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**MPhil Dissertation**

**University of Cape Town**

(Department of Economics)

**“Staying Ahead of the Global Pack”**

**[Creating Sustainable Competitive Advantage in the Marketing of  
South African Table Grapes to the United Kingdom in the  
Deregulated Era]**

**Stuart Symington**

(February, 2008)

**Supervisor – Dr Corne van Walbeek**

## Foreword

The international marketing of South Africa's fresh fruits appears to have been given scant coverage in its educational institutions. This is unusual considering that the fruit exporting industry is 120 years old in this country. It could be symptomatic of several things. Firstly, the industry had its marketing arm regulated for many decades by government. Secondly, the industry has preferred to prioritize production matters ahead of marketing matters. Thirdly, it is a silent commentary on the entrepreneurial - rather than the academic - profile of the typical South African fruit-marketing agent today.

A privileged industry position carries with it the responsibility of recording events, even if it is just for posterity's sake. If this work opens a Pandora's box of research in the marketing aspect of the fruit export business, the effort will have been worthwhile. It is really hoped that this discourse will contribute towards educational material that furthers the understanding of those carrying the torch for our industry – especially for emerging farmers wanting to market their table grapes abroad successfully one day.

To the legion of industry executives that have given generously of their time and knowledge, I am deeply indebted. Some of them were particularly outspoken, and the trust that they have put in me to safeguard their recorded candidness has been most gratifying.

This dissertation has been written during a period in which financial returns in the table grape export industry have been lacklustre to say the least. The world in which grape producers and exporters operate has morphed beyond all recognition in the last 10 years - such has been the pace of our globalizing world.

To my father who fought his terminal illness with unprecedented bravery, I salute you with this effort. And to my wife, Gail, who has patiently watched this unfold - you were the wind at my back.

## Abstract

This discourse uses three of Porter's competitiveness determinants to offer a number of interventions to the leadership of the South African table grape export industry. The *first intervention* considers how exporters can improve their relationships with the major UK supermarkets. It proposes that suppliers should increase their product penetration, deliver more carefully targeted product more evenly across the season and divert surplus product into alternative markets to the UK. It further proposes that suppliers should address UK supermarket power by opening formal dialogue with the UK's Office of Fair Trading. Amongst other things, this buy-supply forum could ensure that a regulator was appointed to manage the buy-supply relationship, that buyers gave timeous prices to suppliers, that sales account formats were standardized and that supermarkets were disallowed from selling at below cost price.

The *second intervention* examines how supporting industries and service providers can increase their rate of post-harvest research and innovation. This could be achieved by addressing container technology, integrated packaging solutions, alternative treatments for diseases and pest control, non-destructive techniques for assessing fruit quality, new cultivar development and the establishment of an industry information hub. The drivers of innovation could, amongst others, be further bolstered by the synergistic use of resources, the effective transfer of new technology and a revision of the current research model.

The *third intervention* analyzes the strategy, structure and rivalry of the table grape export sector. Product quality could be enhanced by eliminating unwanted varieties, raising minimum export standards and revising handling protocols. Service quality could be improved by substantially revising what services should be offered by the PPECB, by ensuring that all exporters are accredited in line with the exporter association's code of conduct and by training programmes that would raise the standards across the whole value chain. Finally, entrepreneurial leadership was required to move the industry mindset from being production-led to being market-led in the free-market system of a globalized economy.

## Abbreviations

The South African Fruit Industry is renowned for being an industry of acronyms. The following are the major acronyms that will be encountered in this dissertation.

<b>ABC</b>	Agricultural Business Chamber
<b>BAF</b>	Bunker Adjustment Factor
<b>BBBEE</b>	Broad-Based Black Economic Empowerment
<b>BEE</b>	Black Economic Empowerment
<b>BTA</b>	Berg River Table Grape Association (producer organization)
<b>CAF</b>	Currency Adjustment Factor
<b>CC</b>	Competition Commission
<b>CCI</b>	Current Competitive Index
<b>CIAMD</b>	Centre for International Agricultural Marketing and Development
<b>CIF</b>	Cost Insurance Freight
<b>CTCT</b>	Cape Town Container Terminal
<b>DFB</b>	Deciduous Fruit Board
<b>DFPT</b>	Deciduous Fruit Producers' Trust
<b>DIP</b>	Delivered in Port
<b>DOA</b>	Department of Agriculture
<b>DST</b>	Department of Science & Technology
<b>DTI</b>	Department of Trade & Industry
<b>ECR</b>	Efficient Consumer Response
<b>EDI</b>	Electronic Data Interchange
<b>EDLP</b>	Every Day Low Prices
<b>EU</b>	European Union
<b>FDI</b>	Foreign Direct Investment
<b>FEU</b>	Forty Foot Equivalent Unit
<b>FOB</b>	Free on Board (Incoterm used in shipping)
<b>FPEF</b>	Fresh Produce Exporters' Forum
<b>FPJ</b>	Fresh Produce Journal (UK Publication)
<b>FPT</b>	Fresh Produce Terminals
<b>FSA</b>	Fruit South Africa
<b>GBP</b>	Great Britain Pound
<b>GCI</b>	Growth Competitive Index
<b>GEF</b>	Grape Exporters' Forum (sub-chamber of FPEF)

<b>HACCP</b>	Hazard Access Control Points
<b>HHI</b>	Herfindahl-Hirschman Index
<b>HTA</b>	Hex River Table Grape Association (producer organization)
<b>IMD</b>	Institute of Management Development
<b>IP</b>	Intellectual Property
<b>ISO</b>	International Standards Organization (e.g. ISO 9000)
<b>MGP</b>	Minimum Guaranteed Price
<b>MNC</b>	Multinational Company
<b>MRL</b>	Maximum Residue Level
<b>NAMC</b>	National Agricultural Marketing Council
<b>NGO</b>	Non-Governmental Organization
<b>NDA</b>	National Department of Agriculture
<b>NPCC</b>	National Productivity and Competitiveness Council (Mauritius)
<b>NTA</b>	Northern Province Table Grape Producers' Association
<b>OFT</b>	Office of Fair Trading (UK)
<b>ORPA</b>	Orange River Producers' Association
<b>PPECB</b>	Perishable Products Export Control Board
<b>RCA</b>	Relative Comparative Advantage
<b>RFID</b>	Radio Frequency Identification
<b>SA</b>	South Africa
<b>SAECS</b>	South African European Conference Service
<b>SAPIO</b>	South African Plant Improvement Organization
<b>SARS</b>	South African Revenue Services
<b>SAT</b>	South African Table Grape Producers' Association
<b>SATI</b>	South African Table Grape Industry (producer and exporter body)
<b>SHAFFE</b>	Southern Hemisphere Association of Fresh Fruit Exporters
<b>SMME</b>	Small, Micro and Medium Enterprises
<b>SPS</b>	Sanitary and Phytosanitary
<b>TEU</b>	Twenty Foot Equivalent Unit
<b>TNC</b>	Transnational Company
<b>TNPA</b>	Transnet National Port Authorities (previously National Port Authorities, NPA)
<b>TNS</b>	Taylor Nelson Sofres (research house, UK)
<b>TPT</b>	Transnet Port Terminals (previously SA Port Operators, SAPO)
<b>USA</b>	United States of America
<b>WCY</b>	World Competitiveness Yearbook
<b>WEF</b>	World Economic Forum

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# Chapter 1: Setting the Competitiveness Stage

## 1.1 Purpose, Methodology and Structure of the Dissertation

The *primary* objective of this thesis is to offer the table grape export industry a few interventions for improving its competitiveness to the United Kingdom market. However the intricacies of exporting a perishable product over considerable distances - in the face of fierce competition and dominant buyers - need to be understood before such recommendations can be made. Information on exporting fruit in a relatively new free-market system in South Africa is not readily available in industry or university libraries. Therefore, putting this thesis together involved interviewing many local executives and referring to international journals written by those familiar with the demand-end of the chain in particular.

The *secondary* objective of this dissertation is to provide - on behalf of the fruit export sector - an up-to-date account of how the table grape export business to the UK actually works. The deregulation of the South African agricultural sector yielded a few unintended consequences, one of which was the fragmentation of - and in some cases a complete loss of - information on certain aspects of the business. In today's knowledge economy, it is incumbent on the leadership of the export fraternity to return this information to the industry table. Otherwise, without business intelligence and the systems that provide it, the industry stands little chance of becoming globally competitive and a leader in its field. There is no role-player better positioned in the export value chain than the exporter himself to provide this information, as he is responsible for the procurement, sale and successful movement of the goods from the farm gate right through to the supermarket shelf overseas.

The fast-changing nature of the business has meant that some of the material compiled over the last three years for this work is already out of date. Despite this, it is hoped that the material is still sufficiently accurate to make the recommendations relevant (even if some of the recommendations have already been implemented). The dissertation is structured in such a way that it deals first with the procurement of product to fill UK supermarket programmes secured by the exporter. It then deals with how the products and services are managed at the South African end of the logistics chain to meet the ever-changing market demands. A major thrust of this thesis is to unequivocally instil a market-led culture amongst every role-player in the value chain, since it is with this mindset that the industry

can reach new heights. The five chapters making up this dissertation unfold in the following manner.

**Chapter 1** sets the stage for the discourse by describing the eventful history of the industry's evolving competitiveness since its inception in the late 19<sup>th</sup> Century. Rather than trying to capture an elusive definition of competitiveness, the writer examines the development of competitiveness via historical economic thought, global composite indices and contemporary themes underpinning the topic. The measured competitiveness trend of the South African *agribusiness* sector is assessed over a 50-year period right up until 2007, and three of Porter's determinants on which this dissertation is built are identified. The bicephalic structures of the South African table grape industry are described, along with the remaining fruit industry structures. The chapter concludes with the South African table grape production and export statistics being put in a global context.

**Chapter 2** describes the brittle nature of the grape product, including its varieties, production regions and intake weeks across the 26-week season. The various ways in which the product can be differentiated in the UK market are highlighted. The de-concentration of the export sector is examined over the deregulated period, and the key drivers of the various models of the export companies - especially the marketing agents and the producer-exporters - are evaluated in detail. The procurement strategies that the larger marketing agents have exploited to keep the encroachment of smaller export companies out of the mainstream of the table grape export business are explained. Finally, the financial procurement tools used by marketing agents in the form of loans, disbursements and minimum guaranteed prices are analyzed, including the risk-management strategies that the agents need to take in order to protect and stabilize their export businesses.

**Chapter 3** looks at the logistics chain, and investigates the major changes in the international transport sector, especially the conventional and containerized shipping sectors. The major drivers of change in the trade chain are noted, including the effect that they are having on the flow of table grapes through the South African end of the chain to the UK market. Five critical areas affecting the congestion of product in the port of Cape Town are evaluated, namely underinvestment in port infrastructure, disorganized exporters, parastatal impotence, overly powerful shipping lines and the volume pressures in the peak exporting weeks. Finally, post-harvest innovation in the value chain is investigated in terms of revised airflow in containers, new designs and components for packaging, post-harvest

disease management of the product, and the provision of accurate, real time information for all stakeholders.

**Chapter 4** looks at the rise to prominence of the retail grocery sector in the UK over the last 30 years, and the metamorphosis of the UK wholesale markets as a result of the growth of the retail sector. Internal and external competitive forces are examined in the pre- and post-Christmas sales windows of the falling price market of the UK. The use of category management to sustain retailer power upstream and downstream in the buy-supply relationship is analyzed along with the first-tier supplier insecurity that it breeds. The mechanics of a UK supermarket programme are assessed in terms of how retailer behaviour gives rise to late price indication, product over-procurement and limited alternative outlets for suppliers. The buy-supply relationship is considered using examples that support the organizational theories of distributive, procedural and interactive justice. The cost chain to the UK is studied to ascertain the levels of profitability available under certain conditions of supply; and then game theory follows to demonstrate price and volume dilemmas encountered by competing suppliers. Finally, the major retailer trends covered indicate the current market power enjoyed by the major UK supermarkets over their suppliers.

**Chapter 5** draws some conclusions and makes recommendations to industry around the three Porter determinants identified early in the dissertation. These three determinants cover the market power exercised by UK supermarkets on their South African table grape suppliers; the value-adding role of service providers in the logistics chain and their need to innovate - and address innovation inhibitors - in order to stay competitive; and finally the transformation of the table grape export sector in terms of its structure, leadership and quality of products and services.

The **Appendix** gives readers an insight into what South Africa's major competitor, Chile, has done to earn its current global reputation as the leading Southern Hemisphere supplier of table grapes to the EU market. It is worth mentioning that South African table grape producers and exporters have revered many of Chile's business practices during the deregulated era; and she is often cited in industry meetings as the leading example to emulate to improve South Africa's competitive performance.

## 1.2 Evolution of the SA Table Grape Export Industry

Precious few books detail the history of the deciduous fruit industry.<sup>1</sup> However, these books uncannily reveal the same issues that have continued to compromise the industry's competitiveness from one decade to the next over the last 120 years. Whilst the issues of today are likely to be on a grander scale and of a more sophisticated nature compared to yesteryear, it is probably fair to say that the more things have changed, the more they have stayed the same. Explosive production volumes, oversupply, uncoordinated sales, inability to organize, logistical inefficiencies, wars, port congestions, natural catastrophes, product quality challenges and governments suffering from inertia have been some of the recurring challenges through the decades. With the number of people currently employed by and dependent on the table grape industry,<sup>2</sup> there remains an enormous social responsibility facing those in industry leadership positions to help companies sustain and improve their competitive positions. And it is the leadership's task in the free-market system operating today to find innovative and enduring solutions that are palatable to the majority.

This section is a synopsis of two books: *The Tree of Life* (Stander, 1986) and *160 Years of Export* (De Beer et al, 2003), and it serves three purposes. Firstly, the colourful history of this industry provides a valuable backdrop to the competitive complexities so characteristic of this industry. Secondly, the gargantuan challenges that cropped up in successive decades demonstrate the ongoing hurdles that the industry has had to jump in order to survive and thrive. Thirdly, it demonstrates the enormous distance the industry has come since its inception. It is also entertaining to read the somewhat antiquated opinions that observers of those times used to express - with lofty phraseology - their disdain for certain industry practices.

### 1.2.1 1882 to the Start of World War II

In the late 19<sup>th</sup> century, the virginal Cape Colony had been similarly compared to the vast fruit growing State of California in terms of climate and soils. And so it was that the grape<sup>3</sup> export industry that lay in waiting was fertile ground for entrepreneurs such as Cecil

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<sup>1</sup> The deciduous fruit sector in South Africa is made up of three industries: the table grape industry, the apple and pear (pome) industry and the stone fruit industry (which comprises apricots, plums, peaches and nectarines).

<sup>2</sup> In 2006, there were 36 949 full-time employees and 147 796 dependents in the table grape production industry alone (OABS, 2006).

<sup>3</sup> The grape industry in this dissertation refers to the export orientated industry of fresh table grapes. It does not pertain to wine grapes, grapes produced for juicing and distilling, or grapes grown for raisin production.

Rhodes (financier), Percy Molteno (shipping guru), Harry Pickstone (professional nurseryman) and Leicester Dicey (exporter). These pioneering godfathers of the industry were demonstrative then of the human capital so necessary in birthing, and maintaining, a successful industry. Export trials began, and the first grapes 'exported' were Hanepoot grapes, wrapped in newspaper, and mollycoddled by their accompanying entrepreneur aboard a mail ship destined for England. Miraculously, the grapes survived the 19-day journey.<sup>4</sup> Commercial volumes were later loaded into a crudely constructed 'cool chamber' on a similar mail ship to the first. But disaster followed as this commercial consignment arrived in inedible condition - most likely because the grapes had been packed with 'fowls, carcasses of beef, hams, livers, all looking and feeling as if they were ice'.

Apart from the technical challenge of shipping table grapes to England at the end of the 19<sup>th</sup> century, there was the added challenge that English consumers were not big eaters of grapes in their winter.<sup>5</sup> An additional marketing observation at the time was that the thin-skinned muscatel grape being shipped was not what the market wanted, and that such a skin was easily abraded by the wood wool that was used as cushion packaging. In order to compete with the Portuguese and Tasmanians who were successfully shipping their fruits to England at that time, Percy Molteno observed simply, but profoundly, that unsuccessful South African shipments had failed 'for the want of the necessary knowledge as to the kind of fruit to send, the mode of packaging, and the temperature to be observed; and that it was necessary to substitute accurate observations and experiment for haphazard chance' (Stander, 1986:10). Molteno made an additional observation of the mistakes that the Tasmanians had been making in the marketing of their fruits in England (which would compromise the competitiveness of the South African grape exporters if they were unwilling to learn from others' mistakes). 'The Tasmanians handed their fruit to a great number of brokers for disposal. If shippers consign their parcels to various brokers indiscriminately, these brokers must necessarily sell all their fruit at the same time, thus dividing the buyers and lowering prices by reducing the competition. In this way the monopoly value attaching to Cape fruits is almost wholly lost' (Stander, 1986: 11).

In terms of the packaging of grapes at the time, it was observed that 'sawdust gave a flavour to the fruit, bran caused heating, paper strips were not a success and cork was too expensive. Finally packers discovered the use of wood wool and an open-sided crate which allowed for proper ventilation' (Stander, 1986: 14).

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<sup>4</sup> Today this same journey takes about 12 days.

<sup>5</sup> South African grapes are harvested in the South African summer and immediately shipped to the counter-seasonal UK winter of the northern hemisphere.

A visiting Professor Wallace also noted 'that the use of seedlings - instead of grafted vines - was producing bastard refuse without a name and without a single quality to recommend it' (Stander, 1986: 14). A certain Mr Butters, a visiting Tramway entrepreneur from California, claimed at the turn of the 19<sup>th</sup> century, that in reference to the successful California Fruit Union, 'specialization was one means to success: but the great and indispensable means was organization' (Stander, 1986: 14).

The Western Province Exporters' Association was formed in 1899 as a co-operative marketing body to: (1) standardize box sizes; (2) employ a single overseas marketing agent; (3) ensure the provision of crop estimates to the shipping companies; and (4) press for the building of cold storage facilities at the docks. This last point produced the world's first pre-cooling chamber which ensured that fruit was cooled before being loaded onto the ship. A Horticultural Board was formed in which scientists researched issues surrounding pest management and fruit inspections. The latter was controversial, simply because there were those who believed that they selected and packed with care and therefore needed no supervision; yet fruit of varying quality continued to arrive in the market place (suggesting fruit inspections were indeed a necessity). It was the government of the day at the formation of the Union in 1910 that insisted that fruit inspections became compulsory. 'The buyer likes to buy according to a guaranteed standard and apart from the confidence established under a strict system of inspection and grading, it undoubtedly facilitates business and improves prices' (Stander, 1986: 18). And it was the South African Fruit Export Act of 1914 that provided another world first in this regard. It laid down the regulations governing fruit quality, namely packaging methods, fruit sizes and quality standards.

World War I had the effect of cutting off the UK and European markets from South African table grape supplies. This spurred the South African industry leadership on to nurturing the local market, investigating the possibility of a local fruit-canning industry and finding new export markets in Africa, Asia and South America. Interestingly, the producer ranks were swelled at the end of the war by soldiers who sought refuge in quieter places with an easier lifestyle, such as the farmsteads amongst the South African vineyards. In 1922 the poor performance of the industry during the peak weeks of exporting grapes through the Cape Town port led to an investigation committee being formed. It determined that the port facilities were inadequate and that congestion was consequently unavoidable. Members of that committee might have been alarmed to find the same issues still confronting the Cape Town port 80 years later!

In the early 1920s, attempts to organize the industry to avoid unnecessary government interference were achieved through the amalgamation of citrus producers (from the north) and deciduous producers (from the south) through the Fruit Growers' Co-operative Exchange of South Africa. In 1924 a commission of enquiry had been established to determine what could be done about the volume-based growth pains being experienced by the industry. Some of the issues tabled were temperature control at the quayside, duty on boxwood, packing and transport methods. Dissent over control of the Exchange led to its demise when the Perishable Products Export Control Board (PPECB) - a supposedly neutral state institution - was established via an Act to wrestle shipping control and other matters away from the Exchange's disagreeable members.<sup>6</sup>

During the period just prior to World War II, some valuable technological innovations were made. 'Circulating air' in storage was introduced into mail ships which improved the condition of the fruit. The 'skid' was invented where wooden platforms on cast-iron wheels made moving a consignment of grape boxes easier from one point to the next. This avoided each box from having to be handled in break-bulk fashion from the cold store (on the quayside) and onto the ship. And the fewer times a box was handled, the less abrasive the wood wool and wooden boxes were on bruising the fruit. 4-tonne cranes were used to maximum capacity by lifting fully laden skids of boxes simultaneously on to a ship. This logistical efficiency seems a simple innovation now, but at the time was a significant breakthrough on quality and costs.

The depression of 1929 caused concern amongst growers, and the decision was made to manage the marketing of grapes offshore from a central marketing office. The first manager, Mr Dykes, had observed coal merchants and librarians selling South Africa's fruits in the UK. In 1932 he complained that 'fruit of indifferent quality is becoming increasingly hard to sell and is tending to damage the whole industry'; and that 'the fruit was being harvested at the minimum of maturity and quality sufficient to pass the all-too-tolerant requirements of the Government Grading Regulations' (Stander, 1986: 22).

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<sup>6</sup> Bickering politicians and conniving capitalists in the Exchange were blamed for speculating with the shipping space for personal financial gain at the expense of the industry. Therefore, one of the functions of the PPECB, as a government-based, non-commercial institution, was to manage the shipping space on an orderly basis on behalf of the industry.

### 1.2.2 Legislative Changes Around World War II <sup>7</sup>

With the decline in profitability of the industry, and the onset of World War II, the re-organization of the fruit industry was perceived as being essential at the time. In 1939 the SA government required the citrus and deciduous industries to consider control measures under two Acts of Parliament: the Marketing Act and the War Measures Act, which would allow the industry to qualify for state subsidies in the face of war and discontinued exports. Producers would need large loans from the government to replace credit formerly obtained from the marketing agents for production and packaging costs. However, a precondition of a state loan required a representative organization under the Marketing Act (no 26 of 1937) through which these state funds could be channelled to the producers. The Deciduous Fruit Board (DFB) was therefore constituted, under proclamation 250 of 1939 known as the Deciduous Fruit Regulatory Scheme. Both export and local fruit matters were to be managed under this Scheme.

By the late 1940s, the powers of the DFB were strengthened after the findings of the Raats and MacDonald Commissions of enquiry, and the following functions were incorporated within the DFB's portfolio: centralized packing, the pooling of proceeds<sup>8</sup> (including transport and other costs), the complete revision of the local market grading and packing regulations, the standardization of packaging, the discontinuation of innumerable individual brands and the rationalization of sales channels. The original Scheme (of 1939) was again reviewed and replaced by an amended Scheme in 1951 that eventually gave the DFB full plenary powers that determined its total control over every aspect of the deciduous fruit business for three full decades thereafter.

The menacing U-boats of World War II eventually put paid to South African grapes reaching England - but not before the DFB had been promulgated in law, and the British-issued, permit-based restrictions had allowed some fruit through the net in the early years of the war. The underlying objective of the DFB was to ensure that the industry could somehow survive the war without foreign income. Financial rescue packages included generous loans from the Land Bank to producers, and subsidies to export growers. Drying

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<sup>7</sup> The legislative changes described here are drawn from "The Controlled Marketing of South African Deciduous Fruit 1951 to 1980" (Bestbier, 1985).

<sup>8</sup> Producers' fruit was pooled in a sense that an average price was paid to every farmer for his grape consignment, irrespective of when and where the fruit had been sold. The disadvantage of the pooling system was that it did not reward quality-orientated producers. In fact it encouraged producers to pack to the lowest possible standard because if they could get 'pool participation' for marginal fruit, they would receive the 'pool price'. Another disadvantage of pooling fruit was that it hid information from the growers regarding the actual prices received for the fruit from each specific market. The major advantages of the pooling system were that it spread the growers' risks across a number of markets and facilitated the financial logistics in the chain (van Walbeek, 1998).

yards were built for raisin supplies to the British War Ministry, even though these ran at a loss. The potential of the local market was revisited, and wineries and distilleries were built to soak up the product, which was otherwise destined for dumping – something that was socially unacceptable considering the plight of the hungry. Optimum use was made of the idle cold stores in the ports as temporary depots for inland markets. A number of DFB policies also helped manage the efficient and effective supply of fruit to consumers: the maintenance of quality, the avoidance of oversupply and the substitution of hundreds of growers' labels with the single "DFB" label.<sup>9</sup> And it was only years after the war that, once the commandeered ships had finished repatriating allied troops back home, did refrigerated space once more become available for fresh produce shipments to begin. The war cloud had a silver lining, for it encouraged access for South African grapes to other, smaller markets like Sweden, parts of the European Continent and the United States.

### 1.2.3 The Roaring Fifties

The war had produced a lackadaisical attitude towards quality, and the quest for zero defects began in earnest. This was particularly necessary in the light of exploding production volumes. The wartime emergencies that included the formation of the DFB were suspended and the industry was left to manage itself...within the confines of the law and the newly promulgated Marketing Act. The Deciduous Fruit Scheme drawn up in 1951 also ensured that the Board of the DFB did not exceed its powers in terms of appointing agents, controlling prices and restricting people's freedom - though the Scheme was not without its inadequacies.

In this decade the government signed a 10-year contract with the SA Conference Lines guaranteeing shipping space for export products for that whole period. The closing of the Suez Canal meant congestion at Cape Point and the DFB had to pay shipping lines extra fuel costs to make up for lost time.<sup>10</sup> In January 1959 the entire pre-cooling facilities at the Table Bay docks were gutted by fire. However there were two interesting spin-offs from the fire: the already approved expansion programme of the pre-cooling facilities was implemented immediately with a greater sense of urgency than had existed before the fire; and the concept of introducing a quota system - as a result of a hiatus in supply - caught the attention of the authorities and was used effectively at a later stage. A good example of

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<sup>9</sup> This was a different marque to the "Cape" label, which came later in the 1960s.

<sup>10</sup> The ships to Mediterranean Europe would have to go via the west coast of Africa and through the straits of Gibraltar. This was a longer journey than going via the Suez Canal. So the DFB had to pay the shipping lines for the extra fuel used so that the ships could sail faster to make up time on the longer journey.

industry ingenuity resulted from this fire. 4000 tonnes of grapes that had not been pre-cooled - because of the incinerated facilities - were loaded onto a ship. The ship was then ordered to sail immediately into the very cold Benguela current (up the west coast of Africa) for as long as possible, essentially to cool the consignment of grapes. The shipment arrived in Southampton in mint condition, and was hailed as a triumph of an industry suffering adverse circumstances.

#### **1.2.4 The Challenging Sixties**

With burgeoning volumes came port congestion and shipping space crises. The appointment of a planning committee for such challenges pioneered the way for groundbreaking recommendations such as palletization, the inspection and pre-cooling of fruits inland (away from the ports), and improved handling protocols. All these recommendations were in search of more economical ways of achieving increased product flow through the chain. They culminated in a 7-day loading week in the ports, something which had never before been achieved. The inland inspection undoubtedly served to increase the flow of fruit through the ports and onto the vessels. The "Cape" product brand was launched that was eventually to be placed alongside the Krugerrand and Appletizer brands in global market ratings. It became synonymous with 'high quality standards and dependability of service'. At the close of the decade, accounting ledgers in the DFB - reportedly a metre wide to accommodate the entries - necessitated the introduction of computer systems to handle the volume of accounting traffic.

#### **1.2.5 The Progressive Seventies**

Corrugated, cardboard cartons started to gradually replace the wooden boxes. By the mid-seventies, huge strides had been made in the metrication, design (the ventilation holes undoubtedly improved the quality of the product in the market) and on-site assembly in the pack houses of these boxes. This innovation was regarded as another 'world first', and additional benefits of the cardboard carton were: (1) the gentleness of it on the packers' hands (wood had been rough to handle); and (2) the production of standardized cardboard box sizes that made palletization much easier.

In 1974, the South African Plant Improvement Organization (SAPIO) was formed to research the improvement of plant material. It was widely acknowledged that farmers,

through optimum production practices, could maximize yields per hectare and the quality of their fruit. But 'genetically superior clones, free of viruses and other diseases, were needed to improve the bloodstock of fruit-producing plants in the country. Such plant material has been shown, both experimentally and under commercial conditions, to be capable of yield increases (per hectare) of as much as 20%' (Stander, 1986: 49). In the case of grapes, such yield increases were around 50%. SAPIO, the development department of the DFB, immersed itself into propagation programmes for new cultivars, and crossbreeding took anything from 15 to 30 years to complete – a significant investment in time for the development of new cultivars.

Pre-harvest and post-harvest treatments of fruit were understood to impact deeply on fruit quality. Containerization was introduced in the late 1970s, and constituted a major breakthrough in the minimization of fruit handling. Any logistical improvement made on the streamlining of fruit from the farm to the supermarket shelf in which multiple handlings of the fruit could be minimized, was prioritized. It was simple economics due to the fact that fruit handled fewer times had better quality results and fetched better prices in the market. By the end of this decade the 'orchard value' i.e. the gross income of producers minus the packing, storing and transport costs, was at 82% of gross income. This made exporting table grapes very profitable indeed.

At the close of this decade, the marketing personnel in Europe were making interesting observations. 'The single label, with fruit graded and packed to uniform standards, gave an opportunity to measure demand, to plot price trends and to determine the influence of various outside factors – all the techniques so essential to modern business' (Stander, 1986: 44). They further added that 'our purpose must not be to maximize price, but to maximize returns for our produce – not just for one year, but consistently over a period of years' (Stander, 1986: 44). By developing the pooling system, the DFB wanted producers to concentrate on the economical production of fruit. The DFB had through the years established a significant rapport with certain agents (panelists) and the consolidation of support for the identified few meant that, by the end of the 1970s, most of the other overseas agents had fallen by the wayside in favour of the privileged panelists.<sup>11</sup> At this stage three types of selling system were in use in South Africa's overseas markets: (1) consignment sales to England; (2) auction systems in Europe with additional movement of

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<sup>11</sup> These panellists were Albert Jacobs in the Benelux countries, Gerd Schubak in Germany, Josef Soderquist in Switzerland and Scandanavia, Rune Rydberg in Denmark and Finland, Gaby Corchia in France, Peng Boon in Hong Kong and Art Fisher in Canada and the USA.

product through the wholesale and retail trades; and (3) Free on Board (F.O.B.) sales to the Middle East buyers who took possession of fruit on the ship in the South African ports.

### **1.2.6 The Costly Eighties & Topsy-Turvy Early Nineties**

Louis Kriel (snr), the Chief Executive of the DFB spoke of the 'ruinous costs' of the 1980s. As South Africa's political polecat status unfolded, so did her economy continue to suffer its truncation from the global economy. Boycotts were rife. Double-digit inflation continued relentlessly. Input costs for producers rose steeply. A depreciating rand against the dollar put rand-denominated shipping costs at unseen levels. With increasing competition in overseas markets, prices flattened, profit margins shrank and growth was severely curbed. Interest rates marched upwards. Economic recession hit hard. Producers started seeking investments away from their farms. Research, an area where innovation can take an industry a quantum leap forward in challenging times, was under-staffed and under-financed. It was noted that 'South Africa allocated only 0.5% of its gross agricultural income to research, compared with 2.5% for most Western countries' (Stander, 1986: 51). All the industry could do was to declare war on costs, though two areas were difficult to contain in this regard: the reliance on government related monopolies in the chain, and the costs of imported goods arising out of a fluctuating and steadily declining rand.

Unifruco was founded in 1987 which gave export producers direct shareholding in the deciduous fruit industry. In 1988, late harvest grapes were exported for the first time, and several new local grape varieties were also commercially exported. In 1989 the Orange River gained importance as a grape production area, exporting more than a million cartons for the season.<sup>12</sup> Lauritzen Cool developed a 40-foot integral container<sup>13</sup> which would change the economics of the grape exporting environment yet again. And in this period, a new grape carton dimension was introduced that had a suitable 'footprint' for the two most commonly used pallet sizes.

Throughout the eighties and early nineties, the liberalization and globalization of world trade had pre-empted the dismantling of regulated industries worldwide. Coupled with the first democratic elections in South Africa and the introduction of a new government in 1994, macro-changes were in the air. Before the actual deregulation of the South African fruit

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<sup>12</sup> The Orange River region exported close on 12 million 4.5kg equivalent cartons in 2007.

<sup>13</sup> Up to this point, only 20-foot porthole containers had been in operation. Using a 40-foot integral container achieved the economies of scale of 20 pallets in a container (instead of the 10 pallets in the 20-foot container).

industry, entrepreneurs had already sniffed the winds of change. As early as 1995, exporting companies were positioning themselves by shipping grapes in a clandestine fashion out of South Africa i.e. without the approval of the former authorities of the regulated channels. These conditions all set the scene for a totally new export dispensation to unfold. This dissertation deals with the onset of deregulation that took hold of the South African table grape exporting fraternity from 1997 through to the present times.

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### 1.3 What Constitutes Competitiveness?

Many innovative measures were taken by the industry in its first 100 years to remain a viable supplier of fruit to its northern hemisphere customers. An attempt is made in this section to find a framework in which these competitive measures can be identified so that they can be addressed by industry and company leadership. Since competitiveness is a vast subject that can be scoped at many different levels, this section starts by taking a historical look at the evolving definitions of competitiveness. Various composite indices on competitiveness are also examined, and the section concludes by honing in on the underlying themes that permeate most definitions on the subject.

There is a rich history of economic thought on competitiveness dating back to Adam Smith's *Wealth of Nations* in 1776. (A summary of these economic theories on competitiveness, including the personalities involved, their concepts and the mechanisms used to motivate their theories, can be found in table 1.1). Adam Smith postulated that the four input factors (land, capital, natural resources and labour) determined the *absolute advantage* of nations in international trade (Walter, 2005). Ricardo followed on from this in 1817 to develop the concept of *comparative advantage* – one that stipulated that a nation should trade only those goods for which it had the greatest relative advantage to another trading nation (Zereyesus, 2003). In 1848, John Stuart Mill added a rider to this classical philosophy on competitiveness by suggesting that infant industries should be initially protected in order that they could later participate in comparative advantage trading opportunities.

These classical economists believed principally that 'countries could reach their highest levels of income by maintaining open (unrestricted) international trade; that domestic production and consumption should be based on what prices foreigners were willing to trade at; and that governments should focus on ensuring competitive national markets by investing in public goods like research and education' (Van Rooyen et al, 2000: 3). A subsequent school of economists that continued the debate on competitiveness issues was spawned in the first half of the 20<sup>th</sup> century. Their neoclassical models expanded on the concept of comparative advantage but challenged their predecessors' thinking. Their theories collectively postulated that there were five attributes contributing to an industry's comparative advantage: technological efficiency, factor intensity of different industries, industry specific resources, domestic demand and exchange rates (Masters, 1995).

By the start of the second half of the 20<sup>th</sup> century, economists were confronted by a fast-changing world. Global production volumes and trade volumes had picked up substantially. Government interventions, through the likes of export subsidies and import restrictions, had rendered the 'unrestricted trade' idea a theoretical concept. As a result, measuring comparative advantage had become a real challenge. However in 1977, Balassa developed his analytical technique - called *revealed comparative advantage* (RCA) - in which a country's share of the world market in one commodity was measured against its share of all traded goods (Van Rooyen et al, 2000). Porter (1990) introduced a more holistic view on competitiveness. He tabled six determinants of *competitive advantage* in his diamond model that incorporated real trading conditions. The six determinants were: (1) factor conditions; (2) demand conditions; (3) related and supporting industries; (4) firm strategy, structure and rivalry; (5) the role of government; and (6) the role of chance.

**Table 1.1 Foundations of Competitive Analysis**

<b>Theories</b>	<b>Key Concepts</b>	<b>Mechanism(s)</b>
<b>Classical Political Economy</b> Adam Smith (1776) David Ricardo (1817) JS Mill (1848) JS Mill (1873)	Market size, productivity Comparative Advantage Infant Industries Politics of Protection	Specialization, competition International Trade Learning-by-doing Income Distribution
<b>Neoclassical Models</b> Ricardo (1817) Heckscher & Ohlin (1919, 1933) Ricardo & Viner (1937) Heckscher, Ohlin & Samuelson (1962) Salter & Swan (1959, 1960)	Technical Efficiency Factor Intensity Special Factors Consumer Demand Exchange Rates	Single Key Resource More Than One Resource Industry-Specific inputs Product Preference Non-Traded Goods, Inflation
<b>Challenges to Comparative Advantage</b> Prebisch & Singer (1950) AO Hirschman (1958) New Trade Theory Porter (1990), Balassa (1977)	Import-Substitution Development Strategy Strategic Policy Competitive Advantage	External Terms of Trade Inter-Industry Linkage Rent-Shifting, Externalities Factor Creation, Demand Signalling

**Source: Masters (1995)**

In a world where old rules of trade no longer apply, many previously protected economies in developing countries are still relying on comparative advantages (like cheap labour) to engage in international trade. Fairbanks & Lindsay (1997) insist that this strategy will simply keep them poor. This, added to the rise of protectionism in major trading regions like the EU and the USA, threatens to further weaken the export performance of these emerging economies (Palmer, 2006). Whilst South African farmers can compete with the best farmers in the world, they cannot compete with foreign governments (da Luz, 2005). This is nowhere better illustrated than in the currently stalled Doha Round in which the biggest role-players, namely the USA and the EU, have been unable to resolve their differences over farm subsidies<sup>14</sup> and tariffs.<sup>15</sup> This has led to a proliferation of bilateral and regional trade agreements. These agreements have serious repercussions on the competitiveness of developing countries that must accept unwelcome trading conditions with much more powerful trading partners than themselves (Lamy, 2006).

From an industry's perspective, there is something vaguely useful about knowing how competitive South Africa is across a basket of economic factors compared to other countries that sell similar products into similar markets. The International Institute of Management Development (IMD) and the World Economic Forum (WEF) compile the best-known composite indices on competitiveness. The IMD's World Competitiveness Yearbook (WCY) is regarded as the world's most comprehensive report analyzing the competitiveness of nations, in which 83 criteria are used to measure economic performance, 77 government efficiency, 69 business efficiency and 94 the quality of infrastructure (Walter, 2005). The WEF sports two such indices: (1) the Current Competitiveness Index (CCI) that uses micro-economic indicators to measure the pattern of institutions, market structures and economic policies yielding immediate levels of prosperity; and (2) the Growth Competitiveness Index (GCI) that concentrates on competitiveness as a set of institutions and economic policies that afford high growth in the medium-term, and forecasts growth five years in advance (Walter, 2005). In 2006, the GCI rankings proposed the following positions of competing grape-supplying countries to the UK market: USA (6<sup>th</sup>), Chile (27<sup>th</sup>), India (43<sup>rd</sup>), South Africa (45<sup>th</sup>), Mexico (58<sup>th</sup>), Brazil (66<sup>th</sup>), Argentina (69<sup>th</sup>), Peru (74<sup>th</sup>) and Namibia (84<sup>th</sup>).

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<sup>14</sup> In 2005, the USA government subsidized its farmers about US\$20 billion while the EU governments subsidized their farmers in the same time period about US\$80 billion.

<sup>15</sup> According to Lamy (2006), the Doha Round proposed that tariffs on farm products be cut by over 50%.

Zereyesus (2003) notes that such indices can be criticized for their heterogeneity, lack of focus and difficulty of interpretation. Walter (2005) also states that composite indices are often based on weak theoretical assumptions and sometimes unreliable statistical methods; and that their authors change the components that make up the indices from time to time on a fairly subjective basis. Despite such criticisms, these indices serve merely as a comparative benchmark of South Africa's international competitive standing with its competitors. After all, Porter (1998), Krugman (1998), as quoted by the National Competitive Council of Ireland (NCC, 2005), and Khemani (2003) all categorically maintain that it is not countries - but companies - that compete with one another.<sup>16</sup> Boehlje (1999) has taken this idea a little further, suggesting that it is supply chains - rather than individual firms - that are competing with one another in international markets.

In the last 20 years there has been a raft of literature alluding to the fact that 'no single definition or measurement of competitiveness has gained universal approval by either economists or management theorists' (Zereyesus, 2003). To try and devise an all-encompassing definition for competitiveness would be to fall into the same trap that many organizations - especially NGOs - find themselves. It is an elusive exercise, because (1) the topic is too multifaceted to encapsulate in one definitive statement; and (2) two countries may, by way of example, have political and social agendas that are vastly different from one another. To then measure both of these countries by the same competitiveness yardstick would make for a meaningless comparison (NCC, 2005). Furthermore, the various definitions often refer to different organizational and spatial entities, namely countries, sectors, industries and firms (NPCC, 2005).

What is possibly more valuable to give here than a single definition of competitiveness is a number of underlying themes that permeate many of the definitions, what Ortmann (2005) refers to as 'sources' and 'indicators' of competitiveness. They are as follows:

- (1) Competitiveness should be considered as a means to an end, and not an end in itself. Esterhuizen et al (2006) put it another way by saying that competitiveness is a dynamic process, not an absolute state of affairs.

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<sup>16</sup> The NCC believes that countries do compete with one another, but only for foreign direct investment (FDI). This is understandable considering that only governments are in a position to provide incentives (like tax concessions and grants) to attract FDI. And FDI brings along with it additional growth, employment, exposure to new technologies and the corresponding upgrade of skills associated with new technologies (NCC, 2005).

- (2) Competitiveness incorporates *efficiency*, which means reaching goals at the lowest possible cost; and *effectiveness*, which implies having the right goals. According to Buckley (1988) it is the choice of these goals that is the most crucial.
- (3) Competitiveness often implies an increase in wealth<sup>17</sup> as a result of a corresponding increase in the productivity of its inputs (capital, labour, energy, etc). Fairbanks and Lindsay (1997) maintain that competitiveness is achieved where high operational productivity and good strategy intersect (i.e. turning informed choices into timely actions).
- (4) Institutional<sup>18</sup> frameworks are assumed to be in place so that policies<sup>19</sup> relating to competitiveness can be managed and coordinated between the public and private sectors.
- (5) Competitiveness demands growth - but without equity, growth becomes politically and socially unsustainable if it is only the business elite that captures the benefits (NPCC, 2005).
- (6) In order to sustain competitiveness, Esterhuizen et al (2006) believe it is important to predict change correctly, to act upon such predictions in an innovative manner, and to mobilize and attract resources from other economic endeavours to act on these predictions.
- (7) A rather hackneyed understanding of competitiveness implies an increase in 'market share'. However, in the world of commodity trading, it tends to be a zero-sum game where each country's gain comes at the expense of another (assuming little or no growth in volume in the market itself) (NPCC, 2003).<sup>20</sup>

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<sup>17</sup> Walter (2005) notes that if competitiveness is a precondition to 'prosperity and wealth', then the different interpretations of 'wealth and prosperity' further exacerbate defining competitiveness. For example, 'wealth' means *GDP per capita* in the WEF; *prosperity* in the IMD; *living standards* for the US Council on Competitiveness; and *living standards and social welfare* for the European Commission.

<sup>18</sup> North (1990) defines institutions as "arrangements" among economic agents that attempt to decrease uncertainty and costs during exchange and ownership i.e. they comprise rules, laws and conventions that govern economic behaviour.

<sup>19</sup> Competitiveness is often viewed as a key indicator of the success or failure of policy (UN, 2001). As an example, Ireland has been leading the GDP growth tables in the EU. Its stellar performance, according to the NCC (2005), has been heavily influenced by policy decisions made in the past in the areas of taxation and regulation, infrastructure, education and training, entrepreneurship and innovation.

<sup>20</sup> Where a developing country in particular fails to innovate, introduce new technology or value-add to its products in some way, often it relies on the devaluation or depreciation of its currency to remain competitive. The NPCC (2003) points out that, in doing so, a nation simply takes a collective pay cut by discounting its products and services in world markets and paying more for the goods it purchases abroad.

In the writer's opinion, too many reports, conferences and workshops concentrate their efforts on addressing competitiveness challenges at a generic level, and they therefore tend to conclude with generalities. According to Walter (2005), national reports on competitiveness tend to carry fairly stereotypical recommendations such as strengthening the competition policy, deregulating and lowering the administrative barriers to business, improving the infrastructure, supporting SMMEs, promoting strong research, innovating and developing a strong and diversified financial system. Such recommendations tend to be produced by those who overlook the 'specifics' affecting a particular industry. What is more, these recommendations end up being endorsed by those who simply herd industries or sectors together for administrative convenience or political expediency.

This dissertation attempts to dredge for the detail that affects the competitiveness of the table grape industry in the areas identified, and to find solutions to improving its performance that companies and industry association personnel can implement at a practical level.

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## 1.4 Sectoral Competitiveness

In order to create sustainable competitive advantage for table grape producers and their marketing agents, it is important to understand the competitive milieu of the SA *agribusiness* sector in which these role-players have had to operate. For example, in addition to dealing with globalization and deregulation issues, South African table grape farmers - unlike their global counterparts - have had to try and stay competitive by adjusting to a myriad of socio-political issues in their sector like land reform, black economic empowerment (BEE), revised labour legislation (that includes minimum wage levels), taxation on farm properties, compulsory levies for skills training and an extension service that has been re-routed from commercial (white) farmers to emerging (black) farmers (Ortmann, 2006). The deregulated road for the SA table grape exporters has not been easy either. Marketing agents have had to cope with a volatile rand, significant service provider monopolies in the trade chain and increasingly powerful supermarket buyers – all of which are essentially beyond their control as individual firms.

In order to contextualize the competitiveness of the era covered by this discourse, two approaches are taken. Firstly, the measured competitiveness trend of the South African *agribusiness* sector is assessed over a 50-year period until 2007. Secondly, the sectoral trends for identified sub-factors making up Porters' determinants are scrutinized from 2000 to 2006.

### 1.4.1 Historical Competitiveness Trends (1961 - 2007)

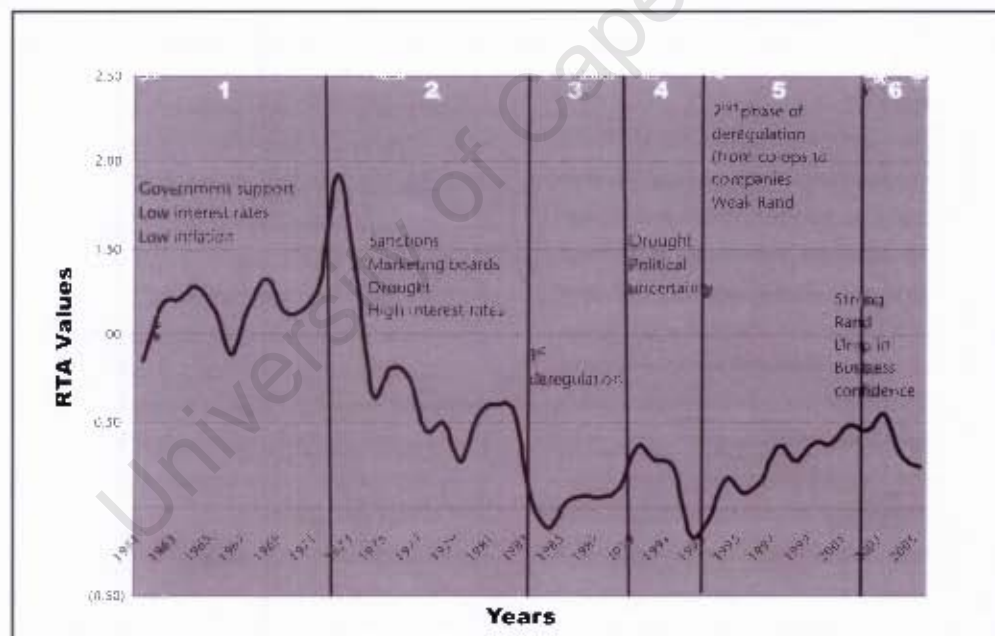
Diagram 1.2 depicts the trends in the competitiveness of the South African *agribusiness* sector over the last 50 years using Volrath's Relative Trade Advantage (RTA) method.<sup>21</sup> It would be useful to consider Diagram 1.2 in conjunction with the competitive evolution of the SA table grape industry described in section 1.2 - particularly the competitive issues coupled with the macro-economic, political and climatological events that unfolded during the decades from the 1960s onwards. They provide an informative backdrop and supporting evidence for the trends being disclosed here.

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<sup>21</sup> Balassa's Revealed Comparative Advantage (RCA) model referred to earlier was extended by Volrath in 1991 to the Relative Trade Advantage (RTA) method (ABC Biennial Report, 2006). An RTA > 0 denotes a trade advantage; RTA < 0 signifies a trade disadvantage, and RTA close to 0 has a marginal competitiveness status. Esterhuizen et al (2006) state that the RTA method allows for the measurement of competitiveness under real world conditions with its uneven playing fields, distorted economies and varying trade regimes.

Diagram 1.2 can be broken up into six phases (periods) during which the directional trend changed from the previous period's competitive trend. In the *first phase* from the 1960s to the early 1970s, a positive trend ensued where the sector was relatively competitive. This was due to low interest rates, low inflation and government support via subsidies and import protection measures. In the *second phase*, from the mid-1970s to the mid 1980s, a strong downward trend prevailed indicating the decreasing competitive status of the agribusiness sector. This was a direct result of the introduction of sanctions, high and volatile interest rates and several droughts. The *third phase* in the late 1980s saw a mild increase in the relative competitiveness that can be attributed to the first phase of deregulation. The *fourth phase* trended downward in the early nineties due to political uncertainty around the first democratic elections, and another drought.

**Diagram 1.2 Competitiveness Trends of the SA Agribusiness Sector over the Last 50 Years**



Source: Agricultural Business Chamber's Biennial Report (2006), Esterhuizen et (2006)

The last two phases are the periods covered by this dissertation. In the *fifth phase* from the mid-1990s to 2003, the competitive trend was again positive. According to Kirsten & Vink (1999), this could be attributed to: (1) the sharp and sustained decrease in the value of the rand against the US dollar; (2) the improved business know-how of South African agribusinesses; (3) the second phase of deregulation of the various agricultural industries that resulted in the movement from cooperatives to companies; (4) the elimination of uncompetitive businesses; (5) the improved quality of products being delivered; and (6) an increase in the productivity of labour in the sector. The *sixth phase*, running from 2003 to

the current year 2007, is not completely covered in diagram 1.3. However, according to the ABC Biennial Report (2006), the decline in the sector's competitiveness during this period has been mostly attributed to the strengthening of the rand.

#### 1.4.2 Current Trends in Identified Factors of Porter's Determinants

Porter's six determinants, referred to in the introductory chapter, are applied to the SA *agribusiness* sector by Esterhuizen et al (2006). Each determinant has been broken down into selected sub-determinants<sup>22</sup> whose competitiveness trends are tracked from 2000 through to 2006<sup>23</sup> – the heart of the deregulated period to date. The following comments should be noted in conjunction with Diagram 1.3 that depicts these trends.

