Overcoming Barriers to Supply Chain Integration in SACU – Lessons from the Private Sector

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1 Introduction

Cross border value chains are increasingly seen as critical for export growth, providing the conduit for more than half of developing countries exports in value-added terms[2]. However, Africa's contribution to cross border value chains remains low, at 1.5%[3]. And African countries' limited participation in value chains is in the lower-value, lower end stages of production.

Reasons for this limited integration include infrastructure, thick borders, geographical remoteness, size, fragmentation and the limited financial capacities and service industries of African countries.

Policy barriers remain, despite the government led and legally driven integration initiatives across the continent under the different Regional Economic Communities that include in Southern and Eastern Africa the Common Market of Eastern and Southern Africa (COMESA) the Southern African Development Community (SADC) and the Indian Ocean Community (IOC). Even within the Southern Africa Customs Unions (SACU), a customs union of over 100 years standing, there has been limited growth in regional supply chains.

Though the growth in production chains has been limited, primarily to clothing and textiles, the growth of the regional retail chain within SACU has been substantial. Many of the bigger South African retailers have a presence in at least one SACU member state. And there are now companies from Botswana and Namibia that have established a presence in South Africa and the rest of SACU.

This growth in retail chains provides an opportunity to see how the private sector is finding its own solutions to barriers to trade within SACU. This paper draws on interviews with companies in the region and identifies where the market is, and is not, providing such solutions.

2 Limited growth of the production chains in Africa

Value chains allow countries to enhance their production capacities and competitiveness. Countries can trade globally at lower cost by focusing production on certain parts or certain tasks which feed into global production network, rather than producing a complete product or service.

Traditionally value chains developed in North-North trade and North-South trade. North-South trade in parts and components increased from 30% to 40% between 1988 and 2013. But the value chains are increasingly important for South-South trade. The share of trade in parts and components in South-South trade increased from 6% in 1988 to just under 25% in 2013. Developing countries' participation in these value chains has increased significantly with over

[2]World Trade Organisation 2014 *World Trade Report, Trade and Development: Recent Trends and the Role of the WTO*. http://www.wto.org/english/res_e/booksp_e/wtr14-2c_e.pdf

[3] Trade Policies and Regional Integration in Africa, Chapter 3, African Economic Outlook 2014

50% of developing countries' exports (measured as value-added) comprising GVC[4]. They are now a fundamental way to increase exports.

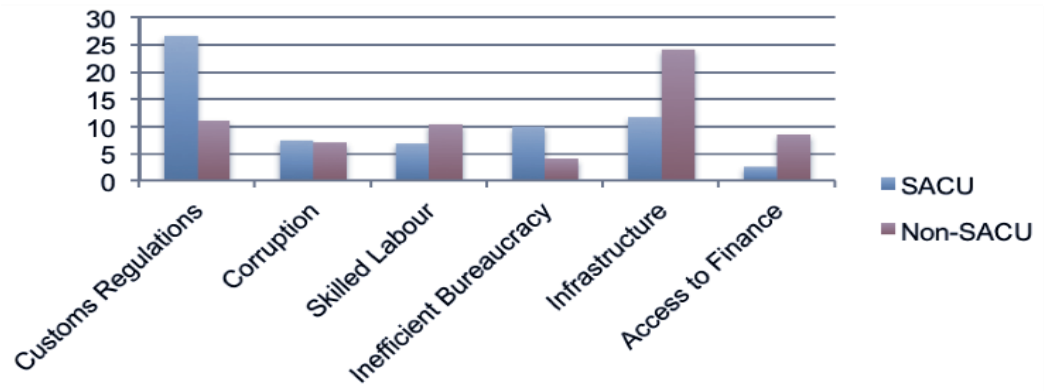
Africa's contribution to global value chains remains low, at 1.5%[5], and participation is in the lower-value, lower end stages of production. Even within SACU, while intra regional trade has grown in recent years, driven by South Africa, it has been mainly in finished food and manufacturing products through the regional retail chain, not inputs to finished products as part of a value chain. The only regional supply chain of note has been in clothing.

The reasons for the limited growth of production chains are infrastructure, thick borders, geographical remoteness, size, fragmentation, limited financial capacities and services industry of African countries; factors which also act as constraints on intra regional trade.

2.1 Trade barriers are a significant problem

The extent to which thick borders are a significant challenge varies by region and by country within regions. Recent case studies of the challenges facing companies across Southern and Eastern Africa suggest that customs regulations are more important for the SACU region, while companies in SADC are more affected by the greater infrastructural deficiencies outside SACU, limited access to finance and a greater skills deficit (Figure 1).

Figure 1 Case Studies: Top Business Constraints in SADC and SACU



Source: 'Making Key Business Constraints in SADC Tangible" Bertelsmann-Scott, Grant and Graf, GIZ/SAIIA (2012)

Within SACU the picture also varies widely. The SACU Enterprise Survey looks at the greatest obstacles that SACU business face. South Africa's greatest challenges are crime, theft and disorder, for both exporting and non exporting companies, as well as inadequate workforce, especially for export companies. Access to finance is a challenge for Botswana export companies. Lesotho struggles with courts, inadequate workforce and tax rates. Namibia's

[4] Data from 2009, The Rise of Global Value Chains, World Trade Report 2014
[5] Trade Policies and Regional Integration in Africa, Chapter 3, African Economic Outlook 2014

biggest obstacles are labour regulations, inadequate workforce, practices of the informal sector and customs and trade regulations for exporting companies. Namibia is also the only country with a significant obstacle for export companies in transportation. Swaziland's greatest obstacle for both export companies and non exporters are the practices of the informal sector.

