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The expansion of regional supermarket chains

Implications on suppliers in Botswana and South Africa

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Abstract: This paper explores the effect of the spread of supermarkets on the participation of suppliers in supermarket value chains in Botswana and South Africa. Using secondary data and in-depth interviews with key players in the value chain, the paper evaluates the buyer power of supermarkets evidenced in the negotiation of trading terms. It further assesses the capabilities and investments required by suppliers to access shelf space and remain competitive. Finally, the paper looks at the role of supermarkets and governments in developing local supplier capabilities and the importance of harmonizing policies across borders.

Keywords: supermarkets, suppliers, regional value chains, buyer power, strategy, capabilities
JEL classification: L1, L2, L22, O1

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1 Introduction

The expansion of supermarkets in the southern African region has important consequences for consumers, local suppliers, and the competitive landscape. In our first working paper on this topic (das Nair and Chisoro 2015[1]), we mapped the growth and spread of supermarkets in the southern African region to understand the evolving retail strategies employed by the different supermarket chains. We provided an evaluation of the structural and strategic barriers to entry into the supermarket industry in South Africa, including the competitive strategies that supermarkets engaged in. An important alternative and growing retail model in the form of independent retailers supported by large buying groups in South Africa was highlighted, a development that has implications on suppliers and consumers alike.

This working paper focuses on the impact of the spread of supermarkets on suppliers in Botswana and South Africa.[2] The procurement and sourcing strategies of large supermarkets have a significant impact on suppliers with regards to participation in the value chain and development of capabilities. Large supermarket chains have indeed transformed food supply chains—from their procurement methods and requirements, to the negotiation of trading terms and the private standards imposed on suppliers (Reardon et al. 2004; Brown and Sander 2007; Humphrey 2007). In both South Africa and Botswana, supermarkets are a growing route to market for suppliers. Given the multinational nature of large chains in the region, supermarkets open up a much larger regional market for suppliers to attain the necessary scale to become competitive in national, regional, and potentially even international markets. This is evident in the growth of supermarkets in the past 15 years and the consequent effects on regional trade flows in food and household products between South Africa, Zambia, Zimbabwe, and Botswana as highlighted in das Nair and Chisoro (2015).

The nature of the relationship between supermarkets and suppliers therefore has important consequences in terms of opening up opportunities for suppliers in the region. In particular, the buyer power that large supermarkets exercise in the negotiation of trading terms and the private standards that they impose have cost implications for suppliers. These can create challenges for suppliers in effectively participating in supermarket value chains. Further, suppliers have had to upgrade their capabilities in order to obtain shelf space and remain competitive in terms of costs, quality, consistency, and scale of production. In this regard, supermarkets and national governments have an important role to play in assisting suppliers to build their capabilities. Internationally, there have been several mutually beneficial initiatives, but in southern Africa such initiatives are often ad hoc, small in scale and scope, and limited to support for small-scale farming. Furthermore, these are seen as corporate social responsibility obligations on the part of supermarkets rather than commercially viable operations and are developed without a regional perspective in mind.

This paper is structured as follows. Section 2 provides a literature review on the interaction between supermarkets and suppliers. This includes changes in procurement practices

[1] Both working papers have been produced as part of a broader study that aims to undertake a regional review of the spread of South African supermarkets, the different retail models employed, the implications for local suppliers, and the impact on competition. The broader study covers four countries: South Africa, Botswana, Zambia, and Zimbabwe. The Centre for Competition, Regulation and Economic Development (CCRED) is undertaking the research for South Africa and Botswana. The Zambia Institute for Policy Analysis and Research (ZIPAR) and the Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU) are undertaking the research in Zambia and Zimbabwe respectively.

[2] A final synthesis paper combining the findings of all four countries will be released in late 2016.

internationally, the impact on the development of supplier capabilities, and forms and implications of buyer power exerted by supermarkets. This section also reviews upgrading of supplier capabilities through supplier development programmes of supermarkets and other initiatives supported by governments internationally. Section 3 describes the methodology employed for the assessment of the impact on suppliers of the spread of supermarkets in Botswana and South Africa. Section 4 presents our results and analysis of the nature of interaction between suppliers and supermarket chains, important factors in the supply to supermarkets, development of supplier capabilities, and the buyer power of supermarkets in South Africa, while Section 5 does the same for Botswana. Section 6 looks at the existing trade dynamics in these two countries, local supplier protection initiatives, and the implications of this on suppliers and their ability to supply the southern African region. Section 7 concludes.

2 Literature review: the interaction between supermarkets and suppliers

2.1 The impact of procurement methods, private standards and buyer power on suppliers

2.1.1 Changes in procurement methods

The procurement methods and requirements of supermarkets have important implications on suppliers. Internationally, supermarkets have moved away from spot purchases to adopting specialized procurement agents, dedicated wholesalers, or procuring directly from farmers and processors. This gives them direct influence over pricing, quantities, terms of delivery, and product quality. This also has the adverse effect of shrinking the supply base by using only preferred suppliers[3] (see Altenburg et al. 2016) and bypassing traditional wholesale markets (Humphrey 2007).

With regards to food items, it is estimated that the majority of products (65 per cent) of large supermarkets are sourced from processors rather than directly from farmers, given that most foods sold are processed in some form and packaged (Reardon and Gulati 2008). Specialized agents and wholesalers can act as 'channel captains' and enter into relationships (formal contracts, including contract farming, verbal agreements, etc.) on behalf of supermarkets with processors and farmers to ensure quality and consistency is maintained. Dedicated procurement agents and wholesalers are usually efficient as they cut costs in terms of search, transaction, and coordination costs. They also assist in maintaining private standards and contract terms between supermarkets and suppliers. However, this has further shifted power away from small farmers and processors to supermarkets. In South Africa, a proportion of fresh produce found in supermarkets goes through wholesalers in municipal fresh produce markets. Similarly, the flow of ambient goods to independent retailers goes through dedicated buying groups (see Figure 1.) But aside from this, the use of dedicated procurement agents for supermarkets appears to be limited. In Botswana, however, there are import agents with large warehouse facilities who supply supermarket chains throughout the country that exclusively supply supermarkets on behalf of selected suppliers (discussed in Section 5).

Modern supermarket chains globally are also moving towards using their own centralized distribution centres to supply stores in the chain and are shifting away from the traditional store-

[3] Several large multinational supermarket chains like Ahold, Tesco, and Metro indeed have preferred supplier lists (Reardon and Gulati 2008).

by-store procurement and supply practices. Since Sam Walton started the concept of building distribution centres to service Walmart stores in villages and small towns in the US in the 60a (Reardon and Gulati 2008), supermarket investments in distribution centres have been a key pathway to retail modernization. This has certainly been the case in South Africa with all the major supermarkets investing heavily in distribution centres (see das Nair and Chisoro 2015).

Reardon and Hopkins (2006) highlight certain procurement trends of supermarkets for different categories of products internationally. They find that supermarkets tend to source from medium to large suppliers of meat, dairy, and processed food companies. Fresh produce also tends to be sourced from medium to large farmers, which presents difficulties for small-scale farmers in developing countries especially if they do not supply export markets. Supermarkets tend to only source indirectly from smaller farmers through wholesalers and processors, but even these smaller farmers are those that have better capital assets, equipment, access to infrastructure, and are more commercially oriented in that they use hired labour and chemical inputs, and have training advantages (Reardon and Timmer 2007). If supply from small farmers is critical, often the intermediaries between supermarkets and the small farmers have to assist with training and credit facilities. Supermarkets typically prefer to procure from large suppliers to reduce transaction costs as large suppliers have the capacity to supply all the outlets of a supermarket chain, therefore ensuring sufficient volumes, consistency, and quality of products.

2.1.2 Private standards

Large supermarkets are imposing escalating private quality and processing standards on suppliers (Boselie et al. 2003; Humphrey 2005). These standards are over and above country-specific basic legal standards that suppliers have to adhere to. The capabilities of local suppliers (particularly small-scale farmers, small food processors, and producers of household consumable goods) to meet these standards and reach the required scale to compete with imports are important for their sustainability. Marketing of fresh food produce to supermarkets has been particularly difficult for suppliers in developing countries as often the institutional, physical, and financial infrastructure support systems are weak (including bar coding, packing houses, cold chains, shipping equipment, credit facilities, standards, and certification processes, etc.). For fresh fruits and vegetables, sanitary and phytosanitary (SPS) protocols are important (Tschirley 2010). Suppliers are usually responsible for all activities up until the product is delivered to a distribution centre or a supermarket and are solely responsible for the costs of escalating private standards of supermarkets.

2.1.3 Supplier capabilities

The modernization of procurement systems has therefore placed considerable pressure on suppliers with regards to their costs, the volumes they are able to supply, and the consistency and the quality of their products (Dakora 2012). Local suppliers often require significant investment in capital, technological, managerial, organizational, and financial upgrades to meet cost and quality requirements of supermarkets.

Brown and Sander (2007) suggest that supermarkets have evolved to become 'global sourcing companies'. But this type of global value chain perspective on multinational sourcing strategies masks the importance of regional dynamics in certain value chains.[4] Supermarkets have important implications for regional sourcing, a potentially powerful avenue for growth in agro-processing and manufacturing value chains in southern Africa. But to be able to supply to the region through

[4] See Fessehaie et al. (2015) for an account of the dynamics in selected regional value chains in the southern African region.

supermarkets, suppliers have to first develop the required capabilities. Currently, as shown in das Nair and Chisoro (2015), a large proportion of products is imported from South Africa. This is because local suppliers in food processing and manufacturing in countries like Zambia, Botswana, and Zimbabwe often lack the scale and capabilities to supply supermarkets.

Supermarkets are more likely to source their products via imports if they are foreign-owned chains than if they are locally owned (Altenburg et al. 2016). A range of factors have contributed to this, including lower relative costs of sea and air freight, tariff reductions, trade liberalization, innovations in communications, improved transport systems, and increased capital mobility (Brown and Sander 2007). This is more so the case for regional sourcing, with transport costs being lower from the region given proximity than for deep sea imports. Further, Southern African Development Community (SADC) trade agreements make it relatively easier to import from South Africa.

Cattaneo (2013) finds that when foreign retailers first enter into a host country, they tend to import a large share of their supplies from their home base, and over time, they increase their share of local sourcing. Using supermarket experiences in different countries (Shoprite's in Zambia and Madagascar, Carrefour's in Morocco and Tunisia, and METRO in Kazakhstan), Cattaneo highlights three phases of connection to the 'global' value chain. Our proposition is that in the southern African region, an obvious first step to connecting to global value chains is to successfully compete in 'regional' value chains. In any case, the phases are likely to be similar whether on a regional or global level:

- **Phase 1**: Lead retailer in developing country imports most of its products given the lack of capabilities and capacity of local producers to satisfy its requirements and standards.

- **Phase 2**: As local producers build capabilities and capacity, they begin to grow their supplies to lead retailer.

- **Phase 3**: Local producers that meet high standards export their products to the retailer's regional/global network.

The duration of each phase is likely to be very dependent on the type of products, the existing level of supplier capacity and capabilities in a given country, as well as country-specific institutional and political factors. Foreign supermarkets are most likely to first source perishable agricultural products locally given the importance of short cold chains for such products. It is often only a few large farmers that can meet the stringent requirements of supermarkets, and it is these that are able to transition to exportation. In southern Africa, however, Phases 2 and 3 are unlikely to be reached in a short period of time after foreign retailers set up operations, especially for products that require significant value addition, given the limited processing and manufacturing capabilities in most of these countries. This is where opening up of markets via regional multinational supermarkets can assist suppliers in attaining the scale needed to be competitive and to invest in building capabilities. This requires a combination of building supplier capabilities and designing enabling policies for the region (and not just on a national level. See Section 6 for a discussion).

2.1.4 Buyer power of large supermarket chains

Over and above demanding lower costs and higher standards from suppliers, supermarkets often impose a range of other costs on suppliers through their trading terms. Large supermarket chains in many cases are able to control pricing in their trading terms by controlling elements such as listing fees, rebates, advertising and slotting allowances, promotion fees, payment period terms, settlement discounts, and new store openings fees (Reardon and Gulati 2008). This unilateral

control of trading terms is reflective of the buyer power of large supermarkets (Clarke et al. 2002; OECD 2015). A combination of increasing retail concentration and significant barriers to entry limits the choices that suppliers have in terms of the competing means of distributing their goods in many countries (Dobson 2015).

In the supermarket industry, abuse of buyer power can result in what is called the 'waterbed effect', where large retailers negotiate price reductions with suppliers that are not cost-related, and then the suppliers increase prices to smaller grocery retailers and wholesalers to compensate for this (Davis and Reilly 2009; Inderst and Valletti 2011). While suppliers would want to have as many retailers to sell to, the threat of being de-listed from large supermarkets' supplier bases may result in suppliers giving in to the demands of supermarkets (Dobson 2015). As we show below, the threat of being de-listed is indeed a significant concern in Botswana. In a number of countries, market inquiries or studies are initiated by competition authorities given concerns around buyer power (Kobel et al. 2015).

Another avenue through which supermarkets can increase their bargaining power against suppliers is through increasing their range of private label or house brand products.[5] Supermarkets in both developed and developing countries are increasingly producing house brands of food and household products. The increase in the number of private labels may also be an indicator of increased competition between supermarket chains, where supermarkets are trying to differentiate themselves. These private label brands are proving to be highly successful and fast sellers for supermarkets as they compete with branded alternatives on price, value, and quality, particularly for cost-conscious customers. However, supermarkets are also producing private label products that target different groups of customers, including high-income consumers (Ezrachi 2010). Given limited branding and advertising for these products, costs of sales are often lower than for other well-known branded products.

Private labels have raised concerns for suppliers of branded products in instances where supermarkets favour private labels on their shelves at the expense of branded products (Harvey 2000). They are part of the bargaining power of retailers, putting pressure on suppliers of branded products and potentially resulting in their foreclosure. However, the overall long-term competitive impact of private labels is ambiguous (Ezrachi 2010). On one hand, private labels are welfare-enhancing as double mark-ups are eliminated and the additional competition created between the brand and private label could lead to lower prices (Mills 1995). Further, retailers that identify a gap in the market and produce private label products to fill that gap enhance consumer welfare (Ezrachi 2010). On the other hand, in addition to the impact on branded goods stated above, private labels can lead to lower levels of innovation if they are produced soon after the branded product is released (reducing incentives to invest in R&D and innovation of branded products). Others have suggested that private labels actually result in an increase in price of the branded product given a core base of loyal customers for the branded product (see OECD 2013). There has been significant growth of private labels in both South Africa and Botswana, with concerns particularly in Botswana around the foreclosure effects of a rapidly rising private label/house brand culture by local supermarket chains (see Section 5.4).

[5] We use the terms private label, own brand, and house brand interchangeably throughout the paper.

2.2 What can be done to support local suppliers and how successful are such initiatives?

Given the rapid pace of the spread of supermarkets in developing countries, concerns arise about whether large retailers are abusing their power or if there are unintended consequences for different groups that lead to their marginalization.

Public policy can play a role to capitalize on the benefits of the rapid spread of supermarkets and mitigate the potential adverse impacts. However, there appear to be very few countries globally, if any, that have a coherent, tailored, national retail modernization strategy. This is even more so for developing countries in southern Africa which have experienced the most recent wave of supermarket foreign direct investment. Given the dynamic impact of the spread of supermarkets on various sectors of the economy, such strategies have to take into account several moving parts on macro and micro levels.

General macro-economic factors and policies affect the food retail sector just as they affect other sectors in the economy (exchange rate fluctuations, interest rates, etc.). Micro-level policies directly affecting the retail sector include retail pricing regulation, zoning regulations, codes of conduct, and competitiveness programmes for wholesalers and retailers. Other policies that impact retail include policies targeted at other sectors such as agricultural policy, industrial policy, labour regulations, and transport and logistics sector policies, as well as more general policies on international trade, foreign direct investment, urban planning, consumer protection, and competition policy (see Section 2.2.2 on some of the specific policies in the selected countries that affect suppliers). Micro-level policies can also include firm-specific policies that can have an impact on the value chain, for instance supplier development programmes discussed in Section 2.2.2. These extensive interrelationships make it extremely difficult to formalize and implement a coherent national strategy specifically for the retail sector (Reardon and Gulati 2008; Altenburg et al. 2016).

In general, the broad levels of intervention presented in Table 1 have been identified in the retail sector globally.

