least 30 years.

46. The Inquiry finds that given the high levels of concentration in the formal retail channel, primarily through national supermarket chains, 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 has also served to prevent economic participation by small independent retailers, including specialist retailers.

47. 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 but have provisions which impact on letting and usage. The Inquiry finds that clauses which simply provide a limited exclusion on the zone area around the tenant in respect of certain businesses which pose a risk of undermining the maintenance of health and safety standards of a tenant are not objectionable. These clauses do not restrict the entry of competing rivals in shopping centres nor do they dictate where in the shopping centre a rival tenant can operate their business. However, the Inquiry is of the view that these clauses must have an objective justification and must be reasonably related to such justifications.
48. A number of small independent retailers and the emerging challenger retailers provided evidence of their inability to access shopping centres across the country as a result of the long-term exclusive lease agreements. Property developers also affirmed that these long-term exclusive lease agreements prevent the would-be entrants from entering the shopping centre environment in competition with the national supermarket chains.
49. 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 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 and that small and independent retailers and the emerging challenger retailers are deprived of this custom as a result of being excluded from shopping centres.
50. 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 grocery retail sector. In essence, the current exclusive leases prevent emerging chains from developing to the point where they can suitably play the anchor tenant role in new developments, which means that the same four retail chains are the only candidates, thereby 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 few that might be appropriate for any single new development given location and target market.
51. The Inquiry finds that the distortion of competition 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 on the landlord's right of letting the rental space. The Inquiry established that the usage clauses essentially stipulate not only current business activities but also those the national supermarket chains could potentially engage in at the shopping centre in future such as sale and hire of video recorders and accessories, electronics and communications.
52. The Inquiry finds that this conduct is akin to the national supermarket chains carving out potential product markets that they may wish to enter 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
53. 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 risk factors, to compensation for the investments made.
54. The Inquiry finds that the justifications provided by the national supermarket chains are not compelling. Although historically the national supermarket chains did not possess sufficient information and the tools to gauge the economic viability of the areas which they were entering 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 research tools, national supermarket chains are able to assess realistically the viability of opening a store in a particular location. Evidence before the Inquiry indicated that a detailed and intensive viability assessment is made by these national supermarket chains before entering into a lease agreement. Further, risk is also reduced for these chains through negotiating low rental rates and transferring more of the development costs onto other tenants, thereby reducing the need for exclusivity clauses. 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. Other tenants are not able to mitigate such risks in the same manner.
55. The Inquiry received evidence of 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 shopping centres. 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 finds that the restrictions on size have the effect that line tenants cannot effectively compete and grow their businesses beyond the required floor space imposed by the landlords at the behest of the national supermarket chains.
56. 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 QBC, 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 challenger retailers by denying them entry specifically. Entry by these emerging challenger retailers into the formal grocery retail sector has largely been outside shopping centres, though very few, such as Food Lovers Market and Fruit and Veg City, have entered the shopping centres. The Inquiry finds 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.
57. The national supermarket chains tendered undertakings to the Inquiry proposing 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. The Inquiry found it challenging to establish a consensus between the national supermarket chains in respect of the conditionalities for the waiver of exclusivity provisions.

58. In summary, the Inquiry finds that the pattern of the sustained use of exclusive long-term contracts has not only restricted competition and given rise to consumer harm, but that it also violates the purpose of the Act which seek, amongst others, to ensure that small and medium sized enterprises are afforded an equitable opportunity to participate in the economy. The Inquiry is particularly concerned that these practices have effectively excluded widespread participation in the retail sector where barriers to entry should be low, thus fundamentally undermining the objectives of the Act and broader national economic policies aimed at facilitating transformation and economic inclusion.

59. The Inquiry was made aware of allegations that line tenants are not only affected by exclusive lease agreement clauses but by other terms enforced by property developers such as high rental costs. 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. The Inquiry is concerned that the higher cost of rental for the smaller tenants limits their ability to effectively compete and to grow their businesses. This constraint 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 gain 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 faced with high rental costs relative to the national chains.

60. The Inquiry finds that this conduct is generally widespread as part of the business model in the retail property leasing environment. The practice is premised on a number of justifications provided by the property developers which include market forces; size and position of the unit to be let; visibility of the unit to be let; footfall likely to be created by the tenant; depth of the store; the cost of installing the tenant; and trading densities. The Inquiry notes that the bargaining dynamics between landlords and the national supermarket chains do appear to have an influence on the differential treatment accorded to different customer groupings. The Inquiry finds that this conduct is akin to the waterbed effect.

