



Building a Sustainable South African Food Retail Sector

Issues for Responsible Investors

August 2012

Commissioned by:

**ARISAIG
PARTNERS**
INVESTMENT MANAGERS

Commissioned by Arisaig Partners, this report was researched and written by Nicky Van Hille and Gina Louw of The Moss Group, with editorial oversight by Sustainalytics. The authors wish to acknowledge the contributions of Kevin O'Brien, Group Company Secretary and Head of Sustainability at SPAR; Alexander Haw, Sustainability and Environmental Manager at Massmart; Andre Nel, Sustainability Development Manager at Pick n Pay; as well as Justin Smith, Head of Sustainability, and Lucy Heyes at Woolworths, all of whom provided valuable insights during interviews carried out as part of the research for this report.

Arisaig Partners



Arisaig Partners is an independent investment management company founded in 1996. Its focus is on the listed dominant consumer businesses in emerging markets. The firm runs three funds in Asia, Africa and Latin America. In addition to the head office in Singapore, Arisaig has research offices in Hong Kong, Mumbai, Cape Town, Rio de Janeiro and London.

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The Moss Group



The Moss Group, a consulting firm based in Cape Town, South Africa, offers strategic thinking on the corporate sustainability issues affecting businesses in the region. The firm partners with corporates on integrating social, environmental and economic sustainability objectives into core business strategy, operations and culture. The Moss Group works with clients to make real business sense of sustainability issues and opportunities. It provides collaboration strategies for engaging with stakeholders and conducts in-depth research on a variety of sustainability issues. The Moss Group also offers specialised engineering consulting services, predominately in the area of water and industrial effluent treatment.

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Headquartered in Amsterdam, the firm has regional offices in Boston, Frankfurt, Madrid, Paris, Singapore, Timisoara and Toronto and representatives in Bogotá, Brussels, Copenhagen and London. The firm has more than 100 staff members with a variety of multidisciplinary and industry expertise. In 2012, Sustainalytics celebrates 20 years of collaborating with responsible investors worldwide.

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Key Findings



The South African food retail industry faces a number of critical environmental, social and governance (ESG) issues and challenges. The implications of not proactively addressing these issues are far reaching, especially with respect to brand longevity and supply chain sustainability.

The Issues

As summarised below, the retail sector has made significant progress in recognising the most material ESG issues that it faces and in implementing various initiatives to address them. Exemplary practices have emerged, although more can be done.

- **Climate Change** – Food retailers will be deeply affected by climate change and need to respond through both mitigation and adaptation. Critically, there is an important opportunity for retailers to leverage their influence to achieve much greater impact through their supply chains than through their direct operations. **Woolworths** has demonstrated leadership in this area through its Farming for the Future (FfF) programme. Retailers need to recognise that, regardless of the mitigation action taken, they will be forced to consider how their business models need to adapt to account for climate change in the future, particularly with regard to sourcing and transportation of agricultural products. Some retailers, such as **SPAR** and **Pick n Pay**, have adopted sourcing models that show some degree of adaptation by sourcing from multiple suppliers in vulnerable food categories.
- **Water Security** – South Africa is a water-stressed country, and water security is one of the most fundamental challenges facing the South African retail sector, particularly through its supply chain. **Woolworths** has demonstrated leadership in this area although, given the company's small market share (less than 10 per cent), its impact on the industry's supply chain is unlikely to be sufficient to drive the systemic changes required to achieve water security. Going forward, all retailers need to actively engage with suppliers around water management, both in supplier operations and in product design.
- **Waste Management** – Increasing legislative requirements and public focus on waste-related issues, particularly with regard to packaging and water pollution, have put retailers and their suppliers at risk. Greater awareness and understanding are required throughout the industry and will assist retailers in extending their initiatives beyond their own operations to include both its suppliers and customers. Key areas on which to focus include recyclability, incorporating recycled material into packaging and lightweighting. Greater efficiencies can be gained from such initiatives, creating opportunities to reduce costs. With **Walmart** as its new parent, **Massmart's** initiatives in area can be expected to accelerate.
- **Integrating Emerging Businesses into Supply Chains** – This represents both a risk (given its importance to the sustainability of their supply chain) and an opportunity (given the benefits of a thriving small business sector). Currently, the primary driver behind small business development and integration is compliance with Broad-Based Black Economic Empowerment (B-BBEE) legislation. As a result, the industry has remained largely unengaged with core systemic issues that hamper

the inclusion of small businesses into the supply chain. There is an opportunity for retailers to work collaboratively to develop industry-wide initiatives, particularly in the agricultural space, that bring about such integration. Doing so will not only have a massive impact on critical issues facing the country, especially job creation and food security but secure cost efficient, locally sourced goods that are not exposed to exchange rate volatility. **Pick n Pay** and **Woolworths** were involved in a successful pilot project to test the model of an agri-consolidator for small farmers to facilitate their incorporation into commercial supply chains.

- **Education, Skills and Job Creation** – All of the food retailers face a shortage of skilled labour, particularly in the areas of buying and artisanal skills. The response to date has been limited. Working collaboratively to develop programmes both to attract workers to the industry and to develop the necessary skills will go a long way toward developing a pipeline of skilled young people for the industry. **SPAR** has demonstrated leadership in this regard through its in-house Academy of Learning for both current and potential **SPAR** employees, as well as its collaboration with Mr Price Group around training and youth employment.
- **Food Security** – This is among the most complex and important challenges that food retailers face. It is systemic in nature and deeply connected with other key issues, including climate change, water security and South Africa’s social development goals. Building resilient and sustainable supply chains is critical to addressing this issue and will again involve working with supply chain partners to support the development of emerging farmers and to encourage sustainable farming methods and marine management. **Woolworths’** Farming for the Future programme is most notable in the agricultural space, while **Pick n Pay** leads the industry in sourcing seafood sustainably. Contributing to food security also means offering a broader range of healthy food options and providing information to consumers about such options.
- **Corporate Accountability** – As South African retailers expand into Africa, they need to ensure that they take the “high ground” in dealing with corruption. By adhering to world class standards, they will not only protect their reputations in their home market, but also play a key role in advancing good governance principles on the continent. Further, stakeholders are demanding far greater degrees of responsibility from retailers, particularly with regard to issues such as ethical sourcing. Establishing robust codes of ethics for suppliers and ensuring compliance thereto is critical for retailers looking to protect their reputations. **Woolworths** has implemented world-class codes that reach well beyond legislative requirements. Other retailers such as **SPAR** and **Pick n Pay** are migrating to a more robust approach to improving supplier performance.
- **Leading and Engaging Employees around ESG Issues** – Sustainability needs to be truly integrated into the fabric of the organisation, starting with the company strategy. The most critical success factor in this regard is that the sustainability agenda be led from the highest level of a company. **SPAR** is notably strong in this area, having structured its leadership such that sustainability is visibly woven

into every aspect of corporate strategy. Companies will benefit from developing robust employee engagement and training programmes. This will ensure that their employees, particularly those engaging with external stakeholders, have a solid understanding of the company’s sustainability agenda and how it affects their day-to-day functions and interactions.

The Importance of Addressing ESG Throughout the Value Chain

A major theme throughout this report is the need for South African retailers to address ESG issues throughout the entire value chain, not only in their direct retail operations. Doing so is in line with best practices among global retailers to address sustainability issues.

Building a Resilient Supply Chain – The food retail industry’s long-term sustainability is directly dependent on an efficient and resilient supply chain. In addressing key ESG issues – most importantly climate change, water security, waste management, and food security – some of the most critical initiatives that companies take to ensure their own long-term success will be those that make their supply chains more sustainable and resilient to major changes, both social and environmental.

Increasing Operational Efficiency – Within each retailer’s own operations the benefits of initiatives to increase efficiency are clear. Such initiatives, especially those related to the environment, not only reduce negative effects but also reduce costs and the risk of regulatory non-compliance.

Addressing Consumer Demands and Fostering Healthy, Sustainable Consumer Markets – ESG issues are increasingly important to the protection and enhancement of food retailers’ brands. With increasing consumer awareness and concern regarding sustainability-related issues, most retailers recognise the need to be seen as highly responsible corporate citizens, to source products ethically and more sustainably, and to engage more proactively with stakeholders around relevant sustainability issues. These activities are important not only to the strengthening of the retailers’ brands but also to building a strong reputation in the communities in which they operate. Food retailers also have an interest in healthy consumer markets for their products and therefore in contributing to food security for all in South Africa.

The Way Forward

ESG issues are complex, far-reaching and usually have a systemic dimension, meaning that it is difficult for them to be addressed in isolation or resolved by a single actor. As a result, the industry would benefit from evolving their approach to ESG challenges, risks and opportunities to (i) engage more proactively with the government and (ii) collaborate with other industry players.

- Engagement with Government** - There is an important policy dimension to long-term solutions and so the sector would benefit from substantially increasing its level of **proactive engagement with government**.

- This may include preparing comprehensive responses to legislative proposals by government in areas that stand to have a material impact on their businesses, such as carbon tax, skills development and labour legislation;
- There is a significant opportunity for the industry to collaborate with government in the creation of business incubators to drive the development of skills and small businesses that can be effectively incorporated into retail supply chains in the future;
- Currently, the Retail Association (RA) and the Consumer Goods Council of South Africa (CGCSA) have the potential to support these goals. The platform will need to be established in such a way that would prevent anti-competitive behaviour.

ii. **Collaboration with Industry Players** - Improved **collaboration** would enhance the effectiveness of initiatives in addressing the issues.

- There is currently considerable duplication of effort with regard to the development and implementation of sustainable farming programmes and, as a result, the impact of such programmes remains limited. A more consolidated, collaborative effort to develop and drive sustainable farming practices throughout the supply base, including among emerging farmers, would therefore be more successful in securing future supply chains;
- Given the critical role that they can play in facilitating the growth of the small business and emerging farmer sectors in South Africa, retailers need to work together to facilitate large-scale incorporation of these sectors into supply chains. Doing so will have a massive impact on critical issues facing the country, especially job creation and food security;
- Retail suppliers, big and small, are required to comply with a wide variety of retail standards and legislative requirements. In many instances, these processes add a significant administrative and financial burden to suppliers, particularly those who supply multiple retailers, each requiring individualised audits and compliance checks. The industry has an important opportunity to work together to develop a common set of standards for suppliers and an audit regime that requires only one audit per shared supplier;
- All South African retailers are grappling with packaging-related issues. While there is some level of engagement and collaboration through the Sustainability Council of Plastics SA, there is potential for a more consolidated effort to develop industry-wide solutions. The development of an industry-based solution to consumer recycling would have a far greater impact than a number of separate initiatives from retailers. There are also opportunities to standardise the labelling of packaging materials across the industry, including suppliers, to improve consumer education and to facilitate the sorting and processing of recyclable waste. The industry could also collaborate on a logistics system to collect, consolidate and recycle consumer waste. Collaboration with government in this instance would play a key role, particularly given that very few local governments have implemented recycling channels that include household-level waste.

In many ways, one of the greatest challenges for South African food retailers will be to develop the means and the readiness to collaborate on these and other ESG issues. Although the retail sector is highly competitive, its players would benefit from recognising that working together to address shared challenges will enhance the long-term sustainability of all of their businesses.

Lessons for Investors

With the South African economy set to grow significantly in the coming years, along with markets in neighbouring countries, investors have a strong interest in ensuring that their holdings are positioning themselves to seize the opportunities and mitigate the risks that are highlighted in this report.

In order to be well placed, investors should aim to gauge the extent to which each food retailer is:

1. Aware of the material ESG issues, risks and opportunities that it faces;
2. Aware of best practices and initiatives to advance the implementation of best practices;
3. Cognisant of the need to develop leadership and awareness of ESG issues, not only at the executive level but throughout the organisation.

Investors can help drive improved disclosure and performance by discussing these issues with company management. They can engage in dialogue to encourage the implementation of best practices as well as participation in collaborative initiatives. By identifying and analysing key ESG issues and providing numerous examples of exemplary practices, this report aims to assist investors in engaging in such dialogue.

In South Africa the government, the Johannesburg Stock Exchange and major investment industry associations are notably advanced with respect to recognising the importance of integrating ESG factors into investment decision-making. This bodes well for investor-company dialogue on material ESG issues, and both investors and companies can expect conversations about ESG issues to become more frequent and sophisticated. There are solid grounds for optimism about the role that investors can play in moving food retailers forward in how they address ESG issues, although it should be tempered with a recognition of the depth and complexity of ESG risks and the urgency of moving toward collaborative solutions.

Introduction



South Africa faces a complex array of environmental, social and governance (ESG) issues that are of major significance to how businesses and investors operate. The country's history has created a deeply divided society and economy, and many of the social and economic challenges caused by this division still plague the country today.

Further, the natural environment plays a very significant role in South Africa, both from an economic and a social perspective. Pressure on natural systems is increasing as a result of economic development and climate change. Companies operating in this context, as well as their investors, need to be cognisant of the risks associated with this pressure and to take proactive steps both to mitigate negative impacts and to adapt their operations to inevitable changes.

Recognising the importance of ESG issues to economic activity, South Africa has become a global leader with respect to encouraging the integration of ESG factors into business and investment decision-making. It is the only country in the world to mandate all listed companies to prepare forward-looking integrated reports, and it is one of only two countries globally that formally encourage institutional investors to integrate ESG issues into their investment decisions.

Many of the challenges facing South Africa today have a direct impact on food retailers. In some cases, these challenges pose significant risks to their ability to operate, while other issues have placed retailers under increasing scrutiny and expectation.

This report assesses eight key material ESG issues as they relate to the food retail sector in South Africa:

- *Environmental* issues that have the most material impact on food retailers are **climate change, water security and waste management**;
- The most fundamental *social* issues include **food security, integrating small businesses into supply chains, and education, skills and job creation**;
- *Governance* issues include the need to **lead and engage with employees** in order to integrate sustainability thinking into business strategy and corporate culture, and the need to ensure **corporate accountability**.

The report explores how these issues are likely to affect food retail companies' prospects for success in the long term, identifying risks as well as opportunities that these issues present for retailers. It highlights examples of best practices as well as retail-specific solutions being implemented by the five largest South African players in this sector, namely **Massmart, Pick n Pay, Shoprite, SPAR and Woolworths**. The report intends to serve as a resource to investors, food retail companies, supply chain partners and other stakeholders with the broader goal of helping to build a more sustainable food retail sector in South Africa.

Scope and Methodology

The "big five" South African food retailers – **Pick n Pay, Massmart, SPAR, Shoprite, and Woolworths** – were researched and analysed for this report. Together, these retailers have more than a 60 per cent share of the food retail market in South Africa. All of them also have non-food related operations although, for the purposes of this report, the focus was on the key ESG issues facing their food-related operations. Many of these retailers have food operations beyond the borders of South Africa and all are actively

looking to expand further into Africa. Although the focus of this research is on South African ESG issues, reference is made to some of the critical ESG issues that these companies face in relation to their expansion.

Background desktop research was conducted, including an analysis of retail market trends, reviews of relevant government regulation, and reviews of relevant government and industry initiatives, in order to identify a broad range of ESG issues facing South African food retailers. Drawing on their in-depth experience and knowledge of the sector, the authors of this report, specialist South African consultants in the area of sustainability and strategy in the retail sector, then identified the eight key ESG issues that they considered to be most material to the future success of the companies. These issues are outlined in the introduction above.



Thorough research and analysis of each retailer was then carried out through a review of publicly available information (i.e. sustainability reports, integrated reports, corporate and other websites, and credible articles). This process was followed by extensive company interviews, and the authors are grateful to the internal sustainability experts at **Massmart, Pick n Pay, Spar** and **Woolworths**, who provided important insights into their operations and ESG-related initiatives. The interviews focused on the key ESG issues identified earlier in the process but also touched on other related ESG issues and questions in order to gain additional insight into relevant strategy, policy and practice at each company. The interviews gave the researchers access to information not available through public sources enabling them to gain a deep understanding of the extent to which sustainability is integrated into each business and to identify best practices in addressing the key ESG issues facing the sector.

One of the core objectives of this research is to highlight best practices and identify the key lessons learned regarding sustainability issues in the food retail sector in South Africa. The structure of the report is designed such that it identifies and explores the various issues and then presents relevant case studies and learnings as identified in the specific retailer reviews and engagements.

All currency figures are presented in South African Rand. As of August 1, 2012 the Rand was valued at USD 0.1191.