2.2 The nature of trade barriers within SACU

There are different sources of information on constraints to trade within SACU.

The Non Tariff Barriers Monitoring Mechanism is a web based "post box" where the private sector can report thief complaints in the southern and eastern African region. It is a platform shared between COMESA, EAC and SADC A summary of the NTBs by category in SACU is listed in Table 1. There are currently 93 complaints (active/resolved) reported through the on-line mechanism within SACU.

The most frequently reported NTBs between SACU countries fall under Customs and administrative entry procedures (Category 2). Within this category, three of the most common complaints at SACU level are lengthy and costly customs clearance procedures (15 recorded complaints), Inadequate or unreasonable customs procedures and charges (7) and International taxes and charges levied on imports and other tariff measures (5). The second most common category of complaints is Specific limitations (Category 5) which relates to issues such as import/export quotas, tax or licensing. Quantitative restrictions (5) are the most common complaint within this category. Government participation in trade & restrictive practices tolerated by governments (Category 1) is the third most cited category with Government monopoly in export/import (6) being the most commonly listed complaint. Costly Road user charges /fees is another commonly cited complaint under Transport, Clearing and Forwarding (Category 8).

Table 1 Types of NTB reported within SACU

By broad category		
Category	**Type of complaint**	**#**
Category 1	Government participation in trade & restrictive practices tolerated by governments	16
Category 2	Customs and administrative entry procedures	37
Category 4	Sanitary & phyto-sanitary (SPS) measures	1
Category 5	Specific limitations	17
Category 6	Charges on imports	2
Category 7	Other procedural problems	8
Category 8	Transport, Clearing and Forwarding	12

Source: Non-Tariff Barriers Reporting, Complaint and Eliminating Mechanism, database, http://www.tradebarriers.org September 2014

Anecdotal evidence from interviews undertaken for this study relate to trade barriers that are not directly reflected in the monitoring system, such as TBT/SPS. This is in part because some of

these identified issues are reported under customs and administrative entry procedures or not reported at all.

The SACU Enterprise Survey reports on a range of constraints facing businesses in the region, including in the area of trade. In Botswana 32% of companies which export consider customs and trade regulations as a major obstacle whereas less than 2% consider these an obstacle in South Africa. Lesotho faces the highest number of days to clear imports from customs (11 days), whereas Botswana has the longest period to clear exports through customs (7.5 days), followed by Lesotho (7 days). Botswana and Lesotho also have the highest proportion of inputs that are of foreign origin.

Cross border barriers compound the other challenges of doing business across the region. For example, a limited production base results in many empty return loads in part drives the high cost of transport in the BLNS. But this is made worse by long delays at the border, helping to explain why cross border trucking is significantly more costly than in country trucking in South Africa. This is because, as a result of the border delays, a truck delivering within South Africa does between 12,000-15,000 km/month whereas a truck doing cross border delivery will only do about 8,000 km/month (estimate provided by Unitrans).

2.3 Specific barriers for Regional Value Chains

The Trade and Transport Facilitation Assessment of SACU (2014) investigates the barriers to the development of regional value chains (**Error! Reference source not found.**). The substantive barriers to effective supply chain integration in SACU include inefficiencies in transport and imbalanced trade flows; border management and logistics which varies between member states; cumbersome fiscal arrangements; poorly designed technical regulations and standards; and other non-tariff barriers (NTBs) such as import bans, permits and licensing.

Table 2 Key challenges for the development of SACU value chains

Category	Challenge/issue identified
Trade Policy	Tariffs raising costs of inputs
	Intra SACU trade restrictions
Transport	Limited intermodal solutions
	Imbalanced freight flows and vehicle utilization
	Limited access to containers in BLNS
	Inland Container Depots ineffectively used
	High costs / poor infrastructure outside the corridors
Borders	Lack of predictability and harmonization of procedures
	Within SACU, electronics systems still not fully integrated
Others	VAT implications on cash flow

Source: Regional TTFA for the SACU Region, November 2014

3 The growth of the SACU retail chain

Though "Factory Southern Africa" has witnessed limited growth, the retail chain has expanded rapidly and extensively, driven predominantly by outward investment from South Africa (see Berkowitz et al.[6]). The majority of the bigger South African retailers have a presence in SACU, some in SADC and some even further afield in West and East Africa. South African retailers with an active presence abroad include general retailers, like Shoprite, Pick and Pay or Spar, Massmart (a subsidiary of Walmart) and Woolworths, as well as more specialized retailers like furniture retailers (e.g. Ellerines) and clothing/fashion retailers such as Mr. Price or Foschini. However, it is important to note that even with the expansion of retail business in SACU and the rest of Africa, Berkowitz et al. found that over 90% of all retail revenue of South African retail outlets is still generated in South Africa.

3.1 Retail expansion across borders

While the majority of regional value chains are led by South Africa, there are a very small number of BLNS companies establishing a significant presence in South Africa. Most notable is Choppies, a Botswana supermarket brand, that currently has 28 supermarkets in South Africa and 13 supermarkets in Zimbabwe.