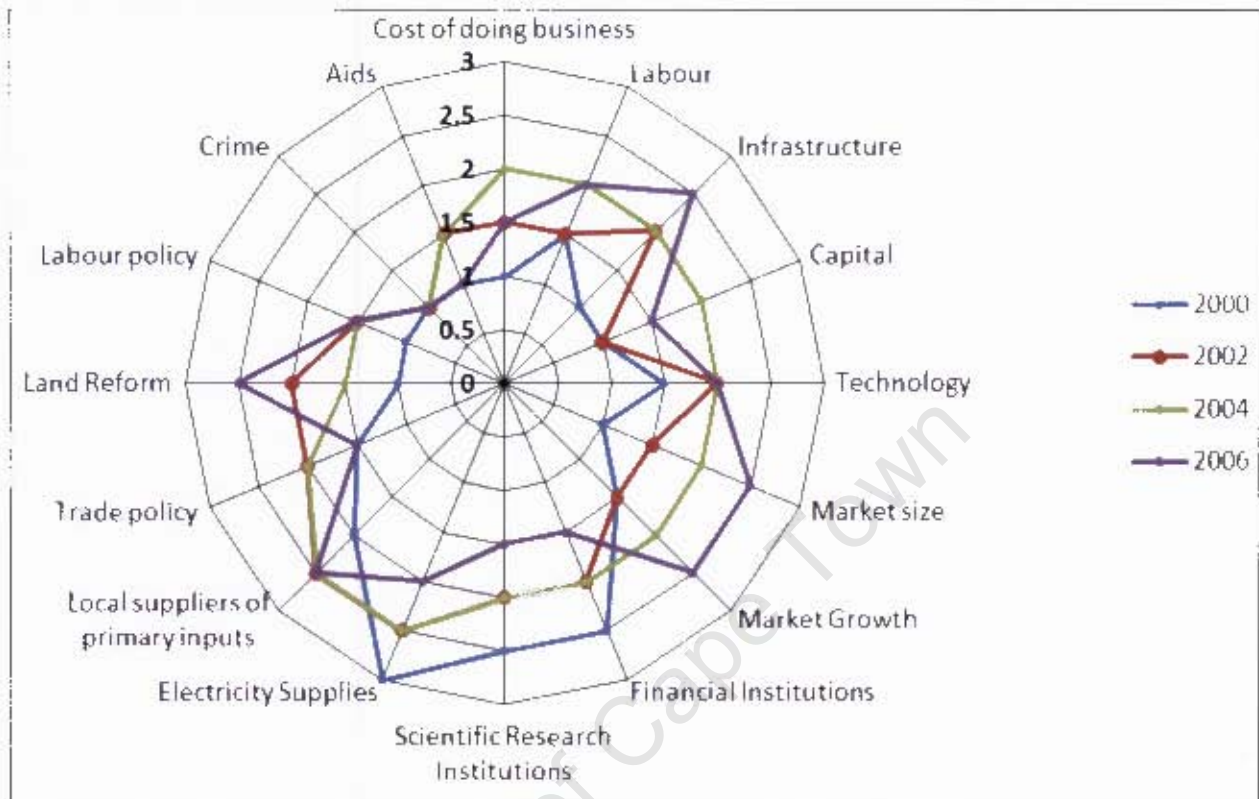
Whilst the *factor conditions* - cost of doing business, labour, infrastructure, capital and technology - show positive trends, there is still room for improvement on the quality of unskilled labour and availability of skilled labour according to the ABC Biennial Report (2006). The *demand conditions* - market size and market growth - illustrate a positive trend. However, in the FPEF's submission to the NAMC regarding the revision of the Marketing Act (FPEF, 2006b), emphasis was placed on the need for the fruit industry to capitalize far more on the burgeoning middle class market in South Africa than it currently does. *Supporting industry* factors - financial institutions, scientific research institutions, electricity supplies and local suppliers of primary inputs - generally show a static trend. Research by Esterhuizen et al (2002) indicates that the lack of competitiveness amongst supplying industries to the *agribusiness* sector is hampering its competitiveness. Note that the writer's 2006 input on Diagram 1.3 reflects a weaker trend in electricity supplies as the state's electricity supplier, Eskom, continues its power outages across the country. Surprisingly, *firm strategy, structure and rivalry* factors are not considered in the diagram. Research by Esterhuizen et al (2000) suggests that the market power of buyers, the threat of substitutes and the threat of new entrants were constraining the competitiveness of the *agribusiness* sector at that stage.

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<sup>22</sup> Van Rooyen & Esterhuizen (2002) list a fuller set of sub-determinants for each of Porter's six determinants on competitiveness as follows: (1) *Factor conditions* [labour, natural resources, infrastructure, location, capital, knowledge and technology]; (2) *demand conditions* [market size, market information, quality of products and market growth]; (3) *related and supporting industries* [financial institutions, research institutions, transport companies, suppliers of packaging material, electricity supplies, agricultural suppliers and related industries]; (4) *firm strategy, structure & rivalry* [adaptability, culture, structure, flexibility, pricing strategy, managerial capability, market power of suppliers, market power of buyers, threat of substitutes and threat of new entrants]; (5) *government* [indirect support, trade policy, land reform policy, labour policy and fiscal policy]; and (6) *chance* [economic stability, AIDS, political stability and crime].

<sup>23</sup> The primary data for the sub-factors was gleaned from a survey of 400 business executives in the sector during 2000, 2002 and 2004 (Esterhuizen et al, 2006). The 2006 data in Diagram 1.3 are the writer's own update based on his personal perceptions, which are influenced by his interactions with farmers, exporters and other industry role-players.

Diagram 1.3 Spider Diagram of Identified Factors within Porter's Determinants



Source: Esterhuizen et al (2006), Symington

In terms of the role of *government* - trade policy, land reform policy, and labour policy – it has demonstrated a declining ability to positively influence the competitiveness of the *agribusiness* sector. Areas in which government could enhance the competitiveness of the sector according to the ABC Biennial Report (2006) include administrative regulations, the tax system, BEE policy, the competence of personnel in the public sector and trust in the political systems. Lastly the factors of *chance* are low, and remain low, particularly in terms of crime and Aids. The ABC Biennial Report (2006) also added the strong rand and developments in Zimbabwe as chance factors influencing the sector's competitiveness. The Report further states that random factors act as a constraint to the sector, evidenced by its inability to cope with local and global shocks, and its inability to be flexible in exploiting business opportunities arising out of a fast-changing environment.

The Porter model and its six determinants is the preferred model on which this dissertation is based, and the emphasis in this thesis is placed on the following three determinants:

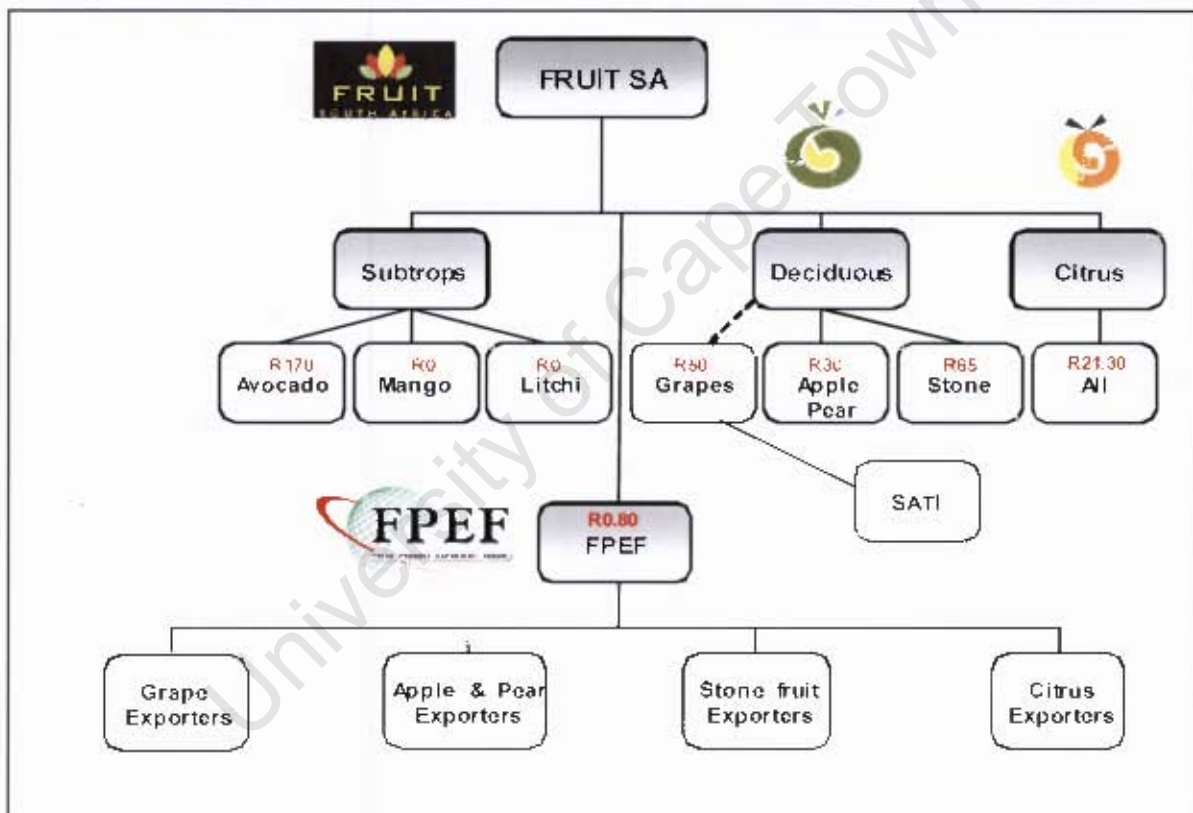
- Firstly, the *structure, strategy and rivalry* determinant of the export sector will be investigated, particularly surrounding the business models employed by grape exporters to procure quality product from producers (chapter 2);
- Secondly, *supporting industries* will be the determinant covering the role of logistical services providers in the South African port environ in particular, including post-harvest innovation required to improve the competitiveness in the chain (chapter 3);
- Thirdly, the *market demand* determinant will attempt to demystify the competitive complexities of selling and marketing table grapes into the UK market (chapter 4). According to Van Rooyen & Esterhuizen (2002), the market demand determinant was to be a major, future focus of study considering that precious few local studies exist on this topic.

Whilst sector level competitiveness trends are certainly worth knowing, they only provide context – not solutions – for the real arenas in which competitiveness battles are won or lost. This dissertation will therefore focus the competitiveness lens at grape sector and enterprise levels where dedicated and specialized capacity exists to remedy competitiveness shortfalls. Industry challenges will be diagnosed and solutions offered, particularly for the three mentioned determinants that hold the key to improving the industry's competitive performance. These solutions will try to: (1) differentiate between quick benefits and slow benefits; (2) understand the paradigm shift needed by the industry's leadership to plot its way out of marginally competitive territory as quickly as possible; and (3) galvanize the industry's energy into only those issues over which it has some control.

## 1.5 Current Industry Structures

The current industry structures pertaining to the producer and exporter bodies of the entire South African fresh fruit export industry are illustrated in Diagram 1.4 below. Most industry associations are Section 21 companies, which in South African law carry a non-profit status, and are exempt from paying income tax. Depending on the organization, working capital is raised either by statutory levies or through voluntary membership fees agreed upon by the members of the organization concerned.

Diagram 1.4 Organogram of the Whole South African Fruit Industry



Symington (2006a)

Fruit South Africa (FSA), the umbrella organization for the whole industry, was registered in 2001, and has since accrued four shareholders: the *Deciduous Fruit Producers' Trust (DFPT)* that represents all grape,<sup>24</sup> apple, pear and stone fruit producers via a statutory arrangement,<sup>25</sup> the *Citrus Growers' Association (CGA)* which represents all orange, lemon,

<sup>24</sup> In December 2006, the grapes division (i.e. the South African Table Grapes Producers' Association (SAT)) withdrew from the Deciduous Fruit Producers' Trust (DFPT) (DFPT, 2006a). This is the reason for the dotted line in Diagram 1.4 from the deciduous sector to the grape sub-sector.

<sup>25</sup> The numbers in red in Diagram 1.4 are the annual pallet fees (in rands) - for exported fruits only - levied on each organization's member. The grape producers raise R50/pallet on a statutory basis, while the grape exporters raise R0.80/pallet on a voluntary basis.

grapefruit and easy peeler producers on a statutory basis; the *Subtropical Association (Subtrops)* which represents most of the avocado, mango, litchi and (recently included) macadamia nut growers on a voluntary basis; and the *Fresh Produce Exporters' Forum (FPEF)* which represents most of the marketing agents and some of the grower-exporters of all fruit kinds on a voluntary basis. Fruit South Africa, with strong support from the Department of Trade and Industry, originally focused its efforts in five areas of generic interest among the fruit kinds, namely market access, market development, transformation, logistics and information (FSA, 2004). However, with executive capacity never having been appointed within Fruit South Africa, the Chief Executive Officers of the individual shareholders have been left to manage the five generic portfolios within their own organizations. The FPEF manages the secretariat for Fruit South Africa, and uses the trademark at selected international marketing initiatives, most notably at trade fairs in overseas markets.

Up until late 1997, the entire affairs of the deciduous fruit industry had been managed via a single desk at the offices of Unifruco.<sup>26</sup> Immediately after deregulation, the DFPT was established to manage the affairs of all deciduous producers<sup>27</sup> to ensure that many of the functions of the former government agent (Unifruco) were not lost to the industry. After a financially disastrous season in 1999/2000, the table grape producers also formed regional associations<sup>28</sup> to organize themselves, particularly in retaliation to the opportunistic marketing agents that were prolifically registering export companies in the wake of deregulation.

It quickly became apparent that the industry urgently required self-discipline and coordination amongst its marketing agents. The FPEF was therefore established (originally by the DFPT) to visibly accredit reputable exporting companies and to foster 'co-opetition' - a healthy mix of cooperation and competition - amongst them. Although the FPEF was registered as a company in 1998, it only employed executive capacity during 2001, arguably a little later than the producers would have liked. The FPEF is currently a consortium of about 70 accredited South African export companies (out of a registered 386

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<sup>26</sup> Unifruco was the government appointed agency of the Deciduous Fruit Board in the regulated era, and was responsible for all deciduous fruit matters – local and export. Outspan was the equivalent agency for the Citrus Board.

<sup>27</sup> The DFPT had three major producer shareholders: the South African Table Grape producers (SAT); the South African Apple and Pear Producers' Association (SAAPPA); and the South African Stone Fruit Producers' Association (SASPA).

<sup>28</sup> The BTA (Berg River Table Grape Association), HTA (the Hex River Table Grape Association), ORPA (the Orange River Producers' Association) and the NTA (the Northern Province Table Grape Producers' Association) were the regional associations, which still exist today.

companies with the PPECB)<sup>29</sup> that collectively export more than 70% of all fresh fruits out of South Africa (Fairweather, 2004). Table 1.5 gives a break down of industry and FPEF member volumes for all fruit kinds exported in the 2005/6 season.<sup>30</sup>

**Table 1.5 Industry Versus FPEF Member Export Volumes (in metric tonnes)  
(2005/6 season)**

<b>Product Group</b>	<b>Industry Total</b>	<b>% of Total Industry</b>	<b>FPEF Vol.</b>	<b>% of Product Group</b>
Avocados	35 270	1,9	6 202	17,6
Citrus Fruits	1 061 449	57,6	790 797	74,5
Grapes	331 426	17,9	257 183	77,6
Litchis	1 545	0,1	906	58,6
Mangoes	2 555	0,1	821	32,1
Pome Fruits	372 041	20,1	240 005	64,5
Stone Fruits	42 604	2,3	36 515	85,7
<b>Grand Total</b>	<b>1 846 890</b>	<b>100</b>	<b>1 332 429</b>	<b>72,1</b>

Source: Symington (2006a)

The five stated objectives of the FPEF (FPEF, 2006b) are to: (1) find international markets for their members' fruits via trade fairs, export handbooks, supermarket promotions and sales missions to various countries; (2) promote its accredited members in producer circles to facilitate procurement of the fruit; (3) uphold accreditation standards via a Code of Conduct worth aspiring to; (4) ensure access to timely and accurate information across the whole value chain; and (5) source funds from the public sector and international donor agencies to enhance initiatives. Other major functions within the FPEF include resolving disputes through mediations and arbitrations, facilitating training of previously disenfranchised citizens (FPEF, 2007a) and facilitating post-harvest innovation across the whole value chain (FPEF 2007b). The FPEF has four sub-chambers<sup>31</sup> or 'fruit marketing fora' which consist of those member companies exporting a particular fruit kind. The Grape

<sup>29</sup> The Perishable Products Export Control Board (PPECB) is an assignee of the Department of Agriculture assigned to evaluate the quality of export fruit according to regulated standards. All companies wishing to export fruit from South Africa are required by law to be registered with the PPECB.

<sup>30</sup> The South African fruit calendar year officially starts on the 1<sup>st</sup> October of one year and ends on 30<sup>th</sup> September of the following year.

<sup>31</sup> These sub-chambers are not registered companies, but simply fall under the legal entity of the FPEF. They are the CEF (Citrus Exporters' Forum), the GEF (Grape Exporters' Forum), the SEF (Stone Exporters' Forum) and the PEF (Pome Exporters' Forum).

Exporters' Forum (GEF) is one such fruit kind forum whose members meet during the season to discuss technical, marketing, quality and topical industry matters.

It is apparent that producer and exporter structures in the deregulated period of the South African fruit industry have been set up along two separate lines, despite their interdependence on one another. However, this changed when, in late 2004, after a particularly poor season, it was decided by the SAT executive that the grape producers needed to work more closely with the exporters of their fruits. SAT producers invited the GEF members to partake in a 50/50<sup>32</sup> joint venture in which two important portfolios – market access and information – would be prioritized (FSA, 2005). This joint venture was registered in 2004 under a new Section 21 Company called SATI (South African Table Grape Industry), and its own executive capacity was appointed. This joint venture lasted two seasons. In 2006, the GEF (exporters) ceded its 50% shareholding in SATI back to the other 50% shareholder, SAT (producers), in favour of incorporating a wider spectrum of stakeholders<sup>33</sup> in the company and at Board level. SATI has continued to operate as a predominantly producer-based organization, but with its Board members being a mix of both producers and exporters (some of which are from the GEF).

This dissertation covers - from late 1997 through to 2007 - the interaction among and between the two major role-players in the industry: the table grape producers (via SAT, SATI and DFPT) and their exporters (via the GEF members of the FPEF). It deals specifically with the competitiveness issues that these industry stakeholders have had to grapple with amongst themselves at company level, and through their representative associations at industry level.

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<sup>32</sup> Producers and exporters had an equal number of Directors on the Board, and both shareholders contributed equally towards the R4 million budget.

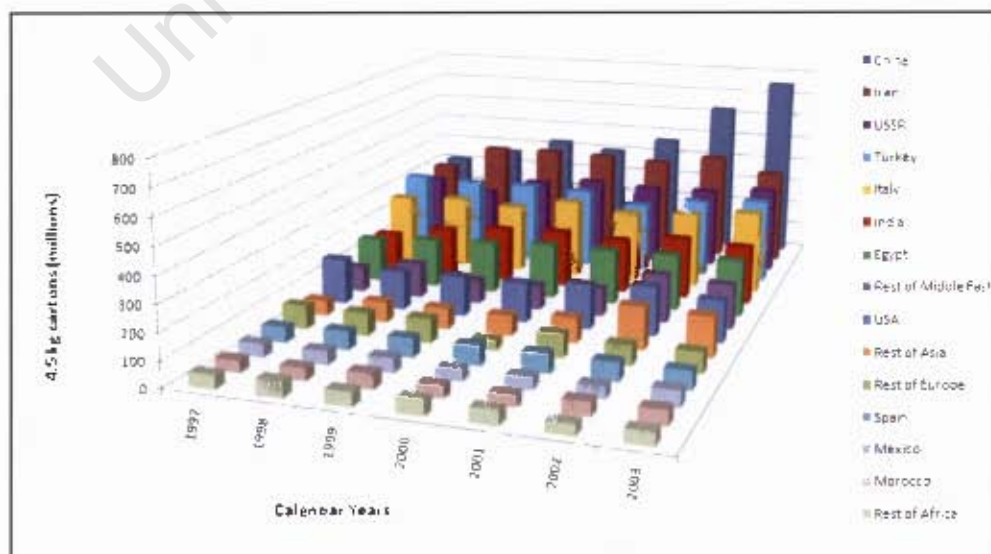
<sup>33</sup> SATI concluded that it was important to give non-FPEF table grape producers (who were doing their own exporting) the opportunity of being represented at Board level in SATI.

## 1.6 International Table Grape Production & Export Scenario

In looking at Figures 1.6, 1.7 and 1.8 in conjunction with one another, the following interesting facts can be gleaned about global table grape production and exports.

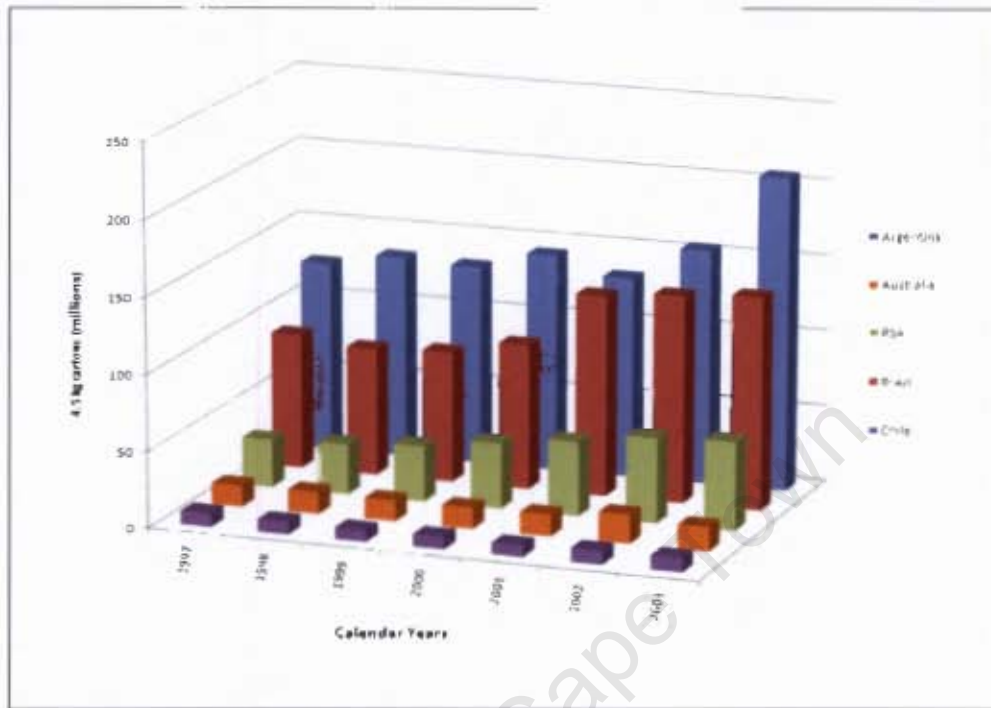
- China is by far the biggest table grape producer in the world, and has a production nearly twice the size of its next global production rival, Iran. Yet neither of these two northern hemisphere producing countries is involved with exports of any significance.
- In a similar vein, Chile and Brazil dwarf the rest of the southern hemisphere producing countries – South Africa included. However, while Chile exports 95% of its production, Brazil exports only about 5% of its production. This suggests that Brazil has enormous potential to export significantly greater quantities than it currently does, and since it produces concurrently to South Africa, constitutes a major threat to its markets, including the UK.
- The southern hemisphere produces a fraction (10%) of the northern hemisphere volumes, yet two of the top four exporting countries by volume in the world are southern hemisphere producing countries – Chile (no 1) and South Africa (no 4).
- Italy is the only country that features amongst the top six producing and exporting nations in the world, making it the global industry leader.

Figure 1.6 Northern Hemisphere Production of Table Grapes (1997-2003)



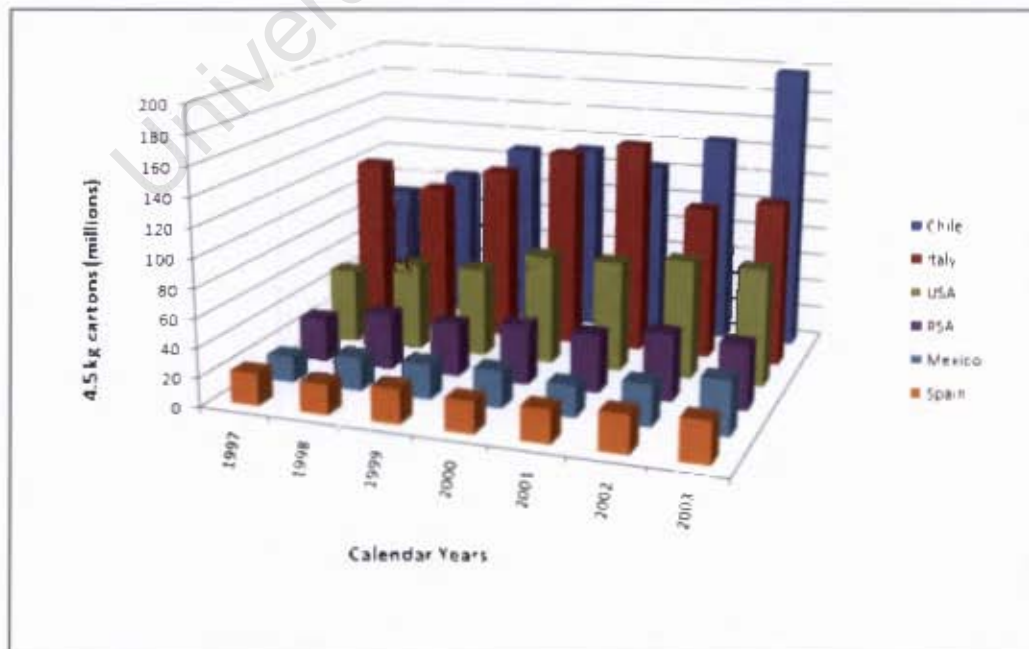
Source: Frudata (2007)

Figure 1.7 Southern Hemisphere Production of Table Grapes (1997-2003)



Source: Frudata (2007)

Figure 1.8 The Top Six Exporting Countries of Table Grapes in the World



Source: Frudata (2007)

## **Chapter 2: Procuring Table Grape Product for Export**

### **2.1 Introduction**

In 1997, a number of entrepreneurial firms entered the export domain of the former state-controlled monopoly, Unifruco. Competition for product in the early years of deregulation was intensified by the proliferation of these exporting firms, and their desire for market share. This chapter starts by demonstrating how the manipulation of the vine at production level leads to product differentiation, product quality, consumer appeal and clear differentials in financial returns.

The dominant export business models of marketing agents and producer-exporter companies are highlighted, including the strengths that they play to when competing for product. Although de-concentration has been significant, this chapter explains how the majority of smaller exporters were faced with the following barriers to entry: capital requirements, economies of scale, predatory pricing, rebates, asymmetrical information, product licensing and backward integration. Most of the major export houses are accredited to the industry's only exporters' association, the FPEF, which has played a major role in stabilizing and unifying the export sector, particularly in the latter half of deregulation.

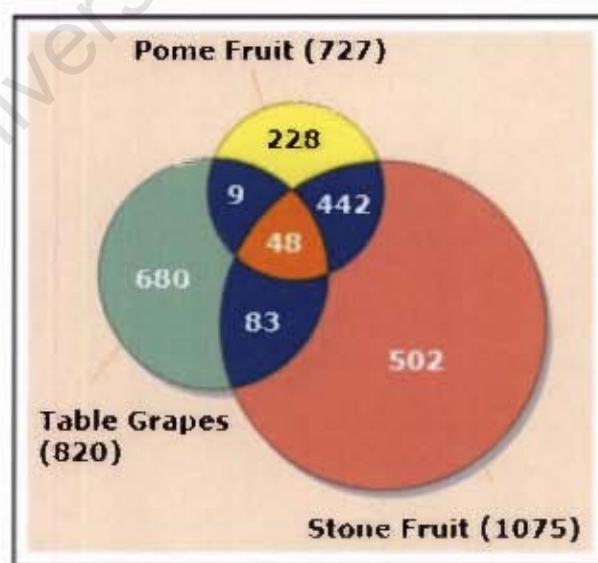
The chapter concludes with two competitive tools that are used by exporters to procure product from growers: minimum guaranteed prices (MGPs), and advance payments in the form of loans and disbursements. These financial instruments have ethical and legal implications that complicate the business and give the exporters an array of opportunities to compete for product.

## 2.2 The Nature of the Product

In the eyes of the consumer, fresh table grapes need to have a good appearance for the pick-up, and a good taste for the return purchase. A good appearance is signified by a bunch of grapes that is properly-shaped, firm, well-coloured and green-stemmed; whilst a good eating experience is commonly described as grapes that are crisp, sweet, and flavourful to the pallet. The product also needs to be appealingly packaged to attract the attention of the consumer, and functionally packaged to protect it from decay. To achieve these product characteristics though, producers and exporters need to have a clear understanding of the nature of the product and how it affects exporters' procurement tactics and consumers' purchasing decisions.

The complex nature of the table grape product requires the undivided attention of the producer, and accentuates the need for him to concentrate purely on the production of table grapes (as opposed to farming other deciduous crops simultaneously). Diagram 2.1 below reflects this to be the case in 2006 where 83% (680 out of 820) of table grape farmers produced only grapes, compared with 47% producing only stone fruit, and just 31% producing only apples and pears.

Diagram 2.1 Producers of Deciduous Fruit for Export (2006)



Source: CIAMD, 2006 (Note, diagram not to scale)

Importantly, the table grape is a non-climacteric fruit, in other words one that starts to die from the moment it is cut from the vine. There is no opportunity to ripen, colour or extensively store grapes after they have been picked, as decay of the product starts

immediately after being harvested. This necessitates the investment in cooling and pack house facilities by almost every table grape producer to ensure that the deterioration of the product is minimized at source. The fact that each table grape producer needs to pack his own product on farm means that exporters have to procure grapes directly from each individual grape producer. For exporters, no efficient, collective procurement opportunities exist in centralized pack houses as is the case with most other fruit kinds. By comparison, citrus is technically a more forgiving product that allows producers to pack cooperatively in relatively few, co-owned pack houses under less harsh temperature regimes. And in the apple industry, controlled atmosphere<sup>34</sup> technology allows producers to store product for up to ten months. This allows exporters to time the advantageous release of product into the market with relative ease, and with a high degree of quality assurance.

Up to the 1980s, table grapes were traditionally grown in the Berg and Hex River valleys of the Western Cape. Realizing the value of producing table grapes in earlier harvesting areas than the Western Cape, South African farmers started producing grapes in the Orange River in the early 1980s, and then in the northern parts of the country<sup>35</sup> in the early 1990s. Premium prices could be achieved by exporters shipping product from these regions into relatively empty markets in the so-called 'early marketing windows' of the South African season. Exporters therefore need to procure product from all regions to ensure that (1) they spread their procurement risk,<sup>36</sup> and (2) that they capitalize on continuous supplies for their customers throughout the marketing windows on offer.

Figures 2.2 and 2.3 demonstrate that the start of the season (in November, week 45) lies in the northern parts of South Africa, and then moves progressively southward, via the Orange River, Olifants River and Berg River regions, finishing finally in the Hex River Valley (in May, week 18). Whilst exporters' attention has been predominantly focused on finding early season marketing windows - especially for the UK market - Leon van Biljon, Grapes Manager of Dole (SA), believes that South Africans should be targeting end-of-season marketing window opportunities as well (especially for a late white seedless variety).

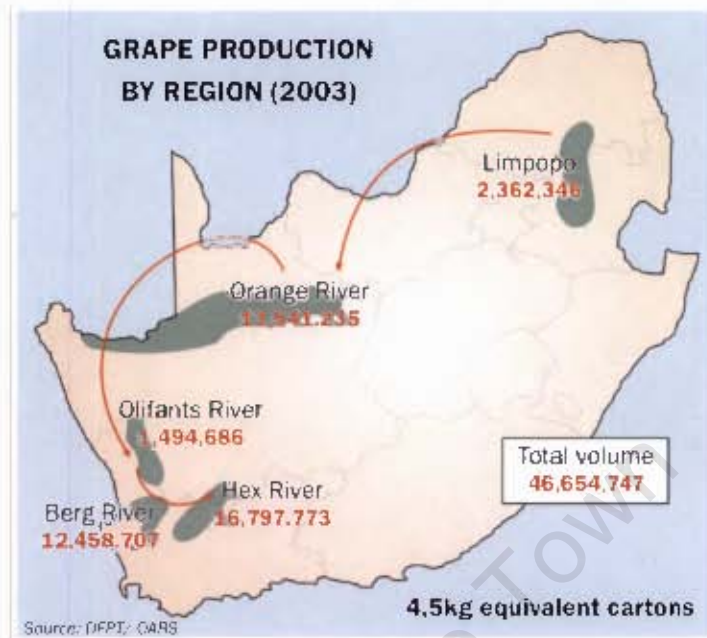
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<sup>34</sup> Controlled atmosphere (CA) storage facilities replace the oxygen with nitrogen in a sealed room thereby effectively 'putting the fruit to sleep' and halting its decaying process.

<sup>35</sup> Grapes are produced in the North West Province (Brits), in the Mpumalanga Province (Marble Hall and Groblersdal) and in areas of the Limpopo Province.

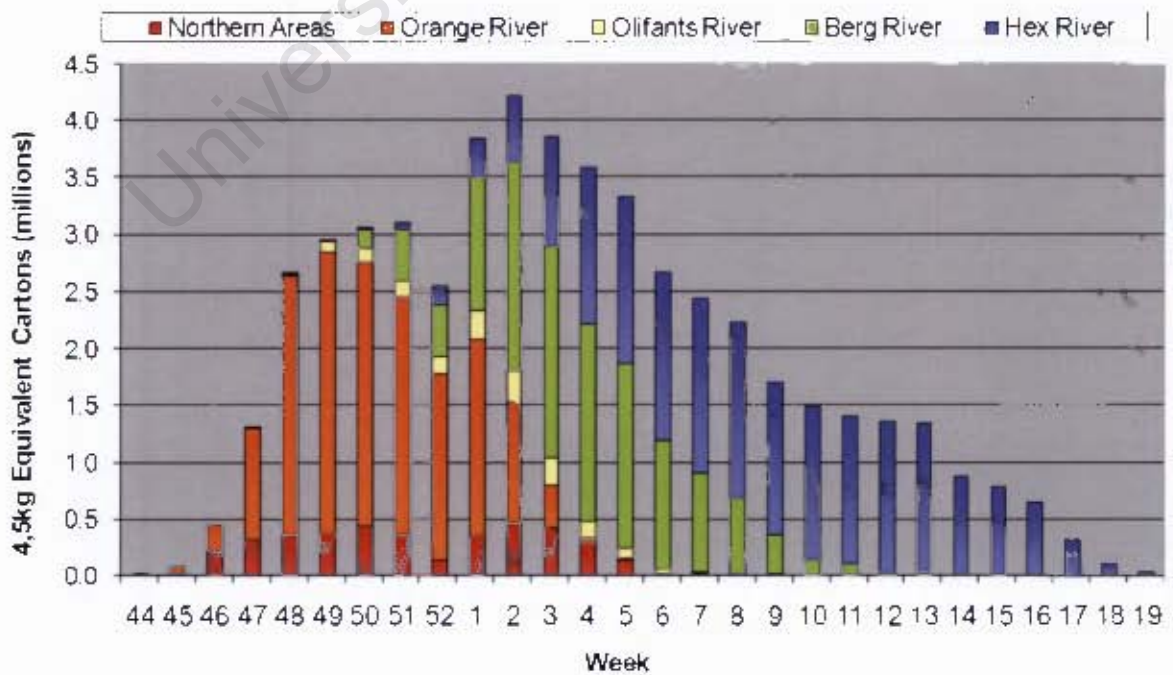
<sup>36</sup> Just as hail can decimate a crop in the northern region, so can unseasonal rain produce quality problems for a crop in the Orange River or Berg River regions. Both are unpredictable risks for the exporter.

Figure 2.2 Grape Producing Areas of South Africa (Volumes 2003/4)



Source: FPEF, Trade Chain Manual (Book 1, 2004)

Figure 2.3 Order of Table Grape Intakes by Region (2006/7 Season)



Source: SATI (2007)

To influence the *quality of the product*, its *consumer appeal* and the ability of the exporter to achieve the optimum price through *product differentiation* in the market place, table grape export product needs to be market-friendly, variety-friendly and quality-friendly. Each is discussed below.

- (1) **Market-friendly.** To enhance the marketability of the product, farmers are able to physically manipulate the number of bunches on a vine well before harvest time.<sup>37</sup> This in turn affects the size of the berries on each bunch, the timing of the harvest, and ultimately the sugar to acid ratios found in the grape berries.<sup>38</sup> Consumers generally prefer bigger-berried, class one grapes,<sup>39</sup> and are prepared to pay premium prices for them. Whilst manipulating vines to achieve these ends is financially viable, many a producer has been reticent to do so. This is, firstly, because there are additional labour cost implications to this process; and secondly because packing berry size at the expense of volume<sup>40</sup> seems to defy logic for producers who have conventionally regarded volume-based production as the path to maximizing profitability. Table 2.4 demonstrates that the bigger the berry size, the better the delivered-in-port (DIP) price per 4.5kg carton for the popular varieties in each production region. The crucial point of interest is the differentials in the DIP prices between the regular and the extra-large berry sizes. This average differential is at its largest in the Orange River where the discrepancy in price (of a carton) between a regular and extra-large berry size is nearly R15.00 per carton on average (and even greater for specific varieties).
  
- (2) **Variety-friendly.** Producers need to consider that certain, newer varieties are now more favoured in the markets by consumers than others - ones that are better flavoured, bigger berried and seedless in nature. Louis Kriel (snr) claims that despite the fact that in the early 1980s, the Agricultural Research Council (ARC) in South Africa produced more new grape varieties than anywhere else in the world, new varieties are now being imported as they are not regularly being developed in South Africa any longer.<sup>41</sup> Exporters vie for the rights to market these new varieties, either with the producers or with the intellectual property holders themselves. The

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<sup>37</sup> This is achievable through pruning and thinning techniques, and applying growth-enhancing hormones to the vines (like gibberellic acid).

<sup>38</sup> Acids give the product shelf life, and sugars give the product its sweet taste.

<sup>39</sup> Class one grapes consist of *regular*, *large* and *extra large* berry sizes. The smaller berries tend to have weaker stems that dry out sooner than the larger berries' stems, making them ultimately inferior to the larger berries.

<sup>40</sup> Leaving more bunches on a vine produces more cartons per hectare of regular sized grapes; whereas reducing the number of bunches on the vine increases the berry size but yields fewer cartons per hectare.

<sup>41</sup> One has to consider that the development of a new variety is a very expensive process, takes in excess of 10 years to develop, and comes to fruition only when commercially viable volumes are available for the market.

'right varieties' also need to be grown in the 'right areas' according to Jan Le Roux, a large producer and exporter in the Berg River. For example, the Orange River should be growing the Flame, Prime and Superior Seedless varieties, and not the Thompson and Crimson seedless varieties that need too much to be done to their vines to make them sufficiently profitable.<sup>42</sup>

**Table 2.4 DIP prices (rands) on berry size for the 2003/4 season**

Region	Cultivar	Average DIP Price (rands)	Discount / premium relative to the average DIP price		
			Regular	Large	Extra-Large
Orange	Flame Seedless	66.34	-19.48	0.76	8.29
	Prime Seedless	68.81	-13.67	4.25	5.51
	Sugraone	45.27	-10.47	0.67	2.37
	Thompson Seedless	40.64	-10.31	0.21	7.34
	<b>Average</b>	<b>47.00</b>	<b>-9.16</b>	<b>0.48</b>	<b>5.48</b>
Berg	Dan-ben-Hannah	35.95	-5.73	0.00	5.01
	Sunred Seedless	32.95	-0.29	-0.37	1.07
	Waltham Cross	32.01	-4.17	-1.42	9.50
	<b>Average</b>	<b>31.42</b>	<b>-4.22</b>	<b>-1.12</b>	<b>3.97</b>
Hex	Barlinka	25.10	-1.69	0.24	2.10
	Dauphine	34.30	-3.06	0.63	-0.12
	Flame Seedless	54.39	-7.74	-0.20	5.85
	Red Globe	26.08	-4.06	-0.69	2.66
	<b>Average</b>	<b>29.67</b>	<b>-2.06</b>	<b>-0.03</b>	<b>1.72</b>

Source: Frudata (2005)

<sup>42</sup> For example, Thompson Seedless is originally a raisin grape that grows prolifically in the wild. But to achieve the right characteristics for table grape consumption, a costly, labour-intensive approach has to be taken towards preparing each bunch on the vine for consumption as a fresh product.

However, there are commercial implications in switching to new varieties in certain areas. In the Hex River valley, for example, there is very little space left for planting new vineyards, so existing plantings have to be pulled out and replaced with new plantings. Producers have to wait several years before an income stream is achievable on the new vineyards.

Many grape varieties are naturally labour intensive, with pre-harvest manipulation of the vines requiring between seven and eleven separate handlings for each bunch on the vine. Extensive labour input is also required in the post-harvest sorting, packing and cooling of the product. This not only makes the chain more costly than other fruit kinds for example, but also has the potential to spoil aspects of the product like the bloom.<sup>43</sup> Sarel Joubert maintains that in the eastern countries in particular, a premium is paid for a preserved bloom, because it signifies product freshness. This implies that many South African producers would have to change their picking and packing processes to ensure that the right workmanship could be instituted to protect the bloom.

Producers tend to prefer varieties that are yield-friendly, since the more product they can pack per hectare, supposedly the better their financial returns will be. Chris Conradie cautions against these varieties as some of them – no matter by how much their yields are improved – simply won't pay for the post-harvest costs because the prices achieved in the market are insufficient in relation to the costs incurred. He cites Red Globe for much of the latter part of the season as a case in point. Marthinus Strauss, MD of Capespan Grapes, concurs and suggests that Regal Seedless can also be added to this list. However, Marthinus Strauss emphasizes that there is no sense in producing a yield-friendly product if the market is not able to pay the required price.

In general, South African exporters and their customers have to live with the existing varieties listed in diagram 2.5. But in order to differentiate their products from competitors' products, and to satisfy the increasingly discerning product quality standards imposed by consumers in developed countries (such as the UK), producers will in future need to consider: (1) eliminating certain unpopular varieties<sup>44</sup>

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<sup>43</sup> The bloom is a waxy, protective coating found on the skin of the grape, particularly in black varieties (Hurndall, 2005).

<sup>44</sup> The exporters (of the GEF technical group) proposed to the producers (of SAT) in May 2005 that, from a strategic point of view, the following varieties should be phased out of production over the following two years: Queen of the Vineyard, Majestic, Muscat Supreme, Bien Donne, White Gem, Datal, Almeria, New Cross and Bellevue.

entirely from production; (2) halting delivery of certain varieties into the markets after certain weeks when it is no longer financially viable to do so; and (3) introducing new varieties - like black seedless grapes - to keep the customer base interested in South African product. In turn, the exporters will need to be disciplined in procuring and delivering only varieties that the market wants, and in the volumes that they want them.

**Diagram 2.5 Popular South African Export varieties**

White Seeded	White Seedless	Red Seeded	Red Seedless	Black Seeded
				
Victoria	Thompson	Red Globe	Flame	La Rochelle
Dauphine	Sugraone		Sunred	Bonheur
Waltham Cross	Prime		Crimson	Alphonse
	Regal			Barlinka

Source: FPEF, Trade Chain Manual (Book 1, 2004)

- (3) **Quality-friendly.** Once the product has been cut from the vines, decay is rapid. Producers therefore need to cool the product down to  $-0.5^{\circ}\text{C}$  on site as quickly as possible. Otherwise the shelf life of the product, which is already just 6 to 10 weeks depending on the variety concerned, will be further reduced. Louis Kriel (snr) says that in days gone by, those producers who picked their grapes at 4am (in the coolth of the day) and were finished by 10am, had product that performed consistently better in the market than the rest. The same holds true today. Cooling grapes down quickly ensures prolonged shelf life. Allied to the cooling of grapes is the application of the correct cooling methods to avoid problems such as freeze-burn and browning.

The nature of the grape product is such that it also attracts pests and fungal diseases. In terms of pests, George Hendrikse, Manager of Special Export Programmes (DFPT) states that vine snout beetle, pear leaf roller, fruit fly and false codling moth (the latter two particularly on organic grapes) are the more common against which producers have to safeguard their crops. Of concern is the infestation in more recent seasons of new pests in areas where farmers have practiced crop diversification. Whilst the use of certain chemicals is allowed to combat specific

pests, maximum residue level (MRL) protocols have to be strictly observed in terms of food safety legislation promulgated in South Africa's major markets.<sup>45</sup> In the marketing of fresh produce, sanitary and phytosanitary (SPS) protocols have to be adhered to; otherwise access to markets could be negatively affected.<sup>46</sup> Those grape varieties that have a propensity for fungal disease<sup>47</sup> through moisture contact are particularly susceptible to the unseasonal summer rains that have plagued the Western and Northern Cape regions in recent years. Table grapes are prone to one such fungal disease called botrytis, which is exacerbated when producers pack too quickly after rain. It necessitates the use of specialized overlay packaging in every carton destined for export. This packaging comes in the form of slow release sulphur pads that emit sulphur gas over the grapes for the entire duration of the voyage to the overseas market. This process retards the development of botrytis, and is designed to preserve the integrity of the product. Again, costly preventative measures against product deterioration need to be adopted, and with the recent attempt at banning the use of sulphur pads<sup>48</sup> in the all-important European market, the industry constantly needs to research new ways of protecting the product, and to overcome non-tariff barriers such as these.

Despite the difficulties and costs in producing and shipping the complex grape product to overseas markets, it has become a highly homogeneous product in relation to grape products delivered from other competing countries. The international tide of table grape commoditization is unmistakable where quality status, sizing and colour have become indistinguishable from one country's product to the next on the retailers' shelves. The only visible point of product differentiation may be the country of origin label - if the consumer is investigative enough, and if the consumer believes that the South Africa product offers a superior eating experience. As a result, price discrimination is hard to achieve, and South African grape producers invariably find themselves being price-takers in many of today's markets.

In order to avoid the commoditization that so characterizes grape products in South Africa's traditional markets,<sup>49</sup> producers and their exporters are attempting to differentiate their wares in the following ways:

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<sup>45</sup> Traceability requirements also have to be observed to support food safety.

<sup>46</sup> For example, the USA had its access to the UK market jeopardized due to the presence of the black widow spider.

<sup>47</sup> The three most prevalent fungal diseases are downy mildew, powdery mildew and botrytis rot (Hurndall R 2005).

<sup>48</sup> In January 2005, the Scandinavian assault on the use of sulphur pads in the EU was successfully rebuffed by the collective action of Southern Hemisphere supplying countries and their importing organizations in Europe.

<sup>49</sup> The UK and the European Mainland, where 84% of her product was sold in the 2006/7 season, are regarded as South Africa's traditional markets.

- (1) By displaying product of varied quality in highly attractive and sophisticated packaging material;
- (2) By offering value-added products by way of newer varieties and composite punnets,<sup>50</sup> especially in thinly-supplied marketing windows;
- (3) By supplying organic product<sup>51</sup> that is becoming increasingly popular, although off a very low base;
- (4) By ensuring that the product legitimately carries the 'fair trade' label, indicating that production occurred under socially and environmentally acceptable standards;
- (5) By branding the product where permissible. Many of the UK supermarkets insist on imposing their own house brands on South African product, but the wholesale markets on the European Mainland - and in most of South Africa's other markets - still afford product brand differentiation for suppliers.

The more recent concerns about the 'carbon footprint' of products traveling great distances to markets has an enormous potential impact on the sales of South African grapes to the UK market. In time to come, exporters may well need to identify the mass of carbon emissions produced per kilogram of table grapes, and indicate this figure on the grape pack for the consumer to see. Exporters could therefore differentiate their products from competitors by supplying product with a comparatively low carbon emission weight to fruit ratio – if they could find legitimate reasons to do so.

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<sup>50</sup> Composite punnets consist of two or more grape types packed in one plastic punnet; for example, green and red seedless grapes packed together in one punnet.

<sup>51</sup> Organic products however do not appear to be fetching the premium prices previously anticipated, and the justification for their production is questionable.

## 2.3 The Exporter Fraternity in Deregulation

Prior to 1994, all fresh table grapes exported from South Africa were marketed through Unifruco, the sole agent of the Deciduous Fruit Board.<sup>52</sup> Between 1994 and 1997, the Deciduous Fruit Board started to relax the single desk approach (in anticipation of deregulation) by issuing a limited number of export licenses. These licenses carried quotas that allowed a select few companies to operate alongside Unifruco. However, in defiance of the government's modus operandi of gradual and selective relaxation, other grape exporting companies began to operate 'illegally', some of which used the Namibian, Angolan and Zambian loopholes as their springboard for exports to the UK and other markets. Therefore, by the time deregulation was officially introduced in October 1997, Unifruco's table grape export sales only accounted for about 66% of the country's export volumes.

The reasons for grape producers giving their product to a particular exporter in the first couple of years of the post-deregulation era were based more on cultural affinity than on anything else. As Gaby Gess of Gess Attorneys notes, relationship marketing may not have yielded the best price, but it was built on trust, which was worth more than price to many a producer in those early, deregulated years. However as more and more exporters entered the fray with the former monopoly, financial returns to producers started diminishing. Trust was traded for temptation as producers accepted offers that promised 'guaranteed', superior returns back at the farm gate. Bruce Brodie, former producer and CEO of the table grape producers' association (SAT), admitted that in an attempt to hedge his bets and maximize returns, he and other producers sold their crops to sometimes as many as eight exporters each in one season.<sup>53</sup> Unfortunately, badmouthing, scare tactics, rumour-mongering, biased price comparisons, promises of minimum guaranteed prices (which sometimes never materialized) and lower commissions were all part of the exporters' arsenal in luring producers' fruit away from one export house to another early in the deregulated period.

Eight years after deregulation, Louis Kriel (snr), former CEO of Unifruco, maintains that low entry barriers to the export industry still accommodate fly-by-night exporters who don't have the interests of the major risk-taker at heart, namely the grower. Chris Conradie, Financial

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<sup>52</sup> The Deciduous Fruit Board (DBF), a state controlled monopolistic institution, was given executive powers in terms of the Marketing Act that created a single export channel for all deciduous fruits exported from South Africa.

<sup>53</sup> Producers usually use two exporters in a season, maybe three if they are big volume producers. Using eight or more exporters would therefore be regarded as excessive.