Background: A Market Overview of South Africa

South Africa has had a turbulent social history. Beginning in the 1950s, the country operated under the Apartheid regime, which was characterised by racial segregation and political and economic discrimination against non-white groups.

Apartheid ended in 1994 when South Africa became a democratic nation. However, many argue that while political freedom was achieved in 1994 a climate of “economic apartheid” still prevails with job insecurity, low education levels and poverty still rife amongst the black population, particularly in rural areas.

South African Society

South Africa’s population has surpassed 50 million and is expanding slowly at an annual growth rate of 1.1 per cent. More than 90 per cent of the population is non-white, of which almost 87 per cent is black.³

Some key statistics for the population are highlighted in Table 1 below.

Population	Total individuals (mid-2011 estimate)	50,590,000
	Growth rate per annum (%)	1.1
Inequality	Gini coefficient	60
	Adults with the lowest LSM ⁴ (% decrease in last decade)	77
Unemployment	Total population unemployed (%)	25.2
	Youth (aged 15-24) unemployed (%)	51.6
	Black Africans unemployed (% of total black Africans)	57
Poverty	Poverty-stricken households (%)	33
Rural living	Rural dwellers (% of total population)	39
Health	HIV-infected people (%)	10.6
	Average life expectancy (years)	57

Table 1: Population statistics for South Africa (Sources: Rosenberg 2011, Statistics South Africa 2011, South African Institute of Race Relations 2011).

The distribution of wealth within South Africa is among the most unequal in the world. The poorest 10 per cent of the population earns only one per cent of the total national income, while the wealthiest 10 per cent claim almost 50 per cent of the earnings. High levels of unemployment, especially amongst the country’s youth⁵ are one of the key drivers of this phenomenon.

South Africa’s poor education system is one of the greatest contributors to the nation’s unemployment crisis. With an education system ranked 119th out of 133 countries in the Global Competitiveness Index,⁶ South African youth entering the work force are severely disadvantaged as they often lack basic competencies and skills.

As a result of South Africa’s high unemployment levels, approximately 16.7 million people live below the poverty line, surviving on less than R322 per adult per month.⁷ The prevalence of HIV in South Africa, one of the highest in the world, no doubt contributes to the population’s low life expectancy, which is similar to that of nations much poorer in terms of per capita income.⁸

Serious and complex health challenges are compounded by poor living conditions. Rural areas in particular are under severe economic and social pressure, with the majority of

rural dwellers residing on small-scale farms. Settlements are often densely populated and are largely reliant on urban remittances and social welfare for their livelihoods.⁹

Household-level food security has become a critical issue in rural communities given these poor living conditions, combined with the constant struggle of marginal and emerging farmers to make ends meet. These communities are placed under increasing pressure in terms of both securing access to food and having the purchasing power to buy it.

Urban food security is also a challenge in South Africa, particularly in densely populated townships and shantytowns. One of the key issues in this environment is the poor nutritional value of food. In the urban context, traditional African meals are often being replaced by Western-style (and often fast) foods that tend to be high in fat and sugar.¹⁰ One of the impacts of this shift has been an increase in the incidence of diabetes and obesity among the black population, which is more accustomed to a grain-based diet.

In spite of these challenges, the country has seen the development of a substantial, emerging middle class in recent years. This trend is set to continue into the future, as economic structures shift to be more inclusive of previously disadvantaged populations.

The emergence of the middle class has been coupled with a growth in urbanisation. In 2011, the urban population constituted 61 per cent of the total population and is expected to increase annually at a rate of 1.2 per cent for the next four years.¹¹ This shift is placing already stressed physical urban infrastructure under additional strain and is also contributing to the continued decline of rural markets.

From a socio-economic perspective, the emerging middle class is characterised by high levels of consumer spending, as opposed to investment and wealth creation.¹² As a result, retailers and consumer goods companies have experienced significant growth over the past 10 years and are expected to continue to see growth going forward.

Although disposable incomes are growing, they are coming under pressure from significant increases in the cost of living.¹³ Thus, price remains the most important consideration for most South African consumers. In an attempt to achieve greater savings on goods, many poorer consumers rely on self-help saving systems, formally known as *Rotating Savings and Credit Associations* (ROSCAs) and locally referred to as “stokvels.” This is a market currently estimated at more than R44 billion and growing.

South African Economy

The country has a very strong and well-governed private sector, which includes a number of large local and multinational companies.

However, it is the small business sector that will be the country’s engine for growth in the future, as neither large companies nor the public sector are likely to be in a position to create the number of jobs required to address the current unemployment crisis.

There is certainly room for growth within the small business sector, which, despite only contributing 30 per cent to the country’s GDP,¹⁴ currently employs between 70 per cent and 80 per cent of the employed population. However, a number of systemic

and structural issues need to be addressed in order to achieve this growth. Apart from improving education and job skills, and providing access to funding, labour legislation will need to become less restrictive for small businesses. Possibly one of the most important issues requiring attention is the ability and willingness of large corporations and government to incorporate these small businesses into their supply chains.

Broad-Based Black Economic Empowerment

“South Africa’s economy is still mostly under the control of whites who held power under apartheid.”

- Jacob Zuma, President of South Africa, June 2012¹⁵

South Africa’s economy is still largely under the control of the white minority despite the implementation of *Broad-Based Black Economic Empowerment* (B-BBEE) legislation in 2003 that aimed to actively drive the incorporation of previously disadvantaged individuals into the formal economy.¹⁶ Figure 1 below provides an illustrative overview of the B-BBEE framework, as set out in the Broad-Based Black Economic Empowerment Act of 2003.

All South African companies are required to comply with B-BBEE legislation through implementing initiatives and programmes in their own organisations and supplier organisations that result in demographics that are more representative of the country’s population. Companies are also expected to address broader societal issues through so-called “Corporate Social Investment.”

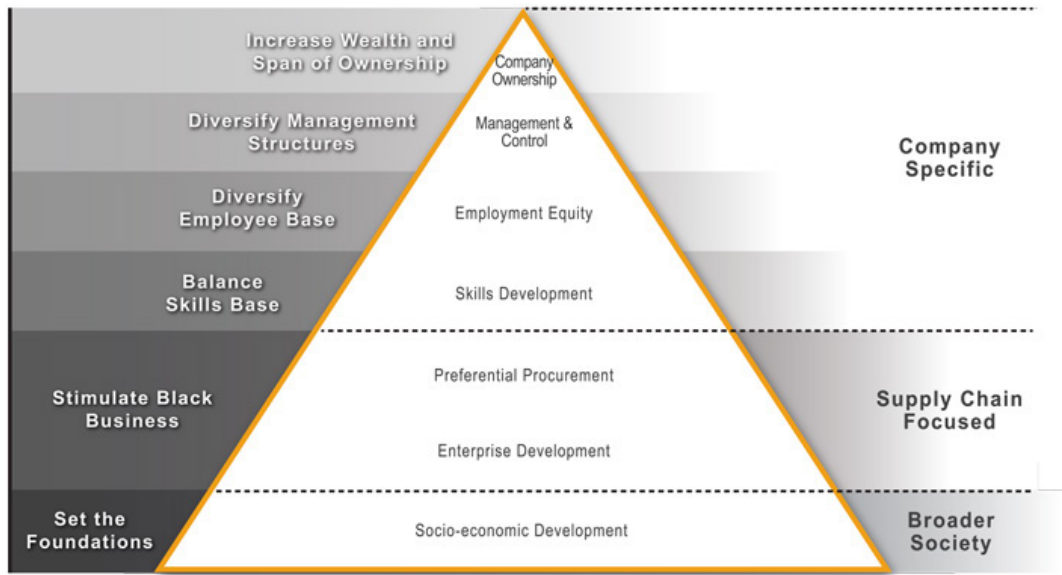


Figure 1: B-BBEE legislative framework (The Moss Group and Dorrington Mathee Consulting, 2009)

The scheme shown in Figure 1, above, is used to reflect the extent to which a company has “transformed” their organisation.¹⁷ Level 8 is the minimum level a company can achieve in order to be deemed compliant with legislation, while Level 1 is seen as completely transformed.

Failure to comply with the legislation carries a reputational risk. Companies that do not comply may find key service providers and other important players not wanting to engage with them. For example, it is understood that Old Mutual Properties, a significant retail landlord in South Africa, was very hesitant to offer a lease to a leading apparel retailer in 2010, as their B-BBEE compliance levels were substandard.

In some industries such as mining, formal licences to operate are dependent on achieving certain levels of compliance. Although the retail industry does not currently have any such restrictions, it is possible that this may be the case in the future.

Labour Market

Of the 142 countries assessed by the World Economic Forum in 2011, South Africa ranked 95th in labour market efficiency. The key issues impacting this measure are rigid hiring and firing practices (139th), a lack of flexibility in wage determination by companies (138th), and significant tensions in labour-employer relations (138th).¹⁸

In 2010, the World Bank noted that South African labour costs are far higher than those of similar nations such as Brazil, Chile and Argentina.¹⁹ A key driver of this discrepancy is trade union demands for salary hikes of more than double the inflation rate.

Labour strikes are another issue driven by labour unions. South Africa currently has the highest number of man days lost through strike activity, with 320 days lost per 1000 employees per annum.²⁰

The inefficient, highly regulated and costly labour market has severely hampered the country’s level of job creation and employment. While the government has acknowledged the need for structural shifts in the economy to address these issues, little progress has been made in this regard.

South African Natural Environment

South Africa is a dry and water-stressed country that is running out of options in terms of dams and inter-basin transfers. Despite this impending environmental emergency, the government has failed to effectively regulate and manage the country’s water resources and infrastructure. The water challenges facing South Africa are expected to worsen in the future and be compounded by the predicted, and indeed the growing unpredictability of, changes in weather patterns. As a result, the availability and cost of water are fast becoming key issues with which industry, in particular, is grappling.

Climate change is recognised as one of the most critical environmental challenges to threaten South Africa’s sustainable development.²¹ The nexus of food security, water security and climate change is of particular concern given the country’s significant agricultural sector and its existing water challenges. While most businesses have focused on mitigation opportunities, climate change adaptation considerations need to become far more prominent going forward.

Waste management is an environmental issue that often gets sidelined by water security and climate change; however, it is a critical issue, particularly for business. Firstly, from a compliance perspective, a *National Waste Management Act* was promulgated in 2009.

The comprehensive act has far-reaching implications for companies, particularly those in the agricultural and industrial sectors.

Secondly, South Africa’s landfill sites are fast approaching their capacity, resulting in a strong call by government for a reduction in waste to landfill and an increase in recycling by both businesses and consumers.

South African Food Retail Sector

Formal and Informal Sectors

South Africa’s food retail industry is composed of a formal and an informal sector. The informal sector constitutes hawkers, street vendors and *spaza* shops (small shops in densely populated townships). This sector is mainly served through the formal wholesale sector.

A significant 22.5 per cent of total consumer expenditure on food and groceries is made at informal or independent retailers, and it is these retailers in turn that supply 81 per cent of households in South Africa.²² The informal and independent sector is forecast to drive growth in the food and grocery sector between 2010 and 2013.

	2010	2013 estimate	Change
Large retailers	R153.0 billion	R212.7 billion	39%
Informal & independent retailers	R79.5 billion	R115.6 billion	45%
Total food and grocery spend in SA	R232.5 billion	R328.3 billion	45%

Table 2: The estimated growth rate of the formal and informal retail sectors in South Africa (Fernridge and Bank of America Merrill Lynch, June 2011).

The South African food retail market is highly concentrated, with five main players accounting for about 60 per cent of market share. The big five, in order of size by market share, are **Shoprite, Pick n Pay, SPAR, Woolworths** and **Massmart**.



Shoprite Holdings Limited (SHP) is Africa’s largest food retailer, operating 1,303 corporate and 427 franchise outlets in 17 countries across Africa and the Indian Ocean Islands. **Shoprite** has a broad customer base which closely mirrors the demographic profile of the country. **Shoprite’s** various store formats cater to all income groups with the Checkers, Checkers Hyper and House & Home stores focusing on higher-income groups and **Shoprite** and OK Furniture targeting the broad middle to lower-income market. The latest format introduced by the company, Shoprite Usave, focuses on the lower-end of the market.

www.shopriteholdings.co.za



Pick n Pay Stores Limited (PIK) is a food, liquor, general merchandise and clothing retailer, with an expanding footprint within South Africa, Swaziland, Namibia, Zambia, Lesotho, Botswana, Zimbabwe, Mozambique and Mauritius. **Pick n Pay** has a total of 775 stores, made up of hypermarkets, supermarkets and family stores (which are franchise stores), express stores, clothing stores, liquor stores and pharmacies. **Pick n Pay** stores predominantly serve the middle and upper end of the consumer market, although their Boxer offering (approximately 140 stores) services the low end of the market.

www.pnp.co.za

The **SPAR Group Limited (SPP)** is a food, liquor and building materials business operating in South Africa and servicing approximately 1,635 stores, almost all of which are independently owned. **SPAR** makes use of a “voluntary trading” model as opposed to a franchise arrangement with its retailers giving retailers more flexibility. **SPAR** operates under a license agreement with SPAR International in Amsterdam. This license agreement currently covers South Africa, Botswana, Namibia, Swaziland and Mozambique. **SPAR** operates a number of store formats, namely SPAR, SUPERSPAR and KWIKSPAR, TOPS at SPAR, Pharmacy at SPAR and Build it. The consumer profile of shoppers for the food and grocery business is spread evenly across the lower, middle and upper segments of the market.²³

www.spar.co.za

Woolworths Holdings Limited (WHL) operates a chain of more than 400 retail stores that offers a range of clothing, food, housewares, beauty and financial services (in partnership with Absa Bank) under its own brand name in South Africa, Africa and the Middle East. **Woolworths’** influence also extends to Australia with a majority share in the Australian retail chain Country Road. All **Woolworths** stores in South Africa are corporate owned, whereas stores outside of South Africa are either franchises or joint ventures. **Woolworths** has several different selling formats, including full-line stores that stock the complete Woolworths range, stores that stock only clothing and home products, and **Woolworths** food stores. Engen Food Stops are a convenience offering operated in conjunction with Engen petrol stations.

www.woolworthsholdings.co.za

Massmart Holdings Limited (MSM) comprises nine wholesale and retail chains and one buying group. In total, there are 330 stores and 633 buying groups operating in 12 countries in sub-Saharan Africa. **Massmart** is the third largest distributor of consumer goods in Africa, the leading retailer of general merchandise, liquor and home improvement equipment and supplies, and the leading wholesaler of basic foods. The company’s supermarket chains operate as Game FoodCo and Cambridge Foods. Other brands include Dion Wired, Makro, Builders Warehouse, Builders Express, Builders Trade Depot, CBW, Jumbo Cash and Carry and the Shield buying group. These brands span a diverse and broad consumer base (LSM 1 to LSM 10). **Massmart** recently became majority-owned by global retail giant Walmart. According to the chairman of Massmart, the acquisition was the largest investment in South Africa by an American company to date.

www.massmart.co.za



Shoprite is estimated to have more than a third of the formal market share, followed closely by **Pick n Pay** and **SPAR**, each with approximately 30 per cent market share.

Woolworths is estimated to have just less than eight per cent share and **Massmart’s** Cambridge Foods²⁴ is estimated at no more than two per cent.²⁵

The Role of International Players

Most South African retailers have links with international retailers, though the impact of these links on the South African food retail market has been limited. However, this is all set to change with the entry of the global retail giant Walmart through its new majority stake in **Massmart**.

Although there are many uncertainties surrounding Walmart’s business model in South Africa, the retailer does have three unchanging characteristics: discounting, automated logistics and buying power.²⁶ The entrance of a global player with the size and strength of Walmart is likely to add a healthy dose of competition to the retail sector and will no doubt lead to a more efficient industry all around.²⁷

The entrance of the international powerhouse has the potential to shake up the retail landscape. Business Monitor International notes that **Pick n Pay** and **SPAR** are probably the most vulnerable to Walmart’s entry into the market. In response, **Shoprite** is expected to continue to aggressively drive competitive pricing.²⁸

Price, however, is not everything. With long-term sustainability critical for business, it is important to ensure that low prices are not associated with the compromising of environmental and social standards and, ultimately, the collapse of local suppliers. Excessive focus on price is not likely to be the most effective way to compete. A better approach for the sector as a whole might be a greater focus on improving customer service experiences and thereby helping to build valuable brand equity.²⁹ Further, engaging more proactively with suppliers can improve productivity and security of supply, which can both have operational cost benefits.