There are significant differences in how companies penetrate the market in terms of corporate associate (wholly owned) and joint venture versus franchise (Table 3). This issue is discussed later on in the paper.

Table 3 Number of stores by retailers in SACU

		South Africa	Namibia	Botswana	Lesotho	Swaziland	RoA
Pick n Pay Holdings	Corporate / Associate / Joint Venture (CAJV)	630	0	0	0	5	60
	Franchise	400	17	9	1	6	0
Shoprite Holdings	CAJV	1703	74	11	11	14	127
	Franchise	218	38	0	0	0	0
Woolworths Holdings	CAJV	~600	5	21	1	4	19
	Franchise	0	0	0	0	0	0
Massmart Holdings	CAJV	346	3	11	3	1	12
	Franchise	0	0	0	0	0	0

[6] *The role of South African business in Africa: South African outward investment*; Trade and Industry Chamber, by Bobby Berkowitz, Yash Ramkolowan, Matthew Stern, Fouchè Venter, Melissa Webb; November 2012

SPAR Group (All Master Franchise holders in Africa)	Corporate	0	0	0	0	0	0
	Franchise	817	28	26	0	4	70
	Other SPAR Brands (Franchise)	927					
Famous Brands Limited	CAJV	101	0	0	0	0	0
	Franchise	1935	35	28	0	7	274
Spur Corporation	CAJV	0	0	0	0	0	0
	Franchise	438	8	4	1	2	21
Pepkor[7]	CAJV	1850					180
	Franchise	0	0	0	0	0	0
Mr Price Group	CAJV	1014	29	19	4	7	6
	Franchise	0	0	0	0	0	23
Choppies	CAJV	28	0	69	0	0	13
	Franchise	0	0	0	0	0	0

Sources: Choppies Annual Report, Mr Price Group Annual Report, Pepkor Website, Spur Corporation Annual Report, Famous Brands Annual Report, Massmart Annual Report, Woolworths Annual Report, SPAR South Africa Annual Report, Shoprite Website, Pick n Pay Annual Report

South Africa's regional interest is market seeking rather than looking for resources or cheap labour in the production process, underscoring the expansion of the South African retail chain relative to production chains (Table 4).

Table 4 Market seeking dominance dominates cross border investment decisions

Main Reasons for investing in African countries of greatest presence:

- To sell an existing product or service into the domestic market: 74%
- To identify new market opportunities: 42%
- To manufacture a product for sale into the domestic market: 26%
- To access or source raw materials –mining: 11%
- To access or source raw materials – agriculture: 11%
- Other: 11%
- To manufacture a product for exporting: 5%

Source: Berkowitz et al.

The most pressing challenge for retailers expanding into these markets remains the issue of profitability. All of the challenges already mentioned have a negative effect on a retailer's ability to supply goods to the market at a market-related price, whilst leaving a reasonable margin. Many of the retailers have burnt their fingers entering new markets where profitability is challenging. These challenges are, to varying degrees, compensated by an ability to price higher in different countries as evidenced by recent research that has shown the relatively wide price

[7] http://pepkor.co.za/

dispersion in Southern Africa[8]. However, there are limits to the ability to ability to bear the higher costs of operations as evidenced by the recent withdrawal of Shoprite from Tanzania (see below).

Woolworths has tried to address this challenge by implementing a "sliding-scale" on their margins for other countries. For instance, their landed cost in abroad markets is calculated on a ratio compared to landed cost in their domestic market, i.e. for Mozambique and Mauritius landed cost is 1.25 times that of South Africa, and for Zambia it is 1.4 times. For SACU countries their close proximity to 'home' markets and SACU arrangements allow for a relatively low ratio of 1.1. This "sliding scale" was also much more challenging to maintain under Woolworths' old franchising model, where some goods would cost up to 75% more in Botswana than in South Africa[9].

4 How the retail chains are meeting the challenges of operating across borders

Retailers have been successful in developing supply chains that extend well beyond SACU. This prompts a series of important questions: How do these lead firms operate across borders in SACU, how are they managing their regional supply chains, and, in particular, what are the opportunities and what solutions have they found to addressing the many barriers to operating these cross border supply chains? Are there differences in their operations that are important for their choice of solution?

4.1 A typology of retailers

The insights of the report come from interviews with some of the leading retailers and cross border operators in SACU (see annex). An important result to emerge from these interviews was that different challenges, and different solutions, were conditional on certain key characteristics, set out in Figure 2. These characteristics are:

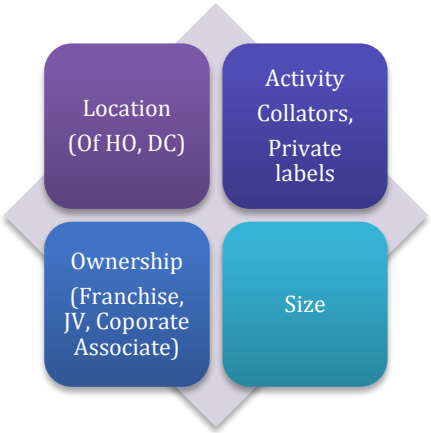
- Location of headquarters and distribution centres: South Africa based, BLNS;
- Activity: are the companies in essence collators and distributors of produce, or private label that distribute their own branded products;
- Ownership: franchise, joint venture or corporate associate;

[8] *A Disaggregated Analysis of Product Price Integration in the Southern Africa Development Community* Economic Research Southern Africa, Working Paper 421, February 2014.
[9] http://www.dailynews.gov.bw/news-details.php?nid=11858

- Size: ability to carry fixed costs

How they affect the challenges and solutions is explained in the discussion below.