& Procurement Director of Afrifresh concurs, claiming that with R20 000, a cell phone and a car, it is not difficult for an unscrupulous agent to procure a considerable number of cartons of grapes from avaricious or unsuspecting producers. Despite this, Mike Grobbelaar, Head of Colors Grapes, feels that the industry has now matured to a level where producer loyalty to FPEF-accredited export companies has risen to significant levels. Not too much sympathy gravitates any longer to those producers who continue to have bad experiences hopping from one exporter to the next, especially when they give their grapes to non-accredited exporters without any formal, written agreement.

With the growing wisdom of exporters has come the realization that not all product offered to them by producers is suitable for export. In fact, Riaan van Wyk, MD of Colors Fruit claims that many of the established exporters chase the same list of top quality producers that have the right varieties, in the right quantities and in the right marketing windows. Neither do all the producers necessarily have good cultural fits with the export houses that target them. GEF exporters claim that procuring big volumes from a big grower<sup>54</sup> today may be a useful point of entry into a market, but if accompanied by a big expectation, may be financially detrimental to the export company. This type of producer may want to pay less commission to his marketing agent, demand access to better markets than his competitors and press for directorship and possibly shareholding in the export company if he senses the opportunity. And this all comes at a cost to the export company concerned.

'Exporters' is a generic term given to those companies that sell their own product, or that of other suppliers,<sup>55</sup> offshore. The business models of these various export companies is based generally on the size of the business involved and the type of business being conducted. In theory, producers can select their exporters according to their own particular needs and according to the advantages being offered by the particular exporter's business model. In practice however, not all producers enjoy this freedom of choice. Due to debt repayments and contractual commitments, many producers have found themselves obligated to certain exporters for protracted periods of time. Be that as it may, four types of exporters currently operate in the SA grape export milieu. They are:

- (1) Marketing agents;
- (2) Producer-exporter companies;

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<sup>54</sup> GEF exporters agree that a small grape grower is one who packs less than 50 000 cartons per season; a medium-sized grower between 50 000 and 150 000 cartons; and a big grower over 150 000 cartons.

<sup>55</sup> Suppliers are not restricted to producers. Some exporters also supply product to other exporters.

- (3) Trading companies;<sup>56</sup> and
- (4) Brokers (or facilitators).<sup>57</sup>

This section covers the business models of only *marketing agents* and *producer-exporter* companies. Whilst there were 161 registered grape-export companies in South Africa over the 2006/7 season (PPECB, 2007), the examples of the export companies discussed in this paper will be drawn from the accredited members of the FPEF in Table 2.6 on the following page.

The GEF members - which form a sub-chapter of the FPEF - exported 93% of all South African table grape products during the 2003/4 season. By the close of the 2006/7 season, these same FPEF members had exported 71% of the crop. This drop of 22% over the last four seasons is indicative of the major producer-exporter companies entering the export arena, many of which emanated from the Capespan Grapes Trust after it was dissolved in early 2005.<sup>58</sup> It is unclear as to why some of the major producer-exporters have not joined the FPEF. Most, if not all of these producers doing their own exporting are, in fact, marketing agents, since they export product on behalf of their fellow producers as well. The most common reason given for these producer-exporters not joining the FPEF is because they would have to pay membership fees to the FPEF in addition to the statutory levies that they are already obligated to pay to their producer association.

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<sup>56</sup> A trading company is one that buys the produce at a fixed price from the supplier at some designated point in the trade chain, and then sells it into offshore markets entirely for its own account.

<sup>57</sup> A broker is an individual (sole trader) or company that puts the buyer and seller together through relationship marketing. The broker takes no risk in the transaction, provides no trade chain services, and charges a brokerage fee usually based on rands per carton.

<sup>58</sup> The two most prominent producers that have exported their own volumes in the last two seasons are New Vision Fruit and Riverfruit, both formerly members of the Capespan Grapes Trust.

**Table 2.6 FPEF- Accredited Grape Exporting Companies  
(2003/4 season to 2006/7 season)**

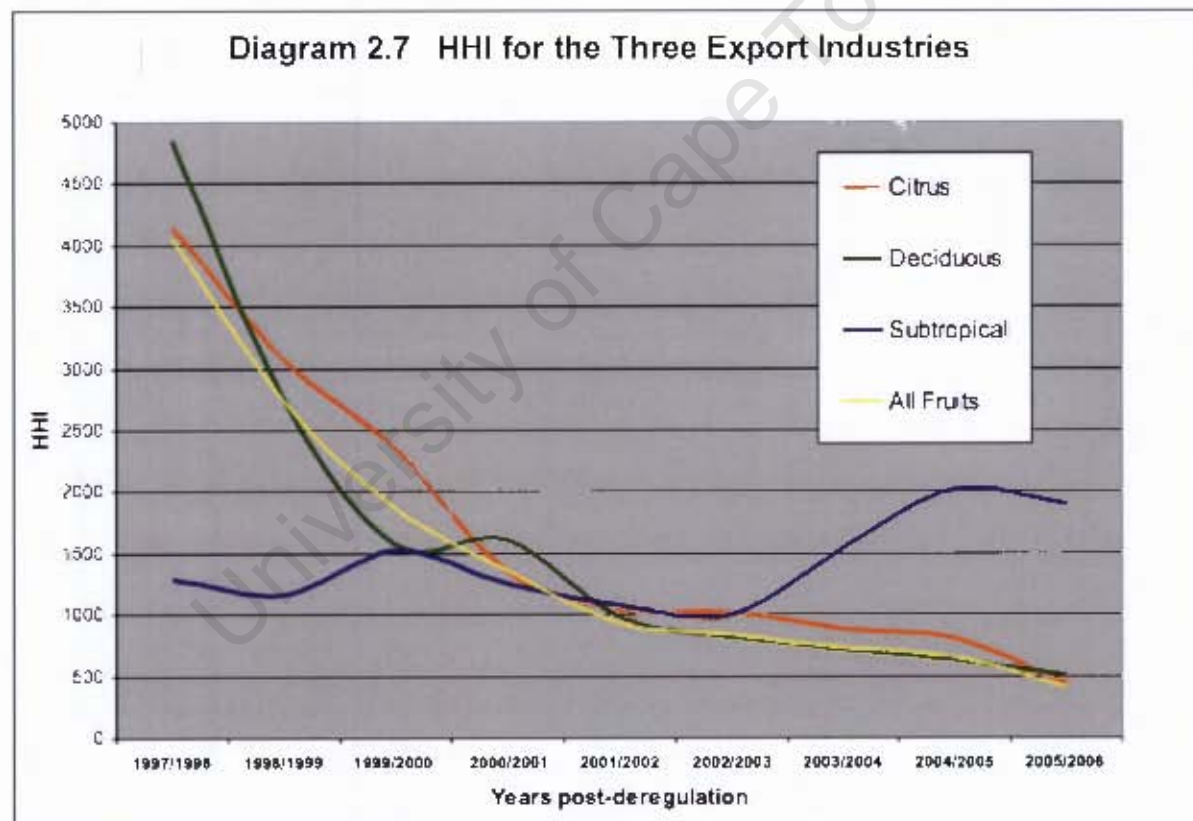
Exporter	2003/4	2004/5	2005/6	2006/7	2006/7
	Pallets ('000)				% Volume
AFRIFRESH / SUNPRIDE	15	20	21	20	6
CAPESPAN	69	62	59	54	17
COLORS	14	20	21	23	7
DELECTA	4	7	8	10	3
DOLE	21	26	22	23	7
EXSA	25	25	30	13	4
FEDFA	1	1	2	1	0
FRESHWORLD	2	2	3	2	1
FRUITS UNLIMITED	12	10	14	7	2
GREEN MARKETING	9	8	10	7	2
IN SEASON	0	0	1	1	0
INTERTRADING	2	1	2	1	0
KATOPE	5	4	3	4	1
LE ROUX	7	8	8	8	2
OCEANIC	0	1	1	1	0
OREX	0	1	3	2	1
SAFPRO	2	2	2	3	1
SAFE	8	9	9	8	2
SOUTHERN FARMS	0	3	1	1	0
SOUTHERN FRUIT GROWERS	2	2	4	6	2
SUNPRIX	0	2	1	1	0
THE GRAPE COMPANY	16	21	25	25	8
UNIFRUTTI	0	1	1	2	1
VAN DER LANS	0	1	1	1	0
VANGUARD	0	1	2	2	1
XL INTERNATIONAL	0	1	1	1	0
OTHER	8	7	6	5	3
Industry Total Volume (Pallets)	<b>239</b>	<b>295</b>	<b>331</b>	<b>327</b>	<b>100</b>
GEF Total Volume (Pallets)	<b>222</b>	<b>246</b>	<b>261</b>	<b>232</b>	<b>71</b>
GEF % of Industry Exports	<b>93</b>	<b>83</b>	<b>79</b>	<b>71</b>	

Source: Grape Exporters' Forum (GEF, 2007) and PPECB (2007)

## 2.4 De-Concentration of the Exporter Environment

### 2.4.1 De-concentration of All Fruit Kinds

The table grape export industry's competitiveness is primarily centred on the companies that export the product offshore. The number of deciduous fruit exporters - under which the table grape exporters are classified - has risen substantially since deregulation, so much so that the market power of Unifruco<sup>59</sup> was eroded from nearly 100% of the export volumes pre-1997, to 17% of the volumes in 2007. Diagram 2.7 graphically represents the Herfindahl-Hirschman index<sup>60</sup> (HHI) based on all<sup>61</sup> fruit-exporting companies registered with the PPECB during the years indicated.



Source of data: PPECB (2007)<sup>62</sup>

<sup>59</sup> Unifruco, the former sole agent of deciduous fruit exports, merged with Outspan in 1999 to become Capespan.

<sup>60</sup> This index calculates the sum of the squares of all the export companies' percentage market share based on quantity of cartons. Theoretically, one export company with a 100% market share would have an HHI of 10 000 i.e. a totally monopolistic situation.

<sup>61</sup> By 'all' companies it is meant marketing agents, producer-exporters, traders, accredited and non-accredited fruit exporters of all fruit kinds in South Africa.

<sup>62</sup> Note that the fruit calendar year runs from 1<sup>st</sup> October of each year to the 30<sup>th</sup> September of the following year, hence the x-axis having two years indicated per timeframe.

A few interesting points emerge from diagram 2.7.

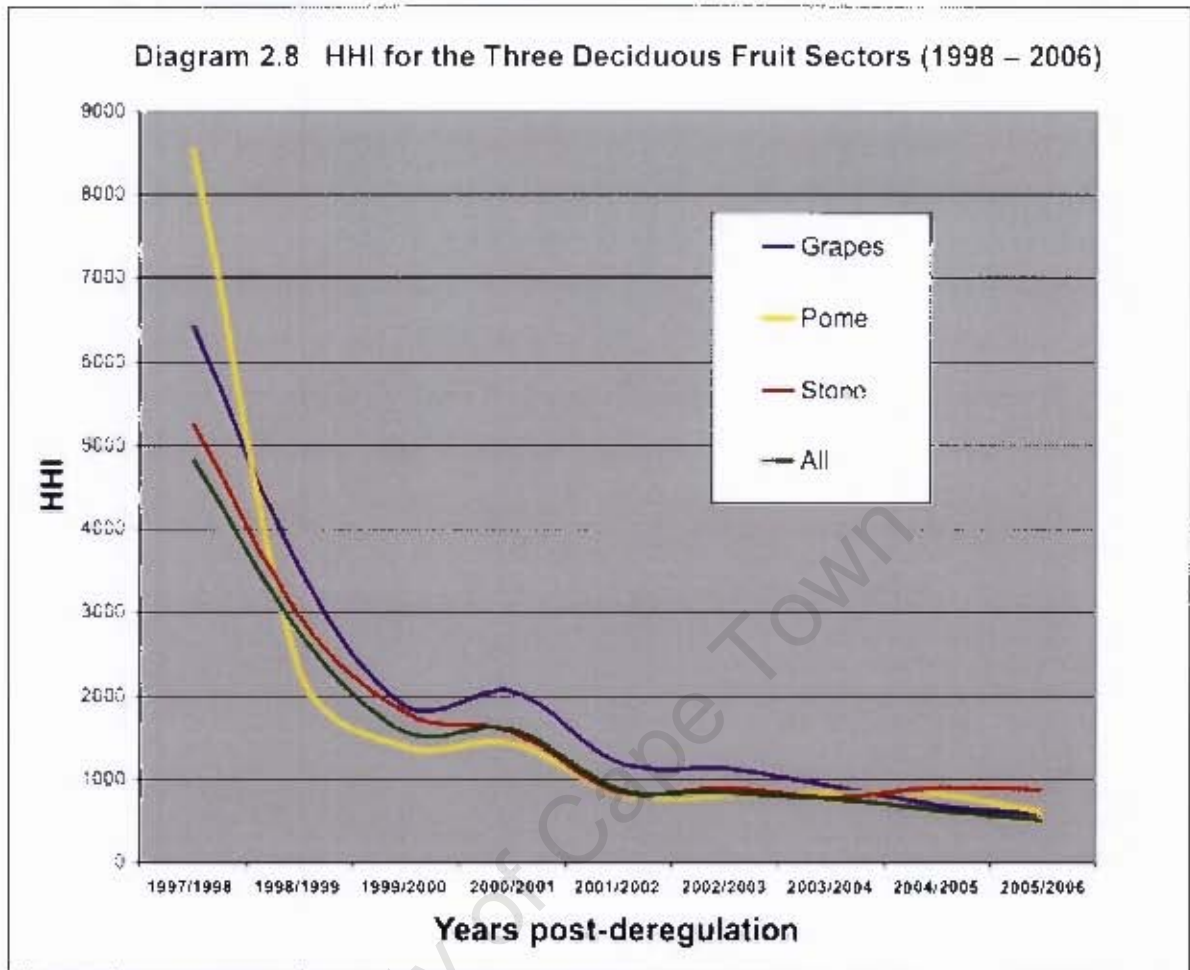
- (1) The HHI values for the subtropical export sector hovered continuously between the 1000 and 1500 mark up until 2002, indicating a highly de-concentrated or competitive status prevalent up to that point. This reflects the fact that this industry has never been regulated. However in the last three seasons there has been a noticeable re-concentration of the industry back above the 1500 level, making it now the most concentrated of all the fruit industries. This has totally reversed the HHI picture to what was occurring at the start of deregulation (when the subtropical industry was clearly the least concentrated of all the industries).
- (2) The HHI of the citrus industry shows a slower market de-concentration with the onset of deregulation compared to the deciduous industry. But by the close of the 2001 season, the citrus HHI was at a comparable level to the deciduous and subtropical industries, all reflecting a highly competitive export environment. From 2002 to 2006, however, there has been a continuous, gradual decline in the citrus HHI where it now matches the highly de-concentrated (and therefore highly competitive) levels of the deciduous fruit industry.
- (3) The HHI for the deciduous export industry – under which grape exporters fall - started off at values well in excess of 1800<sup>63</sup> in 1997, suggesting a high degree of concentration at that time. The market then de-concentrated rapidly reaching values in the 2001/2 season lower than that of even the subtropical industry. It appears that the HHI values have gradually declined in the last few seasons, and by 2006 - along with citrus - is regarded as particularly de-concentrated and therefore highly competitive.

#### **2.4.2 De-concentration of the Deciduous Fruit Sector**

When comparing the HHI values for the exporting firms in the deciduous industry only (i.e. for the pome, stone and grape sectors in diagram 2.8 on the following page), a few points are worthy of mention:

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<sup>63</sup> In the USA, an industry with an HHI value of less than 1000 is considered un-concentrated or competitive; between 1000 and 1800 moderately concentrated; and higher than 1800, concentrated (Mohr, P. 2004).



Source: PPECB (2005)

- (1) The apple and pear sector started off the most concentrated of the three sectors, and within two seasons after deregulation, was the least concentrated of them all. This probably indicated the relative ease with which an exporter could take these products offshore without suffering technical or qualitative difficulties. With this deciduous fruit product, the exporters' risks are probably lower than other deciduous fruit kinds.
- (2) The much smaller stone fruit sector followed the industry average closely lying between the pome and the grape sectors' HHIs.
- (3) Interestingly, the grape sector traced the slowest de-concentration with the onset of deregulation. This was probably as a result of a combination of issues. Firstly, the nature of the grape product makes it trickier for exporters to manage as easily as perhaps the other deciduous products. Secondly, the earlier and larger marketing agents adopted procurement strategies to prevent many other (smaller) exporters

from effectively entering the sector and procuring product.<sup>64</sup> And thirdly, the intervention of the producers after the disastrous 2000/2001 season aided the slower pace of de-concentration thereafter. However de-concentration has been continuous thereafter to a point where the competitiveness levels of the grape export sector now match those of the pome and the stone fruit export sectors.

### **2.4.3 De-concentration of the Table Grape Export Sector**

By the end of the first officially deregulated grape export season in 1997/8, Unifruco had retained 66% of its volumes and had 51 exporter companies trading alongside it (see Table 2.9 on the following page). The conservatism of the producers waned continually over the following ten years as the number of exporters in the industry trebled from 52 in 1997/98 to 161 in the 2006/7. Despite the rise in the industry's export volumes from 136 000 mt in 1997/8 to 327 000 mt in 2006/7, Capespan (formerly Unifruco) found its own export volumes from South Africa declining from 91 000 mt in 1997/8 to 54 000mt in 2006/7. This meant that by the 2006/7 season, Capespan's volumes had declined to 17% of the industry's total export volumes, though it still remains the biggest single export company of grapes out of South Africa.

Another look at Table 2.9 reveals the fact that since the start of deregulation, the top 20 exporters of table grapes have never exported less than 80% of the product. In only two of the ten years of deregulation was the amount of product exported by the top 20 exporters less than 85%. It is apparent then that the long tail of small exporters – from about the 1999/2000 season onwards - has been unable to grow its share of the business.

Interestingly, the number of producers doing their own exporting has been on the rise, particularly in the last three years. This chapter examines some of the reasons giving rise to that trend, including what factors may limit that trend.

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<sup>64</sup> Over this time period, Capespan set up its Capespan Producer Trust of 90 producers who agreed to pack for Capespan only.

**Table 2.9 Table Grape Export Statistics of the Deregulation Period**

	<b>10-Year Period of Grape Seasons in Deregulation</b>									
	<b>97/98</b>	<b>98/99</b>	<b>99/00</b>	<b>00/01</b>	<b>01/02</b>	<b>02/03</b>	<b>03/04</b>	<b>04/05</b>	<b>05/6</b>	<b>06/07</b>
<b>Volume of SA grape exports ('000 mt)</b>	136	172	167	175	198	210	239	295	331	327
<b>Total number of exporters</b>	52	103	131	144	165	158	154	127	156	161
<b>Total number of producer-exporters</b>	3	5	7	11	10	8	14	27	25	34
<b>Export volume ('000 mt) of Capespan and its industry %</b>	91 66%	98 57%	71 42%	82 46%	72 36%	58 27%	68 28%	62 21%	59 18%	54 17%
<b>Export volume share of top 20 exporters (%)</b>	97.5	91.4	87.7	87.0	81.7	85.3	85.4	85.0	86.2	81.8

Source: PPECB (2007) and Capespan (2007)

## 2.5 Business Models of Exporting Companies

### 2.5.1 Marketing Agents

A marketing agent (or export agent) sells product overseas on behalf of his principal, the producer. He adds value to the consignment deal in terms of his product knowledge, his ability to sell to the various international markets, and his skills in coordinating the necessary logistics service providers to move the product successfully through the chain. In return for this value-add, an agent charges his producer a commission<sup>65</sup> on sales.

Pure agency implies that no monies are guaranteed or advanced by the agent to the principal, but this is rarely found in practice in the grape export sector. According to Leon van Biljon, the perception of a marketing agent in South Africa now is rather one who pays advances, takes a relatively small commission, gives sound technical advice, and if he is good, gives production loans (and if he is *really* good, gives production loans for longer than a year). In today's grape exporting environment, the export agent is financing many of the disbursements on behalf of the cash-strapped producer. And the more an exporter can finance the producer's costs, the more attractive it becomes for the producer to use that exporter.<sup>66</sup>

Jan van Nes, Commercial Manager of SAFE purports that the major risks of an export agent are losing his supply base, non-payment by the importer and non-payment of monies loaned to the producer. But the primary risk is losing his supply base. A marketing agent can never be guaranteed of his supply base, since producers can withdraw their product at any time, and for any reason. Without the product, the agent has no business. There is, understandably then, a persistent pressure for agents to constantly satisfy their growers with above-average financial performances. And an export agent is only as good as his last season's returns. Hubert Leclercq, MD of Katope Cape, states that in order to engender professionalism and to entrench their supply bases, many export agents employ full-time procurement personnel that sometimes double up as technical specialists. An export agent can differentiate himself from other agents over and above satisfactory financial returns and sound technical advice through an attractive business model. It is now appropriate to take a

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<sup>65</sup> Generally, marketing agents charge commissions quoted in CIF terms (6%) or in the equivalent FOB terms (9%). These commissions are a (varying) percentage of the sales price of the product. This produces a sliding scale income for the exporter where income is a function of the price and the volume sold. Other marketing agents charge the producer a fixed cost per carton to export the grapes, regardless of the price achieved in the market for the fruit.

<sup>66</sup> It is estimated that about R1.5 billion worth of exporter loans to producers are currently circulating in the whole fruit export industry, pegging the grape sector's 'loan status' at about R350 million.

closer look at some of the business models - and their unique selling points - that marketing agents use to compete for suppliers' product.

Most South African table grape exporters at this stage of deregulation can be regarded as marketing agents. For explanatory purposes only, they can be categorized into one of several types of agents depending on the size of the companies, the functions that they perform, who owns the companies and where that ownership resides. These export agent categories are not mutually exclusive in that aspects of their business models will overlap with one another. They are divided here, for convenience, into: (1) Multinational companies; (2) South African-owned and -based export agencies; (3) Foreign importing companies with branches in South Africa; and (4) South African based producers who export their own product and a few of their fellow producers' crops.

(1) **The multinational companies** like Dole, Capespan<sup>67</sup> and Katope offer producers an array of advantages that their competitors cannot easily match. They can be summarized as follows:

- A multinational's profitability is not dependent on any one fruit kind, from any one company in any one country. It spreads its procurement risks across a basket of different fruit kinds from supplying countries around the world - 365 days a year. These products are then sold into a host of markets spreading their suppliers' sales risk on that basis too. Leon van Biljon claims that Dole's only Achilles' heel could be regarded as its dependency on banana sales (particularly in Europe).<sup>68</sup> Producers therefore perceive multinationals as having a lower financial risk profile and as being more financially stable than other South African marketing agents.
- Multinationals have access to (a) cheap international finance due to their head offices being located in foreign countries where low interest rates have prevailed; (b) ships and preferential shipping rates due to the product volumes that they move around the world through certain shipping lines; and

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<sup>67</sup> Capespan is somewhat of an anomaly being a South African company with a locally based Group corporate headquarters. The group is producer-owned with 10% of its shares being owned by a foreign multi-national company (MNC). The control of its marketing companies in other parts of the world varies from 50% in Europe (Capespan PLC) and the Far East (Metspan), to 100% in the case of North America (Fisher-Cape) and Japan. The Middle East is handled as a Business Unit as part of the export company. Unlike Dole and Katope, for example, Unifruco, Outspan and later Capespan all were - and still are - South African grower-owned and therefore grower-controlled. So for convenience purposes only, Capespan will be categorized here as a multinational company.

(c) valuable international marketing information due to their global networks. Sarel Joubert states that the financial strength of multinationals also enables them to invest in much needed research.<sup>69</sup>

- Multinationals tend to have their own receiving offices overseas allowing them, in principle, to manage their suppliers' costs more efficiently, and in a more transparent manner than their competitors. This is all the more significant considering that the cost chain overseas is based in foreign currency, making it a relatively expensive part of the chain. On the contrary, non-multinational agents usually relinquish control of the product to commission-based foreign receivers who tend not to disclose costs or important information as a means of self-preservation in the chain. However, the receiving offices of a multinational company need not necessarily be of benefit to the producer. MNCs are invariably restricted to sending product largely to their own offices in a particular region, thereby limiting the number of companies to which they can sell product in a region. In addition, it is not certain as to how much control is exercised over which products are sold to which customers, and whether all information pertaining to sales is actually fed back to the South African office and back to the producers.
- Multinational companies have established powerful *product brands* for decades in the international markets, like Chiquita and Dole bananas, and Del Monte pineapples. With the current trend of retailers de-branding suppliers' products, these multinationals will probably be the last to survive the product de-branding campaign (because of the goodwill and sales that these product brands still continue to generate with consumers). These same multinational companies have also developed strong *corporate brands* that can supply the volumes required by large, internationalizing retailers. Producers that supply grape product to such MNCs should be direct beneficiaries of their product and corporate branding.

Chris Conradie is more circumspect on the so-called blue-chip status of multinationals. He cites the demise and exit of Del Monte in the South African

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<sup>68</sup> Fruit sales and fruit prices in the major markets are dependent on the under-supply or over-supply of bananas because bananas are by far the most popularly consumed fruit in the world (25% of all fruit sales). Dole's reliance on banana sales is big, and many of its other fruit products ride into customers on the back of its banana sales.

<sup>69</sup> Sarel Joubert cites the recently released and patented V-channel carton by Experico (Capespan's technology development division) as an example of such research, which improves the cooling rate in grape cartons by up to 30%.

grape-exporting arena in 2003 as being a case where an overly large cheque book was a distraction from the company adding adequate value in the chain for its producers. Jan le Roux is convinced that the weight of a multinational's interest lies with the supermarket rather than with the producer, because he is dealing with the supermarket 365 days a year, and with a South African grape producer for maybe twenty days of the year. Anecdotal evidence also suggests that the smaller producers with their minuscule volumes would not receive the kind of prioritized attention from a large multinational that they would from a smaller, more niche-market orientated export agency.

(2) **South African owned and based export agencies** vary in size from one-man-bands through to companies of 50 employees or more with turnovers<sup>70</sup> of hundreds of millions of rands. These agents are essentially divided into two camps: larger agents<sup>71</sup> and smaller agents.<sup>72</sup> This division has generally manifested as a result of how early the agents started their businesses after deregulation,<sup>73</sup> where on the product quality spectrum they decided to position their businesses, and what their philosophies were on being volume driven. Marketing agents' business models are tailored to meet their own objectives as well as the needs of their producers. The ingredients of the agents' business models are many and varied, with some of the better-known drivers of the agents' business models described below.

(a) Targeting the best quality producers. Hanno Scholtz, MD of The Grape Company, states that his company was founded at the start of deregulation on the principle that only the very best producers would be targeted for supplying his company's needs. He maintains that their producers were identified on the basis that they: (i) consistently delivered the right product specifications for particular markets, year in and year out; (ii) took no chances; (iii) showed financial strength in their farming businesses and therefore had no need to take short-cuts; (iv) practiced state-of-the-art farming methods; (v) had cultivar renewal programmes particularly for the surging seedless demand in South Africa's markets; and (vi) were generally innovative. After considerable trial and error in the early period of

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<sup>70</sup> There is some debate as to the legitimacy of an agent declaring his principal's proceeds as his own turnover. Agents do so to show financial strength on their income statements and thereby secure loans more readily from financial institutions to fund the export costs on behalf of their producers.

<sup>71</sup> The bigger (non-MNC) marketing agents are companies like The Grape Company, Colors, Afrifresh, Sunpride, Green Marketing and SAFE.

<sup>72</sup> The smaller (non-MNC) marketing agents are companies like Delecta, Fedfa, Freshworld and WP Fresh.

deregulation, the top quality producers have found and settled with their selected agents who adopted this approach. In 2001, Capespan started the Capespan Grapes Trust (in which 90 producers resided) in a bid to retain what it perceived to be the best producers. Any new export entrant wishing to corner the best producers today would be hard-pressed to supersede the arrangements instituted by existing export agents at the start of the deregulated era.

- (b) Targeting top-end retail clients. The bigger agents are able to reach the top-end retailers with the volumes and quality demanded by these retailers. And they are able to do so somewhat more directly than multinationals which normally have to go through their subsidiary companies (receivers) based in the country of the targeted retailers. Riaan van Wyk (MD of Colors) claims that from the start of deregulation, his company had very strict control measures in place to ensure that his supermarket clients received only the best of Colors' branded fruit. Consequently, Colors is now renowned for being able to cherry-pick amongst the best supermarket programmes on offer to South African producers. According to Riaan van Wyk, internal business units in his company have to match the exact volumes of their supermarket demand plans with the supply available from their producers. Only in exceptional cases are their business units permitted to deviate from this plan. To ensure that their fruit desks do not over-procure for their programmes, Colors' business units are penalized if they ignore this business principle. This is a disciplined approach in relation to many marketing agents whose commission-based income<sup>74</sup> tempts them to take on more product volume than their business systems can handle and that they have overseas outlets for.
- (c) Charging producers a 'fixed cost per carton' rather than a 'commission proportional to sale value'. For producers, agents that charge 'reasonable commissions' for services rendered are naturally more attractive to deal with than those who do not – unless a premium commission can be justified for a

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<sup>73</sup> The earlier the agency started the more of a chance it had to build substantial volumes over time. EXSA and The Grape Company for example started their companies before the official deregulation date.

<sup>74</sup> The greater the volume of product an export agent can procure, the greater his turnover; and where his commission is a fixed percentage of turnover, he stands to gain more income with a greater volume of fruit exported.

value-added service.<sup>75</sup> Normally, an agent charges a producer a fixed commission that is a percentage of the purchase price of the product (e.g. 6% CIF or 9% FOB). On this basis, an agent can make a disproportionate amount of money from the producer in a good year. However, in a bad year, the exporter could become insolvent, as he is unable to cover his fixed overhead costs with the total commission earned. Chris Conradie of Afrifresh feels that his company's financial model of negotiating a fixed cost per carton (inclusive of any rebates obtained) with his producers for his marketing and logistical services is not only appropriate, but also advantageous for a producer. He reasons that as long as the producer knows his own costs, he can calculate at the point of sale (particularly for FOB deals) what his farm gate return will be. This affords the producer the opportunity of securing bridging finance (if it is needed) so that he can undertake timely and critical post-harvest treatments to his vineyards. It also ensures that no shocks will be encountered by the producer on his sales account<sup>76</sup> from his exporter – especially when it comes to the declaration of rebates earned which can make or break a producer's business in a tough season.

- (d) Targeting as much volume as possible. Securing big volumes of table grapes allows the bigger agents to place the fruit in all market segments, namely with supermarkets, wholesale markets and traders. These agents can also access substantial rebates in the chain which are essentially volume-driven discounts offered by suppliers of goods and services in the chain. If one combines these facts with the reality of the commission-based remuneration system - that exporters are able to generate income regardless of the price of the product achieved and regardless of whether the producer is making or losing money on the consignment - this model is indeed tempting for agents to adopt. However the countervailing power for a producer in this business model is that if the export agent does not achieve an acceptable return for him, the exporter will simply not receive fruit from him (the aggrieved producer) in future.

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<sup>75</sup> A producer-exporter with small volumes cannot access the lucrative, volume-orientated supermarket programmes unless he piggybacks one of the large marketing agents into that supermarket programme. This is a typical value-added service for which a producer-exporter will pay a premium commission.

<sup>76</sup> The sales account aspect of agency business is highly contentious. The enigmatic formats of agents' sales accounts can conceal superfluous costs in the chain that financially compromise credulous growers. For growers to be kept waiting for months on end to hear whether they qualify for some unquantifiable rebate – an amount that can make or break a producer's business - could be construed as unethical.

- (e) Paying favourable terms. David Powter, major shareholder of The Grape Company, claims that his company is amongst the leading payers in the industry. He qualifies 'leading payers' as those companies who not only give advances to their producers but are also the first to pay their producers.<sup>77</sup> The advantage of being a leading payer - about 60 days from delivery of product to the exporter - is that apart from being considered the benchmark of the industry by paying relatively good returns timeously, it puts the later-paying agents under pressure to pay as quickly as possible thereafter – and to match or better the leading payers' returns.<sup>78</sup>
- (f) Procuring from early harvesting areas. Some agents deliberately procure a considerable percentage of grape product from the Limpopo and Namibian growers – both early production regions. Both regions afford the agent the opportunity of selling into early overseas marketing windows that tend to return higher prices to producers than those following in later weeks.
- (g) Securing new varieties. As was noted earlier, the growth of seedless grapes in world markets is evident; and the ARC has not continued the development of new South African seedless varieties. As a result, certain agents like Capespan, Dole and Colors have prioritised securing new varieties for their producers from overseas sources, like those from Sunworld. The initial cost of the vines and the royalties on the intellectual property are worth investing in, claims Leon van Biljon of Dole, not only because Dole's producers can differentiate themselves in the market place; but also because current technology via genetic coding enables new varieties to be effectively enforced in international courts of law where there is a question of fraudulently obtained rootstock.
- (h) Securing funding. Part of volume growth in these agents' businesses has been the need to secure capital to fund that growth. Unlike multinationals, bigger South African-owned and -based marketing agents do not have

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<sup>77</sup> An exporter may give his producer a very late additional payment, sometimes well after the end of the season. When an 'agterskot' like this is paid, it could elevate the exporter concerned to being amongst the better paying agents for the season concerned. So an early-paying agent does not necessarily equate to it being a best-paying agent, but it is normally a good indicator of a well-paying agent.

<sup>78</sup> Interestingly, a number of producers interviewed believe that the later-paying marketing agents go through a 'mixing and matching' payment process. In other words, agents determine which producers they want to keep (by cross-subsidizing them with superior returns); which producers they are ambivalent about (by giving them ordinary returns); and which producers they can afford to lose (by giving them inferior returns). If this is true, it is highly unethical (and perhaps even criminal).

access to a parent company's offshore foreign capital. In order to fund the increasing cost of doing business with financially demanding producers, these agents secure capital from their importers, local commercial banks, specialist finance houses and, to some extent, their own cash reserves. Funding is not made any easier to secure due to the generally assetless balance sheets of many of the export agents. Naturally the bigger and more established of these agents are able to secure considerable amounts of capital to fund their businesses to the benefit of their producers.

- (i) Achieving favourable market splits. A grower wants to know that his export agent can give him sufficient market options so that he can split his volumes, and therefore his risks, across a number of markets. In one sense, a producer who dictates the marketing mix to his agent gives the agent the responsibility of optimizing that producer's return in the *identified* markets. And the producer can hardly complain if any of the markets are 'bad', because he chose those markets. However, if a producer leaves the market split to the agent (to essentially sell 'at best'), the agent is under pressure to maximize his producer's returns. An agent will then need to have access to several well-paying supermarket programmes in several different markets (like those of Canada, the UK and Sweden for example) to spread the income risk for the producer.
- (j) Securing customer patronage through share ownership. One of the more recent developments is the backward integration of UK importing companies into South African exporting companies. Some marketing agents have sold a percentage of their business to their customers overseas in a bid to strengthen the relationship and secure their sales. This would hold appeal for producers wanting to have guaranteed access to certain UK supermarkets during certain weeks of the supply season.

Smaller export agents have an entrepreneurial agility that some of the bigger agents lack. They also have lower overhead costs than their bigger counterparts and are often able to return above-average prices in niche markets for their producers. One of the easiest points of entry into an offshore market for a marketing agent with a relatively small volume of product is on the wholesale markets in Europe, or through a Dutch trader to any market in Europe. According to Jan van Nes, this type of South African product can find its way from Rotterdam onto the European continent into a labyrinth of markets that arguably only the

Dutch can do best with their renowned trading skills. Often, due to the nature of their size, the smaller agents are unable to place their product into the rewarding UK programmes. Sometimes these smaller agents will therefore on-sell<sup>79</sup> their product to bigger marketing agents who have access to such retail programmes. Strategic alliances of this nature do occur within the export agent fraternity. The most common example of agents working together with product is the sharing of logistics (like the chartering of vessels together) where the economies of scale achieved in working together outweigh the apparent contradiction of agents being competitors.

Importantly, all of these marketing agents – big and small – are now having their traditional business models challenged. The bigger and more capable producers have started exporting large percentages of their own product, substantially modifying the agents' traditional role of taking their product overseas on their behalf. Several evolutionary business models are unfolding as a result.

- Firstly, a number of the bigger table grape producers are forming producer alliances. Together these producers are amassing critical volumes of product to export - for their own account. In order to get their product to market, this group of producers employs marketing expertise, most typically the skills of a former marketing agent. The producer alliance therefore ends up paying a salary to acquire this marketing expertise as opposed to paying an ad valorem commission to some marketing agent.<sup>80</sup> It will be interesting to see, in time to come, if many of these producer alliances become members of a co-operative (like the citrus producer alliances did with the South African Cooperative Citrus Exchange (SACCE). In which case, if the co-operative then takes on the marketing function for its members, a form of centralized selling will be re-introduced back into the industry.
- Secondly, the bigger agents are integrating backwards in the value chain by acquiring production units.<sup>81</sup> By doing this, marketing agents are securing product for themselves that they may have lost. Various models around this backward integration are evolving, and it will be a while before these export agents find an

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<sup>79</sup> The on-selling of a grower's product by one agent to another agent is controversial. One school of thought says it adds value to the producer where the originally selected agent is unable to move it profitably for some reason or other. The other school of thought suggests that on-selling lengthens the chain and makes it ultimately more costly for the producer. Some agents are known for their policy of forbidding on-selling to other agents.

<sup>80</sup> Some of these alliances claim that the cost of employing the skills is about 2% of the gross sales price of the product as opposed to the much higher percentage that the independent marketing agents usually charge. The bigger the producer alliance's volumes, the more significant are the savings and the better the return per carton for each producer in the alliance.

<sup>81</sup> For example, Colors, Afrifresh and SAFE have all been involved in buying farms.

acceptable level of risk between becoming farmers and remaining export agents.<sup>82</sup> Chris Conradie maintains that if an exporter can buy a stake in the right farming operation, and retain the best on-farm management, it is a win-win for the producer and the exporter. He believes that taking a shareholding in a farm does not secure the fruit as much as it reduces the volatility in the relationship between the exporter and the producer. This type of investment in all fruit kinds also guarantees the export company a flow of product throughout the year, and gives the exporter a business rather than a seasonal enterprise. Sarel Joubert also points out that in Chile, South Africa's major grape exporting competitor, a more advanced system has evolved where the big five exporters there either own, rent or lease the farms and therefore 'take ownership' of a big percentage of the product for export (these Chilean exporters are therefore understandably called grower-shippers).

- Thirdly, producers are forward integrating and becoming co-shareholders of export agents' companies. This is a win-win scenario where the export agent secures a guaranteed supply base, and the producer secures a financial investment in an exporting company that deals not only with his product but with many other growers' products, thereby potentially increasing his profits.

**(3) Foreign importing companies with branches in South Africa** like Vanguard (American-owned) and Van Doorn (Dutch-owned) do not account for a large volume of grape product being exported from South Africa. Their greatest appeal to producers is the relatively 'direct deal' that the South African branch facilitates with the parent company offshore. The South African leg of the business simply streamlines the movement of the product to the destination market, firstly by sourcing the right product, and secondly by assisting with the South African logistical side of the chain. The sales proceeds are paid directly by the overseas parent company into the producer's account, thereby achieving a level of transparency and directness desired by some producers. The FPEF's experience of this type of business model has sometimes been far from reassuring though. A number of industry disputes has surrounded this type of agency model that tends to have a very thin capacity at the South African end, and is subject to the whims of its

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<sup>82</sup> One of the more appealing models in a backward integration deal is the inclusion of black economic empowerment. In a business model that has the farmer, the exporter and the workers all as co-shareholders of the production unit, the export agent effectively secures some of its supplies from historically disadvantaged South Africans. This is a socially responsible act that has considerable appeal to importing companies wanting to support the 'fair trade' concept.

distant parent company's business decisions. With the exit from the FPEF of both Agrimax<sup>83</sup> and Orion Pacific,<sup>84</sup> who typified this business model, it remains to be seen whether this model can sustainably grow its business interests in South Africa in the medium to longer term.

**(4) A single producer that exports his own and his fellow producers' crops** also constitutes a relatively small part of the South African export business. Because there is a natural empathy between producers, one producer moving product on behalf of another producer is an endearing system. Producers like Hoekstra Farms, Suiderland Plase and the more recently established River Fruits<sup>85</sup> are motivated to take other producers' crops to achieve the necessary economies of scale and the associated cost benefits with service providers. Combining neighbouring farm volumes also enables a producer to access the more volume-orientated supermarket programmes. Retailers are tending to buy more produce directly from the farms believing that they are making a saving of the agent's commission in doing so. However, the success of a producer acting as an agent for a few other producers is subject to the business and marketing skills of that producer whose skills are originally of production - not marketing. Producers in this model also need to bear in mind that the bigger the exporting volumes become, the more the business starts to take on the infrastructural requirements - and costs - of a fully fledged marketing agency or producer-exporter marketing cooperative (discussed in the following section).

## 2.5.2 Producer-Exporter Companies

A producer-exporter company can be described as one whose shareholders are the producers that supply the majority of product for export.<sup>86</sup> They could consist of a single

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<sup>83</sup> The manager of the South African end of the Agrimax business left the company, and with no one to replace him, the company is in a state of limbo.

<sup>84</sup> Orion Pacific claimed that it could not afford to pay the various FPEF membership fees (like those levied on the GEF members), and so withdrew its membership. The degree to which foreign owners appreciate the contribution made by industry associations in supplying countries is questionable.

<sup>85</sup> Riverfruit is an agency that was established by Gerhard de Kock, a producer of substantial volumes in the Hex River and Namibia, and who formerly supplied Capespan through the Capespan Grapes Trust. Riverfruit procures table grapes from other producers and sells them on an agency basis.

<sup>86</sup> Interestingly, some of the marketing agents claim to be of the producer-exporter model because a minor percentage of their total product sold is supplied by their own shareholders. Just because supplying producers sit as directors on the Boards of some of the export agent companies, it does not qualify them for producer-exporter status. With the current trend of supermarkets wanting their service providers (category managers) to buy direct from producers, it is simply a case of these marketing agents spin-doctoring the overseas buyer into believing that the product can be acquired 'as directly' as through the genuine producer-exporter channel.

producer marketing his own product like the Le Roux Group or Karstens Boerdery,<sup>87</sup> to a group of 40 producers or more marketing their own product through their own export houses, like EXSA and Fruits Unlimited. The ideal number of producers in the bigger 'marketing co-operative' type of export business model depends on the number of cartons that need to be packed, the varieties available and the spread across the production regions (to capitalize on all of the marketing windows available to South African product). Samuel Pieterse of EXSA claims that his company retains enough producers to market 10% to 12% of the South African product volume - big enough to be taken seriously by the international buyers, and small enough so as not to attract unnecessary attention from industry competitors. The following are the benefits associated with the producer-exporter model:

- (1) The sales office can confidently generate its marketing plan knowing that it has consistent producer representation with a guaranteed supply base. As a result, the sales office can also develop a market-led varietal mix amongst its shareholders,<sup>88</sup>
- (2) The trust and transparency that are indigenous to this business model are also of benefit to the producers that are essentially shareholders of their own export company;
- (3) Producer-exporter companies can save on procurement costs,<sup>89</sup> since the product is already in-house via its shareholders;
- (4) It is not necessary for shareholders to guarantee themselves minimum prices or to insist on advance payments – sufficient confidence prevails in a company that is essentially managed by the shareholders' employees or the shareholders themselves;
- (5) Capital is not absorbed either in cross-subsidizing one producer with another, or in non-core business activities which can often be the case in a marketing agents'

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<sup>87</sup> Karstens Boerdery, formerly a supplier from the Orange River to Capespan through the Capespan Grapes Trust, now markets its own product through its marketing company New Vision Exports. Karstens Boerdery has also purchased or leased production units in other grape-producing countries. This enables Karstens Boerdery to supply supermarkets with grape product outside of South Africa's traditional marketing windows - a model that starts to resemble that of a 'multinational producer-exporter'.

<sup>88</sup> An advantage of the producer-exporter business model is the on-farm varietal changes that the marketing department of the producer-exporter company makes to its shareholders. EXSA's Managing Director, Samuel Pieterse states that with sophisticated computer models giving technical and marketing considerations to each individual shareholder's varieties and volumes, the producers are motivated to take seriously the market-led advice given to them by their own company executives.

<sup>89</sup> Procurement costs are not saved in their entirety because there is more to procurement more than just concluding a contract.

business model. The focus is on minimizing the costs and maximizing the returns back to the producer-shareholders;

- (6) This model enjoys revenue recognition in alignment with the total turnover achieved in product sales - not just the ad valorem commission on the sale as is technically the case for marketing agents. The ramifications are that turnover is higher, borrowings easier and cost of borrowing cheaper. Capital requirements for expanding the producer-exporter's market base, for example, are readily forthcoming from lending institutions.

The drawback of the producer-exporter model - especially amongst the larger producer-export houses - is that there can be too many shareholders who all need to be heard by management, many of which would prefer their own interests to be prioritized above fellow shareholders. Marthinus Strauss, MD of Capespan Grapes at the time noted in the Capespan Courier (2005) that decision-making can become unwieldy when too many producers are involved in this type of model. Part of the difficulty is determining the fairest pooling system to be used. For example, a sought after supermarket programme with a limited volume off-take cannot be served by all the producer-shareholders in the company (where there is more product available of the required specification than required by the supermarket). Deciding which producer-shareholders supply these sorts of programmes leaves management exposed to criticism, even if nepotism is sheer perception. Samuel Pieterse claims that to placate their shareholders in such matters, they pool the returns of their growers by market, by week, and pay the average return to each producer. Whilst it is management's task to try and satisfy the supplier-shareholders by ensuring that their returns are consistently acceptable and that systems implemented are fair, this is not always possible in this business model.

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## 2.6 Procurement Strategies of the Marketing Agents

There were two important issues behind the race to procure table grapes by the marketing agents early in deregulation. Firstly, realizing the importance of marketing top quality fruit, exporters all targeted the finite number of top quality producers available to them. Attaining top quality product from reputable producers would not only give the successful exporters a competitive edge with discerning UK supermarket buyers; it would also minimize quality claims in the chain. Secondly, procuring substantial volumes would give the early exporters the economies of scale so vital to securing substantial credit lines and rebates from various service providers in the chain. In consignment business, once the agent's fixed office costs have been covered, profits are directly proportional to volume-based commission. This afforded these exporters certain additional opportunities like chartering their own vessels, and procuring the services of technical field staff to assist their producers with production matters. And it further entrenched the capital requirements needed by smaller exporters to compete against them.

This section examines the procurement strategies that the bigger exporters<sup>90</sup> have exploited over the course of deregulation to keep smaller export companies out of the mainstream of the table grape export business. In the first few years of deregulation, certain market forces entrenched the position of the bigger export agents in the industry, and they were as follows:

- (1) Many conservative producers were unwilling to be 'experimental farms' for inexperienced agents, and preferred to stay with the former monopoly, Unifruco (later Capespan) whose 'Cape' brand and loyal customers appeared to remain a safe haven for them. These same producers chose to wait and see what transpired in the exporting arena before spreading their product - and their risk - amongst a number of other competing exporters. In 2001, 90 such producers who could have 'gone it alone' decided to join forces with Capespan and formed a Trust in which prominent producers were elected as trustees. Marthinus Strauss recounts the establishment and motivation behind the Trust as follows. The producers in the Trust felt that in combining their resources they could have a greater say and control over the export of their product. They also realized that if they should compete directly with each other, the industry and its export effort would become

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<sup>90</sup> For the purposes of this dissertation, the top 20 exporters can be considered as those members of the FPEF illustrated in Table 2.6. However Hoekstra Farms, New Vision Fruit (Karstens Boerderij) and Riverfruit (Gerhard de Kock) are notable omissions from the FPEF membership list.

more unstable. As a producer group they negotiated with Capespan to put their grape business in a separate company called the Capespan Grapes Trust (Pty) Ltd, in which they had a 50% stake. This would provide them with control and a share in the profits. In turn, the group was to supply its product to Capespan Grapes on an exclusive basis and guarantee an agreed supply volume. Essentially, Capespan traded some company control and a share of the profits for security of supply. This lasted for four years but for a host of reasons unity of vision could not be maintained, and the structure was dissolved in May 2005.

- (2) At the time of deregulation, multinational companies like Dole, Katope, Unifrutti, Del Monte (at the time) and Capespan started investing in the South African fruit export environment. They brought foreign currency, established offshore markets and powerful brands with them, including financial offerings for their producers in the form of production loans, disbursements, minimum guaranteed payments and paid directorship positions on export company boards (the financial tools that the exporters used to procure product are comprehensively covered in section 2.7 that follows). These activities all raised the financial barriers that the smaller and newer exporting firms could not hope to match.
- (3) Part of the volume-seeking strategy by the bigger exporters was the growth in market share that it afforded them. If an exporter was unable to secure sufficient access to the supermarket buyers,<sup>91</sup> he was able to buy market share through predatory pricing, and run the product as a loss leader for a while if necessary. A keener price to the supermarket could lead to a greater allocation of product volume by the supermarket to that exporter. To further entrench their positions with supermarkets, the bigger exporters offered the supermarkets post-season rebates<sup>92</sup> to lure them into switching additional volumes to their businesses (now supermarkets are in such a commanding position that they actually demand these rebates from their suppliers through an upfront, tendering system<sup>93</sup> where the supplier's rebate is included in the supply price). Once an exporter had developed a significant programme with a supermarket, it was very difficult for another exporter company to unseat such an established relationship.

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<sup>91</sup> Most UK supermarkets do not deal directly with a South African exporter, but rather through an importer or a service provider.

<sup>92</sup> A rebate is a volume-related discount that, in this case, the exporter would give to the importer at the end of the season based on how much fruit the importer had bought from him.

<sup>93</sup> Due to the market power enjoyed by the supermarkets today, exporters are forced to offer rebates as part of their 'supply quote' to the importers. If their quote is accepted, that rebate comes off the top of every invoice as the season progresses - regardless of what actual volumes have been purchased by the end of the season.

- (4) Much of the early trading (1998 to 2001) took place in an enormous information vacuum. Multinationals were at a distinct advantage since their overseas offices could secure vital market information, timeously and cheaply. The bigger export companies could, at a price, buy similar information. But the smaller export companies, relying on industry bodies to provide information to make their decisions, were hamstrung by the fragmentation and dearth of industry information so prevalent in those early days. This asymmetrical information so rampant in the industry was also a disadvantage to those producers who were big enough to possibly export their own product, but who were effectively barred from doing so due to a lack of market intelligence available to them.