Table 1: Levels of intervention (least to most)

Approach	Laissez- faire	Sequenced and assisted	Protectionist
Features:	• Few regulatory constraints on FDI • Limited checks and balances on conduct • Limited development programmes for suppliers • Limited support for displaced local retailers	• Gradual opening of retail sector • Assistance provided to suppliers and local retailers	• Heavily regulated • Several hurdles to entry • Highly protectionist of local and traditional retailers
Typical consequences:	• Creates dominant foreign retailers • Displacement of local retailers: no adaptation • May lead to job losses • No diffusion of technology and learning • High social costs	• Able to exploit gains from modern retailing • Support and grow local firms and suppliers (sustainable development) • Low social costs	• Forgo efficiency gains from modern retailing • Widens productivity gap between local and global retailers
Regions/ countries:	Many African countries, Latin America	China, Russia, South Korea and other emerging countries	India, Vietnam, Malaysia

Source: Authors' own illustration, adapted from Altenburg et al. (2016).

Especially in the 1990s and 2000s, governments in many developing countries supported investments in supermarkets, with some even offering preferential treatment to supermarkets in terms of tax breaks (for example, Russia and South Korea), easy access to credit (for the semi-public food distribution sector in China), cheap land, and other benefits. China also has a policy for converting wet markets to supermarkets. In countries like Brazil and Mexico, commercial development incentives such as subsidies and technical assistance were provided. Supermarkets which now dominate these countries flourished under limited local regulations and liberal conditions (Reardon and Gulati 2008). Conversely, in other countries, such as India and Vietnam, there have been several measures imposed to preserve traditional retailers, wet markets, and wholesalers.

In both South Africa and Botswana, there has historically been a 'laissez-faire' approach to the spread of supermarkets, although more recently, both countries have seen greater government intervention through the competition regimes and drives to increase local sourcing.

While there are practically no examples of countries with successful, coherent national strategies for the supermarkets industry, there are numerous empirical examples of discrete support measures that have been implemented for suppliers to upgrade their capabilities, including in the countries selected in this study. Many of these initiatives are private initiatives, while a few have some government involvement. The following section evaluates these.

2.2.1 Upgrading capabilities of suppliers

While lead retailers are becoming increasingly demanding in terms of reducing costs, raising standards, and increasing speed of production, it has been shown that if they actively provide support in terms of governance in the value chain, they can transfer skills, knowledge, and best practice to suppliers relatively quickly. They can facilitate the upgrading and transition of suppliers that show potential from Phase 1 to Phases 2 and 3 in Cattaneo's (2013) three phases described above. This 'upgrading' effect has been credited for relatively underdeveloped regions becoming

substantial exporters in a short space of time (Humphrey and Schmitz 2002). Upgrading can be categorized as:

- **Process upgrading**: transformation of inputs into outputs more efficiently by reorganizing the production system or introducing superior technology;
- **Product upgrading**: moving into more sophisticated product lines;
- **Functional upgrading:** acquiring new functions to increase overall skill content of activities; and
- **Inter-sectoral upgrading**: moving into new productive activities (lateral migration) (Humphrey and Schmitz 2002).

Upgrading capabilities requires effort from all stakeholders in supermarket value chains as well as from governments. Upgrading initiatives vary by sector (see Section 4.5) but in general can include public and private investments in wholesale infrastructure developments, construction of warehouse facilities and cold chains, investment in systems to improve sorting, grading, labelling, tracking, inventory maintenance, and managerial systems.

Key reasons for increased pressure on the supply value chain are risks and increased competition to access shelf space. Humphrey and Schmitz (2002) emphasize the importance of continuity and consistency of supply in terms of non-price competition parameters such as quality, response time, delivery, etc., all of which affect supermarkets' reputation. For instance, leading UK supermarkets control many of their major fresh vegetable supply chains in terms of which they specify the types of products, processing and packaging requirements as well as the quality assurance systems that need to be in place. Such requirements are typically enforced through audits and inspections. This was mainly due to legislation that made supermarkets liable for food safety in the UK. The governance of the value chain therefore determines the exercise of control of the chain and this in turn has an impact on the development of supplier capabilities.

In southern Africa, there are small groups of farmers with high capabilities that have transitioned into supplying export markets (Phase 3). For example, European supermarkets such as Tesco and Marks and Spencer source produce from Zimbabwe (and Kenya). These retailers were increasingly imposing tighter standards throughout the value chain and, in an effort to meet the new requirements, local suppliers responded by restructuring their operations, upgrading facilities, processes, and logistics handling. The local upgrading processes were made possible through the effective cooperation between government and local suppliers, which was key in designing and implementing appropriate policies. Government extended subsidies to local suppliers to enable them to increase production, invested in infrastructure to reduce lead times, and set up farmer support schemes to reduce costs (Kaplinsky and Morris 2014). Other lead firms in the manufacturing of confectionery and detergent products, such as Zambia's Trade Kings, has also with the assistance of government in the form of an investment licence that provides tax incentives, grown to become a significant supplier in the region (Sutton and Langmead 2013).

2.2.2 Supplier development programmes and local content policies as a means of building capabilities

In addition to government support, targeted **supplier development programmes** (SDPs) are potentially useful in attaining increased participation and capabilities upgrading. Local suppliers that are able to supply supermarkets with products of desired quality, volumes, and consistency clearly benefit supermarkets and so it is in the supermarkets' interest to upgrade supplier capabilities. Internationally, supermarkets have invested in different degrees in supplier development programmes. If encouraged or supported by governments, SDPs can be a form of 'sequenced and assisted' intervention in Table 1.

Some multinational retail chains have large-scale SDPs internationally. For instance, Walmart globally has its Supplier Diversity Programme which supports and helps grow the businesses of suppliers owned and operated by minorities, women, veterans, and people with disabilities. In the financial year 2015, the retailer invested US$13.5 billion in these suppliers, which included US$10.4 billion in direct spending and US$3.1 billion in second-tier spending. Their model is to partner with leading business organizations to jointly support suppliers. (Walmart 2016)[6] The supplier development programmes implemented by Walmart in South Africa after its takeover of Massmart are evaluated in Section 4.5.1.

Another large multinational supermarket group, German-owned METRO group of supermarkets supports various aquaculture ponds, fishing, processing, and packaging projects in Vietnam, while METRO Cash & Carry has set up a company that works with smallholders and cooperatives, providing comprehensive training and advice in China and Pakistan. In Russia, METRO Cash & Carry has implemented SDPs for suppliers of own/house brands and fresh produce, which includes training and gearing suppliers to meet global standards.

Several of these SDPs tend to be focused on fresh produce from small farms, where imports are not a viable alternative and are undertaken with cooperation from international organizations, donors, or development agencies. The most effective SDPs internationally appear to be the ones that were done in conjunction with retailers, donor agencies, or public or private development agencies (Altenburg et al. 2016).

In recent years, local content policies and requirements have emerged in certain SADC countries. Local content policies or rules require companies, particularly foreign-owned companies, to source a minimum amount of goods and services locally by substituting foreign inputs for local inputs (Altenburg et al. 2016). This has an influence on the development of the local supplier base and their participation in the supermarket value chain.

For instance, Zambia embarked on a local content initiative (although not a formal policy) about three years ago. While the implementation has been sluggish, it appears that certain South African supermarket chains in Zambia, such as Pick n Pay and Shoprite, have taken this initiative on board and increased their local procurement proportions as well as invested in developing local capabilities. Pick n Pay Zambia committed to targeting 50 per cent local content within five years (from 2011) and had already achieved 50 per cent local procurement of fruit and vegetable content within one year. Pick n Pay has also replaced certain imported brands of household cleaners with locally manufactured products. While only around 25 per cent is imported directly, this share accounts for 80 per cent of the range of products, suggesting that value addition is still limited in Zambia. Shoprite claims that 70 per cent of their stock is sourced and produced in Zambia; however, it is unclear what level of value addition these products entail (CCRED 2015). In general, such initiatives and opportunities for developing local capabilities although in existence in Zambia remain underdeveloped and appear to be small in scale and the majority of food products are still imported from South Africa.

However, because local content policies by their very nature divert trade, they are in violation of the Trade-Related Investment Measures (TRIMS) of the WTO and, as is the case in Zambia, local content initiatives are not often explicitly required by law. Countries like India and China that are more protectionist of their local industries, however, enforce quite strict local content

[6] For instance, with the National Minority Supplier Development Council, Women's Business Enterprise National Council, US Pan Asian American Chamber of Commerce, and USLBN Disability Supplier Diversity Program in the United States (Walmart 2016).

requirements on their retailers. Often this is thought to be more of a populist, political strategy than a means of stimulating local supplier development given the difficulty in monitoring and enforcing such rules especially for multi-brand retailers (Kapur 2007 cited in Altenburg et al. 2016). Targeted SDP are likely to be more effective in building local supplier capabilities than imposing local content requirements, particularly for diversified products on supermarket shelves.

2.2.3 Cooperatives, contract farming, and outgrowing schemes

Supplier cooperatives are another way of organizing small suppliers to supply supermarkets. Through coordinating functions and sharing costs, such cooperatives are better able to meet the cost and standard requirements of supermarkets. Retail cooperatives on the other hand, act as a cooperative of retail stores that source together to gain economies of scale benefits from suppliers. Such retail cooperatives could also own manufacturing facilities to produce private label products. In Mexico for instance, the domestic chains Soriana, Gigante, and Comercial Mexicana created a procurement group called Sinergia in 2004 in order to be able to compete with Walmart (Reardon and Gulati 2008).

A variant of this model is 'self-managed procurement groups', which include independent small supermarkets that buy together to attain scale economies. This model, known as 'buying groups' in South Africa has in recent years been growing (including in other SADC countries) as shown in das Nair and Chisoro (2015).

Yet another variant is what was started in the United States by a food wholesaler called the Independent Grocers Alliance (IGA). This concept linked up three players: manufacturers, vendors, and suppliers of equipment and grocery items. Some of the manufacturers included large players like Coca-Cola, Kraft Foods, and Unilever. Wholesalers, independent retailers, and small to medium-sized chain supermarkets (although later, small stores were no longer allowed to be members of IGA) also formed part of the alliance. The aim was to link up these three crucial players of the value chain to support independent retailers and allow them to source in bulk from manufacturers and wholesalers, particularly in the face of growing competitive pressure from supermarkets such as A&P at that time.

Another way of including smaller farmers in the supermarket value chain is through contract farming. By providing key inputs to farmers in exchange for exclusive purchasing rights for the resulting crops, contract farming can assist small farmers to participate in supermarket supply chains (Prowse 2008 as cited in Altenburg et al. 2016). Contracts with retail chains ensure that participating smallholder farmers accumulate capital, learn new technologies, and achieve higher yields given the lack of basic skills and knowledge, finance, and farm size necessary to ensure constant supply. However, such contracts are often based on asymmetrical power relations as retail chains tend to dictate most of the terms to small farmers (Altenburg et al. 2016).

For suppliers to invest in developing capabilities, they require guaranteed access to markets. Supermarkets can play a role in ensuring this by entering into long-term contracts with smaller suppliers, which could include elements of assistance in human capital, management, inputs, and equipment (Reardon and Gulati 2008), as well as through the more structured approaches highlighted above.

2.2.4 Improving supermarket–supplier relationships through government-led initiatives

Government can intervene to improve the relationship between supermarkets and suppliers. Competition authorities internationally have mandated or facilitated voluntary codes of conduct between suppliers, wholesalers, and retailers. From the perspective of small and medium suppliers,

such codes of conduct serve to protect suppliers against possible abuse of market power by large supermarkets. This is similar to what has been done in the UK, through the UK's Groceries Supply Code of Practice which stipulates that retailers are required to comply with The Groceries Market Investigation Order of the former Office of Fair Trading. An independent Groceries Code Adjudicator was set up specifically to oversee the relationship between supermarkets and their suppliers to enforce this code.

In Argentina, the competition authority 'threatened' that it would promulgate a national law to closely regulate supermarkets and their relations with suppliers if the retail, wholesale, processing, and farming sectors did not formulate and self-implement a private code of commercial conduct. This threat was credible enough to spur retailers into signing the Code of Good Commercial Practices in 2001. Further, in 2002, the payment period for suppliers of perishable goods was reduced to 30 days by decree. The code, amongst other things, ensured: compliance with contracts by both retailers and suppliers; equal treatment among suppliers; prompt payment; and cooperation in logistics development. There was also a conflict resolution mechanism put in place (Reardon and Gulati 2008).

Similarly, in Ireland, there are plans to institute a mandatory code of conduct in the grocery sector, to be overseen by the Department of Enterprise, Trade and Employment. In Spain, a new act focusing on measures to improve the functioning of the food chain was promulgated in 2013 using a mixed model of regulation and self-regulation (through voluntary codes of conduct) to govern commercial relations between the agents in the food chain (OECD 2013; Kobel et al. 2015).

In developing countries, encouraging private codes of conduct is often a practical and useful approach in the short-to-medium run, particularly when commercial laws and institutions are still in the development stage (Brom 2007; see also Reardon and Gulati 2008).

Governments can further actively contribute in developing supplier capabilities, inter alia, by improving their access to information, improving organizational capabilities, providing market intelligence capital for small suppliers such as market information focused on detailed trends in the food industry, and facilitating face-to-face meetings (bilateral and multilateral, business round tables, conventions) between retailers and suppliers. For instance, the Malaysian Government's Federal Agricultural Marketing Authority (FAMA) under the Ministry of Agriculture and Agro-based Industry regularly facilitates links between producers and hypermarkets and invests in training for contract farmers, as well as providing technology and infrastructure support, logistics, and collection centres. It also assists with risk management and financial facilitation for farmers by ensuring that farmers receive payments in three to seven days from supermarkets, while FAMA receives its payment from the supermarkets in 60–90 days. Governments can further uplift public standards to match private standards. This allows for a diffusion of practices which enables greater uptake by suppliers.

Access to capital and infrastructure are often a major barrier for small suppliers, especially in developing countries. Governments can facilitate access to financial services for suppliers (working capital and for investments in equipment and other physical capital upgrades) (Reardon and Gulati 2008). Governments can also facilitate public investments in wholesale infrastructure development, such as warehouse facilities, cold chains, and better equipment for sorting, grading, labelling, tracking, inventory, and managerial systems (Altenburg et al. 2016).

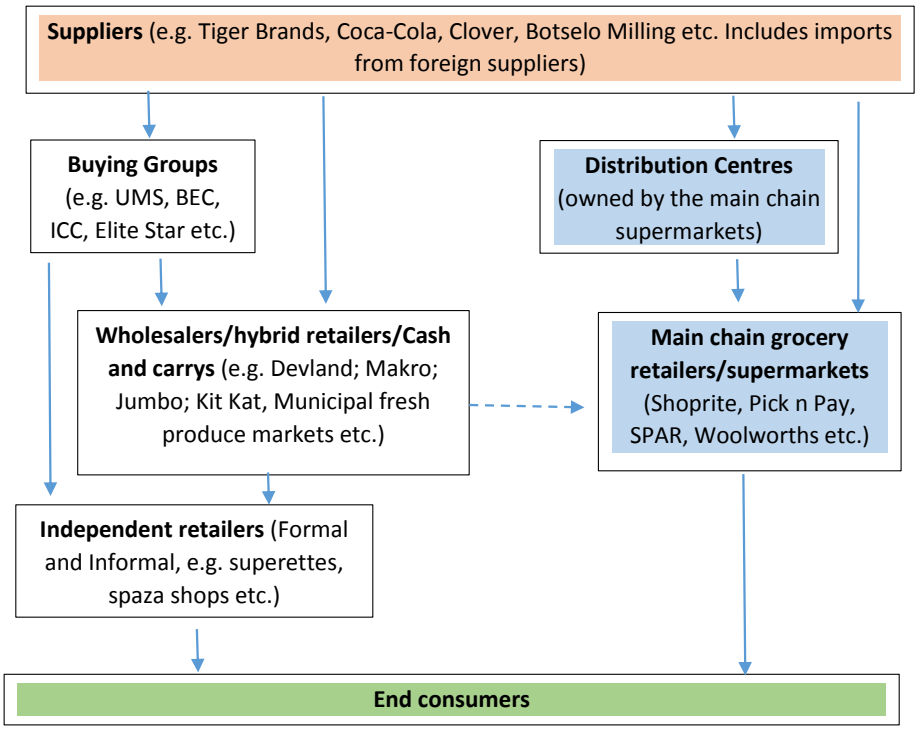
3 Methodology

Guided by the above global and regional trends in the interaction between supermarkets, suppliers, and governments, we use a combination of primary information from field interviews and secondary sources of data from databases and statistical releases to assess the impact of the spread of supermarkets on suppliers in South Africa and Botswana.

