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Trade in Distribution Services in South Africa

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ABSTRACT

The study provides a general overview of current issues in the South African Distribution Sector. It is restricted to focussing on three industries namely, pharmaceutical distribution, distribution in the food industry and distribution in the automotive industry. In examining the behaviour of SA retail pharmacies it becomes apparent that retailers have attempted to obtain political support for regulations that bolster cartel structures and behaviour, and which discourages innovation in distribution. The outcome is perverse. Retailers do not achieve economies of scale, while consumers do not receive lower prices. In the SA food sector it was found that retail and wholesale industries are highly concentrated. The result is that retail and wholesale chains largely compete with one another on price and operate with low margins. Manufactures distribute direct to retail chains at the discretion of the chains. In examining the SA automotive industry it was found that the industry has developed from a highly protected, inward-focused industry to one with a marked export orientation. All South African light vehicle assemblers are either affiliates or licensees of foreign MNEs. The key factors that have assisted in integrating the industry into global networks have been the incentives provided under the motor industry development programme (MIDP), falling tariff protection that has increased import competition, and access to international markets through the parent company. The study also notes the increasing importance of E-commerce in the retail chain. The Internet mode of retail is used extensively in the South African distribution channel, however South Africa's lack of bandwidth development may be constraining South African retailers from effectively competing with foreign retailers.

1. INTRODUCTION

In South Africa, the service sectors as a whole have been largely ignored by both trade and industrial policy literature and by the practitioners in government. A possible reason may be that historically local service firms did not compete internationally; therefore, there was no substantial concern over the level of efficiency, product range, and rates of innovation of domestic service sectors. However, recent changes in the economic and technological environment have meant that much of the previous perceptions of the service industries are now changing. This is mainly because services are becoming increasingly tradable due to advances in information and communication technologies (ICTs) and due to efforts to lower regulatory barriers to trade in services by the World Trade Organisation (WTO) through the General Agreement on Trade in Services (GATS).

In order to give domestic industries some competitive edge, governments have turned their attention to improving local factor markets and intermediate inputs. Services are a significant intermediate input and so policy geared to improving the performance of service industries is beginning to receive considerable attention.

It is at this entry point that South Africa finds itself, following a history of import substitution industrialization policies there has been a turn around in policy to a more open model, namely trade liberalisation and the privatisation of numerous state assets.
In addition to these internal concerns, there is mounting pressure internationally for South Africa to make significant trade offers in services.

This study concentrates on the Distribution Sector, which forms part of the Intermediate Distributive Services category of services. The distribution sector represents the crucial link between producers and consumers. The performance of the sector therefore has a strong influence on consumer welfare. Increased efficiency and competition in the distribution sector can lead to lower price levels, principally since distribution margins are a significant fraction of the final product price. Failures in the distribution sector can lead to serious misallocation of resources and economic costs. The realisation that enhanced competition, both locally and internationally, can improve the performance of the distribution sector is leading to increased deregulation and liberalisation of the sector[1]. At the same time, the scope for international trade in distribution services has grown through the expansion of foreign direct investment (FDI) and the development of new technologies. However, there is no doubt that there remains considerable scope for further liberalisation and for its translation into multilateral commitments.

The study begins in Section I with a brief description of the distribution sector, its economic importance and its structural characteristics. Section II examines the existing liberalisation commitments under the GATS. Section III, looks at the case of study of pharmaceutical distribution. Section IV examines distribution in the food industry. Section V analyses the distribution channel in the automotive industry. Section VI is a brief review of the increasing use of the Internet in the retailing

[1] Pilat, D (1997), Regulation and Performance in the Distribution Sector, OECD Economics Department Working Paper No. 139, OECD, Paris.

channel and Section VII provides a brief overview of the South African Franchise Sector. Finally, Section VIII concludes and addresses possible further work required.

2. THE DISTRIBUTION SECTOR: DEFINITION, ECONOMIC IMPORTANCE AND INDUSTRY STRUCTURE

The distribution sector forms part of Intermediate Distributive Services category of services, which also includes communication services, and transport services. In South Africa this category represents sectors that have strong state intervention, with the exception of distribution services. In South Africa communication services are dominated by the state and have undergone enormous changes in the past few years in response to international and local pressure to open up the markets to competition. Similarly, transport services are a sector where state involvement has been vast. The means of involvement has been through the parastatal giant Transnet, which operates in all modes of transport. In contrast private companies dominate the distribution services sector and government intervention has been minimal.

In the Services Sectoral Classification List (MTN.GNS/W/120) developed during the Uruguay Round, and largely based on the United Nations Provisional Central Product Classification (CPC), the distribution of sector is defined to include four major services: commission agents' services, wholesale trade services, retailing services, and franchising[2].

Commission agents are distinguished from the other categories in that they trade on behalf of others, i.e. they sell products that are supplied and usually owned by others to retailers, wholesalers or other individuals. Wholesale trade services consist in selling merchandise to retailers, to industrial, commercial, institutional or other professional business users, or to other wholesalers. Retailers sell goods for personal or household consumption. Franchisers sell specific rights and privileges, for instance, the right to use a particular retail format or a trademark.

Services trade includes four different modes of supply. The four modes include:
Mode 1: Cross-border- electronic or physical transactions across borders such as air/maritime transport or financial trade.
Mode 2: Consumption abroad- movement of consumer to foreign country for reasons such as tourism or education
Mode 3: Commercial presence – direct investment for the purpose of delivering services such as local telecommunications or electricity.
Mode 4: Presence of natural persons- temporary movement of producer to provide services such as business consulting or construction.

Trade in distribution services takes place mainly through both commercial presence and cross-border supply. The two major components, wholesale trade and retailing, are supplied primarily through the commercial presence mode. Trade in franchising is

[2] An analysis of the recently developed CPC Rev.1 can be found in the document entitled "A Qualitative Assessment of the Relevance of the Changes Resulting from CPCRev.1 for Trade Negotiating Purposes"(S/CSC/W/9/ Add.3 of 9 October 1997).

usually undertaken on a cross-border basis, whereas commission agent services are supplied cross-border and through commercial presence (USITC, 1996, 1997)[3].

Commission agents are usually individuals or small businesses whose sales are difficult to capture in national data surveys. Therefore, trade data on commercial agent services are unavailable. Cross border trade data for most distribution services are also generally unavailable. An exception is the data for cross-border supply of franchising services for the United States, measured by the exchange of royalties and fees. In 1995, US exports of franchising services were $324 million with Europe, the largest market, accounting for 48% of US exports of these services[4]. The fastest growth in US franchising operations in recent years is being recorded in some of the South American markets, such as Argentina, but these markets still account for a relatively small share of total US franchising exports. There is evidence to suggest that franchising is particularly important in the retailing of automobiles and petrol.[5]

2.1 Economic importance

In terms of output in the South African formal economy, services comprised 65.1% of the economy in 1997, well ahead of the manufacturing share of 22.3% and 11.9% for the primary sectors (Hodge, 1998). Within services, the dominant group is comprised of producer services (business services, financial services, construction and utilities) with a share of 23.8% of total output, and distributive services (communication services, distribution services, and transport services) with a share of 21.9% of total output (Hodge, 1998).

The existence of linkages in the economy means that an autonomous increase in output in one sector will stimulate increases in other sectors resulting in significant greater overall increase for the economy. The current output multiplier effect for services (1.87) in South Africa is just marginally more than mining (1.8), but significantly below that of agriculture (2.11) and manufacturing (2.39) (Hodge, 2000). This may be either due to a low true multiplier or just a failure to make links locally. Hodge (1998), reports that general results for services reveal a pattern similar to the output multiplier. Employment creation from a R1million increase in service output is about 50% higher than mining, 25% lower than manufacturing and about 40% of the number achieved by agriculture.

The distribution sector has grown in absolute size in most countries over the years 1979-1994, with the fastest growth recorded in Japan and the Republic of Korea. Employment in the sector has also grown over the period, most notably in Japan, Denmark and Sweden[6]. Only a few countries have data that allow decomposition of

[3] Distribution Services; Background Note by the Secretariat., S/C/W/37 10 June 1998 WTO, Paris

[4] Ibid p.8

[5] Betancourt (1993) reports that in 1970, US companies operated 156 franchised foreign outlets while there were 3,400 foreign outlets in the US; by 1988, US companies were operating 354 franchise outlets outside the US while foreign companies where operating 35,000 franchise outlets in the US. More than half of these franchises were for automobile and truck dealers, around 15 per cent for petrol and service stations, 10 per cent for restaurants, and 4 per cent for non-food retailing.

[6] Distribution Services; Background Note by the Secretariat., S/C/W/37 10 June 1998 WTO, Paris

output and employment growth in wholesale and retail trade, and no clear pattern emerges.[7]

In South Africa the contribution of wholesale and retail trade and catering and accommodation sectors together accounted for 13 % of total gross value added in 1999[8]. This contribution has remained roughly constant since the early 1990's. Total employment in the retail sector for 1997 came to 413 600 (full-time and part-time employees). Before March 1998, employment data from Statistics South Africa did not distinguish between full-time and part-time employment. Employment data since March 1998 show a definite relative increase in part-time employment as compared with full-time employment. Employment in these sectors (wholesale, retail, catering and accommodation) increased by 3.4% over the period March 1997 to March 1999[9].The latest available data indicates that these sectors account for 18 % of total employment[10].

According to the Franchise Association of South Africa (FASA), 270 000 people are currently employed in franchising. Taking into account the linkages with other sectors, direct and indirect employment accounts for over 600 000 jobs[11]. The franchising sector is growing at a rate of 32.5 % per year (Gordon, 2001). On average 13 people are employed in a franchise in South Africa (Sowetan, 18/2/2000). The franchising sector's retail turnover (including petroleum) accounted for 13.39% of the country's private consumption in 1999 (Gordon, 2001). The franchising sectors contribution of retail turnover including petroleum retail to gross domestic product increased from 6.12% in 1995 to 8.47 in 1999 (SA Reserve Bank Quarterly Bulletin December 2000).

2.2 Industry structure

As is the case with many countries, South Africa's service sectors tend to be monopolistic or oligopolistic in nature. This is either because the state has chosen to be the sole provider for natural monopoly reasons (e.g. telecommunications), or because significant economies of scale advantages exist which limits the number of entrants. Even in service sectors where there are numerous firms excessive regulation can often restrict competition to a greater or lesser extent[12]. It is these uncompetitive market conditions that are seen as the dominant reason of inefficiencies in the services sector. The standard solution is to inject competition, through privatisation, deregulation and trade liberalisation.

The structure of the distribution sector varies with the level of development of the country. Despite differences between countries in the levels of development, structural characteristics and policies, it is still possible to make some broad generalisations about the distribution sector. First, in most countries the bulk of retail

[7] Ibid
[8] SARB (March 2000),
[9] T Hartzenberg., *Investment in Consumer Services in South African Retail and Tourism.*, Development Policy Research Unit, School of Economics, University of Cape Town-Unpublished paper.
[10] Ibid
[11] Ibid
[12] This is evident in the South African Pharmaceutical Industry where legislative regulations have hampered innovation in the distribution channel of drugs. This is explained in section three.

enterprises consists of a single shop and are sole proprietorships. Secondly, a large part of the sector is engaged in food retailing both in terms of the number of enterprises and retail turnover. Other important sales categories are textiles, clothing and footwear, household equipment and motor trades. Finally, the sector is usually characterised by relatively low wages, and employs a large number of relatively low skilled workers[13].

Significant changes are taking place in the distribution sector, especially in the more developed countries. These changes are affecting the structure of individual sub-sectors. Firstly, the distribution sector is becoming more concentrated. This is manifested in terms of the emergence of a number of large operators, and in terms of closer links between manufacturers, wholesalers and retailers through the creation of networks. Secondly, there is a reduction in the role of the traditional wholesalers, with a large number of retailers and manufacturers in certain countries seeking to take control of distribution formerly carried out by traditional wholesalers, and subsequently outsource the physical component of these activities to suppliers of logistic services.

In South Africa the distribution services sector, which include retail and wholesale industries, are characterised by many producers operating in a competitive manner. This is because the low capital and skill requirements, as well as the large, spatially distributed market, make this a SME friendly sector.

Similar to international experience, a few changes have taken place in the South African distribution sector. Firstly, large dominant firms have emerged in many of the retail and wholesale sub-sectors. Nonetheless, of the sub-sectors dominated by a few firms, further deregulation seems unlikely to change the market structure significantly as they all operate in markets where either there are significant economies of scale or where the size of the local market restricts the profitability of more entrants.

Secondly, there is a reduction in the role of the traditional wholesalers, with a large number of retailers and manufacturers in certain sub-sectors seeking to take control of distribution and squeezing out the traditional wholesalers.[14] Thus the pressure on traditional wholesalers may be a consequence of the manufacturers' wish to control distribution themselves or the large retailers' practice of upstream extension or both.

3. LIBERALISATION COMMITMENTS UNDER THE GATS

Services have only recently been added to the agenda of multilateral trade talks and the first agreement – the General Agreement on Trade in Services (GATS)- that was concluded in the Uruguay Round.