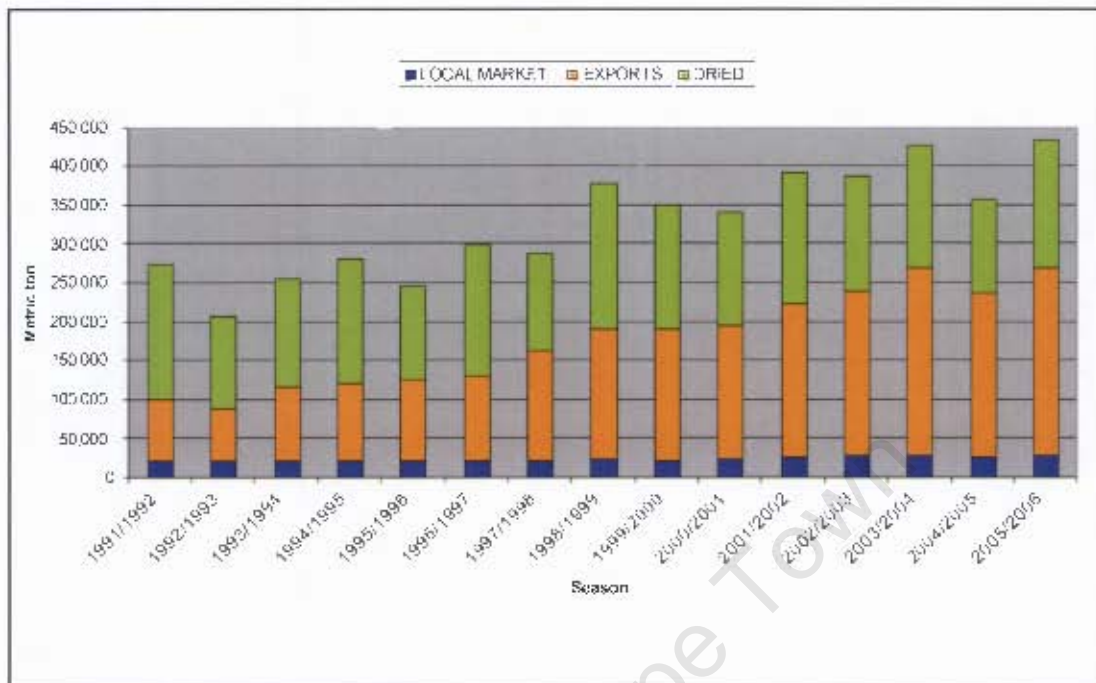
By the time the 2000/2001 season had arrived, the overseas markets had been over-supplied by overly competitive South African marketing agents.<sup>94</sup> The situation had been exacerbated by one critical fact that many industry role-players somehow tended to overlook: that there was a minuscule local market opportunity for the volume of table grapes produced. The local market for South African table grapes has been statically small for 15 years, as indicated by Diagram 2.10. This effectively meant that there would be as many exporters as there were willing producers to supply them with the product. And with the early and bigger agents having already secured the top quality produce, the remaining produce had to be offloaded, sometimes in desperation, to unqualified and sometimes unethical<sup>95</sup> export agents. In cases where the producer had product of mixed quality, the exporter was often coerced by the producer into taking his good product with his not-so-good product. If the exporter refused, there would be a high chance of him not being able to procure any fruit at all from that producer again. The burgeoning over-supply of South African volume in the European market also caused South African exporters to compete against one another – but with the same producer's product.

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<sup>94</sup> It was also a case of too much product entering the EU market simultaneously via South Africa's competitors like Chile, Brazil, Peru and Argentina.

<sup>95</sup> The ease with which exporters could exit the table grape export industry probably peaked in the 2000/2001 season. Liquidations of marketing agents were more commonplace, either because the agents had miscalculated the intricacies of the business, or because self-liquidating agents actually facilitated defrauding producers. With few sunk costs for many of the 'one-man-band' export agents, the exit barriers were extremely low. To add insult to injury for the producers, a lack of industry institutional power and an impotent South African law seemed incapable of preventing the owners of previously liquidated exporter companies from starting up a new export business under another company name.

Diagram 2.10 The Local Market versus the Export Market (1991 - 2006)



Source: DFPT (2006a)

At this juncture, many producers faced bankruptcy for a number of reasons. Firstly, some had not received their proceeds for their crops from their errant exporters. Secondly, those who had received a sales account had experienced very poor financial returns, and many producers were actually required to pay in.<sup>96</sup> And thirdly, those producers who had ventured out to do their own exporting had misjudged the different set of business skills needed for marketing and selling a crop as opposed to producing a crop.<sup>97</sup> Eventually producer profits were eroded to such a degree that it caused a producer revolt after the payouts (‘or pay-ins’) of the 2000/2001 season.<sup>98</sup>

The 2001 winter of discontent saw the birth of Section 21, regional producer associations, namely the Hex River Table Grape Association (HTA), the Berg River Table Grape Association (BTA), the Orange River Producers’ Association (ORPA) and the Northern

<sup>96</sup> If the price realized for consigned grapes in the market is lower than the costs incurred by the exporter in getting the product to the market (exporters often finance these costs on behalf of the producer), then the producer has to ‘reimburse’ the exporter the costs incurred. This reimbursement by the producer to the exporter is defined as ‘paying in’ because normally the exporter would be ‘paying out’ the producer with sales proceeds.

<sup>97</sup> Many a financially-stricken producer has tended to procrastinate the emotionally charged decision of exiting the industry since he has enormous sunk costs in his farm, usually knows no other career, and has nowhere to go considering that his farm is also his home. Even if a producer is liquidated, the table grape farm destined for auction normally has its fruit re-integrated into the production system via another producer buy-out. So the much-needed South African volume reduction - for supply to balance demand - does not materialize. Martinus Strauss believes that supply and demand dynamics are playing as big a role in determining the state of affairs in the industry as intra-industry competitiveness (amongst exporters) and the consolidation of supermarkets for example.

<sup>98</sup> A fact that is often overlooked here is that the 2000/2001 season was generally a very bad fruit-trading year for fruit suppliers globally.

Province Table Grape Association (NTA). The motivation behind their start-up was the unacceptably poor financial returns as a result of the ill-disciplined export agents that were too many in number, and overly competitive in nature. Export agents wishing to procure product from the various regions would, in future, have to be accredited with the producers' regional offices. The regional producer accreditation criteria varied slightly from region to region, but were subject to each individual export company signing a contract with the regional association to qualify for receiving product from producers in that region. This process was controversial because it was:

- (1) Conditional to the exporter providing his sensitive marketing information to the production region's governing body which included disclosing his customer names, the varieties and the volumes delivered in each sale's week; and
- (2) Based on a minimum volume off-take (for the Berg River region only) of around 200000 cartons per exporter. This minimum off-take would have entirely eliminated the smaller export agents, some of whom serviced niche markets very effectively for the smaller producers. The exporters challenged the minimum volume concept as being unconstitutional, largely because it also flew in the face of government policy that supported small, micro and medium enterprises (SMME) and black economic empowerment (BEE) companies which tend to be small volume players.

This producer accreditation process marked the first 'manufactured entry barrier' established in the post-deregulation period to ostensibly reduce the number of market agents operating in the production regions. The producers claimed that they were not deliberately excluding export agents based on their size, but instead were trying to curb inexperienced agents - who did not have established clients overseas - from procuring fruit. However, these producer associations were in no legal position to prevent producers, as owners of their own product, from arranging the marketing of their own grapes through a marketing agent of their choice, or from marketing their own crop.<sup>99</sup>

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<sup>99</sup> As far as the accredited exporters in the FPEF were concerned, many of those producers trying to export their own crop were just as capable of inflicting much damage on the markets as the small, unaccredited and relatively inexperienced export agents. In addition to this, exporters were distrusting of the producers (in the producers' association) who were responsible for vetting their sensitive, marketing information. What would stop an entrepreneurial producer from using that information to set up his own export company and going it alone? To this day, GEF members believe that, in two separate cases, the compulsory submission of their highly confidential information led to the abuse of that information that aided the establishment of two producer-led export companies.

Reluctantly, the majority of exporters conformed to the producer associations' draconian contracts. However the agents that were accredited with the FPEF<sup>100</sup> were in no mood to risk the supply of their product being cut through vengeful or misguided producer association personnel. Exporters were concerned that producer associations might encourage producers to export their own product, or insist that product from a region be given only to a few select export agents. In a show of countervailing power, these agents organized themselves into a sub-chamber of the FPEF called the Grape Exporters' Forum (GEF) to deal exclusively with the management of their relationship with the producer organizations. This body convinced the producer associations that the management of exporters should be left to the devices of its own association. By the 2002/3 season, the producer associations determined that only export agents that had achieved FPEF accreditation were entitled to product from their regions – with a couple of exceptions.

For new exporter entrants and for existing agents operating outside of the GEF, the barrier for procuring product had been further raised. The accreditation criteria established by the FPEF were, in a sense, more stringent than those imposed by the table grape producer associations themselves. For FPEF agents, accreditation involved, inter alia, signing a very strict Code of Conduct, lodging copies of marketing agreements with the FPEF's secretariat and opening producer trust (banking) accounts<sup>101</sup> to avoid producer monies from becoming attached to liquidated exporters' estates.<sup>102</sup> The FPEF had also become the secretariat of the registered Export Council with the dti, which entitled its members to substantial financial assistance towards its members' collective marketing campaigns.<sup>103</sup> Without membership to the FPEF access to the product had indeed become very difficult, but largely at the behest of the producers.

In more recent years, additional procurement strategies have been adopted. Some exporters have secured the rights to new grape varieties from overseas plant cultivators. These varieties are then issued (sometimes in restricted quantities) to producers who are contractually bound to deliver the crop to the exporter concerned. In other procurement

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<sup>100</sup> The Fresh Produce Exporters' Forum (FPEF) is the only Forum in South Africa accrediting export companies of all fresh fruits. Members are required to sign a strict Code of Conduct that governs various aspects of agency business.

<sup>101</sup> This trust account is not required by SA law (as is the case for estate agents' establishing trust accounts for example), but instead is required of the FPEF's members as signatories to the FPEF's Code of Conduct.

<sup>102</sup> In late 2004, during the liquidation of a non-accredited export agent, the affected agent went as far as to suggest that it had been the victim of an FPEF cartel of exporters protecting its already established members by controlling the supply of product through exclusive arrangements with industry producers.

<sup>103</sup> The FPEF is the registered Export Council with the dti which has financially assisted its members with regard to (1) hosting international trade fairs annually in many of its major markets; (2) conducting outward selling missions to customer countries; (3) conducting inward buying missions by bringing major international buyers to meet the FPEF exporters; and (4) producing, printing and distributing, worldwide, Export Handbooks listing its members as South Africa's accredited export companies.

strategies, exporters have integrated backwards and purchased shareholdings in farms in order to secure future grape supplies. Forward integration by producers into export houses has also been a strategy whereby exporters secure product by their suppliers acquiring an interest in their businesses. Those producers who have chosen to do their own exporting (and have sufficient economies of scale to do so), have been able to circumvent the procurement strategies adopted by exporters over the deregulated period.<sup>104</sup> Their product is mostly excluded from being available to agents, and as more producers and producer alliances take on the marketing function, procurement will become more of a challenge to under-supplied marketing agents in future.

Of concern is the inability of historically disadvantaged individuals to penetrate the grape export sector in any meaningful way due to the entrenched procurement strategies of already established agents. Many existing role-players would argue that these procurement barriers are healthy, because deregulation has cost the industry dearly. Had there been no intervention by the producers to discipline the exporters along the way, the industry might have self-destructed further. In that case South Africa may well have lost valuable market-share to its growing competitors in the Southern Hemisphere, and become a shadow of its former self as a world leader in the marketing of fresh table grape products.

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<sup>104</sup> Some of the bigger volume producers who left the Capespan fold were able to buck the trend and 'go it alone', especially since they were already known in the marketplace for their fruit, albeit via Capespan.

## **2.7 Financial Procurement Tactics Used by Exporters**

### **2.7.1 Contracting with a Minimum Guaranteed Price (MGP)**

In managing his risk, an exporter needs to decide whether or not it is feasible to give a producer a minimum guaranteed price in order to secure his product. Where an exporter willingly offers a producer an MGP for his product that he is confident that he can sell at a particular price, and for which he is prepared to take that risk, then that MGP becomes a natural element of a consignment deal in a free-market system. Marthinus Strauss declares that exporters might give producers an MGP for some undisclosed strategic reason like strengthening its position with early product, servicing a programme to an important customer where stock is in short supply and securing a specific (leading) producer for his supply base. Chris Conradie claims that exporters might use MGPs to procure fruit from new producers where using other company resources (like executives' time) to win the trust of that new producer is too time-consuming to justify. This is especially the case if it is a small volume of fruit, and if it is considered probable that the new supplier might not stay with the exporter after the first year of supply.

All MGPs are essentially conditional to the producer satisfying a number of requirements in full, namely delivering the agreed quality specifications, in the designated weeks and at the specified volumes. Only part delivery thereof usually renders an MGP null and void, making it a brittle financial instrument. Gaby Gess advises exporters that such an MGP is legally enforceable by a written, contractual arrangement between the two parties, but that there should be clarity between the parties as to whether the MGP is payable per carton exported, or payable as an average per carton exported over the whole season.

In theory, consignment sales provide the producer with the highest financial returns. However it is attractive for some producers to 'sell' part of their risk in the form of an MGP to his exporter. In a sense, MGPs encourage a more calculated approach to consignment business by both producers and exporters. A producer will be incentivized to grow a top quality product knowing that an exporter will make use of an MGP to procure highly marketable fruit from a reputable producer. The producer is comforted by an MGP for mainly two reasons:

- Firstly, it avoids the producer carrying all the risk in a consignment deal where the commission-based exporter theoretically carries no risk at all – only a reduced commission in the case of a reduced selling price.<sup>105</sup>
- Secondly, an MGP can cover a large percentage of the grower's production cost, and is ideal if it approximates his break-even cost. Mike Grobbelaar is adamant though that the good growers find the good exporters who find the good markets, and these growers do not insist on an MGP from their exporters. For an exporter, agreeing to an MGP only creates potential downside risk for him, and so he has to build in an increased margin to accommodate the risk. The anticipated market price that makes the exporter's additional risk appear commensurate to reward - at the time of the procurement - may not materialize. This is due to the many and varied forces affecting the sales prices of fruit in the market place (Symington, 2003) – particularly the practice of over-procurement by supermarket buyers.

In practice, however, an MGP does tend to produce undesirable results. The short-term, overt unpleasantness of an MGP is the acceptance by a producer of an unrealistically high MGP from a reckless exporter where both parties have scant regard for what the market can actually afford. The market rarely pays a premium for a producer who demands an MGP, let alone one that is extortionate. The FPEF secretariat can testify to the number of mediations that have occurred around such deals which usually have no accompanying contract, and that incur financial losses for both the producer and the exporter. The unhappy conclusion of these circumstances is that the producer consumes resources trying to recover the unpaid balance of the MGP from the errant exporter, while the exporter erodes his income statement further with every payment that he is required to make towards that MGP. As one exporter cynically inferred, in cases where the MGP per carton is noticeably higher than the production cost of the carton, the producer is attempting to transfer the risk to the exporter and secure guaranteed profit in the deal for himself. Producers who do this are sometimes unsure of their costs - as hard as this may be to believe - and they therefore peg an MGP where they *think* they have safely covered their own costs. Hubert Leclercq states that the circumstances surrounding an MGP that is pegged at or above the production cost simply reduces it to being a 'maximum' guaranteed

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<sup>105</sup> Marthinus Strauss notes that most producers do not mind paying a higher commission when they are making money or getting higher than expected prices. However, most producers would like to see their exporters suffer with them when the proceeds are lower than expected. He further notes that some exporters take 0% commission when proceeds are less than the advance payments made (advances are explained in the next section).

price. In this case the producer will not see any additional income from the market above this kind of MGP.

The longer-term problems associated with an MGP are somewhat more latent in the value chain. In a sobering statement, Louis Kriel (snr) claims that the exporter is simply not making a big enough margin to support an MGP. So he fetches it from elsewhere in the chain, and the MGP can be considered a form of subsidy. Exporters in such cases tend to revert to the cross-subsidization opportunities afforded them by the pooling system that is legitimately used by shipment, or by market per week. Those producers without MGPs could subsidize those producers with MGPs. Or those producers in the early growing regions (with premium market prices) could subsidize those producers in the later growing regions. The point is that the gross income of the industry is unlikely to increase as a result of the implementation of an MGP. According to Leon van Biljon, a more serious defect of MGPs that directly compromises the competitiveness of the industry is as follows. An MGP forces a receiver overseas to set a minimum price (to his customer) to accommodate the MGP. But if the competitor's consignment price to that receiver is lower than the South African MGP, it skews the marketing of the South African product. The receiver stores the South African fruit until he feels he can sell it at the price required and if it remains unsold by its sell-by-date, the quality claims start appearing. The moral here is that the flow to market of a perishable product should never be inhibited, otherwise it becomes problematic.

Due to the recent parlous financial state of the industry (brought on by the 2003/4 and 2004/5 seasons) producers have mooted the possibility of implementing an industry-wide MGP. An industry-wide or blanket MGP is essentially a floor price. The concept of a floor price was tested three years ago in the citrus industry, and the writer compiled a document for the citrus industry that carried the following message. The use of a floor price in the 2003 citrus season penalized the exporters because exporters landed up subsidizing producers in markets that collapsed. The floor price concept was also flawed from the marketing agents' viewpoint because producer-exporters landed up selling some of their product to marketing agents at the floor price, and then going into the markets themselves with the balance of their product and selling it to buyers under that floor price.<sup>106</sup> This action effectively sabotaged any potential profits for the commission-seeking export agents. The 2003 floor prices were applied to citrus exporters in the FPEF only, and so a mob of free-riding exporters outside of the FPEF circumvented the floor price, making a mockery of the

concept. These issues, and others, undermined the original intent of the floor price in the citrus industry, which was for exporters to share some of the risk in consignment sales. The floor price also turned out to be the level to which most prices eventually gravitated - because it was perceived by exporters and importers to be the absolute minimum price that producers could tolerate. Instituting a floor price therefore served to be a price-deteriorating and self-defeating exercise.

Despite this, table grape producers - in a collective bargaining approach - have entertained asking for an industry-wide MGP for the following reasons:

- (1) Producers would prefer *to share the risk in consignment business more equitably with the marketing agents*. And they would like to do so by being given some type of guaranteed return in the form of an MGP by the exporter. But asking exporters to now share the risk of a decision that producers took many years ago when they decided to invest in the ground is a controversial perspective on risk sharing – especially in agency-orientated business.
- (2) Producers would prefer *exporters not to put grapes into overseas markets without programmes* (i.e. without a firm buyer for the product) *unless they are prepared to pay producers an MGP for that (unprogrammed) product*. At first glance, it is a logical statement – fruit without an address on it is destined to flood the markets, and prices for that fruit will in all likelihood yield inferior returns. It will also put the prices of programmed fruit under pressure. However the mere request of an MGP in such circumstances is flawed, since South Africa's grape production volumes way exceed what the local market can absorb, and many grape producers are forced to find an income for their produce abroad - with or without an address on it, and with or without an MGP attached to it.
- (3) Producers would justify an MGP on the grounds that *only good quality<sup>107</sup> fruit would leave the country if exporters were made to pay a minimum price for product worth paying for* - and to leave behind fruit not worth paying for. Putting quality product in the market place is considered a cornerstone of the industry's competitiveness, so if a 'minimum guaranteed price' equated to a 'minimum guaranteed quality', then it

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<sup>106</sup> Producer-exporters, whether they sell to export agents at all or go into the markets themselves, are unaffected by a floor price and so will always be potentially more price competitive in the market than an agent who has had to pay a floor price.

<sup>107</sup> *Quality* refers to the specifications to which fruit is packed at source, namely class, size, variety, sugars to acid ratios etc. *Condition* refers to the state in which the fruit arrives in the market some weeks after being packed.

would be worth considering from an exporter's viewpoint. However the following systemic problems militate against the hypothesis that better quality fruit would reach the markets if an MGP was in place:

- (a) Exporters, lacking confidence in the current quality control systems in the country, would not wish to implement MGPs because sub-standard quality fruit can be 'hidden' in the system. Anecdotal evidence suggests that poorer quality fruit tends to be located in the centre of pallets which fruit inspectors are unable to reach through time, volume and manpower constraints. Francois Smit, PPECB National Programme Manager: Grapes says that, in his experience, the financial incentive systems that most producers have with their pack house managers encourage volume rather than quality to be packed.
- (b) Further to this, an exporter that has not wanted to take a producer's poorer quality product in the past has been pressurized to do so on the basis that if he wanted any product at all, he had to take the 'good with the bad'. Otherwise the producer would find another exporter to oblige him. Jan le Roux, a producer himself, states that unfortunately, producers tend to want to sell their worst fruit under such conditions, and this simply makes the cost of doing business more risky and therefore more expensive.
- (c) Fruit can deteriorate unexpectedly en route to the market, leaving an exporter stranded with product he is unable to sell at an MGP-related price. Poor fruit condition on arrival in the market can be due to an unfortunate quirk of Mother Nature. It can also be the result of technical failure or mismanagement of the product in the cold chain, and in this case there are potentially as many culprits as there are technical complexities. Mike Grobbelaar feels that fruit landing in poor condition in the market also drags down the price of good quality fruit in the same market which may have an MGP attached to it. To then assign the accountability of prices via an MGP to an exporter under these sorts of circumstances is considered unreasonable.
- (d) Some exporters would argue that an automatic MGP would breed complacency in producers who could have their costs essentially covered by

an MGP. There would be no further incentive to lift quality if the notion of a pre-paid price was on the table before the grapes were harvested.

In conclusion then it seems that the quality of the product, the quality of the industry inspection systems, the quality of the technical performance in the value chain and the quality of the markets cannot be consistently guaranteed to make provision for an industry-wide MGP. And it would be a tricky exercise trying to determine where that industry-wide MGP would be pegged, because producers can have vastly different costs from one another. As long as agency business continues to operate successfully for those producers and exporters that remain profitable in exporting table grapes, exporters cannot be expected to carry risk for the producers through blanket-MGPs. However, those producers who successfully command MGPs from their exporters on a one-to-one basis will continue to do so based on sound production quality, and sound business practices. It will also depend largely on whether markets are under-supplied or over-supplied at the time. If producers understand their costs well - and there still seems to be doubt about this - then they should have a good understanding of where to peg an MGP - certainly not above cost, as that is total transference of risk from the producer to the exporter plus a guarantee of profit for the producer. Perhaps then an MGP should more sensibly be called an MCP – a minimum cost price. Producers could then look to incentivizing their exporters to fetch optimum prices by creatively profit sharing on the differential between cost price and final price.

### **2.7.2 Managing Risk Associated with Monies Advanced**

A significant number of South African grape export companies have been established by entrepreneurs in the last ten years, many of whom have had a limited understanding of the financial and legal implications of their dealings – particularly with their producers. Giving a producer an advance payment<sup>108</sup> can constitute a substantial risk to the financial well being of the exporter, and therefore the stability of the industry as a whole. In order to secure their supply bases, exporters have fast become finance houses in an industry where many producers are illiquid and some even technically insolvent. Commercial banks have traditionally loaned monies to the producers based only on their fixed assets, namely the value of their land. But the value of the vineyard (and its future harvests) can exceed the value of the land, particularly in weak property markets and a weak rand exchange rate

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<sup>108</sup> The advance payment is commonly known in the South African fruit exporting environment as a 'voorskot'.

environment. Exporters have capitalized on this by securing their advance payments to producers by taking out various forms of security on their producers' moveable assets, most notably their harvests. Whilst the financing of producers by exporters may be controversial (in that producers land up being financially beholden for years on end to non-financial institutions like export companies), it is an economic reality - or market force - and a means by which many a producer has lived to fight another season. But in doing so, exporters have unwittingly procrastinated the inevitable demise of those producers who have not altered their business practices to meet the demands of the modern fresh produce industry. The knock-on effect is that production practices, business practices, volumes and varieties have remained in the system that should have been eliminated, and this is compromising the industry's competitiveness.

Monies are 'advanced' by an exporter to a producer through *loans*, *disbursements* and *MGPs*. In the table grape export industry, money given to a producer in advance of fruit being delivered is categorized as a loan. Whilst this type of loan is ostensibly a 'production loan' and is normally used for picking, packing and packaging costs incurred by the producer, it can actually be used for any purpose. For the exporter though, it is a high-risk loan for several reasons: (1) inclement weather can damage the fruit's quality before its delivery; (2) a producer can unexpectedly give his grape crop to a competitor without warning and contrary to an established (normally verbal) agreement; and (3) a producer can be liquidated after being given the loan and before delivering the fruit. In all three cases, the exporter has loaned the producer money with the potential of not realizing some (or all) of the crop for export. In addition to this, even if the producer delivers the agreed volumes of fruit to the exporter, the market could still yield a poor return preventing the producer from paying back this loan timeously to the exporter. This loan is essentially therefore a relationship-based one, where the exporter is satisfied with the trust that exists between himself and his producer. However such a loan always carries a procurement hook. For as long as farmers insist on their businesses being funded up front by their exporters, so exporters insist that the fruit is guaranteed to them in return for the funding. Those exporters who have a strong cash flow are well positioned to finance needy producers, and can therefore compete very favourably for product, especially in financially difficult times.

Only once the product has been delivered to the exporter do monies advanced to a producer fall outside of a loan status. Two types of 'advances' occur under these

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circumstances. **Firstly**, the exporter often incurs costs in the chain from the farm to the overseas market, and such costs are classified as disbursements made in a consignment deal by the exporter on behalf of his cash-strapped principal. Such costs are typically encountered in transporting the fruit to the port, shipping the fruit overseas, and storing it in destination markets. The net return to the farmer is ultimately calculated as the income for the product minus all of the disbursements made by the exporter on his behalf. Such monies are recovered by the exporter only after the sales proceeds have been received from the overseas customer.

**Secondly**, the exporter may agree to give his producer a portion of the anticipated selling price of the fruit in the market as an advance payment. This early payment usually assists the grape farmer with his essential post-harvest farming activities and their related expenditures. However, it is the refundability of such advance payments that causes consternation. This is partly because the conditions surrounding such payments are rarely documented in a written agreement between the two parties, and partly because of the complicating factors like MGPs and quality claims that often enter the financial equation of a consignment deal. In a fixed price deal, an advance payment is naturally not refundable. But in agency business (which is relevant here), an advance payment is refundable if the market price of the fruit does not realize the amount advanced to the producer. There is a mitigating factor though. If an advance payment forms part of a minimum guaranteed price (MGP) given to the producer by the exporter, the advance payment is not refundable if it is less than or equal to the MGP agreed upon - regardless of the return in the market for the product. However, the situation is made more complex when a quality claim is introduced. If a substantiated quality claim is tabled, advance payments are refundable, regardless of whether or not an MGP is in place – as long as the exporter has not been negligent with the product. But spurious claims and negligence on behalf of the exporter are often difficult to prove, so a grey area of the business is spawned. In practice, financial shortfalls arising in such circumstances are often carried over by the exporter into the following season, on the agreement that the same producer and exporter will attempt to rectify this shortfall in another joint export effort. However, if a similar incident recurs for two or more consecutive seasons, the producer's indebtedness to the exporter spirals into a type of debt-trap, and the farmer can find himself financially obligated to an exporter to an unhealthy degree, and for a seemingly indefinite period.

The question that arises at this stage is whether exporters and producers are fully conscious of the implications of their dealings with one another; or whether the cocktail of ignorance and grey areas in the legal and financial domain of the business is used as an

excuse to secure deals unfairly and unethically from one another. The solution to this dilemma lies in both parties understanding exactly what their legal rights are in agency business, being streetwise around the pitfalls, and of course being principled in their business dealings. Two cases in the 2004/5 season highlight the risks attached to advance payments for exporters.

- (1) In the first case, a Berg River producer sold his crop four times to four different exporters (all GEF members) and took an advance payment from each exporter. When it came to the delivery of the product, each exporter – unbeknown to the other – only received 25% or less of the crop. The exporters eventually determined that there were four of them involved, and their joint legal advisor stepped in to try and recover the monies. In the meantime, the agents were left scrambling for product to placate their short-delivered customers.
- (2) In the second case, an exporter loaned a producer in the Orange River R650000 to secure his total crop for the season. There was a written agreement in place regarding the production loan including the delivery conditions of the crop to the exporter. Despite this, the producer delivered his entire crop to the exporter's competitor without notifying him. By the time the original exporter's delivery was due for expectant customers, there was no product left on the farm. This producer has since been liquidated, and the exporter not only has a disgruntled customer base, but also a R650 000 debt to try and recover.

The FPEF, often expected by producer associations to investigate such alleged misconduct of its own members through mediations and arbitrations, brought both cases to the attention of the producer association, but no action could effectively be taken.<sup>109</sup> In this regard, Gaby Gess believes that the FPEF has, to date, played a greater role in the industry than the statutory organizations when it comes to dispute resolutions.

With loans, disbursements and MGPs, the financial risks associated with exporting a perishable product like table grapes can be high for the exporters. Various forms of security need to be carefully considered by exporters when competing for product. The two tables

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<sup>109</sup> The Deciduous Fruit Producers' Trust (DFPT) is the producer association to which the table grape producers pay their statutory levies. If the DFPT had a Code of Conduct and if it found the producer guilty of misconduct, what could the association do? It has no power to terminate the membership of the producer (where termination is a form of punishment) because by statute, the producer has to belong to the DFPT. 'Naming and shaming' is a possible remedy that has been used quite effectively in the past in the relatively small, but geographically concentrated export sector. But due to the geographical dispersion and the isolated existence in which many producers live, the practice of 'naming and shaming' is unlikely to have the desired effect.

that follow, table 2.11 and table 2.12 (Gess, 2004) should be read in conjunction with one another.

**Table 2.11**

<b>Loan Scenarios</b>	<b>Disbursement Scenarios</b>
<p><b>L1</b> Fruit on the tree</p> <p><b>L2</b> Fruit picked but not packed</p> <p><b>L3</b> Fruit picked and packed, but not yet delivered</p>	<p><b>D1</b> Fruit delivered to exporter at agreed point of intake</p> <p><b>D2</b> Fruit physically delivered to importer, but payment not yet received from importer</p> <p><b>D3</b> Fruit partly sold, with some payment received from the importer, some disbursements made.</p>

**Table 2.12**

<b>Security</b>	<b>Loan Scenarios</b>			<b>Disbursement Scenarios</b>		
	<b>L1</b>	<b>L2</b>	<b>L3</b>	<b>D1</b>	<b>D2</b>	<b>D3</b>
<b>Mortgage bond Immovable Property</b>	Effective if fruit stays on tree	Not applicable – fruit no longer attached to the land		Not applicable		
<b>Special Notarial Bond - Movables</b>	Not applicable, as the fruit cannot be separately described and identified			Not applicable		
<b>General Notarial Bond - Movables</b>	Not applicable, the fruits are not movable and separate from the land	Applicable, but no real right and security unless the fruit taken into the possession of creditor		Applicable, creditor secured as property is in his possession	Not applicable, no longer in possession of the creditor	
<b>Pledge</b>	Not applicable	Only effective if the fruit is taken into the possession of the creditor		Applicable, the pledge has been perfected because the	Not applicable – no longer in possession of the creditor	

			property is in the creditor's possession	
<b>Cession</b>	Not applicable		The right of the debtor to receive payment can be ceded in security for the debt to the creditor	
<b>Lien</b>	Not applicable – not in possession of creditor		Applicable in so far as it relates to expenses incurred in respect of the property or other debts	No longer applicable, not possession of creditor
<b>Suretyship</b>	Liability is that of surety for the debt of the principal debtor			
<b>Bank Guarantee</b>	Liability is that of the guarantor of the debt			

Source: Gess (2004)

These two tables illustrate the relationship between monies advanced and whether the advance forms part of a loan or a disbursement. They also show the different stages of fruit preparation and delivery, and what appropriate securities can be sought by table grape exporters to protect these advance payments. Without this knowledge, and therefore without the securities in place, exporters can incur enormous costs through the provision of finance to, or on behalf of, their producers. As has been stated earlier, not enough attention has been given by the exporters (and their producers) to the financial and legal aspects of this part of the business. The result is that unmanaged risk costs the exporter and his producer dearly, and it serves to undermine the relationship between the two parties and to destabilize the industry.

Gess (2004) further advises that when determining the appropriate security to use, an exporter should also ensure that a conveyancer conducts an adequate research to determine whether or not an immovable property has been bonded in excess of its reasonable value. She further suggests that the exporter cannot work in isolation of certain Acts like the Insolvency Act in relation to preferences and security, the Agriculture Credit Act, the Co-Operatives Act and the Land Bank Act.

Destructive disputes are still prevalent over advance payments in the table grape export industry, largely where there is no written contract in place. They are time-consuming, and largely a combination of uninformed and devious behaviour. They have a number of consequences for the industry: (1) the industry is destabilized and the relationship between producers and exporters is undermined; (2) they erode the balance sheet of exporters who generally struggle on the current margins on which they operate; (3) the international buying community loses confidence in the supply side from South Africa where promised deliveries fail to materialize; and (4) the South African table grape export industry tends to be overly pre-occupied with internal (political) disputes where they should rather concentrate on developing mid- to long-term relationships with their customers in the international marketplace (Promar, 2001).

University of Cape Town

## 2.8 Summary

The non-climacteric nature of table grapes *and* the erratic affects of climate on their quality and production volumes compel exporters to procure their wares from all production regions. This ensures that exporters spread their procurement risk, and capitalize on continuous supplies for their customers throughout the marketing windows on offer. Export table grapes need to be market-friendly, variety-friendly and quality-friendly, as these factors determine the product's consumer appeal and price capability in the marketplace. The inevitable consequence of the product's homogenous nature has meant that price discrimination is difficult to achieve, making SA suppliers predominantly price-takers in the market. Exporters have tried to avoid the commoditization of the product through attractive packaging, offering new and organic varieties, complying with fair trade requirements and pioneering carbon footprint declarations.

Ten years on from deregulation, there is three times the number of exporters doing nearly three times the volume of business. According to the HHI Index, the export industry has de-concentrated to such an extent that it can be regarded now as intensely competitive. Capespan, as a spin-off of the former monopoly, has continued to form a very important backbone of the South African grape exporting fraternity, albeit that its market share at the end of the 2006/07 season was at 17% of the industry's export volumes. The proliferation of exporters has divided into two camps over the deregulation era: the top 20 export companies that continuously retain over 80% of the export volumes; and the long tail of 120 or more exporters that make up the balance of the export cartons. The early years of deregulation gave rise to disorderly and ill-disciplined behaviour amongst producers and exporters, some residue of which still pollutes the industry today. Those marketing agents that chose to accredit themselves with the FPEF have, despite their efforts to act responsibly in the industry, lost ground in export volume to the producer-exporters in the last five years of deregulation. The exporter fraternity is comprised of traders, brokers, marketing agents and producer-exporters, the last two of which have dominated the exporter landscape.

The drivers on which the business models of export agents are based (especially the multinationals and the larger South African owned and based firms) demonstrate the degree to which these companies have been able to entrench their positions in the industry. However these traditional models are now being challenged by the rising tide of producers doing their own exporting. Marketing agents have retaliated by integrating backwards into farms to secure product; and producers have responded by integrating

forward into marketing companies to move away from a seasonal enterprise into an all year round business. Despite the apparent ideal model of the producer 'marketing cooperative', the demise of Capespan's Grape Trust and the recent break-up of the EXSA company has cast doubt on the sustainability of this model.

2001 was 'annus horribilis' for the South African table grape producer. The financial returns of most farmers for the 2000/01 season were ruinous. It sparked a revolution across the country amongst the producers, resulting in the establishment of four producer associations in the various production regions. These associations started accrediting exporters on a regional basis, and forced exporters to sign draconian contracts. The FPEF's sub-chamber, the GEF, was formed to counter these measure taken by the highly organized producer fraternity. The GEF goals were to absorb and respond to the concerns of their suppliers, and to ensure the continued supply of product to their businesses. By the start of the 2001/02 season, only FPEF-accredited agents (i.e. GEF members) could qualify for product, barring a few exceptions. These measures did beg the question as to whether the barrier for entry of new marketers – especially those BEE companies perhaps wanting to enter the industry – had been raised excessively high. Nonetheless, these measures did reintroduce the necessary discipline required to stop the industry from sliding down the slippery slope of deregulation.

Marketing agents have resigned to the fact that the business of exporting table grapes is not an exact science; and that dealing with a product that suffers from the vagaries of Mother Nature will always have an unpredictable cost attached to it. Therefore financial risk management plays an important role in an exporter's procurement strategy. Part of this risk management is the issuing of MGPs, which can land up being a disproportionately expensive offer if inappropriately used. Only in circumstances where, for strategic reasons, it is vital for an exporter to offer his producer an MGP, will he do so. Producers have expressed interest in implementing floor prices across the whole industry; and exporters can't oblige, because insufficient confidence exists in a perishable product system where product quality varies for too many reasons beyond the control of the exporter.

In order to secure product, exporters also choose to advance funds to producers through production loans and disbursements. As long as the exporter and his producer have understood the implications and grey areas affecting this aspect of the business (and always reduce their agreements to writing), then it can be a mutually beneficial exercise. However, anecdotal evidence suggests that there is ignorance and unethical behaviour prevailing in this area of the business, and for their own protection, both producers and

exporters should be well versed with the law in this regard. Finally, where producers and exporters indulge in practices that serve to undermine the relationship between each other, the reputation - and therefore the competitiveness - of the South African export business is at stake.

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## Chapter 3: Challenges in Competing Supply Chains

### 3.1 The Recent Metamorphosis of the Logistics Chain

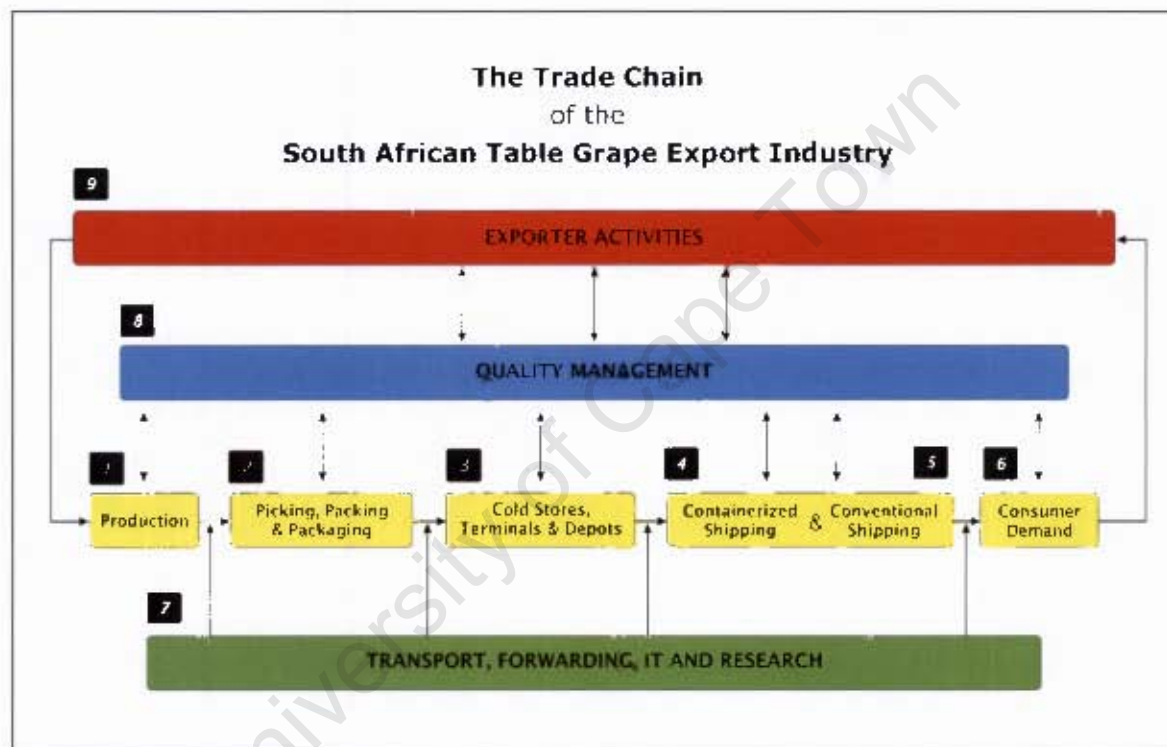
Once the exporter has successfully procured product in South Africa for a supermarket programme in England, it is normally his responsibility to move the product from the South African farm gate to the UK importer's distribution centre. This perishable cargo has to arrive timeously and in the specified condition for a market that is more than 10 000 km from source. For this to happen, the exporter and his producer rely heavily on many service providers to execute their functions diligently in the chain. This chapter covers the all-important, logistical aspects of successfully exporting table grapes mostly through the port of Cape Town to the United Kingdom. The evolution of the logistics chain, the gargantuan changes in the international shipping sector and the various restrictions on the flow of fruit through the South African ports are now discussed. Emphasis is placed on where the exporters need to address competitiveness issues, particularly surrounding the logistical activities in the Cape Town port environ, and on the innovation required in the South African leg of the chain.

The traditional mechanics of a trade chain was that fruit was transferred through a sequential set of separate logistics 'operations' - like trucking, forwarding and clearing, warehousing, terminal operations, stevedoring and shipping - from the supply end of the chain to the demand end of the chain. The implication was that these separate functions were executed by separate organizations; that costs were accrued on a cost plus a margin basis; and that there was little or no integration of the individual logistics elements in this chain (Robinson, 2002).

Diagram 3.1 is a simplistic view of the table grape export chain reflecting this set of logistics operations. Orders for South African table grape products start with the UK importers responding to consumer demand (6). These UK importers communicate their exact product specifications to their South African exporters (9) who are predominantly marketing agents and producer-exporters. The South African exporters, in turn, convey the UK importers' requirements to their producers (1). The exporter then sets about ordering the packaging (2) and having it delivered to the farm. He also books the container with the shipping line (4) and has it sent to the farm to be stuffed with the product. The exporter books the road transport (7) to fetch the product and have it delivered to the cold store or port terminal (3), whichever is appropriate. Once the product has been cleared by customs for export (7) it is

loaded onto the appropriate vessel (4 or 5) and shipped to the UK market. These logistics activities and the movement of the product from South Africa to the UK are recorded electronically at all times and communicated to all relevant parties via electronic data interchange (7). The product and transport equipment is also quality controlled repeatedly along the chain by the PPECB (8).

Diagram 3.1 A Simplistic Sequential View of the Logistics Chain



Source: FPEF (2004b)

Market forces have had to re-engineer the traditional trade chain, primarily because there has been a shift in gears from suppliers in the Agricultural Board era proclaiming 'this is what we offer' to the dominant retail chains today demanding 'this is what we want'. The fact that growers<sup>113</sup> and retailers are not experts in logistics has ensured that a plethora of third party logistics companies (3PLs) has emerged, and that these companies have integrated some of these formerly stand-alone functions within the chain to provide value-

<sup>113</sup> Meintjes (2006d) maintains that producer-exporters entering the export arena do not have the experience or in-house capability for handling their own logistical challenges in the trade chain. This is especially the case because nearly all of these grower-exporters are highly seasonal and are simply too small in volume to make adopting this function themselves remotely cost-effective.

added logistics to their customers.<sup>111</sup> In addition to this, 3PLs and other companies have clustered into a constellation of firms that form 'logistical pathways' or 'value chains' from the supplier to the buyer (Robinson, 2002).<sup>112</sup> So what was once the domain of many types of smaller, individual companies plying their trade in the supply chain is now dominated by fewer, larger integrated companies offering a wider range of services that stretch further up and down the value chain than before.

This approach to the fresh fruit logistics chain in the deregulated era has been driven by a number of major trends. Kaplinsky & Morris (2000) postulated that logistical service providers and their principals have been driven by just in time (JIT) production, total quality management (TQM) and continuous improvement (CI). In addition to this, the need of UK retailers to take greater control over the logistical aspect of the business will become evident in the following chapter. The UK retailers have demanded this not only to satisfy their customers, but also to save costs and to extract greater rents to their end of the chain. Other major drivers of the metamorphosis of the logistics chain include:

- The emerging South African producer-exporters who are bypassing the services of the traditional marketing agents and contracting directly with the logistical companies themselves;
- Strong and volatile exchange rates and deflationary product prices in the UK market that have forced growers to relentlessly scrutinize their costs in the chain (Meintjes, 2006). Growers have had to insist on a far greater element of transparency in the cost chain than has traditionally been the case;
- The need for service providers to integrate forwards and backwards in the chain so as to have a greater degree of control over the product and to improve their profitability levels;
- The growth of non-European destinations for South African fruit in general;

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<sup>111</sup> Well-known European companies that illustrate this integration in the chain (and which South African table grape shippers use) are Danzas, Schenker/BTL and Kuhne & Nagel. All of these companies have evolved from basic forwarders to full logistics service providers (Notteboom and Winkelmanns, 2001).

<sup>112</sup> Today a number of these 'value chains' exist that compete with one another for the table grape export business to the UK. A crude example of two such competing chains would be the 'container shipping chain' versus the 'conventional shipping chain'.

- The inexorable growth in containerized shipping at the expense of conventional (reefer)<sup>113</sup> shipping; and
- The decay of productivity in, and the congestion of, the various South African ports.

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<sup>113</sup> The industry uses the informal word "reefer" to denote "refrigerated". Confusion arises when, for example, the phrases "reefer container" and "reefer vessel" are used. This is because the former refers to the *container* shipping industry whilst the latter refers to the *conventional* shipping industry – yet both have the word 'reefer' in them. "Reefer vessel" will from here on be referred to as "conventional vessel", whilst "reefer container" will from here on be referred to as "refrigerated container".

## 3.2 Sea Changes in the International Shipping Sector

South African table grape exporters are witnessing a dramatic revolution in the shipping side of their business. The container liner sector has shown unprecedented growth, whilst its conventional cousin has been treading water in a bid to compete. Traditional conventional shipping clients have essentially shown a penchant to palletizing a refrigerated container rather than a refrigerated hold of a ship. In the remainder of this section we examine these developments, how they are influencing the evolution of the logistics chain, and the degree to which they are causing congestion in the port of Cape Town – the heart of the table grape export industry's logistics chain.

### 3.2.1 The Container Liner Sector

The expansion of the global container shipping industry is a result of intense, inter-container liner competition, stemming from the industry's high level of fixed costs, the widespread practice of governments subsidizing their shipping and shipbuilding industries, the entrance of newly-established, low-cost Asian shipping lines, and the ease with which containers are able to be transhipped from one mode of transport to another (Trace, 2002: 2). International shipping is moving away from the traditional port-to-port services towards door-to-door solutions (Paixao & Marlow, 2003). This has come about through the interoperability of transport modes, the interconnectivity of land networks with sea and the compatibility of information systems. And because these shipping lines hold such a key position in the chain and essentially operate most of the containers, the extension of their services from specialized shipping to trade chain logistics was a natural progression (Slack, 1992).<sup>114</sup> However the severe competition that has ensued amongst the container shipping lines has forced ship owners to adopt innovative, productivity-enhancing and cost-cutting strategies, which according to Slack et al. (2002) included:

- Deploying larger vessels. Trace (2002) affirms that when vessel size increases, the capital cost per container slot<sup>115</sup> falls, the ratio of crew to

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<sup>114</sup> Notteboom (2004) confirms this by noting just how far Maersk Sealand has progressed with: (1) its door-to-door logistical service packages via Maersk Logistics; (2) its management of container terminals in European ports; (3) its inland transport joint venture with P & O Nedlloyd in European Rail Shuttle; and (4) its direct dealings with exporters in bypassing the forwarders.

<sup>115</sup> A container 'slot' is a 'parking space' allocated for a container on board a vessel.

carrying capacity declines and the consumption of fuel per unit of cargo transported decreases;<sup>116</sup>

- Rationalizing their businesses by participating in strategic alliances and mergers. Slack et al. (2002) advocate that, while there was no clear consensus as to the economic justification of these alliances, economic literature tends towards internationalization theories (minimizing transaction costs) and strategic management theories (performance being shaped by a number of internal and external factors);<sup>117</sup>
- Reducing the number of port calls, hubs and mini-hub ports, and thereby increasing the volume of transshipment cargo;
- Developing a network of feeder services linking hub and regional ports. However, Rademan (2007) observes that shipping lines do not have the ability to transfer containers quickly enough in these congested transshipment hubs, and that remote temperature monitoring capabilities (i.e. via the internet) are normally lost after the first transshipment;
- Developing new types of shipping services.

An example reflecting these initiatives that manifested on the South African shipping route was the introduction of the six new vessels on the South African European Conference Service (SAECS) during 2004 and 2005. According to Meintjes (2004d) this fleet not only created extra carrying capacity - up to a 1000 slots per vessel - for 40-foot integral reefer containers; it also benefitted exporters by reducing the 49-day voyage cycle (from SA to Le Havre, Rotterdam, Tilbury and back to SA) to 42 days. Meintjes further noted that other efficiency factors in this new service included vessel departures from Cape Town on Mondays (instead of the previous Sunday departure service), giving exporters an extra day in which to schedule their cargo onto the ship. In addition to this, the arrival days in the

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<sup>116</sup> Vessel size is classified according to five generations of 20-foot equivalent unit (TEU) container-carrying capacities that have evolved since the 1960s. The most recent 5<sup>th</sup> generation vessels built in the late 1990s – known as the post-Panamax vessels (meaning they will be too wide now to pass through the original Panama canal) – have a carrying capacity of about 6000 TEUs (Cullinae & Khanna, 1997).

<sup>117</sup> Whilst strategic alliances were the order of the day in the late 1980s and early 1990s, mergers and acquisitions dominated around the millennium. Three major alliances that have impacted on the South African shipping routes were the Grand Alliance (Hapag-Lloyd, MISC, NYK, OOCL, P & O Nedlloyd); the New World Alliance (Hyundai, MOL, NOL/APL); and the Maersk/Sea Land Group (Trace, 2002). More recently, the attempted Maersk-P&O Nedlloyd merger and the Lauritzen Cool-NYK deal have raised discomfort levels in the industry with regard to increased concentration in shipping services and the potentially higher freight rates that could result for the South African-European shipping routes (Meintjes, 2005a).

market place were also scheduled for earlier in the week than previous services, giving exporters an extended marketing period in the UK for the same arrival week.

### 3.2.2 The Conventional Shipping Sector

The rationale behind the ebbing conventional shipping sector is, according to Drewry Shipping Consultants (2002), fourfold: (1) the deregulation of export boards; (2) the mounting influence of retailers worldwide; (3) the 'drift' towards the use of containerization by exporters; and (4) the declining conventional shipping fleets. Gone are the days when a conventional vessel would come 'tramping' to your doorstep and service one client, with one shipload and one bill of lading. Today, a supermarket may require 5 or 50 pallets a week, and the same vessel now has 200 clients on board with 200 bills of lading. In addition to this, the vessel may now be carrying 100, 40-foot containers on deck (Oswald, 2003), a sign of how adaptive the industry has had to become in order to compete. But the fundamental decline in this sector can be ascribed to no new conventional vessels being built in the sector for the last five years, the ageing of the existing fleet and older reefer vessels being scrapped (Meintjes, 2005b). In addition, the surplus tonnage that has been created in the container vessel sector has forced the container sector to dampen its freight rates to lure cargo away from the relatively more expensive conventional sector (Knowles, 2005).