Figure 2 Key characteristics of retailers



4.2 The different solutions

Three different types of solutions have been identified for overcoming some of the challenges faced in operating across borders within SACU these are:

4.2.1 Market solutions

The market is providing solutions for the cross border challenges in several ways. These include the use of transporters and clearing agents and retail infrastructure.

- The role of transporters and clearing agents

As already noted, over 90% of all retail revenue of South African retail outlets is still generated in South Africa – limiting the size of investment in servicing cross border markets. Transporters and clearing agents play a key role in providing solutions that individual retailers find too costly. This is because clearing agents are able to benefit from economies of scale and specialization.

Relationships:

Firstly, by having multiple clients and frequent use of the same border crossing they are able to invest in developing a relationship of trust with the customs authorities and can identify specific challenges and therefore manage them appropriately in a way that a retailer making one delivery a week or month will find difficult or costly. An earlier case study of CONCO[10] in Swaziland revealed how important developing this relationship is for operating effectively across borders.

According to one transporter[11] the investment on the ground, i.e. spending time at border posts and establishing relationships with customs is essential to allow for faster border crossing. This process becomes even more efficient if the transporter can use their selected clearing agents rather than the clients.

Capacity:

Clearing agents/ transporters can invest in a significant staff contingent to address crossing the borders in a way that cannot be justified by most retailers in SACU. UTI, a leading transporter, noted that for some of their clients the capacity to deal with the paperwork relating to cross border consignments was limited; and when staff dealing with exports fell ill the consignments stopped, at least for a day.

UTI has a range of clients, including Woolworths, PEP and Foschini to whom they offer very different packages. For some they are merely transporters, for others they offer a complete "solution". Big companies, rather than outsourcing the entire process, often buy in the expertise of freight forwarders in house. For example Transit, specializing in refrigerated cargo, runs 20 vehicles for Shoprite and under the Shoprite logo as part of their logistic set up.

For some of UTI clients, they find that the challenges at the border are compounded by the retailers failing to grasp, or at least address, the big differences in what is required for transporting within South Africa as opposed to crossing the border. For example, newer entrants to the retail export business sometimes use various differently sized boxes that are not marked, sequenced or bar coded in the holding warehouses. If a border official would like to see a specific product, the freight forwarder would have to go through every box until it was found. Inefficiencies also occur in actual packaging, for example a large box that could contain several items, only holds a single piece of clothing bubble wrapped. What is important to note is that UTI estimates that for the newer, inexperienced exporters it is able to increase profitability of trade into SACU by around 5%. This suggests that even though the markets of the BLNS are small, the increased profitability from better managing the movement of goods across the borders is enough to pay for the clearing and forwarding services.

[10] http://www.thetradebeat.com/sadc-business-case-studies/coca-cola-swaziland-conco-ltd
[11] Kevin Barney, Cargo Carriers, January 2015

A further key factor is that the more km completed per month the more cost effective transport becomes. Specialised transporters will further reduce their cost by ensuring that when returning South bound, that they carry a load rather than driving empty (even a full truck load cannot always be guaranteed depending on nature of cargo transported). For example trucks will carry fruit and vegetables from Zimbabwe destined for the European market. The cost of empty trucks on return journeys, at times sitting at borders for clearance even without goods, is significant.

- Retail Infrastructure

Even though retail infrastructure such as malls and physical retail outlets are not directly part of the supply chain, they have provided a market solution to the challenge of cross border market entry for many SACU retailers.The availability of retail infrastructure plays a key role in the opportunity for expansion into emerging markets:

Local knowledge:

Property developers often together with the retailers do the necessary homework on the market. The developers can spread the costs of market identification over a number of tenants, costs that an individual retailer – given the small markets – might not be prepared to pay. Often, as is the case with Shoprite Holdings, a Property Development Division will function as both property developer and centralized leasing agent for the corporate owner.

Land access and regulatory restrictions:

Property developers can secure access to land that might be very difficult or impossible to obtain for a foreign company. And due to the size and scope of the investment, developers will often engage government at the highest level in order to negotiate local content regulations, work permits as well as discuss urban development around the site, road and other infrastructure.

A Club good:

Property developers will carefully decide which retailers/other outlets should be in the mall in order to attract the right clientele. This allows retailers to be able to enter the market without too much concern for the "neighborhood" they are moving into. Equally important, by introducing major retailers as anchor tenants, retail properties can attract other tenants more easily, as they can be assured of constant and relevant consumer traffic into the property.

- Market penetration in small and poor markets: lesson learning from South Africa

Due to the informal nature of retail in Africa and the low purchasing power of consumers, retailers struggle to remain profitable and keep their prices reasonable in developing markets.