Trade liberalisation involves providing greater market access to foreign firms through lowering the barriers to trade. This is a fairly intricate concept for services where the

[13] Distribution Services; Background Note by the Secretariat., S/C/W/37 10 June 1998 WTO, Paris.
[14] This is evident in the South African Pharmaceutical Industry with the emergence of drug distribution companies such as International Health Distribution (IHD). This is explained in section three- the pharmaceutical industry case study.

nature of trade and the type of barriers encountered are not easily quantified. Among the four distribution services, wholesalers and retailers rely most heavily on the freedom to establish a commercial presence. Hence, barriers, which limit the ability of firms to establish a commercial presence and to employ nationals from their home country, affect these distribution services more significantly than franchising and commission agent services[15].

Given the high labour intensity of distribution (especially in retailing), the sector is affected by limitations on the movement of natural persons. Nationality requirements for staff prevent firms from minimizing labour costs through international recruitment. Immigration policy, visa restrictions, and levies and charges for social security also impact on the sector[16].

Determining the main regulations that restrict market access or discriminate in the provision of a service by a foreign provider in the South African distribution sector is a huge task and beyond the scope of this study. However, one can measure the current openness of trade based on South Africa's existing GATS schedule in table 1, and the commitments of 36 WTO Member countries listed in table 2 below. Most WTO Members have undertaken commitments on both wholesale (34) and retail (33) services, and a smaller number on commission agent's services (21) and franchising (23).

Table 1: Summary of South African Distribution Sector Commitments to GATS

Sector	Sub-sector Coverage	Cross-border Supply	Consumption Abroad	Commercial Presence	Presence of Natural Persons
Horizontal measures				Limitation on local borrowing by South African registered Companies with a non-resident shareholding of 25 percent or more	Temporary presence without requiring an economic means test for services salespersons, intra-corporate transferees and persons engaged in establishment
Distribution services	No coverage of commission agent's services	No restrictions on market access or national treatment in all services covered	No restrictions on market access or national treatment in all services covered	No restrictions on market access or national treatment in all services covered	Unbound except for horizontal commitments for all services covered

South Africa has made two horizontal commitments. The first pertains to limitations on market access for the presence of natural persons mode of supply. It binds a commitment to allow the temporary presence for up to 3 years without an economic means test for service salespersons, intra-corporate transferees (executives, managers, specialists and professionals) and personnel engaged in establishment. Although these commitments fall under the presence of natural persons, they play an important role in facilitating FDI in South Africa by service firms. What the offer does not cover is an individual that are not linked to a firm that is establishing or has established itself. It therefore restricts freelance professionals from operating in South Africa without complying with other regulations. The other pertains to national treatment limitations for commercial presence. In this instance a binding commitment was made limiting

[15] Distribution Services; Background Note by the Secretariat., S/C/W/37 10 June 1998 WTO, Paris
[16] Ibid. p.17

the local borrowing of South African registered companies with a non-resident shareholding of 25% or more[17].

In examining South Africa's existing liberalisation commitments for the distribution sector under the GATS it is important to note that South Africa has made no commitments regarding Commission Agents Services to date. However, apart from mode 4 (presence of natural persons) which is unbound in each service except as indicated in the horizontal section, it is evident that the sector is fully lberalised in the following services, namely wholesale trade services, retailing services, and franchising.

Table 2: Summary of Specific Commitments in Distribution Services

Countries	Commission Agents' Services	Wholesale Trade Services	Retailing Services	Franchising	Other	Total
Argentina		X	X	X		3
Australia	X	X	X	X		4
Austria	X	X	X	X		4
Brazil		X	X	X		3
Bulgaria	X	X	X	X		4
Burundi	X	X	X			3
Canada	X	X	X	X	X	5
Czech Republic		X	X	X		3
Ecuador		X				1
European Community	X	X	X	X		4
Finland	X	X	X	X		4
Gambia	X	X	X	X		4
Hong Kong			X			1
Hungary		X	X	X		3
Iceland	X	X	X	X	X	5
Japan	X	X	X	X		4
Korea, Republic of	X	X	X	X		4
Kuwait	X	X	X			3
Lesotho		X	X	X		3
Liechtenstein	X	X	X	X		4
Mexico		X	X			2
Mongolia		X	X			2
New Zealand	X	X	X			3
Norway		X	X	X		3
Panama	X	X		X		3
Peru		X	X			2
Poland		X	X			2

[17] General Agreement on Trade in Services., *South Africa, Schedule of Specific Commitments*., GATS/SC/78 15 April 1994

Romania	X	X	X			3
Senegal		X	X			2
Slovak Republic		X	X	X		3
Slovenia	X	X	X	X		4
South Africa		X	X	X		3
Sweden	X	X	X			3
Switzerland	X	X	X	X		4
Thailand	X					1
USA	X	X	X	X		4
Total	**21**	**34**	**33**	**23**	**2**	**113**

Source: WTO (1998)

There are significant differences between participating Members in the extent of the binding and the restrictiveness of scheduled commitments. Fully liberal commitments on all three modes are rare. Out of the 34 Members who made commitments on wholesales services, only 4 (Burundi, Mongolia, Panama and Senegal), together accounting for less than 1 per cent of participants' GDP, promised fully liberal access. Similarly, only Burundi and Panama in commission agent’s services, Burundi in retailing, and Panama in franchising have bound fully liberal access with respect to the first three modes[18].With respect to cross-border supply and consumption abroad, the largest proportion of liberal commitments are for franchising services and wholesale trade. In the case of commercial presence, the largest numbers of fully liberal commitments (5) have been made in wholesale services. Unbound entries are relatively frequent for the first two modes but rare for commercial presence[19].Even though many WTO Members have not made commitments in any of these sectors, Members with commitments account for, on average, around 90 per cent of the GDP of all Members[20] (table 3 below).

Table 3: Number of Members and % share of GDP of all Members

Sector	Members with commitments (% share of GDP of all Members)	Members with full commitments on modes 1, 2 & 3
Commission agents	21 (86%)	2 (0.04%)
Wholesale trade	34 (92%)	4 (0.06%)
Retailing	33 (92%)	1 (0.004%)
Franchising	23 (89%)	1 (0.03%)
Unless otherwise indicated, percentages for each sub-sector are calculated as a share of GDP of all Members with commitments in the sector.		

Source: WTO (1998)

[18] Distribution Services; Background Note by the Secretariat., S/C/W/37 10 June 1998 WTO, Paris
[19] Ibid. p.17
[20] Ibid. p.18.

Table 4: Numerical Summary of Commitments on Modes 1,2 and 3 in Distribution Services

Sector	Cross-border supply (Mode 1)			Consumption abroad (Mode 2)			Commercial presence (Mode 3)		
	Full	Limited	Unbound	Full	Limited	Unbound	Full	Limited	Unbound
Commission agents	3 (0.04%)	14 (97%)	3 + 1 (3%)	3 (0.04%)	16 (98%)	1 + 1 (2%)	2 (0.04%)	19 (99.96%)	0 (0%)
Wholesale trade	9 (2%)	19 (93%)	5 + 1 (5%)	11 (35%)	18 (60%)	3 + 1 (5%)	5 (0.1%)	29 (99.9%)	0 (0%)
Retailing	6 (2%)	19 (92%)	7 + 1 (6%)	7 (2%)	22 (93%)	4 + 1 (5%)	1 (0.004%)	30 (99.98%)	1 + 1 (0.02%)
Franchising	10 (4%)	13 (96%)	0 (0%)	10 (5%)	11 (92%)	1 + 1 (3%)	1 (0.03%)	20 (99.9%)	1 + 1 (0.06%)

Full: complete sectoral coverage, no market access or national treatment limitations;
Limited: incomplete sectoral coverage or market access/national treatment limitations;
Unbound: both market access and national treatment unbound or market access unbound.

Source: WTO (1998)

In certain respects, table 4 paints an excessively gloomy picture in consigning a large number of commitments to the "limited category" (shaded area in table 4). The reason for many commitments being classified as "limited", even when there are no market access and national treatment limitations, is that Members have frequently chosen to exclude the distribution of certain types of products from the scope of their commitments[21]. There is considerable variation in the scope and type of exclusions, ranging from a narrow class of products, which arouse security concerns to much wider sectoral exclusions (see Table 5). The most commonly excluded products belong to the categories of arms, ammunition and explosives; pharmaceutical, medical and orthopaedic goods; agricultural raw materials and live animals; food, beverages and tobacco; precious metals and motor vehicles. Furthermore, some Members have chosen to exclude distribution services at public wholesale markets or commodity exchange markets, while others have excluded goods subject to import authorization from the scope of their commitments[22].

Table 5: Products Excluded from Commitments on Wholesale and Retail Trade

Country	Exclusion from Wholesale Trade	Exclusion from Retail Trade
Australia	Agricultural raw materials and live animals (6221), food, beverages and tobacco (6222)	Motor vehicles (6111), parts and accessories of motor vehicles (6113), motorcycles and snowmobiles and related parts and accessories (6121), pharmaceutical, medical and orthopaedic goods (63211)
Austria	Pyrotechnical goods, ignitable items and exploding devices, firearms, ammunition and military equipment, tobacco and tobacco products, pharmaceutical products, medical and surgical devices, toxic substances, certain medical substances and objects for medical use	

[21] Ibid. p.18
[22] Ibid. p.19

Country	**Exclusion from Wholesale Trade**	**Exclusion from Retail Trade**
Brazil	Solid, liquid and gaseous fuels and related products (62271)	Motor vehicles (6111), parts and accessories of motor vehicles (6113), motorcycles and snowmobiles and related parts and accessories (6121)
Bulgaria	Tobacco and tobacco products (62213, 62228), alcoholic beverages (part of 62226); pharmaceutical, medical and orthopaedic goods (part of 6225); weapons, munitions and military equipment; precious metals, precious stones and articles thereof (part of 62265); petroleum and petroleum products	
	Grain, oilseeds and oleaginous fruits, seeds and animal feed (62211); intermediate products other than agricultural, waste and scrap and materials for recycling (6227) Services supplied at commodity exchange markets operated on a permanent basis	Beverages not consumed on the spot (63107)
Canada	Agriculture and live animals in 6221; fisheries products in 62224; alcoholic beverages in 62226; musical scores, audio and video recordings in 62244; and books, magazines, newspapers, journals, periodicals and other printed matter in 62262; and 62251 of pharmaceutical and medical goods and 62252, surgical and orthopaedic instruments and devices	Liquor, wine and beer sales in 63107; music scores, audio and video records and tapes in 63234; books, magazines, newspapers and periodicals in 63253; and pharmaceutical, medial and orthopaedic goods in 63211 and printed music in 63251
Czech Republic	Arms, ammunition, explosives, some chemical products, and drugs and precious metals	
EC	Arms, chemical products, explosives and precious metals	
	Motor vehicles (61111)?	Pharmaceutical, medical and orthopaedic goods (63211)
Finland	Arms, alcoholic beverages and pharmaceutical products	
Iceland	Arms, alcoholic beverages, tobacco and pharmaceutical products	
Japan	Petroleum, petroleum products, rice, tobacco, salt, alcoholic beverages, and those supplied at Public Wholesale Market - i.e. a market established under national or local government approval for commission agents' services and wholesale trade services of fresh foods including vegetables, fruits, marine products, meats and other daily foods, and flowers, with auction or bidding hall, parking lot and other facilities necessary for trade and disposal of above goods, which is operated on a permanent basis.	
Rep. of Korea	Firearms, explosives and swords; works of art and antiques; and the establishment and operation of, and distribution services at the public wholesale markets for agricultural, fishery and livestock products, which are officially designated by the local authorities as public wholesale markets.	
	Grain in 62211, raw milk in 62222, meat, poultry and game (62223), red ginseng and farinaceous products in 62229, and fertilizers in 62276	Dairy products and eggs (63102), meat (incl. poultry) and meat products (63103), bread and flour confectionery (63105), sugar confectionery (63106), beverages not consumed on the spot (63107), tobacco products (63108), animal feed, livestock and other animals in 63295
Liechtenstein	Goods subject to import authorization, pharmaceutical products, toxics, explosives, weapons and ammunition, and precious metals	
Mexico	Petroleum-based fuels, coal, firearms, cartridges and ammunition (622), motor vehicles (6111), part and accessories of motor vehicles (6113)	Sales in specialized establishments of combustible liquid gas, charcoal, coal and other non-petroleum based fuels, paraffin and fuel, gasoline and diesel, firearms, cartridges and tractoline ammunition.
New Zealand	Agricultural raw materials and live animals (6221), food, beverages and tobacco (6222), and such services relating to wool and animal hair (2613 – 2615)	Retail sales of motor fuel (613)
Norway	Alcohol, arms, pharmaceutical, fish and grain	Pharmaceutical products, alcohol and arms
Peru	Waste and scrap and materials for recycling (62278), machinery, equipment and supplies (6228)	Non food products (632), motor vehicles (6111), part and accessories of motor vehicles (6113), motor cycles and snow mobiles and related parts and accessories (6121)
Poland	Beverages (62226), tobacco products (62228), pharmaceutical and medical goods (62251), surgical and orthopaedic instruments and devices (62252)	Beverages not consumed on the spot (63107), tobacco products (63108), pharmaceutical, medical and orthopaedic goods (63211), motor vehicles (6111), part and accessories of motor vehicles (6113), motor cycles and snow mobiles and related parts and accessories (6121)
Romania	Arms, ammunition, explosives, narcotics and medicines containing narcotics, tobacco products and paper for cigarettes, alcohol and spirits	