3.1 South Africa

Our selection of which categories of stakeholders to interview was largely informed by the value chain or routes to market for fast-moving consumer goods on supermarket shelves. The value chain in South Africa is depicted in (Figure 1). It is important to appreciate that these routes to market differ in the different southern African countries. In South Africa, suppliers can access consumers either through the formal supermarket value chain, where products flow from supplier to distribution centre or directly through supermarkets to the end consumer. Alternatively, suppliers can sell via independent retailers who access their products through buying groups or wholesalers (see das Nair and Chisoro 2015).

Figure 1: Value chain for fast-moving consumer goods in South Africa—alternative routes to market



Source: Modified from das Nair and Chisoro (2015), adapted from Ravhugoni and Ngobese (2010), and Masscash/Finro Competition Tribunal of South Africa decision: 04/LM/Jan09.

In South Africa, primary data was gathered from 33 interviews with retailers/supermarkets and franchises, suppliers, buying groups, wholesalers, an agent for fresh produce, and industry experts on agriculture and township enterprises/independent retailers (Table 2).

Table 2: List of interviewees in South Africa

Retailers/ supermarkets	Buying groups (4 largest)	Wholesalers	Other
1.Supermarket 1	1.Buying group 1	1. City of Johannesburg Municipal Fresh Produce Market (wholesaler 1)	1. Township enterprise expert
2. Supermarket 2	2. Buying group 2	2. Wholesaler 2 (large)	2. Agricultural economist/expert
3. Supermarket 3	3. Buying group 3	3. Wholesaler 3 (small)	
4. Supermarket 4	4. Buying group 4	4. Marketing agent (small)	
5. Supermarket 5			
6. Supermarket 6			
7. Franchise 1			
Suppliers			
Sector	Firm	Number of employees	Relative size
Dairy*	Firm 1	600	One of the five largest dairy processors
	Firm 2	1,000	One of the five largest dairy processors
Poultry* and eggs	Firm 3	12,000	One of the four largest producers
	Firm 4	5,000	One of the four largest producers
	Firm 5 (eggs)	2,000	Small–medium supplier
Milling and bakery	Firm 6	11,705	One of the largest bread producers
	Firm 7	350	Small supplier <5% market share
	Firm 8	40	Small supplier <5% market share
	Firm 9	-	Small supplier of baked products and pastries
Fresh produce and processed food	Firm 10	-	The largest municipal fresh produce market
	Firm 11	1,200	Large supplier and exporter of fruits
	Firm 12	400–450	Large supplier of processed foods
	Firm 13	-	Small coffee producer <10% of the market
Soaps and detergents	Firm 14	80	Small supplier
	Firm 15	2	Small supplier
	Firm 16	450	One of the largest national and regional suppliers

Note: *Over and above the in-depth interviews with these poultry and dairy producers, we draw from interviews with three other main producers in these sectors conducted by CCRED for another project.[7]

Source: Interviews with suppliers in South Africa, 2015–16.

As seen in Table 2, our interviews included the main supermarket chains operating in South Africa.[8] To understand the alternative route to market, the four largest buying groups that supply

[7] Ncube et al. (2016), 'Competition, Barriers to Entry and Inclusive Growth: Agro-processing', Study undertaken for the National Treasury

[8] A large supermarket chain in the region declined our request for an interview.

independent retailers were interviewed, as well as one of the largest multi-product wholesalers in South Africa. Further, we interviewed the City of Johannesburg Municipal Fresh Produce Market, the largest wholesaler of fresh fruit and vegetables in the country. Suppliers interviewed included suppliers of fresh fruits and vegetables, poultry, eggs, dairy (milk, cheese, yoghurt, etc.), milled products (maize meal and flour), baked products (bread and pastry), processed food (sauces, prepared meals, soups, pre-cut vegetables, etc.), and household soaps and detergents. The food products were selected given their importance in a typical consumer basket in South Africa (such as staples and key sources of protein), and/or because they have the potential to be traded between SADC countries with supermarkets in the region being a key route to market (for instance, in the case of soaps and detergents). In each broad sector, the main producers were interviewed (as highlighted in the last column in Table 2). In soaps and detergents, coffee, as well as in milling, small suppliers were also interviewed to understand the dynamics faced in accessing supermarkets.

A questionnaire administered via semi-structured interviews with the majority of these market participants was used to assess development of supplier capabilities through questions on the size of suppliers, whether they have grown in the past five years, whether they export, what alternative routes to market they have, and what investments have been made (and whether these were because of supermarket requirements). The questionnaire also explored factors that are important for suppliers to participate in supermarket supply chains and the constraints they face. Some triangulation was carried out by comparing suppliers and supermarkets' responses regarding the importance of different factors. To evaluate the degree of buyer power of supermarkets, suppliers and supermarkets were asked about trading terms and conditions, and private standards imposed by supermarkets. Support from government and supermarkets was ascertained by asking suppliers about what kind of assistance they had received towards expanding their sales and upgrading their capabilities. In addition, suppliers were asked about their knowledge of the different supplier development programmes being implemented by supermarkets and by government.

Margins of retail prices over producer prices were assessed for selected products where secondary data were available to provide further indications of where market power lies in the value chains. Secondary data on producer, wholesale, and retail prices for fresh produce, chicken, and milk was used for this analysis. Secondary data was obtained from the following sources:

- Monthly average *wholesale prices* for the top five fruit and vegetables by volume sold in Gauteng from the City of Johannesburg Municipal Market—onions, tomatoes, potatoes, apples, and bananas (January 2008–December 2015);

- Monthly *producer prices* for fresh and frozen chicken from Agrimark—South African-based company that specializes in the analysis and forecasting of national and regional agricultural industry and market information (January 2008–December 2015);

- Monthly *producer/farm-gate prices* for milk from the Milk Producers' Organisation—an industry organization for milk producers in South Africa (January 2008–December 2015); and

- Monthly average provincial *retail prices* from Statistics South Africa for the above products (January 2008–December 2015).

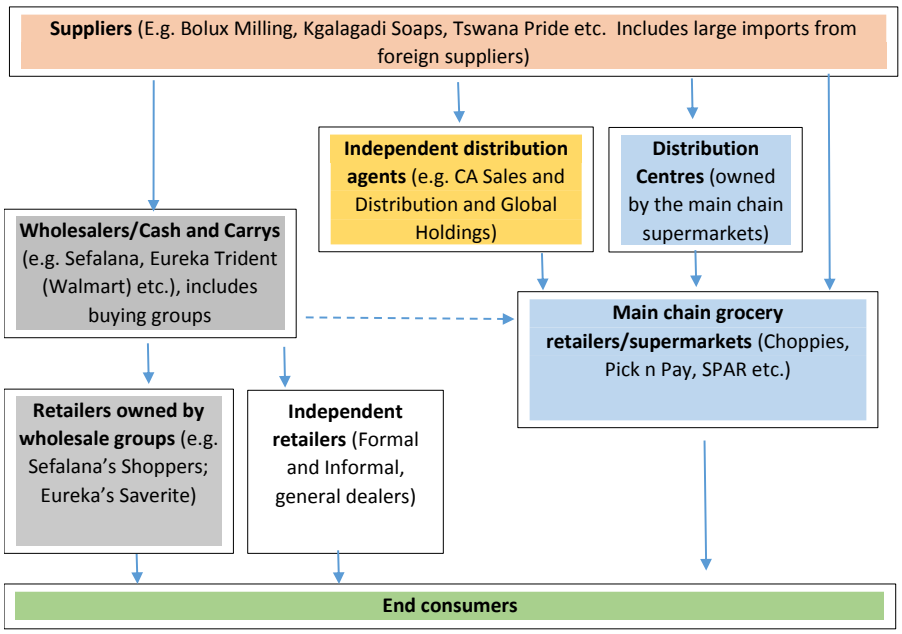
The City of Johannesburg Municipal Market located in Gauteng province is the largest fresh produce market in South Africa with a 48 per cent market share of national fresh produce. The

market is the first point-of-sale for over 6,000 farmers in South Africa.[9] The reported producer prices are recorded as a monthly average of the daily spot prices sold at the market. The prices of products sold from the market are essentially wholesale prices (made up of farm-gate price plus transport costs, plus a commission by market agents who sell on behalf of producers and a cost for using the market premises). Supermarkets buy fresh produce from municipal markets in addition to supply contracts directly with farmers. As highlighted in das Nair and Chisoro (2015), some supermarket chains like Fruit and Veg City procure the majority of their fresh fruit and vegetables from such municipal markets. The other supermarket chains source directly from farmers during periods of low demand and frequent the municipal market during periods of high demand when the product is in short supply and can only be sourced at the central market.[10] The municipal market is a key source for fresh produce for independent retailers, hawkers, and food importers from the region.

3.2 Botswana

Similar to the approach in South Africa, our selection of stakeholders to be interviewed was informed by the value chain or routes to market for fast-moving consumer goods in Botswana. The value chain in Botswana is depicted in Figure 2. As can be seen, there are clear differences in the value chain compared to South Africa with vertically integrated wholesalers and retailers, as well as independent distribution agents of imported products (explained further in Section 5).

Figure 2: Value chain for fast-moving consumer goods in Botswana—alternative routes to market



Source: Authors' own illustration.

In Botswana, primary data was gathered from 11 interviews with supermarkets, wholesalers, and cash and carrys, a large distribution agent, the Competition Authority of Botswana, and the main suppliers of poultry, eggs, milled products (flour, maize meal, pasta), beef, soaps (including laundry soaps), and processed foods (sugar, breakfast cereals etc.) (Table 3). In Botswana, beef is an important source of protein given the advantage that Botswana has in beef production. Fresh

[9] Interview with City of Johannesburg Municipal Market, 10 February 2016.

[10] Interview with a fresh-produce agent at the City of Johannesburg Municipal Market, 10 February 2016.

produce and processed food are largely imported from South Africa. Given that the South African supermarkets interviewed also operate in Botswana, the results from the South African interviews with these players largely also hold for Botswana. The same questionnaires as in South Africa were administered to supermarkets and suppliers in Botswana as far as possible.

Table 3: List of interviewees in Botswana

Retailers/ supermarkets	Wholesalers/ cash and carry	Distribution agent	Other
1. Supermarket 1	1. Wholesaler 1	1. Large distribution agent	1. Competition Authority of Botswana
2. Wholesaler and retailer 2			
	3. Wholesaler 3		
Suppliers			
Sector	Firm	Number of employees	Relative size
Poultry and meat	Firm 1	700	One of the 3 main poultry producers
	Firm 2	700	One of the 3 main poultry producers
	Firm 3	150	Medium-sized meat supplier with 20% market share excluding the Botswana Meat Commission
Milling and bakery	Firm 4	450	One of the largest local suppliers with 80% of flour market; 40% of maize meal and samp market; and 40% of pasta market
	Firm 5	700	One of the largest supplier with 64% of maize market
Soaps and detergents	Firm 6	40	Medium-sized producer and exporter of soaps

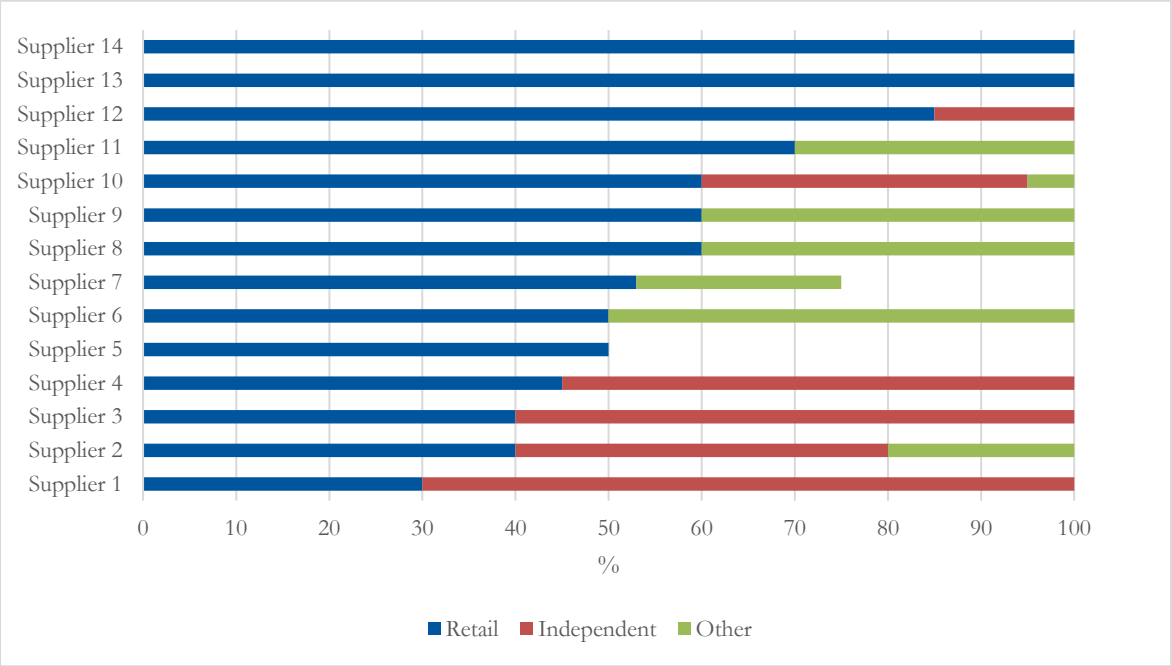
Source: Interviews with suppliers in Botswana, 17–19 November 2015.

4 South Africa: results and assessment

Supermarket/retail chains are the main route to market (RTM) for the majority of suppliers interviewed in the selected product markets, accounting for 30 per cent to 85 per cent of suppliers' total sales. In some cases, supermarkets account for 100 per cent of suppliers' sales (Figure 3).

In South Africa, the main supermarkets are Pick n Pay, Shoprite, Woolworths, SPAR, Walmart, Choppies, and Food Lovers Market (Fruit and Veg City) (see das Nair and Chisoro 2015). Most suppliers interviewed started supplying supermarkets from inception, while a few small suppliers grew organically over time to supplying supermarkets. These suppliers typically started off by supplying small independent retailers and 'spaza' or township shops.

Figure 3: Proportion of sales to retail chains, independent retailers, and other buyers for suppliers interviewed



Note: N=14. Not all the suppliers interviewed provided answers for this question.

Source: Interviews with suppliers, 2015 and 2016.

Alternative retail routes to market include independent wholesalers and retailers, cash and carrys and distributors (captured under 'independent' in Figure 3). The independent retailer market is larger than the supermarket RTM for certain key products such as chicken, bread, and fresh produce in South Africa. According to a large chicken supplier, the total poultry market is roughly R40 to R50 billion (total sales revenue) per annum in size and, out of this, only (approximately) R12 billion is sold via the formal supermarket chains.[11] The balance, which is sold via independent retailers and wholesalers, is mainly sold as loose cut portions targeting the large proportion of low-income consumers whose primary source of protein is chicken. Supermarkets such as Boxer (owned by Pick n Pay) and Cambridge (owned by Walmart) that target low-income customers have also started adopting this method of selling loose cut chicken portions in their outlets. According to a large bread producer, 60 per cent of their business in Gauteng is via independent retailers (what they call 'township business'), while 40 per cent is through formal supermarket chains.[12]

Food services are the main non-retail RTM for food suppliers and these include the Quick Service Restaurant (QSR) industry, fast food outlets, restaurants, hotels, catering, hospitals, airlines, and government departments. Another indirect RTM is through sales to intermediate processing industries. For example, millers and processors of grains interviewed supply up to 40 per cent of their products to large cereal manufacturers like Kelloggs and to other industries such as craft brewers.[13] Suppliers also sell to specialist retail outlets such as butcheries and bakeries. QSR and indirect RTMs are collectively captured in the 'other' category in Figure 3.

Notwithstanding these alternative routes to market, many suppliers have realized growth in sales volumes to supermarkets in the past three years. Main reasons cited for the increased supply to

[11] Interview with a poultry producer, 8 February 2016.

[12] Interview with a large bread producer, 04 February 2016.

[13] Interview with a miller, 30 October 2015.

