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Competition in the Food Supply Chain – Contribution from South Africa

- Session IV -

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This contribution is submitted by South Africa under Session IV of the Global Forum on Competition to be held on 2-3 December 2024.

More documentation related to this discussion can be found at: oe.cd/gfc24.

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Competition in the Food Supply Chain

- Contribution from South Africa –

1. Introduction

1. As a key role player and regulator, the Competition Commission of South Africa's (CCSA) mandate is to contribute solutions to South Africa's economic challenges including the issue of rising food prices through effective competition enforcement, and merger regulation. These challenges also require a strategic approach, where the Commission is not only responsive to market developments, but also proactive in addressing the economic challenges faced by the country with the tools at its disposal. In this regard, the food and agro-processing sectors were specifically identified as priority sectors for the CCSA at the institution's inception given their influence on key staple zero-rated products namely bread, flour, maize meal and cooking oil. More recently, the 7th Administration has identified addressing the high cost of living as one of a few national priorities for the next five year term.

2. The disruptions of the past 4 - 5 years have resulted in an intensified focus on the functioning of food markets as the world has grappled with the Covid-19 pandemic and the subsequent inflationary episode.

3. In this submission, we draw on the CCSA's investigative and research work in food supply chains detailing the features of food supply chains in South Africa, some of the outcomes observed because of the features, and how the CCSA has intervened to correct for uncompetitive market features and outcomes. We conclude with recommendations on how competition authorities can improve the functioning of food supply chains within their countries and globally.

2. Features of food supply chains

4. South African food supply chains are characterized by high levels of concentration with certain firms enjoying a large degree of market power. This feature is not limited to the retail level of the supply chain but can be seen at the processing levels too. The market power of large firms in concentrated markets is further enforced by the vertical integration of these firms into upstream and downstream markets. Consequently, large firms can shape the terms of participation in food supply chains and affect the functioning of the market. The CCSA's work to date has found evidence of this concerning market structure in the poultry, grains, and fresh produce supply chains.

2.1. Poultry

5. Our study of the poultry industry found that most of South Africa's broiler chicken and egg producers are vertically integrated from the level of animal genetics to the processing and distribution levels of the supply chain. In particular,

- 90% of genetic material is supplied by two global firms, Aviagen and Cobb-Vantress. These firms have exclusive distribution agreements with local firms to supply the domestic market.
- Animal feed too is dominated by the largest poultry producers with 75% of the market belonging to vertically integrated companies.

Table 1: Activities of South African Poultry Producers

	Feed	Breeder / Parent Stock / Hatchery	Day-old chick (broiler) / pullet supplier	Reared live broilers / layers	Abattoirs	Broiler Processing & Supply	Egg Production
Company A	X	X	Broiler	X	X	X	
Company B	X	X			X	X	
Company C	X	X	Broiler	X	X	X	
Company D	X	X	Broiler & layer pullets	Broilers (contract) & layers			X
Company E			Broilers	Broilers	X	X	
Company F	X		Broilers	Broilers & layers	X		X
Company G	X			Layers			X
Company H							X

Source: Commission's own compilation based on company websites and publicly available records. Notes: The companies listed are representative of firms active in the sector.

6. The implication of this market structure is that small and independent growers often rely on the large and vertically integrated producers to source feed and day-old chicks / pullets. As such, the main path to entry for intending growers is to be a contract grower for one of the larger integrated players. While facilitating entry, contract growing can entrench a dependence on the dominant firms, which stifles the ability of contract growers to grow and become an independent competitive force in the market.

7. In the broiler meat market, we have observed that the market positions of the largest and vertically integrated players are durable and have not been disturbed by new entrants. Similarly, a reduction in the market share of exports (facilitated by protectionist trade measures) appears to have benefited large incumbents rather than facilitating new entry.

2.2. Grains

8. The grain supply chain has attracted considerable attention and intervention from the CCSA. Grains are the largest agriculture sector in the economy. Furthermore, this supply chain produces many essential food items such as cooking oil, bread, and maize (corn). Grains are also an important ingredient for animal feed. As such, market failures within this supply chain can have far reaching consequences for consumer welfare and food security.