Meintjes (2003b) proposes that issues favouring conventional shipping include: (1) the aforementioned combi-shipping of cargo below deck and containers on deck; (2) self-serving vessels which have built-in cranes on the ship's deck, making them independent of shore crane equipment limitations; (3) high speed sailing capabilities; and (4) flexibility in terms of ports of loading and discharge. Meintjes (2006d) adds that transit times to certain markets are shorter with the conventional lines than they are with the container lines, and that cold sterilization techniques used in conventional ships are also more reliable than in container ships.<sup>118</sup> This, according to Ortmann (2005), is because some industry stakeholders believe that the air circulation in the hold of a conventional vessel is superior to that of a 40-foot integral container. And break-bulk ship loading can continue in high winds whereas container loading has to stop at a certain wind speed, for safety reasons. What's more, Meintjes (2006d) questions the country's ability to manage the entire fruit export crop via containerization with the current infrastructural limitations being experienced

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<sup>118</sup> Meintjes is referring here more to the special export markets of the USA and Japan, for example, than for the UK market.

in the country, particularly at the ports - including the shortage of container boxes to meet the rising tide of container shipping demand. In this regard, Meintjes (2003c) predicts that penetration of containers into the market will be retarded due to the investment costs of: (1) the post-Panamax ships introduced to carry the 40-foot containers; (2) the 40-foot tri- and tandem-trailers used by trucking companies to haul the longer containers; and (3) port equipment such as straddle carriers, 'bathtubs' and gantry cranes that are able to handle the bigger tonnages.

### 3.2.3 Industry Preference of the Containerized Sector

The above-mentioned issues refer to the strategic intents and the infrastructural capabilities of the container and conventional shipping sectors. The relative demise of the conventional sector can be seen more starkly when analyzing the advantages that table grape exporters, service providers and the product glean from using the containerized mode of shipping. These advantages are, according to Rademan (2007), as follows:

- (1) Pallets in containers are handled fewer times (up to seven times less) than the conventional methodology. Since there is an accepted correlation between reduced forklift usage and reduced pallet and fruit damage, this practice has to be advantageous for ultimate product quality (FPEF, 2003);
- (2) The product can be containerized at the pack house, and the cold chain is therefore unbroken from the pack house right up to the customer's premises overseas, offering what is essentially an uninterrupted, door-to-door<sup>119</sup> cold chain service. Food safety issues, non-contamination of the product and the continuity of the cold chain are all enhanced by this mode of transport;
- (3) There are also fewer parties involved in the 'unbroken' process mentioned above, making accountability for product quality losses a much easier exercise;

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<sup>119</sup> Meintjes (2002a) believes that the door-to-door debate is essentially one of comparing the merits of conventional shipping versus container shipping. Those advocating conventional door-to-door shipping claim that many containers do not go to the customer's door, but instead find their way into third party logistics providers' cold stores and depots – either for onward shipping or for de-stuffing and re-working. And this is no different to the way conventional shipments are made. Oswald (2003) concurs that most containers are de-stuffed at or near ports because most retail outlets cannot handle a 40-foot container load of perishable product, and container owners are reticent to have their refrigerated containers used for static storage purposes at retail outlets.

- (4) With the phasing out of the 20-foot porthole (conair) containers<sup>120</sup> and the introduction of the 40-foot integral containers, twice the amount of product could be moved (in one lift) than previously, making the cost per carton of fruit being shipped cheaper.<sup>121</sup> Costs have been further trimmed by the introduction of high-cube containers.<sup>122</sup> With the introduction of these containers - and more recently the specialized integral containers<sup>123</sup> - shippers have also had greater assurances on quality control than ever before;
- (5) For less established exporters, smaller lots of fruit can be moved more flexibly where one container is directed to one buyer. On the other hand, a conventional vessel needs between 2000 and 4000 pallets per sailing, which either favours the bigger exporters or puts the shipping agents under tremendous pressure to fill the vessels;
- (6) Lastly, the cost-effectiveness of shipping by container with its relatively cheaper freight rates than conventional shipping is a major attraction to shippers where cost savings are crucial for their international competitiveness.

In general, smaller volumes of product exported tend to be moved in containers, while larger volumes are moved in break-bulk fashion (Ortmann, 2005). However the mode of shipping employed also depends on the market being served and the exporter involved (Meintjes, 2003b). Whilst congestion in ports can influence exporters' decisions, factors such as cost, transit time and overseas landside operations will also affect exporters' decisions on shipping modes used (Rademan, 2003). The international transport sector - particularly the container shipping lines - has responded to an environment characterized by global corporations, outsourcing, deregulation and technological innovation in two ways.

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<sup>120</sup> With the old porthole containers, the ship's refrigeration system ducted cold air in and out of the container via two 'portholes' in the container's end wall (hence the name). When such a container was discharged at a port, it had to be disconnected from the ship's refrigeration system until such time that it could reach another land-based refrigeration system, and it was during this 'in between refrigeration systems' time that the cold chain could be 'broken'. With integral containers, as long as they have access to electrical power points (i.e. in ships, on trucks, in stacks), the generator set (hence the name 'genset') that is integrated into the container is always powered to deliver cold air from the integrated refrigeration unit into the container.

<sup>121</sup> 20-foot containers hold 9 pallets, whereas standard 40-foot containers hold 20 pallets. 40-foot *high-cube* containers hold the equivalent of 23 pallets as three additional pallets can be 'broken down' and stacked on top of the underlying 20 pallets (van Walbeek, 1998).

<sup>122</sup> With the additional three-pallet capability of a high-cube container, a 15% cost saving was available (due to the fact that the container freight rate stayed constant while the number of cartons being shipped for the same freight rate increased).

Firstly they are offering global logistics packages to shippers in order to achieve *economies of scope*. This amounts to vertical integration in the chain where the 'door-to-door' or 'one-stop-shop' philosophies have revolutionized most shipping lines into intermodal logistics organizations.<sup>124</sup> Secondly, shipping lines are increasing the size of their operations through deploying larger vessels and engaging in mergers and alliances so as to achieve *economies of scale*. This amounts to horizontal integration in the chain in which the lines hope to achieve cost leadership and better service to their clients via advanced IT solutions, more frequent services, a wider global coverage and reduced transit times (Notteboom & Winkelmanns, 2001).

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<sup>123</sup> This refers to the controlled atmosphere capabilities of such refrigerated containers, and it is the subtropical sector that is leading in its ability to capitalize on such technology.

<sup>124</sup> The Capespan Group, as a major shipper of South African table grapes, exemplifies this type of vertical integration in the chain. It part-owns the conventional terminals in the Cape Town port; it leases conventional vessels (the 'snow' vessels) to transport its product abroad; and it now has an investment in the Groot Garieb cold stores in the Orange River production area. According to Meintjes (2004c) and Meintjes (2005e), this allows the company to manage the cargo information right from source and to streamline the scheduling of product into their terminals and onto their ships. As a result, it reduces conventional terminal congestion, optimizes ship loading and minimizes costs for growers. In 2006, Capespan opened a subsidiary logistics company (The Fresh Chain) in a bid to offer other exporters a similar service. It will be interesting to see whether Capespan's fellow exporters (essentially their competitors) will support this initiative.

### 3.3 Flow of Fruit into the Cape Town Port

Table grapes are exported to the UK market predominantly through the seaport of Cape Town.<sup>125</sup> Export consignments are trucked from farm to port using either *merchant haulage*, which is the exporters' responsibility, or *carrier haulage*, which is the shipping lines' responsibility (Allen et al, 2005). These consignments arrive in the port either in refrigerated road trucks or refrigerated containers. The railage of grapes to the port is no longer a viable form of transport,<sup>126</sup> as the correct rolling stock is not readily available for transporting containers and because it is significantly slower than road transport (Ortmann, 2005). This is despite rail being a far more efficient mode of transport compared to road haulage. For example, a single train of table grape containers is the equivalent of using 32 road trucks doing the same job (Ortmann, 2005).

If the fruit is being loaded onto a *conventional vessel*, it is delivered to the break-bulk terminals that unload and store the fruit until it needs to be stevedored onto the vessel.<sup>127</sup> These terminals (as well as the inland storage facilities) provide cold sterilization functions and provide access for the DoA and the PPECB to inspect the fruit. More recently, the conventional terminals have started handling some containers that are loaded on top of reefer vessels for the increasingly popular form of combi-shipping. The break-bulk terminal facilities were monopolized by Fresh Produce Terminals (FPT) in the deregulated era, which is a subsidiary of one of the exporters, Capespan. Meintjes (2005) states that Capespan's ownership of the conventional shipping terminal has been contentious in the deregulated era.<sup>128</sup> There was a challenge to the dominant position of FPT by transient competitor South African Fruit Terminals (SAFT) that has now closed its doors for commercial reasons.<sup>129</sup> However Capespan has in recent years divested of its major shareholding in FPT to a Black Economic Empowerment consortium, and can therefore no

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<sup>125</sup> Some of the early table grapes in the Orange River production region that were destined for the UK market used to be air-freighted from Upington in the Northern Cape Province to England's Heathrow Airport. However these charter flights stopped in 2003, as this mode of transport cost up to 10 times that of sea-freight.

<sup>126</sup> In the 2007/8 season, SATI has investigated the use of rail from the Orange River to the Cape Town port (nicknamed the *Grape Express* initiative).

<sup>127</sup> Sometimes a break-bulk consignment bypasses the terminal and is delivered directly onto the quay alongside the berthed vessel. The consignment is then loaded straight into the hold of the ship. Whilst this enables shippers to save on terminal costs, any deviation from temperature protocols during this 'cross-docking' can result in outright rejection of the entire shipment for export – making it a very costly exercise for the shipper.

<sup>128</sup> The controversy around Capespan owning FPT was because it was considered an asset that had been paid for by the growers in the regulated era, and because it had a dominant position in the ports through which most of Capespan's competitors had to ship their product (giving Capespan an advantage on pricing and an unencumbered insight to their competitors' shipments).

<sup>129</sup> According to Meintjes (2004a), SAFT was essentially established to provide producers and exporters with an alternative conventional terminal service to FPT. Meintjes (2004f) - Managing Director of SAFT at the time - claimed that SAFT was not just a port terminal operator, but a good example of an integrated service provider offering inland cold storage facilities (at the Cold Harvest premises in Paarl which it owned), road transport services from pack house to port, load scheduling onto ships and some container loading for combi-shipping on reefer ships.

longer be fingered as dominating the break-bulk terminal business. With the upsurge in container shipping at conventional shipping's expense, FPT's volumes have shrunk to such a degree that the company has been soaking up spare capacity by diversifying into alternative freight types. However the fact remains that FPT retains 90% of the current break-bulk terminal business countrywide with terminals in Cape Town, Port Elizabeth, Durban and Maputo (Meintjes, 2006a).

If the export consignment is being loaded onto a *container vessel* it is delivered to the Cape Town Container Terminal (CTCT) facility, which is located in a different - more wind-ravaged - area of the port to that of the conventional terminal site. The consignment passes through an administrative checkpoint (A-check) to ensure that the paperwork identifying the driver, truck and booking reference number correspond with what the terminal facility's computer was expecting. Any deviation causes the truck to be held up, or sent away, until the exporter has rectified the problem. If approved, the consignment then progresses to the physical checkpoint (P-check) where the truck registration number and the container number are verified via a wireless, hand-held device also connected to the terminal's computer system. This is for security reasons. The seal on the container is also checked at this stage to ensure that it is intact. Any discrepancy means that the consignment is returned to the exporter. Once satisfied that all is in order, the personnel at P-check inform the truck driver where to meet the straddle carrier<sup>130</sup> inside the port facility, from where it is placed in the stacks<sup>131</sup> and plugged into electrical power while awaiting loading onto the container vessel. The container terminal facilities are monopolized by the state-owned, Transnet Port Terminals (TPT), formerly known as the South African Port Operators (SAPO). It is important to note that in 1995, the share of container shipping was 24% of the fresh produce export business from South Africa (Meintjes, 2002a); but by 2006, the container share had escalated to 70% (Meintjes, 2006a). This growth in containerized shipping has had a deep impact on the effectiveness and efficiency levels of the logistics chain in the deregulated era of the South African table grape export industry.

Generally speaking, conventional ships 'tramp' the market i.e. they provided flexible services as and when needed; whilst container liner services offer fixed-day calls on set routes (like a bus-stop service) on a year-round basis (Meintjes, 2006f). It is important to understand that distance is no longer the decisive factor of transit time or cost in shipping.

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<sup>130</sup> A "straddle carrier" is essentially a crane on wheels that overrides a container truck, lifts the container off the truck and parks it in a stack. The driver's cab on the straddle carrier is hooked up to the CTCT computer system that tells the driver exactly where to park a particular container in a particular stack.

<sup>131</sup> A "stack" is a pile of containers (stacked up to four containers high in the Cape Town terminal) that is grouped together for a particular shipment.

A shipping line's capacity, its ability to use that capacity flexibly and quickly, and its network of paths that it can choose from all determine transit times and costs (Trace, 2002). This is endorsed by Meintjes (2006g), who states that exporters can no longer afford to be dependent on just one shipping line if they need to get their fruit to market on time. And Meintjes (2005) also asserts that logistical solutions today lie in multi-line and multi-modal options that service providers can offer exporters.

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### 3.4 Logistical Logjams in the Port of Cape Town

Port terminal capacities - including the break-bulk and the container terminals - for the exporting of table grapes have been constrained by inclement weather, labour disruption, large traffic volumes, incorrect documentation, fruit out of temperature protocol and equipment break-down (Ortmann, 2005). These issues, combined with the effect of the increased demand for refrigerated container capacity by the grape exporters has meant that the logistics chain in the Cape Town port – particularly in the container terminal facility - has been increasingly overloaded in the deregulated era. Meintjes (2004a) states that whilst container shipping is generally accountable for most of the congestion challenges in South African ports in the new millennium, conventional shipping is not blameless. In this regard, Meintjes (2004b) retorts that it is often only 5% of the cargo volume that can double the loading time of a conventional ship due to exporter incompetence (i.e. insufficient planning and incorrect information).<sup>132</sup> The port authorities – in their function as ‘landlord’ – have been largely unsuccessful in using their monopolistic muscle to achieve the necessary coordination between the powerful shipping lines, unproductive state-owned enterprise organizations and disorganized table grape producers and exporters. Six critical aspects of the logistical chain in the port of Cape Town are now examined under the microscope to understand the affect that they have had on the competitiveness of the table grape export industry in the deregulated era. These key areas are underinvestment in port infrastructure, disorganized exporters, parastatal impotence, powerful shipping lines, peak week pressures and other erroneous factors.

#### 3.4.1 Underinvestment in Port Infrastructure

Although considered too little too late by industry, the South African government in 2005 decided to invest in capital expenditure in its ports over a 5-year period.<sup>133</sup> The 2005 Budget Review (Bisseker, 2005) noted that South Africa’s infrastructural network was characterized by escalating costs, bad service and a weak skills base, and that this had been aggravated by protracted underinvestment. Perkins et al (2005) stated that investment in (South African) ports in the late 1990s was running at 35% of the long-term

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<sup>132</sup> Meintjes (2004b) further intimates that many of the congestion problems result from too many (inept) shippers populating the fruit export industry in the deregulated era, and that delay costs caused by the disorganized few penalizes the orderly majority.

<sup>133</sup> As Louw & Hoffman (2004) make clear, government or private institutions will attempt to delay large capital expenditures for as long as possible, not forgetting too that there is a significant time delay from eventual approval of these projects until completion of their construction.

capital requirement. The consequence has been high logistical costs<sup>134</sup> for the economy and eroded international competitiveness (Bisseker, 2005). The same Budget Review noted that the state-owned enterprises of Transnet Port Terminals (TPT) and the Transnet National Port Authority (TNPA) - formerly known as the National Port Authority (NPA) - had budgeted to spend R30 billion over five years on new railways and port infrastructure. Provision has been made for the purchase of additional gantry cranes, plug-in-points, straddle carriers and other equipment required by the Cape Town Container Terminal (CTCT). Even a new container quay for Cape Town port has been planned,<sup>135</sup> but can only be implemented once the environmental impact assessment (EIA) - that has taken 3 years so far to be reviewed - has been favourably endorsed by the public.

On closer examination, it appears that virtually no upgrades have in fact taken place in South African ports for several decades (Hoffman & Louw, 2003). This begs the question as to why the TNPA, as landlord of the South African ports, is annually levying cargo dues on every pallet of fruit passing over the quayside, since such dues are 'taxes' paid by the industry for the improvement of quayside and super-structural facilities in the fruit terminals. Rademan (2007) notes that cargo dues are not payable in any of the country's destination ports; and when combining cargo dues with the terminal handling charges (THC), South Africa's port costs are 55% more expensive than any other European port. Haarmeyer and Yorke (2003) attest to revenue generated by some US port authorities being used to offset state debt outside of the ports. In South Africa's case, it can be surmised that such landlord revenue has been used to cross-subsidize the construction of Coega port (which *may* be used at a later stage by the fruit industry) and other loss-making activities in the Transnet Group (like South African Airways).

An unpopular port authority revenue model was instituted in 2002 when the old 'wharfage costs' were replaced by the 'cargo dues' taxation system.<sup>136</sup> In 2007, the port authorities collected approximately R120 million in cargo dues from the whole fruit industry (FPEF, 2007c). Flat cargo rates per container for lower value commodities such as fruit are now effectively subsidizing higher value commodities such as motor vehicles (CSIR, 2006). In a letter to the former NPA (Symington, 2004), the FPEF not only challenged this unfair revenue model of flat rate taxes as opposed to the original ad valorem tax, but also the

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<sup>134</sup> According to the CSIR, South Africa's logistical costs in 2004 were 14.7% of GDP, whereas in the USA they were 8.5% of GDP (Perkins et al, 2005).

<sup>135</sup> The intended expansion is a 150-metre reclamation of the sea to double the existing container stacking space. Berths will be deepened and new port equipment will be installed to improve productivity (Meintjes, 2006a).

<sup>136</sup> One of the motivations for the TNPA shifting away from the ad valorem wharfage tax was that many exporters were consistently under-declaring the value of their cargo, thereby evading paying the appropriate wharfage costs.

illogical imposition of differentiated cargo dues per fruit kind *and* per mode of shipping.<sup>137</sup> But no curative action has yet been taken by the port authorities; and the port authorities have claimed that no objections were received by industry at the time that cargo dues were put before industry for comment. The state could argue that cargo dues revenue generated over the deregulated era will be ploughed into the new container terminal planned for Cape Town; and this is undeniably a hefty investment. But for the industry - along with all other South African import and export industries - it has been an uphill struggle through most of the deregulated era to motivate a lethargic central government to prioritize and invest in national logistics infrastructure. And this has been to the chagrin of the country's international customers.

### 3.4.2 Disorganized Exporter Community

There is sufficient evidence to implicate industry as not toeing the line when it comes to alleviating port congestion. The degree of laxity that still prevails amongst producers and exporters continues to exacerbate congestion in the Cape Town port. The following exporter issues are affecting the performance of the table grape export business inside the port:

- (1) Shippers are notoriously unreliable on providing the port authorities and shipping-related service providers with accurate crops estimates and intake estimates for port logistics planning (Louw & Hoffman, 2004).<sup>138</sup> The industry has yet to provide a reliable and regular source of comprehensive table grape export volume information throughout the season that allows logistical service providers to plan properly for optimum port utilization. Meintjes (2005d) stated that it was still the PPECB's intention to work towards the provision of an electronic export certificate, but that it would only be a reality once there was sufficient and timely coordination of EDI between all service providers and shippers, and once the harmonization of industry computer system codes had been achieved. This industry function is particularly necessary over the peak weeks (week 5 to week 7) when Cape Town port

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<sup>137</sup> For example, the cargo dues for roughly one metric tonne (1 pallet) of table grapes passing over the quayside at a *conventional* terminal are R28.50 per pallet, whereas for citrus they are only R13.75. Table grape producers are being unnecessarily penalized here. Furthermore, the cargo dues payable for the same metric tonne of fruit passing over the *container* quayside is R78.00. The industry concludes that with the rising popularity of container shipping evident back in 2001, the port authorities capitalized on the opportunity of differentiating the charges between conventional and container shipping to substantially increase their future revenue streams.

<sup>138</sup> Louw & Hoffman (2004) are adamant that if producers are serious about remaining competitive, they should ensure that accurate crop estimates reach exporters, truckers, port authorities and shipping lines timeously; and that any deviations are reported as soon as the updated information becomes available.

congestion can and does become a costly affair, ultimately for the producer. Some producers are at fault for either not submitting crop estimates (or accurate crop estimates), or for not delivering close to what they promised to deliver into the logistical chain for a particular week. Some exporters are also at fault for tending to overbook shipping space as a precautionary measure against a shipping line defaulting on its commitment, or for fruit they think they may be able to procure for export (i.e. an over-optimistic export crop estimate). Exporters do this by booking shipping space with two different shipping lines (to cater for their best-case export volume scenario that often doesn't materialize), and then land up cancelling the booking at the last minute with the line they don't intend to support (Hoffman & Louw, 2004).

- (2) Exporters are also known to have insufficient or incorrectly completed documentation when their consignment enters the port facilities, and this can cause major truck congestion at the entrance to both the CTCT and the reefer terminal facilities. According to Rademan (2007), the average queuing time of trucks at a container terminal (including container depots and cold stores) is six hours. As Paixao & Marlow (2003) point out, port activities are made up of two flows: the physical flow (of goods) and the information flow – and the information flow should always be ahead of the physical flow. In some cases, containers are refused entry into the port. For example, if the exporters mis-declare the weight of their containers whether through negligence or intent, it can constitute not only a safety hazard<sup>139</sup> but also a selfish act in prematurely shutting out cargo when the ship's tonnage capacity is reached (Hoffman & Louw, 2004).<sup>140</sup>
- (3) Pre-ordained container stacking windows for a particular vessel (usually opened by TPT for three days prior to a ship's arrival) are often not properly used by exporters. Errant exporters tend to either deliver their containers on the last day of the stacking period thereby causing congestion at the entrance to the port; or they deliver their containers after the stacking period has closed (Hoffman & Louw, 2004). According to Schuitmaker (2005), exporters are also delivering their containers to the stacks in daylight hours only (i.e. in normal business hours) and therefore not taking advantage of TPT's offering of stacks being open 24 hours a day for the stack

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<sup>139</sup> On the South African trade routes, the majority of containers are stowed on deck (Allen et al, 2005). Incorrect loading weights can cause the ship's calculated weight distribution to be uneven enough to possibly capsize the vessel.

<sup>140</sup> A vessel has a maximum tonnage at which it can safely sail. If, for example, exporters under-declare the weight of their containers, the ship's maximum tonnage is reached before the last containers are due to be loaded. This serves to penalize the last-in-line cargo owners whose containers have to then remain on the quayside.

period concerned. Needless to say, myopic planning on the part of exporters leads to a catalogue of missed deadlines, the costs of which are ultimately borne by the producer.

### 3.4.3 Parastatal Impotence

The port of Cape Town has two parastatal institutions involved with its activities: the already-mentioned TNPA who is the landlord of the port, and the TPT who exclusively manages the container terminal facilities at the Cape Town Container Terminal (CTCT). The activities of TPT are dealt with here, particularly since the minimizing of a vessels' turn-around time in port (i.e. its length of stay) is critical to the competitiveness of the table grape export industry. According to Henesey et al. (2003), the average container liner spends 60% of its time in port at a cost of \$US1000 per hour, and so terminal operators are obligated to provide a service to shippers that goes well beyond crane moves per hour. Congestion and the simultaneous increase in cargo dwell times in the terminal are costly to the industry.

According to international experience, Henesey et al. (2003) state that the four sub-components making up a container terminal system are: (1) the delivery and receipt system with other modes of transport; (2) the storage system; (3) the transfer from storage to berth; and (4) the shore to ship system. They confirm that it is the *delivery and receipt system* and the *transfer from storage to berth* that cause bottlenecks and congestion in ports. This aligns with the Cape Town port experience. As has previously been mentioned, shippers have aggravated the congestion situation by not submitting correct information timeously to the port authorities and by not fully using the 24-hour stack times available to them. Instead, truck arrivals concertina at the delivery and receipt gates of the CTCT facilities during the conventional eight-hour working day, causing unprecedented bottlenecks – particularly in the peak shipping weeks. It has also been mentioned that the shortage of equipment in the terminals to move the increased volume of container traffic within protocol times has exacerbated the congestion inside the terminal.

These challenges have contributed towards lowering the productivity levels of the Transnet Port Terminals (TPT), which by world standards, have been below average. One measure of port productivity is 'crane container moves per hour'. According to Hoffman & Louw (2004), in 1995, just prior to the deregulation of the fruit export industry, Cape Town's port moved between 28 and 32 containers per crane, per hour. But by 2003 it had dropped to

20 container moves per crane per hour. The management of the container stacking system has also left room for improvement. The shipping lines and the PPECB staff have been known to use their own staff to double check containers in the stacks to prevent containers from being left off power, having the wrong temperature setting points and even being put in the wrong stack (Allen et al, 2005). Poor use of stack availability forces direct truck deliveries that create bottlenecks at the gates. According to the CSIR (2006), TPT is not sufficiently flexible in varying the stacking window periods to suit the size of the vessel (i.e. the bigger the vessel, the longer the stacking window period should be to accommodate the delivery of more containers that can be loaded onto the ship).<sup>141</sup> Instead stacking windows tend to be for the same period regardless of the ship size.

Meintjes (2002b) believed that improving the long-term prospects for the SA shipping industry would also involve addressing productivity and efficiency issues in the ports through the privatization of (monopolistic) conventional and container terminals. Rademan (2007) believes that if privatization of the terminals is not possible, then at least public-private partnerships in these terminals should be encouraged by the state. Meintjes (2005c) concurs, adding that limited commercial choices in the logistical arena, especially in the ports, are a threat to the long-term competitiveness of the fruit export industry at large. The divestiture of state-owned assets (like those of the TNPA and TPT in the Transnet stable) has been a bone of contention within South African government circles for some time. Yet according to global trends, the privatization of ports as a whole entity is unequivocal as private companies face a fuller set of market disciplines making them more operationally efficient than publicly owned enterprises (Haarmeyer & Yorke, 1993). National security and regional economic development are two common arguments given by the state as to why ports such as Cape Town should remain public property. But as Haarmeyer & Yorke (1993: 3) point out, 'no persuasive evidence is given for why efficiently run private ports are inconsistent with either of these concerns'.

#### **3.4.4 Powerful Shipping Lines**

The burgeoning shipping industry – especially the container shipping lines – wields an inordinate amount of market power in the logistics chain. With port congestion continually

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<sup>141</sup> Some controversial proposals have been made to alleviate congestion in the CTCT. One of these is the introduction of a time slot system in which container truckers are allocated stacking times. But too many issues constrain the timeous delivery of product that depends on the vagaries of Mother Nature. Another is a preferential payment system whereby those companies that pay more receive prioritized access to the port (Meintjes, 2005a).

flaring up at the South African supply end of the trade chain, shipping lines have had their shipping schedules repeatedly interrupted over the deregulated era, particularly in the new millennium. The shipping lines have attempted to increase their freight rates - partly to recover the costs of congestion - by resorting to the following tactics:

- (1) Imposing surcharges for port congestion delays. This surcharge, similar to demurrage, was known as the South African Port Additional, and was implemented in 2004 at US\$100 per 20-foot TEU. It remained in place until the average vessel berthing delay in each port over a 2-month period had been reduced to below 16 hours. An independent study calculated the lost revenue to shipping lines as a result of congestion to be R500 million per year (Hoffman & Louw, 2004). The fruit exporting community felt that such non-negotiable surcharges were a result of *port* inefficiencies – yet the shipping lines passed the surcharge on to the exporters who, in turn, had to pass it on to their producers.
- (2) Applying intransparent formulaic calculations to the bunker adjustment factor. The bunker adjustment factor (BAF) is an adjustment made by the shipping lines to the freight rates as a result of the rising or falling price of oil (that affects the price of ship fuel, alias bunkers). It is implemented to hedge against the weakening of freight earnings, and is contentious chiefly because the base of the calculation was developed at a time when ships were considerably less fuel-efficient than they are today. So shippers are in the dark as to the real formula that should apply (as it would no doubt be advantageous to shippers if they knew the facts), and carriers refuse to shed any light on the how the formula is compiled, leaving disparities between what some carriers charge for BAF versus what they should be charging (Boyes, 2005).
- (3) Attempting, from time to time, to unilaterally re-introduce a currency adjustment factor. In March 2005, the Mediterranean Shipping Company (MSC) forwarded to its clients a notice from the European South African Conference (ESAC) secretariat in London announcing the re-introduction of a currency adjustment factor (Middleton, 2005). The CAF of 8.02% was due to the weakening of the US\$ (in which shipping rates are paid) and the consequential weakening of the freight earnings from which the shipping lines suffered. It could be argued that shipping lines should factor in exchange rate depreciations in their initial freight rate offerings and take the commercial risk of their calculations for the season. It is unimaginable to think that

exporters could unilaterally readjust their invoices to their supermarket clients because the exchange rate went against them.

- (4) Attempting to make acquisitions that would have directly affected exporters' freight rates on the South Africa-European shipping route, without consulting the industry. The attempted acquisition of P&O Nedlloyd by Maersk-Sealand in 2005 sent a South African fruit industry delegation scrambling to the EU Competition Commission to stave off the acquisition and thereby preserve lower freight rates for South African fruit shippers;<sup>142</sup>
- (5) Short-shipping cargo by skipping ports. If a vessel falls behind in its sailing schedule, it sometimes bypasses a port to make up for lost time. In doing so, it leaves cargo abandoned on the quayside of the bypassed port. Needless to say, short-shipped cargo can have dramatic consequences for perishable products in particular. In such cases, frustrated customers can land up cancelling their orders claiming inexcusable congestion delays at the South African end of the trade chain.

All of the above have had a significant impact on the competitiveness levels of the South African producer of export table grapes, for it is the producer who ultimately pays for increased freight rates. However, the producer is not often directly involved with the shipping lines, and it is the responsibility of his exporter - or the assigned industry association - to challenge powerful service providers on his behalf.

#### **3.4.5 Peak Week Pressures**

Every year during the peak weeks of table grape exports, the Customs and Excise division of South African Revenue Services (SARS) is slow in processing the EUR1 forms. These forms need to be processed and forwarded ahead of the vessel so that importing agents can affect timeous clearance of the goods and avoid EU duties being unnecessarily paid.<sup>143</sup> Interestingly, Rademan (2007) observes that voyage times between SA and Europe have reduced so significantly over the years that it is now a real challenge to ensure timeous delivery of papers ahead of the ship's arrival. This delay has meant that exporters have had

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<sup>142</sup> If the AP Moller-Maersk group had been able to retain the P&O Nedlloyd share of the SA-Europe container service, its share of two-way container trade between SA and the UK/Northwest European continent would have been reliably 'guesstimated' at 77% (i.e. they would have had 1100 out of the 1420 weekly northbound slots of the northbound reefer capacity (Smuts, 2005).

to pay the higher EU customs duty (11.5% versus 2.8% on value of product) in advance, and then subsequently reclaim the balance of it via a ream of additional paperwork that is costly and time-consuming. As the CSIR Report (2006) suggests, the Customs & Excise division needs to be available around the clock during such periods to reduce these administrative delays, especially for high value perishable goods. Alternatively, the industry needs to negotiate the installation of an electronic certificate system under which the EUR1 can be speedily processed and returned to shippers by Customs & Excise.

### 3.4.6 Other Influential Factors

There are other factors beyond the control of shippers and port authorities that play a role in congesting the Cape Town port, and that affect the timeous marketing of table grapes to the UK. They are as follows:

- (1) A weak South African rand in the past has made the Cape Town port environ a favoured destination for the refurbishment of containers. The arrival and cartage of these empty containers simply adds to space and traffic congestion in the port.
- (2) A weaker rand has also made South Africa a less attractive export destination from the perspective of other countries. This reduces the number of refrigerated containers being imported into the country, and therefore reduces the number of such containers available for re-export use in the table grape industry (Louw & Hoffman, 2004).<sup>144</sup> This automatically affects freight rates, as shipping lines have to then bring in the required number of empty refrigerated containers to satisfy the demand for outbound cargo.
- (3) The growth of South African exports and imports - whose combined volume rose 158% from 1979 to 2001 (Perkins et al, 2005) - has exacerbated problems affecting port congestion. Fruit industry stakeholders need to understand that they share the port facilities with many other industries, and that coordinating their efforts with these other industries might alleviate logistical logjams. It is the responsibility of

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<sup>143</sup> Some exporters claim that accreditation with SARS affords the exporter the opportunity of managing the EUR1 forms via an electronic certification process.

<sup>144</sup> One has to bear in mind that shipping lines can only bring in refrigerated containers where doing so makes the venture profitable on both the inbound and outbound sailings in the long run. Cold chain shipping, regardless of the mode, is a one-way business. Reefer ships on the return leg to South Africa have improved their financial returns in the past by offloading second-hand cars in West African markets where the deviation and time delay is minimal, and the venture is profitable.

industry leadership to coordinate export volumes with other industries through the current mechanisms (such as the Port Liaison Forum), or through other mechanisms of their own initiative. The Cape Town port authority's revenue is being supplemented by interesting new-look accounts, like the oilrig industry (for African oil-producing countries like Angola), and the ship-repair industry. Louw & Hoffman (2004) stated that the CTCT experienced unprecedented growth in its volumes in 2004 and found itself at the limit of its design capacity.

- (4) The Cape Town metropolitan area - as a feeder area to the port - has become choked with road traffic in the new millennium; and with rail rates being too expensive to be remotely competitive, the road congestion into ports remains unavoidable (Meintjes, 2004e). This is a result of the economic upswing and the lack of road infrastructure planning to accommodate the surge in motor vehicle usage on the Cape Town roads. Having all major fruit ports located inside the major cities in South Africa has not helped either (Rademan, 2007). Schuitmaker (2005) points out that roads in the docks have been used as rat-runs by scores of early morning and late afternoon rush-hour commuters taking shortcuts in and out of the city. Consequently, where it was formerly possible to do three truck deliveries into the port per day (of the same truck), such truckers are lucky if they can now do two loads on the same day as a result of city traffic interference (Johan Kruger, 2002).
- (5) Due to the changing configuration of global shipping routes, particularly the East-West bound traffic, the Cape Town port has become an attractive transshipment centre where containers are offloaded, and then reloaded a few days later onto another ship for their onward voyage (Hoffman & Louw, 2003). This may generate revenue for the port authorities, but it adds to the congestion affecting South African export cargo.
- (6) The Cape Town port can never be seen in isolation of other South African ports. The congestion at South Africa's busiest port, Durban, has had a domino effect on other ports. For example, ships delayed in Durban will skip other ports of call (perhaps Port Elizabeth and/or Cape Town) to make up for lost sailing time. If the apple, pear and citrus sectors of the eastern Cape - whose exporting windows partially overlap with the tail end of the grape season - experience inefficiencies at the Port Elizabeth port, much of that product will be trucked to Cape Town further adding to the congestion woes of Cape Town port (and the wear and tear on the roads).

- (7) Once wind has breached 90km/h, ship loading is stopped for safety reasons. Unfortunately in Cape Town, the windiest months are in summer during the loading of table grapes, and the port loading stoppages can be quite significant in a bad year.
- (8) Labour disputes and their accompanying strikes have had a deleterious effect on port productivity in the past. Although labour strikes have delayed vessel departures to the detriment of shippers, labour unions have instigated relatively few incidents of unrest in the deregulated era. It is important that strike warnings are relayed to the industry so that contingency plans can be made, especially for perishable cargo.

There are many service providers supporting the SA table grape export sector at the South African end of the post-harvest logistics chain. This leg of the chain covers the movement and quality of product from the inland cold store through the port and onto the ships; and it is a crucial area in which many improvements can be made. As noted in this chapter so far, the service providers involved consist of South African state owned enterprises, large multinational corporations and South African owned companies. The final section of this chapter will now look at areas in which South African commercial service providers and industry organizations can improve the competitive performance of the industry by offering more innovative products and services.

### 3.5 Innovation at the South African End of the Supply Chain

87% of all research and innovation in the table grape industry has been focused on pre-harvest disciplines such as new variety cultivation and evaluation, biotechnology, entomology, genetics, plant pathology, soil science and production (DFPT, 2006b). Post-harvest research and innovation constitutes the remaining 13%. In order to be more internationally competitive, the FPEF is attempting to rectify this imbalance through the launch (in late 2007) of a post-harvest and cold chain innovation technologies programme. This is a 3-year, public-private partnership between the Department of Science & Technology (DST), the Agricultural Research Council (ARC) and the FPEF. In the innovation programme's business plan (DST, 2006), a number of table grape project proposals were made. Post-harvest specialists in the industry were also interviewed by the DST, and their priority areas for innovation (not necessary solutions) were discussed along the following lines:

- (1) *Container technology.* With the strong growth in container shipping already outlined in this chapter, and the recent shift from porthole to integral container usage, innovation in this area of the business forms a strategic investment for the industry's competitive future. Most shipping containers were developed as multi-purpose units 30 years ago, and whilst these containers have been fitted with refrigeration units, their internal airflow has not been re-designed to accommodate the larger containers, new knowledge about fruit ripening, disease control and insect sterilization (Dodd, 2006). For table grapes to reach the UK market in optimum condition, they need to be kept at the lowest possible temperatures and have the highest possible humidity levels that they can withstand during the container voyage (Dodd, 2006). Early research has shown that this can be more consistently achieved by changing the traditional flow of air in a container from a horizontal to a vertical direction. Otherwise, relative 'hot spots' occur inside the container, negatively affecting the quality of unfavourably located fruit. The table grape industry also needs to investigate the possibility of using controlled atmosphere in containers for the table grape sector, as the advantages gained by the subtropical sector in doing so appear to have been most beneficial.
- (2) *Packaging design and component technologies.* Packaging 'design' refers to the aesthetics, practicality and structural strength of the corrugated cardboard cartons in particular; whilst packaging 'component' refers to the materials from which the

packaging is made, namely low- and high-density polyethylene (plastics), polycarbonates and cardboard. The various configurations of cartons used for table grape exports are not designed to allow air to flow through them both horizontally and vertically (Le Roux, 2006). Yet this is what is required of them. Innovation in carton ventilation therefore needs to be investigated in tandem with vertically orientated airflow proposed in container technology in (1) above. The lack of standardization of internal<sup>145</sup> packaging design also affects the efficacy with which grape product can be cooled, and this creates superfluous costs. For example, polyethylene bags carry a whole permutation of ventilation holes that affect cooling rates.<sup>146</sup> The UK market is now particularly concerned about the carbon footprint<sup>147</sup> of fruit to market, and this will necessitate the acceleration in innovation of more biodegradable<sup>148</sup> materials used in the packaging (Taylor, 2006).

- (3) *Disease and pest control technology.* Poor post-harvest handling of fruit (i.e. roughly handled fruit and fruit whose cold chain is interrupted) and unhygienic conditions in the fruit chain are significant contributors to increased post-harvest decay of fruit (Korsten, 2006). The market place has also been particularly harsh on the industry's use of chemicals to combat disease on fruits in recent years. As Benic (2006) pointed out, the maximum residue level (MRL) issue is a complicated one that threatens to destroy South Africa's market share if not properly managed - not just in the UK, but also in the EU. The 2006 Riebeek-Kasteel MRL case was one in which SA grape product to Ireland was stopped owing to unidentified chemical residues on the product. It was eventually determined that wind-swept chemicals being applied to an adjacent wheat field to the vineyards in Riebeek-Kasteel had contaminated the grapes concerned. Driven by health concerns, authorities have removed many formerly allowed chemicals from the EU-approved list and in addition to this, revised downwards the maximum residue levels permitted on fruits of those chemicals still allowed.

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<sup>145</sup> 'Internal' packaging refers to the packaging adjacent to the product such as polyethylene bags, sulphur pads and punnets. 'External' packaging relates to cartons, pallets, strapping, angle-boards and containers that do not touch the product (directly) itself.

<sup>146</sup> It stands to reason that a grape polyethylene bag that has more holes of a bigger diameter will cool the product at a faster rate than one that has fewer, smaller holes. The faster you bring your product on temperature, the cheaper the cooling cost, and the longer the shelf life of the product.

<sup>147</sup> In the wake of global warming and Al Gore's Oscar-winning documentary "An Inconvenient Truth", EU (and other) consumers are now clearly concerned about how much energy is being expended (and fossil fuels burnt and released into the atmosphere) in order to import fruit products into the EU from around the globe.

<sup>148</sup> Biodegradable packaging will need to incorporate the use of polymer scientists. Innovation along these lines will be costly, and are unlikely to attract funding from the packaging companies producing traditional cardboard substrates that would be reluctant to deviate from the status quo. An alternative solution is to buy in newly developed packaging technology (Griesel, 2006).

However the registration of a chemical in South Africa proving its acceptable use under South African conditions is an arduous and costly process, peppered with government legislation and bureaucracy according to Griesel (2006). There is concern in the industry that the capacity and expertise currently resident in the Department of Agriculture's chemical registration division is insufficient, and that unregistered chemicals are now being sold in the agricultural sector in South Africa. There is therefore an urgent need to establish an industry desk that: (1) identifies locally and internationally manufactured chemicals that the market accepts being used on South Africa's table grapes; (2) confirms whether these chemicals are suitable for local use; and (3) registers them speedily with government so as not to hamper the industry's access to the market place (Griesel, 2006).

The Scandinavian countries launched a European-wide campaign in 2005 in an attempt to have the use of sulphur<sup>149</sup> banned on imported grapes. Whilst the levels of SO<sub>2</sub> usage were considered higher and potentially more detrimental to human consumption than was actually proven to be the case, the whole concept of sulphur usage to stop botrytis rot was brought to the attention of health authorities in South Africa's major markets. The South African research fraternity needs to join the international community in finding a replacement technology to SO<sub>2</sub> (which will in all likelihood re-emerge under the international spotlight and eventually be banned in its entirety). Promising alternatives to sulphur dioxide include various chemical and biological control methods (Korsten, 2006), including ozone, yeasts and modified chlorine packaging (Huysamer, 2006). One should also consider that the litchi product requires similar SO<sub>2</sub> treatment and that collaboration between the subtropical and deciduous fruit industries might be beneficial in this regard.

Currently very cold storage conditions have to be implemented for a lengthy period on the fruit to sterilize certain insects (like the Mediterranean fruit fly on grapes for the UK market). This is harsh on the fruit and detrimental to its quality. An alternative mitigation treatment to cold sterilization is irradiation technology that Benic (2006) believes is well worth investigating. Irradiation technology is currently used in the condiments and medical instrument industries. Like products from those industries, grapes too can be bombarded with gamma rays that would

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<sup>149</sup> Some consumers are reportedly allergic to even low levels of sulphur dioxide (Huysamer, 2006).

sterilize the fruit fly, preventing it from multiplying on arrival in the destination country (Labuschagne, 2006).<sup>150</sup> Whilst some research is being done, there is scope for the Department of Science & Technology to work with the International Atomic Energy Agency (IAEA) to further research in this field (Labuschagne, 2006).

- (4) *Information Technology.* There is a need for the table grape industry to devise a far more comprehensive business intelligence system than what is currently on offer to stakeholders shipping product to the UK (and other markets). To this end Huysamer (2006) proposes that the industry establishes an IT-hub to deliver the following kind of information: (a) the industry's weekly vital statistics on intakes and shipped volumes to the UK (by variety and berry size); (b) securitized website access to weekly market prices; (c) competitors' weekly shipped volumes (by variety) to the UK market; (d) handling protocols and packing standards; (e) market access information like phytosanitary requirements and import tariffs, including new markets being targeted; (f) product tracking and tracing services; (g) teaching material for training of personnel in the industry's value chain; (h) weekly shipping schedules; (i) updates of new technology developed for the industry; (j) collaborative efforts with competitors such as Chile; and (k) industry disputes between overseas buyers and South African suppliers, and between South African exporters and their suppliers, in an electronic pin-board format.

The role of the PPECB (custodian of the industry database for confidentiality reasons) is to ensure that data files are collected electronically every day from the many IT and logistical service providers at the South African end of the chain. The PPECB is then required to 'clean' and 'format' the data files in such a way as to make them user-friendly for industry associations to process into meaningful information for their constituencies. However, PPECB's difficulty in supplying data files to the industry is due to the industry's data collection system, which falls short in accuracy, timeousness and completeness. This negatively affects the competitiveness of those stakeholders - particularly the exporters - needing the right information to make the right marketing decisions at the right time (Huysamer, 2006).

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<sup>150</sup> Interestingly, fumigation (with methyl bromide) is another post-harvest technique used for the eradication of Mediterranean fruit fly to the USA market. Like cold sterilization, fumigation is tough on the fruit and weakens the cardboard packaging. So irradiation is an effective alternative technology that even the USA's Food & Drug Administration (FDA) accepts as a legitimate post-harvest treatment.

The *accuracy* of data is compromised because:

- (a) The barcode systems for cartons and pallets used at the source of fruit entering the IT chain are not standardized (Polderdijk et al, 2002). This is due to the voluntary approach adopted by the industry in matters such as system standardization, and the costs involved for users in switching from their existing system to the recommended industry standard (Le Roux, 2006). It is anticipated that in order for the industry to adopt the universally accepted EAN.UCC barcode standard, for example, some form of government intervention will be required to make it mandatory and affordable.
- (b) The manual entry of data at the start of the IT chain contains too many human errors that, when and if discovered, take time to be corrected and re-entered into the system; and
- (c) The plethora of industry codes in IT and logistical service providers' companies that are not yet standardized (Polderdijk et al, 2006). It has emerged that a pack code, for example, pertaining to a specific grape product might have several variations in the exporters' IT systems (e.g. four different codes could exist for the same product). Unless the code is standardized to one code for all users, a 'translation table' has to be built to convert all the different codes for the same product to one code (and then all the volumes attached to each of those codes have to be summated to one total volume belonging to that one code).

The *timeousness* of data is compromised, firstly, because the electronic data interchange (EDI) technology inadequacies encountered are characteristic of the multitude of IT companies that have emerged to serve the 150 or more table grape export companies in the deregulated era. Secondly, it takes more time to manually rather than electronically capture data at the more remote intake points (which have not yet graduated to electronic data capturing methods) before being forwarded to the PPECB. Laggards land up having their data added weeks later to the industry system by the PPECB, making a mockery of decisions taken in previous weeks based on wrong information. According to Asif & Mandviwalla (2005), a complicating factor to this all is that Radio Frequency Identification

(RFID) technology<sup>151</sup> could make current, electronic data collection systems partially redundant in the near future.<sup>152</sup>

Lastly, the *completeness* of the data (i.e. ensuring that the data received covers all product moving through the system for the period under consideration) is compromised because the 'system' sometimes misses fruit packed – particularly in containers that are sent directly from pack house to the quayside without consignment notes being electronically captured. The contents of containerized fruit is sometimes not known until the mate's receipt from the shipping line is received after the ship has sailed.

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<sup>151</sup> RFID is 'an emerging technology that can either complement or replace traditional bar code technology to identify, track and trace items automatically. It claims to add intelligence to and minimize human intervention in the item identification process by using electronic tags. The tags are superior to printed bar codes in terms of their capacity to hold data, the range at which tags can be read and the absence of line of sight constraints' (Asif & Mandviwalla, 2005: 393).

<sup>152</sup> In 2004, large retailers and government organizations (particularly in the USA) started mandating certain of their suppliers to use RFID technology. Whilst there are barriers against its widespread adoption (like standards, interoperability, costs, forward compatibility, lack of familiarity by users and issues of attenuation and interference), it is a matter of time before it reaches the fresh produce industry (Asif & Mandviwalla, 2005: 393). The SA table grape industry would do well to position itself timeously for the adoption of this technology.

### 3.6 Summary

The logistics chain has been re-engineered to provide the seamless integration of traditionally standalone services into a one-stop-shop opportunity for shippers to contract with 3PLs. This has enabled the exporter, or his producer, to move the grape product from the producer to the customer through relatively few intermediaries. The major drivers of this service provision trend are: the need to reduce transactional costs for both the marketing agent and the self-exporting producer; greater transparency demanded by the producer on consignment business where cost savings and product quality management are paramount to his profitability; and more recently, UK supermarkets wishing to extract greater income from volume-based rebates available in the chain by taking the logistics function away from exporters and contracting directly with 3PLs themselves.

Another influence on the development of 3PLs has been the revolutionary changes occurring in the international shipping sector. The rise to prominence of the container liner sector is a result of international shipping trends, including the interconnectivity of land networks, the interoperability of different transport modes and improved compatibility of ICT systems. Bigger and faster container vessels have come on stream, and provided spare capacity that has dampened freight rates. Sailing-time savings and reduced port calls have improved the SAECs service for UK table grape exporters in particular. Container shipping lines have also invested in subsidiary companies that carry out landside logistics functions, creating additional capacity in the 3PL environment.

By the same token, the tramping of conventional vessels for single clients has morphed into a very flexible, multi-client and combi-shipping service. However, no new conventional ships are being built; older, specialized reefer vessels are being scrapped; and the demand for such vessels by commodity-hungry China is outstripping supply. Therefore the supply of conventional vessels is under pressure, resulting in higher freight rates in relation to the containerized sector. This suits the grape export industry, which has shown a strong migration towards the use of containers (now over 70% of the business). This container migration is due to greater quality assurances as the product is handled fewer times in an unbroken, door-to-door cold chain service.

The congestion at the port of Cape Town through which all grape product flows to the UK has been significant in the deregulated era. There are five identified causes of congestion that compromise the industry's international competitiveness. Firstly, there is underinvestment in the port's infrastructure, which is allied to bad service, weak skills and

escalating costs. This is due to insufficient long-term capital expenditure by central government, and no short-term capital expenditure by the TNPA despite the significant annual taxes being levied on the industry via the TNPA cargo dues system. Secondly, a disorganized exporter community is not providing reliable estimates of product volumes moving from the farms through to CTCT, particularly in the peak weeks. This is symptomatic of a bigger electronic data collection problem across the fruit industry. Exporters are also selfishly overbooking shipping space and subsequently cancelling it at the last minute. The exporters' documentation is often not up to scratch, and proper use is not made of the 24-hour container stacking space available to them. Thirdly, bottlenecks in the container terminal have been ascribed to inferior management of "A" check and "P" check by TPT. Productivity levels in CTCT are also in question in terms of container moves per hour, and the management of container stacking space and container temperatures have been inadequate. Fourthly, powerful shipping lines have raised the cost of doing business for table grape exporters by unilaterally imposing demurrage charges (for port congestion), and by implementing bunker and currency adjustment surcharges without consultation. Fifthly, a timeous response by SARS on EUR1 forms would avoid the unnecessary payment and subsequent recovery of EU duties paid by exporters when clearing the grape cargo for the UK market. Other influential factors causing congestion in the port of Cape Town that are mentioned include Cape Town city's road traffic congestion problem, container loading delays due to wind, the refurbishment and transshipment of containers that exacerbate the congestion of the port, and the massive unplanned-for growth of trade through the port in the last 10 years of South Africa's democracy.