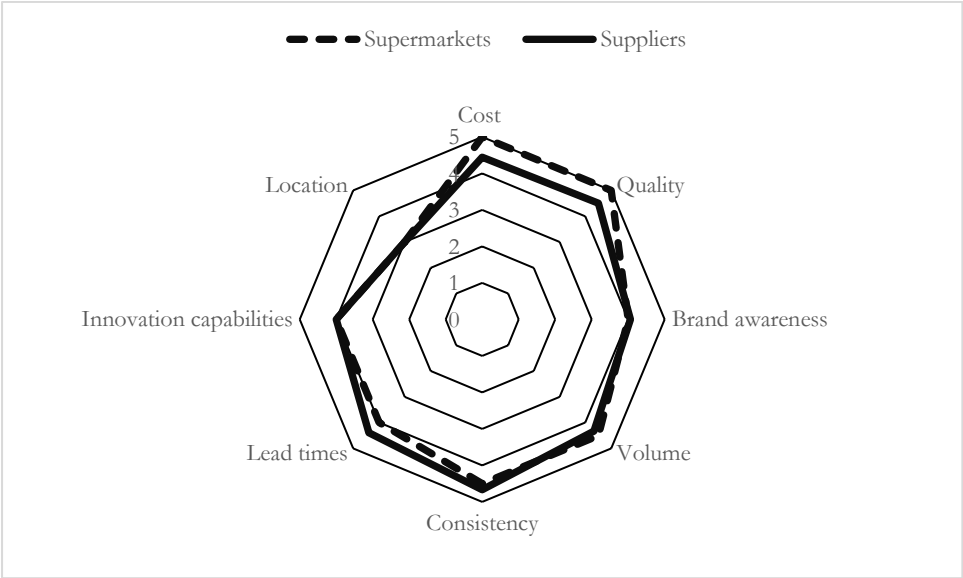
supermarkets include growth of supermarkets, organic growth of suppliers (possibly displacing smaller suppliers), increased customer base, greater urbanization, and greater investments in brand quality, which aids to build a preferred brand among customers.[14]

Another major growth area for supply to supermarkets is in the production of house brands, or private label brands. In recent years, supermarkets in South Africa have been increasing their house brand offerings. The implications on suppliers of this is discussed in Section 4.4.

4.1 Important factors in the supply to supermarkets in South Africa

Suppliers and supermarkets were asked to rank a number of factors that are important in the supply to supermarkets on a Likert scale—1 being unimportant and 5 very important—to provide an indication of areas that require most attention in terms of building capabilities. As highlighted by Dakora (2012), modernization of procurement systems has placed considerable pressure on suppliers with regards to the ability to supply required volumes, consistency, quality, and cost of products, amongst other factors. These can be understood as 'critical success factors' in the supply to supermarkets (Figure 4).

Figure 4: Critical success factors—perspectives of suppliers and supermarkets



Note: N=11. Not all the suppliers interviewed provided answers for this question.

Source: Interviews, 2015 and 2016.

Almost all suppliers interviewed, across the various product categories, considered the **cost** of the product as one of the most important factors to supply supermarkets. The cost of the product is a function of many things, including trading terms, cost of labour, and raw materials, etc. Supermarkets are always pushing for the lowest possible costs from their suppliers, and in many instances, given their considerable bargaining power vis-a-vis suppliers, supermarkets are able to extract rents from suppliers that are not necessarily passed onto consumers.

In addition to costs, **consistency** and **quality** were ranked highly. Supermarkets require suppliers who can supply consistently both in terms of providing high-quality goods and in terms of being

[14] In the egg industry for instance, sales have grown due to an increase in the annual per capita egg consumption over the past five years, from 135 eggs per capita in 2009 to 147 eggs per capita in 2013. Interview with a poultry producer, 04 November 2015.

able to supply all/most outlets regularly. Erratic suppliers not only disadvantage customers who are loyal to the product but are costly in terms of the supermarket's reputation. Quality requirements extend to house brands and private labels. For example, Pick n Pay and Shoprite Checkers have technical teams that regularly monitor manufacturers' plants and processes to ensure high-quality house brands. But quality requirements also depend on the target market of the particular supermarket. So while Shoprite will insist on high-quality chicken products for its Checkers outlets for instance, it may be less stringent on the quality of chicken products sold through its low-income consumer targeting USave format outlets.

In a number of cases, suppliers highlighted that it is important that they are able to produce enough **volumes** to supply multiple outlets in the chain to maintain consistency. This is particularly the case for corporate supermarkets where accounts are centrally managed, and suppliers have to get approval from the supermarket's head office. This makes it difficult for small suppliers and new entrants to start supplying supermarket chains as they often do not yet have sufficient scale to supply all outlets nationally. Furthermore, a supplier's brand image is damaged if shelves run dry, so it is imperative that suppliers have sufficient volumes to meet demand. Large volumes are also necessary to reduce unit costs. This highlights the importance of opening up regional markets for suppliers.

For franchise stores, however, such as SPAR, smaller suppliers are able to participate in the value chain as there is less of a requirement to have consistency across all the franchises given individual ownership of stores. Further, as highlighted in the literature, contract growing or cooperatives are a means by which smaller suppliers can achieve required volumes, quality, and consistency.

For larger suppliers on the other hand, supplying small volumes to individual stores like independent retailers is costly, particularly if their product is a low-value, high-volume product. Such suppliers prefer to sell to wholesalers or distributors who in turn sell to independent retailers. For instance, a large poultry producer highlighted that it is uneconomical to supply less than a 25 tonne truckload and, as such, sold to independent retailers via wholesalers/distributors.[15]

Acceptable **lead times** are also important as they allow supermarkets to more accurately forecast demand. This is especially the case for fresh products with short shelf lives (bread, milk, fresh fruits, and vegetables, poultry, etc.).

Brand awareness was considered less important than costs, consistency, and quality. However, brand loyalty is important amongst lower-income customers in South Africa. Such customers have little disposable income and are typically less flexible in trying new brands, preferring to stick with less-risky tried and tested brands. Suppliers therefore have to invest significantly in building brand awareness through advertising. While not in all instances forced to have an advertising budget, suppliers often have to show supermarkets that they are continually investing in building their brand. The costs of building brand awareness rest solely with the supplier.[16]

Innovation capabilities appear to be relatively less important in the supply to supermarkets according to most suppliers in South Africa. This was largely due to the nature of the products (relatively limited value-added processed food and household products for most of our selected basket). However, a supplier to Woolworths and to supermarkets in Europe highlighted that innovation is highly valued in terms of creating a 'point of difference' for their products. This includes developing new fruit cultivars, and new genetic selections as well as investing in

[15] Interview with a poultry producer, 22 September 2015.

[16] Interview with a poultry producer, 8 February 2016.

packaging.[17] In general, however, while suppliers interviewed did not appear to consistently innovate, there was a recognition that a degree of innovation (either in product range, packaging, etc.) was important to maintain competitiveness. Forms of innovation undertaken included investments that improved the quality of their existing products (see later for more detail on such investments) and introducing new, relatively basic value-added products (such as new flavours in yoghurt and yoghurt drinks in the dairy industry, or processed crumbed chicken in the poultry industry). A key finding was that almost all suppliers interviewed had made some investments in the past five years in the packaging of their products to improve product image on the shelf, even if no investments were made in the core products themselves.

Location of suppliers relative to supermarkets and **transport costs** was ranked as the least-important factor to supply supermarkets or distribution centres. Location of suppliers clearly affects logistics costs in the supply chain. The majority of suppliers interviewed expressed that supermarkets are not concerned about the location of suppliers, although this affects the supplier's costs of getting the product on the shelf. Therefore, this was more of a concern for the supplier than the supermarket, highlighting the market power of supermarkets. The suppliers essentially have to absorb any transport cost disadvantages they may have relative to their competitors.

There are variations across products with regards to the location of suppliers—firms that supply high-volume, low-value products such as maize meal are usually located near the source of the input as opposed to close to the market. It is cheaper for the supplier to transport the final maize meal product to the market, than it is to transport maize over long distances.[18] However, for a large, processed foods manufacturer, it was important to be close to where there was a high density of supermarkets. Similarly, for products with a shorter shelf life, like milk and meat, it is important to be relatively close to retailers.

Suppliers use a combination of direct and indirect methods to get their products onto supermarket shelves. Depending on supermarket requirements, they either deliver directly to stores, distribution centres, or third party warehouses affiliated with transport companies. Some suppliers use outsourced logistics providers (Imperial Cold Logistics, Vector Logistics, Hestony, etc.), while others prefer to internalize transport cost by owning a transport fleet (vertically integrated).[19] A large poultry supplier highlighted that it could save between 8 and 14 per cent on costs which would be incurred if products went through third parties rather than in-house.[20] Suppliers who supplied multiple store outlets highlighted that delivering to a distribution centre saved them considerable transport costs by delivering to a single destination. In most cases, it is the supermarket chain that dictates what the delivery requirements are and suppliers bear all the costs of transporting or distributing the product.

It is useful to compare the above findings with what the supermarkets themselves consider to be important factors when they procure from suppliers (Figure 4). Most of the critical success factors were ranked similarly by suppliers and supermarkets, particularly cost and quality, although supermarkets ranked these higher than suppliers did (on average). Consistency and volumes were ranked as the second most important factors by supermarkets. Supermarkets emphasized the importance of suppliers consistently providing sufficient volumes of high-quality goods so that they can, at the very least, maintain their regular customer base. As highlighted by suppliers, supermarkets were not concerned about their location. This suggests that suppliers can be located

[17] Interview with an exclusive supplier of fruits to Woolworths, 6 November 2015.

[18] Interview with a miller, 3 November 2015.

[19] Interviews with a miller, 3 November 2015 and dairy producer, 22 February 2016.

[20] Interview with a poultry producer, 8 February 2016.

in other countries in the region, and as long as they are able to supply products of the required quality, consistency, and cost, they have the opportunity to supply supermarkets.

4.2 Supermarket requirements: legal and private standards

As highlighted in the literature review, supermarkets are imposing increasing private standards on suppliers.

However, suppliers have to first adhere to basic **legal requirements** before they can start supplying retail chains. In South Africa, these include standard legal requirements/regulations with regards to food safety, bar coding, labelling, and packaging requirements such as the Foodstuffs, Cosmetics and Disinfectants Act, 1972 (Act No 54 of 1972); and the Health Act, 1977 (Act No 63 of 1977). These legislations deal with issues of hygiene at the point of production, general consumer protection, and food safety. They also include the conditions under which food is stored, transported, maintained, and consumed. Other general accreditations include South African Bureau of Standards (SABS) accreditations. Generally, suppliers do not consider these standards as onerous to comply with.

Over and above these basic legal standards, supermarkets impose **private standards on suppliers**. Supermarkets require that suppliers meet the minimum Hazard Analysis and Critical Control Points (HACCP) accreditation standards upon which they receive a certificate. In some cases, supermarkets in South Africa are imposing higher accreditation standards than HACCP, such as Food Safety System Certification (FSSC 22000) which is an international accreditation. In other cases, suppliers are taking it upon themselves to get higher accreditations in order to have a competitive edge over their rivals. Regardless of accreditation, it appears that retailers in South Africa typically send their own auditors to audit the supplier at the supplier's cost. Estimates from suppliers are that HACCP can cost as much as R80,000 and FSSC 22000 can cost up to R200,000 per annum, with additional R100,000 annual fees for maintenance.[21] In particular, Woolworths has high private standards and performs regular audits on its suppliers. Woolworths requires that its food suppliers farm sustainably under its 'Farming for the Future' initiative in addition to other sustainability requirements. In addition to these, most supermarkets require Halaal and Kosher certifications in South Africa. In the poultry industry, almost all producers are Halaal approved, and abattoirs need to be approved by government.[22]

Other global initiatives have implications on local suppliers trying to access international supermarket shelves. For instance, GlobalG.A.P (Good Agricultural Practice), which started as an initiative by British retailers and supermarkets in continental Europe to harmonize their own standards and procedures and develop an independent certification system, has grown into a worldwide initiative, with over 100 countries participating in the programme. GlobalG.A.P consists of a set of harmonized standards for fresh fruit and vegetables. It includes food safety, quality, labour, and environmental standards (Altenburg et al. 2016). In southern African countries, a stepping stone initiative, 'localg.a.p' is a more cost effective solution for suppliers by providing an entry level to GlobalG.A.P certification. Although a voluntary certification, GlobalG.A.P is required to access European supermarkets and this comes at a considerable cost to suppliers.

The cost of adhering to all these private standards and audits is borne entirely by the supplier making it increasingly costly to supply formal supermarket chains. Independent retailers on the

[21] Interview with millers, 30 October 2015 and 3 November 2015.

[22] Interview with poultry producers, 08 February 2016, 22 October 2015.

other hand often have lower, if any, private standards. Independent retailers therefore provide an avenue through which new suppliers can start building scale.

4.3 Trading terms: buyer power balanced by countervailing power?

Over and above demanding higher private standards from suppliers, supermarkets impose a range of costs on suppliers through their trading terms. Supermarkets are able to control pricing and trading terms such as listing fees, rebates, advertising and slotting allowances, promotion fees, payment terms, settlement discounts, new store opening fees, etc. This is reflective of the buyer power of large supermarkets. The interviews clearly reveal that the major South African supermarkets have considerable buyer power, even over large suppliers who would be expected to have considerable countervailing power.[23] This is mainly because supermarkets are a key route to market for many local suppliers (as shown in Figure 3).

Contracts between suppliers and supermarkets are usually evergreen, with the trading terms typically renegotiated on an annual basis. Trading terms include various fees paid by suppliers to supermarkets. These fees can include advertising allowances, promotions, fixed or variable rebates percentage based on sales volumes, swell allowances, slotting fees/listing fees, and settlement discounts. The cumulative sum of these fees would be administered as a percentage discount off the invoice price that the supermarket pays the supplier. For some suppliers, this can be between 10 and 15 per cent off the invoice price but this varies between suppliers.

Suppliers in South Africa are often required to pay **listing fees** to be listed as a supplier in a supermarket's books. Suppliers have to compete for shelf space in supermarkets. Given vigorous competition for shelf space, listing fees from the supermarket's perspective shows the supplier's commitment and confidence in their ability to supply supermarkets and in the quality of their product.[24] Listing fees are typically a once-off payment which can range from ZAR5,000–ZAR50,000,[25] but can also be charged as a percentage (estimates provided range from 12–15 per cent) of the product price.[26]

Access to good **shelf space** (including in gondola ends during promotions) is also critical for suppliers to successfully sell their products. For new entrants, it is a constant battle to access prime shelf space which is usually taken up by dominant suppliers. This is highlighted by a new entrant in a quality instant coffee brand. Poor visibility on the shelf for its product resulted in a drop of its sales by 30 per cent. Prior to its position being moved to a less attractive position on the shelf, it had taken 6–7 per cent market share from the dominant instant coffee producer, Nescafe Gold.[27] Similarly, access to **cooler/refrigeration space** is important for suppliers of cold products (such as soft drinks, ice creams, frozen products, etc.). There have been numerous competition cases globally that have explicitly recognized the harm to competition of dominant suppliers imposing exclusivity on cooler space (European Commission 2005; Competition Commission of Mauritius 2013; and Competition Commission of Singapore 2013). Very recently in South Africa, a settlement was reached in the SAB Miller/Coca-Cola bottlers merger between the parties and the Minister of Economic Development which included, amongst other things, an undertaking to

[23] A recent study by Ncube et al. (2016) found that even for relatively large poultry producers, bargaining with supermarkets remains a significant challenge, particularly in IQF portions which make up 90 per cent of poultry consumption in South Africa.

[24] Interview with a miller, 30 October 2015.

[25] Interview with a miller, 30 October 2015. It is unclear if this is on a per product basis.

[26] Interview with a dairy producer, 25 February 2016.

[27] Interview with a coffee producer, 23 July 2015.

allow 10 per cent of Coca-Cola fridge space in small retail outlets to stock competitors' carbonated soft drink products (Competition Commission of South Africa 2016).

Settlement discounts are also given to supermarkets for paying the supplier within the number of days stipulated in the trade agreement, which varies depending on the supplier (but is commonly 15 to 30 days from statement and usually in the range of 2.5 to 5 per cent).[28] None of the suppliers interviewed had serious concerns about supermarkets delaying payment beyond the contracted period, although many highlighted that getting supermarkets to agree on shorter payment periods is difficult. Long payment periods put considerable pressure on suppliers' cash flow and working capital, which is problematic for smaller suppliers. Certain suppliers also highlighted the need to invest in quality administration systems that invoice accurately and on time to ensure that supermarkets find no reason not to pay or to delay payment. Shoprite was pointed out as being particularly aggressive when it comes to errors or queries on invoices.

