



TIPS FORUM 2017

INDUSTRIALISATION AND SUSTAINABLE GROWTH

GROWTH AND DEVELOPMENT IN THE SUGAR TO CONFECTIONERY VALUE CHAIN

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June 2017

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Paper presented at the TIPS Annual Forum 2017.

The Annual Forum 2017 is being hosted by Trade & Industrial Policy Strategies (TIPS) in partnership with the South African Research Chair in Industrial Development, based at the University of Johannesburg, and in association with the Green Economy Coalition (GEC). It is supported by the European Union and the Department of Trade and Industry.



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Abstract

The member states of the Southern African Development Community (SADC) have placed industrial development at the core of the region's integrated development agenda. This paper seeks to assess the regional competitiveness and opportunities in the sugar to confectionery value chain in Zambia and South Africa. Agro-processing, specifically in the sugar to confectionery value chain, is an important area in which industrial development can be pursued in both countries. This study aims to develop a shared understanding of the challenges impeding the expansion of downstream industrial activity in the sugar confectionery sector and identify the potential for upgrading. The paper also seeks to understand industrialisation in the context of the sugar to confectionery value chain and how these two countries can exploit opportunities to develop low to medium value added products. It is envisaged that this research will inform concrete cross-country policy initiatives based on a shared understanding of industrial development challenges at a regional level.

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Abbreviations

ABF	Associated British Foods plc
ACF	African Competition Forum
AFDB	Africa Development Bank
ASASI	Association of Southern African Sugar Importers
BRICS	Brazil, Russia, India, China, and South Africa
CAGR	Compound Annual Growth Rate
CCPC	Competition and Consumer Protection Commission of Zambia
CCRED	Centre for Competition, Regulation and Economic Development
DoP	Division of Proceeds
Dti	Department of Trade and Industry
EU	European Union
FSSC	Food Safety System Certification
GVC	Global Value Chain
HACCP	Hazard Analysis and Critical Control Points
ICUMSA	International Commission for Uniform Methods of Sugar Analysis
IDCS	Industrial Development Corporation of South Africa
IDCZ	Industrial Development Corporation of Zambia
ISO	International Organisation for Standardisation
ITAC	International Trade Administration Commission
MCEP	Manufacturing Competitiveness Enhancement Programme
NTBs	Non-tariff Barriers
NTE	Non-traditional exports
RVC	Regional Value Chain
SABS	South African Bureau of Standards
SACU	Southern Africa Customs Union
SADC	Southern African Development Community
SASA	South African Sugar Association
SSA	Swaziland Sugar Association
UAE	United Arab Emirates
UNZA	University of Zambia

USD	United States Dollar
WTO	World Trade Organisation
ZABS	Zambian Bureau of Standards
ZDA	Zambia Development Agency
ZIPAR	Zambia Institute for Policy Analysis and Research

1. Introduction

The member states of the Southern African Development Community (SADC) have placed industrial development at the core of the region's development integration approach. In pursuit of this, a series of studies is being undertaken with funding from the Department of Trade and Industry (the dti) to assess the regional competitiveness and opportunities in selected value chains. These studies build on previous related work undertaken on regional development and integration across various sectors.¹

This paper draws key insights from an in-depth study² undertaken as part of this series looking at growth and development opportunities in the sugar to confectionery value chain in Zambia and South Africa. The research was undertaken on a collaborative basis by the Centre for Competition, Regulation and Economic Development (CCRED) at the University of Johannesburg and the Zambia Institute for Policy Analysis and Research (ZIPAR) to build a common understanding of the opportunities and bottlenecks found in the value chain. This lays the foundation to inform concrete cross-country policy initiatives based on a shared understanding of industrial development challenges at a regional level.

The topics of interest at the 2017 TIPS Forum include the interplay between industrial policy, trade policy and sustainability, in addition to broad industrial development in the southern African region. Dynamics in the sugar to confectionery value chains in the region raise pertinent questions on the complex interrelationships between national and regional policies, and competition concerns that arise from concentration at different levels of the value chain. Building on core concepts of governance, linkages and upgrading from the Global Value Chains (GVC) literature (see Gereffi, Humphrey and Sturgeon, 2005; Gereffi and Fernandez-Stark, 2011), these issues are addressed in this paper primarily through a Regional Value Chains (RVC) lens.

The research is motivated by two key factors. First, both South Africa and Zambia are large net exporters of sugar, with Zambia being the lowest cost producer of sugar in the region (Ellis, Singh and Musonda, 2010) and amongst the lowest cost producers in the world. Yet, there is a large trade deficit in both these countries as well as in the SADC region in downstream sugar confectionery products which is a substantial category of processed food. Sugar confectionery products include sweets, lollipops, chews and chewing gum, while baked confectionery goods include sweet biscuits. As such, these countries are well placed to exploit opportunities from low cost sugar to develop relatively low-to-medium technology value added products in the sugar and baked confectionery industries.

Yet despite low costs of production, Zambia and South Africa's domestic sugar price exceeds the world sugar price which results in a relatively higher input costs for local producers in downstream confectionery markets (Chisanga et. al, 2014a). While this gap between domestic and world prices

¹ This includes studies by CCRED, CSID, AIAS and UNZA on inputs to infrastructure in Mozambique (Baloyi and Zengeni, 2015), mining machinery in South Africa and Zambia (Fessehaie, 2015); soy value chain in South Africa, Zimbabwe and Zambia (Takala-Greenish et al., 2015). It also draws on lessons from UNU-Wider studies on regional integration and growth: supermarkets (Das Nair and Chisoro, 2015, 2016 and 2017); implications for local suppliers in Zambia (Ziba and Phiri, 2017); animal feed and poultry (Ncube, Roberts and Zengeni, 2016); mining policies (Fessehaie, 2015); regional transport (Paelo and Vilakazi, 2017).

² The in-depth study will be available on <http://www.competition.org.za/> in August 2017.

arguably exists in several countries given that the world sugar price is distorted³, the relatively higher costs of input sugar in Zambia and South Africa results in significant imports of finished confectionery products from lower cost countries.

Second, the same firms that operate in South Africa also operate at two key stages of the sugar to confectionery value chain in Zambia, namely in the sugar production (until recently) and formal retail levels. The largest producer of sugar in Zambia, Zambia Sugar, was until recently a subsidiary of South African firm Illovo Sugar. It is now owned by Associated British Foods (ABF). Similarly, the largest retailers in Zambia, Shoprite and Pick and Pay, are also the two largest supermarket chains in South Africa with a large regional footprint. This has interesting implications for understanding the regional nature of the value chain and the role of these key firms in determining the structure and developments in the value chain both within each country and between South Africa and Zambia.

The retail level is particularly important in understanding the sugar to confectionery value chain as it plays a key role in local producers accessing final markets. From a national perspective, supermarkets are an important route to the domestic market for local suppliers. But importantly, from a regional perspective, supermarket chains are an avenue to wider regional markets in SADC. Access to regional markets through retailers provides an opportunity for suppliers to grow and reach the desired scale as well as to upgrade their capabilities to become competitive in regional and, potentially, in international markets.

The overarching objective of the paper study is to highlight the potential for mutually beneficial growth and development opportunities for both countries in the sugar to confectionery value chain. The specific objectives are as follows:

- To develop a shared understanding of the challenges impeding the expansion of industrial activities in South Africa and Zambia;
- To analyse the performance and competitiveness of the sugar to confectionery regional value chain and the potential for upgrading;
- To identify concrete plans at the sectoral level for mutually beneficial and collaborative industrialisation strategies for the sugar and confectionery value chains across the two countries.

Based on these objectives, the main research questions identified include:

- How is the production and distribution of the sugar to confectionery value chain organised in terms of inter-firm linkages, governance and regional logistics?
- What are the key determinants of competitiveness through the value chain, with reference to input costs, investment, quality, packaging, marketing, branding, and other requirements in the region?
- What are the key factors in regional confectionery producers supplying regional supermarket chains?
- What are the constraints to regional trade and investment, including the impact of transport costs and costs related to regulation and border controls?
- What levers of industrial policy are most effective in deepening and expanding linkages in South Africa and Zambia?

³ Because sugar producers in large producing countries like Brazil and India are heavily subsidised by their governments and export surpluses over domestic demand at much lower prices.

This paper is structured as follows. Section 2 presents the methodology and data sources utilised. Section 3 briefly sets out the relevant literature on RVCs, the connections to GVCs and why this is an appropriate framework for this assessment. Section 4 maps the sugar to confectionery value chain in South Africa and Zambia, highlighting the key players and the production, trade and revenue trends at key levels of the value chain. It also discusses the complex interlacing trade and policy agreements in the two countries. Section 5 then assesses the dynamics within the value chain including the growth and performance of main players. Section 6 looks at the pricing of sugar as the main input into confectionery production, while Section 7 evaluates constraints faced in accessing routes to market. Section 8 concludes and provides recommendations for mutually beneficial policy interventions for Zambia and South Africa.

2. Methodology

As noted, the research questions were evaluated under a global value chains framework, adapted for regional dynamics to understand constraints to regional industrialisation. This framework was used to understand linkages between firms along the value chain in both countries, as well as to assess governance structures and concerns of market power at different levels. These impact upgrading opportunities for confectionery producers in the region and are therefore relevant in understanding bottlenecks to industrialisation.

The study primarily applied a qualitative data method for data collection to map the value chain and to identify where the core competences of firms lie. The flow of inputs – goods and services – in the production chain were mapped to determine the factors that present constraints or opportunities in the value chain. In particular, the regional point of entry for the value chains and how producers access final markets as well as the critical success factors in final markets are analysed.

Data from both primary and secondary sources were utilised. The principal dataset was obtained through in-depth interviews with key stakeholders throughout the value chain in both Zambia and South Africa, as well as from the annual reports of listed companies. These interviews were conducted using structured questionnaires and face-to-face interviews.

The primary target population comprised all (upstream) sugar and (downstream) sweets and baked confectionery producers from South Africa and Zambia. In depth interviews were therefore targeted at all the main sugar millers, including three large and three relatively smaller sugar producers in South Africa and three sugar millers in Zambia. In order to ensure adequate representation of confectionery producers, large, medium and small confectionery producers were targeted. Importers of sugar and confectionery products, wholesalers, traders and re-packers and retailers (both formal supermarkets and independent retailers) were also targeted. Interviews were further conducted with other key stakeholders such as the relevant industry associations, competition authorities, government departments and development and investment agencies. Not all the sugar millers and confectionery producers targeted were forthcoming for interviews. Overall, data for 5 sugar producers, 12 sweets and confectionery producers were analysed from interviews, in addition to data from retailers, wholesalers, traders and re-packers, government agencies and industry associations. Data from annual reports of millers that were not interviewed face-to-face were also analysed. This was further augmented by secondary data collected from sources such as United Nations Statistical databases Comtrade and Trade Map, Statistics South Africa, the Central Statistical

Office of Zambia, SADC trade documents and past studies in the sector. The data from the various data sources were then triangulated to ensure validity.