Start low, build upwards:

Shoprite's lower segment of the market offering, (LSM (4-7)), helped it grow tremendously in South Africa's urban and urban areas, but for rural and bottom lower segment of the market (LSM (1-5)) dominant areas, Shoprite developed the USave brand. This limited-range, smaller-format store can more easily penetrate African markets by keeping costs lower than their large-format Shoprite supermarkets[12]. Similarly, Pepkor's expansion into Africa was eased by its low-cost offering, and its ability to establish small-format corporately owned stores in new markets. As these markets matured, other brands with offerings for more developed middle-classes enter with many fewer challenges, especially considering that by this time much of the distribution network has already been established.

4.2.2 Organizational solutions

The organisational structure adopted within the retail chain has, in several cases, provided part of the solution to cross border challenges.

- Franchising/joint ventures

Spreading risk and accelerating expansion:

Franchised and Joint Venture operations give retailers the opportunity to benefit from the local knowledge brought forth by partners and franchisees. The franchised approach allows the retailer to mitigate much of the risk of entering new markets, as the franchisee will carry much of the responsibility for making sure the outlet is located in a suitable location and operates profitably.

The franchising model usually includes a strong support structure in retail development and product supply from the franchise holder's distribution centres. With SPAR for instance it has allowed them to expand into troubled markets with greater ease than some of their competitors. This is evident by SPAR's successful expansion into Mozambique where they could rely on the franchisee's understanding of the local retail environment, compared to Pick n Pay's recent exit from that market[13] due to low profitability and challenges that could have been addressed early, should they have utilized franchising.

For Famous Brands, who also operates similarly to SPAR as a logistics and wholesale firm, local knowledge was equally important as they entered into Nigeria in a Joint Venture with UAC

[12] http://www.shopriteholdings.co.za/OurBrands/Pages/Group-Composition.aspx
[13] http://www.bloomberg.com/news/articles/2014-04-15/pick-n-pay-full-year-profit-gains-on-cost-reductions-new-stores

Restaurants[14], and plan to enter Angola and Zambia in a Joint Venture with Shoprite[15]. There is great risk in franchising, however, illustrated by Chicken Licken's expansion to Nigeria in 2005 where problems with the franchisee sub-franchising the brand caused them to close eight stores[16].

Conversely the corporate ownership model that Shoprite Holdings operates has not allowed it to grow quite as quickly as the franchise-based brands, however it has given them a lot more control over how operations function. Even though Shoprite does have a significant number of franchises in its stable, these are almost exclusively inside of South Africa under the OK Franchise Division[17]. African expansion by Shoprite was driven heavily by corporate buyouts and major partnerships, such as with Zambeef in Zambia[18] whom they entered into partnership with to supply all their meat in Zambian and Angolan stores, and to run their in-store butcheries. This allowed Shoprite to also benefit from local knowledge and distribution networks, but allowed them to retain high-level ownership of the stores and mitigate some of the risks of franchising.

Local Sourcing:

Franchise operations predominantly source food produce locally and only request consignments from the distribution centre when certain products remain unavailable on the local market and for certain non-perishable goods. This can satisfy a significant demand without the challenges of crossing the borders with mixed containers of perishable goods. Where a mixed truck of goods crossing the border attracts far greater scrutiny and problems than a truck carrying one or two products. This will also keep stock levels satisfactory within the outlets and cost relatively low. Relying on local sourcing allows retailers to avoid import/quantitative restrictions on products as well as issues around border clearance and transport.

- Local presence

Local presence permits companies to overcome potential administrative/paperwork problems.

Record keeping:

Local presence of a company in the export market allows for better record keeping, i.e. the export docket matches the import docket of the destination country. PEP stores manage their border crossings into all African countries on the basis that there is a local presence – a PEP store

[14] http://www.ibtimes.com/south-african-economy-falters-fast-food-giant-famous-brands-seeks-fresh-pastures-nigeria-1406294
[15] http://www.iol.co.za/business/companies/famous-brands-shoprite-partnership-to-grow-sales-1.1809346
[16] http://www.bizcommunity.com/Article/120/166/100215.html
[17] http://www.shopriteholdings.co.za/OurBrands/Pages/Group-Composition.aspx
[18] http://www.howwemadeitinafrica.com/zambeef-from-humble-beginnings-to-one-of-zambias-top-companies/43830/

registered and owned within the country. This means that PEP becomes the exporter as well as the importer and can ensure that paperwork matches exactly. Item 1 on the export docket from South Africa is Item 1 on the import docket to the destination country.

- Close cooperation between HQ and subsidiaries

Companies in BLNS will draw on skills and specific services from HQ in South Africa when such skills or services are limited or non-existing in country.

For example companies such as Bokomo, Bolux or Nutrifeed, all Botswana subsidiaries with parent companies based in South Africa, overcome challenges of skill shortages and the need for specialized services such as engineering, or marketing by sourcing these from their parent company in SA as needed. This relationship with the parent company provides easy access to services and skills. Another key component is knowledge sharing between the parent company and the subsidiary operation abroad– key here is bench lining data provided in terms of efficiencies of production volumes/inputs/time etc. and quality from parent company. The parent company will ensure best practices are followed by either sending technical staff to the foreign subsidiary operation or staff traveling to SA. The South African parent also supports the subsidiary in quality control.