Supermarkets sometimes demand **advertising discounts** off the purchase price for indirectly advertising on behalf of suppliers when they advertise the supermarket chain. For a miller, this discount is around 5 per cent.[29] However, not all suppliers are required to pay an advertising fee, especially for those that heavily invest in advertising their brands. Supermarkets are interested in suppliers that have a brand strategy and are continually investing in building their brand.

Over and above general trading terms, suppliers usually contribute towards retailers' cost in terms of **promotions allowances**. Suppliers pay supermarkets to participate in different promotions held by supermarkets such as Back to School, Hey Days, Easter, and Christmas promotions in South Africa. Suppliers pay supermarkets to get special shelf space for these promotions. Promotion fees range from approximately ZAR2,500 to ZAR100,000, depending on the scale of the promotion and the size of the outlet.[30] Promotion costs are typically calculated as a proportion of the total invoiced price and are significant particularly for the products we are looking at. For example, approximately 70 per cent of total chicken sales are sold during promotions at a price that is 10 per cent lower than normal price.[31] Suppliers can also run promotions at their own cost in the supermarket premises.

Perhaps the most illustrative example of supermarket buying power is the charging of a 'right to do business' fee. Estimates are that these can be in the range of 3 to 6 per cent.[32] There is no clear indication of what this fee covers.

Suppliers interviewed generally noted that supermarkets do not impose **exclusivity** conditions in the trading terms, where if on the supermarket's supplier list, they are prevented from supplying rival supermarkets. This bears out in practice in that suppliers usually sell to multiple supermarkets. There is an exception to this, however. Certain suppliers are developed exclusively by supermarkets to supply house brands and these suppliers are not permitted to sell the same brand to other supermarkets. As noted, Woolworths primarily sells house brands, building extensive long-term exclusive relationships with suppliers. One such supplier interviewed in the fresh fruit segment highlighted that it was appointed as the category manager for Woolworths over a range of fresh fruits and that it was contracted to exclusively supply Woolworths. This supplier was of the view

[28] Interview with millers, 30 October 2015 and 03 November 2015.

[29] Interview with a miller, 30 October 2015.

[30] Interview with a miller, 30 October 2015.

[31] Interview with a poultry producer, 08 February 2016.

[32] Interview with a miller, 30 October 2015.

that exclusivity worked in its best interest and it would rather not supply other supermarkets given the relationship it has developed with Woolworths over the years.[33]

Suppliers highlighted that entry of new supermarket chains (like Walmart and Choppies) in South Africa has improved competition and has allowed them to secure more beneficial contracts and trading terms.[34] This emphasizes the importance of increased competition between supermarket chains which provides suppliers with alternative routes to market, allowing them to play off one chain against the other during negotiations of trading terms.

4.4 House brands/private labels—an opportunity or a constraint?

As highlighted in the literature review, supermarkets in both developed and developing countries are increasingly producing own/house brands of food and household products. These private label brands are proving to be highly successful and fast sellers for supermarkets as they compete with branded alternatives on price, value, and quality.

There has been growth in private label products in supermarket shelves in South Africa recently. Every major supermarket chain has a range of own brand/private label products, with the majority of Woolworths' products being private labels. Shoprite has its 'Ritebrand' and 'Housebrand' ranges in Checkers, which cover around 300 products. Pick n Pay has its 'No Name' brand and is looking to further expand the private label range. Food Lover's Market produces its own house brands 'Freshers' and 'Food Lovers Signature'. SPAR also has its own branded products. SPAR does not allow major suppliers to manufacture its own private label products, thus allowing new and smaller suppliers to enter the supermarket supply chain.[35] Choppies also has 50 of its own branded products in food, beverages, household cleaning products, and cosmetics.

Many suppliers of branded products in South Africa also manufacture and sell private labels to supermarkets. Supplying house brands is a way in which suppliers can get their products onto supermarket shelves. Suppliers can use this as a stepping stone to get onto supermarkets' preferred supplier lists especially for suppliers that have not yet built a brand name. House brands also confer some bargaining power to supermarkets over large, multinational suppliers. In some instances in South Africa, brands have been developed explicitly by the supermarket to provide it with leverage against dominant suppliers.

In the milk sector, Woodlands Dairy packages private label UHT milk for SPAR and Woolworths (Woodlands Dairy 2016). Coega Dairy manufactures Shoprite's UHT private label milk for their stores in South Africa and in other African countries. It considers the production of private label milk brand to be a significant benefit to the company as it guarantees core volume sales (Ncube et al. 2016). Similarly, in the poultry sector, several main producers produce house brands for different retail chains.

However, a number of the concerns highlighted in the literature were expressed by suppliers of private label brands. In some cases, suppliers are sometimes 'forced' into supplying private labels/house brands at lower margins than their own branded products and this has been used as a tool to negotiate down prices for branded products. A large poultry supplier expressed its difficulty in supplying a house brand to a supermarket chain, where it was forced to compete with

[33] Interview with an exclusive supplier of fruits to Woolworths, 6 November 2015.

[34] Interview with a miller, 30 October 2015.

[35] Interview with a supermarket chain, 11 August 2015.

other house brand suppliers of the same product, making it more difficult to negotiate price increases (Ncube et al. 2016).[36]

4.5 Upgrading supplier capabilities

Supermarkets require that suppliers make basic investments in their product before they can start supplying them. These investments include branding (to build brand awareness and loyalty), advertising, sampling, point-of-sale material, packaging, merchandising, and marketing. Such investments ensure that the product sells in the market, which is the suppliers' responsibility.

The types of upgrading depend on the sector under consideration. Typically, in the poultry industry over and above upgrading of the production process in abattoirs to improve scale economies, upgrading can be done on the characteristics of the breed of chicken. In addition, given that animal feed (made of soya, maize and other additives) is the main input into poultry production and that most poultry producers are backwardly integrated, large investments and upgrading also take place in soya crushing capacity. In milk, typical investments are in upgrading production facilities including UHT production facilities.[37] Given the perishable nature of milk products, upgrading also involves significant capital investments in processing and specialist logistics capabilities to transport milk efficiently (Ncube et al. 2016).

In the past five years, a number of suppliers interviewed have made substantial investments in machinery and equipment, an indication that they are investing in upgrading their capabilities to meet or improve on the critical supply factors (costs, volumes, quality, etc.) identified in Section 4.1 above. Suppliers have indeed upgraded their logistics supply chains to reduce costs, improved the quality of existing products as well as invested in packaging to ensure that products are well displayed on supermarket shelves. Building on Section 4.1 above, a few examples of the types of investments made by suppliers in the last five years are highlighted:

- A supplier in the capital-intensive dairy industry has invested in new lines of high-speed machinery costing around R20 million.[38] Another supplier in the dairy industry recently invested in new machines and upgraded factory facilities at a cost of around R50 million.[39]

- A miller of maize meal has invested R50 million in state-of-the-art equipment to ensure production of high-quality maize meal.[40] A much smaller miller, who received support as part of the Massmart Development Fund (discussed later), invested R2.1 million in new machinery and a packaging line, as well as in training. It further has plans to invest in a new degerminator.[41]

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[36] Ncube et al. (2016) further provide an example of the difficulty of negotiating price increases. An interviewee in their study reported that after they had approached a major retailer with a price increase request, the retailer simply stopped accepting deliveries for a two-week period as they knew that the producer only had freezer space for ~2 weeks' worth of stock. Once they had run out of freezer space, they had no choice but to return to the retailer and offer their product at a lower price.

[37] See for instance, the upgrade of Coega Dairy (Ncube et al. 2016).

[38] Interview with a dairy producer, 22 February 2016.

[39] Interview with a dairy producer, 25 February 2016.

[40] Interview with a miller, 30 October 2015.

[41] Interview with a miller, 03 November 2015.

- A large food processor invested significantly in new kitchen equipment.[42]
- A large poultry producer continued to increase its investments yearly in cold chains.[43]
- A large bread producer invested in an in-house research centre.[44]

These investments were not cited as being necessarily due to direct pressure from supermarkets, but rather to become more competitive both relative to other local producers and against imports in supplying supermarkets. Nonetheless, they occur primarily because suppliers want to improve their sales through supermarket chains. Furthermore, as noted in Section 4.4, investments by firms supplying house brands or private labels are directly linked to supermarkets.

In addition, suppliers continuously invest in skills development and market research to understand the consumer and markets. For instance, a supplier of processed food invested in a R15 million fully fledged lab on site where students can do internships making use of Skills Education Training Authorities (SETA)[45] funding. However, the supplier claims that such funding from SETAs is no longer available to the organization.[46] The majority of suppliers emphasized that the skills shortage in South Africa is a serious impediment to the growth of their businesses.

While some suppliers have made considerable investments in machinery and equipment in the last five years, not many suppliers have introduced entirely new products into the market, signalling relatively low levels of innovation. This is also a function of the nature of the basic products investigated in this study. Nonetheless, a few suppliers have introduced new products to their suite of offerings. For instance, dairy producers have launched ready-to-eat jelly, desserts, flavoured milkshakes, and butters. In the milling industry, suppliers have introduced pre-cooked and flavoured maize meal. Poultry producers have increased sales of value-added products such as chicken nuggets and crumbed chicken in addition to mass processed IQF (individual quick frozen) chicken. Such additions require further investments in cold chains.

In a few cases, suppliers' upgrading of capabilities has been directly linked to a supermarket chain. For example, a large poultry supplier produces pasteurized 'safe eggs' exclusively for Shoprite Checkers.[47] An exclusive fruit supplier to Woolworths invested in distribution facilities with state-of-the-art cooling, ripening, and pre-packing facilities to produce ripe and ready products, as well as developed new cultivars in some of its fruit lines.

In terms of Humphrey and Schmitz's (2002) categorization of upgrading, the majority of the upgrading which appears to occur is 'process' upgrading, with limited 'product' and 'functional' upgrading. There is also very limited 'inter-sectoral' upgrading. It also appears to be the case that when there are exclusive supply agreements to supermarkets in place, suppliers are more willing to invest in innovation and in upgrading. This has important implications on suppliers being able to compete with imported products, which possibly explains the net import position for several

[42] Interview with a food processor, 26 January 2016.

[43] Interview with a poultry producer, 22 September 2015.

[44] Interview with a large bread producer, 04 February 2016.

[45] SETA for the Food and Beverage industry (FoodBev SETA) promotes, facilitates, and incentivizes skills development in the food and beverages manufacturing sector. See later for a description of the activities of this SETA.

[46] Interview with a food processor, 26 January 2016.

[47] Interview with an eggs producer, 05 November 2015.

categories of food products as seen in das Nair and Chisoro (2015). This is even more pronounced in other southern African countries.

4.5.1 Support from supermarkets to upgrade supplier capabilities

Aside from support to develop house brands and exclusive suppliers, suppliers highlighted that they receive limited assistance from supermarkets.

Support for exclusive suppliers is particularly seen in the relationship between Woolworths and its suppliers. Woolworths typically has longstanding relationships with suppliers, investing heavily to achieve the quality and standards of their products. In addition, as part of the Woolworths Enterprise Development programme, Woolworths supports existing suppliers to improve their empowerment credentials and supports the introduction of small, medium, black-owned, and black women-owned suppliers. The programme addresses challenges facing small black-owned businesses to become sustainable through provision of financial assistance (including shorter payment terms), guaranteed business, a package of support that includes mentorship, targeted upskilling, and assistance from external experts (Woolworths Holdings Limited 2010). Black enterprises can access the programme for three to five years, after which they should demonstrate that the enterprise has reached a certain level of sustainability. By around 2010/2011, Woolworths had disbursed R6.234 million in loans supporting 45 businesses employing a total of 5,000 people (Woolworths Holdings Limited 2010).

In 2015 Pick n Pay established a supplier development programme (Pick n Pay's Enterprise and Supplier Development Scheme) to assist small suppliers to enter the retail market through providing mentorship and guidance and business development support. This programme provides preferential trading terms to small suppliers with a turnover of less than R3 million over a period of 12 months. Such preferential trading terms include 1 per cent cash settlement, 1.5 per cent advertising, 5 per cent rebate, and seven-day payment terms from weekly statement (Pick n Pay 2015).

SPAR in 2015 put in place procurement policies to create market access for small business and cooperatives. The supermarket chain initiated a Rural Hub Model in Mopani District in Limpopo aimed at empowering local small farmers who struggle with meeting the required quality, volumes, and consistency needed to supply supermarkets. Funding for the initiative was obtained from the Dutch Government, the Masisizana Fund, and Jobs Fund. This programme involved setting up a fresh assembly point (FAP) which was jointly owned by local farmers and SPAR as the mentor. The FAP assisted farmers in meeting international food safety and quality standards set by GlobalG.A.P as necessary for small suppliers to access larger markets (Parliamentary Monitoring Group 2015).

Shoprite Checkers through Freshmark—its fresh produce distribution arm—embarked on a three-year programme (2008–11) to assist 200 small-scale farmers meet Freshmark's minimum food safety and quality standards in South Africa, Swaziland, Namibia, and Zambia. Failure by small-scale farmers to meet the GlobalG.A.P standard and the Freshmark Good Manufacturing Practice (GMP) standard would mean exclusion of small-scale suppliers from Shoprite's supply chain. The programme entailed comprehensive training sessions, capacity building, data collection, compliance evaluation, provision of technical support, and regular inspections (ECI Africa Consulting (Pty) Ltd 2012).

In instances where large retailers have been mandated to develop suppliers, there have been mixed results. Part of the conditions imposed by the Competition Appeal Court in the Walmart/Massmart merger required the merged firm to set up a supplier development fund and

make available ZAR240 million over a period of five years to develop suppliers (Mandiriza et al. 2016). Massmart worked with TechnoServe, a non-profit organization, to upskill and train farmers to supply fresh produce to its stores, in addition to providing preferential finance terms and inputs. This aspect of the initiative was relatively unsuccessful, with the produce from these farmers not being of the required quality and standards of Massmart. Several farmers ended up defaulting on their loans as Massmart paid lower prices for their produce, highlighting the difficulties of upgrading capabilities of small-scale subsistence farmers to commercial farmers within a short space of time (the programme was over three years) (see Altenburg et al. 2016).

There have been some success stories of the fund, however, on the manufacturing/processing side. One beneficiary, Lethabo Milling, a new entrant producing maize meal and other products, received a R1.6 million grant from Massmart towards refurbishing its plant. The support extended to an offtake agreement with Massmart which helped Lethabo further secure a loan from a commercial bank. Lethabo has a guaranteed route to market through supplying Massmart stores in South Africa and has received additional support for training, waived listing fees, fast-track payments (seven-day payment period as opposed to 30-day payment terms), and assistance with pricing models.

Another similar fund, the Agro-Processing Competitiveness Fund, was set up from the Pioneer cartel settlement. This fund of ZAR250 million, with substantial co-funding from the Industrial Development Corporation (a development finance institution), offers support to non-dominant agro-processing players in the form of investment support, business support, and research grants.

While such initiatives by the major supermarkets have yielded positive results, they are limited in scale and scope, and ad hoc in nature. As can be seen, almost all the initiatives of the supermarkets involve small-scale farmers and are only for a short duration. As the failure of the Massmart farmer development initiative highlights, in order to be successful, it is necessary to have longer term programmes for farmers. Some initiatives involved support in terms of building skills and capabilities, while others included offering preferential trading terms. But all appear to be approached more as corporate social responsibility obligations rather than commercially viable operations. Further, these initiatives are developed without a regional perspective in mind. In order to have wider and more sustainable impact on developing supplier capabilities, such programmes have to be part of regular, long-term operations of supermarkets. As seen in the international experience, the more successful programmes have been the ones that have a triple partnership between suppliers, retailers, and development agencies, although even the success of funds administered in this way is not always guaranteed (for instance, Massmart's farmer development initiative).

4.5.2 Support from government

In terms of upgrading local supplier capabilities, suppliers interviewed stated that there was little or no support from government. The most requested support was financial support. Small suppliers encounter significant challenges with accessing finance and maintaining cash flow and working capital. Lack of access to finance means that suppliers cannot make the necessary investments in their plant, product, and brand.