Country	Exclusion from Wholesale Trade	Exclusion from Retail Trade
Senegal		Motor vehicles (6111), part and accessories of motor vehicles (6113), motor cycles and snow mobiles and related parts and accessories (6121)
Slovak Rep.	Arms, ammunition, explosives, some chemical products and drugs and precious metals	
Slovenia	Pyrotechnical goods, ignitable articles and blasting devices, firearms, ammunition and military equipment, toxic substances and certain medical substances	
	Motor vehicles (61111)	Pharmaceutical, medical and orthopaedic goods (63211)
Sweden	Trade in arms and retail sale of alcoholic beverages and pharmaceutical products	
Switzerland	Goods subject to import authorization, pharmaceutical products, toxics, explosives, weapons and ammunition, and precious metals	Goods subject to import authorization, pharmaceutical products, toxics, explosives, weapons and ammunition, and precious metals
United States	Firearms and military equipment	Alcoholic beverages, firearms and military equipment

Source: WTO (1998)

In developing trade policy one must have an understanding of the current trade regime. From there, assessments can be made as to where there might be a desire to liberalise. However, things are not as simple when developing a trade policy in services because in contrast to goods, tariffs are rarely used for the simple reason that there is often no easy quantifiable unit of measurement in services. Barriers to trade most common in services are regulations or subsidies that serve to restrict market access by foreigner service providers or discriminate against them. These barriers also differ according to which mode of supply is chosen by foreign providers, and may dictate the choice of supply mode. Therefore barriers to trade in services can be classified according to the mode of supply and by the type of restriction. The types of barriers are those restricting market access, those with discriminatory national treatment and other general measures that affect the ability to trade[23]

The most recent commitment requests from the EC to South Africa regarding the distribution sector are:[24]

A: Commission agents' services (CPC 621, 6111+6113+6121)

This sub-sector is not committed. **EC request**:

-Modes 1,2,3: take full commitments, i.e. schedule "none".

-Mode 4: Commit as referred in the section "Horizontal commitments".

B. Wholesale trade services (CPC 622, 6111+6113+6121)

The distribution of motor vehicles (CPC 6111+61113+6121) is not committed.

EC Request:

-Modes 1,2,3,: Take full commitments., i.e. schedule "none".

-Mode 4: Commit as referred in the section "Horizontal commitments".

C. Retailing services (CPC 631+632, 6111+6113+6121+613)

The distribution of motor fuel (CPC 613) is not committed. **EC Request:**

-Modes 1,2,3: take full commitments, i.e. schedule "none".

-Mode 4: Commit as referred in the section "Horizontal commitments".

[23] The joint UNCTAD-World Bank publication "Liberalizing International Transactions in Services: A Handbook" (1994) lists each type of barrier for each mode of supply.

[24] Sourced from DTI unpublished discussion document: GATS 2000 *Request from the EC and its Member States (hereinafter the EC) to South Africa*., by Ad Hoc 133 Committee Services, received 16-03-2002.

In response to the GATS negotiations and target dates, the department of Trade and Industry (DTI) would like to have an initial request ready by October 2002 and an initial offer by March 2003. To achieve this the DTI would need to consult with individual departments as well as private sector stakeholders on a bilateral basis before October for the requests and before March 2003 on the offers. However, these dates are merely indicative, as certain departments are further ahead than others regarding the GATS negotiations.[25] In order to further the process of liberalizing trade in distribution services, an entire audit of the sector needs to be undertaken to assess how much can be achieved within the existing framework of commitments.

4. DISTRIBUTION IN THE PHARMACEUTICAL INDUSTRY

The case study examines the nature of pharmaceutical drug distribution in South Africa. Evidence suggests that institutional rigidities allow pharmacists to successfully participate in a cartel-like environment. The outcome is perverse. Retailers do not achieve economies of scale, while consumers do not receive lower prices.

4.1 Industry background

There are very few industries in which a market can be lost as quickly as in drugs. Reekie (1996) provides a summary of a twenty-year study of pharmaceutical manufacturers in the United Kingdom that demonstrates that only three companies in the top 20 retained their original ranking by sales revenue[26]. Table 6 below illustrates that between 1980 and 1990, five of the leading UK firms in 1990 did not appear in the top 20 at all in 1970, an indicator of the new entry level in the market place, while the second ranked company in 1990 rose from seventy sixth ranked company in 1970 and the top ranked company in 1970 fell to eighth position in 1990, and so on. In the drug industry the volatility of market share is well known, as the drug industry is highly innovative.

Table 6: Market position of Top 20 Corporations (excluding hospital sales), UK

Corporations	1990 Rank	1980 Rank	1970 Rank
A	1	2	4
B	2	7	76
C	3	1	2
D	4	4	5
E	5	6	11
F	6	20	34
G	7	3	1
H	8	8	7
I	9	5	10

[25] Sourced from the DTI Minutes on the forum to initiate a process of consultation in the WTO field of services held 24 July 2002, Pretoria.

[26] See Table 6

J	10	21	17
K	11	30	21
L	12	32	37
M	13	14	12
N	14	17	13
O	15	15	16
P	16	18	32
Q	17	9	6
R	18	12	8
S	19	16	14
T	20	19	18

Source: Beesley, M Schumpeter and UK Pharmaceuticals" in W. Duncan Reekie, *Prescribing the Price of Pharmaceuticals*, IEA Health and Welfare Unit, London 1996.

The emphasis on competition by innovation has traditionally been assumed to arise from two sources, the supply of new technology arising from the therapeutic revolution and the rising demand for ever-improving levels of health care (Reekie, 1996).

Given the nature of the industry it is no surprise that it is a growth industry with a high proportion of qualified scientists in its employ. Research and development expenditures in the industry are, as a percentage of sales, probably among the highest in the South African manufacturing industry (Reekie, 1996).

It is estimated that the South African pharmaceutical industry will generate in the region of R17 billion in revenue in 2001[27]. The industry is dominated by multinationals, although in global terms the South African market is very small. (Some commentators observed that South Africa contributes less than 1 per cent of their company's global turnover)[28].

Locally the industry is very competitive; often company's market shares run neck and neck, separated by less than one percentage point (Reekie, 1996). There is considerable controversy in the industry at present arising largely from differing interests of divergent groups (government, funders, shareholders, etc.) each trying to secure the best stake possible.

More specific to South Africa, there is a general feeling that the uncertainty surrounding the proposed new government legislation is having a detrimental effect on the industry. A particular area of concern is that the South African government does not adhere to free market principles and does not respect intellectual property rights, which manifests in an accelerated registration of patents and parallel imports (to reduce costs). A controversial item of legislation being considered at present is the new Pharmacy Act. If this is passed, retail pharmacists will be forced to sell medicines at cost (single exit price) plus a fixed professional fee of roughly 25 Rand[29].

[27] Interview held with Roche CEO Jorg Michael Rupp on 2 July 2002.
[28] Interview held with Roche CEO Jorg Michael Rupp on 2 July 2002.
[29] Interview held with Roche CEO Jorg Michael Rupp on 2 July 2002.

Most players agree that the pharmaceutical industry is very competitive, both globally and locally. Trade and Industry SA (TISA) report that although there are some 200 firms in the industry, 75 per cent of the market is captured by multinationals, although no one multinational has a market share in excess of 6 per cent[30].

4.2 The pharmaceutical market

The South African pharmaceutical market is divided into two sectors, namely, the private sector and the public sector. The private sector dominates the market in terms of sales value (78 per cent)[31]. This has led to a pattern of cross-subsidisation of the public sector by pharmaceutical companies. They have been forced to increase prices in the private sector in order to preserve their overall margins. The private sector is funded mainly by medical insurance schemes that cater primarily for the economically active, urbanised sections of the population.

4.3 Pharmaceutical manufacturers

In South Africa there are currently 92 pharmaceutical manufacturers (SA Pharmacy Council, 1999). They consist of multinationals that have subsidiaries in South Africa, as well as the local manufacturers and importers. Competition levels are extremely high, with no single company enjoying more than 15 % market share (IMS, 1997). Adcock Ingram, a local company holds the largest market share of both generic and ethical drugs. This is followed by the Swiss multinational, Bayer. The break-up of SA druggists has left Adcock Ingram a clear leader in the market.

The pharmaceutical industry is "competitive" if measured by structure of supply. Table 7 and 8 below illustrate those multinational corporations that dominate the pharmaceutical industry in South Africa. In many cases company's market shares are separated by less than one percentage point, indicating the level of competitiveness.

Table 7: SA Pharmaceutical Industry (Multinational Pharmaceutical Manufacturers)

Multinationals	**Employees**	**Turnover**	**Market Share**
Bayer	1500	1965	13.47
GlaxoSmithKline	800	1350	9.25
Pfizer	600	786	5.39
Aventis	550	700	4.80
Novartis	500	655	4.49
Roche	500	500	3.43
AstraZeneca	300	400	2.74
Merck	300	393	2.69
Janssen-Cilag	300	393	2.69
MSD	300	375	2.57
Schering Plough	225	350	2.40
Abbott	280	316	2.17

[30] African Stats, "*Manufacture of Pharmaceuticals, Medicinal Chemicals and Botanical Products*" SICCODE: 33530, Report Date: September 2001, Johannesburg.
[31] E Schoemaker., "Distribution Channel Structures and Relationships in the Pharmaceutical Industry", Johannesburg, 2000

Boehringer Ingelheim	200	241	1.65
Pharmacia	180	234	1.60
Wyeth	170	221	1.51
Lilly	200	210	1.44
Bristol Myers	124	200	1.37
Schering	140	183	1.25
Servier	107	140	0.96
Sanofi-Synthelabo	100	131	0.90
Byk Madaus	80	105	0.72
Merck Generics	62	81	0.56
UCB	52	68	0.47
Lundbeck	42	55	0.38
Solvay	40	52	0.36
Hexal	42	50	0.34
Ranbaxy	33	43	0.29
Bioforce	30	39	0.27
Norgine	22	29	0.20
Heel	21	28	0.19
Multinational Total	**7800**	**10293**	**70.55**

Source: African Stats © 2001

Table 8: SA Pharmaceutical Industry (South African Pharmaceutical Manufacturers)

SA Companies	**Employees**	**Turnover**	**Market Share**
Adcock	2600	2085	14.29
Aspen	1200	1118	7.66
Vital	287	221	1.51
Alliance	180	158	1.08
Fine	260	150	1.03
Triomed	100	110	0.75
Pharma Natura	350	100	0.69
Be-tabs	300	100	0.69
Cipla	85	100	0.69
Donmed	29	75	0.51
Natural Health Hldgs	134	53	0.36
Mirren	62	20	0.14
Georen	10	6	0.04
SA Total	**5597**	**4296**	**29.45**

Source: African Stats © 2001

The pharmaceutical manufacturing industry can be divided into two main sectors, namely, the innovative market as represented by the larger research based companies, and the imitative market of non-research based companies. The majority of South African companies fall into the latter category since they lack the financial muscle needed for research and development.

Increasing costs of new product development and pressures on profit margins has forced many pharmaceutical companies to pursue economies of scale, such as mergers and acquisitions. This allows them to realise a better return on money spent on R&D. Another trend among multinationals is to reduce the sale of manufacturing plants in

South Africa. This is a result of the fact that technology to make modern ethical drugs is extremely complex, and that it is the preferred method to utilise "centres of excellence" to export the product to the rest of the world[32].

4.4 Pharmacy retailing

The channel of distribution for pharmaceutical products has changed dramatically from the traditional pattern of distribution. In the US, independent pharmacies declined by 14 341; while chain outlets increased by 18 229.[33] By 1996, independent pharmacies were responsible for only 20 % of dollar prescription sales, compared with 28 % for chain drug stores. Mail order, mass merchandisers and other food stores, clinics, hospitals and staff model HMO's (Health Maintenance Organisations) made up most of the remainder[34].

In South Africa in the early 1980's, nearly all private sector sales passed through conventional retail pharmacies, but by 1993 this proportion had fallen to 41 % by value, with 42 % being paid out to dispensing doctors, the balance being accounted for by private hospital usage and the newly emerging mail order distributors[35]. Thus the US trend away from the traditional pattern of distribution is not unique. In examining the behaviour of SA retail pharmacies it becomes apparent that retailers have attempted to obtain political support for regulations that bolster cartel structures and behaviour, and which discourages innovation in distribution.

Private sector sales are conducted through four primary outlets, namely, retail pharmacies, dispensing doctors, private hospitals and supermarkets (non pharmacy retail). Retail pharmacies continue to account for the majority of purchases (65%) even though there has been an increase in sales through supermarkets and dispensing doctors.

Medicines sold to the retail pharmacies fall broadly into two categories

1. Over the counter (OTC) medicines are obtainable without a doctor's prescription as they fall into the schedules 1 and 2 category of medicines. Medicines that are not scheduled can be sold in other retail outlets, such as supermarkets, but some restrictions exist.