- Reducing distribution costs: Centralised Distribution Centres (DC) and cost sharing

That centralised distribution is useful for relatively rapid expansion is evident in two cases, namely SPAR's model, and Pick n Pay's strong investments recently in centralised distribution[19]. For most of Pick n Pay's history their stores were supplied individually by often highly localized suppliers, however as noted by Nick Badminton, CEO of Pick n Pay, "Our decision to move to a centralised distribution centre was motivated by changes in South Africa's retail landscape which had seen us fall behind our competitors, who were investing significantly in supply chains and improved services to their stores through centralised distribution systems." For SPAR centralised distribution has always been a key component of their business model.

These retailers and wholesalers' distribution centres and networks are often operated and owned directly by the retailers in their domestic and bordering markets, but for challenging markets such as Nigeria and Angola partnerships are key. This is illustrated by the joint venture between UAC Restaurants and Famous Brands in Nigeria; UAC has also, through MDS Logistics which owns a network of 50 DCs, entered into a joint venture with Imperial Logistics. These two relationships will help both Famous Brands and Imperial Logistics expand their offerings in West Africa.[20] Centralised regional DCs have the advantage of allowing retailers to be more responsive

[19] http://www.fin24.com/Companies/Pick-n-Pay-to-upgrade-distribution-20100720
[20] http://www.moneyweb.co.za/moneyweb-industrials/nigerian-connection-runs-deep

to their consumer needs. It also allows them to alleviate some of the negative effects of port and road congestion[21].

Retailers that centralize early are also able to very quickly benefit from this. Choppies, for instance, already operates six DCs, four in Botswana, one in Zimbabwe, and one in South Africa.

Centralised distribution isn't a turnkey solution. Even though the DCs are situated geographically so as to service the broadest reach possible, crossing borders still remain a major challenge for Spar, as much as it does for various other retailers. For instance, when opening their first Mozambique store, situated only 180km from the Spar Lowveld DC, says Rob de Vos, Regional MD of SPAR Lowveld, "…we found there were a lot of red tape to traverse… mostly concerning the transportation of goods across the South Africa – Mozambique border[22]". This means that often retailers can't always opt for either DCs, or local supply, but must make an attempt to best balance between the two, depending on the market they operate in.

- Wholesalers vs Retailers

The franchised models operated by SPAR and Famous Brands are similar in that both are better described as a wholesalers and logistics companies, rather than retailers as such. As noted by Mike Hankinson, Chairman of The Spar Group Limited, "Our strategic focus remains on supporting our retailers by leveraging our key competencies in supply chain optimisation and retailer support through our seven distribution centres". This model allows wholesalers to focus on the sourcing and supplying of goods, and the franchisee to focus on the operational elements of the store.

Larger retail groups such as Massmart have also been operating significantly in the wholesale market through their wholesaler brands, allowing them to also benefit from supplying to smaller retail operators. These smaller retailers prefer the convenience of purchasing from a single source, thus minimizing the challenges of developing expensive supply chains from multiple suppliers. This makes it challenging for smaller operators to effectively compete with larger retailers, as their competition is essentially a key component of their supply chain.

- Company provided technical assistance to local sourcing

Several of the retail chains are finding it commercially and politically worthwhile to provide technical support to try to increase local sourcing. The commercial case for increased local sourcing in perishables is clear. 70% of Woolworths business contains products which are perishable, making the margin time for transport smaller. They have an incentive to source

[21] http://www.hortinews.co.ke/article?id=503
[22] http://issuu.com/outlookpublishing/docs/africa_outlook_spar_distribution_br

perishables locally, but need local production to meet the required standards. Part of a solution has been the "farming for the future program", which provides training and development for local farmers, to provide good quality products in a sustainable manor. This includes specific programmes located in Namibia, where they changed the feed used by chicken farmers to a more sustainable and healthy feed, and Botswana where they supervised the production in a bakery to supply the Namibian market. However, at present 90% of all Woolworths food is sourced in South Africa.

4.2.3 Institutional solutions

- Authorised economic operators/preferred traders

Authorized Economic Operators (AEO) are approved operators (any party) involved in the movement of goods across borders who can show customs compliance, appropriate record keeping, safety and security standards and financial solvency. AEO programmes are based on global WCO standards or other equivalent supply chain standards. The AEO concept allows customs to share security responsibility with the private sector while facilitating and easing trade across borders (e.g. reduce controls, allow for deferred payments) resulting in significant cost savings and increased trade. The AEO was initially developed by the WCO under its SAFE Framework of Standards. By March 2014, there were 53 operational AEO programmes, 10 programmes to be launched and 13 Customs Compliance programmes globally.[23]

SACU currently has one regional AEO scheme being developed - the Trans Kalahari Accreditation Scheme - which is a regional cooperation arrangement between South Africa, Botswana and Namibia along the Trans Kalahari Corridor. It is currently at national consultation stage. Once rolled out, it will include freight forwarders, bonded warehouse operators, importers, exporters and transporters.

South Africa is also developing an AEO compliance system. In 2010, SARS started to develop its Preferred Trader (PT) Compliance programme based on the WCO AEO concept. It has been designed similar to the European Union Authorised Economic Operator model and is regarded as AEO compliant[24] [25]. The Preferred Trader programme aims to secure supply chains, increase SARS efficiency and ensure greater compliance. For chosen PT, SARS will provide a Customs Relationship Manager, simplify customs compliance, reduce routine inspections, prioritise requests for tariff and valuation determinations, and provide priority treatment at inspection.