Walmart’s entry into the South African food retail market is likely to have additional impacts, particularly in the area of environmental sustainability. In 2005, Walmart launched its global sustainability strategy, which aims to dramatically reduce the company’s environmental impact and help it to become “the most competitive and innovative company in the world.”

Massmart sees the merger as a great opportunity to leverage Walmart’s resources and expertise in areas such as sustainable agriculture, packaging rationalisation, eco-label advocacy, consumer empowerment and energy efficiency. It is therefore anticipated that **Massmart** will implement some wide-reaching changes in these areas in the coming years.

Expansion into Africa

Since 2000, consumer spending in sub-Saharan Africa has grown by four per cent every year, reaching nearly R600 billion in 2010.³⁰ The increased spending can largely be attributed to the young, urbanising population and the underdeveloped retailing market.³¹ Most African economies are largely cash-based and were, therefore, not heavily impacted by the global recession.

Africa and the Middle East are the fastest growing regions for retailing in the world.³² As foreign investors increasingly act on the opportunity presented by the African market, the greater the urgency for South African retailers to increase their foothold in the

rest of the continent. All of South Africa’s major food retailers already have a presence outside of the country and are now actively expanding their presence. In many instances, South African retailers see their medium-term growth coming from the broader African consumer market.

Corporate Accountability and Reputations

Rising stakeholder expectations and increasing regulatory controls have resulted in a greater focus on corporate accountability and responsibility. The boundaries of corporate responsibility have extended beyond the companies themselves and are now expected to include companies’ entire value chains and to incorporate broad ESG issues. Rising consumer consciousness around environmental issues in particular has placed increasing pressure on retailers to act responsibly, as failing to do so could potentially result in damaged reputations.³³ This is an important consideration for CEOs, with 72 per cent citing “brand, trust and reputation” as the top three factors driving them to take action around sustainability.³⁴

Highly publicised indices, such the *Mail & Guardian’s* Top Companies Reputation Index shown in Table 3 force companies to take note of how their actions impact their brands and reputations, particularly in the long term.

Top Companies Reputation Index 2012	
Winners – overall score:	
1	Coca-Cola SA
2	MTN
3	SAB Miller
4	Pick n Pay
5	Unilever SA
6	Standard Bank
7	Vodacom
8	Absa
9	Old Mutual
10	KFC

Spontaneous association with a good reputation:	
Pick n Pay	26%
Woolworths	17%
Edcon	12%
Vodacom	11%
Coca-Cola South Africa	11%

Table 3: Mail & Guardian’s Top Companies Reputation Index 2012 (www.mg.co.za)

Corporate accountability is under threat in Africa, where bureaucracy and trade barriers may compromise ethical standards and increase costs. This issue becomes increasingly important to manage for companies as they begin to aggressively drive expansion within Africa.

Regulation is also driving companies to at least consider and report on ESG issues as they relate to their strategies and operations. The *King Code of Governance for South Africa 2009* and the *King Report on Governance for South Africa 2009*, collectively referred to as *King III*, state that strategy, risk, performance and sustainability are inseparable and should therefore be managed and reported on in an integrated fashion. King III also provides guidance around key issues related to corporate governance, such as board commitments and structures, enterprise risk management and stakeholder engagement.

As of March 1, 2010, the Johannesburg Stock Exchange (JSE) requires all listed companies

to apply or explain their compliance with King III. Also, South Africa has taken the global lead by being the first country to make integrated reporting a legal requirement for listed companies.

Regulation 28 (Reg. 28) of the *Pension Fund Act*, which prescribes limits and types of investments in which the pension fund industry may invest, was amended in March 2011 to read: “Prudent investing should give appropriate consideration to any factor that may materially affect the sustainable, long-term performance of a fund’s assets, including factors of an environmental, social or governance character.” This firmly places a fiduciary duty on the pension fund industry to actively integrate ESG issues into their decision-making processes.

The broader investment community has also acknowledged the need to actively integrate ESG issues into their investment decision-making process. To this end, the newly developed Code for Responsible Investing (CRISA) was adopted by the industry on February 1, 2012. Globally the United Nations-backed Principles for Responsible Investment (PRI) has been driving the integration of ESG information into investment decisions and South Africa has an established local network of PRI signatories.

The above-mentioned changes to legislation establish South Africa as the global leader when it comes to integrating sustainability considerations into corporate agendas. However, it is widely acknowledged that a true organisational shift towards sustainability by companies in the region will take time. A broad lack of awareness and understanding of ESG issues, coupled with limited skills to address these issues in a corporate context make integration a challenge. It is therefore critical to focus on providing both business leaders and employees with the knowledge and tools required to enable ESG integration.





Environment: Climate Change

“The number one threat to our sustainable development, economic growth and quality of life is related to the impacts of climate change. Early impacts are being felt on agricultural production, food prices and food security, which will have disastrous social and economic consequences if we do not take bold steps to address climate change.”

- Edna Molewa, Minister of Water and Environment³⁵

Climate change is one of the most far-reaching environmental challenges facing South Africa. The scope of the challenge is compounded by the impact that climate change is expected to have on water, agriculture, biodiversity, health and human settlement.

About 80 per cent of South Africa’s greenhouse gas (GHG) emissions are the result of energy consumption, far above the average of 49 per cent among other developing countries. Therefore, unlike other developing countries, South Africa has limited opportunities to cut emissions by tackling deforestation, which contributes only 5 per cent of total emissions.³⁶ South Africa must, instead, focus on reductions in energy usage, particularly of coal-based energy.

The South African government announced in December 2009 a commitment to reduce emissions by 34 per cent by 2020 and 42 per cent by 2025. Achieving this target will only be possible through the active participation of all stakeholders,³⁷ none more so than the private sector.

Retail Implications and Solutions

Climate change poses a material risk to retailers due to its impact on supply chain resilience, costs, and customer expectations. These risks can be addressed through a combination of mitigation and adaptation strategies.

Building a Resilient Supply Chain

Retailers rely on consistent and high-quality produce from their supplier farms in order to operate. In South Africa, however, the ability of agricultural producers to ensure an adequate supply will be negatively affected by climate change impacts related to water stress (South Africa is already a water-stressed country) as well as increased weather variability. Each of these climate change outcomes is expected to contribute to cycles of drought and sudden excessive rain.³⁸ Climate change is, therefore, expected to have a significant and largely negative impact on agricultural production, according to the Intergovernmental Panel on Climate Change.³⁹

Long-term sustainability in both local and continent-wide operations will be heavily dependent on a climate change-resilient supply chain. Building resilience in light of the inherent unpredictability of environmental effects may prove challenging for retailers, but is necessary nonetheless. Indeed, the effects of climate change on agricultural production were identified by the majority of retailers as a considerable sustainability risk to their businesses.

Managing Costs

Climate change is expected to have an impact on retailers’ bottom lines through its

contributions to a variety of costs, the most notable being: carbon taxes, electricity costs, fuel costs and infrastructure costs.

CARBON TAX: The South African government is exploring the creation of market-based mechanisms, such as an escalating carbon tax, to put a price on carbon emissions. The government views such mechanisms as a means of internalising the external costs of climate change and of incentivising the diversification of the country's energy mix, the implementation of energy efficiency measures, and investment in cleaner technologies and industries.⁴⁰

However, the implementation of a carbon tax is highly contentious. Many in the private sector believe that it would be inappropriate for South Africa for a number of reasons:⁴¹

- South Africa would be the first developing country to introduce such a tax, thereby placing it at an immediate disadvantage relative to its competitors;
- The country already has a tax on motor vehicle fuels and a carbon tax would therefore result in double taxation, and;
- Economic growth and employment creation could suffer as a result of the added tax, stifling development in the lower income groups.

The implementation of a carbon tax would affect the South African food retail industry significantly. Food retailers generally recognise the direct impact that a carbon tax would have on their operating costs.⁴² As noted by **SPAR**, the resulting increase in operational and capital costs would place margins under pressure, to the extent that the company would no longer be able to absorb the costs and would have to pass them along to customers in the future.⁴³

There is currently a significant amount of debate around a carbon tax, the forms it could take and the potential implications for South Africa. To date, the retail industry has not presented its own views on the issue nor actively engaged in these debates. It is in the best interest of the industry to step up and contribute proactively to the discussion in order to ensure that the government's final decision with regard to a carbon tax is adequately informed.

ELECTRICITY COSTS: Food retailing is an energy intensive industry. Warmer conditions as a result of climate change could further increase the need for energy. According to **Woolworths**, although a warmer climate will result in a reduction in heating costs, the increased need for cooling and refrigeration in their stores and distribution centres will more than offset this reduction, leading to a net increase in energy consumption.⁴⁴

Warmer weather may also lead to spikes in demand and higher rates in a country where electricity costs are already rising. South Africans were hit by a 31 per cent hike in electricity prices in 2009/10 and another 24.8 per cent increase in 2010/11.⁴⁵ Eskom, the leading South African electric utility company, has warned that price increases will continue to be quite steep (as high as 25 per cent per year) until around 2014/2015.⁴⁶ Food retailers, therefore, have a strong incentive to reduce their energy costs, and for many retailers their initial climate change mitigation tactics are indistinguishable from cost management initiatives.

While South African food retailers are pursuing cost savings through energy reduction initiatives, they report that lowering their overall absolute emissions presents some challenges:

- As the industry continues to grow, the addition of more stores will result in increased energy usage;
- The investment required to make use of renewable energy sources to generate electricity can be significant;
- Raising awareness and understanding across large and diverse employee groups around climate change strategies and energy reduction efforts can be challenging.

FUEL COSTS: Transport-related emissions are the second largest source of emissions for retailers, after electricity-generation. Fuel costs are also a critical cost driver within the retail sector. Although medium and heavy commercial trucks are exempt from the existing tax on motor vehicle fuels, government and the motor manufacturing industry are seeking an agreement on taxable emission levels.

As noted by **SPAR**, should an additional carbon-related tax be levied on diesel, the cost per litre would increase and the savings from a fuel switch would be more significant. Of note, locally produced fuel is relatively dirty, currently sitting at the Euro 2 standard.⁴⁷

INFRASTRUCTURE COSTS: Another set of costs associated with climate change relate to the potential adaptation requirements resulting from damages to physical infrastructure and facilities caused by extreme weather events. Repair of damages, rising insurance premiums and operational downtime will all result in higher operating costs.

Meeting Customer Expectations

Climate change is becoming a differentiator in how retailers relate to their customers. Customer research indicates an increasing demand for communication regarding climate change and for environmentally friendly products and services. Customers are placing pressure on retailers, not only to act, but also to communicate their activities. Retailers that are leaders in this regard have the potential to gain favour in their customers' eyes.

Balancing responsibility and price is a key challenge for all retailers, but it is particularly important in the South African context. The consumer market is highly price sensitive due to the fact that fuel, food, water and electricity price increases have significantly reduced disposable incomes.

Best Practice and Case Studies

The complexity of addressing climate change has resulted in a myriad of responses by retailers that address both mitigation and adaptation. The section below highlights various practices and approaches that have been successful and that address some of the most critical challenges related to climate change.

Building a Resilient Supply Chain

As outlined in the Water Security section of this report, **Woolworths'** Farming for the Future programme drives resilience in the company's agricultural supply chain through water and soil management. Sourcing from multiple suppliers in vulnerable

food categories can also mitigate some of the risk associated with a potential shift in agricultural land use. This is a strategy used by both the **SPAR Group** and **Pick n Pay**.

While retailers cannot go so far as to request full audits or information on suppliers' GHG inventories (this level of diligence is not seen as currently feasible due to the cost and complexity), emissions reductions and energy efficiency discussions are fast becoming part of retailers' supplier engagements. For example, **Massmart** conducts an annual environmental survey of selected suppliers which includes questions regarding their approaches and disclosures around climate change. The company's most recent survey results indicated that 64 per cent of the 117 respondents had not engaged in climate change reduction practices and had failed to take action in addressing environmental threats.

It is likely that **Massmart** will draw on Walmart's experience in reducing supply chain emissions. Working with the Carbon Disclosure Project, Walmart has taken steps to identify GHG reduction opportunities in more than 20 product categories, with a specific focus on China. Walmart's global goal is to eliminate 20 million metric tonnes of GHG emissions from its supply chain by the end of 2015 (this amount constituted 72 per cent of the company's total emissions in 2006).⁴⁸

Managing Costs

CARBON TAX: Apart from recognising a carbon tax as a significant risk to future earnings, retailers are not actively engaging on this issue. **Pick n Pay** has attempted to estimate the financial impact that a carbon tax would have on its business. The company estimates that, if the tax were similar in size to the proposed carbon tax of R175 per tonne in the UK, its current Scope 1 and 2 emissions would result in a cost of more than R100 million annually.⁴⁹

REDUCING ELECTRICITY USE: All retailers are implementing measures to improve energy efficiency in the areas of lighting, refrigeration, temperature control and transportation. This is largely driven by the need to mitigate increases in energy prices.

The new trend in energy efficient temperature control is thermal storage systems, which reclaim "waste heat." Chillers are run at night in low ambient temperature conditions when demand and tariffs are low. The ice that is created is then used during the day for the purposes of air conditioning. The excess heat generated in the process is then available for use in heating water, resulting in huge energy savings. This method is currently being used by **Pick n Pay**, **Woolworths** and **Massmart** in their new green store formats.

The installation of online electricity meters at stores and distribution centres has proven to be very useful to the monitoring and management of energy use. In addition to helping companies manage their efforts to reduce energy consumption, online metering enables them to confirm billing and tariff structures from electricity providers. Both **Pick n Pay** and **Woolworths** have noted that online metering has enabled them to recoup significant amounts from electricity providers due to incorrect billings and tariffs.

REDUCING FUEL USE: In an effort to reduce costs, retailers are paying more attention to the management of their fuel consumption. Initiatives include route optimisation and consolidation (**all retailers**), the incorporation of biodiesel into the fuel mix (**SPAR**, **Pick n Pay**, **Woolworths**) and centralised distribution centres (**all retailers**).

The use of biodiesel (contributing between five and 10 per cent of fuel mixes in the retailers' fleets) reduces carbon emissions and could also save the operator money if and when a carbon tax is levied on diesel.

SPAR was the first retailer in South Africa to adopt the centralised distribution centre model, now used by all of the retailers examined in this report. By using centralised distribution centres, **SPAR's** commercial vehicles travel shorter distances and make fewer trips, thus reducing costs as well as carbon emissions. The construction of **Pick n Pay's** distribution centres resulted in a reduction of more than 730 tonnes of carbon emissions. **Woolworths** has also reportedly seen huge benefits in shifting one of their distribution centres to a more central location.



The **SPAR Group** is also pioneering other transport and fuel efficiency mechanisms. For example, the company implemented a group-wide fleet management program wherein a Group Transport Manager is tasked with driving operational efficiencies to minimise fuel consumption and emissions. In addition, driver trainers are employed at all distribution centres to improve driver performance, thereby extending vehicle life and minimising fuel consumption.

Woolworths has also updated its vehicle fleet with five trial vehicles using Euro 5 technology. These trucks are equipped with Bluetec technology (which has lower rates of particulate and nitrous oxide emissions), resulting in a two to five per cent fuel saving. However, with South Africa's fuel standards still at Euro 2 levels, there is much work to be done to improve companies' fleet efficiency. **SPAR** has identified the need to work together with other players across the fuel value chain to understand and address the challenges in this regard.⁵⁰

INFRASTRUCTURE COSTS: Given the potentially damaging effects of extreme weather events, some retailers are integrating this possibility into their site selection criteria for both stores and distribution centres. The **SPAR Group** is at the forefront of this risk analysis and has begun to actively incorporate such considerations into their site selection process.

Meeting Customer Expectations

All retailers view their climate change action as a means of strengthening customer loyalty and expanding their customer base. To leverage their role in empowering their customers to deal most effectively with climate change impacts, retailers are responding in a number of ways.

Woolworths is meeting the growing pressure from customers to address climate change. The company uses its website, social media, magazines and in-store marketing campaigns to communicate its efforts to stakeholders. It has embarked on a new relationship with the environmentally focused television program *50/50*, and was behind an expedition up Mount Kilimanjaro in January 2011 to create awareness around the impact of climate change on coffee farmers in Tanzania.

Effectively communicating with consumers about sustainability initiatives and products will greatly assist in creating positive brand perception for retailers. This is an area that **Pick n Pay** has indicated will receive increased focus going forward. In the meantime, **Shoprite** has leveraged the Consumer Centres at its stores to channel climate change information to its customers.