2. Prescription medicines, which fall into the schedules 3 to 7, require a doctor's prescription and can only be dispensed from pharmacies under the supervision of a registered pharmacist. This category can be further divided into ethical and generic drugs.

Recent changes in legislation have benefited the retail pharmacies:

1. Rescheduling of some medicines from schedule 3 to schedules 1 or 2. This means that these medicines do not require a prescription from the doctor and

[32] Interview with Roche CEO Jorg Rupp held on the 2 July 2002
[33] Pharmaceutical Research and Manufacturers of America, *Industry Profile*, Washington DC, 1997 (30-1).
[34] Ibid, pg. 36.
[35] Melamet Report, *Report on the Commission of Inquiry into the Manner of Providing for Medical Expenses.* Pretoria: Government Printing Office, 1994 pg.41

may now be sold over the counter. In addition, the growing trend towards medical consumerism is bringing more patients into the pharmacy for self-treatment before visiting their doctor. The significant growth in sales of OTC medicines bears testimony to this trend[36].

2. New legislation will force dispensing doctors to apply for a license to dispense and this is expected to return much lost dispensing back to the pharmacy.

3. The retail pharmacist will soon be able to substitute patented medicines for equivalent generics.

The initial premise is that the retail pharmacy in South Africa is an example of a failing cartel. The shrinking market share of independent retailers in both the US and South Africa support this view. In South Africa retailers have successfully lobbied against 'closed' Private and Public Provider's (PPO's) of selected retail pharmacists by reimburses[37]. In South Africa regulations exist prohibiting the emergence of chain stores and/or of corporately owned retailers. Despite this, innovation has arisen from dispensing doctors and mail order outlets, both of which have significantly encroached on the cartel's former pre-eminence. Predictably these activities are strongly opposed by retailers.

The continued lobbying against corporate ownership in South Africa illustrates how retailers aim to minimise differences in their cost levels and so facilitate cartel cohesion. The existence of store retailing elsewhere, as in the UK and the USA, indicates that its absence is hardly necessary for consumer protection (Reekie, 1996). Consumers are not deprived of the professional services, skills and advice of qualified professionals in chain stores. Protection of the traditional distribution mode is not necessary to protect that role. To practice, as a pharmacist, does not imply that one should simultaneously be a conventional storekeeper (Reekie, 1996).

Entry barriers to the profession are low- a professional qualification is required but trading licensure rules are liberal. Thus given similar costs due to a ban on corporate ownership, overtrading tends to be the outcome. Government reports in South Africa have frequently reiterated the view that the country has too many outlets with too small a turnover. This overtrading may be a reason why the consumer has to pay the higher price further down the distribution chain.[38]

4.5 Price discrimination by retailers

Scherer (1997) indicates the success with which the cartel has lobbied against the practice of manufacturers awarding discounts to innovative forms of drug distribution in the US. South Africa takes a similar view.[39]As a consequence of retail lobbying it

[36] Interview held with Lyn Govender, Weleda pharmacist on 28 June 2002.
[37] Competition Board Report 52, *Investigation to determine whether any Restrictive Practices exist in the Supply and Distribution of Medicine*. Pretoria: Government Printing Office, (1996:32).
[38] Snyman Report, Commission of Inquiry into High Cost of Medical Services and Medicines, Pretoria: Government Printing Office, 1962. (Paragraph 912).
[39] Reekie, W.D., Medicine Prices and Innovations, Institute of Economic Affairs, Choice in Welfare Services No. 30, London, 1996.

has legislated a "single exit price"[40]by manufacturers for "equivalent transactions". Moreover, the Department of Health officials favour a "transparent" pricing structure and imply that transaction prices should not deviate from list prices.

The South African cartel also argues for transparent pricing structures. But transparency per se is neither desirable nor undesirable in the public interest. For example, unnecessary high (but transparent) price levels are undesirable. Appropriate or competitive transparency is where buyers, whether patients insurers or others, can easily obtain information on the alternative offers of lower price suppliers (Reekie, 1996).

This results in lower prices and better services as higher costs and less satisfactory suppliers are forced to cut prices to gain or retain business. Inappropriate or anti-competitive transparency, such as guaranteed buy-in prices, where negotiation between buyer and seller is illegal, discourages this rivalry and preserves and conserves existing high prices and distribution modes.

Retailers have influenced regulation and legislation in many countries. Their success includes slowing down by legal process advances in distribution. Developments that are hampered range from conventional cost reducing devices such as attainment of scale economies to recent innovations designed explicitly to contain the costs of medicines.

The consequence is that competition has been dampened. This outcome is partly a result of the well-known difficulty of deciding whether price discrimination is pro- or anti competitive. In South Africa it was proposed that differences in manufacturers' prices would only be "justifiable" if they are required "to provide for the cost or probable costing of the manufacture or distribution of the medicine"[41]. The policy problem is that costs are subjective. When the manager of a firm takes a decision only she knows, the benefit she is forgoing- the cost-of the decision.

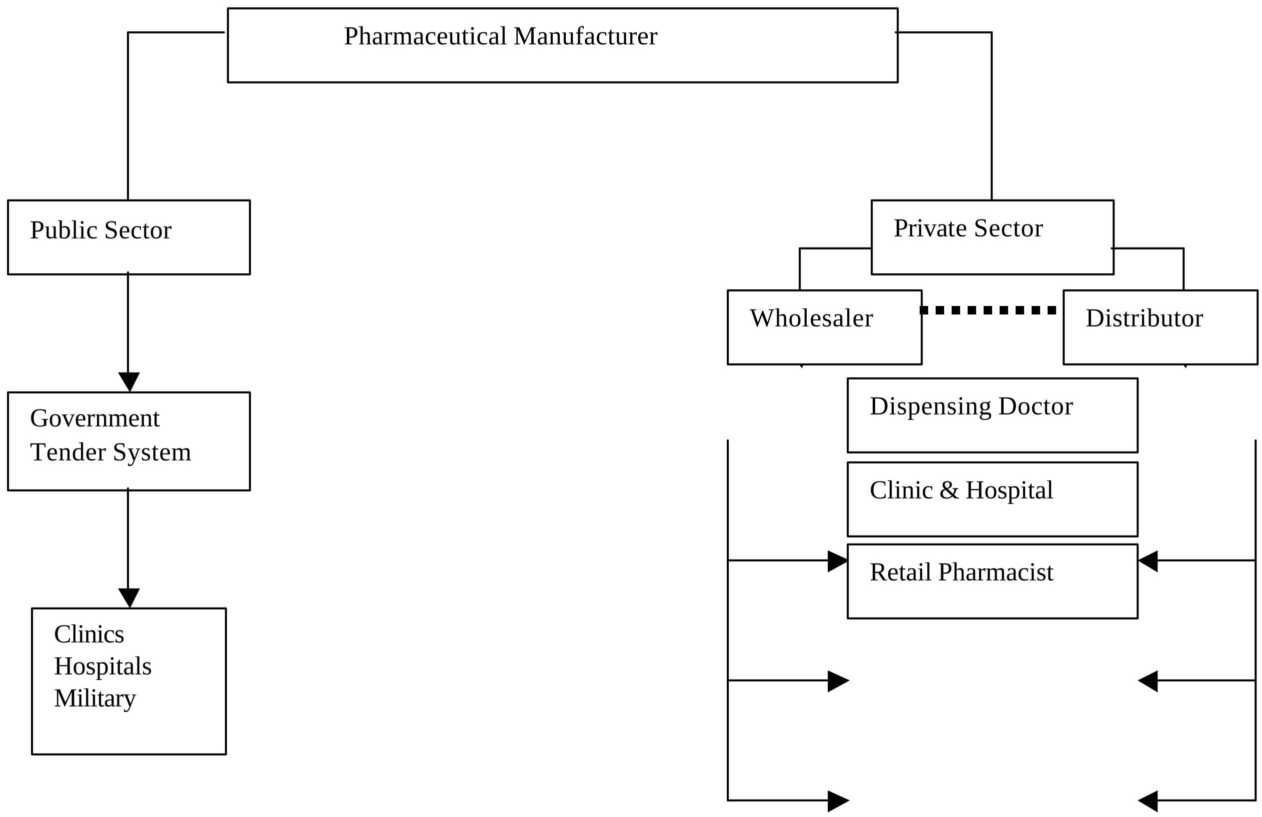
4.6 Distribution of Pharmaceuticals

The most commonly used distribution channels between the pharmaceutical manufacturers and retail pharmacies are the following three:

1) Manufacturer--------Distribution Company-------Retailer----Consumer
2) Manufacturer--------Independent Wholesaler-----Retailer----Consumer
3) Manufacturer---Retailer----Consumer

[40] Jargon for single list price.
[41] See Notice 1136, Amendment to Competition Act, Government Printing Office, Pretoria, 1993.

Figure 1: The distribution of pharmaceuticals in South Africa



In the 1950's pharmaceutical distribution started to evolve in South Africa. Cooperative buying groups of retail pharmacies started emerging. One, the South African Pharmaceutical Development Corporation (SAPDC) had 300 members and the other (SA Druggists) was almost as large. Traditional wholesalers were losing business to the groups and wrote to the Ethical Drug Association (EDA) asking for a five per cent higher discount than what was awarded to the groups. The EDA voted "overwhelmingly" to agree to this request (Reekie, 1996).

Hartzenburg (2001) catalogues the changes that have taken place at the distribution stage of the supply chain, with the establishment of three exclusive distribution enterprises.

4.7 The distribution companies

The distribution company of International Healthcare Distributors (IHD) has caused much concern in the retail pharmacy sector and accusations of monopoly tactics have been made against it (Business Report 1998). IHD was launched in 1993 and distributes directly to end dispensers such as doctors, clinics and pharmacists. It is jointly owned by eleven major multi-national pharmaceutical manufacturers for whom it distributes, namely Abbott Laboratories, Aventis, Bayer, Boehringer

Ingelheim, Bristol-Myers Squibb, Eli Lilly, MSD, Novartis, Roche, Schering and Wyeth.[42]

The distributor holds the manufacturers inventory, but does not own it as in wholesaling. The distributor operates on behalf of, and upon instructions from, their clients, and the manufacturers. As a distributor, IHD is not party to pricing issues and has no involvement in the setting of prices and trading policies. Thus IHD can be viewed as an extension of the manufacturers and, by dealing with the distributor, the retailer is effectively trading directly with the manufacturer.

The retailer is faced with a single distribution channel for these products and it becomes difficult to source these products from elsewhere. This has forced some retailers to increase inventory levels to avoid stock-outs and margins have been reduced.

IHD has introduced a number of innovative practices to the South African pharmaceutical sector. First, the introduction of batch tracking, where the product is batch tracked from manufacturer to end dispenser. The ability to track a specific invoice and customer is critical in the event of product recalls and countering the growing trade in stolen stock[43].

Second, patient safety measures such as fully air-conditioned warehousing, stringent cold chain maintenance are of critical importance to the end dispenser concerned for his patient's health, in dealing with a distributor (IHD), the health provider is assured that he is dispensing the genuine article that has been handled with the necessary care in transport and storage[44].

4.8 The independent wholesaler

There are currently 403 wholesalers in South Africa, the majority located in the Gauteng area (SA Pharmacy Council, 1999). Wholesalers purchase the medicines from the manufacturers and put a mark up on the product before passing it on to the retailer.

There are two types of wholesalers, namely, short line and front line wholesaler. The short line wholesalers keep a limited range of products (usually about 3000) in large quantities and offer good prices to the retailers. The front line wholesalers keep a wide range of products (usually about 12000), but prices are less competitive. It is these wholesalers that are declining in numbers and the short line wholesalers are taking their place. One retail pharmacist interviewed expressed concern that, should the wholesalers disappear, the retail sector will have difficulty obtaining non-medical products, such as toiletries, as distributors do not supply these products.

The wholesaler can receive stock from IHD, but must pay prices similar to what the retailers pay. It is for this reason that these products are rarely stocked by the wholesaler and thus, IHD have been accused of monopoly tactics.

[42] IHD website (www.ihd.co.za)
[43] Interview with Roche CEO Jorg Rupp held on the 2 July 2002
[44] Interview with Roche CEO Jorg Rupp held on the 2 July 2002

Interesting developments in the wholesale market have been the entry of large chain stores namely, Pick n Pay and New Clicks. Pick n Pay operates 7 pharmacies known as HealthPharm on a franchising basis, with registered pharmacists[45]. New Clicks on the other hand has gone one step further and has purchased the drug wholesaler and distributor United Pharmaceutical Distributors (UPD). New Clicks already owns a controlling stake in the Link pharmacy franchise, comprising more than 300 pharmacies, and has lent money to purchase Milton & Associates, which in turn has acquired about 70 pharmacies[46]. But it is still not allowed to manage the entire supply chain because promised deregulation has not taken place.

The entry of large retail chains could help rationalise and increase efficiency in an industry that has such low operating margins. New Clicks 'and Pick n Pay franchises may boost pre-tax margins to between 5% and 8%[47]. UPD supplies about 4 000 pharmacies, many of them independent. An interesting outcome to assess will be how independent pharmacies are going to be affected by the New Clicks –UPD deal and whether New Clicks will have the market power to change the trading policies. At this point one could ask the question- is there enough competition in the wholesale industry for independent pharmacies to source wholesale goods at competitive prices?