61. The Inquiry acknowledges the complexity associated with the determination of applicable rental rates to different types of customers. It is for this reason that the Inquiry does not make any recommendations in this regard. However, the Inquiry is cognizant of the need to ensure that there is balanced treatment of tenants, premised on the principles of fairness and transparency.

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

62. The Inquiry finds that the presence of buyer groups in the 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 pool their purchasing power in bargaining with suppliers of FMCG. The Inquiry established that buyer groups play a pivotal role in improving the competitiveness of wholesalers and independent retailers.

63. It is against this finding that the Inquiry assessed the bargaining dynamics between the suppliers of FMCG 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 chains, 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.

64. The Inquiry finds that the structure of the formal grocery retail segment is characterised by factors that are conducive to the existence of an unequal bargaining framework between the national supermarket 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 both on revenue and volume contributions. With few exceptions, there was evidence of the inability of FMCG suppliers to walk away from negotiations with national supermarket chains and the rigidity of trading terms, particularly related to the composition and quantum of the terms. The national supermarket chains are able to extract more favourable trading terms than customers in the informal segment.

65. The findings of the Inquiry suggest that in some instances there is no clear rationale to explain the difference in the quantum of the rebates paid to the national supermarket chains and 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 were the larger customers. This differential treatment is indicative of the exercise of buyer power.

66. 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. 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, do not benefit from similar rebate categories and, therefore, are placed at a material and competitive disadvantage to the national supermarket chains.

67. The Inquiry is thus of the view that these rebates are more favourably offered to the national supermarket chains, which, as a result, reduces their costs of offering FMCG products, maintains their market positions and provides 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 of these costs with no rebates, even in instances where they qualify for the rebates as they conduct the same activities of ultimately placing products on shelf. This ultimately impedes these independent retailers' ability to compete and grow.

68. Furthermore, whilst some of these rebates paid by FMCG suppliers appeared to be underpinned by productive efficiencies (as in the case of distribution allowances), there were some which did not appear to have any efficiency or beneficial justification, they were simply a reflection of buyer power by the national chains. Further, the Inquiry found mixed evidence about the pass-through of rebates to the final prices paid by consumers. This is particularly concerning since some suppliers factor in the cost of these rebates to 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, there is a lack of transparency regarding back-end margins.

69. The Inquiry has concluded that cumulatively, the grocery retail sector possesses features and characteristics that are conducive to the exercise of buyer power. The indicative

which they have invested funds towards the development of a diversified supply base. This action is commendable and ought to be developed further in order to optimise the gains to competition that arise.

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

78. The Inquiry notes 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 close competition whether from national supermarket chains or foreign nationals in the immediate vicinity. Since 1994, this economic landscape has changed dramatically.

79. The Inquiry has found that the entry of the national supermarket chains into township areas has shifted the competitive landscape in those areas. The observed decline or exit of spaza shops and independent retailers, especially in the rural towns, can partly be attributed to this change. The Inquiry also finds that as spaza shops and independent retailers in townships were grappling with this changing competitive dynamic, there was, simultaneously, increasing competitive pressure from foreign-owned spaza shops that have displaced, in some cases, local-owned spaza shops.

80. The Inquiry found that spaza shops and independent retailers serve a critical role in the grocery retail ecosystem, particularly for those residing 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 products in smaller quantities making them affordable to poor consumers who could not afford to purchase bulk products from supermarket chains. This convenience role is akin to the 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.

the national supermarket chains and spaza shops, as well as the massive buyer power held by these retailers, such entry and diversification, if allowed, can only have the effect of obliterating ordinary spaza shops. This conduct warrants action by policy makers.

74. The Inquiry received submissions that indicate how the high levels of concentration in the formal grocery retail sector and the position of the national supermarket chains in the grocery value chain have created disadvantages for smaller suppliers (emerging, black and smallholder producers), and effectively acts to exclude these smaller producers from the agro-food value chain. The Inquiry received evidence indicating that the buyer power of national supermarket chains, exercised in the context of rebates, externalises the risks of national supermarket chains and passes them up the value chain towards farmers and producers and also limits the ability of smaller suppliers to access shelf space in the formal retail segment, as these smaller suppliers cannot afford the rebates required.

75. Some small suppliers believe that access into the formal retail channel can be promoted through supplier development funds. The Inquiry was made aware of the difficulties faced by small suppliers in terms of qualifying for the existing supplier development programmes and substantively benefitting from them.