Case Study: Shoprite's Mission to Educate Customers

Through its in-store and online Consumer Centres, **Shoprite** uses leaflets to educate its customers on a variety of environmental and social issues. **Shoprite** has leveraged these centres, which are located at the entrance of its stores, to channel climate change information to its customers. For example, the centres provide valuable information on how to save electricity by outlining the average electricity consumption of various electrical appliances, providing kitchen and lighting tips, and providing information about solar geysers and heat pumps as energy-saving appliances.

Proactively providing useful energy saving tips and information demonstrates **Shoprite's** awareness of environmental issues and enhances the company's brand among eco-conscious consumers.



Key Findings

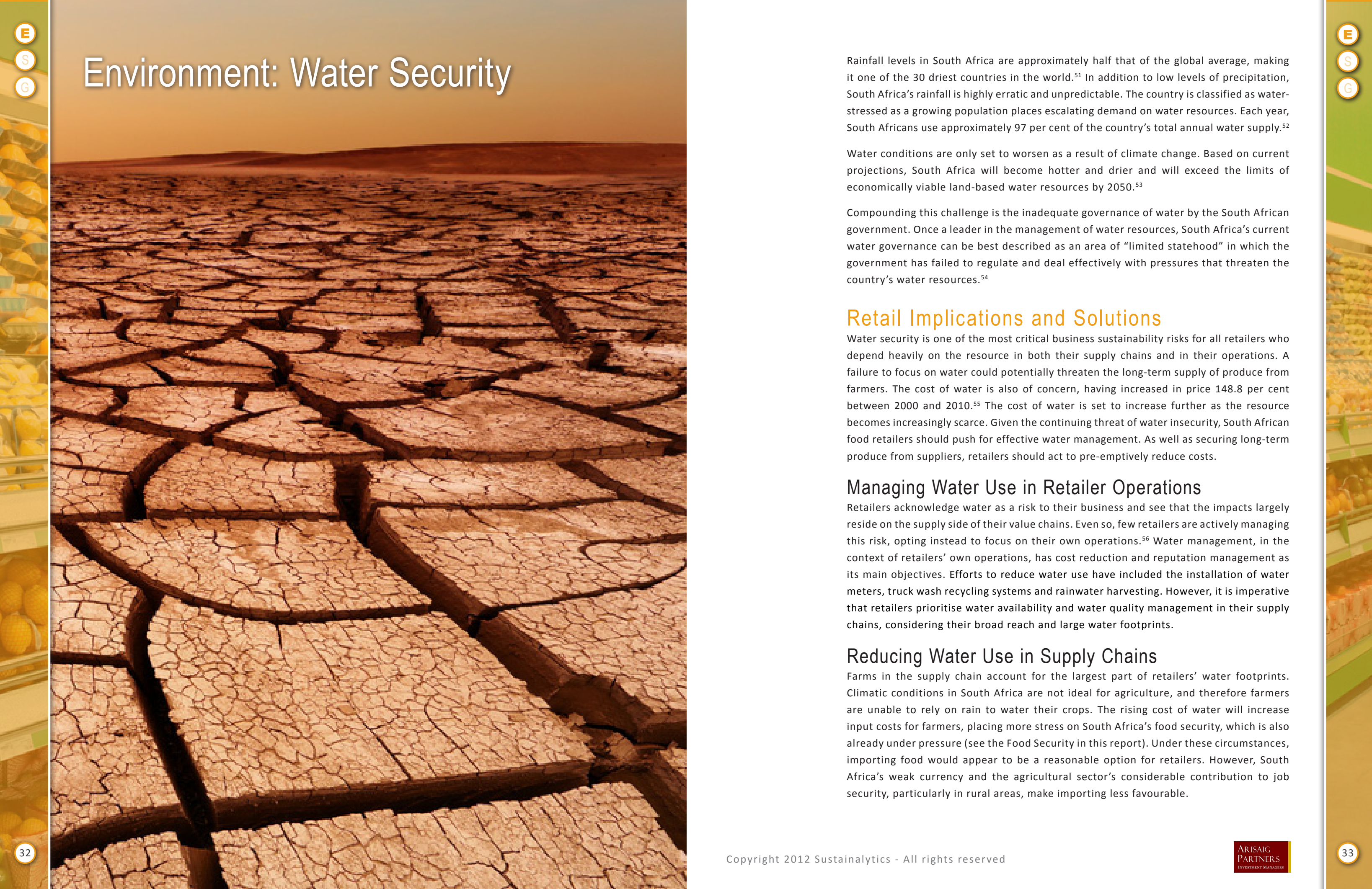
The impact of climate change will be far-reaching and will exacerbate existing challenges in South Africa. The interconnected nature of climate change makes responding to it a complex and challenging feat for retailers. It is important that their efforts focus not only on mitigation but also on adaptation in order to ensure the long-term sustainability of their businesses.

For food retailers, the impacts of climate change lie largely in supply chain insecurity, higher costs and increasing pressure from customers to be part of the solution.

Woolworths is advanced with respect to building supply chain resilience, as the monitoring and practices in its FfF programme are best in class. **Massmart** is also well-positioned to improve in this area by leveraging Walmart's expertise on sustainable farming methods.

Managing costs is the strongest driver behind retailers' efforts to reduce energy and fuel consumption. The retailers with new green store formats are making good progress in terms of light, refrigeration and cooling. **Pick n Pay** and **Woolworths** are ahead of their peers in this regard. With respect to transport management, **SPAR's** efforts appear to be the most advanced.

Due to increasing customer awareness, retailers are beginning to see the value in communicating and engaging on issues around climate change. **Woolworths** is currently doing the most in this space, and has tied its brand to its targets and commitments. Although not purely climate change-focused, the approach that **Shoprite** is taking with its Consumer Centres illustrates its awareness of consumer expectations related to climate change.



Environment: Water Security

Rainfall levels in South Africa are approximately half that of the global average, making it one of the 30 driest countries in the world.⁵¹ In addition to low levels of precipitation, South Africa's rainfall is highly erratic and unpredictable. The country is classified as water-stressed as a growing population places escalating demand on water resources. Each year, South Africans use approximately 97 per cent of the country's total annual water supply.⁵²

Water conditions are only set to worsen as a result of climate change. Based on current projections, South Africa will become hotter and drier and will exceed the limits of economically viable land-based water resources by 2050.⁵³

Compounding this challenge is the inadequate governance of water by the South African government. Once a leader in the management of water resources, South Africa's current water governance can be best described as an area of "limited statehood" in which the government has failed to regulate and deal effectively with pressures that threaten the country's water resources.⁵⁴

Retail Implications and Solutions

Water security is one of the most critical business sustainability risks for all retailers who depend heavily on the resource in both their supply chains and in their operations. A failure to focus on water could potentially threaten the long-term supply of produce from farmers. The cost of water is also of concern, having increased in price 148.8 per cent between 2000 and 2010.⁵⁵ The cost of water is set to increase further as the resource becomes increasingly scarce. Given the continuing threat of water insecurity, South African food retailers should push for effective water management. As well as securing long-term produce from suppliers, retailers should act to pre-emptively reduce costs.

Managing Water Use in Retailer Operations

Retailers acknowledge water as a risk to their business and see that the impacts largely reside on the supply side of their value chains. Even so, few retailers are actively managing this risk, opting instead to focus on their own operations.⁵⁶ Water management, in the context of retailers' own operations, has cost reduction and reputation management as its main objectives. Efforts to reduce water use have included the installation of water meters, truck wash recycling systems and rainwater harvesting. However, it is imperative that retailers prioritise water availability and water quality management in their supply chains, considering their broad reach and large water footprints.

Reducing Water Use in Supply Chains

Farms in the supply chain account for the largest part of retailers' water footprints. Climatic conditions in South Africa are not ideal for agriculture, and therefore farmers are unable to rely on rain to water their crops. The rising cost of water will increase input costs for farmers, placing more stress on South Africa's food security, which is also already under pressure (see the Food Security in this report). Under these circumstances, importing food would appear to be a reasonable option for retailers. However, South Africa's weak currency and the agricultural sector's considerable contribution to job security, particularly in rural areas, make importing less favourable.

Water consumption should also be managed at the food processing stage, which can contribute significantly to retailers’ water footprints. It is crucial for retailers to work with and encourage farmers and food processors to implement better water management practices. Supporting activities in this area will help secure a stable supply of locally sourced produce, and can increase productivity.

Addressing Poor Water Quality

A lack of effective governance by the South African government is a leading contributor to South Africa’s compromised water systems. Water is being polluted by inadequate municipal waste water treatment plants, unregulated discharge from industry and agriculture, and the infestation of invasive alien vegetation in riparian zones. These impacts on water quality pose a major challenge for retailers.

Mine water pollution, particularly acid mine drainage (AMD), was identified by the Department of Environmental Affairs only as an “emerging” issue “that may affect the future state of the environment.”⁵⁷ The reality is that contaminated mine water has already manifested itself as an exacerbating factor to already stressed major systems,⁵⁸ such as the Vaal River. The government’s slow and ineffective reaction to this issue is another example of its poor leadership in the area of water management.

That being said, the retail industry has done little to deal with water quality thus far; though there is agreement that this issue poses a material threat to business. Addressing this issue should be two-fold. Firstly, retailers should regularly monitor water quality in their supply chains and operations to ensure that it is of sufficient quality. Secondly, retailers should ensure that their own and their suppliers’ actions do not further degrade water quality and ecosystems. Ideally, retailers should be exploring ways to restore ecosystems to ensure higher quality water into the future.



Best Practice and Case Studies

Water Management in Supply Chains

Woolworths is notably advanced in terms of managing water use in its supply chain at both the farming and production stages. **Woolworths’** influence is applied through its Farming for the Future (FfF) programme, an ongoing sustainable farm development and auditing initiative. The rationale for developing such a programme grew from an increasing concern about the future supply of fresh produce. The retailer recognised that a sustainable supply chain is fully reliant on the environmental integrity of farms, and farms’ water and soil quality.

The programme has proved to be immensely successful in terms of reducing water farmers’ water usage. The latest audit of the 15 largest fruit and vegetable growers, who supply 37 per cent of fresh produce, saw a 16 per cent reduction in water usage as a result of optimising irrigation and upgrading old systems. **Woolworths** is targeting a 30 per cent reduction by 2015.



Case Study: Supplier Engagement – Lessons learned from Woolworths’ Farming for the Future Programme

With the success of the FfF programme, a number of key lessons emerged for retailers wanting to improve their supply chain water management through supplier engagement.

- A likely precondition for the success of the FfF programme has been the long-term collaborative relationships that Woolworths has with its suppliers.
- External auditors can play a key role in identifying and prioritising risk areas and their probable causes through annual audits. They also identify areas in which action or change ought to be applied.
- The audit takes the farm’s context into consideration, including crop type, geographic area and climatic conditions. It is important to recognise that farms and crop types are unique and may pose very specific challenges. It is therefore often not viable to have generalised solutions.
- A dynamic and interactive approach with farmers can be critical to the success of a programme. Rather than a policing system or a checklist of requirements, dialogue with farmers is more effective as they are often unaware of the consequences of their farming methods. Recommendations made for improving or changing existing practices are more likely to be understood after this process.
- Investing in one programme and expanding it across the supply chain if proven successful can be an effective strategy. The FfF programme was a bottom-up initiative that started as a pilot scheme and has now been transformed into a successful business model.
- Improvements have financial benefits as a result of reduced input costs for farmers. Having evidence of cost savings is crucial for facilitating buy-in, investment and support.

Managing Water Quality

Pick n Pay has identified AMD as a risk to water security within its supply chain. This recognition is possibly due to the fact that the soil of one of its supplier's farms was polluted by toxic mine water, which affected produce safety. As a result, the farmer's approved supplier status was withdrawn.

With respect to municipal water, the **SPAR Group** noted that it has already felt the effects of poor water quality levels. The municipal water used for the refrigeration units at one of its distribution centres was of such poor quality that the implementation of a reverse osmosis plant was necessary to ensure the efficient operation of these units.

Key Findings

A number of factors are placing increasing pressure on the private sector to address water management:

- South Africa is a water-stressed and semi-arid country;
- Some individuals still do not have access to potable water;
- Climate change is predicted to exacerbate the water security issue;
- Government's leadership is falling short of what is needed to meet this challenge.

Although food retailers have identified water insecurity as a major sustainability risk, they should be encouraged to implement additional initiatives to address the issue within their supply chains. While most monitor water use within their own operations, this is a negligible water footprint when compared with the overall supply chain.

The next steps for food retailers in this area are:

- To develop pilot water management programmes within the food retailers' supply chains and within their own operations. Food retailers should leverage such pilot programmes to develop more comprehensive and wider-reaching initiatives over time;
- To actively engage and assist suppliers in their water management. This should go beyond a simple audit;
- To monitor and manage water quality as it poses an increasingly material risk going forward, especially in light of AMD becoming a progressively more challenging problem to rectify.



Environment: Waste Management

Due to a general disregard for the way in which waste was handled, there was no national framework in existence for the regulation of waste handling prior to the implementation of the National Waste Management Act in July 2009. The results of this negligence have seen air and water systems polluted.

Industry experts have also warned that South Africa is rapidly running out of landfill space. Unlike in many developed nations, there are almost no official channels for recycling in South Africa. Municipal waste collection from households by local authorities does not separate out recyclable products. A significant 95 per cent of urban waste is deposited either in open dumps⁶⁰ or in one of the approximately 1,200 landfill sites operated mainly by local authorities.⁶¹

Retail Implications and Solutions

Waste management is an environmental issue that is often sidelined in favour of water security and climate change. However, the gravity of the issue, particularly for business, must be recognised. This *National Waste Management Act* has far-reaching implications, such as fines, penalties, and legal fees, for companies that fail to comply. Nevertheless, waste management is also an area in which cost savings can be made. Efforts to this effect should also be made in order to reduce the environmental impact on the natural systems upon which food retailers depend. Therefore, current solutions to waste management have been driven by the need to comply with regulations, reduce costs, and reduce negative impacts on the environment.

It is noteworthy that, although many challenges relating to waste management were identified by all retailers, they generally do not see waste as being a high risk to their business. **Massmart** is an exception, however, perhaps in part due to the nature of the products that the retailer sells, with food making up only a small proportion of its total portfolio.

Waste Management within the Supply Chain

There is notably strict regulation associated with the agricultural and industrial sectors under the *National Waste Management Act*. As well as being a compliance-driven issue, retailers also run the risk of reputational damage in the case of poor management impacting communities and natural ecosystems. The key challenge for retailers in terms of managing supply chain waste is the lack of understanding and awareness on the part of farmers about both relevant legislative requirements and the implications of their actions.

Managing the waste generated through agriculture and food processing appears to be an emerging issue for the food retail industry, and one to which companies have not responded comprehensively to date, bar **Woolworths**. Going forward, however, waste management should become a key topic for engagement between retailers and suppliers, as irresponsible waste management behaviour within the supply chain could have severe reputational implications for retailers who are deemed to be either ignoring or condoning such behaviour.

Packaging

Packaging is a problem for retailers, both from a production cost perspective (i.e. the energy needed to produce virgin materials and transport costs), as well as from a reputational perspective, given increasing consumer awareness around issues such as recycling and excessive packaging. Thus, retailers are under pressure to address this sustainability risk. Retailers are seen to have a significant amount of leverage when it comes to packaging issues, and they are encouraged to exert their collective influence in order to push sustainability among their suppliers.

Woolworths, Pick n Pay, Shoprite and Massmart are all members of the Sustainability Council of Plastics SA. The council provides an ideal platform for the sharing of information and lessons learned about the challenges that packaging presents.

Progress on packaging improvement in the industry has been a slow and frustrating issue for retailers. A shortage of local expertise and an inability to source sustainable packaging locally at competitive prices have been identified as two of the key challenges in this regard. The Institute of Packaging SA has also identified the structure of the South African consumer market as another challenge. Affluent consumers tend to require packaging that is convenient, while poorer consumers primarily demand affordability and safe product transportation and storage.

Three key opportunities lie in packaging, namely:

- *Recyclability*, i.e. the ability of a package to be readily sorted and recycled;
- *Incorporation of recycled content*, which enables retailers to “close the recycling loop,” particularly where they are able to utilise their own waste streams as inputs into their own packaging solutions;
- *Lightweighting*,⁶² which enables a reduction in both the packaging material and energy requirements during transport.