9. Concentration in the grain supply chain begins with the silo storage level where most storage providers are regional monopolists because of the agricultural regulatory dispensation that existed before market liberalization in the mid-1990s. Under this dispensation, silo operators received government financial assistance for construction and were located such that they did not compete with one another. They were also owned as cooperatives with the farmers in their region as members of the cooperative and therefore the silo owners. Following the deregulation of the agricultural sector, these cooperatives became private agribusinesses and have extended their operations into other areas of the grain supply chain, notably grain commodity trading and supplying inputs such as sowing seed and chemicals.

10. The markets for grain milling and processing also show a tendency towards consolidation and integration. However, these markets are also fragmented with several small firms operating alongside a few much larger firms. For example:

- There are 162 firms active in white maize milling with the top 5 responsible for processing 40.6% of maize for human consumption.
- Regarding bread, 5 bakery groups produce over 75% of the units baked in South Africa.
- There are 19 firms active in sunflower seed crushing with the top 5 crushers holding 81% of the market.

2.3. Fresh produce

11. The features of South Africa's fresh produce supply chain further reinforce the notion that food supply chains are highly concentrated and dominated by large firms. While large farms account for 6.5% of all farms by number, in 2017/18 they earned 67% of the total income. Our research has also found that the agricultural supply chain has become highly industrialized and characterized by super commercialization, which limits the scope of small-scale participation in farming.

2.4. Grocery retail

12. Retailers remain an important force in local food supply chains as they can act as gatekeepers that facilitate market access for players upstream in the value chain. The CCSA has also probed the state of competition in the grocery retail sector in the Grocery Retail Market Inquiry (GRMI). The GRMI found that largest retailers have considerable market power over value chain participants, which they have exercised in various ways such as listing requirements, contract terms, and exclusive leases with retail property owners. The CCSA therefore entered into agreements with the largest retailers to phase out exclusive leases.

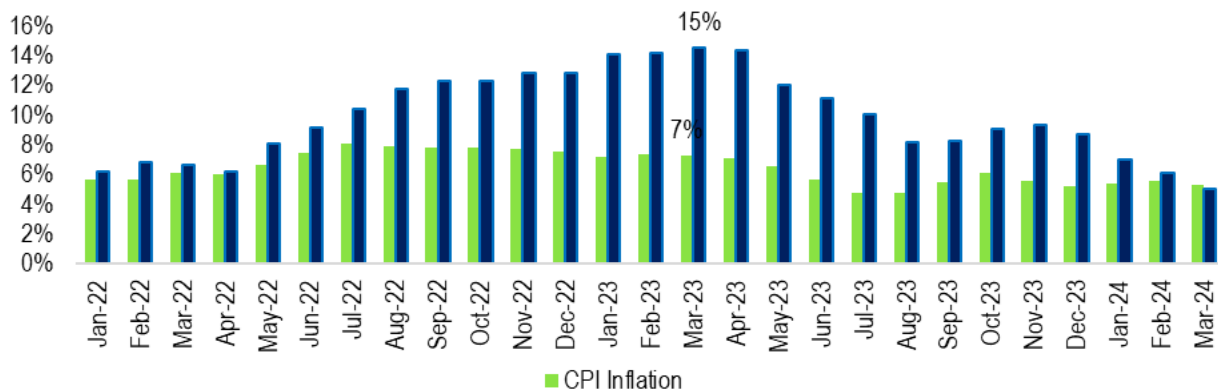
13. Agriculture and food supply chains have been characterized by the need for scale. Chasing economies of scale partially explains the prevalence of concentration and vertical integration described above. Scale has often been achieved through mergers and acquisitions. While economies of scale throughout the supply chain may lead to lower prices for consumers, concentrated markets also raise the risk of unilateral and coordinated anti-competitive conduct. This also raises barriers to entry as new players must make larger sunk investments in order to compete. Indeed, the CCSA has investigated several violations of the Competition Act in the food supply chain. These include margin squeeze and inducement in grain storage, cartels in wheat and maize milling, alleged cartels in fresh produce markets, and exclusionary abuses in poultry breeding.