3. Literature Review: A regional value chain framework to identify opportunities and bottlenecks to industrialisation

Global value chain (GVC) theory helps to explain how patterns of international trade and production have shaped prospects for development and increased competitiveness (Gereffi, 2014). GVC perspectives are often used to analyse international trade and production networks (Gereffi, 1999). Due to the increased globalisation of processes involved in the manufacturing of various products, it has become important to understand the inter-firm linkages found in these trade networks. These international trade networks are generally characterised by unequal distribution of economic rents (Gereffi et al. 2001). This necessitates analysis to understand where and how the distribution of these economic rents is determined, that is, an understanding of the locus of power in the trade network. A GVC framework allows for an understanding of how the distribution of rents can be changed for firms to receive more equitable shares of these rents through mechanisms such as upgrading. Another important building block in GVC analysis, especially in the realm of policy-making, is industrial upgrading (Gereffi et al., 2001). Upgrading “*refers to several kinds of shifts that firms or groups of firms might undertake to improve their competitive position in global value chains*” (Gereffi et al., 2001: 5).

The consideration of regional value chains is particularly important because these chains may be more amenable to upgrading than GVCs as they are likely to be less tightly controlled than the latter (Keane, 2015). Issues such as harmonisation of standards or border controls may further be easier to negotiate between countries that share borders than between those that do not. Thus, understanding firm and state strategies in the formation of regional value chains is important to understand their operation and potential for regional industrialisation.

Until recently, there has been limited literature on regional value chains in Africa. Apart from the case studies on various African agricultural and mining commodities feeding into GVCs⁴, the GVC literature on African value chains either focused on the effect of Asian firms on African producers or on the demand patterns driven by BRICS countries (Brazil, Russia, India, China, and South Africa) (Keane, 2015). However, more recently, regional value chains studies have been carried out in various forms. These studies have either had a regional focus assessing the potential or existence of regional value chains (Farole, 2015 and Keane, 2015 in their assessment of the SACU region), or as case studies looking at specific value chains (e.g. Fessehaie, et al., 2015).

In the assessment of SACU and the possibility of developing regional value chains, Farole (2015) advocates for the development of regional value chains in SACU. Using the ‘gateway’ model, he suggests developing regional value chains specifically for these to be plugged into GVCs. The gateway model would involve the development of SACU regional value chains, led by SA lead firms, to plug into GVCs. However, this gateway approach is often found to be hampered by geographic remoteness, high transport costs, trade barriers and low levels of skilled labour (Farole, 2015). Also

⁴ See for example Cramer (1999), Dolan and Humphrey (2000) and Gibbon (2003)

in an assessment of SACU, Keane (2015) looks at the firm-level characteristics of SACU firms participating in GVCs, finding evidence of a production network, particularly in the metals industry.

Two key insights emerge from the limited research on regional value chain. First, most regional value chain studies are conducted with the view to develop regional value chains as preparation for entry into GVCs (Keane, 2015). For instance, Kaplinsky and Morris (2015) find that regional value chains can play an important role as a learning ground for African suppliers ultimately destined for global markets. This is because African markets generally have far less stringent standards and requirements than global markets (largely found in developed countries). As such, regional value chains are seen as a means to an end, not an end in themselves. However, it has also been suggested that for some countries plugging into regional value chains as an end in itself might be the most viable strategy for development as they may have very low domestic capabilities (Keane, 2015).

The second key insight is that, as highlighted by Farole (2015), regional value chains in southern Africa remain largely underdeveloped. This underdevelopment extends to the agro-processing sector where it is suggested that regional value chain development should be the greatest given the level of agricultural production in southern African countries (Farole, 2015). For example, in their analysis of the soya regional value chain in South Africa, Zambia and Zimbabwe, Fessehaie et al. (2015) found that there is very little interaction among the three countries. This is despite the fact that South Africa has the largest trade deficit of the three and Zambia has a trade surplus. Yet, South Africa does not import from Zambia and instead imports from deep sea sources. (Ncube et al., 2016). This is not consistent with a view of developing the SADC region.

The development of regional value chains depends on both structural and policy factors. Structural factors include the southern African region having difficulty in achieving scale and having large intra-regional imbalances. The SACU region is characterised by relatively small regional markets which make it difficult to take advantage of scale economies because production volumes are relatively low (Farole, 2015). Policy factors are also important for the formulation of regional value chains. This is especially the case in the context of regional communities' integration. Regional communities are seen as an avenue by which countries could improve their trade-competitiveness through upscaling in value chains. The upscaling can be facilitated by enacting regional policies which reduce excessive protectionist trade measures, as well as increased tax incentives for attracting new technology (AFDB *et al.*, 2014). These policy measures are meant to boost trade within the regional community as the regional value chain is dependent on the free flow of goods and services within the region.

Regional integration has long been a goal for SADC countries. However, despite the regional integration agenda, national policies are often in opposition to the regional integration initiatives in SADC (Hartzenberg and Kalenga, 2015). Although countries have ostensibly implemented a number of trade liberalisation measures, they have also found ways to circumvent the effects of application of tariff liberalisation by implementing non-tariff barriers (NTBs), including in agriculture (Hartzenberg and Kalenga, 2015). Particularly for agro-processing, trade policies undermine the potential for the development of downstream activities (Farole, 2015).

As such, the concept of unlocking the development of regional value chains is directly affected by issues of trade cooperation between neighbours in the region. While complete regional integration may no longer be a viable means by which to encourage intra-regional trade, countries may still be able to foster trade cooperation among close neighbours to encourage the development of a regional value chain.

The positioning of regional value chains as a 'gateway' to entry into GVCs is certainly interesting in the context of economic development in Africa. The African continent is commonly cited as having the highest growth rates and growing markets, particularly for consumer goods including food. Moreover, while intra-African trade has grown by an average annual growth rate of 13.5% between 2000 and 2010 (AFDB *et al.*, 2014), Africa is still missing out on growth which was observed in more integrated and connected regions in other parts of the world. As such, the development of regional value chains could be viewed as an end in itself, not only as a gateway to GVCs.

A key participant and the last link to end consumers in many agro-processing and industrial value chains is the retailer. The rapid growth and spread of modern retailing in southern Africa is an important dynamic in shaping regional food value chains. Modern retailers, supermarkets in particular, are becoming a growing route to market for consumer goods in southern Africa, providing opportunities for suppliers to participate both within and outside their home countries (Boselie, Henson and Weatherspoon, 2003; Reardon and Hopkins, 2006). Past studies have shown that as a result of the spread of supermarkets, suppliers have had to invest in their capabilities to ensure that products sell off shelves as fast as possible. This presents a barrier to small and medium-sized suppliers. However, the biggest concern with the spread of supermarkets is the ability for dominant supermarket chains to abuse their buyer power. Over and above demanding higher standards from suppliers, supermarkets often impose a range of other costs on suppliers through their trading terms. This is reflective of their buyer power and affects the ability of suppliers to sustainably supply supermarkets, in turn affecting their development (see das Nair and Chisoro, 2015, 2016 and 2017).

4. Mapping the sugar to confectionery value chain in South Africa and Zambia

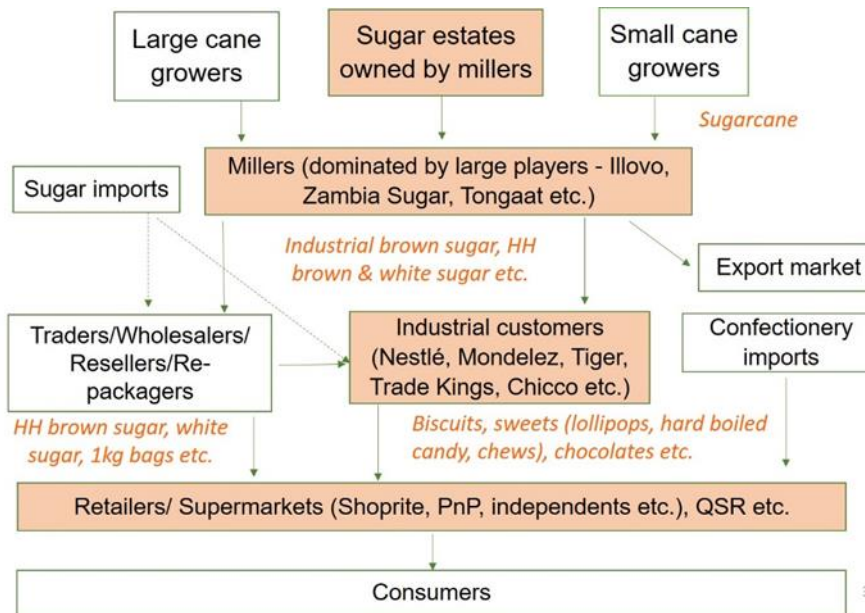
The figure below represents the sugar to confectionery value chains in South Africa and Zambia (Figure 1). The upstream level is the agricultural component, where sugarcane is grown. The next level downstream of this involves the milling of sugarcane into sugar. In both countries, there is a degree of vertical integration between sugar growing and milling (discussed below). The sugarcane growing level was not focused on in detail in this study.

Generally, sugar from millers is of two grades: household grade (HH) or industrial grade. Industrial grade sugar is largely used by industrial customers to produce confectioneries, biscuits, cereals, and beverages among other products. Within this category, there is a better quality white refined sugar which is used in the beverage industry graded as ICUMSA⁵ 45 and a less refined, more fibrous, 'plantation white' grade which is used in the confectionery industry (graded ICUMSA 150, as purity is not as crucial for aesthetics in confectionery compared to the beverage industry). Industrial customers can also on-sell to retailers and other customers after re-packing (to restaurants, Quick Service Restaurants etc.). While confectionery producers can use more refined ICUMSA 45 grade sugar to produce confectionery products, this obviously comes at a higher cost and is not strictly necessary. In South Africa, until very recently (2015/2016) ICUMSA 150 grade was not locally produced and confectionery producers either used beverage grade sugar or relied on imports.

⁵ ICUMSA - International Commission for Uniform Methods of Sugar Analysis

Household grade sugar on the other hand is sold from the millers directly to distributors, wholesalers and retailers. Both grades are also exported (in SA and Zambia).

Figure 1: Sugar to confectionery value chain in Zambia and South Africa



Source: Authors' own

The rest of this section assesses each level of the value chain, focusing on the key players, production and trade in sugar and sugar confectionery products.