Existing government funding and support available to small suppliers involves complicated and extensive paperwork. Accessing government funds is associated by suppliers interviewed with administrative inefficiencies and bureaucracy making it difficult for local entrepreneurs to benefit from them. It involves considerable red tape and bottlenecks forcing suppliers to use consultants, at their own expense, to try to access such pockets of funding.

Some support is available from the Industrial Development Corporation (IDC), a national development finance institution set up to promote economic growth and industrial development, through rebates on capital expenditure (estimates are that a rebate of around 15 per cent is obtainable), but this is contingent on several conditions such as employment conditions and proof of investments or upgrading in a plant. However, new start-ups often do not have the means of making the investment first and then apply for the rebate after. Most development finance institutions also assess an application based on the entrepreneur's track record and new entrants do not have this record. Many suppliers elaborated that given these difficulties, they are often left with commercial banks as the only option to borrow funds from, in the absence of shareholders or financially strong owners, or to use personal funds to finance the business. However, commercial banks have stringent requirements for accessing finance. In many cases, suppliers are required to repay the loan before the business has stabilized enough to generate cash flows.

As mentioned, the lack of skills in South Africa has been identified as a major impediment to developing capabilities of suppliers. Suppliers expressed the need for government to assist with skills training and development as well as subsidizing companies that provide training to their employees.

The government established the Wholesale and Retail Sector Education and Training Authority (W&R SETA) in 2000 to facilitate the skills development needs in the retail sector through learning programmes, disbursement of grants, and monitoring of education and training. In 2015, the W&R SETA created a central supplier database where suppliers of different products are encouraged to register. Public entities are then required to procure goods, services and/or products from the listed suppliers (W&RSETA 2014). This is meant to provide markets for small suppliers through increased government procurement. It is too soon to evaluate the success of this 2015 supplier database initiative.

The Food and Beverages Sector Education and Training Authority (FoodBev SETA) also aims at promoting skills development in the food and beverages manufacturing sector. This SETA identifies critical and scarce skills through annual reports submitted by employers in the following sub-sectors: baking, cereals, confectionery and snacks, beverage manufacturing, dairy manufacturing, manufacture of food preparation products and processed and preserved meat, fish, fruit and vegetables. It assists with skills gap in the food and beverages sector by awarding bursaries annually for undergraduate and postgraduate studies (FoodBevSETA 2016). Very few suppliers interviewed were aware of or had used the FoodBev SETA initiatives. Their impact on building skills in this sector appears limited.

Government, through the Department of Trade and Industry (DTI), runs the Black Business Supplier Development Programme (BBSDP)—a cost-sharing grant offered to existing small black-owned enterprises aimed at improving small suppliers' competitiveness and sustainability. It is not for start-up businesses (DTI 2016).[48] This programme shares costs with suppliers by extending grants for tools, machinery, and equipment in addition to supplier business development and training interventions meant to improve corporate governance, management, marketing, productivity, and use of modern technology. Very few suppliers interviewed were aware of any DTI support measures in place.

[48] The requirements are: CIPC registered company or cc; 50.1 per cent black-owned (Black, Indian, or Coloured) or more management team 50 per cent Black; trading for at least one year and have financial statements to prove turnover. Turnover must be between R250k and R35m per annum; Valid SARS tax clearance and VAT registered if turnover is greater than R1m (DTI 2016).

There is a clear problem with the government initiatives available for suppliers to the retail sector in South Africa. While ostensibly aiming to assist suppliers, the level of awareness of these programmes appears to be very low, and for those that do attempt to access such pockets of funding, the process is burdensome, requiring expensive consultants to get through the requirements.

4.6 Assessment of margins

The preceding sections provided a review of the ways in which supermarkets can exert their buyer power on suppliers. This section evaluates whether the retail–wholesale price margins and price correlations provide any further evidence of buyer power and more generally, market power of supermarkets for the selected products.[49]

4.6.1 Retail–wholesale margins for selected fresh fruit and vegetables

Fresh produce farmers are diverse and dispersed in South Africa. Given the difficultly in interviewing a representative sample of these farmers, we assess retail–wholesale margins for the top five products by volume (apples, bananas, onions, potatoes, and tomatoes) sold in the Johannesburg Municipal Market to provide an indication of possible market power in the value chain. We are also able to make deductions from wholesale and retail prices trends given the limited value addition that takes place once the produce leaves the wholesale market and before it gets onto supermarket shelves.

We compare wholesale prices of the above products to the Gauteng provincial retail prices. As stated in Section 3 above, the Johannesburg Municipal Market is the largest fresh produce market in South Africa, located in Gauteng province, with 48 per cent market share of national fresh produce.

It is important to note up-front some of the caveats in this type of analysis. First, it is limited to Gauteng province, although we note that the Gauteng retail prices for the selected products are very similar to average national retail prices. Second, the retail–wholesale margins do not give a complete picture of the profits realized by retailers from selling different products because these margins obviously do not take into account a range of other costs incurred by the retailer such as transport, cold storage, and re-packaging costs. Third, we acknowledge that there are several other factors that contribute to fluctuations in prices for fresh produce, not in the least weather patterns, seasonality of the produce, and other supply and demand considerations. Finally, while some supermarkets such as Fruit and Veg City procure most of their produce from municipal markets, others like Shoprite, Pick n Pay, etc. have direct contracts with farmers, buying produce from the market for top-up purposes during periods of high demand. The prices therefore of fresh produce that these supermarkets receive may not be the same as the wholesale price at municipal markets. While Dobson and Lan (2015) find that, in the UK, the wholesale prices from national wholesale markets could be higher than the actual supply prices that supermarkets pay directly to contracted suppliers, the opposite appears to be true in South Africa. Sourcing directly from municipal markets is said to have given Fruit and Veg City a competitive advantage in price over their competitors, allowing them to charge prices that are between 20 per cent and 25 per cent lower than the other major retailers (Pitman 2009). This suggests that the market wholesale prices are

[49] See Dobson and Lan (2015) for an assessment of market power by analysing the movement of wholesale and retail prices for 26 fruit and vegetables in the UK.

lower than direct farmer prices. This also suggests that the margins seen below are likely to be overstated.

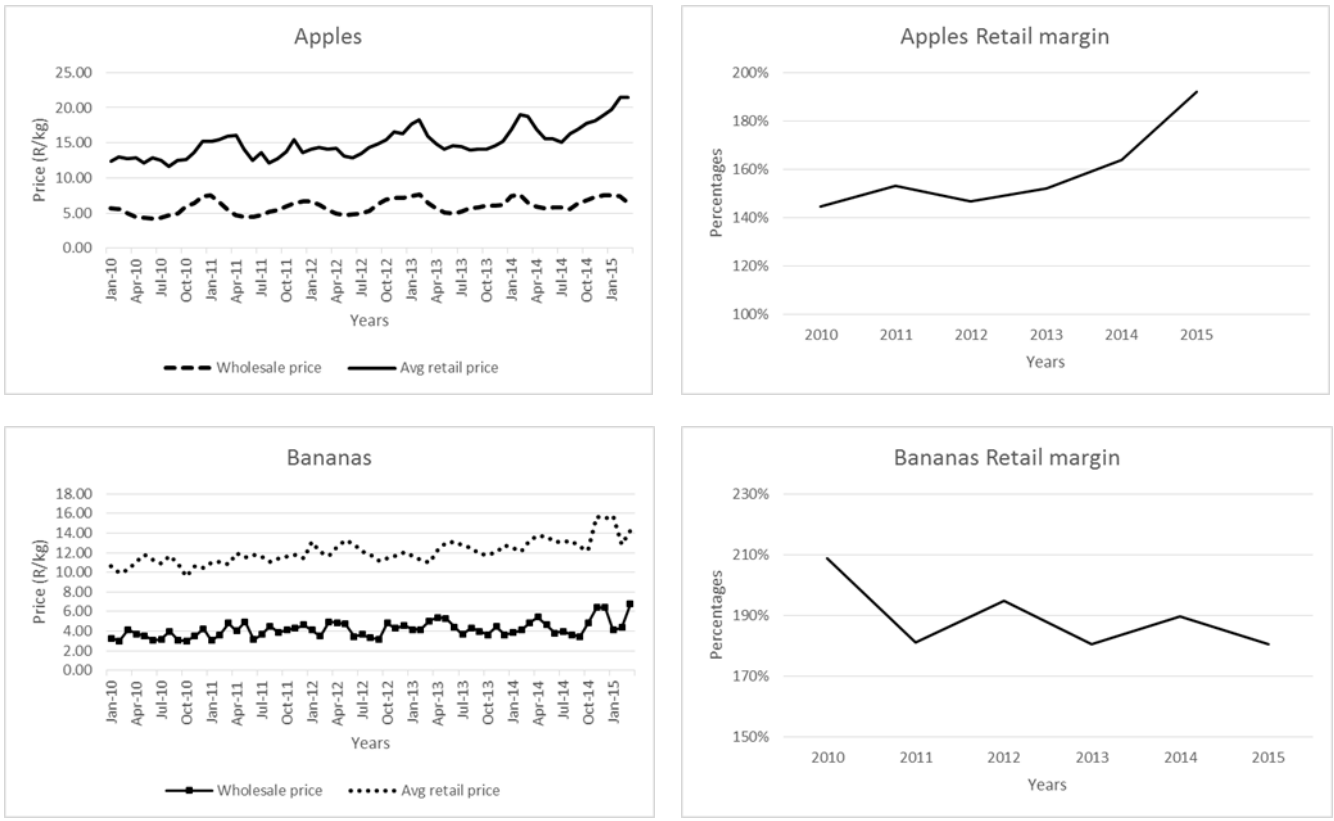
Bearing these caveats in mind, Figure 5 shows trends in wholesale and retail prices for apples, bananas, onions, potatoes, and tomatoes between the period January 2010 and March 2015.

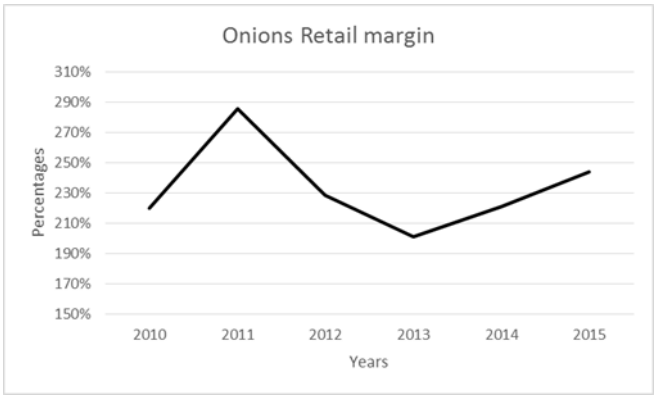
- The retail–wholesale margin (as a percentage of the wholesale price) for apples in 2010 was 145 per cent, while that in 2015 was 192 per cent. The increase in margins therefore was around 47 percentage points in this period. The margins in onions were 220 per cent and 244 per cent in 2010 and 2015 respectively, an increase of 24 percentage points over the period. In potatoes, margins increased by 23 percentage points, from 264 per cent in 2010 to 287 per cent in 2015.

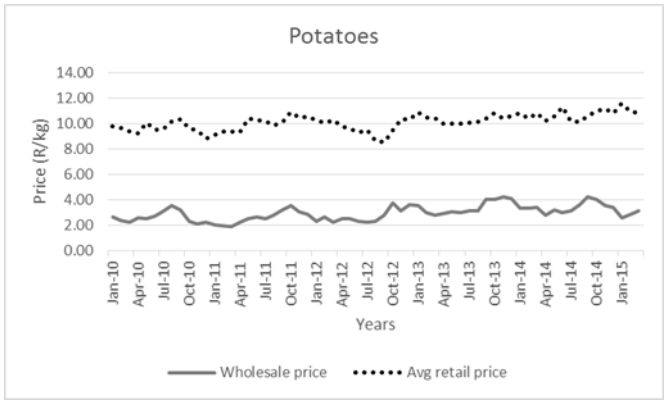
- On the other hand, retail margins for bananas and tomatoes have declined from 209 per cent to 181 per cent and from 257 per cent to 239 per cent, a decline of 28 and 18 percentage points respectively over the five-year period. However, it appears that margins for onions and potatoes started increasing again from 2013, while that of tomatoes started increasing from 2014.

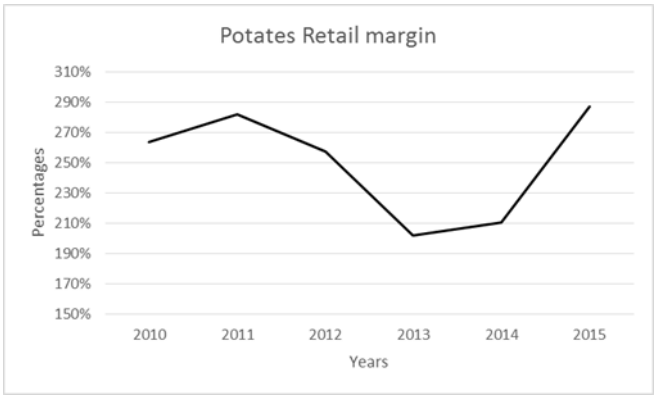
In general, these margins are large, even if the wholesale price was in fact 20–25 per cent lower than contract farm prices for these products and if there were certain additional costs (transport and re-packaging costs), considering there is limited value addition at the retail level for these products. These widening margins are suggestive of market power of retailers.

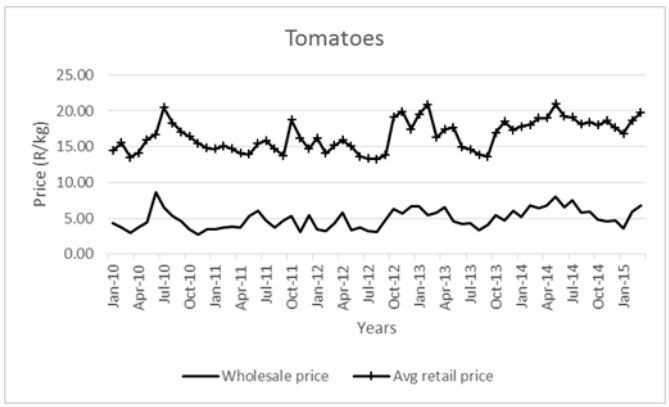
Figure 5: Selected fresh produce retail–wholesale margins, January 2010 to August 2015

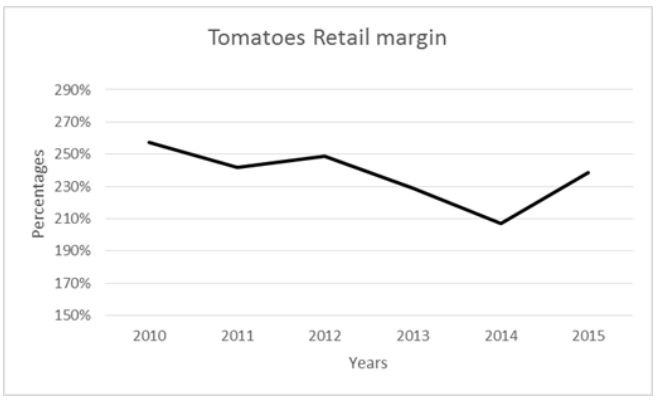












Source: Authors' illustrations based on data from Stats SA (Statistics South Africa) (n.d.) and the City of Johannesburg Municipal Market (n.d.).[50]

We also examine the correlation between retail and wholesale prices in the market (Table 4). Retail–wholesale correlations in levels are relatively high, ranging from 0.6 to 0.72 for all the products indicating a fairly strong relationship between wholesale and retail price movements. However, to take into account non-stationarity of prices due to increases in prices over time, driven by inflation for example, we examine price correlations using first differences. The first-difference correlations for all the fresh produce are significantly lower than in-level correlations. This suggests that retailers do not take into account wholesale price changes and set retail prices independently of

[50] Both datasets given to CCRED by personal request.

wholesale prices. This supports the general findings from our interviews that there is considerable exertion of market power by retailers (although in itself is not conclusive).