76. The Inquiry notes that concern over unfair trading conditions in the food value chain, as well as the impact on prices paid to smaller and historically disadvantaged suppliers, has culminated in an amendment to the Act in the form of (a new) section 8(4) directed specifically at the abuse of buyer power by dominant firms in designated sectors.

77. The Inquiry also notes that the national supermarket chains recognise the need to ensure and to increase access by smaller suppliers to shelf space in the formal retail segment. Each of the national supermarket chains have established a supplier development programme in

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 also to consumers.

70. Following further engagements with stakeholders, the Inquiry did not receive any evidence that challenged the existence of buyer power by the national supermarket chains. However, the Inquiry noted the justifications proffered for the difference in treatment between the national supermarket chains and other customer segments such as wholesalers and independent retailers, namely, the provision of efficient distribution services and valuable data on end-consumer purchases which suppliers can use to improve their business strategies. Wholesalers and independent retailers were said to be unable to offer these services due to their lack of vertical integration. The Inquiry also received submissions, particularly from the suppliers of FMCG products, indicating that there is a recognition of the need for a more balanced treatment of the different customer segments.

71. The Inquiry engaged with stakeholders to discuss possible recommendations to deal with those instances of unreasonable and unjustified differential treatment. The Inquiry decided that a code of conduct premised on the principles of fairness and transparency would be an appropriate and proportionate means of addressing the concerns raised.

72. While the suppliers of FMCG had differing views regarding what should be contained within such a code, and to whom it should apply, the Inquiry found that, in the main, suppliers supported the principles of fairness and transparency.

73. The Inquiry has noted the direct entry and diversification of Shoprite under its "Usave e-Kasi" brand into the spaza shop segment. Given the evidence and discussion of the buyer power possessed by the national supermarket chains, the Inquiry finds such direct entry and competition to spaza shops to be very concerning. Given the asymmetric competition that exists between

81. Further, and most importantly, the Inquiry has concluded that spaza shops and independent retailers are a crucial tool for the realisation of the objectives of the 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, for example, offering the potential to build one's own business and accumulate capital rather than simply engage in salaried employment.

82. The Inquiry believes 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 monthly shopping activities and offered the range and lower pricing of larger supermarket chains. Historically consumers from township areas would have travelled greater distances to frequent these chains, incurring greater costs in terms of time and transport.

83. 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. However, the shorter shopping hours, a 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 for those located further from the supermarket store.

84. 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 adaptation may include longer opening hours or a change in products stocked in order to fulfil the convenience role more appropriately. Location has also become more important. It may involve moving further from the new supermarket location, although 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 the area.

85. The challenges for local spaza shops from a changed competitive environment due to large supermarket chains entering peri-urban areas are compounded by the additional challenge of new entry by foreign nationals into these same areas. The Inquiry found that local spaza shops face competition from a growing number of foreign-owned spaza shops and independent retailers that are generally perceived by consumers to be cheaper than most local-owned spaza shops. As a result, foreign-owned spaza 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 areas where changes to business models are required.

86. 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 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.

87. The Inquiry established that foreign-owned spaza shops and independent retailers in many instances employ horizontal (operational ties) and vertical (spaza shops linked to wholesalers) co-operative

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 as 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, providing 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.

88. 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 means that local-owned spaza shops are not able to fully cater to the demand from customers compared to the foreign-owned spaza shops.

89. The Inquiry found that trade in counterfeit goods confers some form of price advantage to those that engage in the sale of such goods. There are also 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.

90. Having regard to the emerging competitive pressures, from both the national supermarket chains and foreign nationals,

90.1 an inability to 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, and a lack of co-operation amongst locally-owned spaza shops which prevents them from taking advantage of the opportunities for bulk buying at more competitive prices;

90.2 an inability to tap into credit markets due to again the small and informal nature of these businesses. There is typically a lack of verifiable performance information and systems in place which result in information asymmetries with all potential providers of credit, thereby limiting the ability to ensure greater stock levels and variety to meet the convenience requirements of customers, which is reinforced by the lack of social networks of cooperation;

90.3 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.

91. In addition, the Inquiry found that the regulatory environment is not conducive to supporting the sustainable competitiveness of small and independent retailers, in competition to supermarket chains, and in many cases, actively undermines their ability to respond to the changing competitive environment.

92. 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 play. 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. It also creates an asymmetry between those shops willing to ignore the trading hours and to 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 do comply, which also undermines their transition from informal to formal enterprises.