Lastly, post-harvest innovation in the table grape export industry trade chain has been largely neglected when considering that the predominant expenditure of producers' statutory levies has been on pre-harvest matters in the deregulated era. The Department of Science & Technology's Post Harvest & Cold Chain Innovation Programme plans to unravel new technology in terms of revised airflow in containers, new designs and components for packaging, post-harvest disease management of the product, and the provision of timeous, accurate and complete information for all stakeholders in the value chain via a centralized information hub.

## **Chapter 4: Competing for UK Market Share**

### **4.1 Introduction**

In this chapter, the UK market is contextualized by understanding the growth of the retail sector over the last 30 years. The top five supermarkets have essentially usurped the traditional market of the wholesalers, which have had to metamorphose into regional markets that predominantly supply the catering sector now. The retail sector of the UK High Street - where supply volumes are carefully controlled by the supermarket buyers - is significantly more concentrated than the contiguous European Mainland market. As a result, the laws of supply and demand do not operate as fluently in the UK as on the European Mainland where an eclectic market is supplied through a maze of traders, wholesale markets and varying retail formats.

Internal and external competitive forces are examined in the pre-Christmas and post-Christmas windows of the falling price market of the UK. This chapter shows how the major UK supermarkets make use of importers to enhance their buying power with their suppliers. The mechanics of a UK supermarket programme are discussed in which it is shown how retailer behaviour gives rise to, amongst other things, late price indication, product over-procurement and limited alternative outlets for suppliers. The buy-supply relationship is evaluated using actual examples emanating from the organizational theories of distributive, procedural and interactive injustice.

Various retail and supplier price points are injected into a cost chain model, and this model demonstrates varying levels of profitability for South African producers under certain supply conditions. The controversial rebates and slotting fees (alias 'handing charges') are discussed, with the latter being addressed from the perspective of the efficiency and market power schools of thought. Aspects of South African exporter competitiveness are highlighted using game theoretical concepts.

The content of the chapter is synthesized into six major UK supermarket trends. These trends indicate the degree to which supermarket power has concentrated over the deregulated era, and the impact that it is having – and will continue to have – on South African table grape suppliers.

## 4.2 Ascendancy of UK Retailer Power: 1970 to 2007

Up until the 1970s, British retailers had passively displayed manufacturers' goods in a mass merchandizing approach towards consumers. Competition amongst retailers at a national level was weak, with only local and regional variations in consumer demand spurring on competition between these retailers. However the rising affluence of British consumers with their increasingly sophisticated purchasing decisions meant that more products, of a greater variety and of a superior quality were being demanded. Coupled with the economic difficulties of the 1970s, these same consumers became very cost conscious. Consequently, the British public started shopping around for better value, and it soon became apparent to the retailers that their old approach of passively displaying manufacturers' goods would no longer suffice with the gregarious and discerning nature of the 'new consumer'. Retailers would have to compete actively for customer patronage in different market segments, and would need to save costs in order to make their total retail offer more affordable to these customers, on a national scale. The structure of the UK retail sector was to change substantially throughout the 1980s and 1990s. Essentially, retailers were to extract more and more value over time from the manufacturers in the cost chain. They initially achieved this through strategies that centered around capitalizing on economies of scale and scope (Dawson, 2004). Retailers would need to reach critical business mass at a national level in order to take advantage of cost savings in the supply chains (scale), and of market share in precisely targeting consumers through various retail formats (scope). Gradually the larger retailers increasingly became the 'gatekeepers' for suppliers to access consumers (Dobson, 2002).

In an attempt to become the national, dominant firm, retailers expanded organically and through mergers and acquisitions. The accrual of supermarket power began when retailers were able to change the cost structures between themselves and their suppliers. They also started to eliminate wholesalers by integrating backwards in the chain (Hollingsworth, 2004). The dictates of scale that accrued power to the retailers were retail brand product development at the expense of manufacturer brand development, logistics control through outsourcing and distribution centres, product quality control, shelf-space management and its associated fee structure, and the determination of trading conditions (price, payment terms, rebates etc) with suppliers (Dawson, 2004). At the same time, retailers moved from mass merchandising to focused merchandising by introducing customized store formats through economies of scope. These formats were founded on marketing concepts like market segmentation, target marketing, range planning and behavioural research on consumers (Dawson, 2004). Essentially, retailers determined the range or scope of store

formats that were required to attract their customers. These store formats were classified into superstores, supermarkets, convenience stores and the like. Each retailer developed its own formula within these formats and achieved economies of scope through 'tighter management of product lines, improved merchandising, the use of category management, offering a mix of services complementing product lines, and store level branding' (Dawson, 2004: 9). The diversification of these store formats deepened further through changes in the store's 'images, internal design, opening and closing times, space allocation and store location' (Newman & Cullen, 2001: 46).

In the late 1980s, managerial control of retail outlets migrated from store-level to corporate headquarters (Burt & Sparks, 2003). The following three major strategies of scale and scope adopted by corporate retail management have been highly influential in their ascendancy to power in the UK, particularly over their fresh produce suppliers.

- (1) The UK Food Safety Act of 1990 required supermarkets to take 'all reasonable steps' to ensure safe food for the British consumer (Fearne and Hughes, 1999). Retailers were conservative in their interpretation of the word 'reasonable' and insisted that their suppliers start delivering safe food in line with accreditation protocols.<sup>153</sup> In 1993, the European Union authorized governments to 'name and shame' retailers who sold, for example, fresh produce that had chemical residues on them superseding the maximum residue levels allowed (Dolan & Humphrey, 2004). The plethora of standards that arose as a result of food safety pressures culminated in the supermarket-driven, sectoral standard called EurepGAP in 2001. This protocol of good agricultural practice covered not only food safety, but also worker welfare, chemical residue levels, wildlife protection and natural resource conservation for fresh produce suppliers (Freidberg, 2003). All the while the costs of being compliant with these safety standards (including the ever-escalating standards of product quality demanded by the supermarkets), were passed by the supermarkets onto their suppliers.

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<sup>153</sup> With the locus of quality control moving from 'product quality' to 'process quality', trade associations, NGOs, corporations and the public sector developed an array of standards or codes over the years such as: *generic* codes (e.g. ISO 9000 Quality Systems); *social* codes (e.g. Ethical Trading Initiative); *manufacturing* codes (e.g. HACCP); *company* codes (e.g. Tesco's Nature's Choice); and *sectoral* codes (e.g. EurepGAP) – Dolan & Humphrey (2004).

- (2) The implementation of efficient consumer response (ECR)<sup>154</sup> and category management (CM)<sup>155</sup> enabled retailers to scrutinize their suppliers extraordinarily closely (Fearne & Hughes, 1999). Category management essentially developed because supermarkets were starting to lose market share in certain product categories to warehouse clubs, supercentres and discount stores that had come to be known as 'category killers' for the supermarkets (Steiner, 2001). Through ECR and CM, supermarkets were able to change the nature of the business and stem the loss of certain categories to these category killers. The fact that fresh produce had become a 'destination category' was also of major importance to supermarkets, because this meant that consumers were prepared to switch stores based on the attractiveness, quality, variety and price of the store's fresh produce department (Fearne & Hughes, 1999). With almost all fresh produce carrying the private label of the retailer, it afforded the retailer the important opportunity of differentiating its product from its rivals' products (Dolan & Humphrey, 2004).
- (3) Supermarkets have converged to every day low pricing (EDLP) forcing suppliers to constantly scrutinize their costs at every junction in the chain. In order to squeeze costs out of the chain and thereby increase profitability and win market share, UK supermarkets have concentrated particularly on product and supplier rationalization. In preferring to deal with fewer and bigger suppliers, supermarkets can reduce transaction costs and lower their risk on the quality and food safety front (Fearne et al., 2005).

As a result of these major retailer strategies, the battle for market share between the supermarkets has continued unabated. Fearne and Hughes (1999) note that there is no more growth opportunity for new stores, as the market is physically saturated. They claim that growth lies in: (1) consumers spending more money on value-added produce (rather than consumers buying more produce), and (2) market steal, that is retailers attempting to acquire each others' market share through promotions, below-cost selling and any other predatory means available to them. Levels of concentration in the retail sector have therefore intensified considerably over the period discussed, as shown in Table 4.1. The

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<sup>154</sup> ECR is defined as 'a process whereby suppliers and retailers work together in order to reduce inefficiencies in the supply chain, particularly in logistics. The emphasis is on determining consumer needs and reacting to them rather than persuading consumers to buy what is available' (UK CC, 2000: 241).

<sup>155</sup> CM can be defined as the process between the retailer and supplier in which categories are managed as strategic business units to enhance results and deliver consumer value (Europe ECR, 2000).

chief casualties of this concentration were the small, family-owned retail stores that closed in large numbers (Dobson, 2002).

**Table 4.1 Levels of Concentration in the UK Retail Sector <sup>156</sup> (1971 – 2000)**

	1971	1976	1980	1986	1990	1995	2000
<b>Retail Organization (000's)</b>	368	261	256	244	241	209	215
<b>% sales of 10 largest firms</b>	13	15	19	27.3	30.4	32.3	38.1
<b>Gross margins as % of sales</b>	29.2	27.2	26.9	28.3	29.7	30.7	32.9

Source: Dawson (2004)

In 2000, the UK consumer's perception of higher grocery prices in the UK (compared to other EU countries and the USA), and the disparity between farm gate and retail prices caught the attention of the competition authorities (UK CC, 2000). An official investigation was launched into the business practices of supermarkets,<sup>157</sup> their alleged abuse of dominance in the chain and the claims made regarding the ubiquitous abuse of their market power with their suppliers. Despite this investigation, the new millennium has witnessed a further set of cost economies that is being extracted by UK retailers in the chain, namely 'the effect of convergence of information and communication technologies', enabling the retailers to internationalize their store operations and to offer complementary retail services like financial, health and leisure services to their customers (Dawson, 2004). With the introduction of loyalty cards and the use of sophisticated computer software, UK retailers are now mining their customer databases to plumb the intimate depths of individual consumer behaviour. An article on the "*Tesco-isation of Britain*" states that 'Crucible' -

<sup>156</sup> The phrase 'retail sector' is used generically throughout this dissertation to denote 'grocery sector', which incorporates the fresh produce category (see footnote below).

<sup>157</sup> The Competition Commission (UK CC, 2000) investigated the practices of those UK supermarkets that supplied groceries (which includes fresh produce) from 600 sq metres or more of grocery sales area, and which was one of 10 or more stores controlled by a single person. 24 such supermarkets qualified on this basis, but only five 'main parties' were assessed because they were potentially wielding excessive market power, namely Asda, Morrison, Safeway, Sainsbury and Tesco. This chapter concentrates its efforts on these stores, but excludes Safeway as it was acquired by Morrison in 2003.

Tesco's massive customer database - stores information on the shopping preferences, travel habits and makeup of practically every British household through the Tesco club card system, or by trading information with certain consumer group companies (O'Grady, 2006). According to Terry Leahy, CEO of Tesco, their ability to use stored information to understand their customer is now limited only by their imaginations (Leahy, 2005). This IT capability is affording the retailers the opportunity of tailoring their product offerings more accurately not only in store, but also in new virtual formats via the internet (Dawson, 2004).

It is this rising UK supermarket power with which South African table grape producers and exporters have had to contend in their biggest single (country) market since deregulation.

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### 4.3 Transformation of the UK Wholesale Markets <sup>158</sup>

Traditionally, the wholesale markets were a meeting place for buyers and sellers to make the daily prices for fresh produce in England. Covent Garden, the larder of London, sourced product and distributed it to all the retailers, secondary wholesale markets in London and the outlying wholesale markets of England. However, the procurement muscle of the major retailers (as outlined in the previous section) soon became apparent as they gradually bypassed the wholesale market system to source product directly from producers. Today it is the market power of these same retailers that enables them to encroach on the wholesalers' traditional markets by acquiring many of the independent retail chains and convenience stores, and by forcing small family-owned retail formats out of business.

The wholesale sector has therefore had to rely heavily on the residual catering sector as a panacea for its ills. This nationwide sector consists of hotel chains, restaurants, gastro-pubs and public institutions like hospitals and prisons. Face-to-face selling in the wholesale markets has been replaced with telesales, e-selling and distribution-led trading (whereby wholesale markets no longer receive business at their premises, but instead distribute ordered product to the customer's premises). This has resulted in wholesaling businesses having to invest in cold room facilities, warehousing, IT systems, distribution vehicles and sales staff. The term 'wholesaling' can largely be considered a misnomer now because the business has evolved into an amalgamation of services, namely the sourcing, importing, clearing, selling, re-packing and distribution of composite offerings (i.e. fruit, vegetables, flowers, meats and packaging products). This includes so-called 'keyhole services' which refers to the delivery of such a composite basket of products to a client just before opening for business. The current development unfolding in the catering sector is the rise of specialized, supplying companies that have broken away from the wholesale markets to source and supply the catering sector directly themselves. The buying power of these breakaway companies is gradually concentrating into the hands of a few.

The net effect of these market changes is that many of the UK's wholesale markets are in the process of re-defining their futures, and the following trends are challenging the status quo:

- (1) The major retailers and discount chains have cornered the supply of fresh produce to most of the grocery stores beyond the reach of wholesalers;

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<sup>158</sup> The information provided in this section is a synopsis of the FPJ's supplement on the UK wholesale markets (Leighton, 2006a).

- (2) The catering sector, currently the major market for the wholesalers, could also slip through the wholesalers' fingers into the retailer's hands;
- (3) An individual wholesaler's growth has been at the expense of its competitors where ageing owners of wholesaling companies with no succession planning for their businesses have either been involved in mergers and acquisitions, or been forced to close their businesses;
- (4) Staff recruitment has become problematic in an industry that has a stereotypical, barrow boy image with anti-social hours and an unglamorous future associated with it;
- (5) Most wholesale markets are in dire need of renovation and have become physically unattractive to traders and customers. With the emphasis now on food safety, many people believe that these markets are no longer appropriate as food handling sites;
- (6) The bureaucracy continues to strangle the business especially when it comes to the legislation of the sector (for reasons such as recycling, health and safety, vehicle registration, traceability, minimum residue levels, employment contracts and due diligence procedures);
- (7) The complex agendas of central and local government are unpredictable and far-reaching; and
- (8) Many industry leaders in this sector continue to react in an unresponsive manner to swift market changes.

Despite the decline of this sector, such market dynamics bring with them some 'problem opportunities' for suppliers – including South African table grape suppliers. Independent retailers and smaller shops in the more remote parts of the UK are managing to stave off the creep of the big retailers to the benefit of the wholesaling trade. Some wholesale markets like Glasgow are thriving, though they are in the minority. In an attempt to survive, the various wholesale markets in greater London have metamorphosed by relocating, merging and modernizing their fresh produce offer to meet the challenges of a re-engineered customer base. Public-private ownership models have been designed to revive the sector. The consolidation of regionalized wholesale markets down to the bigger urban

areas is bound to improve the buying power for these new, one-stop-shop food distribution centres. Many cities in the UK will be undergoing regeneration programmes over the next 10 years, and it is hoped that this will breathe life back into cities and provide a rejuvenated support base for the wholesale markets. The British public, backed by its consumer organizations and politicians, is revising its dietary habits to the benefit of fresh produce consumption as a whole.<sup>159</sup>

Apparently the resident Asian communities in the UK (in cities like Leicester) are tending to preserve the old-style shopping experiences of food markets rather than retail formats. And with the growing crossover of international eating styles that demand different types of fruit products, it provides some potential for the future of this sector. For example, the Asian communities are particularly partial to their grocery shops (non-retail format), and their eating preferences include exotic fruits (e.g. mangoes and avocados) and grapes that are more yellow and sweeter than those traditionally offered in the UK retail outlets. South African table grape suppliers should therefore be alive to the future possibilities of this metamorphosing sector.

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<sup>159</sup> This is evident in the implementation of the 5-a-day campaign and the national school-feeding scheme.

#### 4.4 UK Market Versus the European Mainland Market

The UK and European Mainland markets are briefly compared here because, firstly, about 85% of South Africa's table grape shipments have landed in the EU market since deregulation - 25% to the UK, and 60% to the European Mainland. Secondly, both the UK and the European Mainland markets are inextricably linked due to their geographical proximity and the effects that the two markets have on each other. The UK market is a single country market where almost entirely seedless grape product is sold to consumers on the High Street. The retail sector has evolved into a decidedly structured, sophisticated and concentrated sector. Growth available to the supermarkets is sought by resorting to: (1) cannibalizing each other's market share through mergers and acquisitions; (2) stealing each other's market share through below-cost selling; and (3) expanding into new territory by internationalizing their businesses. Supply volumes to the UK market are essentially controlled by these supermarkets, and so the laws of supply and demand do not operate as fluently as a free-market system would suppose.

On the other hand, the European mainland is a conglomeration of many countries and is therefore considered a heterogeneous market where the product is sold through a maze of traders, wholesale markets and a variety of retail formats. The market is more consumer-driven where the laws of supply and demand are far more prevalent than in the UK. According to GEF members, South African table grape suppliers cannot be generic in their approach to Europe. Their supply strategy will depend on the country,<sup>160</sup> market segment,<sup>161</sup> week and variety being targeted. Certain business cultures are flexible,<sup>162</sup> others are not, and the culture of the country generally determines what will be sold in that country, and how it will be sold.<sup>163</sup> The scope of the EU market therefore offers far more varied selling opportunities for the South African grape offer than the UK. Whilst it may therefore be regarded as 'relatively easy' to supply Mainland Europe, avoiding the middlemen and maximizing returns in this market are still two of the major challenges

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<sup>160</sup> Non-grape growing countries like Switzerland, Belgium, Austria and Sweden can be considered very close in stature to the UK market. The colour green is considered 'ripe' and so green-coloured grapes are the preferred grape group. Conversely, grape-growing countries like France, Spain and Italy demand grapes that their consumers are used to eating during their own growing seasons, which are typically the yellow, red or black varieties.

<sup>161</sup> The wholesale markets in most countries on the European Mainland - particularly in the Mediterranean countries - play a dominant role in supplying grapes to the supermarkets and directly to the consumers.

<sup>162</sup> Germany's market is particularly flexible on supply and is normally the first port of call for any South African supplier. There are the supermarkets (e.g. Edeka and Tengelmanns), discounters (Aldi and Lidl), wholesale markets and traders in the port of Hamburg that provide a multitude of distribution channels for SA suppliers. Holland is similar, and the traders that congregate around the port of Rotterdam provide experienced and inexperienced SA suppliers significant penetration into EU market within a 24-hour trucking radius from Rotterdam.

<sup>163</sup> Countries like Spain and Italy are made up of geographical regions that operate entirely independently from one another. According to Leon van Biljon, Dole, for example, has four offices selling its product in Spain. Each office is run by different people, serving different market segments, that speak different Spanish dialects (for the region they serve) and that supply different varieties from one another.

facing many South African table grape suppliers. Another major challenge today is catering for the rapid changeover on the European Mainland from seeded to seedless grapes (driven by convenience), particularly on the red seedless grape front. Whilst there is still a significant percentage of seeded grapes consumed on the Mainland, this is waning rapidly, and South African producers will need to accelerate the switch in their vineyards to become more market-driven. Whilst it can be dangerous to generalize, the main differences between the UK and European Mainland markets are summarized in Table 4.2 below.

**Table 4.2 Differences between the UK and European Mainland Markets**

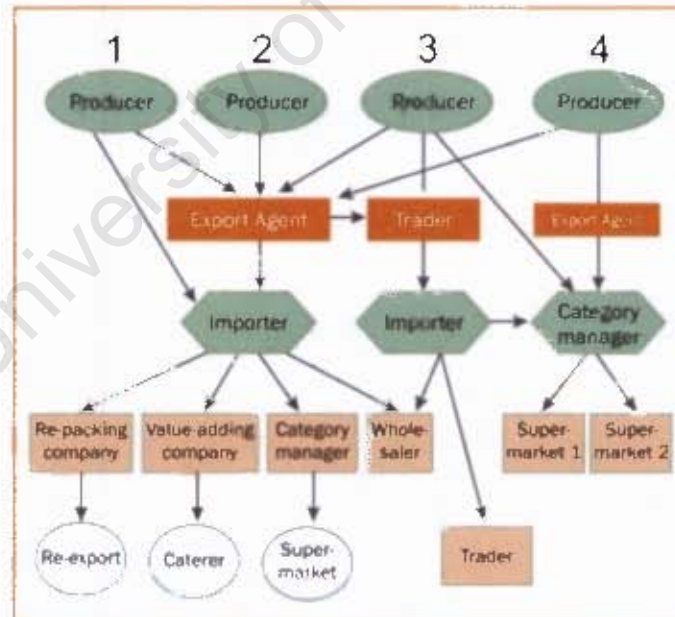
<b>Economic Factors Considered</b>	<b>UK</b>	<b>Mainland Europe</b>
<b>% Business Through Supermarkets (2005)</b>	82%	49%
<b>Market size (of SA sales, 2005)</b>	25%	60%
<b>Size of Wholesale Market</b>	Small	Large
<b>Destination Market</b>	One country (homogeneous)	Many countries (Heterogeneous)
<b>Nature of Market</b>	Predominantly retail	Predominantly traded
<b>Supermarket Purchasing Channels</b>	Directly from the Category Manager	Mostly from the Wholesale markets
<b>Packaging Type</b>	Very specialized (packaging sells product)	Plain (product sells itself)
<b>Berry Size</b>	Large & Extra Large	Regular to Extra Large
<b>Grape Type</b>	Seedless	Mostly seeded, but seedless growing
<b>Branding</b>	House Brands	Supplier Brands

Source: GEF Members (2006), PPECB (2006), Promar (2001)

#### 4.5 Distribution Channels, the British Consumer and the Product

South Africa is one of 27 countries supplying table grapes to the UK retailers in a calendar year, and these retailers sell 82% of all fresh produce consumed in the UK market (Leighton, 2005a). The wholesale market also accounts for about 10% of the British spend, and the balance of the product (8%) is distributed directly to the hospitality industry (catering sector), the national school feeding programme and government institutions. Four supermarkets now control most of the supply into the mature retail market through carefully controlled supermarket 'supply-programmes'. According to GEF members, the four major retailers and their current market shares are Tesco 29%; Morrison 20%; Sainsbury 16% and Asda 12%. Around 25% of South Africa's harvest (60 000 tones) was exported to the British market in the 2004/5 season, and with the growth of the UK market up by 12% on the previous year (Leighton, 2005a) South Africa's deliveries are set to increase to this market in the foreseeable future. The supply channels of South African table grape product to the UK are illustrated in Diagram 4.3.

Diagram 4.3 Four Major Supply Channels for SA Table Grapes



Source: FPEF, Exporter Activities (Book 9, 2004) - Adapted

In diagram 4.3, channels one, two and three are the predominant distribution channels for the flow of product onto the European Mainland market. Export agents, import agents, wholesalers, retailers and traders abound as product finds its way from the producer through a labyrinth of distribution networks to the consumer. Distribution channels three and four are the principal channels used to access the UK consumer. In channel three, the

product is shipped directly from the producer to a supermarket client via his category manager. This relatively short route is an increasingly popular one due to its cost-effectiveness.<sup>164</sup> Channel four exemplifies the traditional consolidation of a number of South African producers' fruit through a commissioned South African marketing agent to a supermarket's importer (category manager).

The UK's senior citizens (particular women over 45) and children under the age of 10 are driving the consumer growth of table grapes, primarily for health reasons (Leighton, 2005a). The market has migrated to almost entirely seedless grape consumption, with green seedless varieties (Thompson, Sugraone and Prime) dominating, and red seedless varieties (Crimson and Flame) showing catch-up growth rates. As far as the more flavourful, black seedless varieties are concerned, only a few of the retailers service niche market segments for these new product lines since sufficient commercial volumes are not yet available from suppliers.

According to the FPJ's Grape Supplements (Leighton, 2005a & 2006b), grapes are an impulse purchase for the British consumer. Price promotions tend to significantly influence the uptake of additional volumes, suggesting a high price elasticity of demand. UK consumers buy grapes for different reasons, so supermarkets merchandize the product in various packaging configurations to segment the market and thereby assist the consumer with his/her purchasing decision. In general, grapes are either presented 'loose' in open top cartons; or they are displayed in 'pre-packed' bags, stand-up pouches or punnets.<sup>165</sup> The pre-packed range has evolved specifically to address the expanding segmentation in the grape category, and consists of sealed bags with perforations in the bags, re-sealable zip-lock bags, and stand up pouches for the snacking segment. The greatest growth though is being demonstrated in the 500g and 1kg punnet range, but other smaller punnet configurations are now being introduced for the growing grape snack market as well.

In general, the UK consumer is being encouraged by the High Street retailers to trade up from loose packs to pre-packs. According to the GEF members and the FPJ Grape supplements (Leighton, 2005a & 2006b), the reasons are as follows:

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<sup>164</sup> In the 2006/7 season, New Vision Fruit (Karstens Boerdery) further shortened the distribution channel by delivering his table grape product directly into the supermarket's distribution centre (effectively bypassing both the SA marketing agent and the UK category manager). This channel would be indicated by an arrow in diagram 4.3 from Producer 4 straight into Supermarket 1 or 2.

<sup>165</sup> Punnets are increasing in popularity across the whole EU market. They give an unforgiving visual clarity to the product forcing suppliers to pack consistently good-looking product.

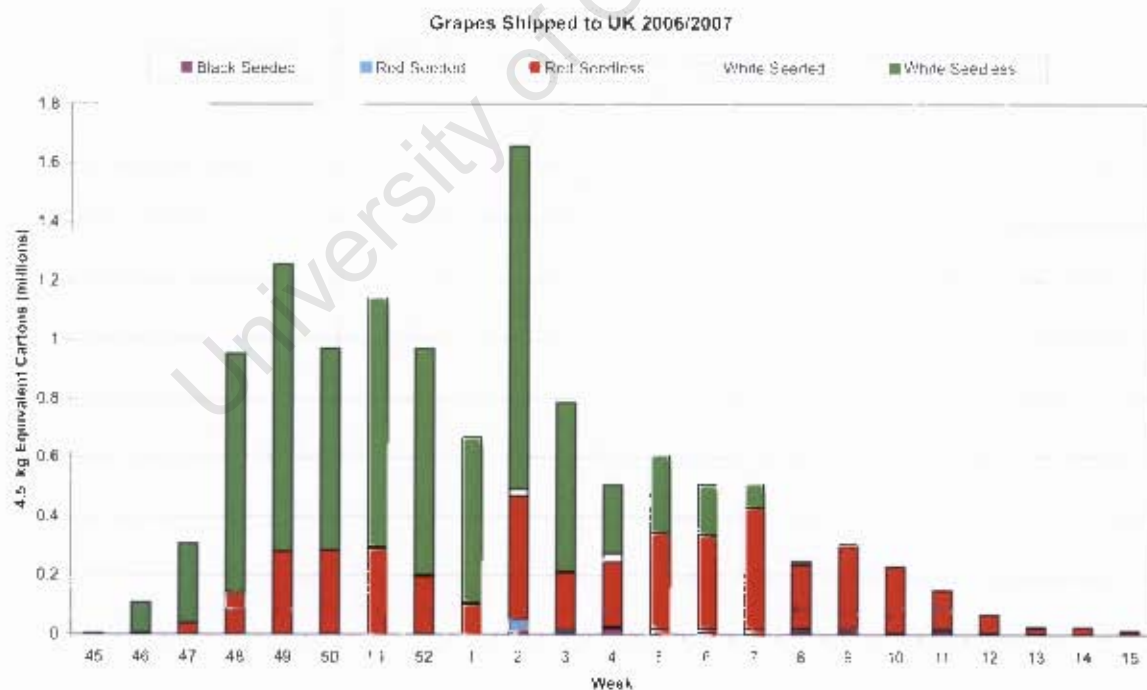
- (1) Shoppers tend to rummage through loose grapes, fingering them and conducting informal taste testing as they go along. This unhygienic activity poses a food safety threat to consumers. It has resulted in broken berries falling to the floor causing customers to slip and injure themselves;
- (2) Loose grapes need more merchandizing, as they tend to look messy after being tampered with;
- (3) In-store consumption and spillage of product are responsible for shrinkage and wastage respectively, the costs of which the retailer is keen to eliminate;
- (5) Supermarket personnel that decant loose grape bunches from a carton onto a supermarket shelf often cause damage to the product;
- (6) Customers need to weigh the loose grapes at the checkout till to determine the cost of the purchase. This is not only a source of inconvenience for the customer, but also a source of embarrassment sometimes when she discovers that she has overspent her budget and needs to dump the purchase at the checkout point; and
- (7) The profit margins of the supermarkets in pre-packs are superior to those in loose packs.

## 4.6 Suppliers Competing for UK Supermarket Programmes

### 4.6.1 Accessing Strategic Marketing Windows

The chief criterion about supplying the British supermarkets is for supplying countries to capitalize on favourable marketing windows afforded to their exporters. In South Africa's case, the window of greatest financial opportunity in the UK market has traditionally been the pre-Christmas period where prices have been relatively high and supplies relatively low. This is essentially from week 46 at the end of November to week 51 which is the week leading up to Christmas Day. South African deliveries continue after Christmas up until week 15 towards the end of April. Figure 4.4 illustrates the shipment of South African table grape product into the UK (by grape category) for the 2006/7 season.

Figure 4.4 SA Table Grape Deliveries to the UK (2006/7 season)

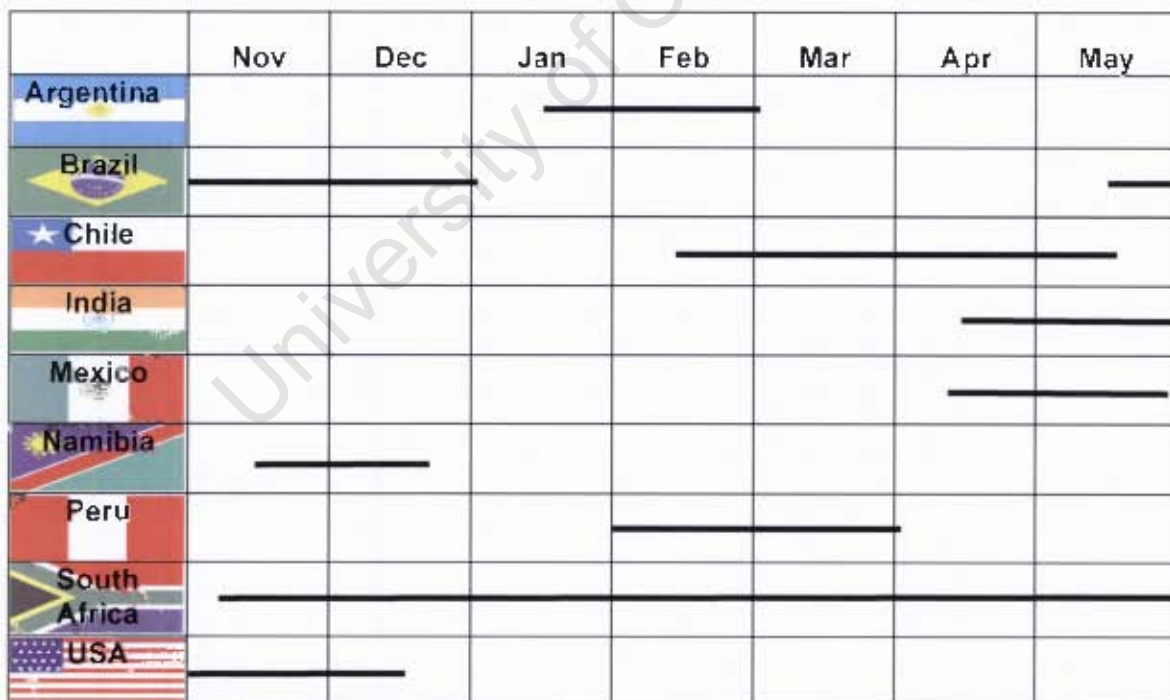


Source: SATI (2007)

Note that the South African early deliveries of grapes to the UK are predominantly white seedless varieties, whilst the back of the season finishes with red seedless varieties.

Diagram 4.5 shows the various months in which other supplying countries compete with South Africa for the UK market (these competitors will be discussed later in this section). It is important to understand that the first and last arrivals of a country's harvest are dependent on the vagaries of Mother Nature, and can differ from season to season - sometimes by up to two weeks. This unpredictable fact alone can substantially change the annual opportunities presented to those countries competing in their particular timeslots. For example, the start to the South African 2007/8 season was delayed by two weeks. The implications were that: (1) some of the product had to be air-freighted to the UK supermarkets to fulfill promised programmes making the product more costly for the consumer (which is detrimental to sales); and (2) many producers missed landing their product in the UK prior to Christmas, with the suppliers' price points changing from £28 per 9kg carton before Christmas to £15 per 9kg carton straight after Christmas. This aspect is covered in section 4.7.

Diagram 4.5 The Marketing Windows of Supplying Countries to the UK.

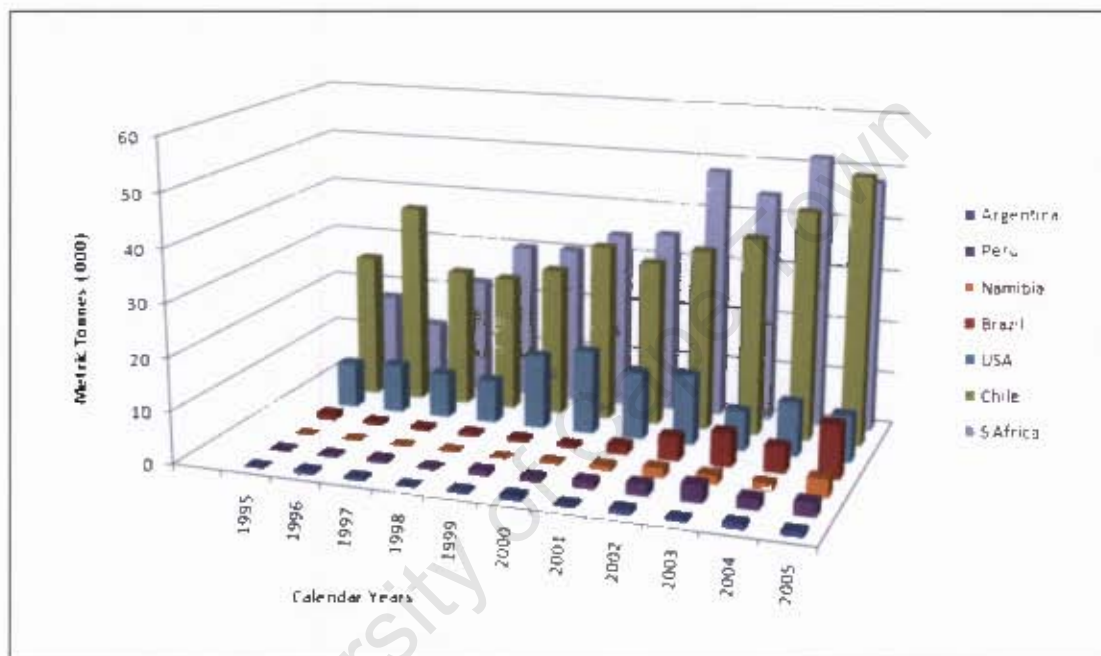


Source: GEF members (2005)

In order to appreciate the degree to which competition in this market has increased in the deregulated period, Figure 4.6 demonstrates the volume growth (or decline in one case) of the various countries' table grape deliveries to the UK market for the last 10 years. A number of trends are revealed. South Africa and Chile's volumes have grown steadily in the

new millennium, with Chile surpassing South Africa's volumes in 2005 for the first time since 1997. Brazil and Namibia have shown very impressive growth rates for the same period, although these growth rates are off a much lower base compared to Chile and South Africa. Only the US shipments have been in steady decline since 2000, whilst both Argentina and Peru continue to play minor - though growing - roles in supplying this market.

Figure 4.6 South Africa's Competing Suppliers to the UK (1995 – 2005)



Source: SHAFTE (2006)

#### (a) The Pre-Christmas Market

South Africa has been challenged with 'internal' and 'external' competition for the UK's pre-Christmas market. In looking at the 'internal' competition first, it was historically the *Orange River* producers that enjoyed the relatively empty pre-Christmas marketing window to themselves. They were able to airfreight product from Uppington to Heathrow and fetch very high prices, despite the expensive airfreight rates. According to Sarel Joubert, in the late 1980s, producers grossed R250/9kg carton in the pre-Christmas UK market. However that situation changed when the *northern region* growers in South Africa started capitalizing on the same market opportunity. By harvesting their grapes two weeks earlier than the Orange River producers, the northern growers afforded themselves the opportunity of sea-freighting their product to the UK market in time for pre-Christmas sales. This then forced the Orange River producers - on freight cost alone - to sea-freight their product to the UK in order to be

price-competitive. As a result, some of the Orange River producers now miss that marketing window. Hanno Scholtz observes that some Orange River grape producers, desperate to try and fetch the earlier (higher) UK prices, are tempted to pick their grapes earlier than they should. In so doing, these over-eager producers compromise the brix (sugar) levels of their grapes, and the quality suffers. This negatively affects consumer expectations and prices invariably suffer, bringing the image of South African product amongst the supermarket buyers into disrepute.

One could question why the two South African regions seem to compete 'unnecessarily' with each other for this early marketing window in the UK, and in so doing erode the price points.<sup>166</sup> Hubert Leclercq, whose company has traditionally procured substantial volumes from the early-producing northern region, points out that it was simply a question of the northern growers being calculatingly opportunistic with their favourable climate and their early ripening varieties. These northern producers have managed to capitalize on the early prices that are higher in relation to those that follow in the falling price market of the UK.<sup>167</sup> Hubert Leclercq further adds that the Orange River growers with their higher production costs and naturally later harvesting period are simply unable to compete with this scenario.

With regard to 'external' competition, South Africa has encroaching competition from two major supplying countries – Namibia and Brazil. Some stored Californian product still finds its way to the UK market in the pre-Christmas marketing window, but UK buyers prefer to put fresh arrivals on their shelves rather than stored product, which is to South Africa's competitive advantage, and America's competitive disadvantage. As the **Namibians** have planted westward down the Orange River, so their marketing window in the UK has preceded the earliest pickings of South Africa's northern region – sometimes by up to 10 days. This time difference has allowed the Namibians to send their product to the UK by sea freight as well. Namibia's early harvesting window and concomitant sea-freight opportunity yields a competitive advantage that has - with the South African growers from the north - put paid to the entire Orange River air-freight programme. Unlike South Africa, the Namibian Desert production areas are not affected by rain and therefore do not suffer from problems allied to packing after rain. Nor are the Namibian vineyards plagued by

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<sup>166</sup> It is not fair to label price deterioration only on this issue. With the availability of more product into the same marketing window, this pre-Christmas window started to yield a dilemma on pricing for the supermarket buyers. Whilst prices should be kept buoyant with the consumption growth of the market and the higher volumes demanded at Christmas time, supermarkets are tempted to promote the product at discounted prices in order to sell more volume and to try and capture greater market share from one another. According to Mike Grobbelaar, UK supermarket lore has it that if you win a customer over Christmas, you win him for the rest of the season; but if you lose him over Christmas, you will not see him again for the rest of the season.

<sup>167</sup> At the same time, these northern producers incur the risk of rain affecting their crops at this time of the year.

insects, so production areas do not have to contend with chemical applications and their associated minimum residue level requirements for the UK market. As a relatively new grape growing and exporting country, most pack houses in Namibia are state-of-the-art establishments. Yet despite these advantages, the product quality of the relatively inexperienced Namibian farmer in recent years has left a lot to be desired. And by preceding South Africa's grape deliveries in the market, prices and sales of South African product are sometimes compromised by supermarket buyers making unfair and unfavourable comparisons with inferior Namibian stock. Buyers use quality-related, discounted prices on the Namibian product as an excuse to start South African prices at a lower level than they deserve. South Africans can nevertheless expect increasing volumes to emerge from Namibia in future seasons, with Namibian quality problems becoming a thing of the past.

**Brazil's** unique climate of similar day temperatures throughout the year (its proximity to the equator provides no real winter or summer) allows its producers to manipulate their vines to yield two harvests from the same vineyard each year. This has yielded a shorter payback period for investments made by the Brazilian producers compared to their South African counterparts. The Brazilians can use these climatic advantages and vine manipulation techniques - in months when it doesn't rain - to harvest and target the relatively empty, profitable UK market. Brazil is geographically closer to the UK market than South Africa and therefore has a relatively lower freight cost than South African shipments.<sup>168</sup> Brazilian production is strong in white seedless (from the middle of November to the end of December), and competes more intensively with South Africa's white seedless production to the UK market. Chris Conradie, who has visited the Petrolina grape-growing region of Brazil to investigate business opportunities there, notes that in the last six years, the Brazilians have gone from grape production being a hobby to it being a serious business. Whilst ironing out their logistics and quality problems will continue to challenge the Brazilians, most GEF exporters opine that the Brazilians will soon master these issues. Sarel Joubert is concerned that with Brazil creeping into the UK market with additional and improved quality product year on year, the pre-Christmas prices in the UK will eventually approximate the much lower, pre-Christmas prices of the European Mainland. This oversupply will continue to erode the competitive advantage that South Africans once enjoyed in this exclusive marketing window.

## (b) Post-Christmas Marketing Window

As can be deduced from Diagram 4.5, the major contender to South African supplies in the post-Christmas marketing window in the UK is Chile. To a much lesser extent, Peru and Argentina have been gaining a foothold in the early months of the New Year; while India, Mexico and a few other smaller countries have been showing strong growth at the tail end of the South African season in the UK.

**Chile**, South Africa's major competitor to the UK market after Christmas,<sup>169</sup> warrants comprehensive coverage. Appendix A of this dissertation is dedicated to examining how Chile has attained stellar status as the major Southern Hemisphere supplier of table grapes to not only the UK market, but also to world markets. The writer believes that the South African table grape export industry has much to learn from Chile's competitiveness strategy. **Argentina** does not deliver much product to the UK market, mainly because their farmers are not yet accredited with the necessary UK supermarkets' quality assurance programmes like Nature's Choice. Fortunately for South Africa, Argentina at this stage is seen as a small, unreliable and inconsistent quality supplier to the EU market, and its product prices generally reflect this fact. However, Leon van Biljon cautions that the South African industry should not be complacent about Argentina's rising star, since her production volumes are expanding rapidly, and it will just be a matter of time before she too sees to her quality and accreditation issues. **Peru** suffers from similar quality perception problems to that of Argentina. Its growing conditions are not favourable, and with winds and sandstorms plaguing their production regions, their grapes are often dirty. But like the other countries, as their producers gain the expertise, so their quality standards will lift, and significant entry to the UK market will become a reality.

Leon Van Biljon states that the big challenge with most of South Africa's competitors is actually at the tail end of the season. Countries like India, Israel, Egypt, Morocco, Mexico and Brazil (with their second crop) all enter the European market at the end of the South African season. Many of them are new-producing countries and have sensibly planted seedless varieties according to market demand.<sup>170</sup> To counter the threat of rising competitive volumes in the UK and other markets, Samuel Pieterse believes that the South African table grape industry should have a desk dedicated to researching and studying

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<sup>168</sup> This discrepancy is exaggerated with a higher dollar price of oil.

<sup>169</sup> Having stated this, there is a perceived Chilean threat to South Africa's unique, pre-Christmas marketing window. Production in the Copiapo region of Chile is theoretically able to supply volumes into the UK market at the same time as South African sendings (Promar, 2001).

<sup>170</sup> South African producers are still going through the very lengthy process of switching production units from seeded to seedless varieties.

developments in competing countries. Samuel Pieterse further believes that South African producers and exporters simply don't have the time or the resources to analyze each competing country, apart from the fact that it would be an unnecessary duplication of resources, and therefore costs, for them to do so. He proposes that industry associations should determine the details about competing countries' shipments to South Africa's markets during the season, since such information affects the timing - and therefore the profitability - of South Africa's deliveries.

#### 4.6.2 UK Supermarket Buy-Supply Structures

Most UK supermarkets are supplied with their produce requirements by their own-appointed, UK-based 'category managers'<sup>171</sup> (sometimes also referred to as 'importers' or 'receivers'). These receivers or 'category managers' are separately owned entities that have been established in the value chain between South African table grape suppliers and the British supermarkets. They essentially procure, prepare and deliver on demand to the retailer certain categories of fruit to their retail customers' depots or stores. According to Sarel Joubert, this structure is in place because most of the retailers (except for Morrison) do not have the facilities, manpower or infrastructure to fulfill the functions necessary for importing and preparing fresh produce for sale. These category management companies carry out functions that include customs clearing, quality control, re-packing of the product into bags or punnets, labelling of the packaging with sell-by-dates and distributing full and half pallets to the depots and retail outlets. An important function of these category managers is to source continuous grape suppliers<sup>172</sup> for their supermarket clients, 365 days a year. They do so by targeting the produce from countries around the world, in both northern and southern hemispheres, across the seasons. White (2000) observes that from a retailer's point of view, it ensures continuity of supply and spreads its risk amongst a number of supplying countries, preventing an over-reliance on any one particular country.

Category management, which started in the mid-1990s, has become a dominant form of buy-supply structure between suppliers and the UK supermarkets today.<sup>173</sup> What was

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<sup>171</sup> The name 'category manager' is derived from the 'category' of fruit that such a company supplies to its retail customer (where, for example, grapes, apples and citrus are considered different fruit categories). In cases where more than one category manager supplies a supermarket, a 'category captain' is the term used to describe the leading category manager to that supermarket.

<sup>172</sup> The term "suppliers" is used collectively here (in the case of South African suppliers) to mean 'marketing agents' and 'producer-exporters'. Distinction will only be made where it is important to differentiate between the two different types of suppliers.

<sup>173</sup> The 'supermarket' and his 'category manager' are, for convenience, used interchangeably from here on as the 'buyer' to whom South African suppliers sell – unless a distinction is specifically made for clarification.

formerly a conflictual relationship<sup>174</sup> between retailers and their suppliers prior to the onset of category management has supposedly evolved into a close, long-term partnership based on trust, cooperation and mutual benefit (White, 2000). Steiner (2001) stated that the original objective of category management was for both the category manager and his first-tier suppliers (i.e. producer-exporters and marketing agents from production-based countries) to share confidential information that would eliminate costs from the chain. In scrutinizing each other's businesses, the parties could identify procedural problems, eliminate redundancies and calculate more efficient ways of doing the business. Steiner (2001) further noted that for retailers, the most important aspect of category management was the role that it played in contributing towards reducing its overhead costs and positively affecting its profitability; whilst for category managers, it enabled them to influence decisions regarding a category. Hogarth-Scott and Dapiran (1997) recognized that a good partnership could be regarded as a corporate asset and a competitive advantage, and the benefits of category management that they identified for the retailer, supplier and consumer are listed in Table 4.7. Whilst there are clear benefits to be had from such a buy-supply structure - especially for an appointed category manager - this very same structure brings about cost efficiencies, but also potential anti-competitive concerns. If cooperation between a retailer and his category manager reduces competition, margins could be raised and consumers would suffer. This arrangement can exclude smaller producers, give market power to the category captain, be welfare reducing for the UK consumers and facilitate price-fixing (Steiner, 2001).

Clarke (2001) notes that supermarket chains are big sellers downstream and big buyers upstream. Both activities can give rise to potential economic benefits or the potential misallocation of resources (welfare losses), depending on whether the supermarket uses or abuses its market power. *Downstream*, supermarkets can abuse their market power by charging excessive prices at retail level, thereby earning monopolistic profits from consumers. They can also practice predatory behaviour by selling products at below cost price, which, while benefitting consumers in the short-term, also serves to force smaller retailers to exit the market, as they are unable to match such subsidized prices. In the longer term, this has the effect of reducing competition at the retail level, leading eventually to monopolistic prices and reduced product offerings to consumers. *Upstream*, supermarkets can abuse their market power to earn monopsonistic profits. They do so by threatening to de-list suppliers' products - particularly the more vulnerable, smaller suppliers - if they do not comply with their requests for lower supply prices. By the same

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<sup>174</sup> This relationship was formerly characterized by buyers and sellers haggling on price with little priority being given to the stability of the business relationship.

token supermarkets can use their market power against large suppliers to reduce retail prices for consumers – as long as the full benefit of reduced supply prices is passed on to consumers downstream (Burt & Sparks, 2003).

**Table 4.7 The Benefits of Category Management**

<b>Supplier</b>	Increased profitability & business knowledge and improved relationships with retailers.
<b>Retailer (Financial)</b>	Increased sales, increased margins, reduced costs, improved efficiency and increased market share.
<b>(Non-Financial)</b>	Organizational learning, more effective strategy implementation, better customer service, better understanding of cost structures, more open communication with suppliers, improved personal relationships and stability of business practice.
<b>Consumer</b>	Reduced consumer confusion, product ranges reflecting customer desires, greater product variety, increased product availability, product information, new facilities, and lower prices.

Source: Hogarth-Scott and Dapiran (1997)

Diagram 4.8 is a summary of the structural relationships between the biggest UK retailers, their respective category managers and their most important first-tier suppliers. The dynamic and somewhat brittle nature of these relationships affects the stability and competitiveness of the first-tier suppliers in particular. The following important points can be interpreted from Table 4.8:

- (1) The bigger supermarkets (Tesco and Sainsbury) tend to have several category managers in place to service their needs. If a supermarket de-lists a category manager, it can have severe implications for those first-tier suppliers who were accessing the supermarket through the de-listed CM;
- (2) Asda has reduced its category management over the years down to only one company, namely International Produce (IP). For suppliers wishing to access Asda, there is only one channel of entry now. If a first-tier supplier is unsuccessful with IP, there is no other access to an Asda programme.