4.1 Sugar and sugar confectionery production

Sugar production

The sugar industry in South Africa generates approximately R12 billion (USD806 million), with 79,000 direct jobs and 35,000 indirect jobs (SASA, 2016). There are approximately 22,500 registered sugarcane growers, with sugar being produced by 6 milling companies operating 14 sugar mills (SASA, 2015). Just over 21,000 of these sugarcane growers are small-scale growers (95% of the growing population), but 83% of the sugarcane produced in South Africa by volume is produced by large scale growers. The milling companies are also involved in upstream activities, albeit at a relatively small-scale, accounting for approximately 8% of the sugarcane grown in the country (SASA, 2015).

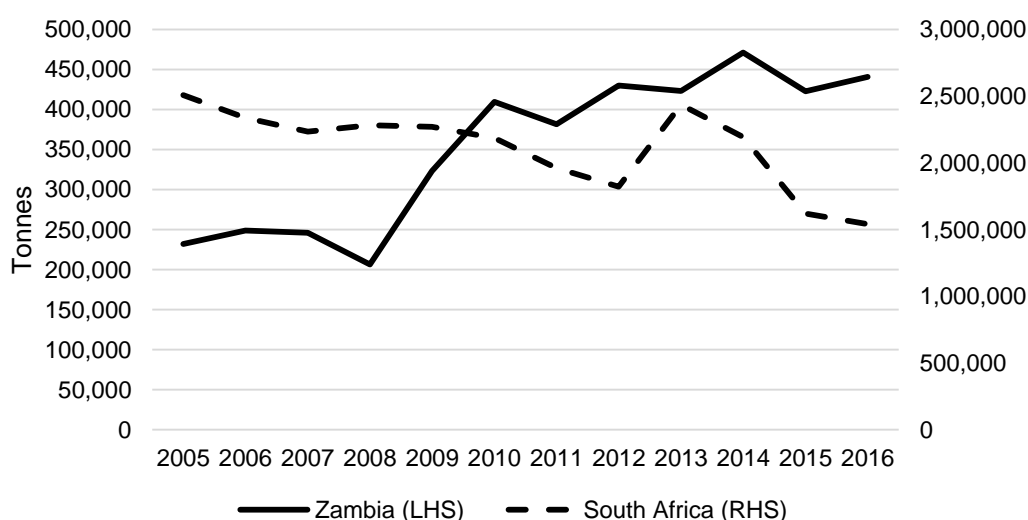
Sugar in South Africa is produced by six millers with 14 sugar mills operating in the cane-growing regions of Mpumalanga and KwaZulu Natal. Illovo Sugar (Ltd), Tongaat Hulett Sugar (Ltd), and TSB Sugar (Ltd) are the largest three milling companies. The other relatively smaller sugar producers are Gledhow Sugar Company (Ltd), UCL Company (Ltd) and Umfolozi Sugar Mill (Ltd) (SASA, 2015). There are a number of sugar traders/ distributors who act as intermediaries between millers and confectionery producers. Distributors include Sugar on Tap, Royal Rice, Lluvia Sugar, Foodcom and

Makro, while the Akila Group and Dreyfus are involved in the trading of sugar in addition to other major agricultural commodities.

The Zambian sugar industry generated over USD200 million in export revenue alone in 2015. It employs approximately 10,000 people (Zambia Sugar, 2015; Sable Transport, 2016). Like South Africa, smallholders in Zambia supply a much lower proportion of sugarcane than largescale growers to millers. The total national raw sugar production in Zambia of around 450,000 tonnes is produced primarily by three firms – Zambia Sugar, Kafue Sugar and Kalungwishi Estates. The largest by far is Zambia Sugar, with approximately 90% market share in sugar production in Zambia and who is the sole exporter. There are however future investments by Indian investors that are likely to come on board soon.

Production volumes of sugar in South Africa have been relatively consistent, on average about 2.1 million tonnes between 2005 and 2016 (Figure 2). The drought reduced sugar production in South Africa to approximately 1.6 million tonnes in the 2015/16 season (SASA, 2016). In contrast, Zambia’s production has increased over the years, particularly between 2008 and 2010 (Figure 2). The average production between 2010 and 2014 is almost double that of the period between 2005 and 2008. However, Zambia’s production still lags far behind that of South Africa.

Figure 2: Sugar production (tonnes/annum) in Zambia and South Africa



Source: Compiled from SASA; FAOSTAT and CSO

As evident, the sugar milling level of the value chain is concentrated in both South Africa and Zambia. This has implications on the pricing of the sugar as well as on the relationship between sugar millers and their industrial customers.

Sugar confectionery production

The sugar confectionery industry in South Africa generated R5.6 billion (USD414 million) in 2016 up 6% from the previous year. The categories which generated the most revenue are pastilles, gums and jellies, followed by boiled sweets and toffees. The growth in the pastilles, gums and jellies category could be explained by investments into that category. For instance, Tiger Consumer Brands opened a R160 million gums and jellies plant in Durban in 2014 (Euromonitor International, 2015a).

The production volumes of sweets by category yield similar results with pastilles, gums and jellies yielding the highest production volumes in 2016, followed by boiled sweets (Table 1).

Table 1: Sales of sugar confectionery by category in South Africa (volumes, thousand tonnes)

	2011	2012	2013	2014	2015	2016
Boiled Sweets	16.1	15.7	15.4	15.0	15.2	15.3
Liquorice	1.6	1.7	1.7	1.7	1.7	1.8
Lollipops	4.0	4.1	4.3	4.5	4.8	5.1
Medicated confectionery	0.8	0.8	0.8	0.8	0.9	0.9
Mints	0.4	0.4	0.4	0.4	0.4	0.4
Pastilles, gums, jellies and chews	17.2	18.0	19.0	20.0	21.0	21.8
Toffees, caramels, and nougat	6.8	7.1	7.5	8.0	8.5	8.8
Other	4.5	4.7	5.0	5.3	5.5	5.9
Total	51.4	52.5	54.1	55.7	58.0	60.0

Source: Euromonitor International (2016)

There are a few notable general characteristics and developments in the confectionery production industry in South Africa. Specific details of investments are discussed in Section 5.1 below. First, the confectionery production industry is made up of large local and multinational firms - Tiger brands (Beacon), Premier Foods (Manhattan and Super C), Nestlé and Mondelez International (Cadbury). Second, there has been significant new entry by three international players - Mondelez International, Trade Kings and Aldor - of which the last two set up production in South Africa from Zambia and Columbia respectively. There has also been some consolidation with the creation of Lodestone Brands in 2014 following the merger of two key producers (Candy Tops and Mister Sweets). Other notable confectionery producers include Broadway Sweets (producer of Stumbo Pops and Heartbeat brands) and Pioneer Foods which sold off its (Bokomo) biscuit portfolio in 2015. A third feature of the sugar confectionery industry in South Africa is that there has been an increase in private label sales attributed to leading retailers increasing their product ranges (Euromonitor International, 2016).

The sweet confectionery industry in Zambia consists of a few players and has historically been dominated by imports from the sub-region and deep sea. However, like in South Africa, recent years have seen a number of firms get into the production phase of the sugar and confectionery value chain predominantly led by Trade Kings, a key player, Chicco Quality Foods, Monginis Bakers, Musa Biscuits, Speciality Foods and a few other small firms, all of which produce products ranging from biscuits to hard candy, gums and lollipops. These firms are exhibiting strong capabilities and exporting to the region and several are 'retail ready' in terms of meeting supermarket standards. The growth and assessment of confectionery producers is discussed further in Section 5.

4.2 Trade of sugar and confectionery products

Trade of raw sugar

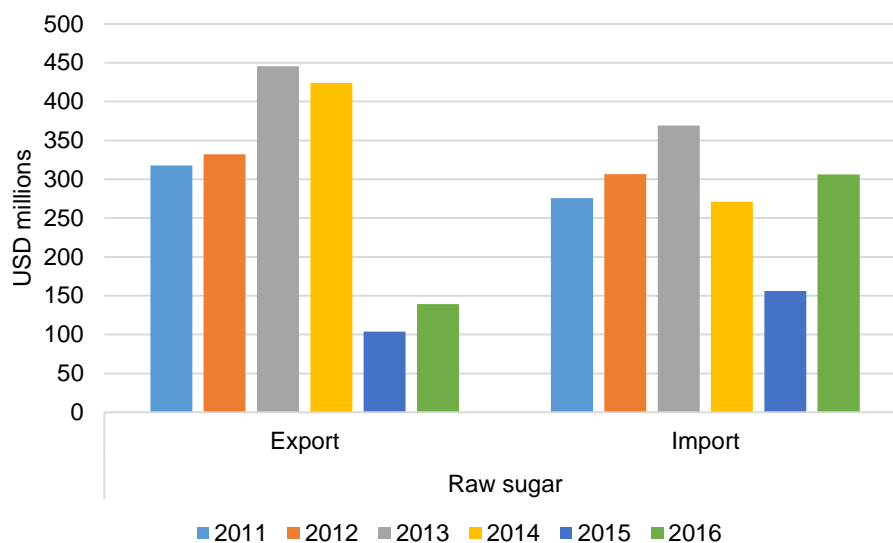
While both countries are net exporters of raw sugar (Figure 3 and Figure 4), South Africa has seen significant imports between 2011 and 2013, after which there was a decline before increasing again in 2016, where imports almost doubled relative to the previous year. Between 2013 and 2015, sugar imports into South Africa decreased by 51% (Figure 3). This is primarily because of the import tariff

which kicked in around this time. Although data for 2017 is not yet available, interviews with industry players suggest that imports again started increasing particularly in January 2017 given the strengthening of the Rand.

Exports of raw sugar decreased between 2013 and 2015, with a drastic decrease in 2015. Between 2014 and 2015, sugar exports decreased by USD 320 million. Namibia, Mozambique and Botswana are key export markets for South African sugar, while Swaziland and Brazil are key sources for South Africa’s sugar imports.

This decrease in exports can be attributed to the drought and lower production given less investment in sugarcane growing by farmers. According to a sugar miller, coupled with the drought, low levels of production are as a result of mothballed capacity given low returns to cane growing. Farmers are not investing sufficiently in cane growing and are not employing methods to get the best yields. This was confirmed by another sugar miller, who highlighted that even millers were not re-investing in mills and that farmers were not utilising appropriate levels of fertilisers. Yet another sugar miller further noted that small scale growers lack the capital to invest in planting, management and equipment and they do not have the collateral to borrow funds, affecting their yields. Exports however picked up (by 34%) in 2016.