3. Indications of poor outcomes in food supply chains

14. The recent inflationary episode brought the functioning of markets to the fore. The high inflation levels recorded globally in 2021 and 2022 were largely borne of the post-Covid economic recovery, which induced supply chain pressures. These supply chain pressures were further exacerbated by the onset of the war in Ukraine which contributed to an energy price shock and supply disruptions in the global grain market. South Africa was grappling with its own energy crisis at this time resulting in continuous rolling blackouts to maintain the national electricity supply grid.

15. The CCSA initiated its essential food price monitoring (EFPM) in 2020 and in direct response to the disruptions brought about by the Covid-19 lockdown measures. The inflation burst in 2021 and 2022 necessitated continued food market surveillance particularly as food inflation outstripped headline inflation by a considerable margin with food inflation peaking at 15% in March 2023 while CPI inflation was 7% in the same month.

Figure 1. Comparison of CPI and Food Inflation

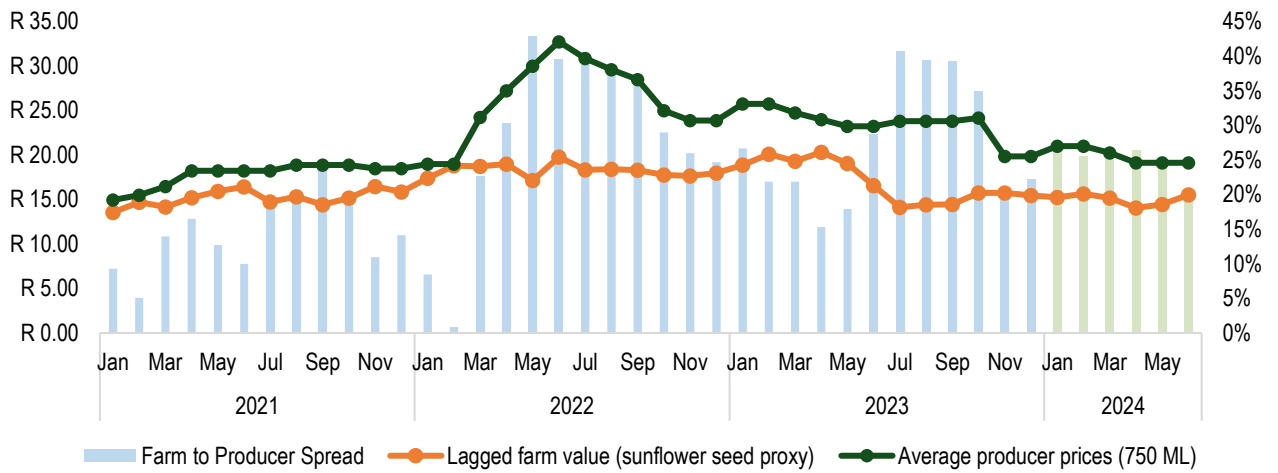


16. The CCSA’s intensified efforts found that the shocks and crisis experienced in food supply chains played out as a ‘rocket and feather effect’. The animating principle is that prices are quick to rise in response to a shock – like a rocket – but slow to fall once that shock has subsided – like a feather. There is a long-standing theoretical and empirical body of work exploring the asymmetrical transmission of costs throughout supply chains. Several explanations have been offered for this phenomenon including adjustment costs and lumpy contracts in the food supply chain, which mean that prices are adjusted periodically. However, the explanation that is the most salient for a competition regulator is that asymmetric price transmission may be an indicator of market power in food supply chains.

17. A series of shocks in several food supply chains demonstrate how the rocket and feather effect played out in South Africa and how producers and retailers can benefit from these shocks while leaving consumers worse off.