**Table 4.8 The Major Structural Elements of Category Management (2004/5 season only)**

<b>Major Retailers</b>	<b>Category Managers</b>	<b>First-Tier Suppliers</b> (SA Exporters)
<b>Tesco</b> 29%	Grapes Direct	Dole SA Fruits Unlimited Green Marketing Int. Southern Farms
	Capespan (PLC)	Capespan Exports SA New Vision River Fruit
	Prima Fruits	Delecta Afrifresh
	Hochfeld	The Grape Company
<b>Sainsbury</b> 16%	Grapes Direct	Dole SA Fruits Unlimited Green Marketing Int. Afrifresh Southern Farms
	Mack Multiples	EXSA
	Capespan PLC	Capespan Exports SA
<b>Asda</b> 12%	International Produce	EXSA Colors Afrifresh Katope
<b>Morrison</b> <sup>175</sup> 20%		Colors New Vision The Grape Company Afrifresh Capespan (PLC)

Source: GEF members. Note that this template is for illustrative purposes only. It was accurate as at November 2005, but will have likely changed by the time this dissertation is complete.

<sup>175</sup> Morrison also has a very small percentage of 'indirect deliveries': Delecta supplies them through the importers Alfred Price, and Hoekstra Farms through the importer Hars and Hargenbauer.

- (3) Morrison buys directly from its suppliers and has not traditionally made use of category management companies.<sup>176</sup> This cost-effective model is predicted to put increasing pressure on the CM-based business models. In order to stay price-competitive, CM-based models may continually need to put price pressures on their first-tier suppliers.
- (4) First-tier South African suppliers are a mixture of marketing agents and producer-exporters. Competitiveness between these two types of sellers from South Africa - according to the application of game theory later in this chapter - forces them to ruinously compete with each other on price.
- (5) The Capespan Group enjoys the benefit of being a category manager (Capespan PLC) and a first-tier supplier (Capespan Exports SA). This does beg the question whether the Capespan Group is advantaged in being able to exercise any vertical restrictive practices by securing this position. Capespan's first-tier supplier status is now being bypassed by several South African producers who insist on going directly to Capespan PLC (so as to avoid paying a double commission to Capespan Exports SA as well as Capespan PLC).
- (6) As category managers, Grapes Direct and Capespan PLC both supply more than one of the major UK supermarkets. One school of thought might regard this as too much market power vested in the hands of a single CM. But suppliers do have other points of entry to Tesco and Sainsbury. Another school of thought might argue that it is better to increase the market power of suppliers with this model than to succumb to structures that further concentrate supermarket power (i.e. through continually fragmenting supply structures).

The UK buy-supply structures can be very destabilizing if one of the following two incidents disturb the supply chain:

- **Firstly** - if a supermarket, for some reason known only to itself, de-lists its category manager, then all those South African export companies supplying that category manager are, by implication, de-listed from supplying the corresponding supermarket. In 2004, Asda de-listed Malet Azoulay, and replaced it with

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<sup>176</sup> However, Morrison acquired Safeway in 2003, through which it inherited a category management system. So Morrison is effectively operating a dual system for the moment.

International Produce (IP), and in this case Katope as a marketing agent and its South African producers 'lost' their access to Asda. In 2005, Sainsbury de-listed its CM Chingford, and in this case, The Grape Company and its South African producers 'lost' their access to Sainsbury. Those SA companies that are affected by the restructuring of the category management companies need to immediately establish with the buying director of the retailer whether or not they are still important as suppliers to that retailer. If it is established that they are still important, they need to fight for re-entry to the supermarket programme through the remaining category managers. Contesting a programme is usually done on price, and on the track record of the supplier, which is based on his consistently good service and problem-free product that he has given to his supermarket (via the category manager). This is, in essence, how South African growers can compete with one another through their marketing agents to retain the much-needed, volume-based programmes of the UK supermarkets. An ousted South African marketing agent and his producers may, for example, find themselves contesting a supermarket programme, which another South African marketing agent and his producers are already supplying.

- **Secondly** - if a category manager de-lists its first-tier supplier (e.g. a South African supplier), then that supplier has no choice but to fight for its access to that same supermarket via another category manager; or to fight for a new programme altogether with another supermarket via its corresponding category manager(s). In both cases, the notice can be short, and unless SA exporters can react swiftly and successfully, it can have dire consequences for their businesses.

There is no rule that disallows a South African supplier from supplying more than one UK retailer via more than one category manager. But Mike Grobbelaar believes that if the category manager feels there is a conflict of interest in his supplier delivering product to his supermarket's competitor as well, that supplier will, soon enough, see a diminishing order book from his category manager. GEF members state that to avoid this conflict of interest, suppliers can serve more than one supermarket by packing different product specifications for different retailers that ultimately target different segments of the consumer market. For example, the packing specifications for Marks & Spencer at the high-end of the market are quite different to the packing specifications for Asda at the volume-end of the market. The market seems to be shifting though, in that more supermarkets are starting to offer branded, top of the range product lines that were once the exclusive domain of Marks &

Spencer. In fact, individual supermarkets are managing to draw a larger customer base by offering more diverse product ranges under different brand names. As a result of this, South African exporters can supply 'competing' UK retailers without creating a conflict of interest – but the category managers will have the final say in the matter.

#### **4.6.3 Mechanics of a Supermarket 'Programme'**

A supermarket 'programme' is a written notice given to a first-tier supplier confirming the category manager's intention to purchase a certain volume of a specific variety of product, over a certain number of weeks. It also states the quality specifications of the fruit and the designated packaging format in which it must be delivered. Importantly, there is no indication of price on that written notice. The only consolation about this last point – which appears to be unusual business practice - is that it is the same for all first-tier supplying countries. The UK retailers argue that the grape category is one of the listed commodities on the retailers' commodities index. Due to the price sensitivity of the grape product, the retailers cannot afford to commit to a price with their suppliers, because if their competitors' prices are keener than theirs, they are saddled with a perishable product and its associated potential wastage cost. Nevertheless, in analyzing certain elements of such a 'programme', the following points are observed:

- A programme is an intention only - it can be cancelled at short notice regardless of where the product is in the chain. Hubert Leclercq maintains that, despite programmes being an intention only, they are mostly honoured by the British retail fraternity.
- When referring to product quality, the class, variety, berry size, colour and sugar levels are all specified by the supermarket for the supplier. However, moving a perishable product successfully through a cold chain is dependent on many variables, and sometimes the condition of the product does not meet the specification when it arrives in the marketplace. According to Hanno Scholtz, South African producers and exporters are unfortunately sometimes tempted to sneak non-specification product into the market. The problem can originate at source where pack house managers pack borderline fruit into the carton. For example, a 'large' berry can slip through

the system as an 'extra large' berry.<sup>177</sup> The problem can also manifest in the marketplace where South African suppliers sometimes sneak unwanted varieties into the supermarkets' distribution centres. For example, the red grapes that the UK consumers really demand are Crimson seedless - not Sunred seedless. By the time it is picked up in the system, it is too late, and the less preferred product is already on the supermarket shelf. This is a short-term ploy, because the slow Sunred seedless sales rates cause stocks to build up. When the preferred Crimson seedless variety eventually arrives in the market after the Sunred seedless overstocked situation has developed, prices have to be discounted to move the Sunred stock. Consequently, Crimson does not achieve its deserved premium price because it is very difficult to revert to normal price bands after the consumer has developed an expectation of discounted prices for red grapes.

- The packaging of the product is usually in the supermarket's branded colours and the unique 9kg carton format of the British retailers. Jan le Roux notes that, in demanding this, the supermarket has not only de-branded the supplier's product brand of its former identity and thereby usurped what premium the product brand may have brought the supplier. The supermarket has also in fact re-branded the product by putting its own 'no name' brand on it, and it serves to disempower the supplier if he is forced, for some reason, to find an alternative outlet for the product. According to Sarel Joubert, if the product is not re-packed but simply moved to another buyer in the original supermarket's packaging, it is very apparent to the new buyer what situation the seller is in - and the new price suffers.<sup>178</sup> It is expensive to re-pack product for another client, and the added handling could further compromise its quality.
- Without a price commitment, a supplier to the UK becomes vulnerable to the whims of the buyer. Price is only given to the supplier, on average, a week before delivery is due. Some exporters in the GEF maintain that they find out the price that their retailer is prepared to give them only *after* the product has

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<sup>177</sup> South African pack house managers are incentivized unwisely sometimes, in this case on an extra-large berry pack-out (because better prices can be achieved with bigger berries). Samuel Pieterse maintains that packing borderline quality is a major problem in South Africa where up to 10% of that which is packed may fall outside of the market specification. One solution to this may be incentivizing pack house managers on the number of product claims – the fewer the claims, the greater the bonus incentive.

<sup>178</sup> If product has to be moved from the UK market for sale on the European Mainland, it is instantly recognizable by its unique '9kg carton' packaging format because the mainland sells grapes in 4.5kg (or smaller) cartons only.

actually been sold. This effectively means that the product has already landed in the UK in the branded colours of the targeted supermarket, and is awaiting delivery to the supermarket from one of its distribution centres – *without the price being known*. The buyer is therefore fully conscious of the situation that he has put the seller in, and it is not uncommon for a buyer to assign blame on some nebulous issue for insisting on a reduced price at the last minute. It is at this point that the euphemistic requests come from the category managers in a last ditch attempt to get first-tier suppliers to capitulate further on the expected price. For example, a category manager might tell a South African exporter that his (the SA exporter's) aspirations are, say, 40 pence per carton higher than his fellow exporters' aspirations, and immediately enquires what the exporter intends to do about it. This encourages South African exporters to liaise with one another to determine whether the category manager is in fact conducting a misinformation exercise in an attempt to play one supplier off against another on price. According to GEF members, they often discover that this is indeed the case.

One of the hallmarks of the UK supermarket programme is the sequential over-procurement of product that occurs in the chain. Mike Grobbelaar maintains that category managers tend to secure a buffer of stock for themselves from South African suppliers to make sure that they have their shelves covered. This is understandable because lost sales in a week due to lack of product cannot be recovered – they are lost forever. Also, product rejected on quality grounds needs to be replaced immediately (with buffer stock). Weekly sales rates in the UK are sometimes difficult for retailers to forecast because unpredictable weather patterns influence consumer behaviour. South African exporters in turn over-procure from their producers: firstly, because they cannot afford to be caught short on their UK supermarket programmes; and secondly, because many of their South African producers are notorious for overstating their crop sizes. Many South African producers often exaggerate their crop estimates, chiefly to mollify their bank managers, but also to maintain the interest of several exporters from whom they will select one or two to export their product. Inaccurate estimates can also be the result of producers not factoring a percentage loss of product due to the vagaries of Mother Nature (like rain), or incorrectly calculating their vine yields.

Good quality fruit sells, and a marketing agent's commission increases for every extra carton of grapes that he can procure and sell. This also explains why an exporter might over-procure product from table grape farmers. The net effect of this over-procurement is

that the category managers will have too much fruit for their supermarket programmes, and it is really not difficult for them to find a reason for rejecting unwanted grapes. This scenario exacerbates the price pressure already placed on the product, and the marketers' skills are truly tested in trying to find alternative outlets for rejected product in a somewhat limited UK wholesale market.

It is standard business practice for category managers to complain to their suppliers about product quality deviations and fruit condition problems during the season. This could be a ploy to seek a lower price or to mask over-procurement. It could also be a genuine quality or condition problem. Whatever the reason, when the category managers reject product,<sup>179</sup> it is prudent - in Mike Grobbelaar's opinion - for suppliers to plan having the back door open to the UK wholesale market. This is because re-routing the product from the UK to the European Mainland is a costly last resort. If a supplier can correctly time his rejected product onto the volume-sensitive UK wholesale market (usually near the beginning and end of the season), it can sometimes return a better price than even the retail sector. But for most exporters this route is not really an option because the wholesale market is simply too small to absorb additional supermarket product.

The quintessential challenge that an exporter faces with a UK supermarket programme is that if he resists too strongly on price, the category manager can always source the product from an alternative supplier – either from another country, or from a South African comforted at being able to put in more volume at the expense of his competing compatriot. If the grape supply price is not right, the UK retailer could even substitute the grape product on his shelf with another fruit kind altogether. In most cases, the UK retailer honours a programme in full - but with price always being the wild card.

#### **4.6.4 Organizational Theory: Justice in the Buy-Supply Relationship**

According to Fearn et al (2005), organizational and inter-organizational theory examine two aspects of fairness in a relationship: 'distributive justice' and 'procedural justice'. The former looks at how the economic burdens and benefits (i.e. costs and profits) are shared between trading partners at the behest of the more powerful<sup>180</sup> of the partners (Kumar

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<sup>179</sup> There is a three-strike quality system operating amongst some of the category managers in the UK. For each product quality defect picked up from the same supplier, that supplier receives a strike. After a third strike, the supplier may lose his programme altogether.

<sup>180</sup> Hogarth-Scott and Dapiran (1997) state that "power" can be defined operationally as the ability of one marketing channel member to control the decisions of another member, and happens when resources are unequally endowed.

1996). Procedural justice deals with the process of decision-making, and the degree to which individuals in the relationship have a chance to offer input, or influence decisions (Gilliland, 1993). Kumar (1996) lists the six factors of procedural justice as being refutability, explanation, communication, impartiality, familiarity and courtesy. A third type of justice, introduced by Lupfer et al (2000), is 'interactional justice', in which fairness is perceived to have increased when decisions are explained in the relationship.

Duffy et al (2003) use procedural and distributive justice to categorize the behaviour of the category managers' fresh produce buyers; and their conclusions tie up closely with the experiences of those South African table grape exporters interviewed on the subject. The relationships between South African suppliers and their category managers are very complex. Both parties operate portfolios of relationships, where different relationships are in different stages between different entities at the same time (White, 2000). From a supplier's viewpoint, it avoids him being over-reliant on one supermarket; and from a retailer's viewpoint, it ensures continuity of supply and the spreading of risk (White, 2000).

Using empirical research, Duffy et al (2003) conclude from their suppliers interviewed that: (1) procedural justice was more important than distributive justice because prices are acknowledged to be largely set by market forces and are beyond the control of both partners. Kumar (1996: 104) puts it quite succinctly when he says that 'opportunities for attractive returns are usually the magnet in a relationship, but procedural fairness is the glue that holds the relationship together'; (2) not all supermarkets were bad, but practices do vary significantly within and between supermarkets; (3) supermarket strategy based on EDLP (every day low prices) is not an automatic recipe for supplier suffering; and (4) the 'code of practice' introduced in 2002 by the UK Competition Commission had not made a difference to supermarket behaviour towards its suppliers.<sup>181</sup>

If a South African table grape supplier cannot access a supermarket programme via a category manager, he essentially has no meaningful access to the British consumer for his product. Not surprisingly, South African exporters therefore value relationship marketing (with their category managers) as one of the major tools by which sustained access to a programme can be achieved. However, partnership building is fast becoming superfluous in a retail environment where commodity<sup>182</sup> purchasing demands mostly transactional encounters. In addition, suppliers interviewed by Fearne & Hughes (1999) were skeptical

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<sup>181</sup> The investigation by the UK Competition Commission of the identified UK retailers will be examined later in this chapter.

<sup>182</sup> White (2000: 7) essentially describes a fresh produce commodity as being characterized by a 'large volume throughput of product to a wide number of independent buyers who purchase unbranded, undifferentiated produce on an ad hoc, transactional basis'.

about some of the supermarkets' commitment to partnership, especially due to the regularity with which fresh produce buyers are rotated in some of the supermarkets. To illustrate how certain types of injustices are meted out in the buy-supply relationships, three examples cited by South African suppliers are now considered.

### **Example 1**

Sometimes a retailer decides that it is going to dispose of one of its category managers. One of the retailing trends is supplier rationalization, whereby supermarkets prefer to deal with fewer and bigger suppliers because such suppliers: (1) can reduce transaction costs through economies of scale; and (2) are considered a lower risk in terms of quality and food safety (Fearne et al, 2005). In 2005, Sainsbury auctioned its shelf-space to four category managers: Chingford, Mack Multiples, Capespan (PLC) and Grapes Direct. All of them had to re-bid for the business, where only two of them would be successful. These category managers immediately turned to their first-tier suppliers for financial assistance. In this case, Mack Multiples and Grapes Direct won the bid with the lowest supply price and the highest rebate (6%) to Sainsbury. This rebate is a deduction on the category manager's sales account back to the South African exporter and amounts to a 6% reduction calculated on the selling price by the category manager to the retailer.

In effect, when the CM wins the business with Sainsbury, it means that the South African *exporter* has had to offer the most competitive (lowest) price, and the South African *grower* has had to accept the lower price and pay the rebate. This rebate constitutes a payment for, essentially, the right to do business with the supermarket concerned. This controversial payment is often referred to as a "slotting fee" whereby a supplier 'buys' a slot on the supermarket shelf to enable him to display his goods. Unfortunately, this is where exploitative category managers force first-tier suppliers to offset losses by returning lower prices to the primary producers (Fearne et al, 2005). In Jan le Roux's opinion, it is an indirect way of producers having to pay for the right of importers (category managers) to do business with these supermarkets. And buying the business is equivalent to buying the UK supermarket 'shelf space', considered to be the most expensive 'real estate' in the world. Jan Le Roux further believes that, in the case of a marketing agent, such a decision belongs to the producer, not the exporter; but this is rarely practical in agency business.

Interestingly, the UK's Office of Fair Trading (OFT) has declared that no lump sum payment may be made to buy a UK retailer's business and that such business practice is

challengeable (Leighton, 2005b).<sup>183</sup> However, the CM argues that it is not a once off, lump sum payment because it is a cost reflected on each and every invoice as and when the product fulfills ongoing orders. This is classically a distributive injustice where the burdens (or costs) are not shared evenly. Here the supermarket and his CM have passed all the cost on to the first-tier supplier who in turn has passed it on to the second-tier supplier (namely the grower). In essence, the entire 6% benefit has been hijacked by the retailer. The only benefit gained by the first-tier supplier is the potential increase in sales volumes that *may* result from the consolidation of the supermarket's volumes from three to two category managers.

### **Example 2**

There is a surfeit of literature on the various distributive injustices practised by category managers on suppliers. Examples of distributive injustices noted by Fearne et al (2005: 574) include 'payment terms, costs, imposed charges, requested contributions, discounts, retrospective discounts, lump sum payments, over-riders, contributions towards marketing costs, payments for wastage, funding of promotions and undue delays in payments'. However there is a cost to suppliers that GEF members have discovered that the UK's Office of Fair Trading and the UK's Competition Commission authorities appear to have overlooked. There is evidence to suggest that certain category managers are moving South African product unnecessarily from the port to their own inland facilities instead of directly to the supermarket distribution centres. By levying a charge for conducting what amounts to an unnecessary or superfluous business activity, the ethics of the category management company are put into question. A number of South African exporting companies that have set up offices in the UK to monitor this kind of problem have been penalized for querying this type of business practice. The exporters are punished by having their volumes reduced by their CMs at the expense of their non-complaining competitors. Again, this emphasizes a distributive injustice where unjustifiable costs have been passed on to the supply side of the chain.

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<sup>183</sup> Suppliers rarely express controversial opinion about supermarkets and their category managers for fear of commercial reprisals. However, the OFT claims that it cannot investigate any potential wrongdoings unless it receives official complaints from suppliers. Consequently, healthy debate is muzzled and the effectiveness of an OFT is often in question.

### Example 3

In cases where SA exporters - according to GEF members - have voluntarily refrained from continuing to do business with a UK-based category manager, they have done so for two main reasons:

- **Firstly**, decisions regarding prices and rebates to the supermarkets were, according to Hanno Scholtz, being taken unilaterally by the category manager without consulting the supplier. Often a supplier would be asked by his category manager whether he is prepared to 'support' his supermarket – a euphemistic way of the category manager packaging a price cut to his supplier if he wants to retain the business. Again, there is a fine line between a category manager continually requesting 'support' from his supplier to survive a retail price war, for example, versus a category manager abusing a supplier's engineered price vulnerability for ulterior motives.
- **Secondly**, some SA exporters have refrained from doing business with category managers because excessive and erroneous charges were being levied without explanation by the category manager – no matter how many times the supplier asked for a logical explanation. This gives the South African marketing agent the embarrassing task of trying to account transparently to his growers. Two of the six principles underpinning procedural justice are relevant here (Kumar, 1996): 'refutability', where the supplier feels he cannot raise concerns about the buyer's decisions or policies without fear of reprisals; and 'explanation', where the more powerful party should provide its partner with a plausible rationale behind his decisions so as to balance the power in the relationship.

In understanding (1) the size and importance of this market to South African suppliers, (2) its growth potential, (3) the breadth of competitors (both South African and foreign) and (4) the tight access criteria to these supermarkets, the stage is now set to understand the crux of supplier behaviour when vying for this business. The next section looks deeply at supply costs, price points and pricing dilemmas that suppliers face in securing the business at profitable levels.

## 4.7 Competitive Dynamics Amongst SA Suppliers

### 4.7.1 Cost Chain Analysis into the UK Supermarket

Cost chains have many variables on which their outcomes are dependent. Table 4.9 demonstrates all the different variables involved that ultimately determine the profitability levels of a producer delivering table grapes to the UK market.

**Table 4.9 Pre- and Post-Christmas Cost Chain of the UK Supermarket for an Orange River Producer, Considering Various Retail Price Points (2004/5 Season)**

Row		Unit	Pre-Christmas		Post-Christmas	
			A	B	C	D
1	<b>Retail Price Points (£/kg)</b>	£	4.49	2.49	2.18	1.99
2	Gross Price (£/9kg ctn)	£	40.41	22.41	19.62	17.91
3	<b>Retail Gross Margin (%)</b>	%	30.71	19.68	23.55	27.41
4	<b>SA Supply Price (£/9kg ctn)</b>	£	28.00	18.00	15.00	13.00
5	SA Supply Price (R/9kg ctn)	R	336.00	216.00	180.00	156.00
6	4.8% Import Duty	R	16.13	10.37	8.64	7.49
7	8% Importer's Commission	R	26.88	17.28	14.40	12.48
8	UK Handling Charges	R	14.00	14.00	14.00	14.00
9	FOT Costs	R	2.50	2.50	2.50	2.50
10	<b>Foreign Costs (sub-total)</b>	R	59.51	44.15	39.54	36.47
11	<b>CIF (R/9kg ctn)</b>	R	276.49	171.85	140.46	119.53
12	Sea Freight (incl BAF and CAF)	R	14.00	14.00	14.00	14.00
13	FOB (R/9kg ctn)	R	262.49	157.85	126.46	105.53
14	<b>FOB (R/4.5kg ctn)</b>	R	131.25	78.93	63.23	52.77
15	8% Exporters' Commission	R	10.50	6.31	5.06	4.22
16	Port Charges	R	2.30	2.30	2.30	2.30
17	Other charges	R	0.82	0.82	0.82	0.82
18	<b>Sub-total SA Logistics Costs</b>	R	13.62	9.43	8.18	7.34
19	<b>DIP (Delivered in Port) Price</b>	R	117.63	69.50	55.05	45.43
20	On-Farm Costs	R	52.00	52.00	52.00	52.00
21	<b>On-Farm Income</b>	R	65.63	17.50	3.05	-6.57

Source: GEF Members **Note:** The exchange rate is assumed to be R12.00 to the GBP

**Note:** The industry standard deals in 4.5kg carton equivalents, hence the conversion from 9kg to 4.5kg ctns in row 14.

Whilst the individual costs will differ (marginally in many cases) from one supplier's cost chain to another, there are four factors that can deeply impact on the producer's bottom line in a business like this:

(1) **The SA supply price to the supermarket** – the cost chain in Table 4.9 shows four supply price scenarios (row 4, A to D) to illustrate the impact that it has on the producer's profitability (row 21, A to D). The retailers' and suppliers' price points, summarized in Table 4.10 below have been configured over the years around the following influencing factors:

- (a) In which week the fruit is being delivered, especially before or after Christmas;
- (b) What gross margin the supermarkets are prepared to work on;
- (c) The sales rates being experienced which are chiefly dependent on the weather and the availability, popularity and price of other fruit products;
- (d) How much competitive product is normally in the market; and,
- (e) Whether or not a promotion is being conducted.

These price points are not static, and have been declining over the years. Sarel Joubert states that there has been a consistent erosion in the suppliers' price points from 1998 when product sold pre-Christmas for £39/9kg carton to the 2004 pre-Christmas prices of £22/9kg carton. Sarel Joubert also maintains that the UK retailers have increased their gross margins from 15% to as much as 35% over the same time period. This could partly be attributed to the supermarket adding value to the product (i.e. packaging the grapes in punnets as opposed to loose formats).

**Table 4.10 Retail and Supplier Price Points (pre- and post-Christmas)**

Retail Price Points		Retailers' Gross Margins	Suppliers' Price Points	Sales Weeks
£ / kg	£ / lb	(%)	(£/9kg ctn)	
4.49	1.99	30.71	28.00	Pre-Christmas
2.49	1.13	19.68	18.00	
2.18	0.99	23.55	15.00	Post-Christmas
1.99	0.90	27.41	13.00	

Source: GEF Members

(2) **A volatile and strong rand** – this cost chain bases the exchange rate on R12.00 to the GBP. In the new millennium, the rand has ranged from its low point in December 2001 of circa R20.00 to the pound to its March 2006 high point of R10.80 to the pound. Such a variation in one's currency is beyond the control of individual companies and the industry in which they operate, but has a profound influence on a producer's profitability. The volatile rand makes business unpredictable, risky and therefore more expensive. The demoralizing influence of a strengthening currency is particularly prevalent where all role-players are continuously making cost-cuts in their part of the chain only to see a marching rand expunge all hard-earned efficiency gains. Table 4.11 shows a matrix of an Orange River producer's profitability level (for the 2004/5 season) that depends on the exchange rate and the on-farm cost at the time of his sale.

**Table 4.11 Producer Profitability – Exchange Rate vs On-Farm Cost**

		Rand per Pound exchange rate							
		10.5	11.0	11.5	12.0	12.5	13.0	13.5	14.0
On farm cost per 4.5 kg Carton	38	-0.40	2.21	4.82	7.00	10.03	12.64	15.25	17.85
	40	-2.40	0.21	2.82	5.42	8.03	10.64	13.25	15.85
	42	-4.40	-1.79	0.82	3.42	6.03	8.64	11.25	13.85
	44	-6.40	-3.79	-1.18	1.42	4.03	6.64	9.25	11.85
	46	-8.40	-5.79	-3.18	-0.58	2.03	4.64	7.25	9.85
	48	-10.40	-7.79	-5.18	-2.58	0.03	2.64	5.25	7.85
	50	-12.40	-9.79	-7.18	-4.58	-1.97	0.64	3.25	5.85
	52	-14.40	-11.79	-9.18	-6.58	-3.97	-1.36	1.25	2.85

Source: GEF members (2004)

Table 4.11 is for product being sold in the pre-Christmas window at a projected promotion price of 90p per pound (for the 2004/5 season) equating to a £13.00/9kg carton SA supply price. The supermarket's gross margin is calculated at 27.41%. The blue zone indicates profitability while the red zone indicates loss for the

producer concerned. The producer is faced with two extremes under these conditions: a maximum profit of R17.85 per carton or a maximum loss of R14.40 per carton - for the same carton of fruit. According to Ferrandi & Van der Merwe (2005), the on-farm cost of the Orange River producer over the 2004/5 season was, on average, R44.56 per 4.5kg carton. The average exchange rate over the pre-Christmas delivery period of 2004 was R11.50 per GBP. It can therefore be deduced from Table 4.11 that if the exporters were to accept the retail promotion price, then the average farmer in the Orange River would have run at a loss of roughly R1.18/4.5kg carton produced. The most profitable producers would have been at R4.82/4.5kg carton, the least profitable at a loss of R9.18/4.5kg carton.

(3) **The rebates** - an area of the business that the cost chain in Table 4.9 does *not* account for is the income from rebates on offer to the exporter (and his producers) by the various service providers in the value chain. These rebates, usually paid in arrears of the season, are volume-related discounts offered by service providers to the exporters in the value chain. In South African law, rebates collected in agency business are for the producer's account, unless contracted out between the exporter and his producer.<sup>184</sup> Rebates are traditionally paid by trucking companies, packaging firms and shipping lines regardless of whether the service or product is being rendered on the South African side or the overseas side of the chain. With the deflationary prices and diminishing returns experienced in the industry during deregulation, the rebate proceeds are currently a valuable source of income. In fact, today this is so much so that it is often said that the money to be made in this industry is no longer in the fruit but in the chain. However there is clear evidence to suggest that the UK category managers in particular are now usurping much of the rebate value in the chain. The following cases demonstrates how the UK supermarkets are taking the value chain rebates from the South African suppliers for themselves:

- Samuel Pieterse states that certain South African grape exporters have been instructed by their UK supermarkets / category managers to procure their *packaging* (plastic bags) from Chinese manufacturers. Since the supermarket/category manager has put the deal together with the Chinese manufacturers, the supermarket / category manager claims the rebate directly from the Chinese manufacturers.

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<sup>184</sup> The extent to which marketing agents 'declare and share' rebates gleaned in the chain is still a bone of contention in the industry.

- Mike Grobbelaar confirms that the UK supermarkets are determining for their category managers which *inland hauliers* should be used to move South African product from the UK ports to the inland cold stores and depots. Again the rebates for putting this deal together would be for the supermarket's benefit.
  - In the case of *shipping* the product overseas, Asda is already buying fruit from supplying countries, including South Africa, on an FOB basis. As soon as the product passes over the ship's rail in the South African port, the risk passes to Asda – but so do the shipping rebates. According to GEF members, shipping rebates can be in the order of \$700 per 40ft container, underscoring the financial loss of this income from the South African suppliers to the UK retailer. It is quite probable that if Asda decided to subsidize its retail price by using these rebates to do so, the other UK retailers would be under pressure to follow suit. And in this manner, all rebates could eventually be removed from the chain by competing supermarkets.
- (4) **The 'handling charges'** – this is a cost-accounting term used to describe what the industry calls 'slotting fees'. The term originally arose from the physical 'slot' in a warehouse that was given to new products that would gain access to retail shelves (Wilkie et al, 2002). It is certainly questionable as to whether fresh produce can be considered a 'new product', but the term has more recently been broadened to cover a genre of fees and incentives for old and new products. In the cost chain, slotting fees are the single biggest cost per carton (in rand terms) for the producer - along with the sea-freight cost. These fees were introduced in the late 1980s, and are incurred by suppliers at the behest of their importers. They are characterized by outlandish sobriquets that seem to lend little credence to their validity.<sup>185</sup> The reason for their development is cited by Wilkie et al (2002) as being a result of greater retailer influence. Economic theory puts forward two schools of thought on the validity of slotting fees: the *efficiency school* and the *market power school*.

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<sup>185</sup> These 'fees' have a lot of latitude attached to their imaginative names but include the likes of: '*display fees*' for merchandising the product; '*pay-to-stay fees*' for continuing to stock the product; '*failure fees*' or '*kill fees*' for a product that does not do as well as originally envisaged, and has to be removed from the shelves; '*facing money*' for prime shelf positioning; '*street money*' for displays at the American ends or gondola ends; '*presentation fees*' or '*hello money*' for the privilege of making sales presentations to supermarkets; and '*wedding anniversary money*' for celebrating the annual date on which the buyer's company merged with or acquired another company.

The **efficiency school** of thought proposes that slotting fees are an automatic market response to an excess of product trying to access a shortage of shelf space. From a predominantly retailer's perspective, Bloom et al (2000) state that slotting fees:

- (a) Allocate shelf space efficiently;
- (b) Indicate the degree of confidence that a supplier has in the staying power of his product, especially where there is a degree of uncertainty by the retailer (Sudhir & Rao, 2004);
- (c) Help the retailers share - more equitably with their suppliers - the increasing costs of managing suppliers' products in the retailing environment. Slotting allowances compensate retailers for costs associated with warehousing, transporting, stocking, changing scan files, realigning shelf stocks, merchandizing the product, discounting discontinued items, personnel hours and computer time (Buzard, 2002). The opportunity cost of foregoing more profitable products should also be considered (Bloom et al, 2000). However, critics claim that such fees simply do not reflect the actual cost that retailers say they incur, and are plainly being used to increase the retailers' profits (Buzard, 2002);
- (d) Fairly allocate more of the new product risk onto the supplier, though fresh produce can hardly be termed a 'new product'. According to Sudhir and Rao (2004), these fees provide a form of insurance for the retailers indemnifying them from a loss of profit if the new product should fail (and if the smaller supplier should not be around to clean up the residue); and
- (e) Facilitate the lowering of retail prices.

From a predominantly supplier's perspective, the **market power school** of thought proposes that slotting allowances are used by retailers who have market power. The controversy of slotting fees has, according to Bloom et al (2000), led to:

- (a) Dysfunctional relationships in the channel between supplier and buyer;
- (b) Price discrimination between suppliers and retailers based on the size of the organizations. Slotting fees not only transfer profits from the supplier to the

larger retailer; they also hurt the smaller retailer by raising its marginal costs (Hao, 2001);

- (c) Foreclosure of smaller firms by bigger firms;
- (d) Reduced welfare for consumers as a result of reduced retail competition, higher prices and less innovation (Hao, 2001). One of the suppliers interviewed by Wilkie et al (2002: 284) maintained that 'slotting fees are anti-competitive graft used by large retailers to thin out competition for both brand recognition and shelf space. The sufferer is the consumer who pays more for less selection'. Balto (2002) concurs, stating that consumers are harmed by slotting allowances because they result in wealth transfer from supplier to retailer.

Whilst there is no clear evidence of market failure or legal wrongdoing in the findings of Bloom et al (2002) with respect to slotting allowances in the US, the controversy has elicited the need for public policy to be scrutinized the world over. According to Buzard (2002), anti-trust authorities in the US are continuing to challenge slotting allowances from an *anti-trust perspective*. If supplying firms are purchasing more shelf space than they need in an attempt to foreclose on their competitors accessing the same shelf space, such fees could be construed as illegal under anti-trust law. Balto (2002) affirms that US law is watching closely that dominant firms are not demanding shelf space beyond their market share. A precedent was set in 1995 when the Bureau of Alcohol, Tobacco and Firearms prohibited the use of slotting fees for alcoholic beverages (Sudhir & Rao, 2004).<sup>186</sup>

From a *legal perspective*, Buzard (2002) puts forward three arguments that could be used against the use of slotting fees: firstly, the *essential facility* doctrine, where smaller suppliers are denied access to shelf space (an essential facility to compete) through monopolistic competitors; secondly, *predatory promotion* whereby bigger suppliers force smaller suppliers to raise their costs through the payment of slotting fees (especially where smaller suppliers' payments are larger than bigger suppliers' payments); and thirdly, *price discrimination*, where a (bigger) supplier sells the same product to two different retailers at different prices that do not reflect a differential in the costs of supply (penalizing the smaller supplier and the smaller retailer in the process).

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<sup>186</sup> Sudhir & Rao (2004) felt that the Federal Trade Commission (FTC) was correct in not banning slotting fees outright, as their research found more support for the efficiency theory rather than the anti-competitive (market power) theory.

From a suppliers' point of view in particular, progress needs to be made in resolving the fairness of slotting allowances in the market place. When contracting parties do not put their agreements in writing regarding slotting fees, information is concealed and the case is difficult to prove in a court of law. With retailers tending to support the efficiency theory, and suppliers the market power theory, an integrated approach towards detente will need to be adopted by both schools of thought. South African suppliers have an ideal opportunity to use the current investigation into UK supermarket power by the UK competition authorities to address this matter.

#### **4.7.2 Game Theory: Exporters Trapped in a Prisoners' Dilemma**

South African table grape exporters acknowledge their commercial interdependence in the UK market. Yet they are often unable to cooperate with one another to achieve the desired outcome for themselves and their producers, and anti-trust law certainly doesn't aid their cause. Can the exporters therefore remedy this situation, or are they doomed by some economic premise to consistently under-achieve in price terms in the UK market?

'Game theory examines oligopolistic<sup>187</sup> behaviour as a series of strategic moves and countermoves among rival companies. It analyzes the behaviour of decision-makers where choices affect one another' (McEachern, 2003: 230). Various types of strategy games exist (e.g. sequential games, simultaneous games and coordination games), and the strategies adopted by the players will depend on the circumstances with which they are faced. There is one type of game that epitomizes the predicaments faced by South African table grape exporters to the UK, and it is called a prisoners' dilemma.

The prisoners' dilemma game is based on the well-known strategic approach that police officers take in separating and interrogating two criminals (the 'players') suspected of committing the same crime together. Depending on whether the criminals 'remain tight-lipped' or 'confess', three outcomes are possible depending on the strategies the criminals adopt individually.

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<sup>187</sup> Diagram 4.8 shows how many South African first tier suppliers of table grapes to the UK supermarkets are in fact involved in mini-oligopolistic markets. Two examples will suffice: only four South African suppliers sell to International Produce as Asda's sole category manager; and only two South African suppliers sell to Prima Fruits as one of Tesco's category managers.

- Firstly, if the criminals both desist from confessing to the police, they receive a minimal, one-year sentence (for example, for being illegally in possession of a hand gun).
- Secondly, if the police manage to encourage an early confession from one of the criminals - thereby implicating the other criminal - the confessor is rewarded and allowed to walk free, whilst the uncooperative criminal is punished with a hefty 10-year sentence.
- Thirdly, if the police get both criminals to confess, they both serve 5-year sentences.

Criminals cornered under such circumstances invariably 'spill the beans' to the police, despite them having agreed beforehand not to do so in the event that they are caught. As a result of crafty police work, the criminal realizes the following. By confessing, the criminal would either get zero years (if the partner remained tight-lipped), or five years (if the partner also confesses). However, if he remains tight-lipped and his partner remains tight-lipped, he gets one year; but if he remains tight-lipped and his partner confesses, he gets ten years. The criminal is left to conclude that walking free is better than one year in jail, and that five years is better than ten years in jail. Thus confessing is the criminal's *dominant strategy*. Neither of the criminals ever knows what the other is thinking or saying to his interrogators. Both suspect each other of going back on his word and confessing in an attempt to get the most lenient sentence possible. And with both criminals capitulating to the police, they land up in a worse position than if they had cooperated with one another by remaining 'tight-lipped'. If the criminals were 'regulars' on the job and had learnt to trust one another over time, they could theoretically cooperate with one another for their own benefit. But this is unlikely to happen, and the police are delighted because justice has prevailed and society is better off for having fewer crooks on the streets.

The characteristics underpinning such a prisoners' dilemma game are as follows. The players want to maximize their payoffs or minimize their losses; the players would be better off cooperating with one another in order to do so; one player can only guess what strategy the other player is adopting; the game involves punishments and rewards; there are incentives to cheat, so players are often dishonest with one another; players land up trying to maximize their own payoffs by taking cognizance of other player's strategies; in a once-off game, players land up adopting strategies that guarantee an inferior outcome for themselves; and, if the game is repeated enough times, trust may be established between

the players to produce a more favourable outcome. According to Miller (2003), no mercy or compassion exists amongst players in the world of game theory: only self-interest. And this is all the more economically frustrating for players because they have the opportunity to cooperate right from the start to maximize their payoffs, yet they seem destined - due to situational circumstances - not to be able to capitalize on the opportunity.

How does game theory - and the prisoners' dilemma in particular - play itself out in the UK marketplace between South African table grape suppliers? With grapes being an impulse purchase and having a high price elasticity of demand, the UK retailers are keen to sell big volumes to attract customers and acquire market share. The retailers are particularly keen to do this in the pre-Christmas market, and are tempted to run promotions to achieve this. However, SA suppliers consider any promotional activities before Christmas unnecessary, since insufficient product of the right quality is not normally available to meet the already high consumer demand that prevails at this time of the year. Besides, suppliers are keen to preserve the traditional price points so that their profit margins can be protected. So the motivation for exporters wanting to maximize their payoffs by not succumbing to the price-cutting promotions of the supermarket buyers already exists.

Every year, the UK supermarket buyers are naturally keen to test the new (potentially lower) price levels at which some South African exporters may be prepared to supply the product.<sup>188</sup> Using a simultaneous move game, Figure 4.12 shows how price competition often pushes exporters into a prisoners' dilemma. Player 1 is a marketing agent (MA) and player 2 a producer-exporter (PE), both competing on price and volume for the retailer's business.

If both exporters agreed to cooperate and charge the highest possible price - in keeping with the aforementioned price points - then they could maximize their payoff on a per carton basis, namely £22 per carton. Both the MA and the PE would achieve total revenue each of £22 x 5000 cartons = £110 000. This assumes that the MA and the PE are satisfied with the volume take-off of 5000 cartons each by the retailer; and that the retailer is happy to split the business between the MA and the PE on an equal basis. The retailer would have to pay that price if all SA suppliers - without exception - agreed not to sell below that price.

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<sup>188</sup> Leclercq believes that it has been every UK grape buyer's ambition to retail the product before Christmas at 99p a pound instead of the traditional £1.99 per pound.

**Figure 4.12 Pre-Christmas Price Competition**

		<u>Producer-Exporter (PE)</u>	
		Low Prices	High Prices
<u>Marketing Agent (MA)</u>	Low Prices	£75 000, £75 000 (£15 x 5000) (£15 x 5000)	£0, £150 000 (£15 x 10000)
	High Prices	£150 000, £0 (£15 x 10000)	£110 000, £110 000 (£22 x 5000) (£22 x 5000)

However, as indicated in the prisoners' dilemma characteristics cited above, this is unlikely to happen. This is because the supermarket buyer - like the police in the prisoners' dilemma example described earlier - are going to be tactical in forcing the two players (MA and PE) to compete with one another on price by pushing them into a prisoners' dilemma. Self-interest will then take hold of the MA and the PE to the detriment of one another. Why does this happen?

From the MA's point of view, he would like to be rewarded with as much product volume as possible by the buyer, because a marketing agent's income is based on a percentage of his total revenue generated. The MA can achieve a greater turnover under slightly different conditions. He could sell more volume at a lower price to essentially capitalize on the maximum revenue available to him in the sale. In other words, the MA would prefer to sell all 10 000 cartons required by the retailer at £15 per carton and thereby achieve a turnover of £150000 (i.e. £40000 more than the previous option). He would also prefer to do this even if it meant that the retailer bought all 10 000 cartons from the MA and gave nothing to the PE. In other words, the MA will be unwilling to cooperate with the PE because he can make more money than the PE if he looked after his own and his producers' interests entirely.

In fact, given half a chance, the MA might even trick the PE into believing that they should both stay at £22 per carton; yet, unbeknown to the PE, the MA could be quietly planning to curry favour with the buyer by offering him the product at £15 per carton. Neither of the suppliers really knows what price strategy the other is adopting. They can only guess what

the other is strategizing, since this lower price option is available to them both. The following justifications would go some way towards appeasing the conscience of the devious MA:

- (1) The MA may have a substantial supply history with the retailer and supply the retailer all year round with all fruit kinds – perhaps even on a multinational basis with product sourced globally from countries other than South Africa. Why should this MA have his programme jeopardized by a relative neophyte attempting to muscle his way in on an established programme?
- (2) Why should the MA lose its hard-earned business with the retailer over a price drop, which could be a temporary support measure anyway? If the retailer called for the MA's loyalty, the MA should heed the call to protect his businesses, even if it was at the expense of a few of his producers<sup>189</sup> (which the MA could subsidize with his own commission anyway).
- (3) A large MA might be conscious of the fact that the retailer could not, for example, go for a table grape promotion in his stores without his volumes. This large MA is in a powerful position to negotiate incremental volumes - along with reduced prices - with the retailer.

From the PE's point of view, he may want to discount his price as well for slightly different reasons. If he is one of the larger PEs, he has the concern of being left out in the cold with a large volume of perishable product if he does not stay closely competitive on price with the MA. If he is one of the smaller PEs, his marketing window will be fairly tight (small), and it will be important to capitalize on this once-off opportunity when it presents itself. Fortunately for the PE, he has some leeway with his price because as owner and marketer of the product, he does not incur the total cost of an agent's commission. So he does have some room to move downward on price. However, the PE will not want to heavily discount his price at the retailer's request because, unlike many of the MAs, he does not have other fruits that he sells throughout the year into other markets with which he could spread his income risk and afford himself cross-subsidizing opportunities. But the PE also realizes that if he sneaks in at a lower price, the supermarket buyer has already indicated to him that he

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<sup>189</sup> When MAs sell at a lower price, their supplying producers are proportionately taking a greater financial loss than the MA with his reduced agent's commission.

will give him all of the business. This appeals to the PE who is desirous of offloading his entire product as soon as he can.

However, the profit motive of the supermarket buyer encourages the buyer to push the MA and the PE as far as possible into this pricing dilemma. The buyer has a number of tactics available to him to achieve this. He could: (1) quite clearly buy from both MA and PE, allocating more volume to the one who was prepared to supply at the lower price; (2) examine each supplier's history in terms of loyalty, volume and track record, and thereby determine which suppliers would stay, and which would be 'released from the programme'; (3) threaten that he will not buy from one or both of them again in the future if they do not reduce their price aspirations in line with his expectations; and (4) threaten to purchase product from competitors instead (e.g. the Chileans) by asking them to airfreight product in as a substitute product. This last option may be an excessive one, and it would probably be a loss leader for the retailer; but it would be a show of strength to a potentially intransigent bevy of South African suppliers. In addition to this, the MA and the PE also have to be constantly mindful of the constraints that they face in supplying the UK market (as discussed earlier in this chapter).

The retailer has to be competitive on the High Street, and to ensure that he is in fact getting the very best (lowest) price from his suppliers, he uses the power of chaos to keep his suppliers in check. Miller (2003) suggests that in order to multiply suppliers' mistrust of one another, a buyer can adopt such a tactic by randomly giving all of his business to the PE only - for no apparent reason - so that the MA might suspect treachery on the part of the PE. Once that ploy is used, the ostracized MA becomes immediately suspicious of the chosen PE, and a price war ensues between the suppliers to get the business. As is often experienced by producers, self-interest leads their exporters into a form of ruinous competition where suppliers' selling prices frequently equate to their cost prices; and they are often no better off having traded (Dixit & Skeath, 2004).

Once the buyer has created an environment of distrust amongst its suppliers, both the MA and the PE have by this stage gravitated to the top left quadrant of Figure 4.12 in which the lowest possible prices are offered to the supermarket buyer. It illustrates once again that an MA and a PE will normally have two dichotomous interests, and cooperation is nigh impossible to foster where interests are so diametrically opposed. Interestingly, where society was the beneficiary of the classic prisoners' dilemma in which two crooks were removed from the street, in this case the consumer is the beneficiary with the lowest possible prices - as long as the retailer passes the benefit of the lower prices on to the

consumer. It is also somewhat ironical that 'the invisible hand guides markets to allocate resources efficiently only when markets are competitive, and markets are competitive only when firms in the market fail to cooperate with one another' (Mankiv & Taylor, 2006: 335). In such cases, suppliers ultimately can't regret the outcome of their decisions. They can merely be satisfied with the strategy that they chose given the strategy that their competitors chose.

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## 4.8 UK Supermarket Trends and their Effects on Suppliers

UK supermarket trends are undoubtedly having a significant impact on the South African exporters' competitiveness, their profitability and ultimately their *raison d'être* in the value chain. Being market leaders within the European context, the UK supermarkets' actions need to be watched closely by all those South African suppliers intent on sustaining this business and adding value in the chain. The major supermarket trends that have been identified are the following:

- (1) UK supermarkets have to be able to *compete with one another on price*; otherwise they would be forced to exit the business. In order to stay price-competitive, they have to achieve the kinds of growth that allow them to offer 'every day low prices' (EDLP). According to Hollingsworth (2004), this growth is hard to come by as the UK market is now saturated with its various retail formats.<sup>190</sup> Organic growth and acquisitions appear to be the last two avenues of growth opportunity left for these UK supermarkets (Dobson, 2002). Retailers are able to cannibalize each other's market shares by acquiring one another, and the most notable acquisition was that of Safeway by Morrison in 2003. Burt & Sparks (2003) talk of the 'spiral of growth' or 'virtuous circle' in which dominant retailers are able through scale, investment and efficient asset usage, to increase this growth through sales density (where sales density is defined as the sales per square foot in the store). This increased sales density yields lower unit costs and higher net margins, and is in fact a self-perpetuating circle of growth.

Burt & Sparks (2003) go on to suggest that there is a dual-option outcome of this spiral of growth for surplus income generated by surviving retailers. The retailer can generate greater sales by: (a) investing in new facilities by upgrading existing ones or acquiring new ones;<sup>191</sup> or (b) investing in price reductions by taking even lower margins and continually creating an environment of every day low prices (EDLP). Wal-Mart's Asda can perhaps be characterized by this sort of trading environment considering the lower gross margins taken on product (or subsidization of price) compared to the other supermarkets. According to Sarel Joubert, South African exporters are no longer able to assist UK retailers on price, contrary to what has happened in the last four to five years. With no price manoeuvrability available any

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<sup>190</sup> Hollingsworth (2004) states that evidence in the USA retail sector suggests that competition between retailers intensifies when store format diversification has evolved (store formats refer to either convenience stores, supermarkets or superstores).

longer, South African suppliers can only deliver to other markets, or simply not supply the UK retailer.

- (2) The *consolidation of category managers* by their supermarket clients continues apace. It has been demonstrated earlier how this affects the way in which (South African) suppliers have had to re-establish their access to a supermarket via another category manager in an aggressive manner - or lose the business. There has also been a *rationalization of first-tier suppliers* delivering product to the retained category managers, putting constant pressure on the remaining suppliers to try and preserve the business. The reasons for this are threefold: (a) it reduces transaction costs for the retailers; (b) it reduces the risk of problems associated with food safety and food quality; and (c) the supply base is a source of competitive advantage that requires strategic investment (Fearne et al, 2004).
- (3) There is a considerable amount of *vertical integration* being implemented in the chain by some of the supermarkets. Asda, for example, has appointed International Produce (IP) as its sole category manager.<sup>192</sup> IP has been opening procurement offices in supplying countries, including an office in South Africa. It therefore appears that IP is attempting to bypass the South African marketing agent to procure directly from South African producers. In 2009, Asda plans a share swap with IP in which IP will no longer be an independently owned entity in the chain, but instead a procurement division of Asda (Pike, 2006). The net effect of this will be that Asda, as the supermarket, will control the entire supply chain of South African table grapes - from 'farm to fork'. In successfully implementing this model, Asda will have significantly shortened the chain. However, certain GEF members are circumspect about Asda's controversial business model believing it to be unsustainable due to the UK supermarket having underestimated the cultural, financial and logistical complexities at the South African end of the chain.
- (4) The *rebates in the value chain are being usurped* by the supermarkets, slowly but surely, from the supply side to the demand side of the chain. The consequences of this trend are significant for the South African table grape export industry. Suffice to say that the profitability of the marketing agent and his producer are both

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<sup>191</sup> Tesco's portfolio of future property developments cited in the UK CC (2000) suggested that this is the predominant route that this retailer has decided to follow.