[23] WCO Compendium of Authorized Economic Operators Compliance and Facilitation Directorate (2014 edition)
[24] http://www.sars.gov.za/ClientSegments/Customs-Excise/Processing/Pre-assessment/Accreditation/Pages/default.aspx
[25] SAAF Presentation: SARS Preferred Trader and AEO Journey Customs Preferred Trader, 2013

SARS initially only works with traders (selected importers and exporters) under the PT programme, with the aim to expand this into a full AEO programme to include operators, agents etc. once the PT programme has been fully established. The PT programme is still at early implementation stage and the private sector feels that it will only be effective and cost saving once it is extended to other actors in the supply chain such as freight forwarders and clearing agents. South African Association of Freight Forwarders (SAAFF) is currently engaged with SARS to understand their role in the AEO concept and to develop green lane processes.

Once fully ruled out, PT/AEO will allow smaller players to expand into cross border trade by reducing customs costs significantly. The East African Community rolled out a Compliance pilot programme in April 2013, including seven border posts and 13 operators. Benfits for AEO include fatser document processing time and lower cargo storage costs due to faster relase of cargo. This pilot has shown the cost saving potential of the AEO model. In the first 11 months 3,413 consignments benefited under this regional AEO programme. Total savings experienced by the 13 operators were at least US$1,365,200 (equal to US$400 per consignment) in the 11 months under review. A full scale regional supply chain AEO is planned after a second pilot.

Individual member states of the EAC have devised additional country level AEO programmes. Uganda registered 21 AEOs, by September 2014, including both exporters and warehouse keepers. Kenya has a total of 64 AEOs of whom 24 are clearing agents, 38 importer/exporters and 2 transporters/shippers.

An independent assessment of the Ugandan Revenue Authorities has shown the efficiency gains and cost cuttings through AEOs (i) reduced clearance time for AEOs from 4 days to 1 day which enables them to double their operations; (ii) some AEOs have recorded cost savings of $100-$200 per consignment

5 Where the market is not coming up with a solution

A fundamental issue is the small size of SACU markets. Each of these markets is too small to absorb any significant fixed costs. This results in a number of challenges that cannot easily be resolved by the private sector alone, such as complex consignments or the problems of documentation of more complicated products (the “cheeseburger” problem discussed below). Private labels add a further challenge due to differences between local standard requirements versus private label standards.

- Consignment complexity:

Consignments supplied to BLNS can contain a large mix of products in one delivery that may result in up to 2000 HS tariff lines or more that need to be administered. Freight forwarders are

reluctant to move such shipments as they do not have the capacity to deal with the complexity of such tasks, given the capacity challenges of customs authorities in some of the BLNS states. The optimal consignment composition for BLNS markets is not optimal for the freight forwarders' capacity.

- The "cheeseburger" problem:

The problem of complicated consignments can be further aggravated when value added processed food (food store products such as a cheese burger) are part of a consignment. These products consist of a variety of ingredients, including dairy, vegetables, grain and meat within one product. In Namibia, for example, there are currently no border or state vet documents that can accommodate such a composition and clearance agents end up filling out multiple forms for one product. This in turn causes confusion and delays with border officials.

The market is too small for a private company to invest sufficiently to develop border or state vet documents and to train custom officials. And it is not a priority of government.

- Private standards:

Private label products, such as Woolworths own branded products or Pick n Pay no name products, are often based on different, albeit higher standards than local products standards. Problems arise as the standards of these private label products do not match the local standards specified and hence do not "tick the boxes".

A company like Woolworth manages its supply chains to high standards, where suppliers are tracked and regulated to adhere to the requirements of the Woolworths retail chain[26]. Running a vertical supply chain from producer to outlet, the company has considerable control over the quality and standards of products. They control their own supply system, where they vet their suppliers, transport from suppliers, packaging and labelling of products, and finally distribution and transport to retail stores - including the export process[27]. Woolworth standards are continuously reviewed by the company.

But challenges emerge both at national and regional level. For example, while Woolworth's supplier code and expiry system allow full traceability from point of sale to the hectare of production, it does not exactly match the Department of Agriculture and Fisheries requirements for tracking producers and pack houses. And similar challenges are often experienced at the border. Dispensation from the relevant authorities is often required.

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[26] Woolworths, http://www.woolworths.co.za/store/fragments/corporate/corporate-index.jsp?content=../article/article&contentId=cmp100601 , 27 January 2015

[27] Imperial Logistics, http://www.imperiallogistics.co.za/case-study/361/new-business-model-boosts-competitiveness-and-sustainability , 27 January 2015

Were standards to be more ":objective" than "process" focused, the use of the equivalence principle would allow for appropriate private sector standards to be used for trade.

- Appropriate supervision of the supply chain by the Authorities

There are other areas where the realities of a modern retail chain are not reflected in regulatory practice. (Though it was noted in several interviews that authorities do go out of their way to find solutions, regulation by dispensation and exemption is less favourable that the adoption of an appropriate framework.) For example, with retailers that control the entire supply chain to the point of sale, instead of border inspections it is possible to move inspection to the retail stores in the specific country (market inspection) making it less costly. The current system of border inspection for all consignments is based on the wholesale distribution model. In this model of distribution the products, once imported, are difficult and costly to trace to the point of sale as the wholesaler distributes to a potentially wide number of different stores.