Reducing Waste to Landfill

The rapid rate at which landfills are reaching capacity limits has prompted the South African government to adopt a waste minimisation approach that places the responsibility to reduce the waste to landfill on manufacturers and retailers.

The preventive and proactive waste management steps laid out in the *Integrated Waste Management Act* are designed to slow the rate of waste disposed to landfill sites. This includes both waste that is generated within operations as well as waste produced by customers.

Operational Waste

Waste that is generated from retailers’ own operations is easier to manage than waste that derives from their supply chains. As well as legal aspects and keeping reputations in check, managing operational waste also provides a great opportunity to reduce costs.

Many of the food retailers included in this report have incorporated recycling initiatives into their distribution centres, with some companies backhauling recyclable retailer waste to combine with their own. All five of the retailers have placed an emphasis on

handling dry waste, although wet waste is also a key issue. Wet waste handling is one of the unique challenges for the food industry, as the management thereof needs to incorporate critical hygiene and health considerations.

Consumer Waste

There are almost no official channels for recycling in South Africa. Many retailers have seized the opportunity to fill this gap for consumers who wish to recycle. Stores offer a mutually beneficially location for the provision of recycling facilities as many customers combine their waste drop-off with grocery shopping.

With fairly severe fines or imprisonment associated with non-compliance to the *Consumer Protection Act*, retailers are required to ensure that take-back facilities or collection facilities are provided if certain products, such as batteries, CFL light bulbs and cellphones, are sold within their stores. Retailers therefore need to ensure that they have the capability to manage such facilities, which some have done.

Best Practice and Case Studies

Waste Management within the Supply Chain

Woolworths has recognised the need to actively address waste management in its supply chain. The company has been driving waste management initiatives through its Farming for the Future programme (see the Water Security section of this report for more detail), with a large degree of success. The most recent audit of its largest fresh produce growers showed a 32 per cent increase in recycling and a 13 per cent decrease in solid waste going to landfills.

The findings of a water trial that **Woolworths** conducted with 66 of its food suppliers were highly insightful with respect to how waste was being managed by suppliers. The greatest challenge identified was the mismanagement of runoff water (into rivers and aquifers) from irrigation practices and waste water from farm processing. The company followed up with efforts to increase awareness around legal compliance responsibilities. Many of the suppliers have since put water treatment solutions in place on their properties as a result of the programme.

Packaging

Recyclability

Woolworths’ greatest challenge in lightweighting is ensuring food protection while reducing packaging. As a result, the company shifted its attention to other areas on which it can improve, one of these being increasing the recyclability of its packaging.

Woolworths’ public commitment is to ensure that 100 per cent of its packaging is recyclable by 2015. Currently, 86 per cent of its packaging is reportedly recyclable.

Recycled Content

SPAR has demonstrated leadership by achieving a degree of “closed loop” recycling. The company backhauls retailer recyclable waste into its distribution centres. **SPAR** combines this waste with its own recyclable waste and passes it to one of its suppliers, which then

processes the recyclable waste and uses it in the production of secondary packaging for one of **SPAR**’s main houseware brand lines.

Woolworths and **Pick n Pay** have taken the initiative to incorporate rPET (recycled polyethylene terephthalate) into their packaging.

Case Study: Packaging – An Area of Expertise for Walmart

Packaging is a top priority for Walmart. The company has committed to being packaging-neutral by 2025 and has a dedicated in-house team specialising in packaging. Every year Walmart hosts a packaging conference that facilitates the exchange of information between packaging companies and Walmart suppliers, and which aims to identify opportunities for reducing and improving the environmental attributes of product packaging.



Massmart has started to follow in Walmart’s footsteps. Recent efforts have included a workshop exclusively focused on packaging, which engaged a number of players (e.g. packaging companies, suppliers, buyers and directors) on issues such as improving shelf life, increasing the durability of lightweight packaging, and increasing the recyclability of packaging. There is no doubt about the benefits that the merger will have for accelerating **Massmart**’s progress in the area of product packaging.

Reducing Waste to Landfill

Operational Waste

Woolworths has extended its commitment to incorporate recycled waste beyond its product packaging initiatives:

- Eighty-six per cent of trolleys and in-store baskets are made from recycled material. The company’s commitment is to update its entire fleet in the future;
- Thirty per cent of in-store signage is made from recycled material, with water-based chemicals and boards made from recycled fibre and virgin pulp.

Woolworths’ combined waste management initiatives (in operations, distribution centres and some stores) have resulted in a 14 per cent decrease in waste to landfill.

Pick n Pay has committed to zero waste to landfill by 2015. An important element of this commitment is the consideration of wet waste. To this end, **Pick n Pay** is exploring the use of biodigesters (oxygen-free tanks) to digest organic material biologically.

In addition to being an effective method to deal with waste, biodigesters also produce methane that can be used in cooking, lighting and heating. This approach provides the additional benefit of combusting methane – a greenhouse gas far more potent than carbon dioxide – that would otherwise have been released into the atmosphere.

Consumer Waste

Woolworths initiated a collaborative project in 2009 in conjunction with Engen and Nampak at 12 Engen service stations in the Western Cape. Consumers are able to drop off glass, paper, plastic and cardboard for recycling at these stations. The recycling project has been supported by the community

and, as a result, there are plans to extend the project to an additional 22 Engen sites in Gauteng over the next few months. The greatest challenge with this rollout appears to be a lack of support from individual filling station landlords.

Woolworths has gone beyond providing recycling facilities, with 95 per cent of its food lines displaying symbols on the packaging to prevent confusion and assist in the effective sorting of waste.

Pick n Pay has recently implemented a unique reverse-logistics initiative for online shoppers in South Africa. The company has offered to remove any used plastic bags, plastic containers and batteries for recycling when making home deliveries to customers who order their groceries online.

Key Findings

Waste management is an issue for all companies in South Africa. In the food industry in particular, the responsibility of the retailer needs to extend beyond its own operations to include both its suppliers and customers. However, waste management is a relatively new issue for the food retail industry and it has yet to be identified by most companies as a material sustainability issue.

To a large extent, the issue of waste management has often been sidelined by the other looming environmental crises such as climate change and water. However, the initiatives described here demonstrate the retail sector’s recognition of the need to address the issue, most notably through packaging reductions, especially with customers potentially using it as an indicator to gauge responsible retailers.

Retailers have made some progress in reducing their operational waste to landfill and are encouraged to continue to work with their suppliers and farmers to better manage waste along the value chain. Addressing waste management with these groups will have huge implications for the sustainability and resilience of the food supply chain as well as the successful incorporation of small emerging farmers.

The response of retailers to the challenge of packaging has focused mainly on increasing the recyclability and recycled content of packaging, while lightweighting is an approach that not many retailers are grappling with. Sustainable packaging and packaging reductions are expected to gain momentum with Walmart’s entry into the market, which bodes well for **Massmart**’s initiatives in particular.

Although retailers have come relatively far in reducing their operational waste to landfill, there remain a number of key areas on which to focus their ongoing efforts:

- In light of the complexity of sustainable packaging, retailers need to proactively share knowledge amongst themselves and to drive collaborative efforts in the packaging space. The Sustainability Council should be used as a platform to facilitate these efforts;
- All retailers should incorporate recycled material into packaging. The biggest opportunities for the use of post-consumer recycled (PCR) content is in the packaging of carbonated beverages, water and juice bottles;
- Increased attention should be given to lightweighting, which not only reduces material costs, but also fuel costs and emissions during the transport of products;
- More focus should be placed on the handling of wet waste, which also holds opportunities for the generation of alternative energy.



Social: Integrating Emerging Businesses into Supply Chains

Despite the significant progress that has been made since the advent of democracy in 1994, South Africa is still plagued by very high levels of inequality, poverty and unemployment. A vibrant small business sector could potentially create job opportunities and foster economic growth in the country; however, a number of barriers are preventing this sector as a whole from becoming a strong economic force. The small business sector has been hampered by factors including the complexity of doing business in South Africa, poor education levels, weak management, a low level of employable skills, a lack of working capital, and insufficient investments in research and development.

Retail Implications and Solutions

As the government of South Africa works to develop appropriate mechanisms to address the barriers facing the small business sector, the retail sector can support these efforts by leveraging the influence it carries in its supply chain. The industry's buying behaviour has far-reaching consequences for job creation, food security and food prices, especially in rural areas where agriculture plays a key role in the region's livelihood. By integrating small local businesses into their supply chains, particularly black-owned enterprises, retailers can promote economic growth and contribute to the reduction of poverty and unemployment, ultimately creating a more stable operating environment and empowering their consumer base.

In light of South Africa's shrinking agricultural sector, with the total number of farmers projected to decline by more than 60 per cent over the next 15 years, retailers have an additional responsibility to carefully consider the buying power that they hold through their value chains.⁶³ Pressure by retailers to drive down prices could precipitate the industry's collapse, which would also have a catastrophic effect on rural consumer markets. Retailers should instead work towards a goal of a sustainable supply base, engaging with their suppliers and empowering a new generation of small businesses to serve their supply chains.

Case Study: Impact of Retail Buying Practices on Small-scale Farmers

The number of commercial farmers in South Africa declined by 31 per cent between 1993 and 2008.⁶⁴ However, net farm income increased by more than 410 per cent over the same period.⁶⁵ This dramatic rise in income is a direct result of large commercial farmers, which were supplying retailers directly and indirectly through food producers, benefitting from economies of scale.

Over the same period many smaller and marginal farmers went out of business, as they were unable to compete with the commercial farmers and cheap imports. As a result of this lost income, the food security of a large numbers of households has been put at risk.⁶⁶

Integrating Small Business

As described previously in this report, South Africa's Broad-based Black Economic Empowerment (B-BBEE) legislation requires all large companies operating in the

country to actively integrate transformed (black) businesses into their supply chains. While retailers can conform to B-BBEE by ensuring that their existing large suppliers are B-BBEE compliant, there is also pressure on them to help develop black-owned small and medium enterprises (SMEs) and to incorporate these SMEs into their supply chains, using the Enterprise Development (ED) programme.

However, current interpretations of ED guidelines and B-BBEE Codes of Good Practice have largely focused on compliance, rather than the integration of SMEs into the supply chain. This fixation on compliance has spawned a large number of often unrelated ED projects, diluting their potential efficiency and impact. The greatest challenge for retailers in this regard relates to the resources⁶⁷ required to support the ED beneficiaries and to monitor the progress of multiple ED initiatives.

The private sector can collaborate with government to improve this situation. The South African government's 2011 National Development Plan (NDP) encourages the establishment of business incubators, in partnership with the private sector. These incubators will include "early-stage entrepreneurial training, artisan training and assistance to small-scale farmers and construction firms." The retail industry should proactively and collaboratively engage with government to establish these incubators and to incorporate the emerging businesses into their supply chains. These incubators could also be used in support of ED initiatives in order to streamline the process and develop sustainable businesses capable of servicing the entire industry.

In addition to fostering more capable small businesses, retailers should also aim to better facilitate the access of small businesses to their supply chains. At present retailers, whose requirements are of a high standard and vary between companies, often struggle to incorporate small businesses. Retailers, therefore, need to re-engineer elements of their supply chain processes to enable easier integration of smaller suppliers.

For instance, the cost of complying with each individual retailers' standards and their various audit requirements are often prohibitive to small businesses. In order to reduce the cost and complexity of supplier audits, particularly for small businesses, all retailers in South Africa could seek to agree on the standards that they require of suppliers and then develop a single audit regime that requires only one audit per shared supplier to ensure compliance.

Ultimately, such an audit regime would both facilitate small business integration into retail supply chains and save both the retail industry and suppliers a significant amount of time and expense.

Integrating Small and Emerging Farmers

Actively incorporating small and emerging farmers into retail supply chains can help secure the long-term availability of supply and protect rural consumer markets from collapse. However, retailers face a number of challenges when incorporating small and emerging farmers into their supply chains:

- Small farmers do not have the capacity to match the scale of demand from large retail supply chains;

- Farmers are not adequately informed about quality standards or legislative requirements. Retailers need to go beyond auditing to engage with farmers and support them in integrating the complex and specific standards at play;
- In addition to market access, farmers also need access to capital, inputs, technology and extension services in order to thrive. Retailers are part of the equation, as they can at minimum provide market access. However, they cannot act alone and farmers also need the support of government and community organisations in order to succeed;
- There are significant start-up costs, both in terms of investment and time required, to establishing farming operations. For retailers who choose to establish ED programmes for small farmers, there is a substantial delay before the farmers can deliver effectively into their supply chains.

One potential solution for many of these challenges is an agri-consolidator for farmers: an efficient produce sourcing, processing and logistical services facility. In addition, a consolidator provides management support and assists in the development of bankable investments. The agri-consolidator approach has the potential to integrate many of South Africa's small farmers into the formal food supply chain.



Best Practice and Case Studies

Integrating Small Businesses

As part of their ED strategy, **Massmart** has formed an innovative new partnership with a leading private sector small business incubator company, Raizcorp (Pty) Ltd.

Raizcorp's role is to nurture small businesses and assist them in bringing their products to market, in accordance with **Massmart's** quality standards, as well as facilitating and accelerating small business access to **Massmart's** divisional buyers. The partnership addresses a number of the common barriers to incorporating small suppliers into retail supply chain, including quality management and scalability.

In an effort to reduce the administrative burden and relieve frustration felt by suppliers (predominantly farmers) in meeting numerous retailer audit standards and quality checks, **Pick n Pay** is presently transitioning to a new database system to track supplier compliance. This system will enable retailers to access all relevant standards information on suppliers, eliminating the need for costly and redundant auditing.

Small and Emerging Farmers

The International Fund for Agricultural Development (IFAD) funded a small farmer agri-consolidator pilot project in Tzaneen in 2011. The project was run by the Pleiad Foundation and involved **Pick n Pay** and **Woolworths** as key partners.

The pilot project aimed to facilitate small farmers' access to markets and build their production management and business administration skills. The project will also help emerging farmers develop bankable business cases and present them to investors, thereby attracting investments.

The key objectives of the pilot were to test the concept of a consolidator within the South African context and to inform a national programme around developing emerging farmers and incorporating them into commercial supply chains. The pilot was successful and the site is now in operational mode.

Following the pilot, IFAD commissioned baseline studies in eight districts across four provinces. The objective of the baseline studies was to understand the current status of emerging farmers in the districts and to identify the key opportunities for development. These baseline studies are being used to inform the design of a national programme which IFAD will fund.

Running parallel to this IFAD process, a jobs fund application was made to the Development Bank of South Africa (DBSA) for the establishment of four additional consolidators that will function along the same lines as the Tzaneen pilot. This application was approved and will commence once sufficient matching funds are obtained (as per DBSA requirements).

This initiative provides an ideal opportunity for the food retail sector to become actively involved in developing a robust system to efficiently integrate small agricultural producers into their supply chains. The major food retailers should be actively considering their contributions to this programme.

Key Findings

Securing supply into the future whilst also addressing the broader socio-economic challenges of transformation, poverty alleviation and job creation requires retailers to actively drive the integration of small suppliers into their supply chains.

B-BBEE legislation, particularly as it relates to ED, has ensured that retailers have given some attention to this issue. However, retailers' interpretation of the legislation has generally resulted in a myriad of relatively small projects being adopted, many of which are time consuming and challenging to manage.

This current approach to small business development and integration is unlikely to yield any major shifts in the overall economic system of the country or to unlock the potential of the small business sector. In order to drive change, retailers need to start working collaboratively to develop industry-wide initiatives that integrate small businesses, particularly in the agricultural space, into their supply chains.

To this end, retailers should focus on the following key areas:

- Seek to partner with government on developing and leveraging business incubators;
- Re-engineer supply chains to enable the easy integration of small business;
- Reduce the cost and complexity for suppliers (predominantly small businesses) to service the sector, particularly as it relates to auditing and compliance;
- Engage more strategically with agricultural suppliers, in particular, to enable their long-term survival and growth;
- Actively explore the agri-consolidator approach as a potential industry-wide solution to develop emerging farmers and integrate them into supply chains.

Social: Education, Skills & Job Creation



The South African education system is in dire straits. The Global Competitiveness Index of the World Economic Forum ranked South African primary schools last out of 133 countries worldwide for “maths and science education” and 125th for “health and primary education.” Overall, the quality of the country’s education system was ranked 119th out of 133.⁶⁸

Meanwhile, unemployment levels are currently at 25.2 per cent, with youth unemployment levels at 51.6 per cent.⁶⁹ Companies are unwilling to hire new entrants into the job market because these workers tend to lack experience and require a great deal of training. Additionally, South Africa’s restrictive labour laws make it difficult to dismiss staff, and thus companies are often hesitant to hire candidates with no previous work experience.