- Following the onset of the war in Ukraine many market players locally and abroad anticipated that the supply disruptions would lead to higher prices for grain and oilseed products. Indeed, the CCSA began observing social media complaints about the price of cooking oil and responded by analysing price formation in the sunflower oil value chain for the September 2022 edition of the EFPM Report.
- The report found that the commodity prices of sunflower seeds in South Africa did not respond to global shortages and maintained their pre-war levels. However, there was a considerable surge in the producer price of sunflower oil, which in turn led to higher retail prices. However, retail prices increased to a lesser degree than producer prices. This indicated that producers may have taken advantage of the global supply crisis to price at levels that their own costs did not justify. Following the release of the CCSA’s report, there were social media reports of discounted cooking oil prices throughout the country.

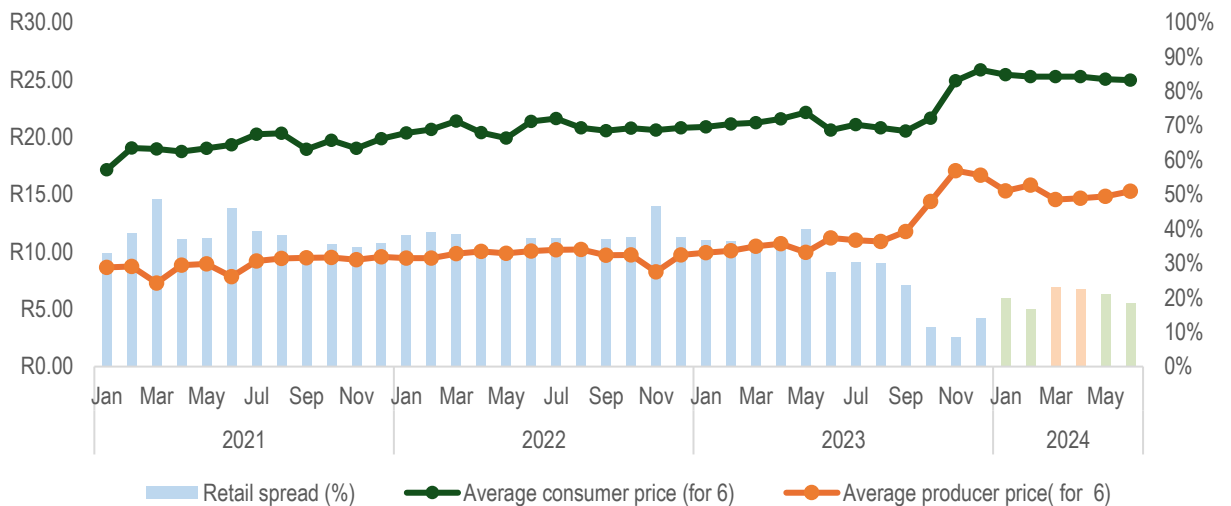
Figure 2: Farm-to-producer spread of sunflower oil.



Source: Commission’s own using StatsSA; JSE AMD.

- Towards the end of 2023, South Africa was hit by an outbreak of avian flu. The outbreak was concentrated among egg-laying hens and necessitated mass culling to contain the spread. This resulted in a surge in producer and retail prices of eggs. As with sunflower oil, the producer price increased by more than the retail price of eggs. Egg prices have remained elevated for much of 2024. While egg supply chains take up to 6 months to recover, the CCSA is concerned that eggs have settled much higher levels than before the outbreak of the avian flu as shown by the figure below.

Figure 3: Producer-to-retail spread of eggs.



Source: Commission’s own using StatsSA

18. Throughout the inflationary period, South African food producers have shown an ability to pass through higher costs and maintain or expand their margins. This suggests that costs are merely passed through the supply chain and are ultimately borne by consumers. Furthermore, it indicates that competitive constraints throughout the supply chain are not sufficient to incentivize price competition through producers absorbing some cost increases and gaining market share from rivals, on the contrary some producers have reported that they would rather sacrifice volumes instead of decreasing prices.

19. Bread and maize meal are manufactured by the same publicly listed companies in South Africa many of which have seen rising revenues and profits recently. These companies also reported making efficiency enhancing investments to contain their production costs.