As another example, the regulation for auditing the retail supply chain is also a practical challenge. Again because it was established for a wholsale distribution model. At present DCs can be audited as food handling facilities but again this is by dispensation. The regulation for distribution centres does not match current business practice.

- Franchise model becoming outdated?

The franchise model that has allowed retailers to minimize consignments across borders - relying on local sourcing - does not sit well with the dynamics of modern retail.

For many years, Pick n Pay and Woolworths followed franchise models for shops in the BLNS countries, but for both retailers the trend is now to buy back old franchises or at least not selling any further franchise licenses. This is the result of an increased need for quality control over customer experiences by large retail outlets, e.g. with Woolworth exporting to Australia, the company cannot afford below standard products in any of their stores regionally. Big retailers also aim to have a fully integrated distribution system and get their logistic capabilities spread across as many outlets as possible to benefit from economies of scale, as well as the opportunity to keep their range and quality consistent across all stores; BLNS countries are an integrated part of the South African retailers' logistic supply chains. Being inside the Common Monetary Area (excluding Botswana) facilitates and stabilizes business as prices and costs remain relatively similar to those within South Africa.

And with the growing importance of private labels to retail, the option of local sourcing (except for fresh produce) is becoming less and less attractive.

- No whistle blowing

Companies in BLNS countries will be reluctant to point out restrictions in contravention of SACU/ SADC commitments. They will wait for another company to make the first move ("hostage" game), to see if there are any repercussions of doing so and if so the other company will take the consequences. Due to the small size, proximity and long standing history, it is close to impossible for any BLNS company to keep anonymity.

- Local supply challenges

Most of the products on offer in Southern African markets are sourced from South Africa. For instance, in 2001 Shoprite estimated that about 65% of its products in Zambian stores originated in South Africa[28], with some perishable items being sourced from Zimbabwe. This influx of foreign product can cause political friction. This is evidenced in Tanzania where Shoprite allegedly imported approximately 80% of their products from South Africa[29], and was warned by the Government that they may lose their operating license if they do not supply more local products. Shoprite in turn sold their Tanzanian operations to Kenyan retailer Nakumatt, and exited the Tanzanian market, indicating the difficulty of developing a local supply chain.

Several factors make local sourcing difficult. Small production volumes by producers and processors often do not meet the necessary demand from major retailers across a large market, especially if they have a centralized distribution model. Equally, production may not available. For example, as of March 2015 all poultry in Woolworths stores will be free range, but there were no free range poultry producers in Namibia as of the end of 2014.

Logistics are also important. A lack of reliable cold-chain distribution for perishable products; it may be more effective for a South African retailer to supply their foreign operations from a South African distribution centre where they have control over the entire chain, rather than supply stores in a foreign market from a supplier closer to the outlet, but with a higher risk of product spoilage.

6 Conclusions and way ahead

There has only been limited growth in cross border production chains in SACU. In contrast, retail chains have grown strongly, and offer several insights into how the barriers to operating across the borders in SACU are being mitigated.

The private sector has come up with a number of solutions that are market driven. Logistics and transport companies are able to make a profit even when dealing with the small volumes going

[28] http://africafiles.org/article.asp?id=18515
[29] http://www.businessdailyafrica.com/Corporate-News/Nakumatt-set-to-take-over-Shoprite-stores-in-Tanzania/-/539550/2116452/-/14227l5/-/index.html

to the BLNS, and as importantly increase the profits of their clients to allow their clients to pay for their services. And the growth of malls has facilitated market entry for the lager retailers. The organizational structure of retailers has also provided some solutions. Franchising allows for more local sourcing and closer links to local authorities in the BLNS. And having a local presence often reduces the administration problems of customs documentation.

However, challenges remain. The small markets of the BLNS means that commercial consideration dictate a consignment of many different products, while the capacity of customs and standards authorities, and consequently transporters, require consignments that have fewer products and are easier to manage. The "cheeseburger problem", where ready made food involves several different food items each regulated separately, presents a similar problem for authorities; as does the increasing importance of private label standards. And with the move away from franchising as a business model to owner-operator, borders become more relevant again.

While the challenges of trading across borders pushes up costs, they also fragment the regional markets and thereby give greater pricing power to the companies operating in these markets. It is likely that in many instances the status quo generates higher rates of profit to compensate the retailers for their troubles. However these higher profits will be generated by the ability of the regional retailer to benefit from the economies of scale that come from being able to source and distribute regionally. And the case of Shoprite's withdrawal from Tanzania shows there are limits to the extent to which retailers can offset greater costs by making the customer pay higher prices.

There are clearly areas where public –private dialogue can play a role in facilitating trade within SACU. This will be needed to provide direction on updating the regulatory framework to better reflect modern business practices of the retail chains. It is also important to promote a more constructive engagement on the challenges for local sourcing.

Though the focus of the analysis has been retail chains, the increasing importance of private labels does provide insight into the challenges facing producers within the region. Of particular note is the issue of the compatibility of private sector standards, and the consumer preferences they are designed to meet, with national and regional ones. And possibly more importantly there is the challenge of facilitating trade in compound products, what has been termed the "cheeseburger problem", which is fundamental if the region is develop agro processing. This is particularly relevant given that developing the agro industry is a stated priority for SADC industrial policy.