The poor quality of South Africa’s education system coupled with its high unemployment rates will have a negative impact on the country’s continued economic growth, as well as the redistribution of wealth across the population.

Retail Implications and Solutions

Retailers are at risk of not being able to source sufficiently skilled workers to enable them to operate effectively in the future. They are already feeling the impact of poor numeracy and literacy levels, which are hampering their ability to hire and train staff, particularly for entry-level jobs such as store cashiers.

On a more specialised level, finding skills in the areas of butchery, bakery and specialised vehicle handling is also proving a challenge for the retailers. Buying skills are also in great demand within the industry, although the pool of experienced buyers from which to hire is very small. Given the importance of price, effective buying capability is crucial to ensuring that food retailers remain competitive.

With respect to both artisanal and buying skills, one of the greatest challenges for retailers is attracting young people into these types of roles. Young adults do not seem to be aware of job opportunities in food retail or may feel that these jobs are not as desirable as others.

At a management level, retailers are struggling to find suitable black candidates to take on key roles. This employment gap is attributed, in part, to the small number of existing black candidates who have worked their way up through the organisation and gained the necessary operational experience.

There also appears to be a general reluctance among young candidates to work under the tough conditions typical of an operational retail environment prior to moving into management positions. Other industries may offer more attractive options with respect to both lifestyle and remuneration, thus many young people choose those industries ahead of retail.

Clearly it is in the best interest of South African food retailers to contribute to the creation of a pipeline of skilled young people. They can do so by working together to raise awareness about job opportunities within the industry and to promote it as an attractive place to build a career.

The industry should also work on creating programmes to help young employees develop critical skills, such as buying and artisanal skills. Although each food retailer is currently developing such programmes for their own business, there is significant opportunity for them to collaborate, as an industry and with government, on initiatives to address these skill gaps.

More broadly, poor education and high levels of unemployment are likely to constrain household disposable income and, therefore, hinder the growth of the consumer market. This slow market development, in turn, will have a direct impact on retailers' ability to expand, creating an additional incentive for them to support the broad development of skills and education.

Retailers' responses to these challenges have, however, been limited.⁷⁰ In cases where retailers have become involved in the school system, their initiatives have largely been related to food security issues.⁷¹

Best Practice

The **SPAR** Group has the most holistic view of skills development, particularly from an internal perspective. The company's Academy of Learning provides in-house training to both current and potential **SPAR** employees. Specific training initiatives focus on operator, technical and supervisory skills, as well as management and leadership development training.

Through its Management Growth Programme and its Senior Leadership Development Programme **SPAR** has created succession plans and a graduated development process aimed at fostering leadership. These programmes focus on technical, supervisory and management competencies with a strong emphasis on developing change management capability. There is also a strong focus on educating future leaders on sustainability issues and on how to incorporate them into their everyday working lives.

SPAR has recently entered into a joint initiative with the Mr Price Group, an apparel and homeware retailer, to establish a training and work experience programme for unemployed youth. The programme aims to address both youth unemployment and the lack of a skilled and experienced pipeline of candidates.

Key Findings

The poor skills and unemployment within the retailers' potential workforce pose a significant risk to the retail sector and to South Africa as a whole. The response to date has been limited, and retailers should be encouraged to become more engaged.

One of the key areas in which the sector can play a role is in the development of a pipeline of skilled young people for the industry. **SPAR** has demonstrated leadership in this regard through its Academy of Learning and its collaboration with Mr Price Group around training and youth employment.

Going forward, food retailers should focus on the following key areas to enable them to develop a strong skills pipeline and ensure adequate transformation at management levels:

- Active engagement as a sector with government around potential legislative changes such as labour broker restrictions, skill levy rebates and youth wage subsidies that may further hamper skills development and job creation;
- Building the profile of the industry as an employer, with an emphasis on the opportunities at the artisanal and buying levels in particular;
- Working with government to establish programmes and initiatives to enable the development of key buying and artisanal skills. These skills could be leveraged directly by the sector itself, as well as by its supply chain;
- Attracting and developing young black employees who will have the ability to move into management positions over time.





Social: Food Security

Food security exists “when all people at all times have access to sufficient, safe, nutritious food to maintain a healthy and active life”.⁷²

South Africa is considered to be a food secure nation, as it produces enough staple foods and has the capacity to import food, if needed, in order to meet the basic nutritional requirements of its population.⁷³ However, the same cannot be said for South African households. An estimated 35 per cent of the population, approximately 14 million people, are vulnerable to food insecurity.⁷⁴ Households headed by women, particularly in remote rural areas and informal settlements, are most at risk.⁷⁵

Although there are large uncertainties regarding the impacts of climate change, robust evidence supports the prediction that all aspects of food security will be affected.⁷⁶ In South Africa, maize, sugar cane, soybean and wheat are expected to see major decreases in production.⁷⁷

Tackling food security was a major focus in South Africa after the nation became a democracy in 1994. Until 2009 developing effective interventions was challenging because there were no specific, accepted measures of food security and no consistent ways to monitor it. However, in 2010, food security once again became a priority of the South African government, though the issue still receives very little media coverage.⁷⁸ Given the enormity of the problem, food security and nutrition need to remain in the spotlight.

Retail Implications and Solutions

Accepting a Role in Achieving Food Security

The responsibility to ensure food security rests largely on the shoulders of government. However, most food is produced, processed, packaged and distributed by private sector companies.⁷⁹ Although the government influences value chains through regulation, incentives and the provision of infrastructure, much will depend on the private sector in meeting the growing challenge faced by both the rural and urban poor. The possible implications for retailers who do not recognise their role in the food security challenge are a damaged reputation (especially if they are perceived to be profiting at the expense of the poor), as well as social unrest and conflict when people go hungry.

Food security has been identified by many of the big five food retailers as a major issue for South Africa. However, few recognise the huge influence that they have in terms of reaching a solution – or the consumer expectation to do so.

Food retailers should be leveraging their influence in all three dimensions of food security:

- *Food availability:* Sufficient quantities of food available on a consistent basis at both national and household levels;
- *Food access:* The ability of a nation and its households to acquire sufficient food on a sustainable basis;
- *Food use:* The appropriate use based on knowledge of basic nutrition and care, as well as adequate water and sanitation.⁸⁰

Food Availability

The food systems through which we strive to achieve food security rely heavily on extractive approaches that deplete soil, drain freshwater resources, pollute air and reduce biodiversity. In light of a growing population and the declining pool of resources, extractive approaches should no longer be considered an option. Agricultural production has also been singled out as the area that will be hardest hit by climate change. The negative impacts on production are likely to be compounded by an already-shrinking commercial farmer base and put further strain on small-scale and emerging farmers. (For further analysis of this issue see section on Integrating Small Businesses).

The challenge for South African retailers is to ensure sustainable sourcing methods that will allow for the long-term availability of produce. Imports may, therefore, become increasingly relied upon and have been suggested as an appropriate protection against droughts.

The majority of retailers recognised failure to ensure sustainability in their supply chains as one of the major risks to their businesses. Thus, some retailers have implemented or have begun developing programmes to achieve supply resilience. However, there appears to be a significant amount of duplication between retailers’ activities in this space. Also, the focus of such programmes tends to be on the commercial agricultural sector, and often excludes emerging and small-scale farmers.

Along with agricultural production, the availability of marine products is also under threat. The rising demand for fish and fish products, coupled with a growing human population, has placed increasing pressure on fish resources.⁸³ Most countries in the southern African region have experienced a decline in many stocks since 1972.⁸⁴ In South Africa, 68 per cent of commercial line fish species have collapsed, while a small 16 per cent are “optimally exploited.”⁸⁵ Severe impacts on biodiversity are also expected with climate change. According to WWF, a decrease in marine biodiversity has already had significant impacts on the fisheries sector and on the local economy of small-scale and subsistence fishing communities along the West Coast of South Africa.

Overall, the industry appears to have made significant commitments to the fisheries sector. **Pick n Pay**, **Woolworths** and **SPAR**, as well as 60 per cent of the entire South African retail market, currently participate in WWF’s South African Sustainable Seafood Initiative (SASSI).⁸⁶ The initiative is a consumer awareness programme which categorises fish species, using different colours, deters consumption of illegal species, and guides consumers towards more ecologically sound choices when purchasing fish.

Sustainable sourcing of marine and agricultural produce must be addressed in order to ensure procurement in the future. Since South Africa has committed to maintain and rebuild fish stocks to levels able to produce maximum sustainable yields by no later than 2015, those that are perceived to be hindering progress will be placed under increasing scrutiny.⁸⁷

Food Access

Although food may be available, it is often accessing it that can prove challenging for those threatened by food insecurity. To combat this issue, retailers can make stores more accessible and make food as affordable as possible.

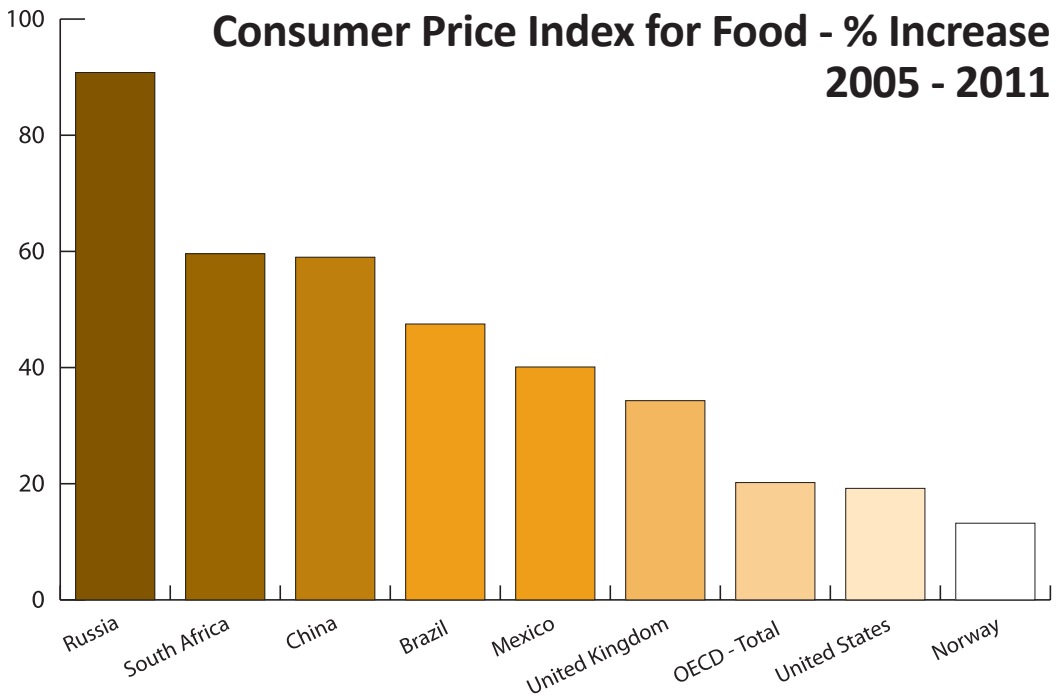
Physical Access to Stores

Retailers assist food access for low-income communities through strategic store locations in remote and rural settings. Building stores in rural settings can reduce or eliminate the need for individuals to travel long distances to buy food, which can have significant implications for consumers with relatively little disposable income.

Most retailers recognise that placing stores in rural areas not only assists poorer communities, but it also expands their operations into the lower LSM groups, which constitute a significant proportion of the population. These areas present new and attractive growth opportunities as they offer sufficient volumes for businesses to prosper, provided products are affordably priced. At present, **SPAR** has the most retail outlets in rural area, while **Massmart** currently dominates the wholesale sector to informal traders.

Financial Means to Acquire Food

In late 2001 and early 2002, food prices rose to a record high in South Africa. The inflation rate escalated and had a huge impact on food security and the stability of the economy. Food prices became less volatile between 2003 and 2005, but increased again in December 2007 by approximately 13 per cent.⁸⁸ It appears that food prices are on the rise once again, with a 3.1 per cent increase from 2010 to 2011.⁸⁹



Source: <http://stats.oecd.org/>

Significant inflation will have a negative impact on household food security in South Africa, affecting the affordability of important staple foods such as maize meal, bread, cabbage, tomatoes, chicken, milk and margarine, as well as food items that constitute a diverse diet.⁹⁰ These price hikes are also most significant in rural settings, which is where the majority of people facing household food insecurity dwell. Possible reasons for this disparity include transport costs, stock losses, loading costs and low/no volume discounts.⁹¹

All retailers interviewed recognised the impacts of rising food and other input costs on their operations. The main response by the retail industry has been to manage and offset costs as much as possible, so as to pass on savings to their consumers and ensure affordability of the goods they sell. This move is not directly linked to concerns around food security but rather to the consumer demand for low prices. Walmart's entry into the South African market puts retailers under further pressure to ensure that they remain cost-competitive in the future. Most of the retailers are focusing heavily on marketing low prices and good value in an attempt to attract more shoppers.

Some of the most significant savings can be made through the implementation of labour-, energy- and water-efficiency measures in the supply chain. With water being such a scarce commodity in South Africa, the cost of producing certain irrigation-fed crops may mean that importing becomes a more economically and environmentally feasible option for securing the nation's food.⁹²

All retailers also acknowledge that additional price hikes are becoming increasingly difficult to absorb. Despite this threat, retailers have not engaged with government on the potential ramifications of cost increases for their businesses and for their customers. It is crucial that the industry provide insight to the government, especially in light of future new potential costs in the form of labour broker usage, carbon tax and e-tolling. Apart from the management of costs, another strategy which all retailers have implemented in order to make food more accessible is the sharing of retailer "food waste" (i.e. food that is still safe for consumption but not suitable for sale) through feeding schemes and charitable donations. Although retailers continually strive for excellent supply chain efficiencies and accurate stocking methods to minimise waste, there will always be some food waste at the store level.

Food Use

As with many developing countries around the world, food use patterns have changed across a number of population groups within South Africa. Increased levels of disposable income as well as improved access to alternative food options, particularly amongst the emerging black middle class, have resulted in changes in dietary norms.

In many instances, these shifts have resulted in a significant increase in the consumption of fats, carbohydrates, sugar and salt. Fast food and convenience meals have now become a major part of many South Africans' staple diets, the average nutritional value of which is typically relatively low. These dietary shifts have resulted in increased rates of obesity, heart disease and diabetes.⁹³

Retailers can play a very positive role in addressing these food use issues by offering reasonably priced healthy eating options. These healthy options can also include the removal of or reduction in ingredients associated with health problems. These types of offerings tend to be tailored to meet the upper end of the market which is often more health conscious; however, retailers should also be mindful to address the emerging middle class segment, as well as lower-income groups.

Retailers can and should use their influence to educate their consumers on health and

well-being, particularly as it relates to food consumption. To this end, food labelling and nutritional quantities are particularly relevant education tools.

Some retailers have seen the value in going beyond temporary solutions, such as feeding schemes. They have taken action in areas such as consumer education, health and well-being, and nutrition. Much of the education has focused on teaching individuals to sustain themselves through growing their own food. **Pick n Pay** and **Woolworths** have been active in this area.

Food labelling and providing the relevant information around nutritional quantities in stores is another area where retailers can educate individuals around food use. The aim of food labelling is to ensure that consumers have access to complete information on the content, composition, provenance and nutritional value of the foods they purchase, from which they can make informed choices that protect their health and interests.

The **SPAR Group** has taken steps to ensure that it stays in line with global trends by incorporating helpful "Guidelines on Daily Amounts" (GDA) icons on its own-branded food packaging. The percentage value in each block is based on the recommendations for an average adult of healthy weight and average activity level.

Retailers can also have a positive impact in the area of food use by finding innovative ways to ensure that their low-income consumers have access to the nutrition they need at affordable prices. Product fortification is one area that should be considered to address this need.

Although all retailers are including small farmers as part of their transformation agendas, few see this as a means of contributing to food security. However, with roughly 1.3 million small-scale farm units nationwide, the incorporation of emerging farmers can be driven more strongly in retail organisations as a means of increasing household food security.