4.9 Summary

The drug industry is a high value added, research intensive industry. In South Africa the retail pharmacy cartel has proven it possesses political clout in the market. Its success includes slowing down by legal process advances in distribution. Developments that are hampered range from conventional cost reducing devices such as the attainment of scale economies, to regulations that have raised entry barriers such as the regulations that prohibit the emergence of corporately owned retail chains.

Despite this, innovation has arisen from dispensing doctors and mail order outlets, both of which have significantly encroached on the cartel’s former pre-eminence. Predictably these activities are strongly opposed by retailers. The continued lobbying against corporate ownership in South Africa illustrates how retailers aim to minimise differences in their cost levels and so facilitate cartel cohesion. Moreover, given similar costs due to a ban on corporate ownership, overtrading tends to be the outcome. Government reports in South Africa have frequently reiterated the view that the country has too many outlets with too small a turnover. Simultaneously there is also the question of whether there is enough competition in the wholesale industry for independent pharmacies to source wholesale goods at competitive prices.

[45] Interview with Dave Robbins Pick n Pay Enterprise Group Director of International Divisions held 29 July 2002

[46] Financial Mail Article “New Clicks Furthered”, http://www.financialmail.co.za 20 August 2002

[47] Interview with Dave Robbins Pick n Pay Enterpris e Group Director of International Divisions held 29 July 2002

5. DISTRIBUTION IN THE FOOD INDUSTRY

The case study examines the nature of distribution in the South African food industry. Three major food retailers (Shoprite Checkers, Pick n Pay, and the Spar Group) and two major wholesalers (Metro Cash 'n Carry Ltd. and the Massmart Group) have been reviewed. The study found that the channel of distribution does not follow a traditional pattern. Major retail chains distribute directly to the consumer and in many cases have their own internal distribution networks, thus squeezing out the traditional role of the wholesaler.

5.1 Industry background

The retail and wholesale chains in South Africa are highly competitive and operate on high volumes and low margins. The number of consolidations between retail and wholesaler chains over the past ten years has led to a notably more concentrated retail and wholesale industry. For example, in 1991 two of the largest wholesale chains Metro and Trador were amalgamated[48]. In 1996, Metro bought Price Club from the Pick n Pay group and the following year acquired Blochs, alliance and DF Scott. Furthermore, recently, the Competition Tribunal approved the large merger between Maasmart, Jumbo and Sip n Save[49]. Retail franchises have grown in recent years; these require franchises to purchase their products from or through their respective franchisers. This growing trend will probably extend the buying power and role of the retail chain in South Africa.

In South Africa there is a distinct division between the formal and informal retail markets[50]. The formal market is comprised of major retail and wholesale groups i.e. Pick n Pay Group, Spar Group, Shoprite Checkers Group, Massmart Group, Metcash Group and Woolworths.[51] The informal market is comprised of independent traders[52]. In the formal market the market share is split roughly equally between wholesale and retail chains.[53] In the national formal retail market Shoprite / Checkers has a market share of 30.6% . If the Hyperama market share (4.1%) is added to that, the Shoprite group has a market share of 34.7% (Merrill Lynch, 2001:102). Pick 'n Pay has a market share of 36.6%. The Pick 'n Pay Group (Hypermarkets, Supermarkets, Family Stores, Minimarkets and Score) have a combined market share of 39.3%. Spar has a lower market share (20.2%). It has grown this market share over the last ten years from 15% to the current 20% of the national retail market (Financial Mail, 1/2/2002). Woolworths is a much smaller player, targeting the upper middle-income consumer, with a market share of 5.8%. In the wholesale market Metro Cash 'n Carry market share is estimated at around 35%[54].

[48] Interview with Bruce Cayzer Director of Makro Food Division held 25 July 2002
[49] Interview with Bruce Cayzer Director of Makro Food Division held 25 July 2002
[50] Interview with Dave Robbins Pick n Pay Enterprise Group Director of International Divisions held 29 July 2002
[51] Retailers in the formal market are commonly referred to as "the Majors".
[52] Retailers in the informal market are commonly referred to as "The Minors".
[53] Interview with Dave Robbins Pick n Pay Enterprise Group Director of International Divisions held 29 July 2002
[54] Metro Website (http://www.metro.com)

5.2 Food Retailers

5.1.1 Shoprite Group

The Shoprite group of companies is one of Africa's largest food retailers. The group currently owns 592 outlets and achieved a turnover of R10, 982 billion in the 6 months ended 31 December 2001 (R19, 6 billion for the 12 months ended 20 June 2001)[55]. Shoprite Holdings Ltd. is a public company listed on the JSE Securities Exchange. The Group provides employment for 28 000 permanent and 34 000 temporary and casual employees. The Group has a large expansion drive and currently operates chain stores in 11 African countries apart from its interests throughout South Africa.

Shoprite Holdings Ltd comprises the following entities: the Shoprite Checkers supermarkets group, which consists of:[56]

- 290 Shoprite supermarkets,
- 78 Checkers supermarkets,
- Freshmark (a fruit and vegetable procurement division) with 9 fresh produce distribution centres,
- 137 OK Furniture outlets,
- 19 Checkers Hypers,
- 21 House and Home stores,
- Rainbow Finance,
- 47 Hungry Lion fast food outlets, and a
- Properties division.

Through its OK Franchise Division the group procures and distributes stock to

- 107 Sentra convenience stores,
- 27 8'Till Late outlets,
- 23 OK Mini Market convenience stores
- 32 OK Foods supermarkets,
- 81 Megasave wholesale stores,
- 53 Value stores,
- 23 OK Grocer stores, and

[55] Shoprite website homepage (www.shoprite.com)
[56] Ibid

- 44 buying partners.

The Group started in 1979 with the purchase of a chain of 8 Cape-based Shoprite supermarkets with a turnover of R10, 8 million[57]. Shoprite grew market share by opening new stores in an aggressive acquisition strategy. In 1990, the Company acquired Grand Supermarkets and converted its' 17 outlets to Shoprite stores. Followed by buying the Checkers chain, and merged this business of 170 stores with Shoprite. In 1995 Shoprite bought Sentra, a central buying organisation, acting as a buying group for 550 owner-manager supermarket members. This introduced Shoprite to the franchising field, enabling it to compete in smaller markets, where the emphasis is on convenience. The most recent acquisition was in 1997, where the group bought the loss-making OK Bazaars Group comprising 139 supermarkets, 18 Hyperama's, and 125 Furniture stores. The group's stores have since been integrated into Shoprite, Checkers and the Franchise division.

The OK Franchise Group's market share for the 12 months ending December 2001 was measured at 29.5%. Shoprite has its own central distribution system for groceries, household items, non-food products as well as fruit and vegetables. It also employs a strategy of buying direct from the farm or factory[58].

Over the past 7 years, Shoprite has expanded its operation beyond South African borders. Currently, 77 outlets have been established in 11 African countries namely, Egypt, Uganda, Zambia, Tanzania, Mozambique, Zimbabwe, Namibia, Lesotho, Swaziland, Botswana and Malawi. The Group's expansion programme in Africa has also resulted in the creation of a substantial export market for South African producers and manufacturers. During the past 12 months, Shoprite exported stock to its outlets trading outside this country to the value of more than R200 million[59].

5.1.2 Pick'n'Pay Group

The Pick 'n Pay Group have been trading for over 35 years as retailers of food, clothing and general merchandise. [60]. The Group owns more than 380 stores and employs roughly 30 000 employees.[61] The company operates through three divisions, the Retail Division, the Group Enterprises Division and Franklins Australia. The Retail Division manages Pick 'n Pay branded business. These comprise Hypermarkets, Supermarkets, Family Franchise, Mini Market Franchise, and Home Shopping. The Group Enterprises division was created as a separate division within the organisation in 1995 when the Company restructured, and consists of TM Supermarkets, Score, RiteValu, Boardmans and Go Banking. Traditionally this division has housed all the non-Pick 'n Pay branded companies[62].

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[57] Ibid

[58] Shoprite website homepage (www.shoprite.com)

[59] Shoprite website homepage (www.shoprite.com)

[60] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

[61] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

[62] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

In 1994, the Group acquired a 50% interest in the “Score “stores, a 122-store chain with eight franchise stores. The Group has a number of stores (trading under the Score Stores banner) in Botswana and has captured roughly 50% of the market share in Botswana[63]. Products are supplied to the corporate and franchise stores by the Score Central Distribution Centre, which is located in Johannesburg and which distributes about 60% of the product requirements to the stores. Furthermore, the company has 52 stores in Zimbabwe, 5 stores in Namibia and 4 stores in Tanzania[64]. In addition to its African expansion drive the group has expanded into Australia by buying Franklins Supermarket Chain and operates 70 stores. All 70 stores trade under the Franklins' banner.

The company vigorously supports its own-labelled products (i.e. “Pick ’n Pay Choice” and “No Name Brand”). These generally enjoy prime merchandising positions on shelves, usually adjacent to the market leader. The shelf space allocated to its own-labelled food products exceeds the actual share accounted for by such products of total products purchased by consumers. In addition, although total sale of own-labelled products in South Africa are less than those of the larger producers, “in-store” sales of own-labelled products approximate those of food producers[65]. The company’s franchise operations have grown from within the Pick n Pay Group and include “Pick’ n’ Pay Family Stores”, “Rite Valu” and “Mini Markets”.

5.1.3 SPAR

The SPAR concept of voluntary trading was first introduced in the Netherlands in 1932. The organisation was named DESPAR which is an abbreviation of the Dutch slogan, which when translated into English means, "All will benefit from united co-operation". The success of voluntary trading has made SPAR one of the biggest food retailers worldwide with 17 500 stores in 32 different countries, employing 180 000 people throughout Europe, the Far East, Africa and South America. SPAR International sales have reached the US $25 Billion mark[66].

The Spar Group unites food wholesalers and retailers with the objective of enabling independent retailers to compete with other chains. Grocery chains emerged in South Africa in the 1960's. To counter the threat of independent retailers a group of 8 wholesalers were granted exclusive rights to the SPAR name in South Africa in 1963, to service 500 small retailers. A number of mergers and take-overs have followed, and today all but one of the wholesalers is owned by The SPAR Group.[67] The Spar Group currently accounts for 25% of the grocery market in South Africa. The group operates six distribution centres in South Africa, which supply goods and services to over 680 stores[68].

The group’s stores adopt the following three formats:

[63] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002
[64] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002
[65] Pick n Pay website http://www.picknpay.co.za
[66] Spar website (www.spar.co.za)
[67] Spar website (www.spar.co.za)
[68] Ibid

1. "Spar" stores, which offer a range of groceries and fresh food. These stores include a butchery, salad bar and wine selection. In addition, they sell the group's range of fresh food under the "Fresh Line" brand as well as ready-to-eat meals at selected stores.
2. "Superspar" stores are aggressively prices against retail chains and after a full range of groceries include a butchery, bakery, delicatessen and wine selection. In addition, they sell take-away food as well as various ready meals.

"Kwikspar" stores focus on convenience and offer a reduced range of fast selling groceries and fresh food. These stores include a butchery, bakery, delicatessen, salad bar and wine selection. In addition they sell take-away and prepared food.

5.3 Wholesalers

5.3.1 Metro Cash and Carry Ltd

Metro Cash and Carry Ltd (Metro) is the largest distributor of fast moving consumer goods (FMCG) on the African continent. The group also has significant interests in Australia, as well as a trading office situated in Hong Kong. Over the last 6 years, the group has increased its turnover from R6.6bn to R33.9bn via a combination of organic and acquisitive growth[69]. Metro is the only distributor that can offer manufacturers coverage of the entire Southern African sub-continent. Its employee base currently numbers over 17 000 employees, with over 55% of such employees based in countries outside the Rand monetary area[70].

South African operations comprise the group's businesses in the Rand denominated area (and include Namibia, Swaziland and Lesotho). These include cash & carry (C&C) outlets as well as conventional distribution operations. The domestic operations comprise 148 C&C-stores, 12 Trade Centres and 4 regional Distribution Centres which service garage forecourt stores and independent supermarkets as well as almost 200 company-franchised IGA-Friendly (previously Foodies/Friendly Grocer) convenience/grocery stores[71].

Metro owns 64% of Metcash Trading – the largest Australian wholesaler with operations in conventional Distribution, C&C, and liquor wholesaling. This subsidiary was acquired in May 1998. Metro's African operations currently comprise over 250 C&C outlets in seven countries outside the Rand monetary area, including Botswana, Kenya, Malawi, Mozambique, Uganda, Zambia and Zimbabwe. The group also operates a franchise operation in Madagascar as well as a bond store in Angola[72].

Metro's franchising operations with its banner (or symbol) groups was one of the first retailing operations in South Africa. Banner groups are: Lucky 7, Square Deal, Pop-In, Buy-Rite and Viva. The first 3 groups buy from Cash and Carry stores and the last 2 from Trade Centres[73].