20. Despite the recent shocks in food supply chains, South African retail margins have remained remarkably stable between 5 – 7%. The global inflationary crisis was compounded by rolling blackouts (loadshedding) that resulted in retailers spending increasing costs on diesel powered generators. Nonetheless, South African retail margins remained resilient and far higher than those in observed in developed nations such as Canada, the United States, and the United Kingdom. As such, the CCSA considers that there remains considerable scope for investigations and interventions that enhance the competitiveness of the retail market to the benefit of consumers.

21. The CCSA's work and engagements have shown how the pricing practices of retailers may contribute to slow price adjustments in food supply chains.

- During engagements between the CCSA and various stakeholders in the dairy value/supply chain, the CCSA learnt that price negotiations in the dairy market could reflect the relative market power of retailers. Crucially, there are two window periods per year where processors can negotiate with retailers. A processor would receive a notification from the retailer during December-January about terms, and negotiating happens from March-April. Then price changes occur in April. There is then one other opportunity to negotiate with the retailers later in the year. This raises concerns about delayed cost transmission in this value chain, especially following shocks that squeeze processors who are unable to recover them timeously.
- The on-going Fresh Produce Market Inquiry (FPMI) was initiated to investigate any adverse effects on competition that may be present in the value chain. The pricing practices of retailers are a significant part of the scope of the FPMI. In its initial draft findings, the FPMI found that formal retail accounts for approximately 50-60% of fresh produce route to market. The retail route to market was also found to be concentrated with the top 4 national supermarkets accounting for 81% of fresh produce sales. Regarding pricing, the FPMI observed that there were (i) instances of increasing prices without any decline in sales volumes, (ii) relatively high markups for certain produce such as tomatoes and onions, and (iii) unexplained gross and/or net margin estimates. It was also found that there was lack of transparency in retail pricing of fresh produce, such that consumers are unlikely to be able to compare prices between products and retailers. The FPMI is yet to be concluded and further analysis of market dynamics and retail pricing is still being conducted.

22. The role of global commodity traders in food supply chains and their ability to profit of supply shocks and crisis has also received attention particularly, in the context of the Bunge / Viterro merger, which will further consolidate global trading.

23. This is a long-standing area of concern that dates to the 2008 food price crisis and concerns that speculative activities may have influenced commodity prices at the time. For countries that, like South Africa, are integrated into global supply chains the activities of global traders can have effects on local food prices. Specifically, there are concerns that speculative activity could drive prices away from market fundamentals and reflect the effect of speculative bubbles and profits.

24. Another concern stems from the integration of traders into other parts of the value chain that can influence food availability and access at a global level. For example:

- Cargill has investments in the animal feed and meat sectors.
- ADM is a supplier of biofuels and fertilisers.
- In Brazil, Bunge owns important assets for trading grain including 62 storage facilities, 9 grain mills, 8 crushing facilities, 6 ports, 6 refineries and 4 oil packaging factories.
- COFCO is also vertically integrated in China and owns pig farms, slaughterhouses, and retail brands.

25. Locally, the largest South Africa trading companies are also integrated into grain storage, supplies of inputs to farmers, and offering agricultural financial services. The largest of these traders have experienced a substantial increase in profits from trading in their most recent financial years.

26. In response to concerns about the increasing trend towards speculative behavior in global commodity markets led to the CCSA assessing the relationship between commodity prices and speculative in the September 2024 edition of the EFPM report. At this stage, there is no evidence that an increase in speculative behavior on the local market has driven commodity price increases in the sunflower seeds, maize, and wheat markets over a sustained period. However, news reports about the current rapid escalation in the domestic maize price of 60% argue it is partially linked to speculative behaviour on top of a poor crop last season.¹ Notwithstanding this observation, South Africa is an open market economy and is a price-taker in the world market for many agricultural commodities – it is therefore exposed to the speculative actions of traders in global markets. Therefore, global market features, including a tendency towards more speculative behavior, in the commodities trading may filter into the South African market even if those features are currently not a part of the local market.

27. The CCSA's experience and research show that in food supply chains soft competition has resulted in weak incentives for robust price competition among market actors, especially in the context of price shocks. It is evident that when faced with these shocks, the prevailing impulse is to merely pass price increases down the supply chain until they are borne by consumers. In some instances, there could be margin increases as supply chain actors attempt to insulate themselves from cost increases which either do not materialize or are smaller than anticipated.