Figure 3: Sugar trade, SA (USD millions)

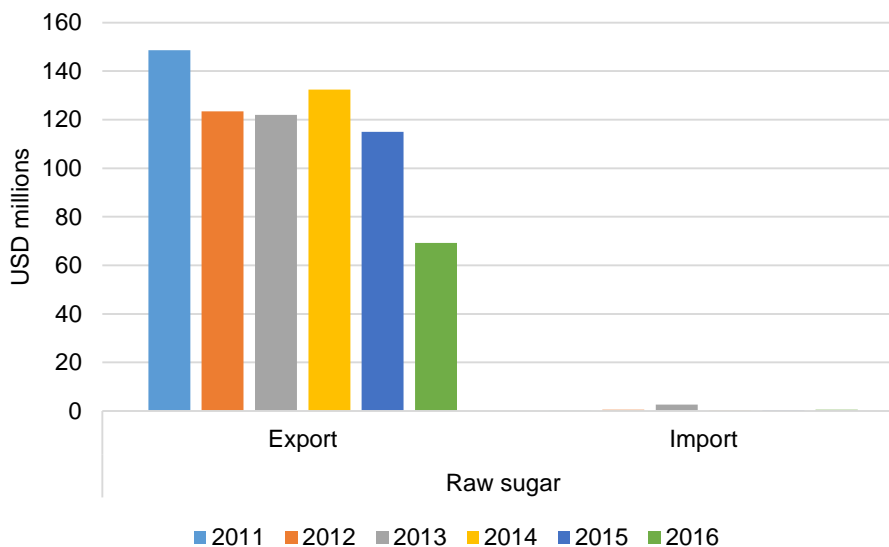


Source: Comtrade

The extent of Zambia’s net exports is a reflection of its position as a low-cost producer of sugar (Figure 4). The largest export destination was the DRC followed by Mauritius (although this sugar is actually destined for Europe, with the importing company domiciled in Mauritius), Kenya and South Africa. The value of exports to South Africa increased significantly between 2011 and 2014 (approximately USD5 million in 2011 to USD25 million in 2015). The DRC is a very significant market for Zambian exports of sugar and according to the Zambia Development Agency (ZDA), Zambia Sugar exported around USD100 million of sugar to the DRC in 2015/2016.

DRC is generally the biggest export destination of Zambia’s Non-Traditional Exports (NTE), amounting to USD574.76 million in 2015 (although down from USD802.57 million in 2014) (Zambia Development Agency, Export Audit Report, 2015).

Figure 4: Sugar trade, Zambia (USD millions)



Source: Comtrade

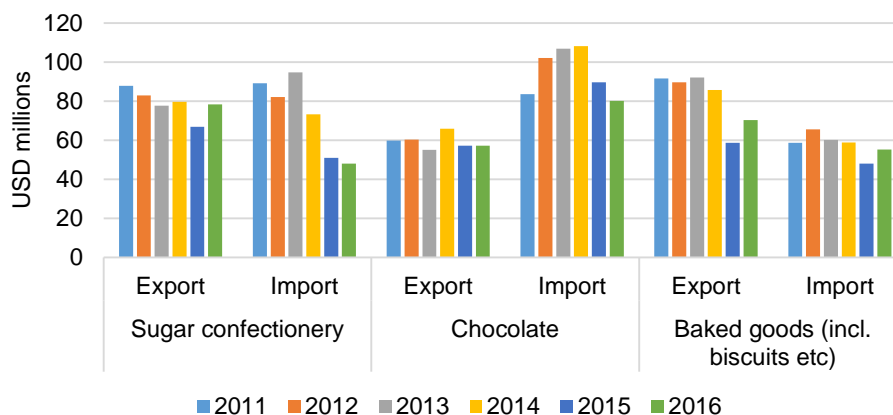
Note: Trade values for 2016 in USD millions for Zambia are mirror data. These are data for countries that have not reported their trade data to UN Comtrade database, which is then reconstructed on the basis of data reported by partner countries. Mirror data have a number of shortcomings: they do not cover trade with other non-reporting countries; they do not cover intra-African trade accurately, and the trans-shipment issue can hide the true origin of goods. Lastly, the number of reporting countries is different from one year to another

Zambia has had almost no imports of sugar over the 6-year period considered (Figure 4 above). This is because the production levels of the three mainly players can more than meet local demand. Furthermore, the vitamin A fortification legislation which requires that all domestic and imported sugar meet the fortification requirement acts as an entry barrier (a non-tariff barrier) for imports into the country (discussed in 4.3 below). Because this legislation does not exist in other countries, it prevents sugar produced in other countries being imported into Zambia. This legislation is seen by some industry participants as an NTB on imported sugar from other countries (Kalinda and Chisanga, 2014). The ostensible reason for its introduction was in response to a vitamin A deficiency crisis in Zambia.

Trade of sugar confectionery products

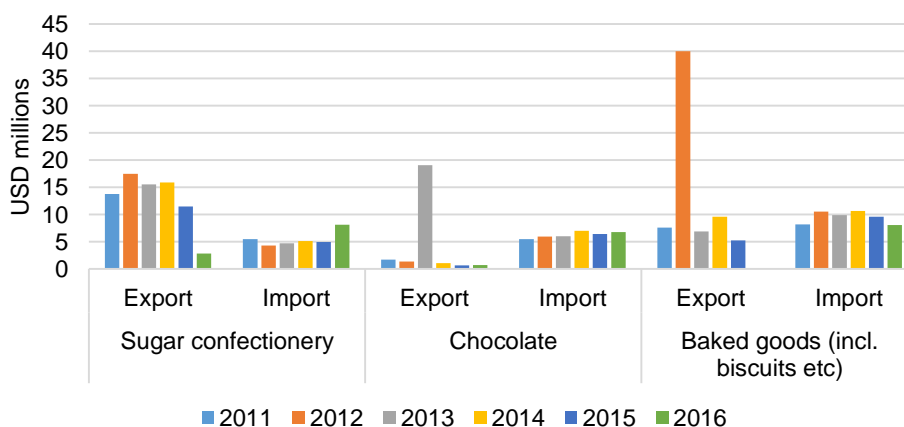
Trade data for sugar and baked confectionery products indicate that South Africa has almost balanced trade in sugar confectionery and a trade surplus in baked goods. When looking at the trade of baked goods (Figure 5) (particularly sweet biscuits), the top 8 export destinations are all in southern Africa, with Namibia and Botswana making up just under 40% of all exports. On the other hand, Zambia's confectionery trade (Figure 6) is at far lower levels than that of South Africa, although they are net exports of sugar confectionery products.

Figure 5: Confectionery trade, SA (USD millions)



Source: Comtrade

Figure 6: Confectionery trade, Zambia (USD millions)

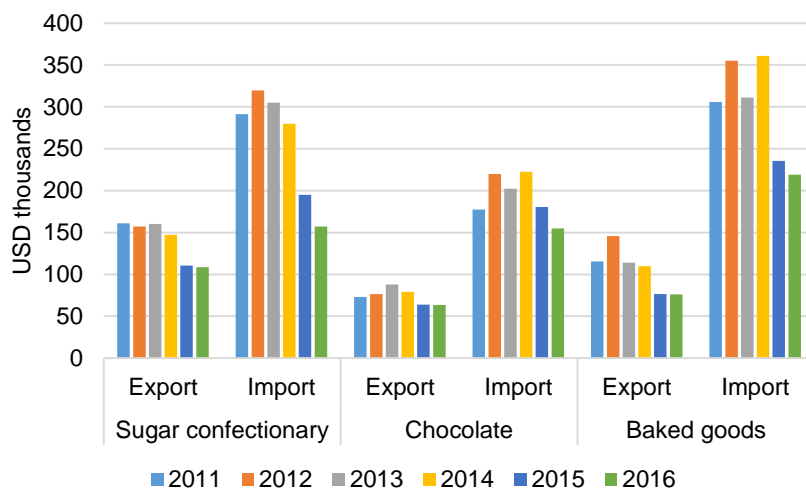


Source: Comtrade

Note: Trade values for 2016 in USD millions for Zambia are mirror data.

In 2015, over 98% of Zambia's exports of sugar confectionery products were to Zimbabwe, DRC and Malawi, with Zimbabwe alone accounting for over 50% of these exports. This indicates strong demand for Zambian sugar confectionery products in the region. The SADC region as a whole however is still a net importer of confectionery goods. In 2016, the trade deficit was USD48 million (see Figure 7). Although this is a decrease from USD162 million in 2012, there is a potential opportunity for the region to replace deep sea imports, particularly those from China and Brazil (highlighted in Table 2) which have been key import markets for SADC, even relative to countries like Zambia.

Figure 7: SADC confectionery trade (USD thousands)



Source: Trademap

Note: SADC trade value for 2016 in USD thousands includes mirror data for The Congo, Namibia, Angola, Tanzania, Swaziland, Zambia, Malawi, Seychelles and Lesotho.

Table 2: SADC, top non-SADC import sources for sugar confectionery

Country	Average (USD) value (2011-2015)
South Africa	79,323,000
Swaziland	29,215,000
China	24,195,000
Brazil	18,029,000
Kenya	17,848,000
Botswana	13,322,000
Zambia	13,141,000

Source: Trademap

A few key issues emerge from this analysis of regional trade patterns in these industries. First, regional markets are very important for the sugar to confectionery value chains which potentially provide a stepping stone towards further industrialisation and investments into these sectors to further replace deep-sea imports.

Second, while South Africa is a net exporter of baked goods and Zambia is a net exporter of sugar confectionery products, it is important to note that a large proportion of South Africa’s exports are to neighbouring SACU countries which impose limited import barriers on South African products. In contrast, Zambia does not benefit from the SACU trade arrangement enjoyed by South Africa.⁶ As a result, the observed exports of sweets and sugar from Zambia into South Africa are indicative of Zambian firms’ significant progress in terms of increasing competitiveness. This can be nurtured to incrementally replace demand from deep-sea imports in the SADC region.

⁶ Although Zambia does benefit from SADC concessions in the case of Zimbabwe and Malawi

4.3 Trade agreements and protection in the sugar sector in southern Africa

The above import trends raise questions about why regional sugar producers such as those in Zambia and South Africa do not meet the regional demand. Not only is there limited trade in sugar confectionery products in the region, there is also limited trade in actual sugar in the region as the trade data above shows. This is despite there being regional agreements in place which are meant to encourage regional trade as discussed below. However, it is precisely these agreements that appear to have a limiting effect on intra-regional trade, and that appear serve to protect incumbent millers within national markets.

The global sugar market is highly distorted with world prices for sugar often being referred to as ‘a dumped’ or highly subsidised price. Sugar is one of the most heavily subsidised products and the average price of sugar on the world market is consistently below the average cost of production of this sugar (Wood, 2013). This has resulted in imposing tariff and non-tariff barriers against the free importation of sugar to protect domestic industries in many sugar producing countries including South Africa.