Table 4: Fresh produce retail–-wholesale price correlations (per kg)

Product name	In-levels	First difference
Apples	0.72	0.42
Bananas	0.57	0.16
Onions	0.58	0.31
Potatoes	0.59	0.10
Tomatoes	0.70	0.21

Source: Authors' calculations based on data from Stats SA (Statistics South Africa) (n.d.) and the City of Johannesburg Municipal Market (n.d.).[51]

4.6.2 Retail–producer margins for poultry

Figure 6 shows trends in retail–producer price margins for fresh and frozen chicken between January 2008 and December 2015. Overall, retail margins for fresh chicken have increased from 105 per cent in 2008 to 128 per cent in 2015, an increase of 23 percentage points. Conversely, producer–retail price margins for frozen (IQF) chicken[52] have declined by 22 percentage points from 57 per cent in 2008 to 35 per cent in 2015.

The retail margins for frozen (IQF) chicken which continued to fall over the entire period might be explained by the increase in poultry imports from Brazil. Imports are in frozen form and therefore compete directly with frozen chicken produced locally. Between 2010 and 2014 the value of poultry imports increased from (approx.) US$180 million to Us$400 million, resulting in greater competition and lower prices in the local market (Ncube et. al 2016). After 2013, the retail margins stabilized, ranging from between 33 per cent and 35 per cent, which could be explained by the anti-dumping tariffs imposed in 2013 (12 per cent to 82 per cent on chicken imports from Brazil (Tregenna and Kwaramba 2014)). The imposition of anti-dumping duties resulted in a decline in chicken imports although with some fluctuations (Ncube et al. 2016). The 2012 price hike by producers, especially for frozen chicken, has been attributed to a spike in feed prices (Ncube et al. 2016). This price hike was passed through directly by retailers as is evident in (Figure 6, frozen chicken).

[51] Both datasets given to CCRED by personal request.

[52] In Ncube et al. (2016), it was found that on a 'per kilogram' basis, frozen chicken is cheaper than fresh chicken. However, if it is taken into account that frozen chicken usually contains 30 per cent brine and inflate frozen prices to account for this, a 'meat-for-meat' comparison shows that frozen chicken pieces are more expensive than fresh chicken.

Figure 6: Chicken retail–producer price margins, January 2008 to December 2015

Source: Authors' illustrations based on data from Agrimark (n.d.) and Stats SA (Statistics South Africa) (n.d.).[53]

However, while poultry producers interviewed suggested that retailers exert buyer power, especially in price and trading terms negotiations, it appears that the retailers are constrained in exerting market power in terms of the sale of IQF chicken to final consumers. The margins for IQF are not close to the high levels seen in fresh produce, and have been declining. There are two very plausible reasons for the inability of retailers to charge high prices at the retail level for chicken. First, there has been increased competitive pressure particularly in chicken sales from independent retailers. As highlighted, a large proportion of chicken sales for the producers is through independent retailers (over 60 per cent) as loose frozen cut portions. Second, the influx of imported chicken has also served to supress retail prices, not allowing retailers to earn high margins.

4.6.3 Retail–producer margins for milk

A retail–producer (farm-gate) margin analysis for milk is more problematic than for fresh produce and poultry. This is because there is an intermediate processing level of the value chain, which is dominated by large players like Parmalat, Nestlé and Clover. As highlighted by Ncube et al. (2016), South African dairy farmers have raised issues of asymmetric bargaining power and buyer power of *both* processors and retailers in the South African dairy value chain.

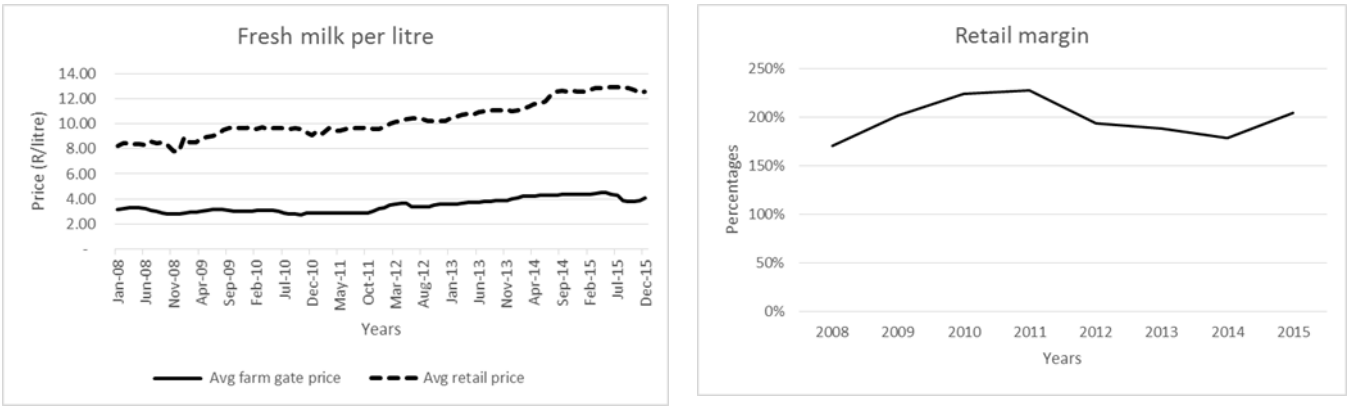
[53] Both data sources given to CCRED by personal request.

An abuse of dominance case was filed by the Milk Producers' Organisation against the major retail chains in 2009, alleging that supermarkets used their bargaining power to place downward pressure on farm-gate price. Additionally, various contraventions of cartel conduct (including price fixing and market allocation) were alleged against the main milk processors, and while the Competition Commission withdrew the case on procedural grounds in 2011, this highlights the possibility of exertion of market power at the level of processors (Ncube et al. 2016).

This blurs the assessment in that high margins of retail prices over producer/farm-gate milk prices may be reflective of processor buying power, retailer buyer power, or a combination of both. With the data available, it is not possible to disaggregate these effects.

Nonetheless, Figure 7 shows a widening of margins from 170 per cent in 2008 to 204 per cent in 2015, an increase of 34 percentage points. Farm-gate prices have remained stable at between ZAR3.00—just above ZAR4.50 for the entire period, suggesting that either processors or retailers have been suppressing prices from farmers, providing some evidence of the concerns of dairy farmers.

Figure 7: Milk retail–producer price margins, January 2008 to December 2015



Source: Authors' illustration based on data from Stats SA (Statistics South Africa) (n.d.) and the MPO (Milk Producers Organisation) (n.d.).[54]

4.7 Conclusions

Supermarkets are an important route to market for most suppliers interviewed. In order to supply supermarkets, suppliers need to produce cost-competitive, high-quality products as well as meet consistency and volume requirements.

A growing opportunity for suppliers to participate in supermarket chains is through producing house brands or private label brands for supermarkets. However, consistent with the literature, there are concerns around buyer power being exerted on suppliers of house brands at the expense of their branded product in South Africa.

Supplying supermarkets involves a range of costs for suppliers, which is burdensome particularly for smaller suppliers. These include costs of adhering to private standards of supermarkets (over and above legal requirements), but also the costs imposed on suppliers given the substantial buyer power of supermarkets. The exertion of buyer power of supermarkets is evident in the negotiation

[54] Both datasets given to CCRED by personal request.

of trading terms which often tilt in favour of the supermarket. Of the products analysed, the extent of both buyer power and market power is further suggested by the widening retail margins over time.

There is evidence of suppliers upgrading their capabilities to meet supermarket requirements and in response to growing competition, but there appears to be only limited support from both supermarkets and government to do this. The support from supermarkets is largely for brands that are exclusively supplied, and supplier development programmes generally appear to be small in scale and scope. Furthermore, government funding and programmes are difficult and costly to access.

5 Botswana: results and assessment

Like in South Africa, supermarkets are a key route to market for suppliers in Botswana, accounting for between 50 and 70 per cent of sales for the suppliers interviewed.[55] Choppies, the largest local supermarket chain, is a major route to market for local suppliers. The other main supermarkets present in Botswana are the South African chains—Shoprite, Pick n Pay, Woolworths, and SPAR. These supermarkets tend to source products from preferred suppliers, who are typically South African.[56] Alternative routes to market include wholesalers such as Sefalana and Trident Eureka, and large distributing agents such as CA Sales and Distribution and Global Holdings. These routes account for approximately 25 to 30 per cent of total sales,[57] while the balance of food products goes through the growing Quick Service Restaurant market and through government contracts (for instance, Choppies is a major supplier of groceries to the Botswana Defence Force and prisons department (Konopo 2015).

An interesting recent development is that of wholesalers like Sefalana actively rolling out retail outlets. Sefalana now has 23 'Shoppers' supermarkets in addition to its cash and carry offerings in Botswana, and is considering moving into the region. Trident Eureka wholesalers have also launched 'Saverite' retail supermarket outlets. There is therefore growing competition to South African retailers in Botswana, with strong local retail chains emerging. Unlike South African wholesalers who have moved to offer 'hybrid' (both wholesale and retail) offerings within their large wholesale outlets (see das Nair and Chisoro 2015), in Botswana, wholesalers are actively setting up new retail shops. The reason for this is legislation. In Botswana, the licensing of traders of goods is regulated by the Trade Act 2003 and is further regulated by the Trade Act Order, 2008—S.I. No. 21 of 2008.[58] These pieces of legislation limit wholesalers from selling directly to end consumers.

This, and the growth of the retail sector in general, is evident in the trends in Figure 8. There has been a steady decline in the wholesale sector in Botswana which has been replaced by retailers.

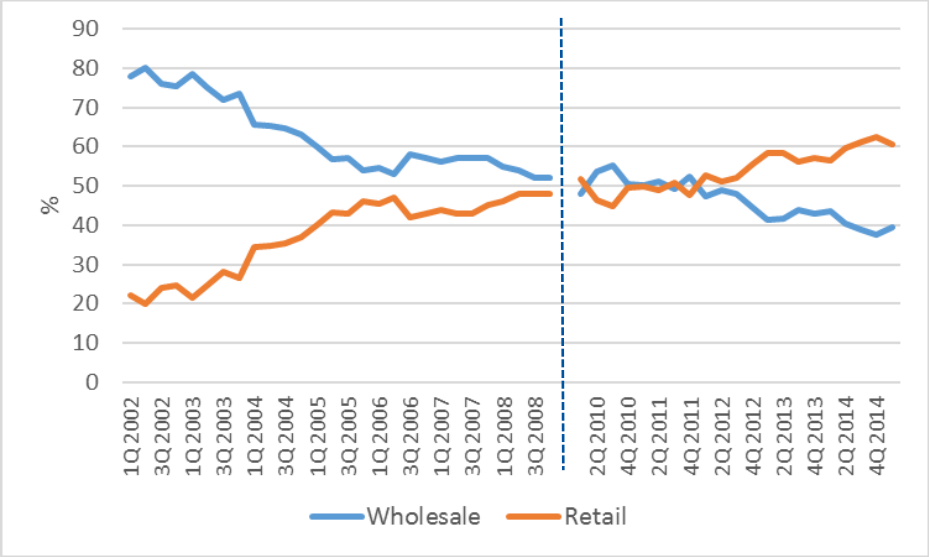
Figure 8: Change in wholesale: retail proportion of sales of fast moving consumer goods (FMCG) in Botswana

[55] Interview with a miller, poultry producers, meat producer, 18–9 November 2015.

[56] Interviews with a poultry producer, 18 November 2015, local soap producer, 19 November 2015.

[57] Interview with millers, poultry producers, meat producer, 18–19 November 2015.

[58] Interview and data, in the form of non-publicly available reports, a presentation, and numerical data, bought from Briggs and Associates (2016) by CCRED.



Note: We were unable to get data for 2009.

Source: Authors' illustration based on data from Briggs and Associates (2016).[59]

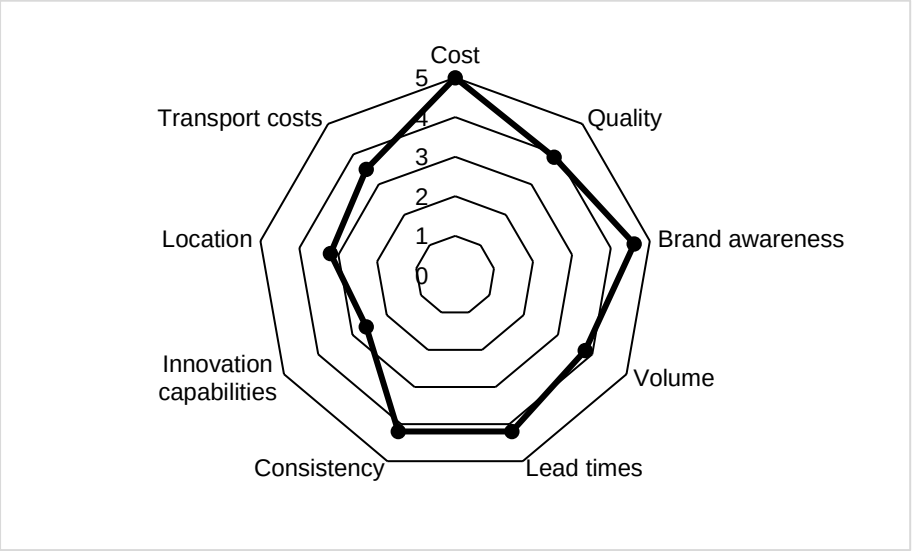
In Botswana, there is a further intermediate player in the value chain for ambient products—distribution agents. Given the lack of manufacturing capacity in Botswana, the majority of products on supermarket shelves are imported. This appears to be coordinated through large-scale distribution agents like CA Sales and Distribution, Global Holdings, and Safari. These agents are exclusive distributors for certain suppliers, although it appears that there is some degree of competition to become an agent for a supplier. Distribution agents procure products from main suppliers on behalf of supermarkets and wholesalers. As highlighted in the literature review, dedicated procurement agents are a feature of retail modernization.

5.1 Important factors in the supply to supermarkets

Similar to the interviews in South Africa, suppliers were asked to rank a number of factors that are important in the supply to supermarkets on a Likert scale—1 being unimportant and 5 very important (Figure 9).

[59] Data, in the form of non-publicly available reports, a presentation, and numerical data, was bought from Briggs and Associates (2016) by CCRED.

Figure 9: Critical success factors—suppliers' perspective



Note: N=5.

Source: Interviews 2015.

In Botswana, the main suppliers of chicken, maize meal, flour, soaps and detergents, meat, processed food, and sugar were interviewed. All these suppliers considered **cost** and **brand awareness** as the most important factors to supply supermarket chains. This is quite different from the South African case where brand awareness was not considered an important factor to supply supermarkets. **Quality** was also not ranked as highly as it was in South Africa, being ranked similarly to **consistency** and **lead times**. The ability to supply the required **volumes** was also not ranked as highly as in South Africa.

As in South Africa, **location** of suppliers relative to supermarkets and transport costs are less important factors to supply supermarkets. This is purely a supplier's decision driven by the nature of product they produce and the relative ease in transporting or accessing raw material inputs. Further, given the large volumes of imports of products (aside from poultry, maize meal, and meat), the majority of imported ambient products are delivered from distribution agent premises in Gaborone, like CA Sales and Distribution. Local suppliers deliver products directly to stores either using their own transport fleet or outsourced transport logistics companies such as Cold Line Distribution and Global Holdings. As in South Africa, all costs of transporting or distributing products are borne by the suppliers.

Most suppliers ranked **innovation capabilities** as the least-important factor to supply supermarkets, far lower than it was ranked by South African suppliers.

5.2 Supermarket requirements: legal and private standards

Suppliers should meet local packaging and labelling legislation. In particular, poultry and meat producers are required to have approved abattoirs and Inspection and Safety Division (ISD) certification. Millers are required to meet Botswana Bureau of Standards (BOS) requirements with regard to flour and maize meal. Suppliers do not find these requirements to be overly onerous although they come at a cost to the supplier. Suppliers highlighted that retailers are increasingly imposing stringent private requirements on suppliers and this was more so the case with the South African retailers rather than the Botswana retailers. SPAR and Shoprite for instance were

highlighted as imposing their own requirements and inspections with regard to house brands and they often insist on multiple audits. HACCP standards are also required by supermarkets.

5.3 Trading terms

Supply contracts are generally evergreen, as they are in South Africa, with trading terms negotiated every year with a few exceptions.[60] Given that the majority of the same retailers that operate in South Africa also operate in Botswana, the practices in general are quite similar in both countries and are not repeated in detail here. Often, decisions are made at head office level back in South Africa, and these are consistent with group policies of the retailer.