Best Practice and Case Studies

Accepting Their Role in Achieving Food Security

Pick n Pay has undertaken baseline studies on measures of food security in order to gain a more comprehensive understanding of the risks and challenges. The company sees the implications for its business as well as for its customers in not addressing this issue. Food security is therefore the main focus of **Pick n Pay's** Corporate Social Responsibility budget.

The retailer is also starting to consider how all the actors in the food system (i.e. retailers, consumers, suppliers, communities, interested organisations and regulators) impact food access and natural systems, as well as how the company itself has an impact on the other actors in the system.

Food Availability

Of the sustainable farming efforts that have been applied, **Woolworths' Farming for the Future** Programme stands out. (For further detail on how they are ensuring sustainability in their supply chain, refer to the sections in this report on Water Security and Climate

Change.) It is important to note, however, that **Woolworths'** focuses only on farmers for whom the retailer is their sole customer. These efforts, although considered best practice, are therefore not likely to result in systemic change.

In the marine space, **Pick n Pay's** commitment to align its entire fresh, frozen and canned seafood operations with SASSI guidelines by the end of 2015 is also noteworthy.⁹⁴

Food Access

Physical Access to Stores

The **SPAR Group's** new retail format, SAVEMOR, has made the store increasingly prominent in rural areas. The format is designed for small rural towns and central business districts, where the cost of setting up a **SPAR** store cannot be justified. **SPAR's** business model of owner-managed retail stores is one that will have a long-term, positive economic impact on rural communities, as profits derived through the retail stores will remain within the communities in which they operate.

The company has also addressed one of the emerging challenges associated with bringing the formal retail sector into areas where informal retailers (i.e., hawkers and spaza shops⁹⁵) had previously been the only point of trade. **SPAR** took appropriate action when tensions arose between it and the large number of informal traders operating in close proximity to a **SPAR** store. After engaging with the informal traders, the retailer was able to structure a deal whereby the traders continued to operate close to the store and were able to procure their goods for sale from the **SPAR** store at reasonable prices. This was a win-win-win situation for the retailer, the informal traders and the local community as a whole.

Financial Means to Acquire Food

Massmart was involved in an exploratory study on the impact of product packaging on food security. The results were extremely insightful and should be taken into account as a means of addressing the financial challenges that face households that are in a state of food insecurity.

Case Study: Through the Eyes of the Consumer

An exploratory study was initiated by **Massmart** to obtain insights on food security, by looking at "bottom of the pyramid" consumers' buying patterns and their views on packaging and labelling of basic food products.

Some interesting findings emerged from the selection of consumers in Diepsloot: Respondents were found to buy most of their groceries (such as maize meal, rice, sugar, cooking oil and coffee) in bulk once a month in order to get products at lower prices and to save on transport costs to and from shops.

Dependence on public transport and the lack of cooling or freezing facilities in their homes limit their ability to buy certain products in bulk and put further demands on their already limited budget for groceries.

These consumers are experienced bargain hunters. Before they decide where to do their monthly grocery shopping, they scan advertisements for specials and compare prices at a wide variety of retailers. They will travel long distances to the cheaper retailers despite the higher transport cost.



These consumers are extremely loyal to certain product brands (Ricoffy, Black Cat, Rama and Ace), whilst purchasing the lowest priced brand available for other products (sugar, tinned fish and frozen chicken pieces). Brand loyalty is mostly associated with good taste, perceived nutritional value, and/or more value for money. (Source: Food security and product packaging - An exploratory study among a selection of Diepsloot consumers. March 2011).

Food use

With the increasing necessity for consumers to make healthy eating choices, **Woolworths'** convenience range is currently the best practice among the retailers.

Woolworths currently offers a range of healthy convenience foods, including low-fat options, which may assist in curbing diabetes and over-consumption in South Africa. As part of its Good Business Journey, **Woolworths** has committed to have 50 per cent of its food products be healthy food options by 2015.

The retailer has also ensured that ingredients associated with health problems, such as unnecessary additives (including preservatives), excess salt and sugar, and products such as tartrazine, monosodium glutamate and aspartame, are removed where possible.

The same measures should be considered by all of South Africa's major food retailers.



Key Findings

Although national food security in South Africa is not currently a matter of concern, food security at a household level is a major challenge which needs to be prioritised if social development is one of the country's goals. Food retailers can leverage their influence in all three areas related to food security, namely food availability, food access and food use.

Pick n Pay is a leader when it comes to recognising its role in food security. However, it is not clear how the company intends to address the issues from an operational and supply chain perspective, as its focus appears to be on driving corporate social investment activities in this space as opposed to adapting business models to address the challenges.

Some players have recognised the need to ensure sustainable farming methods and marine management programmes in their supply chains and have implemented programmes to this effect. **Woolworths'** Farming for the Future programme is most notable in the agricultural space, while **Pick n Pay's** commitments lead the industry on the seafood front.

However, there is little acknowledgement and even less action being taken by the industry to actively drive sustainable agriculture programmes with emerging farmers while simultaneously striving to incorporate these farmers into the broad industry supply chain. Initiatives in this regard represent an opportunity for retailers in that direct sourcing from emerging farmers could reduce operating costs.

All retailers are acutely aware of rising food prices and the impact that this has on consumers and food security. As a result, they are focusing on driving efficiencies in an attempt to eliminate any unnecessary costs. The industry appears not to have recognised the need to actively engage with government around key regulatory issues that may impact their businesses and, therefore, food prices in the medium term.

The industry appears to be lagging in terms of developing healthy convenience food options, particularly at the low end of the market; only **Woolworths**, a higher-end retailer, has implemented ranges in this space. Affordable healthy food options provide a valuable opportunity for retailers going forward.

To address food security, retailers should focus on the following areas:

- Actively engaging suppliers, large and small, on sustainable sourcing opportunities. Suppliers should be able to identify the value for themselves in implementing changes to unsustainable practices;
- Collaborate with the government on sustainable agriculture issues, especially in light of the government's plan to invest in developing "climate-smart agriculture";⁹⁶
- Combine efforts and work collaboratively to simultaneously drive sustainable farming practices and emerging farmer integration. This will go a long way to addressing some of the key systemic issues that are impacting food security;
- Engage with the government as an industry on the potential impacts of proposed legislation on food prices;

- Explore the fortification of staple products to increase nutrition for the lower-end consumer. This should be explored in collaboration with food processing companies;
- Develop healthy food options, especially in the convenience space, for lower and middle class consumers.



Governance: Leading & Engaging Employees Around ESG Issues



Businesses are focusing on corporate responsibility and sustainability more than ever before. Previously niche social and environmental issues have moved from fringe considerations to executive and board-level agendas. However, even in cases where executives understand the long-term economic value of embracing sustainability, embedding it into a company's culture and integrating it into business processes remains a significant challenge. Food retailers in particular face the challenges of providing sustainability leadership within their organisations and engaging the hearts and minds of their employees.

Retailer Implications and Solutions

Sustainability Leadership

Business strategy is owned and driven at an executive level. Sustainability considerations, therefore, need to be integrated into the overall strategy and ongoing strategic decisions of an organisation at the executive level. When senior managers put in place strong governance and accountability structures they provide the necessary foundation for the integration of sustainability factors. However, few executives are equipped with the skills and experience to address issues around sustainability or to drive a sustainability agenda. This is true for most organisations in South Africa, not just retailers.

In most cases within the food retail sector, the individual responsible for managing and co-ordinating sustainability strategy does not sit on the company's executive team but rather reports to an executive in charge of either marketing or corporate affairs/governance.⁹⁷ The fact that the sustainability team tends to support the overarching objectives of these functional areas rather than their own agenda hampers its ability to embed sustainability at a strategic level across the organisation.

Some retailers have established structures such as operational-level steering committees and business unit feedback sessions that enable them to engage regularly with functional teams around sustainability issues and target-setting. These organisational structures have proven valuable in building awareness of issues and have led to an increased focus on driving operational performance in key areas.

Embedding sustainability is first and foremost a leadership challenge. Interestingly, many investors have reported that they gain confidence in a company with strong sustainability leadership as it is a good indication of strong overall management.

Key indicators of strong sustainability leadership include:

- Dedicated sustainability staff with reporting lines to the executive team or the board;
- Incentive structures that reward strong sustainability performance ;
- In-depth and appropriately broad sustainability disclosures (preferably in the form of a GRI report);
- Appropriate policies and management systems;
- Time-bound performance improvement targets in material areas of ESG performance.

Engaging the Hearts and Minds of Employees

While leadership is a prerequisite for strong sustainability performance, there is a general consensus that the successful integration of sustainability into a business relies heavily on high levels of staff engagement. Given that customers’ awareness of sustainability is increasing at a rapid rate, it is critical that employees, particularly those who deal directly with customers, be knowledgeable and passionate about their companies’ sustainability agendas. The most notable challenge appears to be at the store level, where staff turnover tends to be high.

Employee engagement on corporate sustainability agendas was a challenge noted by all of the food retailers interviewed. Most retailers face a company-wide lack of knowledge and understanding of sustainability issues and how to address them. Traditional approaches to education have not provided staff with the necessary skills and competencies to enable them to integrate sustainability considerations into their thinking.

Best Practice and Case Studies

The way in which retailers are handling leadership of and engagement with employees varies substantially.

Sustainability Leadership

SPAR Group demonstrates notably strong executive-level sustainability leadership. The individual responsible for sustainability is a member of both the executive team and the board. Being intimately involved in the development and management of **SPAR**’s strategy puts this individual in a position to strongly influence how sustainability considerations are integrated into this strategy. The individual has a strong academic background in sustainability, having attained a Post Graduate Certificate in Sustainable Business from the University of Cambridge. According to the retailer, this capability has proved invaluable in the process of integrating sustainability into the fabric of the company’s strategy.

Engaging Employees

Each of the five food retailers claims to see the value of employee engagement. In fact, many mentioned this as one of the key lessons learned in the integration process.

Woolworths believes that its sustainability performance management system is a crucial tool for integrating sustainability into the organisation and gaining employee buy-in. The company notes that, without this system, sustainability targets and objectives would have been unattainable.

The **Woolworths** tracking system has over 200 indicators, each with a one-year and a five-year target. Monitoring and evaluation of sustainability performance is extended to each employee in the form of an employee scorecard. Employees’ annual bonuses are influenced by the sustainability performance of the company and their particular business unit.

Pick n Pay has placed significant focus on engaging its employees at all levels on its sustainability agenda. In contrast to **Woolworths**, which focuses almost entirely on

engaging with head office staff, **Pick n Pay** has placed a lot of emphasis on store-level employees from the outset of its engagement programme. This strategy is clearly in an attempt to ensure that customer-facing employees are aware of and understand **Pick n Pay**’s activities in this space.



Case Study: Seeing the Value in Communication

It is of utmost importance that employees be brought along on the sustainability journey if any efforts in this area are to be successful.

Pick n Pay is a retailer that has focused greatly on its internal communication. The company believes that effective communications of its sustainability agenda will reduce employee turnover, something which has considerable financial benefits. The retailer also feels that a good reputation in terms of its climate change initiatives will help attract the best and brightest employees, providing a strategic advantage over competitors.

Pick n Pay has used a wide range of media to communicate with its staff, including in-store plasma screens, printed material (i.e. Pick n Patter magazine), video communication (i.e. Fresh Connexion), electronic newsletters, as well as radio broadcasts (i.e. Memeza radio station). **Pick n Pay** has also leveraged its partnership with WWF to assist in educating employees on climate change. All of these endeavours facilitate communication around projects, changes in business processes and climate change awareness.

The company has tried to make these channels of communication as simple and as appealing as possible for its staff. The relatively low levels of education among staff, particularly at the store level, make visual communication highly effective.

Pick n Pay sees communication around climate change and other sustainability issues as crucial to increasing employees’ awareness and understanding of the current and future impacts of climate change on the organisation.

Since 2010, **Pick n Pay** has integrated sustainability measures into its evaluation of divisional performance. However, the scorecards have only two or three key sustainability indicators, chosen in part due to their clear positive impact on reducing costs. **Pick n Pay** intentionally chose a simple approach to performance tracking so as not to make achieving targets overwhelming for employees. The retailer notes that the tracking of these performance indicators has neither helped nor hindered the company’s ability to drive sustainability throughout the organisation. This is largely due to the fact that employee awareness and engagement is already being driven through a strong internal communications platform.

Case Study: Educating Leadership Around Sustainability

The **SPAR Group** has focused heavily on engaging senior and middle management around its sustainability agenda. Its communications to date has placed an emphasis on why sustainability is important to **SPAR** and its related strategy and commitments. Most communications have taken place through forums and engagement sessions.



SPAR has recognised that a potential stumbling block to the successful implementation of its strategy will be a lack of internal understanding and knowledge about sustainability. In order to pre-empt this, the company has decided to focus heavily on educating its staff about sustainability. To this end, sustainability has become central to **SPAR's** Senior Leadership Development Programme and the Management Growth Programme. **SPAR** is also investing in developing a formal sustainability training programme for staff with key functions within the organisation.

Key Findings

The food retailers generally acknowledge the need for focused leadership to drive the sustainability agenda of their organisations. Each has created a centralised function responsible for company-wide integration, although the reporting lines of these functions vary considerably. In order to truly integrate ESG considerations into an organisation, strong leadership needs to be driven by senior management to ensure that ESG issues are consistently identified as well as appropriately addressed and managed at both a strategic and an operational level. **SPAR** is the only retailer in South Africa with this level of oversight in place and, as a result, the only one in which sustainability is visibly woven into every aspect of the corporate strategy.

Retailers also recognise that there is little chance for the successful integration of sustainability initiatives without a strong degree of employee engagement. Three different approaches to engaging staff have been implemented by the various retailers.

- **Woolworths** has chosen to drive engagement through performance management;
- **Pick n Pay** focuses on employee communication, particularly at a store level, and;
- **SPAR** is focusing on training and educating management and key staff on sustainability thinking.

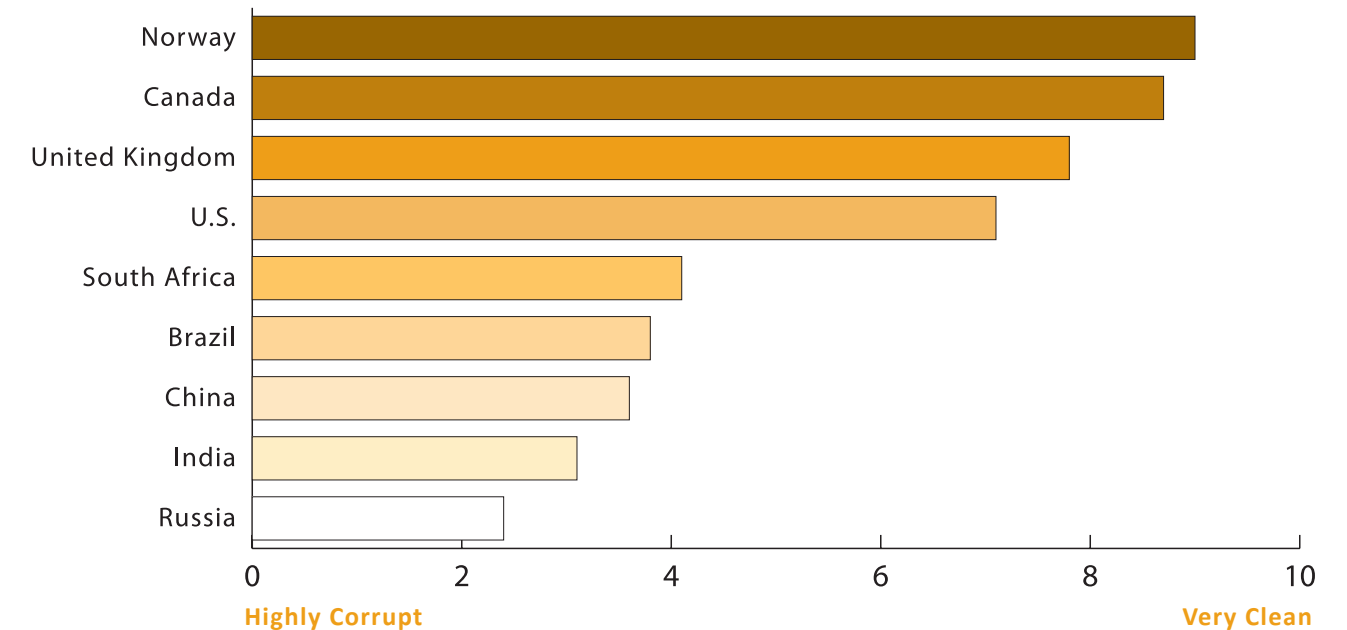
While only time will tell which of these approaches to sustainability leadership and employee engagement will have the greatest success, each one has its merits as culture change and embedding sustainability requires a variety of approaches in order to have a lasting effect.