Policy and Regulatory Framework in South Africa

The protection for the sugar industry in South Africa by the government comes in the form of:

- (i) tariff protection against low world sugar prices;
- (ii) the Sugar Cooperation Agreement between the members of the Southern African Development Community;⁷
- (iii) provision for the establishment of equitable export obligations for millers and growers; and
- (iv) other bilateral agreements
- (v) the Sugar Act and the Sugar Industry Agreement of 2000 (discussed in Section 6).

According to the Sugar Association of South Africa (SASA), the South African Government's support in these areas is endorsed in the Department of Trade and Industry and the South African Sugar Industry's Joint Strategy for the Optimal Development of the Sugar Industry within a South African Customs Union and SADC Context.⁸

(i) Tariff protection

Tariff protection on sugar imports into SACU member states kicks in when the long-term average world price of sugar (adjusted for distortions in global markets like subsidies and cheap loans) drops below a given dollar-based reference price.⁹ Global increases in the sugar price since 2009 meant that this tariff did not kick in until around 2014 when the reference price was raised by the South African International Trade Administration Commission (ITAC) by 58%. This meant that importers had to start paying tariffs for the first time in over 4 years in 2014.¹⁰ In January 2017, the reference price was USD 566/t.

⁷ Annex VII of the SADC Protocol on Trade, titled ‘Concerning Trade in Sugar’

⁸ http://www.sasa.org.za/sugar_industry/MarketCompetitiveness.aspx

⁹ http://www.sasa.org.za/sugar_industry/MarketCompetitiveness.aspx; Wood, 2013;

¹⁰ <https://www.bloomberg.com/news/articles/2014-04-08/south-africa-sugar-fee-raise-means-first-import-duty-in-4-years7>

The increase in the reference price was a result of heavy lobbying since 2008 of ITAC by SASA and the Swaziland Sugar Association (SSA). SASA argued that the local sugar industry was under threat from cheap imports. However, independent importers under the Association of Southern African Sugar Importers (ASASI)¹¹ claimed that the imposition of the duty harmed the whole sector and only benefited the large SASA members upstream. It argued that the tariff just served to protect and benefit the millers who continued to report robust profits.¹²

(ii) The SADC Sugar Co-operation Agreement

Key relevant objectives of the SADC Sugar Co-operation Agreement include, amongst others, promoting within the region the production and consumption of sugar and sugar-containing products according to fair trading conditions and facilitating the development of small and medium sugar enterprises. This agreement attempts to facilitate a more integrated regional market for sugar and a higher level of co-operation between member states, with the stated aim of improving the competitiveness of the region's sugar producers.

The agreement also allows for partial access of the SACU market for SADC surplus sugar producers. This partial access is in the form of import quotas governed by a formula that allocates access based on the size of each country's surplus sugar production, and the level of market growth in SACU. The rationale is to offer non-SACU surplus producers (Malawi, Mauritius, Mozambique, Tanzania, Zambia and Zimbabwe) the chance to export some level of duty-free sugar to the region at higher prices than what they can get in global markets. In effect, the agreement limits the volume of sugar that SADC countries can send to South Africa duty free. Exports over this volume would attract duties.

Despite the SADC Sugar Co-operation Agreement, and other agreements, it appears that sugar-containing products or downstream confectionery producers may not be benefiting from their stated objectives, although the promotion of such industries also appears to be an explicit objective of the agreement. This is seen in the limited intra-regional trade in confectionery products.

(iii) Local and Export Quotas and Equitable Export Obligations

To distribute exposure to the world market equitably amongst growers and millers, a redistribution of proceeds is effected via SASA. The Sugar Act (1978) and the Sugar Industry Agreement (2000) (see Section 6.1) provide regulatory support for this redistribution of proceeds.

SASA allocates to each mill a quota for both the local and export markets. This quota is allocated for refined white sugar and brown sugar, and is done so in proportion with each mill's total saleable production of sugar. If mills sell more than their allocated quota on the local market (an 'over-performing' mill), then they are obliged to pay an amount for redistribution purposes determined according to rules laid down by SASA (see also Chisanga et al., 2016).

Export quotas are managed by Sasexcor - SA Sugar Export Corporation (Proprietary) Limited. It appears that the millers cannot export independently of Sasexcor. Sasexcor is obliged to buy the full export quota from millers at prices determined by SASA. Export quotas are broadly determined on the basis of the previous year's production figures and estimated future production. These appear to be determined and administered by the SADC Secretariat with industry participation through SASA.

¹¹ It is unclear if this association is still in existence.

¹² <https://www.bloomberg.com/news/articles/2014-04-08/south-africa-sugar-fee-raise-means-first-import-duty-in-4-years> and <http://www.fastmoving.co.za/activities/sugar-tariff-proposal-raises-costs-for-sa-food-industry-4012>

(iv) Other Bilateral Agreements

There is, amongst others, an existing bilateral agreement on the importation of sugar between South Africa and Mauritius which prohibits sugar imports from Mauritius.

Policy and Regulatory Framework in Zambia

In Zambia, there are stringent and bureaucratic import procedures and import permit requirements for raw sugar. There are also import duties for imports outside COMESA and SADC. Exports of sugar are largely to countries outside the region, bolstered by preferential access to EU markets¹³ (although this was phased out in 2015). A study by the African Competition Forum (ACF) raises the question as to why Zambia would export to the EU at lower net returns (given considerable transport costs) than export to the region to cater for its demand (Chisanga et al., 2016). This is partly explained by the import restrictions under the Sugar Co-operation Agreement. The lead sugar millers essentially control sugar trade flows in the region and heavily lobby governments on aspects of protection as discussed above. The regulations and strategies pertaining to the sugar sector in Zambia include:

(i) Vitamin A Fortification legislation – The Zambian government through the Ministry of Health and with the help of the U.S Agency for International Development enacted this piece of legislation which mandates that all sugar in Zambia meant for direct consumption has to be fortified with vitamin A supplements. This legislation was motivated by the need to enhance Vitamin A availability to Zambians. However, since this legislation is not universal, it makes Zambian sugar expensive compared to sugar coming from the region despite the low production costs. The legislation also acts as a structural barrier to entry and in effect allows Zambia Sugar to maintain its quasi-monopoly status by reducing competition from cheap imports (Serlemistos and Fuso, 2010). Potential importers are further required to obtain import permits from government. However, the process is not transparent and this often leads into delays since the process has to be cleared by at least three ministries (Chisanga et al., 2016). The effect of these non-tariff barriers is evident in the negligible sugar imports as shown above.

(ii) Zambia National Sugar Strategy (ZNSS) - Recognising the importance of the sugar industry, the Government formulated the Zambia National Sugar Strategy (ZNSS) in which the main objective is to adapt the sugar sector in response to European Union's Sugar trade regime which came into effect in June 2006. The EU together with the World Trade Organisation (WTO) implemented reforms aimed at removing artificialities in the EU sugar market that reduced sugar production and that also slashed prices by 36% over a four-year period beginning 2006/07. Owing to the sugar reforms, Zambia Sugar as of 2016 saw exports to EU reduce from 22% to 14% as it continued to focus on African regional markets, both traditional and new markets. The reforms have impacted on the sugar regimes and resulted in prices in the EU converging into global prices.

The strategy is also seen as a tool to further accelerate the expansion of the sugar production through out-grower schemes and to provide a clear objective for the industry, with implementation targets and mechanisms that are jointly agreed by government and its regulatory framework on one hand, and the various private sector interests on the other hand. The strategy is also expected to

¹³ Often through Mauritius. Concerns have been raised in Nicolaou-Manias & Yuchen Wu (2016) around financial outflows, including loans, from Zambia Sugar to sister companies in Ireland and Mauritius.

shift volumes of sugar away from the EU to regional markets since regional markets provide valuable alternatives. The ZNSS sees the sugar industry playing a crucial part in the Zambian economy with far reaching benefits through its multiplier effects and the value addition to assist agricultural and industrial diversification.

(iii) Zambia National Export Strategy - The Zambia National Export Strategy outlines Zambia's strategic vision on how it intends to structurally transform and diversify its export base (generally) and enhance the export sector's competitiveness at both regional and multilateral level with a view to contribute to sustainable and inclusive social-economic development. The strategy identifies sugar and confectionery products as key export commodities which could help the country attain export market diversification and increased value addition and enhanced contribution of non-traditional exports to export earnings. The document identifies the DRC, South Africa, Namibia, Switzerland and Zimbabwe as the main export markets. The aim of the Zambian government in the sugar sector is to increase investment and promote local producers with the view to increasing Zambian participation in the industry. The government also intends to increase product diversification at a regional level.

It is not clear how these strategies speak to the SADC Sugar Co-operation Agreement, if at all.

5. Assessment of the growth and performance of the sugar confectionery industries in Zambia and South Africa

In the in-depth study, we assessed the growth and performance of both sugar millers and confectionery producers in each country. The details of the growth and performance of the sugar millers are not discussed further in this paper given that the focus for present purposes is on downstream confectionery producers.

It is however important to note that sugar millers in both countries have been growing and have made significant investments in refining and storage capacity. Zambia Sugar, as recently as 2016, invested USD90 million in a refinery plant while Tongaat Hulett invested in sugar processing plants in Mozambique and made an additional investment of R120m in downstream capacity in 2015. Illovo South Africa also made a significant investment in a self-sufficient warehouse in 2015/16.¹⁴ Small millers however have been more vulnerable to external factors (such as drought conditions and imports) and have been less able to invest.

The growth and performance of downstream confectionery producers in both countries is evaluated below from the primary data collected through interviews and from secondary data from public sources.

5.1 South Africa

As previously noted, the South African confectionery production industry is mostly made up of large local and international multinational firms. Recently, the industry has also seen significant new investments from three international players - Mondelez International, Trade Kings and Aldor. Notable among these is Trade Kings, a Zambian firm which entered the South African market in 2010

¹⁴ Information from interviews and annual reports

as an importer of sweets from Zambia. The company subsequently set up a production plant in South Africa. While its market share is marginal in comparison to the other players, it has managed to quadruple its share from 0.3% to 1.1% since entry in 2010 (Euromonitor International, 2016).¹⁵ This is a clear indication of its capabilities. Aldor from Columbia has also invested heavily by setting up a production plant in South Africa.

The South African biscuits sector is also dominated by one single player. AVI's National Brands has in the last 5 years controlled over 45% market share (Euromonitor International, 2016). The company's baker biscuit brand has the highest market share of about 22%. The second largest player is the Pioneer Foods group which has seen significant declines in its market share since 2015. This is as a result of Pioneer selling off its biscuit brand. Foodcorp follows with a market share of around 6% between 2011 and 2014.