An interesting finding is that suppliers often claim to receive better trading terms from local supermarkets than they do from South African supermarkets. For instance, local supermarket chains like Choppies do not charge **listing fees** to suppliers.[61] On the other hand, certain suppliers highlighted that South African retailers like Pick n Pay and Shoprite often charge listing fees. A large local miller, however, indicated that it does not pay listing fees to the South African retailers.[62] This may be an indication of the countervailing power that local millers have given a 13.5 per cent import duty on flour. Suppliers generally highlighted the difficulties in accessing decision makers of South African supermarkets who are located in South Africa. It is much easier to access high-level decision makers of the local supermarkets in Botswana, particularly Choppies, who are more amenable to negotiating with local suppliers than the South African supermarkets.

Typical **payment terms** are 30 days after statement, determined largely by the supermarket. There were concerns that certain South African supermarkets were particularly aggressive in holding back payment if there were any errors or discrepancies in invoices. Again, particularly Shoprite and, to a lesser extent, Pick n Pay, were singled out in this regard. This puts pressure on the suppliers' cash flow. Delays in payment result in a lack of working capital for day-to-day operations. A supplier in the meat industry highlighted that even 30-day payment terms can be problematic for its business. This supplier had invested in capital equipment and is capable of doubling its output, but without working capital, it has not been able to increase its production.

The Competition Authority of Botswana (CAB) undertook an inquiry in the retail sector in Botswana in 2015/2016. It evaluated potential abuses of buyer power of supermarkets, including in the negotiations of payment terms. Some of the concerns highlighted were:

- De-listing and threat of de-listing when suppliers do not reduce their prices or agree to other demands of the supermarket;
- Demanding advertising fees for both branded and house brands;
- Demanding retrospective rebates, and after-sales rebates from manufacturers;
- Delaying payments; and

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[60] One poultry producer's trading terms are revised every two to three years (interview with a poultry producer, 18 November 2015). The prices for maize meal are negotiated more regularly (every six weeks) according to a large milling company (interview with a miller, 18 November 2015).

[61] Although some suppliers claim that supermarkets such as Sefalana do at times deduct listing fees off payments. Interview with a meat producer, 18 November 2015.

[62] Interview with millers, 18 and 19 November 2015.

- Demanding swell allowances etc.

The CAB highlighted that the various terms of trade typically lowered supplier price by at least 10 to 15 per cent (CAB 2016). This is similar to what we found to be the case in South Africa (see above).

5.4 House brands

Suppliers are increasingly manufacturing and packing house brands for supermarkets and wholesalers such as Choppies, Sefalana, and Trident/Eureka.

The CAB is particularly concerned about the rapid increase in house brands stocked by retailers and wholesalers in Botswana. The CAB's retail inquiry highlighted that house brands considerably increased the buyer power of supermarkets and that this negatively affected the margins of suppliers who supplied both house brands and branded products. The CAB's study focused on millers, who pack house brands for retailers. The millers highlighted that house brands, although costing the same to produce, were less profitable for them relative to their branded products, and that the rapid growth of house brands resulted in lower profitability. The concern was that retailers in Botswana were pushing the sales of house brands at the expense of branded products (in terms of better shelf space, promotions, advertising, etc.). In 2014, maize meal house brands accounted for 69 per cent of total sales of maize meal products in terms of volumes. The CAB appears to take the view that while consumers would benefit from the low prices of house brands in the short term, in the long term, branded products might exit the market altogether. As highlighted in the literature, however, it is difficult to conclude on the long-term net effect of the growth of house brands.

A further development in Botswana is that local supermarket chains have been backwardly integrating into manufacturing of house brands. In 2015, Choppies entered the broiler industry by acquiring existing abattoirs in Bwate, and started producing its own chickens. The other poultry producers highlighted that this development resulted in a significant decrease in their sales to Choppies of IQF chicken.[63] Choppies appears to have backwardly integrated into the manufacture of other supermarket products, like house brand bottled water and packaged sugar.[64] There is therefore a concern that such vertical integration, along with the growth in popularity of house brands and the buyer power of supermarkets, could result in the foreclosure for suppliers of branded products.

5.5 Upgrading supplier capabilities

In order to face competition in the past five years, suppliers interviewed have invested in new machinery and equipment. Some suppliers are consolidating lines in order to increase volumes on core products and reap economies of scale. For instance, a large miller invested in a more efficient flour mill, costing around Pula 50 million.[65] As in South Africa, suppliers are mainly investing in improving the quality of existing products and packaging. There is little innovation in terms of introducing new product categories, although a large poultry producer indicated that it is investing

[63] Interview with poultry producer, 18 November 2015.

[64] Interview with poultry producer, 18 November 2015.

[65] Interview with miller, 18 November 2015.

in a free-range chicken plant with assistance from Woolworths.[66] It is important to note, however, that such investments may be as a result of the ban on imports of poultry into Botswana.

5.5.1 Support from supermarkets

It appears that supermarkets in Botswana offer limited assistance in terms of developing local suppliers' capabilities. Only a few examples of assistance were noted by suppliers. As stated above, Woolworths is assisting poultry producers. Choppies also claims to have, especially in the agricultural produce sector, driven enterprise development by procuring from (and in some cases, advancing cash to) smaller farmers in Botswana. Choppies states that 75 per cent of all fresh produce produced in Botswana is sold through its stores (Choppies 2011). There appear to be no large-scale supplier development programmes in Botswana, even for products that are not imported (see below for import restrictions on certain products).

5.5.2 Support from government

Local suppliers in Botswana also highlighted that they receive little or no assistance from government. There have, however, been some recent developments in terms of government initiatives to assist local manufacturers. This includes a lower tax rate of 15 per cent for manufacturing companies, compared to 25 per cent for other industries. A training levy was further introduced to allow suppliers to claim back for certain types of employee training. The government has also built abattoirs for small-scale farmers who are typically used as contract growers in places like Palape. They further support these farmers by providing them with raw materials.[67]

With regards to access to finance, suppliers largely rely on self-finance using resources from shareholders, banks, and re-investing profits. Government programmes such as those available from the Citizen Entrepreneurial Development Agency (CEDA) have some funding programmes but, like the concerns raised in South Africa, these are difficult to access and secure. The agribusiness division of CEDA provides loans at preferential rates for various sub-sectors, including poultry and dairy (CEDA 2013–16).

5.6 Conclusions

Like in South Africa, supermarkets are a key route to market for suppliers, particularly Choppies, the largest local supermarket chain in Botswana. While South African supermarkets have expanded in Botswana, local chains remain competitive and recently, there has been further growth in local retail chains as wholesalers launch their own new retail supermarkets. The manufacturing and processing capacity for supermarket products is limited in Botswana and therefore a large proportion of products are imported. This adds a level of the value chain that is not present in South Africa—that of independent distribution agents who act as exclusive distributors to supermarkets for key suppliers (see Figure 2).

The critical success factors to supplying supermarkets in Botswana are similar to South Africa, although it appears that the South African supermarket chains are more expensive to supply than the local chains given that they often require a range of additional fees and audits at the supplier's cost. It is also more difficult for suppliers to negotiate with South African supermarkets given that many decisions are taken at head office outside Botswana.

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[66] Interview with a poultry producer, 18 November 2015.

[67] Interview with a poultry producer, 18 November 2015.

The growth of house brands has been particularly strong in Botswana, and has brought with it both opportunities and concerns for suppliers. The Competition Authority of Botswana has undertaken an inquiry into the impact on suppliers, with preliminary findings revealing that supermarkets exert considerable buyer power over suppliers of house brands at the expense of margins in branded alternatives. There is a concern that branded products will be foreclosed from supermarket shelves in the long run. This concern is exacerbated by the fact that some large chains like Choppies are vertically integrating backwards into the production of supermarket products under house brands.

There is some, although limited, upgrading of capabilities through improvements in quality of existing products and packaging, irrespective of very little assistance from both supermarkets and governments.

6 Existing trade dynamics and implications on suppliers

A further indication of whether suppliers have developed their capabilities is to assess whether they have managed to successfully enter and compete in export markets, whether regional or global, and whether this has been via supermarkets. This analysis is complex, however, as it has to consider country-specific government policies on local content, protection of local suppliers, trade restrictions, etc.

As highlighted in das Nair and Chisoro (2015), much of the trade in the region has been biased towards products being exported from South Africa to other SADC countries. The larger suppliers interviewed in South Africa confirmed that they export directly or indirectly via supermarkets into the region, with a few exporting to international markets. Smaller suppliers interviewed expressed that they view supermarkets as a way in which they could start exporting their products into other countries in the region. For example, a small miller with a long-term partnership with Massmart stores in South Africa now has plans to export to Lesotho where Massmart has a footprint. It was also approached for an export opportunity to mill and package maize flour for the Angolan market.[68] For a large supplier of various processed food, an important route to overland export markets, particularly Zimbabwe, Botswana, Swaziland, and Mozambique, is indeed through supermarket chains such as Shoprite Checkers and SPAR in the region.[69]

Large poultry producers in South Africa export to the region (except to Botswana in which there is an import ban).[70] Dairy producers in South Africa also export to other African countries and to Asia, particularly UHT long life milk and value-added products.[71] Another large supplier of fruit, who exclusively supplies Woolworths, started by exporting to European supermarkets. Exports of products with a short shelf life like fresh produce and bread are typically not exported.[72] However,

[68] Interview with miller, 03 November 2011.

[69] Interview with a food processor, 26 January 2016.

[70] Interview with poultry producer, 18 November 2015. This producer highlighted that there was significant round tripping happening in South Africa, especially if the buyer in the importing country appoints the transporter. Round tripping occurs when products destined for export markets actually get re-sold in the local market. This happens because export prices are often lower than local prices to account for transport cost. that are incurred to get to export markets. This is also an indication of the possible exertion of market in local markets.

[71] Interview with dairy manufacturer 22 February 2016.

[72] Interview with a large bread producer, 04 February 2016.

an exception is Botswana, where fresh produce is imported, particularly by Choppies, from the fresh produce municipal market in Pretoria.

South African suppliers who export need to meet phytosanitary regulations, acquire export certificates and permits, comply with state vet audits, as well as complying with the export country requirements.[73] Some suppliers highlighted the difficulties in acquiring some of these permits, as well as the customs and clearance process.

As noted, Botswana has an outright ban on imports of poultry in order to protect local producers from imports. In instances of a shortage in the local Botswana market for poultry, import permits can potentially be obtained. However, it appears that only the existing large poultry producers are able to obtain these permits through associated intermediaries, Cold Line and Senn Foods. Swaziland also has an outright ban on imports of poultry from South Africa (Lovell 2013). Namibia has further imposed import restrictions on chicken imports from South Africa (Jenvey 2015). Botswana further has a 13.5 per cent import duty on milled products to buffer the milling industry from imports.

The majority of suppliers in Botswana do not export. However, a supplier of green bar soaps exports 90 per cent of its products to Zimbabwe, selling to wholesalers who do not impose stringent requirements beyond an export permit.[74] This soap producer has struggled to sell his product in Botswana given South African imported soaps and detergents on supermarket shelves. Large South African suppliers like Unilever have engaged in aggressive competitive tactics, including practically giving away their Sunlight-branded bar soaps in order to gain market share.

Botswana also has restrictions on exports of meat. There is a law that only permits the government parastatal, Botswana Meat Corporation (BMC), to export, even though other private suppliers have abattoirs that meet European Union standards and could potentially supply European supermarkets. This has had the effect of preventing the growth of private local meat producers. For example, one meat producer was planning to invest in a 7 million Pula burger patty line, but the local market is too small to allow for production at full capacity. Access to export markets in the region would allow it to operate at an efficient level.

In addition to import and export restrictions, there are local content initiatives in both South Africa and Botswana. In South Africa, however, the local content policies are mainly focused on public procurement, particularly for construction, maritime industries, green and energy industries, and for a range of designated sub-sectors, including canned/processed vegetables (DTI 2015a).[75] The private supermarket chains are therefore, to a large degree, under no obligation to procure locally. The Department of Trade and Industry, however, is looking at interventions in certain sub-sectors that aim to increase the competitiveness of local industries for which supermarkets are a key route to market (for instance, in the agro-processing sector, including dairy) (DTI 2015a). More targeted intervention in the sectors designated for localization and generally in agro-processing by the DTI will be through the Black Industrialists Policy in the near future (DTI 2015b).

Similarly, in Botswana, local content requirements are part of the government's procurement policy (including the 'Buy Botswana' campaign). Aside from the outright ban of imports of certain

[73] Interview with an egg producer, 05 November 2015.

[74] Interview with a soap manufacturer, 19 November 2015.

[75] Rail rolling stock, power pylons, bus bodies, canned/processed vegetables, certain pharmaceutical products, furniture products, electricity meters, valves and actuators, electrical and telecommunication cables, components of solar water heaters, and the clothing, textile, leather and footwear sector.)

products, there are movements towards encouraging greater levels of local content even though there are no formal local content policies. The 2012 Citizen Economic Empowerment Policy has preference for local companies, and foreign investors are encouraged to purchase from local sources, even if there is no specific percentage of local content requirement (US Department of State 2015).

7 Conclusions

This working paper has assessed international experiences on the implications of the modernization and spread of supermarkets on suppliers, and has applied these broad frameworks to developments in South Africa and Botswana. These have been viewed through a regional lens, rather than a national or global lens, in order to potentially identify what can be done to encourage the growth of suppliers in the southern African region through supermarkets as the key route to market.

The nature of the relationship between supermarkets and suppliers has important consequences in this regard. The paper has shown that multinational supermarket chains in the region have significant buyer power, the exertion of which is clearly seen in the negotiation of trading terms. This results in additional costs for suppliers. The international experience has shown that voluntary codes of conduct between suppliers and supermarkets have been a useful way to control the exertion of buyer power and have been identified as a practical and effective approach in developing countries. Such codes of conduct can be encouraged by national governments, harmonized across the region given that it is largely the same retailers that operate in the different countries in the region.

The exertion of buyer power and private standard requirements are lower in the alternative retail route to market in both countries—the independent retailer route—providing an avenue for suppliers to get their products to market and to build scale and capabilities. Alternative routes to market provide suppliers with options and improve their bargaining position. This highlights the importance of encouraging fair competition between supermarkets and independent retailers, as well as encompassing open and flexible retail space in urban planning to ensure a mix of retail formats.

A growing opportunity for suppliers to participate in supermarket chains in both South Africa and Botswana is through producing house brands or private label brands for supermarkets. However, concerns around buyer power being exerted on suppliers of house brands at the expense of their branded product have been raised, particularly in Botswana. This foreclosure concern is exacerbated by the fact that some large chains like Choppies are vertically integrating backwards into their own production of supermarket products under house brands. Again, codes of conduct covering negotiations of trading terms tailored for house brands can potentially alleviate some of these concerns.

The paper further showed that in order to sustainably supply supermarkets, suppliers need to produce cost-competitive, high-quality products as well as meet consistency and volume requirements of supermarkets. This requires investing in, and upgrading of, supplier capabilities. While the paper presented evidence of some upgrading of supplier capabilities to meet supermarket requirements and in response to growing competition, there appears to be only limited support from both supermarkets and government to do this. The existing supplier development initiatives are small in scale and scope, are mainly targeted at small-scale farmers with limited success, and do not have a regional development objective in mind. Successfully developing

supplier capabilities requires a much larger, long-term and commercially oriented approach by government in partnership with supermarkets. Support institutions and research and donor agencies can actively contribute to different aspects of the initiatives, especially if these are to be extended to a regional level.

In both South Africa and Botswana, suppliers have invested in upgrading capabilities to meet competition (including from imported products) for supermarket shelf space. This has largely been through process upgrading, with limited product, functional, and inter-sectoral upgrading. The upgrading which has occurred nonetheless speaks to improving the critical success factors identified in terms of costs, quality, consistency, and volumes. It may well be that only a few, already large, suppliers are able to upgrade to supply sustainably to the region in each sector. This can result in increased supplier concentration within these sectors in the region. Competition authorities would therefore have to be aware of any inadvertent consequences of large suppliers upgrading their capabilities to supply the region.

Supermarkets are clearly an important route to a larger regional market for suppliers. However, simply developing the capabilities to supply regional markets is not sufficient if suppliers are unable to sell to supermarkets in the region given laws or policies that protect local suppliers in each country. In both South Africa and Botswana, there are local content initiatives which, by their very design, support local suppliers only. Although these have not been strictly enforced and are at different stages of implementation, they are not aligned with an agenda to develop suppliers to supply regional markets. If supermarkets are to become a key route to regional markets for suppliers, then the country policies and laws that currently exist need to be harmonized across the region with a wider view of developing regional value chains.

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