[69] Metro Website (http://www.metro.com)
[70] Metro Website (http://www.metro.com)
[71] Metro Website (http://www.metro.com)
[72] Metro Website (http://www.metro.com)
[73] Metro Website (http://www.metro.com)

The Metro conventional distribution network operates from four main warehouses situated in Johannesburg (2), Cape Town and Durban. This includes perishables and frozen foods distribution centres (DCs) situated in Johannesburg. The business' target market is the independent retailer, garage forecourt shops and, through its catering division, the hospitality segment of the market. In addition, this division services the group's franchise chains, 'IGA Friendly Supermarket' and 'IGA Friendly Everyday' store and 'Friendly Shoppe' convenience stores.

5.3.2 MassMart Group

The Massmart Group is comprised of nine chains, housed under four coherent segments, namely, Dion, Game, Makro, CCW Wholesalers, Browns and Weirs, Jumbo, Shield and Furnex. The first two divisions are Mass discounters, and the warehouse club outlets (Makro). The third division called Masscash houses is comprised of CCW, Browns, Weirs and Jumbo, all cash and carry businesses targeted at lower income consumers. The fourth division, called Masstrade, house Shield and Furnex, both buying associations that assist independent retailers and wholesalers with procurement and marketing[74].

Massdiscounters is a chain of 65 discount stores trading under the established Game and Dion retail brands in South Africa, Namibia, Zambia and Botswana. Game operates nationally and has a wide spread (middle and upper income groups) of customers. Dion is Gauteng-based and focuses on upper income customers[75]

Makro is a chain of 13 large warehouse club outlets, situated in South Africa and Zimbabwe trading in food, liquor and general merchandise with commercially affiliated customers. Access to a Makro store, and more particularly the ability to purchase, is restricted to cardholders. This policy has allowed Makro to build its cash customer database in the Southern African distribution industry[76].

The Cash & Carry division is a peri-urban and rural chain of 45 cash-and-carry warehouses trading under the banners CCW, Browns and Weirs. It distributes basic food and groceries to lower income customers in South Africa, Namibia & Lesotho. Cash & Carry division has a low cost highly competitive distribution and wholesale formula that has enabled it to grow aggressively. Jumbo is a six store cash-and-carry distributor, expert in the distribution of mass-market cosmetics and toiletries.

Shield is a voluntary buying association assisting 244 independent wholesalers and 273 independent retailers to procure food more efficiently for resale to lower income consumers in South Africa, Namibia, Botswana, Swaziland and Lesotho[77]. Whilst Furnex is a voluntary buying organisation for 415 independent retailers of appliances, home electronics and furniture throughout South Africa, with procurement and limited marketing services.

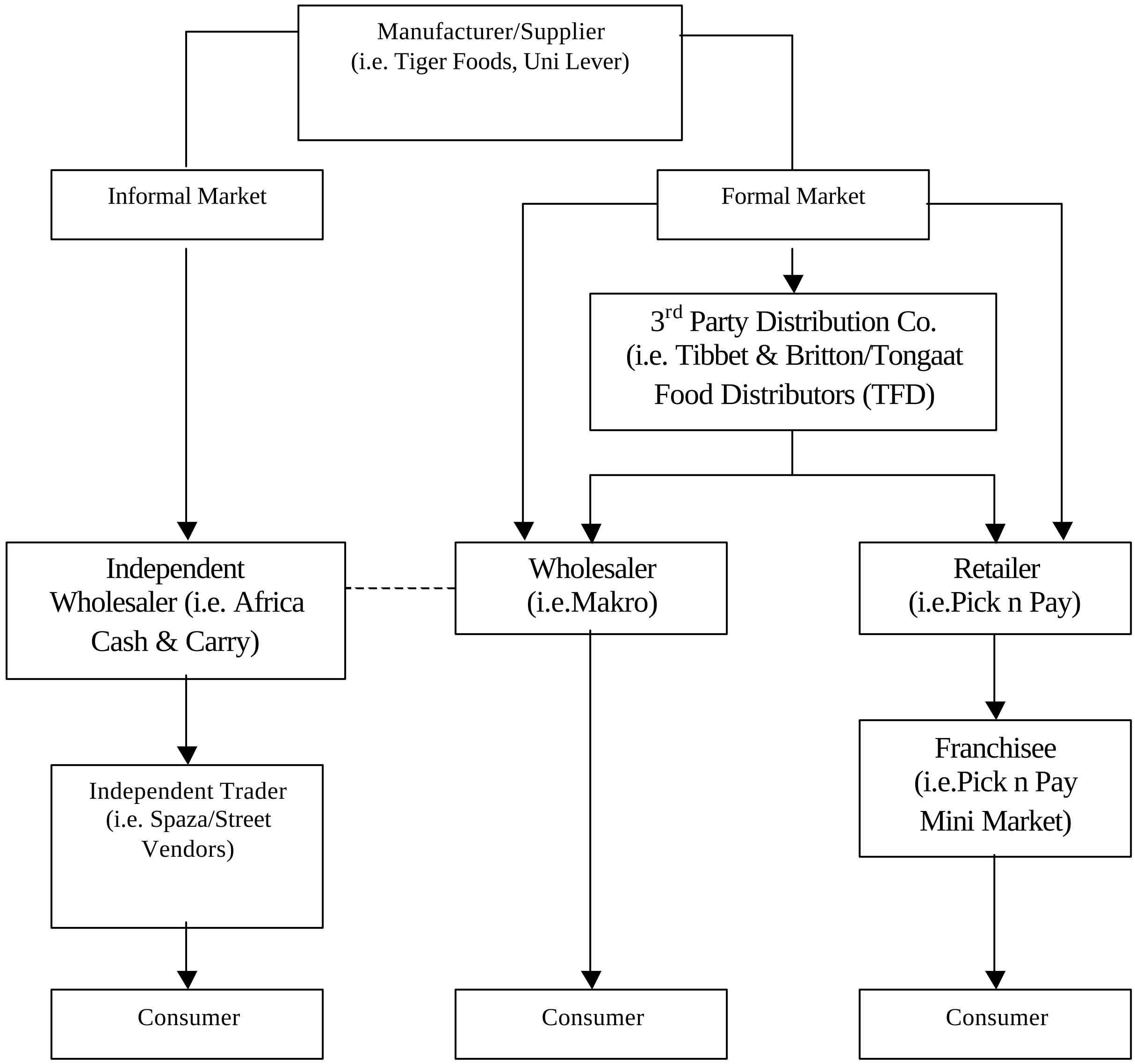
[74] Interview with Bruce Cayzer Director of Makro Food Division held 25 July 2002
[75] Interview with Bruce Cayzer Director of Makro Food Division held 25 July 2002
[76] Interview with Bruce Cayzer Director of Makro Food Division held 25 July 2002
[77] Massmart website (http://www.massmart.co.za)

5.4 Distribution of food

The most commonly used distribution channels between the manufacturer and the retails and wholesale chains in the food industry are the following three:

1. Manufacturer----Wholesaler----Independent Trader----Consumer
2. Manufacturer----Retailer--------Franchisee---------------Consumer
3. Manufacturer----Distribution Company----Retailer-----Franchisee----Consumer

Figure 2: Distribution in South African Food Sector



There are two forms of distribution in the food industry. The first form of distribution is where the manufacturer distributes direct to the wholesale or retail chains and products are delivered either to individual stores or to distribution centres. Manufacturers are required to off-load at the discretion of the chains[78]. For example,

[78] Interview held with Graham Rebello, Massmart Project Manager-Foods Project Forum held 29 August 2002.

Uni Lever will distribute directly to a retailer (i.e.Pick ‘n Pay stores) or direct to a wholesaler distribution centre (i.e. Makro). Retail chains such as Spar, Shoprite and Woolworths make use of a central distribution system[79]. For example, the company will order Campbell Soup which is then delivered to a central warehouse and then distributed from there to the regional market. The manufacturer charges a distribution fee of 6% of the value of the product. Pick n Pay does not operate a system of central distribution but prefers the option of direct delivery to individual Pick n Pay stores. Pick n Pay’s choice of distribution is due to the costly consequences associated with central distribution such as theft.[80]

The second form of distribution is the where the manufacturer will make use of third party distribution companies, such as Tibbet &Britton, Ullman Distribution or Tongaat Food Distributors (TFD). These third party distribution companies provide the following services; storage of stock, redistribution of stock to regional storage depots and direct distribution to the market[81].

Once retails chains have decided on what products to list, orders are then placed with manufacturers and the negotiations then commence with manufacturing agents in respect of the amount of shelf space that is allocated to particular products and brands as well as their positioning in the store.[82] In addition, after theses negotiations manufacturers employ merchandisers in order to ensure that “their” shelves are properly stocked and their products displayed. Chains normally require manufacturers to substantiate their proposed price increases with reference to various costs and there is no guarantee that these will be accepted. Chains use particular products (known as “value items” or “KVIs”), which are heavily discounted to consumers in order to compete fiercely with one another on price[83]. Importantly, chains sometimes threaten to de-list products and may refuse to list new products if unhappy with price increases. Thus retail chains have significant bargaining power when dealing with manufacturers and the high concentration levels due to all the amalgamations have strengthened their market power even further.

5.5 Summary

The South African retail and wholesale industries are highly concentrated. The result is that retail and wholesale chains largely compete with one another on price and operate with low margins. The industry is characterised by large retail and wholesale chains such as Pick n Pay and Massmart respectfully. Whereas these chains generally

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[79] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

[80] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

[81] Interview held with Graham Rebello, Massmart Project Manager-Foods Project Forum held 29 August 2002

[82] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

[83] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

purchase products directly from manufacturers, processors and agents, small independent traders almost always purchase from these chains.

The industry is highly concentrated due to all the consolidations between retail and wholesale chains that have taken place over the past decade. For example, the Shoprite Group acquired OK Bazaars in 1990, Checkers in 1991, RMG (Sentra/Megasave) in 1996 and OK in 1997. Similarly, in 1991, Score and Fairways were amalgamated. In 1994, the Pick n pay group acquired a 50% interest in Score Stores and an additional 25% interest in 1996. In 1997, the Pick n pay Group acquired a further 10% interest in Score Stores, which in turn acquired Superliner[84].

A logical deduction is that a large proportion of sales in the market take place through large chains such as the Shoprite Group and the Pick n Pay Group. The Financial Mail ranked Shoprite thirteenth and Pick n Pay twentieth in its 2001 annual survey of South Africa's top 100 companies. Retail chains in South Africa have a lot of bargaining power vis-à-vis manufacturers as they have access to significant consumer information through scan data recorded at the "point of sale". Furthermore, retail franchises have grown in South Africa over the last couple of years. These franchisees are required to purchase their products from or through their respective franchisers. Thus, these growing trends further extend the buying power and role of the South African retail chains.

6. THE SA AUTOMOTIVE INDUSTRY

6.1 Industry background

In South Africa motor vehicle assembly accounts for 60 % of automotive industry production. Furthermore, motor assemblers account for 40% of the motor vehicle parts sector total sales (DTI, 1998). It should be noted that motor vehicle assembly is dominated by foreign-based Multinational Enterprises (MNEs). South African based local and foreign companies compete for a share of the domestic market.

The South African automotive industry has developed from a highly protected, inward-focused industry to one with a marked export orientation. A study on the South African automotive industry prepared for UNCTAD, by Hartzenberg and Muradzikwa (2002) reports that the motor industry development programme (MIDP) played a pivotal role in reversing the import substitution programmes that had shaped the industry since the early 1960s. In addition, institutional support has also contributed significantly to innovation and technological development to meet the high technical standards necessary to compete in international markets.

6.2 Automotive assemblers

[84] Interview with Dave Robbins Pick n Pay Group Enterprise Director of International Divisions 29 July 2002

South Africa has eight light vehicle assemblers nearly all of them also manufacture heavy vehicles. All the assemblers are either affiliates or licensees of foreign MNEs. The components sector however does not have a significant local ownership level.

Table 9 below, demonstrates Toyota is the single largest producer of domestically assembled vehicles accounting for 22% and 30 % share of the car and light commercial vehicles respectively. VWSA accounts for large percentage of the market share. VWSA accounted for 22.5 % of the local car market while Toyota SA was responsible for 21.6% of the domestic market. Due to high rates of tariff protection, imports of completely built-up units (CBUs) have until recently been negligible. They account for approximately 15 % of the car market. Hyundai, a new entrant to the market who set up an assembly plant in Botswana manufacturing vehicles from imported kits from Korea, has eclipsed its direct competitor in the shape of Nissan in the South African car market. Nissan lost half its market share between 1995 and 1997 (Financial Mail, 1997, September, 05).

Table 9: Assembly Firms Operating in South Africa

Assembler	***Ownership***	***Makes***	***Market Share %***	
			Cars	***LCVs***
Automakers	Nissan	Nissan	6.4	13.8
	Sankorp	Fiat		
BMW (SA)	BMW (AG)	BMW	5.0	-
Delta	GM	Opel/Isuzu	11.2	
Landrover	BMW (AG)	Landrover	0.8	-
MBSA	MB (AG)	Mercedes/Honda/Mitsubishi	8.1	5.2
Samcor	Ford Amic	Ford Mazda	13.6	19.2
Toyota	TMC Wesco	Toyota	22.0	30.3
VW (SA)	VW (AG)	VW Audi	18.7	4.6
Importers				
Daewoo	Daewoo	Daewoo	3.0	-
Hyundai	HMD	Hyundai	7.5	3.2
Other			3.8	3.2

Total			100	100

Source: Black, 1998

The South African automotive industry is characterised by too many assemblers competing for a share of a small market by international standards. Through this they deny the industry as a whole the opportunity to reap scale economies benefits. In a study assessing the industry performance of components and assembly, Netshitomboni (2000), reports that exports have grown rapidly since 1989 while the reduction of tariff protection has permitted the penetration of imports into the South African market. In addition, faced with the reality of imports, local automotive producers are under pressure to supply high quality and cheaper products.