For one producer, which previously exported sweets products from Zambia to South Africa, the decision to switch to production of sweets in South Africa was due to the lack of profitability of importing sweets from Zambia, which was exacerbated by the high cost of sugar in Zambia. High transport costs between South Africa and Zambia further impeded importation efforts. For another producer in South Africa, the continued success of importation of lollipops from South America to South Africa between 2003 and 2010 prompted them to set up their own production plant which began production in 2011. Another producer entered the sweets market through the acquisition of existing brands and product portfolios but with its own manufacturing capability. Yet another medium-sized producer of sweets started manufacturing their lollipop brand in South Africa in 2007.

The positive story is that medium-sized sweet confectionery producers are investing in South Africa. South Africa is seen as a gateway to the region and this has subsequently encouraged investment in the country. Investments have been made in plant and machinery, new flavours, packaging, accreditations such as HACCP and FSSC 22000 to signal quality and gain acceptance by supermarkets, and training, amongst others. Likewise, most if not all of these producers have also invested in barcodes which is an additional demand by retailers.

However, confectionery producers in South Africa face a range of barriers to expansion. The industry has seen considerable competition in cheap, hard candy which is the main product for most of the producers in the industry. Cheap imports from South America and Spain make it very difficult for local suppliers to compete favourably due to high production costs. Gums and jellies from India and Turkey are also imported into South Africa at increasing rates. It was also alleged that imported sweets from Colombia, Brazil and Thailand did not have to comply with local packaging regulations.

Other constraints include high transport and distribution costs. Related to this is the difficulty in running double shifts given the lack of public transport in South Africa. The costs of advertising to build brand awareness (e.g. one producer spends R1mill/month on TV adverts, and below the line advertising costs a further R0.5mill a month); and high labour costs/inflexible labour in South Africa are also significant. Producers also highlighted that dti funding was hard to access. A sugar re-seller, for instance, hired a consultant and incurred significant fees to apply for the dti's Manufacturing Competitiveness Enhancement Programme (MCEP) which was then put on hold indefinitely. One company invested in a new plant with the understanding that the dti would assist with funding only

¹⁵ We note that these are not shares for defined antitrust markets as they include producers of private labels, who in our understanding, also include some of the main players listed in the table. Nonetheless, the information provides useful insights on developments in the sector.

for funding to be pulled partway through the project. One confectionery producer was however successful in getting a loan from the IDC in September 2013. High labour costs/inflexible labour in South Africa (compared even to Zambia) were also raised as concerns.

Other constraints raised include crime in areas of production such as Crown Mines/Booyens area in Johannesburg; and a serious shortage of technical skills (especially maintenance fitters, instrumentation electricians and production managers. It takes 4-5 years to train artisans). Further problems experienced with exports into the region included smuggling and under-invoicing.

5.2 Zambia

The sweets and confectionery industry in Zambia has for a long time been dominated by imports from the sub-region and the deep sea. With the slowing of the manufacturing industry in the 80s and 90s, most firms which were producing sweets and confectionery products either relocated to other countries in the region or closed down due to high production costs which ensued after the collapse of the Zambian economy in the 80s. As a result, the gap created by these manufacturing firms was filled up by imports mainly coming through regional supermarkets which had started expanding into Zambia. In addition, a good number of sweets and confectionery products found themselves on the market through direct imports by small Zambian firms that wanted to take advantage of the void. However, the last two decades have again seen the rise of local firms expanding in this sector predominantly led by Trade Kings, Chicco Biscuits, Musa Biscuits, Speciality foods, Monginis Bakery and a few other small and medium-sized firms. As noted, these firms are exhibiting strong capabilities and exporting products into the region and most of their products are 'retail ready' in terms of meeting supermarket standards.

Trade Kings Zambia dominates the production of sweets and confectionery in Zambia with a wide product range of sweets, lollipops, gums and biscuits. Trade Kings diversified into the production of a variety of sweet products in 1998 with an initial production of 30 tons per month and has since grown to producing over 400 tons per month. The company has expanded its sweets and candies production in the region with new production plants in Zambia and South Africa, and more recently looking into Zimbabwe. During the same time, Trade Kings has grown its market share considerably in the region and penetrated new markets in sub-Saharan Africa such as Angola, Mozambique, the Congo DRC and the Great Lakes region. In 2005 and 2006, Trade Kings started producing gums and lollipops respectively. By 2013 the production had grown significantly due to increased demand from new markets mainly attributed to its growth strategy centred on new markets. The company is also looking into opening a new sweets production plant in Harare as a result of high sugar prices in Zambia so that it can access cheaper sugar in Zimbabwe where it is able to import sugar from Brazil at a third of the cost of sugar in Zambia.

In addition to the production of sweets and lollipops, Trade Kings also runs Swiss Bake Limited, a company which specialises in the manufacture and production of a wide range of biscuits under brand names. Swiss Bake was established in 2011 and has since grown by adding a variety of product range and can now export its biscuits into more regional markets such as South Africa, Malawi, Congo DRC and Zimbabwe. The company has plans to grow through backward integration which includes setting up a wheat mill which will be producing biscuit flour to cut input costs. It is also looking to expand its market share in the region (central, east and southern Africa) and to enter North and West African markets. Currently the company has established the export base for the

Great Lakes region in Bujumbura where all its products are shipped from its production plants in Zambia, Zimbabwe and South Africa. In addition to these markets, Trade Kings' products have access to Australia, New Zealand, Dubai and Switzerland. Trade King's growth has been driven by the company's competitiveness which has allowed it to access exports market and its ability to penetrate supermarket chain stores which stock majority of its products. Its growing workforce of over 6,000 employees also speaks to how the company has evolved over the years.

Nonetheless, the company continues to face the challenge of production hiccups caused by the constant electricity supply power cuts which affect all players in the sugar to confectionery value chain. This constraint is one of the major production costs which contributes to the high sweets and confectionery costs in Zambia. It is for this reason that Trade Kings is investing in a power plantation so that it can generate its own electricity. The company has an in-house packaging plant where all the design, labelling and branding is done and has heavily invested in regional and global quality standards such as HACCP (Food Safety) and ISO (quality). These standards have enabled the company to compete not only at a regional level but on the global scale too.

Chicco Quality Foods (the main brand of Zayaan Investments) is the second largest player in terms of revenue and employee numbers. With a workforce of just over 200 employees, the company roughly has similar workforce strength as Musa Biscuits and Monginis. The company has two production plants located in Lusaka and from these plants it can meet the volumes demanded by supermarket chains such as Shoprite. The company's main route to market is through supermarket chain stores, wholesalers and traditional retailers. Chicco Foods gets all its sugar from Zambia Sugar and the lack of competition and quality concerns of sugar from other small sugar mills limits the alternative sources available for confectionery producers. Sugar alone accounts for a high proportion of the total production costs resulting in expensive sweets and confectionery products in Zambia. Currently, the company exports its products to Malawi and the DRC. The manufacturer has also invested heavily in modern machinery to compete and expand its market base.

Musa Biscuits supplies its products to supermarkets like SPAR, Melissa, Choppies and a few emerging mid-tier supermarkets such as Sana, Cheers in addition to wholesalers and other traditional retailers. Like the companies discussed above, its key export markets are in the region and include Malawi, DRC and Botswana. For Musa biscuits, the cost of doing business in Zambia is generally high and this is a major challenge for the company.

The fourth player, Monginis Bakers, manufactures a small range of sweet, chocolate and biscuit products and only supplies one of the major supermarket chains in addition to wholesale and traditional retailers. Although it is 'retail ready', it has experienced difficulties in accessing supermarket shelves discussed in Section 7. Monginis exports a small proportion of its products to the DRC, and like many firms, has electricity power challenges in addition to accessing supermarket chains for their products. Monginis has also recently launched new chocolate products and is looking into introducing other new products (wafers). The company lists the high fees for Zambian Bureau of Standards (ZABS) standards as an added cost which contributes to high cost of doing business in Zambia.

Confectionery producer Speciality Foods, on the other hand, produces products that are tested on site at every stage of production, at the University of Zambia (UNZA) and the ZABS. It has a production capacity of about 500,000 cases of various products, having produced 300,000 cases in 2011 (Sutton and Langmead, 2013). It has limited exports to the DRC and manufactures to order for

retailers such as Shoprite, Pick n Pay and SPAR and also supplies over 100 wholesalers across Zambia (Sutton and Langmead, 2013). It produces only to order to minimize inventory costs (Sutton and Langmead, 2013). Electricity shortages generally result in the company cutting its product range by a third. Furthermore, since the company is family owned, access to finance continues to be a challenge and it is now looking into partnering with investors as a way of attracting outside funding.

In addition to the constraints already mentioned, the price of input sugar and the lack of alternative suppliers is an important issue to tackle. We discuss this below. Other general concerns include lack of access to finance through commercial banks and government programmes. In Zambia, interest rates can be up to 30 to 40%, and there are limited alternative sources of finance.

6. Concerns around sugar pricing and relationships between confectionery producers and sugar millers

The pricing of white and brown sugar is a contentious issue in both South Africa and Zambia. In Zambia, the concerns around pricing stem from allegations of excessive pricing by the quasi-monopoly supplier of sugar – Zambia Sugar. This is discussed below. In South Africa, the concerns around pricing stem from the complex regulatory framework governed broadly by the Sugar Act in conjunction with the trade agreements discussed in Section 4.3. The sugar millers in both countries were not willing to provide pricing data for the sale of sugar to industrial customers.

6.1 Pricing in South Africa and relationship with suppliers

The Sugar Act of 1978 in South Africa provides for setting of the *sugarcane* price, and not directly for the setting of the sugar price. While the Sugar Act provides for the general structure and principles, and the general framework, it is the Sugar Industry Agreement of 2000 that provides details on pricing mechanisms.

The cane price is jointly determined through the Division of Proceeds (DoP) formula. The DoP is essentially a pool of proceeds made up of the weighted average of revenues from local sales of white, brown and exported sugar. These proceeds are pooled and shared between millers and growers in a predetermined (roughly 64:36) ratio split between growers and millers, with growers entitled to the 64%. The justification for the DoP method is to protect growers, who otherwise would be subjected to very low global sugar prices forcing down the price of their cane. The funds for growers/farmers from the DoP allocation go through the Sugar Farmers' Association. The operation of the DoP requires a considerable amount of current and future projected information to be exchanged through the South African Sugar Association (SASA).

The individual millers then set sugar prices to industrial customers based on average industry costs¹⁶ at their own discretion, allowing for rebates, discounts and different packaging formats for different customers (retail and big industrial customers). The local price is allegedly typically around 5-8% above prices of imports according to one interview source.