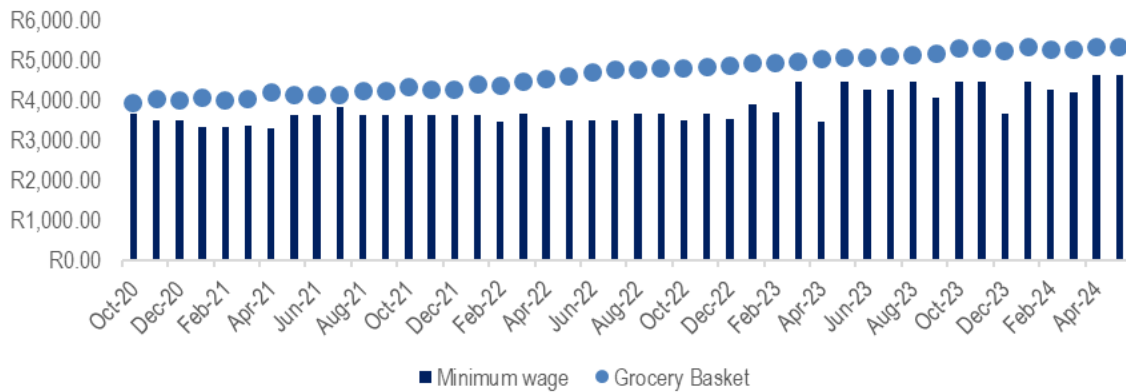
28. During the last few years of high and increasing food prices in South Africa, the food security situation has deteriorated as incomes at the lower end of the distribution are increasingly unable to purchase basic food items.

¹ <https://www.dailymaverick.co.za/article/2024-11-24-food-inflation-to-rise-with-price-of-white-maize/>

29. Figure 4 shows how the Food Basket tracked by the Pietermaritzburg Economic Justice & Dignity Group has evolved since September 2020, when the world was grappling with the effects of the pandemic until May 2024, when the inflationary episode started to subside.

30. The price of this food basket increased by more than 50% over this period and became less affordable for households earning the national minimum wage. Whereas a month of work at the minimum wage would have earned a worker R3 653.76 in October 2020 resulting in a R262.96 (7%) shortfall, that same worker would have earned R 4633.76 in May 2024 resulting in a R696.86 (13%) shortfall. This is on top of increased transport costs driven by high oil prices over the period. This comparison highlights that many households still face the risk of food insecurity given the relative levels of food prices and incomes.

Figure 4. PMBEJD Essential Food Basket from October 2020 to May 2024



Source: Commission’s own using Pietermaritzburg Economic Justice and Dignity Group Household Affordability Index. Note: The PMBEJD method for calculating the is the product of the prevailing national minimum wage and the number of working days in each month.

4. Actions to improve the functioning of food supply chains

31. South Africa’s extensive experience in food supply chains both in enforcement and research has led to the identification of several areas of focus or intervention that competition authorities can pursue to improve the functioning of food value chains.

32. Improving transparency on price formation.

- Consumers feel price increase at the retail level of the supply chain; however, food supply chains are often long and involve multiple actors that can influence end prices. Our methodology for the EFPM Reports uses publicly available data to assess how commodity prices and producer prices may have contributed to higher retail prices. As is evident from the examples of cooking oil and eggs, the price increases were led by producers and not retailers. Understanding the source of price formation can help with targeted and rapid responses by competition authorities and government more broadly. Competition authorities should use the full range of data available to them to understand how markets are functioning, particularly in times of inflationary shocks.

- The ongoing FPMI has highlighted that there is an information asymmetry between sellers (market agents) of fresh produce and buyers (wholesalers, retailers and traders). Specifically, buyers only have access to historical information, while market agents possess real-time data. The exchange of information and subsequent transparency in the agricultural sector are crucial for several reasons. Reliable and accurate market data can offer valuable insights into market conditions, empowering market participants to anticipate potential fluctuations. Transparent pricing allows producers to make informed decisions regarding crop selection, optimal selling times, and pricing strategies. Correcting these asymmetries may contribute towards improving competitive outcomes in food supply chains, provided that the level of transparency does not enable collusive conduct.