6.3 Ownership structure

A very distinctive feature of the South African automotive industry is its particular ownership structure. All assemblers are now wholly or partly owned by their respective parent company in Japan, the US or Europe (Hartzenberg and Muradzikwa, 2002). The associated corporate governance structures have significant implications for and technology transfer and integration of the industry into global markets. For instance, local producers, through the networks and supply chains of their 'parent' companies, are able to access new technologies and tap into existing markets (Hartzenberg and Muradzikwa, 2002).

The existence of foreign MNEs in South Africa automotive industry produced a mixed bag for the components sector. They are essential in accessing markets on the one hand, while they source the bulk of their components overseas on the other.

The Japanese and the American auto producers have invested quite substantially in the South African automotive industry. Toyota (Japan) and Nissan (Japan) have invested over US$74.6 million and US$77.6 million respectively, since 1996 in the purchase of shares in the local subsidiaries, which has in turn allowed the local subsidiaries room for upgrading plant and equipment that generates further production capacity (Hartzenberg and Muradzikwa, 2002). The American auto producers, Ford and General Motors have also recently invested in the South African industry.

BMW (Germany), Volkswagen (Germany) and Daimler-Chrysler are big auto producers who have always maintained a presence in South Africa. Huge investments by these companies over the past 5 to 6 years have been motivated largely by the desire of these firms to capitalise on the opportunities presented within the MIDP framework (Hartzenberg and Muradzikwa, 2002).

BMW has invested US$149 million since 1996 for the expansion of production capacity at its Rosslyn plant near Pretoria. Since BMW had an existing plant in South Africa, and also since the BMW market share in South Africa is larger than it's share in Germany, it made business sense to invest in their existing facility as opposed to opening a new plant in a new location (Hartzenberg and Muradzikwa, 2002).

Volkswagen, with the aim of using the incentives provided by the MIDP to tap into overseas markets, launched a US$149 million investment in 1998 to increase production capacity and upgrade workshop facilities. Volkswagen is now currently exporting Golf 4's to Europe (Hartzenberg and Muradzikwa, 2002).

6.4 Economic performance

Economic performance and profitability in the component industry have fallen sharply. This is highlighted by the fact that average employment levels per sampled firm have declined 14% between 1995 and 1997, and that turnover in real terms has stagnated over the same period (Barnes, 1998). In a subsequent survey conducted by the Department of Trade and Industry in 1997 of 21 component firms, Black (1998) reports that of the sampled firms profits fell by 74.6% during 1996 from the record levels of 1995. The prominent contributing factors have been falling margins resulting from pressure applied by vehicle manufacturers, and the increasing desire of the vehicle manufacturers to use imported components.

6.5 Export performance

Automotive exports from South Africa have expanded dramatically from just US$121.15 million in 1988 to approximately US$2.45 billion in 1999 of which just over US$0.81 billion is accounted for by vehicles (Hartzenberg and Muradzikwa, 2002). The main destination for vehicle exports is to Africa. However exports to non-African markets are likely to be the fastest growing in the short term and will consist mainly of passenger cars. Volkswagen has a large contract to export Golf 4 vehicles to the UK and BMW exports the 3 Series vehicle to Australia and a number of Asian markets.

Hartzenberg and Muradzikwa (2002), report that while South African automotive exports into the Southern African Development Community (SADC)[85] have increased rapidly, this has been at a slower rate than total automotive exports. For example, light vehicle exports to SADC accounted for 12% of the total in 1999, a sharp decline from the 64% share in 1996. For medium and heavy commercial vehicle exports, which have not grown significantly in volume terms, Africa remains the dominant market although the SADC share has declined from 89% in 1996 to 60% in 1999. The UNCTAD report provides two reasons accounting for this.

Firstly, the collapse of the Zimbabwean market as well as the raising of tariff barriers in response to economic problems has slowed sales into South Africa's major regional market. Secondly, light vehicle exports from South Africa have been increasing at a very rapid pace to markets such as Australia and Europe reflecting the increasingly important role played by South African operations of firms such as BMW and VW in the global strategy of the parent company.

Furthermore, the growth in exports to Europe was reported as a direct result of local subsidiary firms accessing the traditional markets of the parent companies. As the global automotive producers invested in local operations, it facilitated the inclusion of these local firms into the 'parent' company's global supply networks and markets.

[85] SADC, a regional economic bloc consists of 14 countries in southern and eastern Africa. South Africa is by far the largest member country with the most diversified industrial base.

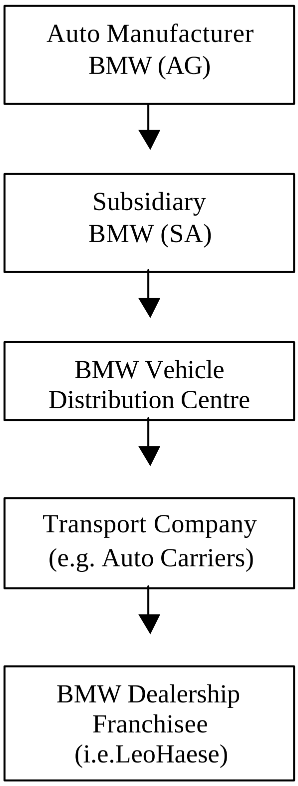
6.6 Distribution in the automotive industry

The most commonly used distribution channel between the MNE Automotive manufacturer and retail car dealerships is as follows:

Manufacturer -------Local Firm------Transport Company----Retailer------Consumer

BMW (AG) BMW (SA) Auto Carriers Franchisee

Figure 3: Distribution Channel in Automotive Industry



For example, BMW SA does not have its own distribution system for locally assembled vehicles and sub-contracts to a transport company called Auto Carriers, which loads the BMW vehicles at the Rosslyn Vehicle Distribution Centre (central warehouse) and offloads directly at BMW dealerships nationwide[86]. With regard to imported vehicles, BMW SA subcontracts to Auto Carriers to transport three makes of imported vehicles namely, the X5, Z3 and 7 Series BMW vehicles. Auto Carrier driver's unload the vehicles at Durban port (process is referred to as stevedoring vehicles) once cleared via landing order these are then driven to the PortNet Car Terminal where Auto Carriers perform their Tally function (i.e. count vehicles and conduct quality inspections). The vehicles are then loaded onto Auto Carrier truck fleets and driven to BMW Rosslyn Distribution Centre where the vehicles are de-waxed and made available for distribution to the local market[87]. The balance of other

[86] Interview held with Samantha Pieterson, Export Specialist BMW SA held 22 August 2002

[87] Interview held with Graham Robins, Auto Carrier Pretoria Branch Manager, held 22 August 2002.

makes of BMW vehicles are handled by Spoornet and railed to the BMW Central Warehouse[88]. Regarding the distribution of components BMW subcontracts to a company called Mediterranean Shipping Company (MSC), which handle the customs process and drive the shipments up to Johannesburg and unload at the BMW central warehouse[89].

6.7 Inter-firm relationships

The relationships between parent (foreign) and local firms are particularly important both among assemblers and component manufacturers. Through the franchise modality of involvement with South African firms, the parent companies are engaged in technical support, training programmes and financial commitment in terms of investment. Barnes (1999) found that these links were fostered by the following factors:

1. The growing levels of foreign ownership and investment and the rapid expansion of trade especially exports. Direct equity stakes by Nissan and Toyota could be the forerunner of direct Japanese investments in the component industry.

2. Until the early 1990s, with the exception of the German companies (Mercedes, BMW and Volkswagen) all local assembly operations were domestically owned and operated under licence.

3. Ford and General Motors have taken substantial equity stakes with Ford recently increasing its stake to 90% in Samcor (now renamed Ford), that produces Ford and Mazda vehicles.

4. Political acceptability (of South Africa) and an automotive policy, which encourages exports and, therefore, specialisation have given strong encouragement to parent companies to increasingly incorporate their South African interests into their global networks.

5. There has also been significant foreign investment, particularly by German firms, in the component industry in areas such as tyres, catalytic converters, engines, seating and axle assemblies.

6. Certain South African automotive firms have subsidiaries in the region and South Africa tends to act as regional headquarters to foreign firms with interests in southern Africa.

Examples include South Africa's US$ 33 million investment in the Afinta MotorCorporation of Swaziland for the assembly of medium-to-heavy commercial vehicles, and a R7million investment by Nissan (SA) in the Quest assembly plant in Zimbabwe for the manufacture of a range of Nissan vehicles[90].

[88] Interview held with Samantha Pieterson, Export Specialist BMW SA held 22 August 2002
[89] Ibid
[90] BusinessMap, 2000 (unpublished data) in Hartzenberg T and Muradzikwa S, (2002).,*Transfer of Technology for Successful Integration in the Global Economy:* The Case of the South African

6.8 Summary

The South African automotive industry has evolved from highly protected, inward-focused industry to one with a marked export orientation. Industry features which have contributed to its integration into international markets are firstly, extensive foreign ownership of both vehicle assemblers and component manufacturers; secondly, close links with parent companies; and thirdly, effective linkages between assemblers and components manufacturers.

The key factors that have assisted in integrating the industry into global networks have been the incentives provided under the MIDP, falling tariff protection that has increased import competition, and access to international markets through the parent company.

In the UNCTAD report Hartzenberg and Muradziwa (2002), report that due to the high integration of South African automotive industry with parent companies, it is unlikely that adverse effects may have occurred at least in the form of injury to the domestic production of other Member or in the way of nullification or impairment of benefit accruing directly and indirectly to other Member under GATT 1994. In this case, those adverse effects may have arisen from the displacement or impediment of imports of a like product of another Member into the market of the subsidising Member.

The Netshitomboni (2000) study found that the benefits of reliance on foreign MNEs in the South African automotive industry far outweigh the costs of hosting them. Furthermore, the study recommends that licensing agreements that confine exports of local manufacturers to the limited sub-Saharan Africa market need government intervention with a view to making them less restrictive. The more difficult area to control is the technology licensing which is undermined by the underdevelopment of the domestic capital goods sector.

The performance of the South African automotive industry may be constrained by the limited size of the domestic market, but the industry in tandem with the whole economy is increasingly becoming part of the global automotive industry. This has manifested itself through growing imports and exports as well as foreign direct investment.

7. THE SA FRANCHISE SECTOR

Franchising is defined as a marketing and distribution system used where a licensing relationship exists between two or more parties. The principal (the franchisor) grants a third party (the franchisee) the right to market products or services using the trade name and marks and, in some cases, the developed business format (Gordon, 2001).

Automotive Industry, Paper prepared for UNCTAD, Development Policy Research Unit, School of Economics University of Cape Town.

The real growth in franchising did not occur until the late 1950's, with the advent of fast food outlets and ice-cream parlours. Today, the franchise method of distribution accounts for close to 50% of all retail sales in the United States with most developed countries following suite[91].

Business format franchising, which is the dominant mode of franchising today developed after World War II, with the return of millions of US service men and women and the subsequent baby boom. There was an overwhelming need for all types of products and services. Franchising was the ideal business model for the rapid expansion of the hotel/motel and fast food industries as well as retail franchises.

In South Africa franchising has grown significantly over the past 20 years. The Franchise Association of Southern Africa (FASA) began with very modest membership number of 30 in 1986 and this figure currently stands at approximately 150 franchisers[92]. The fourth survey of the Franchise Sector in South Africa by Gordon (2001), reports that since 1994 the number of franchise systems has increased threefold. Between 1994 and 1998 growth was exponential. Although the net increase in the number of franchised systems since 1998 is 18%, activity in the sector has been buoyant. 144 new franchised systems entered the market and 52 exited the sector.

Where once fast food was synonymous with franchising, today anything and everything can be franchised - from education to travel; from the Internet to hotels. Table 10 below illustrates the business categories in the South African franchise sector. The distribution of franchised systems amongst the 16 business categories is vast with the major players being retail (18% of franchised systems), fast food (14% of franchised system) and Restaurants (10% of franchised systems). The range of business categories has been increased to include Telecommunications, Industrial and Financial Services due to the number of franchised systems operating in these categories.