93. Similarly, in relation to liquor regulation, the Inquiry found differential treatment of small and independent traders and the national supermarket chains that are licensed with longer trading hours. This difference 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, conferring upon the national supermarkets a level of competitive advantage.

94. 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 so in a 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.

95. More generally on zoning and trading hours, submissions were made that some municipalities used these laws to push out informal traders in favour of the national supermarket chains and formal independent stores because these stores contribute to municipal taxes. However, the Inquiry notes that the informal businesses

98.9.2	Second, the enterprise development programmes of the national retail chains should be formalised and strengthened. Accordingly, the Inquiry recommends that the national supermarket chains commit to a formal ongoing programme to develop small and historically disadvantaged suppliers. Furthermore, that such a programme should establish binding industry targets for a proportion of turnover to be supplied by SMMEs and historically disadvantaged suppliers, as well as a proportion of turnover to be spent on the development of new SMME and historically disadvantaged suppliers. These may initially be set in line with current enterprise development spend in order to entrench such programmes. However, the formal commitments should also entail a gradual escalation of these binding commitments over time. This escalation should take into account what is realistic and achievable but should also be ambitious in its efforts to address concentration in the supply chain. Given that it is also the government department that oversees the B-BBEE codes of practice which incorporate an enterprise development component, this industry commitment may be facilitated by the DTIC.	and the establishment of an industry Ombudsman financed by suppliers of FMCG.	Relations Framework Act, 13 of 2005 to give effect to the following recommendations:	for the registration of informal businesses, particularly spaza shops.
		<i>Competitiveness support for spaza shops and small independent retailers</i>		
	98.11	Government should facilitate the establishment of distribution centres to be located in peri- and non-urban areas to service small and independent retailers and wholesalers;	98.13.1	organised local government must seek to develop a common approach for local government in terms of section 3(3)(a) of the Local Government: Municipal Systems Act, 32 of 2000 to develop uniform guidelines for by-laws and regulations to give effect to these recommendations;
	98.12	Government should establish an incentive programme that will provide seed finance for innovative commercial models of private businesses that aim to offer the following support for small informal spaza shops:	98.13.2	provinces and municipalities must coordinate and streamline applications for liquor licenses with applications for the rezoning of premises;
	98.12.1	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;	98.13.3	municipalities must review the trading times in by-laws and regulations in relation to spaza shops and street traders, with a view to amending or abolishing those by-laws and regulations in accordance with the uniform guidelines;
	98.12.2	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; and	98.13.4	municipalities must fast-track the processing of existing re-zoning requests for spaza shops in township areas;
	98.12.3	the development of consumer and business information to assist in the improvement of such businesses, including business and financial management training.	98.13.5	municipalities must proactively rezone areas to enable them to carry on business in a more effective and formalised manner and in accordance with the uniform guidelines;
		<i>Removal of regulatory obstacles to meeting competitive challenges</i>	98.13.6	municipalities must develop and implement preferred zoning processes and practices that facilitate ease of entry for SMMEs in non-urban areas including imposing conditions on the approval of shopping centre developments to secure the inclusion of SMME businesses in and around shopping centres; and
	98.13	All three spheres of government involved in the regulation of planning and trade should cooperate with one another to coordinate their activities and legislation in accordance with section 41(h)(iv) of the Constitution and coordinate their actions in terms of section 35 of the Intergovernmental	98.13.7	municipalities must develop and implement a simplified framework
98.10	In order to continue with the work of the Inquiry, the Minister should appoint a facilitator to seek to secure voluntary compliance by suppliers of fast-moving consumer goods. If the facilitator is unable to secure voluntary compliance within six months from the date of publication of this Final Report, the Government should introduce a legislative framework to give effect to these recommendations in the form of a code of good practice			98.14 In so far as counterfeit goods are concerned, it is recommended that-
			98.14.1	law enforcement officers appointed by municipalities are given powers to enforce the Counterfeit Goods Act, 37 of 1997 either under section 22 of that Act or by way of declaration in terms of section 334(1) of the Criminal Procedure Act, 51 of 1977; and
			98.14.2	there must be increased coordination between the South African Revenue Services, South African Police Services and municipalities to facilitate proactive policing of counterfeit goods.
			99.	Given the multiplicity of issues that appear to distort and impede competition in the South African grocery retail sector, the Inquiry recommends that government should develop a legislative framework with a statutory industry body for the regulation of the retail sector in South Africa, taking into account, among others, the findings and recommendations of this Inquiry.



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