4.1. Legal instruments to tackle market power

33. Market power does not only manifest itself in terms of traditional unliteral and coordinated conduct. To this end, market inquiries have been a powerful tool for identifying market features that impede competition in food supply chains. In 2019 the Amendments to the Competition Act made the remedial actions from market inquiries binding on market participants. The same amendments also introduced Buyer Power and Price Discrimination provisions aimed at tackling unfair trading practices that prejudiced small and medium enterprises.

- *GRMI phasing out exclusive lease agreements:* In October, the Commission announced the signing of a consent agreement reached with Pick n Pay Retailers Proprietary Limited (Pick n Pay) and Shoprite Checkers to eliminate exclusive leases in shopping malls in compliance with the recommendations of the Grocery Retail Market Inquiry (GRMI). Pick n Pay has committed to phasing out exclusivity leases with supermarket chains over six years ending 31 December 2026 and will not sign any new lease agreements that contain exclusivity clauses.¹⁶ Shoprite Checkers made similar commitments. In its final report, the GRMI found that long-term exclusive lease agreements are widely prevalent in the grocery retail sector and give rise to customer harm as they limit consumer choice and reduce competition within Shopping Centres. Furthermore, such agreements prevent the participation of SMEs and historically disadvantaged persons in the grocery retail sector. This is a significant step in removing barriers to entry and participation for SMEs and historically disadvantaged individuals in the South African grocery retail sector.

34. *Buyer power and price discrimination amendments:* Concerns over unfair trading conditions in the food value chains and the impact on prices paid to smaller and historically disadvantaged suppliers, has culminated in an amendment to the Competition Act in the form of a new section 8(4) directed specifically at the abuse of buyer power by dominant firms in designated sectors and includes the agro-processing, grocery wholesale and retail and the e-commerce and online services sectors

4.2. Advising government on pro-market or non-distortionary measures to assist with food security and developing the sector.

35. The strategic importance of agricultural markets and food supply chains means that government often intervene to promote their development or food security. However, there is a risk that intervention could result in uncompetitive market outcomes or strengthen the market power of existing players. As such, competition authorities can play a role in advising governments on the competition dynamics of their policies in the sector.

36. The CCSA has recently contributed to two policies; namely the ‘Draft Policy for the Transfer of Commercial Fishing Rights (2024)’ (“Draft Transfer Policy”) and the ‘Draft Policy on the Allocation and Management of Rights to Operate Fish Processing Establishment (2024)’ (“Draft FPE Policy”) under the custodianship of The Department of Forestry, Fisheries and the Environment (“DFFE”) policies. The CCSA’s contributions aim to promote market entry, participation, and expansion by SME and HDP firms and ensure that they are not inadvertently hindered by the evaluation and allocation of fishing rights. The CCSA is currently doing joint research with the Department of Agriculture, Land Reform and Rural Development (DALRRD) on the value chains of essential foodstuffs that are zero-rated for VAT purposes, to determine price formation, costs, the potential effects of inadequate competition and the best strategies for state intervention.

5. Conclusion

37. Food supply chains are of utmost importance for national welfare. Much of the CCSA’s work in this area has highlighted the various ways in which food supply chains may not be functioning optimally and the impact of this sub-optimal performance on food prices and ultimately food security. While some issues can be addressed domestically, the complexity of global supply chains poses new challenges for competition authority interventions in these areas.

38. The CCSA’s observation has been that food inflation has been worsened during shocks and disruptions by the overreaction of market actors to the shock resulting in market fundamentals not able to explain fully the observed food price levels. As such it is observed that market actors have an ability to increase margins as they are fast to increase prices when costs go up and slow to increase prices when costs come down. These observations and outcomes underscore the importance of information and transparency to enable competition authorities to quickly detect market failures along food value chains.