The final sugar price to industrial users is therefore not legislated and, in theory, is open to competition. However, given a regulated cane price and a well understood framework, the

¹⁶ Including the cane price, which is the most significant component.

regulatory mechanism appears to inadvertently enable the millers to collectively set the final selling price for sugar around a range. This is exacerbated by a provision in the Sugar Industry Agreement of 2000 which allows for a more direct mechanism for millers to coordinate around a focal point called the 'notional price'.¹⁷ The notional local market price¹⁸ refers to the notional price attributed to local market brown sugar, refined sugar and molasses, respectively, determined by SASA for the purpose of backwardly determining the DoP. A study by the African Competition Forum (ACF) describes this notional price as being set given input from producers and growers (Chisanga et al., 2016). While millers are not obligated to their own final prices at this value, prices tend to around fluctuate around this.

The supply of sugar (and glucose, another key input) is either directly from millers or from traders/distributors who buy from millers and on-sell to manufacturers. However, given the relatively small volumes sugar required by smaller producers, these producers procure their sugar requirements from sugar distributors such as Sugar on Tap, Royal Rice and Akila group.

Negotiations on contractual agreements with suppliers are generally skewed towards the sugar mills as they have more leverage, especially against the smaller producers. It is typically difficult to secure discounts. The payment terms are generally very strictly within 7 days, although some players have been able to negotiate payment terms up 15 days or even a month, depending on the supplier. Large sweets and confectionery producers with more negotiating power and large offtake commitments typically have fixed price annual contracts.

In terms of local sugar price increases to industrial customers, ordinarily, there is an annual sugar price increase around February/March, which in 2016 was approximately between 12 and 14%. However, given the global shortage of sugar and the drought, there was a further price increase in June/July in 2016 which brought the total price increase for the year to approximately 30%, placing considerable strain on producers.

6.2 Pricing in Zambia and relationship with suppliers

Although Zambia is a low-cost producer of sugar (in LMC International rankings, see Chisanga et al., 2016), domestic sugar prices are high (CUTS, 2014) and are above other African countries with higher costs as shown in the ACF study. Various reasons have been suggested including high internal marketing costs, the requirement to fortify sugar with Vitamin A creating barriers to cheaper imports and the exercise of market power by Zambia Sugar (Chisanga et. al, 2014a). While country-specific factors such as high transport costs may affect prices in Zambia, the prevailing high domestic prices of sugar given the country's relatively low production cost signals potential competition concerns (Ellis et al., 2010).

Despite some market entry in the past two decades by two small millers, Zambia Sugar continues to dominate the production of sugar. The entry of Kafue and Kalungwishi sugar have not affected the dominance of Zambia Sugar given their much smaller sizes and capacity and quality constraints. This dominance is exacerbated by protection from outside competition by NTBs (Vit. A fortification and import permits through a bureaucratic and non-transparent system).

¹⁷ Sugar Industry Agreement, Chapter 6: Determination and Distribution of Proceeds and cane prices

¹⁸ 'Local market' means the geographical area falling within the borders of the Republic of South Africa and the states of Swaziland, Namibia, Lesotho and Botswana.

Some retailers, like Shoprite in Zambia, are actively trying to support rivalry in sugar suppliers. Superior Milling, a re-packer of sugar, has a three-way contract with Kafue Sugar and Shoprite. Shoprite sells this sugar at a 15% discount to Zambia Sugar's price. This promotes Kafue Sugar and also creates rivalry to Zambia Sugar so that Shoprite is not held to the demands of the dominant Zambia Sugar. In addition, Shoprite ensures favourable trading terms for Superior Milling as part of a good and long-term working relationship which include not paying listing, and promotional fees, as well as not having long payment periods. This is an example of how retailers can 'sponsor' rivalry at the upstream supplier level by developing the smaller rivals to dominant suppliers.

The high cost of sugar in Zambia has allegedly led Trade Kings Zambia considering relocating some of their sweets production facilities to Zimbabwe where the cost of Brazilian imported sugar is said to be three times cheaper than the cost in Zambia. As a result, the company is able to produce its products in Zimbabwe at a lower cost and then ship the goods into Zambia for sale. The price of sugar in Zambia also contributed to the lack of profitability of Trade Kings' products in South Africa motivating setting up the plant in South Africa, in addition to wanting better access to regional markets. The high cost of sugar is a concern to other main confectionery producers in Zambia who highlighted the difficulty in negotiating with Zambia Sugar and the lack of profitability in selling to other countries in the region. Currently, sugar pricing is the subject of an investigation by the Competition and Consumer Protection Commission of Zambia (CCPC).

7. Role of retailers in the sugar to confectionery value chain

7.1 Routes to Market - South Africa

The distribution of sugar confectionery products in South Africa is largely through store-based retailing, with grocery retailers, mainly supermarkets followed by independent retailers being the main route to market for sugar confectionery products (Table 3 below). The distribution profile has not changed much between 2010 and 2015, with each channel maintaining similar shares during the period. It is important to note that independent small grocers, convenience stores and other grocery retailers are all, collectively, independent retailers. As such, when assessed collectively, they are a significant route to market.

Table 3: Distribution of sugar confectionery by type of retailer (% shares)

Outlets	2010	2011	2012	2013	2014	2015
Store-Based Retailing	98.60	98.60	98.70	98.60	98.60	98.50
(1) Grocery Retailers	83.70	83.70	83.30	83.20	83.10	82.60
<i>Supermarkets</i>	46.00	46.40	46.00	46.00	46.00	45.50
<i>Independent Small Grocers</i>	14.80	14.80	14.80	14.80	14.60	14.50
<i>Convenience Stores</i>	5.00	5.00	5.00	5.10	5.20	5.30
<i>Forecourt Retailers</i>	6.10	6.00	5.90	5.80	5.80	5.80
<i>Other grocery retailers</i>	11.8	11.5	11.6	11.5	11.5	11.5
(2) Non-Grocery Specialists	3.90	3.70	4.10	4.00	4.00	4.20
Mixed Retailers	11.00	11.20	11.30	11.50	11.50	11.80
Non-Store Retailing	1.40	1.40	1.40	1.40	1.40	1.50
Total	100.00	100.00	100.00	100.00	100.00	100.00

Source: Euromonitor International (2015b)

In South Africa, sweets produced by small and medium-sized producers (hard candy such as lollipops and hard boiled sweets) are mainly sold to wholesalers (around 90%) who on-sell to the informal market either via independent retailers, spaza shops, or hawkers. This is the dominant route to market for small to medium-sized sweets producers in South Africa, with only large producers accessing markets via formal supermarkets.

Producers are constantly making efforts to penetrate the retail market. However, the requirements to get into the retail channel have generally been too onerous for small to medium-sized producers. For example, these can include rebates (ranging between 12% to 20% on average off the price suppliers can get), stock and merchandising costs (around 4%), promotion fees (around 3%), returns given their perishable nature (around 10%) and listing or support fees (can be approximately R100,000 to R200,000 for a single stock keeping unit). Listing fees for lollipops can range from R250,000 to R300,000 for till positions for 6 months for inland supermarkets only. Other fees include advertising and promotional rebates. Long payment periods to small suppliers also negatively affect their cash flow.

It appears easier for suppliers to supply franchise stores such as SPAR stores because the franchisees have more leeway regarding the manner in which they run their businesses, including the choice of products on their shelves. Non-standardised private standards across supermarkets further make it difficult for suppliers to invest in equipment that can supply all supermarket chains. One producer estimated that the costs of accreditations can be up to R2million, with R100,000 per annum to maintain. As noted previously, some producers have nonetheless invested in HACCP (food safety) certification (and a further investment into ISO quality standards by one producer) knowing that this given them greater opportunity to enter the retail space and to export. It was noted though that HACCP is not a legal requirement but a voluntary standard although supermarkets sometimes insist on suppliers having this certification. Larger confectionery producers also agree that retail chains have onerous requirements. As with the sweets, store-based retailing is the main route to market for biscuits in South Africa.

Confined-label or house brands (where the retailer does not own the brand, unlike a private label) offer opportunities for local producers of sweets and biscuits. However, it appears from our fieldwork that supermarkets are not loyal when it comes to these agreements. For example, it was reported that supermarkets can unilaterally decide that they no longer want the product, or they can switch suppliers at short notice. As such supermarkets tend not to enter into long-term agreements where house brands are concerned. Moreover, getting a contract for house brands in one year does not guarantee that the producer will get the contract in the following year. Retailers allegedly tend to import confined labels and do not offer local producers this opportunity. There are opportunities to get regional manufacturers to produce these instead.

7.2 Routes to Market - Zambia

Retail channels in Zambia are also a growing route to market for most consumer products and thus provide confectionery suppliers an opportunity to participate in the supply chain. Aside from supermarkets and wholesale distribution networks, small to medium-sized local suppliers use alternative route to markets through independent groceries, convenience grocers and other retailers.

Among the challenges local suppliers face in integrating into the supermarket value chains is the level at which procurement decisions are made in Zambia. Store managers do not have the discretion in selecting local suppliers for corporate stores. This is almost exclusively the decision of top management at head office, often located in South Africa. In contrast, supermarkets operating as franchises have more flexibility regarding decisions on suppliers. Therefore, like in South Africa, it is easier to start supplying chains like SPAR which operate several franchise shops in Zambia.

Furthermore, in addition to legal requirements stipulated by the Zambian Bureau of Standards (ZABS) and other regulatory bodies, supermarkets impose additional private standards not mandated by law that domestic firms are expected to fulfil in order to be able to supply them. This calls upon the local firms to invest in modern machinery and new production techniques to access supermarket chains. In Zambia, other demands by supermarkets include: possession of barcodes for goods supplied for inventory and sales records purposes; allocation of a marketing budget for the promotion of the firm's goods; hiring of merchandisers to man the firm's shelf space in the store; arrangement of firm's own transport logistics when supplying goods; and for some supermarkets, ability to supply a certain minimum number of stores in the country. These demands impose costs on local firms and they require capital injections to invest in these requirements.

Interviews with Zambian confectionery firms revealed that the most common reasons for not supplying was the long credit period imposed by supermarkets for payments of their products supplied. Most firms in the sugar to confectionery value chain face an average of 30 – 45 days waiting time for their payments after supplying their goods. This poses a cashflow challenge as their working capital is held up by the supermarket chains. The conditions of selling to wholesalers is often much less onerous. The growing popularity of private labels, which are often imported, are also crowding out local suppliers.

8. Conclusions and policy recommendations

Despite having a clear advantage in sugar production, Zambia, South Africa and the SADC region as a whole are net importers of sugar confectionery products (sweets and biscuits). There are opportunities to develop confectionery producers in the region to reduce the trade deficit and recent investments in both Zambia and South Africa highlight these opportunities. However, the research has revealed several challenges faced by confectionery producers in each country, particularly small to medium-sized producers. We propose the following key policy interventions to increase the levels of production and exports in the sugar confectionery sector in both countries.¹⁹

(i) Pricing of input sugar

While there are multiple challenges faced by downstream confectionery producers in both countries, a key concern especially for smaller confectionery producers is the price of input industrial sugar. While enjoying an advantage in sugar production, the price of sugar remains relatively high in both countries which makes it difficult for local confectionery producers to compete with finished imports of confectionery products.