Governance: Corporate Accountability

Transparency, accountability and ethical leadership are the pillars of good governance and are key elements for organisations to create and sustain value into the future.

Although South Africa is among the least corrupt countries on the African continent, scoring a 4.1 on a scale from 0 (“highly corrupt”) to 10 (“very clean”) on Transparency International’s 2011 Corruption Perceptions Index, the country is still affected by the broader continental context in which bribery and corruption are more prevalent.⁹⁸ Furthermore, a legacy of poor governance and state corruption continues to affect economic and corporate governance today.⁹⁹

Transparency International Corruption Index



Source: <http://cpi.transparency.org/cpi2011/results>

Retail Implications and Solutions

The retail sector has an extensive reach into society from both a supply chain and consumer perspective. Good corporate citizenship, including ethical practices, corporate responsibility, and stakeholder engagement, is a strong branding practice that can boost public trust and recognition. More importantly, strong corporate citizenship can also reduce business costs born out of retailers’ vulnerability to corrupt practices like bribes and facilitation payments. In light of this vulnerability and the breadth of their reach, South African food retailers should make good governance and corporate citizenship a priority.

Corruption

Compared with other developing retail markets, South African companies fair best in terms of governance.¹⁰⁰ Although corruption may not be of great concern within their South African operations, retailers face a major challenge in this regard when doing business in other African countries. All of the major food retail groups have identified Africa as the region in which their major growth opportunities lie. Risks associated with corruption are therefore significant, not only from an ethical perspective but also from

a cost perspective, as corruption can disrupt supply chains and increase costs.

Retailers have responded to the challenge of corruption in Africa in a number of different ways: shortening supply chains into African countries, creating regional supply chains, and driving exports from South Africa where possible.

Pick n Pay follows a unique strategy in Africa, as they are the only retailer to source all food from within each country in which they have retail operations. As a result, they may have greater exposure to bribery and corruption throughout Africa.¹⁰¹

From a code of conduct perspective, retailers generally make use of the same codes at their African operations as they do at their South African operations, although associated audits and compliance checks appear to be less rigorous in the rest of Africa. Retailers should be looking to drive audits more rigorously and to implement disciplinary action where applicable. Over time, these actions will not only protect the companies' reputations but will also help to advance good governance principles on the continent.¹⁰²

Ethics and Corporate Responsibility

South Africa's *Companies Act* mandates that businesses should have Social and Ethics board committees. Although this requirement was initially regarded by some businesses as a burden, many are now realising the benefits of such committees; they force retailers to actively monitor their behaviour and impact on broader society, both of which have a direct bearing on their corporate reputations.

To identify ethical responsibilities, retailers should scrutinise the entirety of their value chain to find areas, whether in products or practices, where they can leverage their influence to go beyond legislative compliance and drive stronger ethical norms. In doing so, they can pre-empt the costs related to complying with future legislation and build a reputation as a strong corporate citizen.

It is critical that retailers develop and implement comprehensive codes of ethics¹⁰³ for their own businesses as well as their suppliers. Monitoring and tracking compliance with these codes should become standard practice. The retail sector as a whole should, however, seek ways to ensure that this process does not place an undue administrative burden on suppliers. Retailers also need to ensure that they enforce the necessary corrective and disciplinary action when employees or suppliers are found to be in breach of the code.

Example of Ethical Responsibility to Protect Licence to Operate: Liquor Market Activities

The retail industry's participation with the alcohol industry presents an area of significant ethical responsibility risk. All of the "big five" retailers market and sell wine in their supermarkets and **SPAR**, **Shoprite**, **Massmart** and **Pick n Pay** all have a significant number of stand-alone liquor stores that stock a full range of alcoholic beverages.

Retailers need to be cognisant of how their behaviour, in terms of alcohol-related social responsibility, influences the government's already tarnished view of the liquor industry. It is critical that retailers advertise and promote alcohol responsibly and find ways to engage with consumers around responsible consumption. If retailers fail to act in this regard, they are likely to face more stringent and costly government regulation.¹⁰⁴

The Industry Association for Responsible Alcohol Use (ARA) handles self-regulation of advertising for the broader liquor industry and is also responsible for developing consumer advocacy programmes relating to responsible alcohol consumption. **Massmart** and **SPAR** are the only retail members of ARA.

Membership and active participation in the ARA by all major retail groups acting as distributors could play a critical role in combatting some of the social ills associated with inappropriate liquor consumption. Such involvement may also improve the reputation of the liquor industry as a whole, particularly in the eyes of government, which is actively seeking opportunities to impose strong restrictions on the industry.

Stakeholder Engagement

Accountability to all stakeholders is also an important element of good governance. The most effective way to achieve accountability is through stakeholder engagement which facilitates dialogue between retailers and other parties.

Retailers in general appear to be lagging in terms of developing and implementing robust stakeholder engagement strategies. A strong engagement strategy makes it easier to track, respond to, and report on issues raised by the stakeholders.

Best Practice and Case Studies

Ethics and Corporate Responsibility

Woolworths has demonstrated advanced processes to drive ethical behaviour within its supply chain. The company has a very robust supplier code of conduct that extends well beyond legislative requirements, particularly in areas related to animal welfare.

The company has developed policy guidelines to help farmers integrate ethical predator control measures into their livestock production and have incorporated merchandise guidelines such as stocking only badger-friendly honey, free-range chickens and dolphin-friendly tuna. **Woolworths** has also committed to using only sustainable palm oil by 2015 (see case study below). The company has an extensive audit capacity to ensure on-going adherence to their policies.



Case Study: Woolworths’ Sustainable Palm Oil Commitment

Palm oil is a major focus for **Woolworths**. It was the first South African company to become a member of the global Roundtable on Sustainable Palm Oil (RSPO), an alliance of palm oil producers, processors, traders, consumer goods manufacturers, retailers and non-governmental organisations (NGOs).

Woolworths has committed to purchasing certified “Green Palm” certificates, replacing palm oil with alternatives where possible, and using only certified sustainable palm oil by 2015. Through its focus on palm oil, the retailer is not only contributing to the conservation of species and ecosystems, but also reducing a large proportion of GHG emissions in its supply chain (i.e. Scope 3 emissions).

This case study highlights how **Woolworths** has gone beyond the traditional corporate environmental responsibility. This type of action serves to support **Woolworths’** reputation as a responsible business.

(Source: Woolworths Holdings Limited Good Business Journey Report 2011)



Stakeholder Engagement

Stakeholder engagement plays a critical role in corporate accountability. **Massmart** believes that its stakeholder engagement process represents the first and most important part of its corporate accountability journey.

The company carries out a structured stakeholder engagement process following a six-step process, as illustrated below.

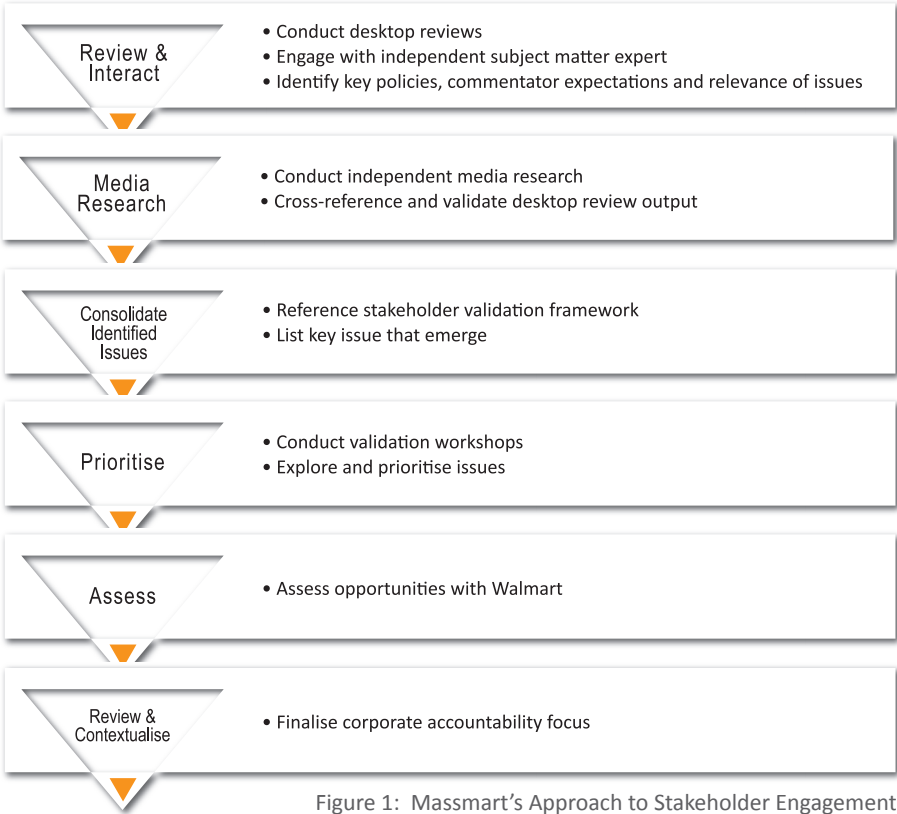


Figure 1: Massmart’s Approach to Stakeholder Engagement
(www.massmart.co.za)



Case Study: Woolworths Missteps over use of Frankies By-line

Managing reputation through proactive stakeholder engagement is essential. This point is well illustrated by a controversy in late 2011 and early 2012 involving **Woolworths** and Frankies, a small-scale soft drink manufacturer.

Although **Woolworths** maintains its innocence, the Advertising Standards Authority of South Africa (ASA) found that **Woolworths** had “deliberately and intentionally copied” Frankies by-line for its products, despite having been made aware of this fact by Frankies in early 2011.

The incident attracted a significant amount of media attention and public outrage against the retailer, fuelled by the concern that **Woolworths** was pursuing its own success at the expense of small local businesses.

Woolworths’ has asserted that if anything was to be done differently in this situation, the company should have notified Frankies of its private label strategy and its plan to launch a drinks range that may have resembled the Frankies range.

Given that **Woolworths** prides itself on its reputation as a responsible and ethical retailer, its approach to handling this particular issue was surprising. There are definitely lessons to be learned from this by themselves and other retailers for managing stakeholders going forward.

Key Findings

Protecting their reputations should be of the utmost importance for retailers as this has a direct bearing on the long-term sustainability of their brands.

Corruption is a key reputational and cost issue for South African retailers, particularly as they expand into other parts of Africa. Surprisingly none of the retailers appear to have particularly comprehensive or innovative ways of addressing corruption, although many are seeking different business models for operation outside of South Africa in order to overcome the problem.

In terms of extending ethical responsibility into their supply chain, **Woolworths** is clearly the market leader. The company’s approach has played a key role in building its strong reputation. **Woolworths’** codes of ethics and its compliance process set a good benchmark for the industry, the majority of which is lagging in this regard.

While all retailers acknowledge the need for proactive and robust stakeholder engagement, few are managing it in a holistic and structured fashion. As the recognised industry leader in this regard, **Massmart** acts as a valuable example for other retailers.

In the areas of ethics, corporate responsibility and reputation management overall, the key focus areas for food retailers going forward should be:

- Ensuring ethical business practices throughout their African operations by finding innovative ways of doing business in these markets;
- Engaging with supply chain partners to ensure more responsible behaviour in areas such as human, animal and environmental welfare and taking increased responsibility for behaviour along the value chain;
- Protecting their licence to operate by pursuing a more responsible and proactive approach to addressing social issues related to liquor;
- Viewing stakeholder engagement as a critical and strategic component of their corporate accountability agendas.

Endnotes

¹ South Africa is governed by very strict competition legislation and regulation. Retailers cite this as one of the key drivers behind the lack of industry collaboration on sustainability-related issues.

² Naidoo, Sharda. “Big five fight for food market share”. Mail & Guardian. URL: <http://mg.co.za/article/2011-11-04-big-five-fight-for-food-market-share/> (accessed July 23, 2012).

³ Statistics South Africa. “Statistical release P0302: Mid-Year population estimates 2011”. 2011. URL: <http://www.statssa.gov.za/publications/P0302/P03022011.pdf> (accessed July 24, 2012).

⁴ The Living Standards Measure (LSM), developed by the South African Advertising Research Foundation, has become the most widely used marketing research tool in Southern Africa. The LSM classifies South Africa’s population according to 10 LSM levels, with LSM 1 representing the lowest living standard and LSM 10 representing the highest. The levels are defined using numerous criteria such as degree of urbanisation and ownership of motor vehicles and major appliances. See <http://www.saarf.co.za/LSM/lsms.asp>.

⁵ Statistics South Africa. “Statistical release P0302: Mid-Year population estimates 2011”. 2011. URL: <http://www.statssa.gov.za/publications/P0302/P03022011.pdf> (accessed July 24, 2012).

⁶ World Economic Forum (Schwab, Klaus) “Global Competitiveness Report 2011-2012”. Switzerland: SRO-Kundig. 2011.

⁷ Rosenberg, Eureka. “Poverty alleviation through sustainable development”. In: The Enviropaedia, edited by Parry-Davies, Pg 217, Eco-logical edition. Cape Town: Ecol-logic publishing, 2011.

⁸ Statistics South Africa. “Statistical release P0302: Mid-Year population estimates 2011”. 2011. URL: <http://www.statssa.gov.za/publications/P0302/P03022011.pdf> (accessed July 24, 2012).

⁹ The Government of the Republic of South Africa. “National Climate Change Response White Paper 2011”. October 2011.

¹⁰ Strydom, Jeanette. “Diabetes is on the rise in Africa”. Blog 4 Global Health. URL: <http://blog4globalhealth.wordpress.com/2010/09/30/diabetes-is-on-the-rise-in-africa/> (accessed July 24, 2012).

¹¹ Index Mundi. “South Africa Demographics Profile 2012: Index Mundi. URL: http://www.indexmundi.com/south_africa/demographics_profile.html (accessed July 24, 2012).

¹² Smith, Theresa. “Who makes up the emerging black market?” IOL news. URL: <http://www.iol.co.za/news/south-africa/who-makes-up-the-emerging-black-market-1.242763> (accessed June 19, 2012).

¹³ Key cost of living expenses include the cost of medical and financial services, electricity and water which have all risen sharply in the last decade (104 per cent, 40 per cent 229 per cent, and 121 per cent respectively). (Chris Becker, Market Strategist of ETM Analytics: <http://beta.mnet.co.za/carteblanche/Article.aspx?Id=4562&ShowId=1>).

¹⁴ SouthAfricaWeb. “Small business in South Africa”. South Africa Web. URL: <http://www.southafricaweb.co.za/page/small-business-south-africa> (accessed July 20, 2012).

¹⁵ Herskovitz, Jon and Peroshni, Govender. “Whites still mostly control S.Africa economy – Zuma”. Reuters. URL: <http://www.reuters.com/article/2012/06/26/safrica-zuma-idUSL6E8HQ5S020120626> (accessed July 25, 2012).

¹⁶ These include women, workers, youth, people with disabilities and people living in rural areas.

¹⁷ It is important to note that the Black Economic Empowerment (BEE) Act is a reporting exercise and is not equivalent to transformation, as true transformation is the establishment of a fair working environment along with the removal of preconceptions and assumptions (www.bee.co.za).

¹⁸ World Economic Forum (Schwab, Klaus) “Global Competitiveness Report 2011-2012”. Switzerland: SRO-Kundig. 2011.

¹⁹ Fin24. “World Bank fingers SA labour costs”. fin24.com. URL: <http://www.fin24.com/Economy/World-Bank-fingers-SA-labour-costs-20100729> (accessed July 25, 2012).

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⁹⁶ National Treasury Republic of South Africa. “Budget Review 2012”. 22 February 2012. URL: <http://web.up.ac.za/sitefiles/file/40/2012%20Budget%20review.pdf> (accessed July 20, 2012).

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¹⁰³ These codes should address areas such as human rights, animal welfare and environmental responsibility and should ideally extend beyond basic legislative compliance requirements.

¹⁰⁴ The South African government is actively focusing on increasing the level of regulation of the liquor market. Advertising bans and liquor licencing restrictions are the two areas that are likely to have a negative impact on retailers. In some areas, such as Gauteng and the Western Cape, some retailers were unable to secure licences for new stores.

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