Table 10: Business Categories in Franchise Sector

Categories	**Number of Franchised Systems**	**% Of Total**
Retail[93]	77	18
Fast Food[94]	61	14
Building Office and Home Services[95]	45	11
Restaurant[96]	45	11
Automotive Products[97]	42	10

[91] Interview conducted with Mr. Nic Louw, Executive Director of Franchising Association of Southern Africa, held 28 August 2002.
[92] Franchising Association of Southern Africa website (http://www.fasa.co.za)
[93] HealthPharm, Link Pharmacies, Weleda Pharmacies, Pick 'n Pay Mini Markets, Family Stores, OK (Sentra, 8'Till Late, Mini Market, Mega save, Value Stores), Kwikspar.
[94] Bimbo's Fast Foods, BJ's fast foods, Black Steers, Bustas, Fish Aways, Kentucky, King Pie, Mc Donald's South Africa, Captain Dorego, Chicken Licken, Fontana Famous Roastery and Steers.
[95] Ceramic Tile Market (CTM), Coastal Tool Hire Network, Easy Fit Cupboards, Glow Getters, The Drain Surgeon, Timber City, Wilcole
[96] Greenfields Café, Juicy Lucy, La Cocina, Ocean Basket, Saddles Steak Ranch, Something Fishy, Spur Steak Ranch, Squires Legendary Grills

Education and training[98]	41	10
Business to Business Services[99]	27	6
Health hair and Beauty[100]	24	6
Entertainment and Leisure[101]	15	4
Printing and Photo Development[102]	11	3
Personal Services[103]	9	2
Real Estate[104]	8	2
Telecommunications[105]	5	1
Industrial[106]	4	1
Financial Services[107]	4	1
Travel[108]	4	1
Total	**422**	**100**

Source: Gordon B (2001), *The Franchise Factor 1999/2000 - Fourth Survey on the Franchise Sector in South Africa*, Franchise Directions, and ABSA.

7.1 Business development in Africa

Numerous South African franchises are leading business development in Africa. A study commissioned by the African Development Bank conducted 75 interviews with franchise companies, 5 with financial institutions, 13 with government organisations and consultancies and 21 with legal firms in South Africa, Egypt, Morocco and Ivory Coast. South Africa was reported as the leader in franchising with more than 23 000 outlets and 478 systems (Finance Week 21 June 2002). For example, South Africa has invested more than R2 billion in Kenya since April 1994 and about R496 million in Uganda. Some of the big companies involved are SA Breweries, Metro Cash 'n Carry, Standard Bank, Old Mutual, MTN, Vodacom, Uniglobe, Shoprite Checkers, Pep Stores, Steers and Nando's (Finance Week 21 June 2002).

Whilst not as substantial as the USA figure quoted above, the South African franchising sector's contribution to the economy is substantial when considering that it is estimated that approximately 15% of all retail sales originates from a franchise outlet[109].

[97] Battery Centre, Caltex, Fasfit, Hi-Q Automotive, King Midas, Koenic & Wheel Warehouse, Kwik-fit, Mr X-Haust, Mr. Tyre, PG Autoglass, Supa Quick
[98] Beau Arts, Master Maths, Smiley Kids, Boston Business College, Academy of learning, Creative Minds
[99] Post Net, Minute Man Press, Express Personnel Services, Sign-A-Rama, Courier Junction
[100] H2O International South Africa, Spec savers, Sure Slim
[101] Block Buster Video's, Days Inn Hotels of SA, Video Town
[102] Kodac Stores
[103] Dream Nails, Spec Savers, Sure Slim
[104] Pam Golding, Re/Max Southern Africa, Aida National, ERA Real Estates
[105] Vodacom Service Provider Company
[106] Inso Aluminium
[107] Curator Services
[108] Uniglobe, Harvey World Travel, SAA Flight Centre
[109] Interview conducted with Mr. Nic Louw, Executive Diretor of Franchise Association of Southern Africa held, 28 August 2002

8. INCREASING IMPORTANCE OF E-COMMERCE

Developments such as electronic data interchange (EDI) have for some time been important elements of business-to-business commerce. But now similar developments are affecting retailing. Online-vendors of flowers, books, cars, music, computers or software, and even groceries have been making some inroads into traditional retailing through specialization on certain items or product lines. For instance, electronic purchases of books and other products allow an easy tracking of buying patterns, and sellers can target advertising and information to customers on the basis of their revealed preferences.

In attempting to measure the scale of electronic commerce, it is necessary to define what should be counted under this term. The narrowest definition includes only products that can be delivered electronically, while wider definitions also include products that are advertised, ordered or paid for electronically. The degree to which these functions can be performed electronically will determine the manner in which the distribution of specific products is affected. For instance, if the product can be adequately displayed electronically, the need for costly show-room space diminishes. In many cases, considerable cost savings can result when products are not only ordered and payed for, but also delivered electronically. Online sale and downloading of software ranks first among all goods and services retailed on the Internet[110].

More than 50 000 on-line merchants were active by 1998 (Condon, Gerber, Green & Hodge, 1998) indicating that retailers in the United States have been quick to grasp the importance of the Internet as a retailing channel. In South Africa, the third edition of the South African Internet Services Industry Survey by Goldstuck (1999) found that the number of Internet users reached 1,3 million by the end of December 1998 doubling every year since 1994. Goldstuck and Stadler (1998a) estimate that consumer on-line spending reached R1 billion in 1998 with 43% of users having already purchased on-line and 89% saying that they intended using the Internet for making purchases in the future (Goldstuck and Stadler 1998b).

The ubiquitous nature of the Internet has made global competition a very real threat to retailers in South Africa, as consumers are no longer limited to shop within a geographical location. Kegler and Wittkopf (1996) refer to the Internet as the "death of distance" and "the end of geography". Today, a remote consumer from a small town has access to every on-line store in the world, knowing that the merchandise can be delivered within two to three days.

Technological advances, such as the "Web-TV" already offered by Teljoy, are making the Internet more affordable and more accessible to a broader spectrum of the population. Ghosh (1998) points out that the ubiquity of the Internet, the fact that anyone can link to anyone else, makes it potentially possible for a participant in the value chain to usurp the role of any other participant. Pavitt (1997) predicts that Internet retailing has great future potential when considering the demographic and cultural trends. Succeeding generations are increasingly comfortable with computers

[110] Distribution Services; Background Note by the Secretariat., S/C/W/37 10 June 1998 WTO, Paris

and trends have shown that the medium is moving away from being male dominated. Burke (1997) sights the expanding number of dual-income and single parent households as a driving force of home shopping. A growing number of people are time constrained by obligations to work and family. Burke (1997) believes that many people do not enjoy shopping anymore, especially routine chore of grocery shopping. After six focus groups, Burke (1997) concludes that convenience is the most frequently cited reason for wanting to shop electronically.

Ghosh (1998) explains the threat of disintermediation with the example of how the book publisher could bypass the distributor and sell directly to readers. Virtual stores such as Amazon.com however, could decide to publish their own books as they have collated in-depth information about reader's interests. Another example cited is that of Dell Computers who has bypassed the physical retailers and is selling over US$5 million worth of computers daily over the Internet. Pavitt (1997) adds that traditional retailers will need to focus on the process of shopping as a source of entertainment and pleasure with tactile and visual appeal of their goods and on the quality of their service to avoid being disintermediated.

Therefore, the Internet is a new retailing channel with the potential of enabling access to wider markets as well as providing market development opportunities through offering a range of added services to the consumer. It is possible that Internet retailing may one day replace the shopping experience of a store. E-Commerce is growing at a phenomenal rate in South Africa as traders are recognising its advantages, just a few of these include: 1) 24 hour trading allowing the trader to purchase at any time, 2)instant ordering, 3) immediate access to promotional pricing, and 4) customised cyber trolleys for convenience and fast efficient trading. In the drug industry the drug distributor companies such IHD have collected a comprehensive market database from consumers. Furthermore, in the food retail sector stores such as Pick n Pay and Woolworths offer electronic grocery shopping to customers on their websites. The retail chain Makro, offers bulk trading via its Internet site by means of an online catalogue. It also allows you to create your own standardised shopping lists, which speeds up the ordering process significantly[111]. In the South African furniture industry FurnEx an independent buying group for independent furniture retailers solely uses E-commerce or its Internet website in which to conduct sales.

Thus, the possibilities of the Internet as a retailing tool are boundless. However, a real obstacle to the advancement of electronic shopping faced by many South African retailers is the lack of broadband development. For example, in the UK, the introduction of asynchronous data services line (ADSL) to the commercial market has meant the world of difference for Internet consumers. ADSL offers high bandwidth of 512kbps substantially faster than Telkom's Diginet Service that currently offers 64kbps. Although Telkom's Diginet Plus offers speeds from 128 kbps up to 2048 kbps in 64 bit/s aggregates, and allows users to develop highly efficient integrated voice/data networks it still lags behind developed countries bandwidth development and commercialisation of services such as ADSL.

[111] Makro website (http//: www.makro.co.za)

It should be noted that ADSL has the ability to provide 2Mbps but telecommunication operators have opted to commercially offer 512kbps as offering greater bandwidth, could cannibalise other services that they offer. Rapid technological change has impacted on the provision of telecommunications, for example broadband development and the increasing capacity of new networks, are major factors influencing growth. Unfortunately South Africa lags behind the rest of the world in terms of broadband telecommunication services offered and this negatively impacts on South Africa's ability to effectively participate in economic activity.

9. CONCLUSION

The study has provided a general overview of current issues in the distribution sector.

The study has restricted itself to focussing on three industries namely, pharmaceutical distribution, distribution in the food industry and distribution in the automotive industry. The summary findings for the three case studies are as follows:

9.1 Pharmaceutical industry

Sales are conducted through four primary outlets, namely, retail pharmacies, dispensing doctors, private hospitals and supermarkets (non pharmacy retail).

Retail pharmacies continue to account for the majority of purchases (65%) even though there has been an increase in sales through supermarkets and dispensing doctors. In examining the behaviour of SA retail pharmacies it becomes apparent that retailers have attempted to obtain political support for regulations that bolster cartel structures and behaviour, and which discourages innovation in distribution. The outcome is perverse. Retailers do not achieve economies of scale, while consumers do not receive lower prices.

9.2 Food industry

Retail and wholesale industries in the food sector are highly concentrated. The result is that retail and wholesale chains largely compete with one another on price and operate with low margins. Whereas, large chains generally purchase products directly from manufacturers, processors and agents, small independent traders almost always purchase from these chains. Manufactures distribute direct to retail chains at the discretion of the chains. Companies such as Spar, Shoprite and Woolworths make use of a central distribution system, where the manufacturer offloads at a central warehouse. Pick n Pay on the other hand does not operate a system of central distribution but prefers the option of direct delivery to individual Pick n Pay stores.

Retail chains in South Africa have a lot of bargaining power vis-à-vis manufacturers as they have access to significant consumer information through scan data recorded at the "point of sale". These growing trends further extend the buying power and role of the South African retail chains.

9.3 Automotive industry

The South African automotive industry has evolved from highly protected, inward-focused industry to one with a marked export orientation. Industry features which have contributed to its integration into international markets are firstly, extensive foreign ownership of both vehicle assemblers and component manufacturers; secondly, close links with parent companies; and thirdly, effective linkages between assemblers and components manufacturers. The key factors that have assisted in integrating the industry into global networks have been the incentives provided under the MIDP, falling tariff protection that has increased import competition, and access to international markets through the parent company. The performance of the South African automotive industry may be constrained by the limited size of the domestic market, but the industry in tandem with the whole economy is increasingly becoming part of the global automotive industry. This has manifested itself through growing imports and exports as well as foreign direct investment.

The study also notes that the growth of electronic commerce can be expected to bring about changes in the distribution sector as a whole. The ubiquitous nature of the Internet has made global competition a very real threat to retailers in South Africa, as consumers are no longer limited to shop within a geographical location. Therefore, the Internet is seen as a new retailing channel with the potential the of enabling access to wider markets as well as providing market development opportunities through offering a range of added services to the consumer. The Internet mode of retail is used extensively in the South African distribution channel, however South Africa's lack of bandwidth development may be constraining South African retailers from effectively competing with foreign retailers. Perhaps the greatest benefit to the South African retailers who rely on E-commerce, is likely to come from a new round of government negotiations that will see liberalisation measures foster effective competition in the telecommunication sector.

9.4 Further research

The study has restricted itself to the CPC definition of distribution services, which include four major services: commission agents' services, wholesale trade services, retailing services, and franchising. However, in practice, the definition of the distribution sector may understate the increasingly wide role of many operators in the sector. For instance, the principal service rendered by wholesalers and retailers may be characterised as reselling merchandise, accompanied by a variety of related, subordinated services such as: maintaining inventories of goods; sorting and grading goods in large lots; breaking bulk and redistribution in smaller lots; delivery services; refrigeration services; sales promotion services rendered by wholesalers; and services associated with retailers' businesses. Article XXVIII (b) of the GATS states, "the supply of a service' includes the production, distribution, marketing, sale and delivery of a service."

The empirical importance of these subordinated services is not clear, and hence the implications of their CPC exclusion, are not immediately clear. Therefore, further research is required to identify South African companies that fall into this category of subordinated services[112]. It is important to access what role these subordinated service

[112] For example, companies such as Clover Cargo International a distribution company which manages sea and air freight import and export logistics and Thrutainers International -an indirect carrier as a

companies play in the distribution sector, whether they export their services, and whether they have ever encountered trade barriers in exporting their services.

cargo consolidator and a non Vessal Operating Carrier Cargo (NVOCC).Thrutainers operates from South African seaports, it also operates branch offices in Tema (Ghana), Maputo and Beira (Mozambique), Dar es Salaam (Tanzania) and Mombassa (Kenya).

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