¹⁹ For recommendations pertaining to the sugar milling level of the value chain, see the in-depth study. These include recommendations around alternative uses for sugar cane, such as in the co-generation of electricity or ethanol production. Other recommendations around general concerns raised and that require country-specific responses can be found in the in-depth study.

The sugar milling level of the value chain in both South Africa and Zambia is highly concentrated, particularly in the production of industrial sugar. In Zambia, the sugar price is essentially set by monopoly player, Zambia Sugar. There is no regulation that governs the setting of the sugar price. However, regulation in place in terms of vitamin A fortification and onerous import permit requirements serve to maintain the dominant position of Zambia Sugar. The market power of Zambia Sugar is also apparent from the interviews conducted with downstream confectionery producers and their inability to negotiate prices and terms with Zambia Sugar. Of serious concern is the impact on downstream confectionery industry of uncompetitively priced input sugar. A clear example is the relocation of lead firms with capabilities to other countries outside Zambia to benefit from lower sugar prices as Trade Kings has done. This contributes to the deindustrialisation of countries like Zambia. Small millers in Zambia, such as Kasama and Kafue Sugar, also struggle to access finance in order to modernise and expand their operations in order to become effective rivals to Zambia Sugar and to undercut their prices. This issue is discussed jointly with the lack of affordable finance for confectionery producers below. Currently, sugar pricing is the subject of an investigation by the Competition and Consumer Protection Commission of Zambia (CCPC), and the outcomes of the investigation are awaited before any further recommendations are made.

Unlike in Zambia, there are three large millers and a few smaller ones in South Africa. In South Africa, the setting of the sugar price is more complex given the regulatory framework that sets the sugarcane price. The combined result of the regulations is that the sugar price downstream is in effect 'controlled'. The time-to-time setting of the 'notional local market price' for sugar for purposes of backwardly deriving the cane price through the Division of Proceeds mechanism creates a focal point for millers to coordinate prices around.

While the legislation offers protection to sugar millers and sugar cane growers, it appears that its impact on downstream industries in the region has never been evaluated. In addition, the overall impact of the numerous agreements and regulatory frameworks that govern sugar traded within the SADC region (including the resultant impact on price) on the development and growth of downstream confectionery producers has not been considered.

It is therefore recommended that a cost-benefit analysis be undertaken to evaluate the overall impact of the legislation and regulations in the region throughout the value chain, including the downstream industry. This needs to be done to see if they collectively speak to a common goal for the region. While it is accepted that sugar cane growers and millers in the region are vulnerable to low world sugar prices that result from the heavy subsidies given to producers in countries like Brazil and India, the combined impact of such protection on downstream industry needs to be assessed. Governments tend to be extensively lobbied to protect growers and millers, mainly on the grounds of their large contributions to employment especially in rural areas. However, this might be at the expense of downstream value-added industries and can have the outcome of keeping the region an exporter of basic commodity sugar and a net importer of value-added confectionery products. Despite such regional agreements, countries continue to pursue national interests to protect their own industries. Tariffs, bans and non-tariff barriers in Zimbabwe for instance have reduced Zambian exports of confectioneries to Zimbabwe. Therefore, agreements like the SADC Sugar Co-operation Agreement need to be revisited to check if it really benefits the whole region and the full value chain, and if it contributes to SADC industrialisation.

(ii) Access to markets/routes to market

Another area for possible intervention is with respect to access to markets for confectionery producers. As shown, store-based retailing is an important route to market for producers of sweets and biscuits. Particularly for small and medium-sized producers, the large supermarket chains are currently not a sustainable route to market and majority of their sales are to wholesalers who on-sell to independent retailers. The research revealed several reasons for this, but the overarching, unanimous sentiment is that the large supermarket chains are very difficult to deal with. Given their considerable buyer power over small and medium sized producers, it is hard to negotiate favourable terms for producers. Supplying supermarkets comes at additional costs, some of which are reflective of the strong buyer power of supermarkets. These additional costs squeeze supplier margins and make them uncompetitive against imports.

Competition law is often a blunt instrument to deal directly with issues of buyer power, and such issues are typically dealt with through market inquiries. The Retail Inquiry by the Competition Commission of South Africa will be looking into issues of buyer power in South Africa. We recommend that one of the potential outcomes of this process, and one that the dti could support as part of its contributions to this inquiry, is a regional code of conduct which can be implemented in SADC. Such a code would govern the relationship between suppliers and supermarkets. Given that it is essentially the same supermarkets that operate in the region, a common code could be developed and adopted for SADC. This could be a voluntary or mandatory code of conduct. If mandatory, further considerations of which body would oversee and enforce this code would need to be had. In this regard, lessons can be learned from international experiences and adapted to the African context. In the United Kingdom, the Groceries Supply Code of Practice has been established, which stipulates that retailers are required to comply with the Groceries Market Investigation Order of the former Office of Fair Trading (now the Competition and Markets Authority).²⁰ In Ireland, there are plans to institute a mandatory Code of Conduct in the grocery sector, to be overseen by the Department of Jobs, Enterprise and Innovation. 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.

There is also intense competition from large, well-known multinational confectionery brands like Cadbury and Nestlé and from imports. In this regard, supermarkets can ensure, also through a code of conduct, that category management practices and trading terms with these large producers are not at the expense of the growth and development of smaller regional brands.

In some cases, supermarkets have been known to actively support rivalry in suppliers. Shoprite Zambia supporting a rival to the dominant Zambia Sugar, Kafue Sugar, through Superior Milling as discussed is an interesting case in point. It is also to the supermarkets' benefit to have multiple suppliers of a product so that they are not solely reliant on a single/small number of supplier(s).

While a code of conduct could assist in reducing abuses in buyer power, it cannot ensure that suppliers with potential in the region can easily access supermarket shelves, especially that of South African supermarkets. A major concern is that South African supermarkets which operate in host

²⁰ This Code is enforced in the United Kingdom by an independent Groceries Code Adjudicator, set up specifically to oversee the relationship between supermarkets and their suppliers and housed within the Competition and Markets Authority.

countries in the region exclude local suppliers, instead opting to import products from South Africa. This stifles the growth and development of suppliers in the region. It has also created resentment towards South African retail FDI. Our research has shown that confectionery producers in Zambia show clear potential to sell to supermarkets in the region. Indeed, a few Zambian firms are already 'retail ready', and perhaps with some support in marketing, packaging and merchandising, these firms will be ready to supply regional supermarket chains. An agreement with South African supermarkets to 'open up' a jointly determined proportion of shelf space on sustainable terms to these producers in stores in the region would provide a much larger route to market for them. From a SADC perspective, this could reduce the trade deficit for confectionery products while stimulating industrial development in the region. This requires a mind-shift by supermarkets. While growing current sales is often a supermarket's primary objective, encouraging the growth of local suppliers, even if their products are not initially the fastest selling products in the category, has long-term benefits and positive spillovers even for the supermarket industry.

A growing opportunity for confectionery suppliers to participate in supermarket chains is through producing confined labels, house brands or private labels for supermarkets, which currently are largely imported in both countries. Small and medium-sized confectionery producers can get their foot in the supermarket door by producing house brands initially. However, concerns around buyer power being exerted on suppliers of house brands at the expense of their branded product have been raised in past studies (see das Nair and Chisoro, 2016 and 2017) and these would need to be carefully considered. Again, a code of conduct covering negotiations of trading terms tailored for house brands can potentially alleviate some of these concerns.

(iii) Developing capabilities and capacity

From the supermarkets' perspective, smaller producers and producers in countries outside South Africa have limited capability and capacity to sustainably supply all stores in a chain. Given the importance of maintaining availability and consistency across stores, as well as the reputation of the chain, this is a valid concern.

Policy intervention in this regard requires commitment from both government and supermarket chains to build capacity of suppliers. For instance, a bilateral agreement could be reached between the South African and Zambian government to create a centre of excellence in Zambia to assist small to medium confectionery producers to develop their packaging, branding, marketing and merchandising capabilities. Supermarkets, with the assistance and possible matching of funding from government, could also embark on targeted supplier development programmes to build these capabilities for small to medium-sized confectionery producers in both countries.

(iv) Harmonisation of standards in the region

A major stumbling block for non-South African producers in supplying supermarket chains with confectionery products in South Africa (and in other countries outside their home country) is the non-harmonisation of standards across the region. National standards such as South African Bureau of Standards (SABS) and the Zambia Bureau of Standards (ZABS) are not harmonised, and this means that South African supermarkets don't see Zambian products bearing a ZABS stamp as being of the same quality as products bearing a SABS stamp. There are problems faced by ZABS in terms of management, costs and delays in obtaining standards. These costs, and the perception that ZABS

and SABS are not on par with one another, result in difficulties in Zambian confectionery producers getting their products on supermarket shelves in South Africa.

We propose a harmonisation of standards across the region. In Zambia, ZABS sets the barest international minimum standards to accommodate the profile of domestic firms in Zambia that cannot afford to meet higher standards. Therefore, ZABS needs to enhance the mandatory standards to bring them to par with regional and international standards. This can be done in a phased manner for different categories of supermarket products over time, focusing first on products in which non-South African producers are exhibiting capabilities and in which there is growing intra-regional trade (such as in confectionery). This will increase the competitiveness of Zambian products and ease entry into supermarkets regionally.²¹

(v) Access to development finance

A key issue raised by the smaller sugar millers and small and medium-sized confectionery producers was access to finance for growth and development. In Zambia, the situation is particularly severe with commercial banks not being a viable source of finance for businesses. This is the case given the high interest rates of between 30 to 40% charged by these banks and the lack of backing/guarantees by insurance companies.

While the Zambian Development Agency (ZDA) has funding available for export promotion and enterprise development, the impact of the use of funds in the recent past has not been very positive. The Industrial Development Corporation of Zambia (IDCZ) can also potentially provide development finance to the sugar value chain in Zambia. However, it is still relatively new (incorporated in 2014) and is yet to build a strong portfolio of investments and expertise. There is potential for the IDCS of South Africa to collaborate with the IDCZ (and potentially the ZDA) to build capacity. This could mean collaborating in pooling resources and seeking of funds from potential investors for the sugar value chain.

²¹ The East African Community provides a good benchmark in this regard. It has harmonised standards across for six of the top 20 most traded products in the region, and is pushing for the harmonisation of the most traded products.

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