<sup>192</sup> For a UK supermarket of Asda's size to have only one category manager is considered a controversial strategy in South African supplier circles. SA Suppliers are not optimistic that one company can successfully run the entire importing business for all fruit kinds across the whole year for a customer the size of Asda.

endangered by this new development in the business. Whether the supermarkets decide to pocket these rebates or to pass some or all of their value into a reduced retail price tag remains to be seen. To remain profitable in this business without the supply chain rebates, suppliers (producers and marketing agents) could be forced to rely on fruit profits only. To achieve this, farming units will have to become super-efficient: no gearing, big economies of scale and highly effective and efficient production systems. This would certainly level the 'ploughing fields' between the producers in that only the *very best* farmers would survive under such circumstances.

(5) Some of the UK supermarkets like Asda and Tesco are multinationals with significant *global expansion strategies*. According to Leahy (2005), the CEO of Tesco, 30 million people shop weekly at Tesco's more than 2000 stores in 13 countries around the world. For suppliers, this makes these supermarkets a force to be reckoned with, especially if their international growth strategies are characterized by international buyer groups and cross-border alliances (Dobson, 2002; Burt & Sparks, 2003). Mike Grobbelaar is adamant that with the growing consolidation of supermarket business worldwide and the strict quality specifications demanded by these supermarkets, all roads lead to the future upgrade of South African product quality to secure its shelf space with these globalizing, retail behemoths. South African exporters therefore have to be strategic in their outlook not to alienate themselves from these internationalizing retail chains. However, Wrigley & Currah (2003) write of the complexities and stresses involved in retailers internationalizing their businesses, citing more failures than successes. Burt et al. (2002) confirm that UK retailers have struggled with internationalization because they have underestimated the need to adapt their store formats to the competitive realities of their offshore markets; their strategies have been serendipitous or misguided; and they have lacked experience in decentralized control of a business.

(6) Each of the top ten UK retailers has a unique approach to *Corporate Social Responsibility (CSR)*, and all maintain that CSR is tightly integrated within their core business (Jones et al, 2005). However, all the UK-based supermarkets are demanding that their suppliers integrate the basic tenets of CSR into their products and services, namely: food safety, traceability, environmental concerns and ethical

trading principles.<sup>193</sup> Furthermore, the supermarkets are insisting that these value-additions are incorporated into the product offering totally at the supplier's expense. Frustratingly for suppliers, double standards are sometimes created by supermarkets that normally insist that only accredited suppliers may do business with them. Yet business is conducted with non-accredited suppliers if cheaper prices can be obtained, or more understandably where a shortage of product from accredited suppliers encourages the supermarket to look to non-accredited sources of supply.

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<sup>193</sup> Each supermarket has its own accreditation standard. Without some form of harmonization between all of the UK supermarkets' standards, compliance by suppliers becomes unwieldy and costly.

## 4.9 Summary

From the early 1980s, the British retail sector started revolutionizing its offerings to the UK consumer through a combination of cost-economies of scale and scope. The issues of food safety, efficient consumer response, category management and every day low prices enabled the top four UK supermarkets to concentrate their retailing power at the expense of the smaller, family-owned retail stores. This retailer concentration was compounded by the ailing wholesale sector which had its traditional markets usurped by these retailers. By 2000, the UK competition authorities had been requested to investigate the levels of dominance being practiced by these top four British supermarkets, particularly with their suppliers.

82% of fresh produce is sold to the UK consumer through its supermarkets, with the homogeneous UK market showing very different characteristics to its contiguous, heterogeneous European Mainland market. 25% of South Africa's table grape export production supplies the UK market that is showing a year-on-year growth of 12% - primarily for health reasons. Green and red seedless grapes that are merchandized in loose and pre-packed formats, help segment the grape category for consumers. However, supermarkets are encouraging consumers to trade up from loose-packs to pre-packs for food safety, shrinkage, wastage and profitability reasons.

Competition for the lucrative, pre-Christmas marketing window of the UK has been characterized by forces that are both 'internal' (South Africans from different production regions competing with one another), and 'external' (South Africans competing with other countries like Brazil and Namibia). South African table grape suppliers are challenged in the post-Christmas UK market mostly by Chile. Other smaller competitors like Argentina and Peru are on the rise, whilst Israel, Egypt, Mexico, Morocco, Mexico and Brazil (second harvest) all compete for the tail end of the season.

Category management is justified as a 365-day a year supply structure as a result of UK supermarkets needing services such as customs clearing, quality control, the re-packing of product into bags or punnets, the labelling of packaging with sell-by-dates and the distribution of full and half pallets to depots and retail outlets. This same structure that was introduced to bring about cost efficiencies has, however, also led to anti-competitive concerns by suppliers. These concerns surround category management companies excluding smaller suppliers, giving category captains disproportionate market power, reducing the welfare of UK consumers and facilitating price-fixing. Through these

structures, supermarkets can exert their market power by earning monopolistic profits from consumers, and monopsonistic profits from suppliers. The stability of the whole category management structure for suppliers is under threat when supermarkets de-list their category managers, and where category managers de-list their first-tier suppliers.

UK supermarket programmes appear to favour the buyers in that prices for product are given to their suppliers at the last minute, suppliers' products are de-branded in favour of supermarkets' house brands, and buyers tend to over-procure product to suit their own ends. These issues, amongst others, give rise to 'procedural' and 'distributive' injustices where the balance of power in the buy-supply relationship is shifted in favour of the buyers. Partnership building between buyers and suppliers is now being considered superfluous in a retail environment where buyers are being regularly rotated through the buying chair, and where commodity-purchasing demands largely transactional encounters only.

The cost chain demonstrates how suppliers delivering grape product to the UK market have their returns affected by three major factors: the SA supply price to the supermarket (which is largely dependent on sales rates, supermarkets' gross margins, the amount of competing product, promotional activities and whether deliveries are pre- or post-Christmas); a volatile exchange rate which makes business unpredictable, risky and more expensive; and the handling charges or slotting fees levied by retailers on their suppliers. The unquantifiable rebates that exporters glean on behalf of their suppliers from various service providers in the chain also have an affect on the profitability of exporters and their producers.

The various scenarios of suppliers optimizing their sales volumes and prices are demonstrated via game theory. The sales strategies available to both the marketing agent (MA) and the producer-exporter (PE) produce a dominant strategy in which both the MA and PE are doomed to zero profits. The provision of accurate, real-time information is considered important in fostering cooperation between marketing agents and producer-exporters to optimize returns for producers in the UK marketplace.

Finally, the major UK supermarket trends which South African exporters have to contend with are as follows: the relentless pursuit of growth by the major UK supermarkets through organic growth, acquisitions and EDLP strategies; the consolidation by supermarkets of their category managers, and the rationalization by category managers of their first-tier suppliers; the vertical integration by some supermarkets in an attempt to bypass intermediaries in the chain; the usurping of the rebates in the chain by the supermarkets from their suppliers; the internationalization of some of the UK supermarkets and the

opportunities that it may bring to some suppliers; and, finally, the prioritization by supermarkets of corporate social responsibility issues like food safety, traceability, ethical trading and carbon footprint concerns.

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## Chapter 5: Conclusions and Recommendations to Industry

This final chapter draws conclusions around the three Porter determinants being evaluated in this discourse, namely: (1) *market demand* in which exporters need to consider how they can improve their services to, and commercial relationships with, the major UK supermarkets; (2) *supporting industries* and how service providers in these industries should interact with producers and exporters to innovate products and services that provide a competitive edge to their businesses; and (3) the *strategy, structure and rivalry of the table grape export sector*, with particular reference to how industry leadership can take the sector forward in the foreseeable future. The recommendations made to the table grape industry's leadership in line with the three determinants are not exhaustive. Hopefully they cover the main issues that would make a substantial difference to the competitiveness of the South African table grape export sector, if applied.

### 5.1 Supermarket Demands: Developing Countervailing Supplier Power

It is evident that the UK supermarkets dominate SA table grape suppliers – and all fresh fruit suppliers to the UK supermarkets for that matter. This is partly due to the *abundance of suppliers* (there are approximately 2000 suppliers of fresh produce to the UK supermarkets), and partly due to the *opportunistic behaviour* of certain supermarket buyers. Ascertaining just how South African suppliers can counteract this situation is no easy task. And if, as Sarel Joubert suggests, the UK supermarkets are the example from which the European Mainland supermarkets are already taking their cue for the future, then the South African table grape export fraternity needs to develop a sense of urgency on how it addresses its competitive position in the EU market at large. The following considerations are offered in the context of what has been covered.

#### 5.1.1 Improving supplier performance

- (1) *Increasing product penetration into the UK market* is crucial, considering that there is still household penetration potential, with only 77% of UK homes purchasing grapes as opposed to 90% purchasing bananas (Leighton, 2005a). South African suppliers therefore need to take note of the factors behind the growth of the UK grape category outlined in the FPJ Grape Supplement (Leighton, 2005a), namely: (a) the growing segmentation of the

market; (b) the extension of the season for the more popular varieties; and (c) increased storage opportunities. Storage of the product can be improved by looking at the various techniques of storing product on the vine, in the SA cold rooms, under controlled atmosphere conditions, in the market, according to variety and whilst applying the correct post-harvest treatments; and (d) the consistent quality and range of new and existing varieties from suppliers.

Conradie (2007) claims that consumer marketing has been neglected by South Africa in the years after deregulation. In order to achieve greater UK market penetration, and to create a *pull* for SA fruit, he proposes that the industry considers marketing a South African lifestyle. To achieve this, SA fruits (including grapes) should be used as a platform to conduct a national marketing campaign, which would expose the typical attributes of the South African lifestyle, namely wildlife, golf courses, beaches and holidays. In-store theatre and travel competitions should provide the UK consumer with the opportunity to experience this lifestyle. The International Marketing Council should be broached to consider supporting the concept using the national branding of 'South Africa – Alive with Possibilities'.

(2) *Abiding by the five key performance indicators* that separate the 'best from the rest' of the suppliers, as noted on the supermarkets' scorecards of their suppliers (Fearne & Hughes, 1999), namely: (a) the strategic orientation of the supplier; (b) the organizational structure and its business culture; (c) its ability to mine market information efficiently and effectively; (d) its cost-consciousness around serving customers; and (e) its ability to innovate. With shorter product life cycles, shorter lead times, limited first-mover advantages and constantly advancing technology, commodity suppliers are under pressure to fund the innovation required to stay ahead of the pack (Fearne & Hughes, 1999). This commodity remains a poverty trap unless suppliers are able to innovate their way out of it. However, innovation around the product remains a relentless challenge, and it will need to come primarily in the form of new varieties, new packaging formats and extended shelf life for the product (Fearne & Hughes, 1999).

(3) *Delivering more carefully targeted product volumes*, more evenly across the season, especially over the peak (South African) delivery weeks i.e. from

week 52 to week 4. If the ships bunch during the season, they put pressure on stocks and ultimately on prices. In order to truncate these peak week volumes, exporters need to be given accurate, real-time information pertaining to the weekly shipments of product to the UK market. Hubert Leclercq points out that once South African suppliers have collectively consulted the vital statistics, and are made aware of the volumes that supermarkets have historically been able to sell during these weeks, suppliers cannot be hoodwinked into delivering more to these supermarkets that can be sold by them. Hubert Leclercq further maintains that this is why the Chileans annually publish all their grape export volumes, by week, by exporter to the named receivers in the UK. It prevents any UK receiver from inflating its volumes to over-procure from over-zealous suppliers and thereby disadvantage uninformed producers.<sup>194</sup> In addition, Hubert Leclercq maintains that this requires collaboration - not collusion - on volumes between the South African exporting companies.

- (4) *Increasing penetration into other existing and new markets.* A strategic imperative for any country dealing in a fast-commoditizing product like table grapes is that there should be numerous other markets to which its product can be sent. As soon as a country has this choice, it alerts buyers to the fact that suppliers have other market outlets. In supplying only the volumes and varieties that the UK market can absorb during the season, South African grape suppliers will need to divert superfluous volumes (especially those in the peak weeks) away from this market. Manning (2004), former representative of the Chilean fruit industry in Europe, suggests that South Africans should be looking to penetrate the Spanish and Italian markets to a much greater extent than they currently do. He also insists that there are still untapped supermarket opportunities in Europe where South African product is under-represented. Of course, these opportunities may not yield the same price benefits as the UK market, but they do serve to absorb volume and diversify risk for the exporter and his producer.

It should also be borne in mind that in taking volume pressure off a market, prices in that market should, in theory, be more buoyant if demand remains

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<sup>194</sup> The only exception to predictable volumes sold by supermarkets is when a supermarket conducts a promotion. But even then, sales rates can be estimated according to the retail price planned for the promotion.

unchanged. However, if the South African suppliers should remove what is considered to be 'excess volumes' from the UK market, one or more of their competitors could fill that 'volume gap' created by South Africa. This would entirely defeat the purpose of the exercise. Sarel Joubert points out that a relatively small amount of South Africa's citrus goes to the UK market because the South African citrus industry has gained access to considerably more markets than the table grape industry.

It seems apparent, therefore, that the South African table grape industry should have gained access to more countries than it has in the deregulated period - including exploiting a burgeoning local market. Meintjes (2004g) maintained that with the production volume growths expected in South Africa, the industry could not afford to continue selling more than 80% of its product into the European Mainland and the UK. Yet the industry is still grappling with access to new markets, especially the markets in the east like Japan and South Korea. (In fact, whilst completing the closing chapter of this discourse, the industry had just lost its market access to Thailand for table grapes). Israel and China are the only two newly acquired markets for South African table grapes in the last 10 years (FPEF, 2006a). With official market access to China very recently acquired,<sup>195</sup> Samuel Pieterse cautions the industry against believing that this market will be the panacea of its market access ills. He claims that for as long as the dollar remains weak against the rand, the industry will not be able to profitably capitalize on the official opening of the Chinese market. All of South Africa's dollar-based markets have been putting volume pressure on the pound and euro markets due to the strength of these latter currencies in relation to the dollar.

### **5.1.2 Approaching Retailers Over their Market Power**

In April 1999, the UK Competition Commission launched an investigation as a result of a complaint laid by the Director General of the UK Office of Fair Trading. The origin of the complaint revolved around three issues: (1) the public perception that the price of groceries in the UK was higher than in comparable EU countries; (2) the disparity between farm-gate

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<sup>195</sup> South Africa has had unofficial access in the past to China via Hong Kong (through the grey channel). Official access is preferable in the long run, even though there may be no short-term financial gain by having it (due to the import duties which will only come down slowly over time).

and retail prices; and (3) the disappearance of competing high street retailers due to the ubiquitous presence of large out-of-town supermarkets (UK CC, 2000). The UK Competition Commission (CC) Report unusually - though not unprecedentedly - recommended no remedies other than the application of a Code of Practice (CoP) to identified retailers. However, the UK CC Report did find that 27 of the supermarkets' 30 identified business practices in relation to their suppliers were against the public interest. The CoP was finally implemented in March 2002. But by February 2004, the UK OFT's Review on the CoP found it to be ineffective in its original intentions. In February 2006, the UK CC decided to proceed with a new investigation into the market power being exerted by the UK retailers.

In order for South African suppliers to address those 27 business practices found not be in the public's interest, it is proposed here that formal dialogue be opened between the South African table grape exporting industry and the UK's OFT. It paves the way for some countervailing supplier power to be developed indirectly with the retailers, but in a non-confrontational way. The South Africans can also do this in collaboration with supplying countries via the Southern Hemisphere Association of Fresh Fruit Exporters (SHAFFE), all of whom are in very similar supply positions to the UK retailers. The voices of directly affected groups like the UK's National Farmers' Union (NFU)<sup>196</sup> and the European importers' association, FRESHFEL, can also be party to the dialogue with the OFT. Due to potential commercial reprisals, industry officials accompanied by government officials should represent each of the grape-supplying countries at the OFT - not professionals from the commercial side of the production and export sectors.

The aim of opening this channel of communication would be to redress vertical and horizontal restrictive practices being adopted by certain supermarkets and their receivers. The objective of the exercise would be twofold: firstly, to have more palatable buy-supply models implemented for both parties; and secondly, to develop policy against economic exploitation of dependency relationships due to the long-term damage that it causes (Dobson, 2002). The writer therefore proposes the following considerations:

- (1) *Supermarkets should give a timeous price to their suppliers according to an agreed industry standard.* This would allow suppliers to take their product elsewhere if they were not satisfied with the price. Supermarkets should also be guided as to what

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<sup>196</sup> British suppliers have also been squeezed on price by their own supermarkets (about which there has been ongoing public condemnation in the UK press. One of the rationales behind the very low supply prices is that UK supermarkets are discounting the agricultural subsidies that UK farmers receive from the EU in arrears of the season.

constitutes a 'fair price' in relation to suppliers' cost chains, which some supermarket buyers insist on scrutinizing.<sup>197</sup>

- (2) *A standardized sales account format should be published which stipulates maximum charges allowed on identified items of expenditure, which are agreed to, in writing, on an original order.* The unethical issues surrounding unexpected, unexplained and unnecessary costs - including handling charges - that appear on receivers' sales accounts would be largely eliminated. South African table grape exporters have long suspected (and proven) that certain category managers incur superfluous costs at the expense of their suppliers – possibly without the knowledge of their supermarket clients as well.
- (3) *The character profiles, incentive schemes, career development paths and training regimes offered to UK buyers in the current retail purchasing environment need to be overhauled.* Suppliers will continue to be disadvantaged if: (a) buyers' bonuses depend on how much they can extract from suppliers; (b) buyers' careers are built on courses teaching them how to do so; (c) the rotation of buyers' jobs gives them no relationship-building ability to speak of; and (d) very young professionals are assigned to these national buying positions. The conduct of some of these buyers does little to uplift the commercial image of British supermarkets, the values of British society and the virtues of capitalism at large.
- (4) *All supermarkets should be disallowed from selling product at below cost price.* Cost price here refers to the cost at which the retailer is getting the fruit from the supplier. Legislation in other European countries (like Ireland, France and Germany) has barred below-cost selling to curb retail-buying power over their suppliers (UK CC Report, 2000). Whilst economics suggests that selling a product as a loss-leader is legitimate, forcing relatively tiny suppliers to sell at or below cost to assist internationalized retailers into financially harrying smaller (competing) convenience stores into liquidation seems indefensible. Eliminating competition to the degree that has occurred in the UK retail sector is an unhealthy development for suppliers and consumers, and some form of government intervention (regulation) is required to stabilize what is becoming an unstable form of capitalism.

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<sup>197</sup> Some consider it unethical that supermarkets demand to see suppliers' cost chains. However supermarkets argue that suppliers know the supermarket's gross margins by knowing the supply price and by seeing the retail price on the product.

- (5) *Retail buyers should factor in a country's exchange rate in its supply-price calculation.* It is in their long-term interests to do so if they wish to continue buying on a sustainable basis from all their supplying countries (and their established supplying companies) across all the marketing windows throughout the year. Although Mike Grobbelaar believes that there can be no such thing as a 'compassionate purchase' and that forward cover is available at a cost, a developing country's commodity competitiveness - perhaps even survival - hinges very heavily on its country's exchange rate. Supermarkets that intend to build long-term relationships with their suppliers should therefore factor in the supplying country's exchange rate into their buying price.
- (6) *A category management company should be prohibited from servicing more than one supermarket client,* otherwise too much vertical and horizontal market power is vested in that one CM company. Whilst the economic counter-argument could be that economies of scale justify this configuration, the CM's interest lies with the supermarkets he serves - not the first-tier suppliers he uses - and the power is again skewed in favour of the supermarket.
- (7) Whilst UK competition law exists to deal with horizontal and vertical restrictive practices, and mergers and acquisitions, the lack of a universally accepted definition of buying power,<sup>198</sup> ambiguous policy guidelines,<sup>199</sup> and vested national interests<sup>200</sup> are all causing variations in legal interpretations of anti-competitive situations, leading to inconsistent decision-making (Dobson, 2002). *The UK policy makers need to tidy this up by applying structural and behavioural remedies* (Dobson, 2002).
- (8) *Social responsibility should be emphasized by insisting that supermarkets subscribe to a Code of Conduct centred on 'ethical trade' that is monitored by a British government authority that has 'teeth' to implement effective punitive measures.* One of the recommendations has been the appointment of an independent regulator to oversee supermarket conduct with their suppliers (Bell, 2003).

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<sup>198</sup> Where market share statistics are seen as a proxy measure of market power (Burt & Sparks, 2003), according to Dobson (2002) the UK CC suggested that 8% of market share of a supermarket could afford buying power, whereas the OECD suggested 15% and the European Commission 22%.

<sup>199</sup> Whilst seller power is well covered in UK policy guidelines, the corresponding guidelines on buyer power seems totally under-developed (Dobson, 2002).

<sup>200</sup> Burt & Sparks (2003) suggest that it is in the UK's national interests to develop a "national champion" (like Tesco) – as encouraged by France with the merger between Carrefour and Pomodes – to be able to take on the Wal-Mart juggernaut. An additional national interest that could be mooted is the ability of Tesco to assist the British central bank with its inflation targeting policy by consistently offering deflationary food prices.

(9) *Non-governmental organizations like Oxfam, Greenpeace, Friends of the Earth and ActionAid should be included in a “Buy-Supply Forum” together with the supplier, supermarket and OFT representatives so that a more balanced, ‘societal’ perspective can be brought to the commercial table.* Besides, retailers are sensitive to the demands of NGOs, especially those adroit at attracting negative media attention to apparent abusive practices in their supply chains (Freidberg, 2003). Much has been written regarding UK supermarkets keeping their suppliers’ labour forces trapped on the edge of poverty - particularly in developing countries. In a similar vein, the supermarkets are considered to be keeping South African producers and exporters trapped on the edge of profitability. In a recent article, ActionAid (2005) appealed to transnational companies (TNCs) regarding the way they are handling their suppliers. They called for an adoption of new standards at the United Nations – the UN Human Rights Norms for Business – to establish legal requirements for TNCs to respect and secure the human rights of all workers within a company’s area of interest. TNCs have largely outgrown the reach of national law. However, rights violations committed by TNCs are not effectively addressed by international law, allowing them to operate in what is effectively a regulatory void.

In 2006, the UK Competition Commission launched another investigation into market power being exercised by supermarkets. However, the perception is that with the UK CC’s benign attitude it adopted towards the 2000 investigation, no effective remedies are expected to emanate from this new investigation. For this reason, suppliers should be masters of their own destiny and continue to approach the OFT in England. In fact a UK NGO has already suggested to the OFT that it should strengthen the Code of Practice by, *firstly*, bringing it in line with the original recommendations of the UK CC, as it was watered down by round-table discussions between the UK CC and the affected retailers before its implementation; and *secondly*, including definitions for what was meant by ‘reasonable’ in the Code of Practice document. Bell (2003) further suggested that the Code of Practice should be imposed on retailers instead of negotiating with them what was tenable or not. Finally, Dobson (2002) proposed that the Code of Practice should be rigorously worded to avoid legal loopholes, and should be determined unilaterally by the UK CC authority and be accompanied by an appropriate dispute resolution procedure.

As a last resort, the matter can be taken up with the EU Competition Commission in Brussels considering that the UK is a member of the EU, and considering the

internationalization of UK retailers and their foray onto the European Mainland.<sup>201</sup> If this is not attended to, South African suppliers will have their competitiveness compromised on an even larger scale in their single biggest market.

University of Cape Town

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<sup>201</sup> An example of a successful intervention by the South African industry involved an industry delegation to the Competition Commission in Brussels. This delegation forced Maersk to abandon its proposed merger with P&O Nedlloyd in South Africa. The Competition Commission based its decision on the additional concentration that the merger would have brought to the already limited number of containerized shipping lines operating out of South Africa, and the concomitant effect that it would have had on higher shipping rates for the South African fruit exporters had it been allowed to go through.

## **5.2 Service Providers' Mantra: Innovate or Evaporate**

The second determinant being covered by this discourse is the degree to which supporting industries could essentially improve their logistics services in the post-harvest leg of the chain - especially from an innovative point of view. The following recommendations are made based on the recently launched innovation programme for the whole fruit industry *and* the inhibitors that, according to industry specialists, need to be dissolved in order for competitive progress to be made in the table grape export industry.

### **5.2.1 Capitalizing on the New Post-Harvest Innovation Programme**

Hansen and Birkinshaw (2007: 121) state that innovation requires institutions - in this case service provision institutions - to 'come up with better ideas, look outside the company for concepts and partners, establish different funding mechanisms, protect new and radically different businesses from the old and sharpen the execution'. Kaplinsky and Morris (2000) emphasize that innovation in itself is not a guarantee of staying competitive. If your *rate* of innovation is lower than that of your competitors, then your value-added component - and subsequently your market share - will still be in relative decline. And with technology changing faster than economic theory, new solutions will have to be found from a different platform of thinking from that which has been experienced in the past.

Fortunately, the FPEF has just launched a three-year Post Harvest Innovation Programme partnered by the Department of Science & Technology and the Agricultural Research Council. It represents an ideal opportunity for the table grape export industry - and all service providers in the chain - 'to network for the generation of new knowledge for a sustainable future, to assimilate new technologies in the cold chain and to develop collective leadership with a vision that will propel the industry to the next level of global competitiveness' (FPEF, 2007b: 1). There is little comfort in knowing that South Africa's table grape competitors have taken the lead in the fields of post-harvest research and development, innovation and infrastructural developments (DST, 2006). As the business plan for this innovation programme states, 'a centrally capacitated facility needs to be instituted that tracks global trends and disseminates information to producers and exporters on benchmarked, best-practice trends and case studies, industry threats, industry vulnerabilities and government support. Such a facility needs to target, implement and monitor research, development and innovations that would provide cutting-edge technical, institutional, human resource, supply chain and R&D information' (DST, 2006: 2).

The South African deciduous fruit sector has compromised its global competitiveness in the deregulated era by continuing to prioritize pre-harvest R&D<sup>202</sup> issues at the expense of post-harvest innovation and technology development. A gap analysis conducted by the DST (2006) concluded that service providers in the table grape export value chain urgently needed to concentrate their attention on the following:

- (1) *Container technology* for the improvement of airflow, gas, temperature and humidity controls;
- (2) *Integrated packaging solutions* for the development of new internal and external packaging and pallet platforms;
- (3) *Alternative treatments for disease and pest control* by, for example, substituting the controversial use of sulphur dioxide with an alternative product;
- (4) *Non-destructive techniques for assessing fruit quality* using, for example, infrared devices that measure the ripeness and readiness of fruit;
- (5) *The instigation of an information hub* that provides a much wider provision of business intelligence than is currently the case; and
- (6) *New cultivar development including an assessment process of new cultivars* that are being imported from overseas plant breeders. Interestingly, the capped production volumes of new cultivars, the exclusive allocation of their production and sales rights and the restriction on which markets these cultivars can be sold into, should provide some form of countervailing price power for South African suppliers to British supermarkets in the near future.

The South African table grape industry's ability to innovate – particularly at post-harvest level – will depend largely on its ability to remove obstacles that block the industry from carrying out such innovation. The following section deals with what has to be done to remove such innovation inhibitors.

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<sup>202</sup> Despite the prioritization on pre-harvest matters, it has been noted that there is already an under-investment in pre-harvest R&D when comparing what the South African deciduous sector spends on R&D in relation to its F.O.B. turnover and international benchmarks.

## 5.2.2 Bolstering the Drivers of Innovation

According to Taylor (2006), the major drivers for research and innovation are the reduction of operating costs, changing consumer needs, health and safety issues, carbon footprint issues, improved fruit quality at the packing stage and improved fruit condition on arrival in the market place. Post-harvest research and innovation drivers that should therefore be amplified to improve the table grape industry's international competitiveness are as follows:

(1) *Synergistic use of resources.* It is widely felt that most stakeholders in the South African table grape export value chain prioritize their self-preservation ahead of group-collaboration. Perhaps it is instinctive for commercial survival and a characteristic of a highly competitive free-market system. Or perhaps it is simply an indictment on the independent culture prevailing in the industry. Whatever the cause, insufficient resource clustering manifests itself amongst various government departments, universities, industry associations, export houses, service providers and growers. The following serve as examples.

(a) Alleviating congestion in Cape Town port, for example, is a matter of many public and private sector institutions coming together in an unprecedented form of cooperation. It requires industry association leadership to motivate, coordinate and fast-track (i) planned infrastructural investments by central government and state owned enterprises in the port of Cape Town; (ii) service level agreements between TPT and the shipping lines which would incorporate revised productivity levels and improved operation systems within TPT; (iii) the formation of an effective port steering committee that encompasses all port stakeholders to evaluate port performance and to suggest improvements; and (iv) the commissioning of fruit industry research studies that pinpoint information and communication deficiencies connected with the supply chain into the port.

(b) Taylor (2006) believes that commercial packaging companies are still tinkering with smaller innovations - like structural strength and carton ventilation - and not addressing the strategic, long-term innovations such as changes in the material used in the packaging

for biodegradability purposes (as this could jeopardize the future of such commercial packaging companies). In order to achieve this, Taylor (2006) suggests that a consortium outside of the traditional domain of industry-connected institutions should join forces that could, for example, involve the CSIR and polymer science departments from various universities.<sup>203</sup>

(c) Le Roux & Coetzee (2006) maintain that the South African table grape industry and its stakeholders should be cooperating more closely with their competitors. Nortje and Craffert (2006) allude to the ongoing successful collaboration between the South African avocado sector and its competitors (Mexico, Spain, Kenya and Israel). Each country makes marketing intelligence available to the other, and all countries contribute financially to generic avocado promotions in the UK. Chile, like South Africa, has similar climatic conditions and exports similar fruits at the same time of the year to similar markets – like the UK market. Chileans allegedly embrace technology more readily than South Africans as indicated by their adoption of modified, controlled atmosphere packaging for exporting nectarines (whilst most South African nectarine growers are still in the embryonic stage of conducting trials on this same packaging). Samuel Pieterse also notes that industry associations should be regularly researching and providing information on competitors for the SA exporters as these exporters do not have the time or the resources to do this.

(d) In noting the lack of strategic alliances between the various fruit sectors - and industry associations - Benic (2006) suggests that an advisory committee should be established that shares detailed information pertaining to the important areas of market access and phytosanitary matters between the fruit sectors. For example, the two leading multinational export companies, Dole and Capespan, have for some time, been conducting research on the browning of table grapes knowingly - but independently - of one another. This

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<sup>203</sup> Griesel (2006) and Huysamer (2006) concur that there needs to be a much greater multi-disciplinary approach to cold chain innovation. For example, cold chain technology is chiefly an engineering discipline and so engineering sciences need to integrate with horticultural sciences to produce the required results.

seems an unnecessary duplication of resources, and the GEF leadership needs to bring together its members with research institutions and the DST Innovation Programme to create the necessary synergies for quicker breakthroughs to be made - for the benefit of all.

(e) Perhaps the biggest culprits of non-collaboration are the various government departments that interact with the industry. Karaan (2006) writes in his review of the Agricultural Marketing Act that the DoA and the dti in particular are the two major departments where much greater cooperation and clearer definitions of portfolios need to be fostered so as not to handicap the industry. In the few cases where synergistic relationships have been formed, the benefits are clearly being harnessed.<sup>204</sup>

(2) *Effective transfer of new technology.*<sup>205</sup> Labuschagne (2006) questions the validity of cold chain innovation if the table grape industry is unable to ensure that new technology is transferred to the beneficiaries' knowledge base; and if the technology is not applied appropriately or correctly in the chain by the intended beneficiaries. Hansen & Birkinshaw (2007) extrapolate Labuschagne's statement by bluntly stating that diffusion-poor industries have trouble monetizing good ideas. Labuschagne (2006) further maintains that despite the existence of thoroughly researched and well-maintained protocols for the post-harvest handling and treatment of table grapes, many people in the cold chain still pay scant attention to applying the established protocols. Examples of this are the lack of adherence to hazardous access control point (HACCP) systems by exporters, and producers not packing and stacking pallets in containers correctly. For this reason, Labuschagne believes that the industry should accelerate the implementation of the product quality management system (PQMS) via the PPECB so that quality systems can be audited throughout the cold chain, which is currently not the case.

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<sup>204</sup> Benic (2006) noted the success of the South African Pesticide Initiative Programme between the South Africa fruit industry and the European Union, which was facilitated by the National Department of Agriculture.

<sup>205</sup> This refers to the dissemination of technology developed in the deciduous fruit industry for the grape sector; and technology developed by other SA industries that are adopted by the grape sector (for example the automotive industry's paint spraying techniques adopted for spraying chemicals on grape vines).

What technology transfer is taking place at production level is now being conducted by the thinly staffed DFPT Research institution, and by those few export houses that can afford this function via their technical specialists. According to Huysamer (2006) it is not just a question of the affordability of technical specialists by every producer and exporter; there are simply not enough experienced and qualified technical specialists to populate the table grape industry today. Campbell & Hurndall (2006) acknowledge that technology transfer under the current regime has not wholly succeeded, and that alternative initiatives need to be sought. Le Roux & Coetzee (2006) do not believe that the solution for technology transfer lies in deploying extension officers (as in the regulated era) or technology transfer consultants (as in the deregulated era).

A technology diffusion programme in the industry could incorporate the following ideas. Du Toit (2006) states that prior to deregulation, the pome industry had 'workgroups' in which producers discussed cooling, pack house and storage issues on a quarterly basis. This was an extremely effective way of disseminating information where the opportunity was provided to learn from someone else's experience without the cost of having to experience it oneself. Korsten (2006) advocates that a virtual, post-harvest technology centre is the answer, where the primary objective would be technology transfer. Alternatively, a 'hot-bed' for technological development for the industry could be established where producers, exporters and service providers could 'fetch' newly developed technology from a 'one-stop-shop' (physical) demonstration facility (Van Vuuren, 2006).

Perhaps a clue to this technology diffusion challenge lies in Gladwell's *Tipping Point* (2000) in which he proposes his three techniques used to spread an idea like an epidemic. Gladwell's three rules of epidemic creation are: (a) the '**law of the few**' where the industry needs to identify those few, well-connected people who have a rare set of social gifts that when they speak, everyone listens; (b) the '**stickiness factor**' that says the way in which you package something can take on an irresistibility that really sticks to the target audience; and (c) the '**power of context**' in which the messenger understands how a small change in the circumstances of the message delivery (like through the medium of a video rather than a chalk and talk delivery) can make the essential difference required.

(3) *Revised research model.* Historically, the deciduous fruit industry relied heavily on the government to help it fund basic, innovative research via the ARC. However, due to the political re-prioritization of government spending and the ARC's degenerative management since 1994, the institutional memory of the ARC has been severely compromised over the deregulated era. DFPT Research (on behalf of the table grape industry) has ended up funding basic research at the ARC and Stellenbosch University, and applied research at Experico. Campbell and Hurndall (2006) confess that this approach is not without its dilemmas. For example, should DFPT Research only be supporting these three institutions? And when DFPT Research successfully funds applied research using growers' money, who owns the intellectual property, and how does the royalty income stream get split – if at all?

Le Roux & Coetzee (2006) challenge the current model believing that research project funding should be appropriated on a cost-benefit basis, and that all projects should go out to tender. They maintain that this would ensure that research funding is productive, is not consumed by institutional bureaucracy, lures niche-based research firms into tendering and harnesses research capacity on a countrywide scale. Le Roux & Coetzee (2006) further believe that a revised research model for the industry should not rely too heavily financially on one institution, or too heavily on one individual in an institution. If a holistic research model is not established for the industry's competitive future, then the research system is driven by commercial entities that fear a loss of industry competitiveness; and this system defaults to a non-cooperative race to see who can access new technology ahead of their competitors.

(4) *The recruitment of experienced research staff.* According to Griesel (2006), there are almost no NRF-rated researchers in South Africa that enjoy international recognition in the area of post-harvest technology. Dodd (2006) adds that it is a global phenomenon that young people are no longer making career choices in health and horticultural sciences, but are shifting rather to business science and engineering related degrees. This is exacerbating the already insufficient research capacity that exists. The large disparity in remuneration between research positions and commercial positions in the

South African fruit industry might go some way towards explaining this phenomenon (Le Roux & Coetzee, 2006).

What is more concerning is that the industry is not doing anything to attract a sufficient number of graduates for the long-term stability of this area of the business (Huysamer, 2006).<sup>206</sup> It is apparent then that industry leadership needs to prioritize the retention of its experienced staff and the attraction of (young) new blood to its research ranks. In order to stem and reverse the tide of research staff losses, the public sector could consider co-investing with the industry in this area of the business. This could include public relations campaigns at school level, bursary schemes at universities and mentoring programmes that normally accompany such bursary students (Le Roux, 2006).

- (5) *Continuous research and innovation.* Le Roux (2006), Griesel (2006) and Alexander (2006) lament the fact that innovation is driven by net farm income, which in turn drives research and development. When companies move into survival mode, investment in research becomes a low priority. This is a myopic approach to competitiveness, since the industry needs to build substantial financial reserves that can sustain the momentum of research and innovation over the long-term. A solution could lie in an annual, voluntary (or statutory) levy per carton. Karaan (2006), in his review of the Agricultural Marketing Act, recommended to the Minister of Agriculture that she incentivize industry in this type of situation by promoting cost-sharing arrangements with the industry.

Service providers in the value chain reap considerable profits from the table grape export sector. Industry association executives would therefore do well to ensure that these service providers make greater financial contributions to industry research and innovation than is currently the case. Finally, it should be remembered that only 13% of the table grape statutory levies are currently being used for post harvest research. If the growers decided to make the levy contribution more equitable between pre- and post-harvest

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<sup>206</sup> Huysamer (2006) further notes that in the last five years, there have been fewer than 10 people in each of the final years of the BSc Agriculture course at the University of Stellenbosch (the only South African university specializing in post-harvest technology in the deciduous fruit industry). He maintains that if the industry does not address this, then the real crisis will reach the industry in 10 years from now when the current research staff are due to retire.

innovation and research, this would boost post-harvest innovation funding that would ultimately accelerate the international competitiveness of the industry. If industry leadership was to actively seek these available resources, a substantial reserve fund could be built up over the long-term for post-harvest innovation in the table grape industry; and this would effectively make the state of the industry's financial returns irrelevant to the intensity of innovation carried out every year in the future.

Any innovation that affords the SA producer and his supermarket client a degree of differentiation from their competitors will be rewarded. It is therefore the task of industry leadership to take up the reins on research and innovation, and to ensure that it is proactive rather than reactive (Dodd, 2006; Huysamer, 2006); that the bigger companies with their in-house capabilities collaborate rather than compete, and then share that knowledge with the rest of the industry (Du Toit, 2006); that matters of confidentiality around technology formation are not abused so that newly-developed, South African technology lands up in the hands of foreign companies (Taylor, 2006); that more South African post-harvest researchers publish their work in peer-reviewed journals (Griesel, 2006); and that research scientists work under less pressurized circumstances - with a greater amount of discretionary funding - so as to more readily reach the cutting edge of innovation (Campbell & Hurndall, 2006; Le Roux & Coetzee, 2006).

### 5.3 The Table Grape Export Sector: Quo Vadis?

#### 5.3.1 Quality Products and Services: The Ultimate Differentiators

Maintaining superior product and service quality along the value chain and in the marketplace could probably be considered the ultimate differentiator between the South African table grape export sector and its competitors. As has been noted in this discourse, South Africa's product quality has arguably slipped in the deregulated period due to: inferior quality product being hidden in the system by ill-disciplined suppliers; PPECB quality inspection systems being weakened by labour, time and cost constraints; and producers and marketing agents being tempted to pack volume with secondary considerations being given to quality.

The following recommendations for improving the **product quality** of the South African table grape performance were offered by the GEF members at the 2004 and 2005 SATI strategic planning sessions:

- (1) *Eliminating unwanted varieties in the market;*
- (2) *Enforcing marketing cut-off dates after which certain varieties should not be sent to the market;*
- (3) *Raising the minimum export standards and regulating revised berry size, sunburn and blush export standards for certain varieties;*
- (4) *Prioritizing post-harvest research and innovation;*
- (5) *Enforcing revised handling protocols, especially for packing after rain;*
- (6) *Implementing 'quality spot checks' in Cape Town port to improve quality control systems;<sup>207</sup> and*
- (7) *Putting in place an independent South African quality control presence in the UK ports (via the PPECB). The purpose would be to not only feed back to*

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<sup>207</sup> The further inland the inspections have been located over time in this industry, the worse the condition of fruit that has landed in South Africa's export markets (Symington, 2005). Hence the need to check table grapes in the ports - at least five days after being packed - as this is where quality problems will manifest themselves.

industry arrival quality problems, but also to eliminate spurious quality claims that negatively affect South Africa's image and unnecessarily erode financial returns to producers.

Understandably, vested interests among individual producers have made the first three recommendations tough to implement. One of the functions of the market is to make difficult or unpopular decisions for suppliers. If a producer, contrary to his exporter's advice, insists on sending a variety into the market that is unpopular, then the market rightfully punishes the product with poor financial returns. Eventually it becomes no longer viable to send that product to the market, and the market's decision is often more palatable to the producer than the exporter's request. However, the difficulty is that the market sometimes takes too long to penalize ill-disciplined suppliers, and as a result, other suppliers cannot avoid being polluted in the protracted process of price deterioration. Alternatively, the National Department of Agriculture - as a neutral third party - could, after a consultative process, legislate standards with which the industry would have to comply. This would effectively bypass the vested interests of producers and exporters that interfere when trying to come to joint decisions on such quality standard recommendations.

In terms of **service quality**, the FPEF (2006a) made a number of recommendations in a paper submitted to the NAMC in the revision of the Marketing Act. These and additional recommendations are proposed below.

- (1) *The quality control services of the PPECB should be revised in keeping with changing market requirements.* With many exporters now employing their own quality inspectors to ensure compliance with the array of British supermarket standards being demanded, it is recommended that the PPECB entirely deregulate its product inspection services in favour of an auditing system. This will prevent the double cost that an exporter currently pays for his own inspector and the mandatory PPECB inspector. It will also ensure a superior inspection service as the exporter's inspector quality-controls to his specific supermarket customer's standard (whereas a PPECB inspector has to try and inspect to all the UK supermarket standards).<sup>208</sup>

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<sup>208</sup> GEF members have proposed that the array of quality standards prevalent in the UK be reduced to a few standards thereby simplifying quality control procedures for inspectors.

- (2) *The container equipment inspection services exclusively conducted by the PPECB should be deregulated allowing private companies to compete in the same market.*<sup>209</sup> This should further improve services and reduce costs for the shippers.
- (3) *All marketing agents and producer-exporters should become members of the FPEF.* Anecdotal evidence suggests that the poor marketing skills of an inexperienced group of cavalier producer-exporters and marketing agents have tarnished the South African export effort in the deregulated era. Accreditation to the FPEF would encourage the entire table grape exporting fraternity to collectively determine a high standard of marketing. In addition to this, it is recommended that producers not directly involved with the marketing of their own product should be encouraged to use only accredited members of the FPEF. In this way, much of the ill-discipline prevalent in the industry around legal, financial and quality matters can be effectively managed through the FPEF Code of Conduct and its speedy dispute resolution procedures.
- (4) In order to preserve and enhance the provision of accurate, real-time information to producers and exporters, the PPECB should remain custodian of the industry's information database for confidentiality purposes. However, considering that the PPECB's core business is fruit inspection services, *the PPECB should outsource the management of the database to an IT company whose core business deals with IT matters of the magnitude and complexity emanating from the industry.* Marketing decisions are facilitated by the supply of weekly vital statistics from the PPECB, and the preservation and improvement of this system is a top priority for the enhanced competitiveness of the industry.

### 5.3.2 Black Economic Empowerment in the Export Sector

Whilst transformation or BEE at production level is traditionally beyond the scope of such a dissertation dealing with marketing matters, recent developments suggest otherwise. Essentially, the marketing arm of an industry cannot operate effectively from a politically problematic production platform. Two initiatives reflect this fact. **Firstly**, the ownership of land has been identified as the key to politically satisfy previously disenfranchised

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<sup>209</sup> An exception was made in which the FPEF proposed that the PPECB retained its statutory right to enforce the inspection of ships.

individuals in South Africa. As a result, the production leg of the table grape value chain has been targeted by the SA government in a land reform initiative that transfers ownership of land to emerging black farmers. In an article titled 'Emotional Intelligence' published in the South African Fruit Journal, Symington (2006) suggested that the spoils of the industry needed to be more fairly distributed by white commercial farmers amongst their black workforces, as this gesture would determine the political stability of the industry in future. **Secondly**, impoverished labourers on a South African apple and pear farm have, with the assistance of NGOs, found their way to the last two Tesco Annual General Meetings in London. Their mission was to complain about the poor working and living conditions that they have personally experienced on their farm due to the allegedly poor financial returns received (by the owners of their farms) from Tesco.

A subsequent visit by the Chairman of Tesco (and some of his executives) in March 2007 to the FPEF and two of its members (Capespan and Fruitways) resulted in the establishment of a Multi-stakeholders' Forum. This Forum - inclusive of every role-player involved at the South African end of the pome supply chain - determined that if the South African deciduous industry's fruit export performance to the UK was not to be compromised, then the following issues related to production and labour practices need to be addressed: (1) tenure security; (2) labour rights violations; (3) race and gender discrimination; (4) unethical labour broker practices; and (5) the poor treatment of migrant labour (Webster, 2007). As a result of what is transpiring in the apple and pear industry, table grape producers can anticipate the auditing of their labour practices in the near future by their more socially conscious UK customers. Otherwise, as was unambiguously implied by the Tesco executives, they might well be forced to take the business elsewhere in future. As for the claims on Tesco's prices being too low for the farm to be profitable, that is a matter for the Buy-Supply Forum to take up, as proposed in section 5.1.2.

It is therefore incumbent on current and future industry leaders - for both producer and exporter institutions - not to divorce on-farm matters from marketing matters, as the two are becoming inextricably linked, particularly in the UK market. Industry leadership is encouraged to address the following transformation activities to preserve and enhance the competitive state of the industry's future:

- (1) *Assist table grape producers in the northern parts of the country (where most land claims originate) to successfully transfer land to claimants. The new owners should be encouraged to continue supplying the product for export by*

instituting effective mentoring programmes to bridge the knowledge gap between the old and the new owners;

- (2) *Develop a rapid response system for on-farm matters that are negatively affecting the workforce involved, namely those mentioned by Webster (2007) above. Remedial action should be applied immediately on such farms, and industry leadership can play a valuable, mediatory role in bringing about the required attitude changes;*
- (3) *Institute training programmes for previously disadvantaged individuals on table grape farms to lift standards across the board for table grape exports. There is currently no dedicated training school or courses within the table grape export industry where stakeholders at all levels can further their understanding of the value chain and increase their opportunities for career advancement on a recognized industry basis. New training courses could be developed, or existing training courses could be used (like the *Top of the Class* programme) to uplift targeted individuals immediately and spawn future entrepreneurs;*
- (4) *Help identify BEE opportunities throughout the South African end of the supply chain; and*
- (5) *Develop 'co-operative structures' for emerging farmers or 'twinning programmes' between emerging farmers and commercial marketing agents.*

### **5.3.3 Industry Leadership and Structure**

One of the hallmarks of being internationally competitive means being the preferred country of origin for UK table grape buyers. This implies that South African table grapes should be consistently delivered at the right quality, in the right quantity, at the right time and in the right place – for the right price. In trying to achieve this, a key concept for table grape exporters is how to stay ahead of the global pack, as getting it wrong is the equivalent of entering a 'race to the bottom' - that undesirable path of immiserizing growth in which commodity producers are locked into a spiral of super-competitiveness but declining incomes (Kaplinsky & Morris, 2000).

The key to unlocking the potential of the table grape export sector - not only to the UK market but also to all other markets – is coordinated, industry leadership. This thesis has attempted to demonstrate that the line between exporters and producers has become increasingly blurred over the last five years, and this is predicted to continue. Therefore any industry structure - or leadership type - that keeps these two major stakeholders apart will be detrimental to the long-term, commercial health of the industry. Innovation at industry leadership level requires company owners and industry association leaders to:

- (1) *Continually move the industry mindset from being production-led to being market-led;*
- (2) *Replace the old guard of industry hegemony with a new guard of more entrepreneurial leadership;*
- (3) *Persuade producers to pay income tax in good years based on their profits earned (rather than spend all profits earned on farm improvements to avoid paying any income tax). This would enable producers to build a working capital buffer for the bad times that invariably return in commodity cycles. This will also make producers less dependent on marketing agents for export funding;*
- (4) *Eradicate the blame culture that has prevented people from taking personal responsibility for their own businesses;*
- (5) *Re-prioritize the industry's strategic asset list by placing the long-term supply of sufficient electricity and good quality water at the top of the list; and*
- (6) *Re-prioritize statutory levy expenditure on post-harvest research and innovation rather than on the long-favoured, pre-harvest research.*

Coordination of the major role-players at the highest decision-making level of the industry is paramount for a future industry characterized by unity, growth and stability. Three fault-lines have developed in table grape industry structures in the latter half of the deregulated era. Firstly, the GEF exporters' partnership with the producers in SATI was dissolved after the 2004/5 season, thereby rekindling the bicephalic structure that has so characterized and hampered progress in the industry. Secondly, at the end of 2006, the grape producers broke away from their parent organization, the DFPT, placing SATI at arm's length from

traditional industry structures and from synergies created over the years. Thirdly, the 'progressive producer group', which is a consortium of large-volumed table grape producers by region, has emerged sporadically from the fringes of the industry to veto certain decisions taken by the incumbent industry leadership.

It is recommended that the decision-makers of the major stakeholders - i.e. the marketing agents, producer-exporters and producers - avail themselves of leadership positions on a single board that serves the industry's interests. Such a board that governs the strategic and financial affairs of the industry could:

- (1) *Sit independently from any of the traditional industry associations* (namely Fruit South Africa, SATI, DFPT and the FPEF).
- (2) *Mandate the traditional institutions to carry out various functions on behalf of the table grape export industry, either independently or through joint ventures with one another.*
- (3) *Centre the industry's activities around the constellation of strategic (competitiveness) themes offered by Spies (2003), namely: innovation and technology development; quality of products and services; consumer and market demands; transformation within the SA table grape industry; human capital development; the facilitation of strategic alliances; and the coordination of industry leadership matters.*
- (4) *Ensure the sourcing of additional industry funds from the private sector (producers, exporters and service providers), the public sector (e.g. the Departments of Agriculture, Labour and Trade & Industry) and the international donor community. Executive capacity in the traditional industry associations should be incentivized to cast the donor fund net far and wide, as Section 21 companies in particular qualify for such funding due to their representivity, political neutrality and non-profit status.*

Without authentic leadership, widely representative working capital and a strategic intent, industry efforts degenerate into a 'talk show'. And with the number of people currently employed by and dependent on the table grape industry - especially for its success in its biggest single country market - there remains an enormous social responsibility facing those in industry leadership positions to help companies sustain and improve their

competitive positions. And it is the leadership's task in the free-market system operating today to find innovative and enduring solutions that are palatable to the majority.

University of Cape Town

## Appendix A: Chile – A Formidable Competitor

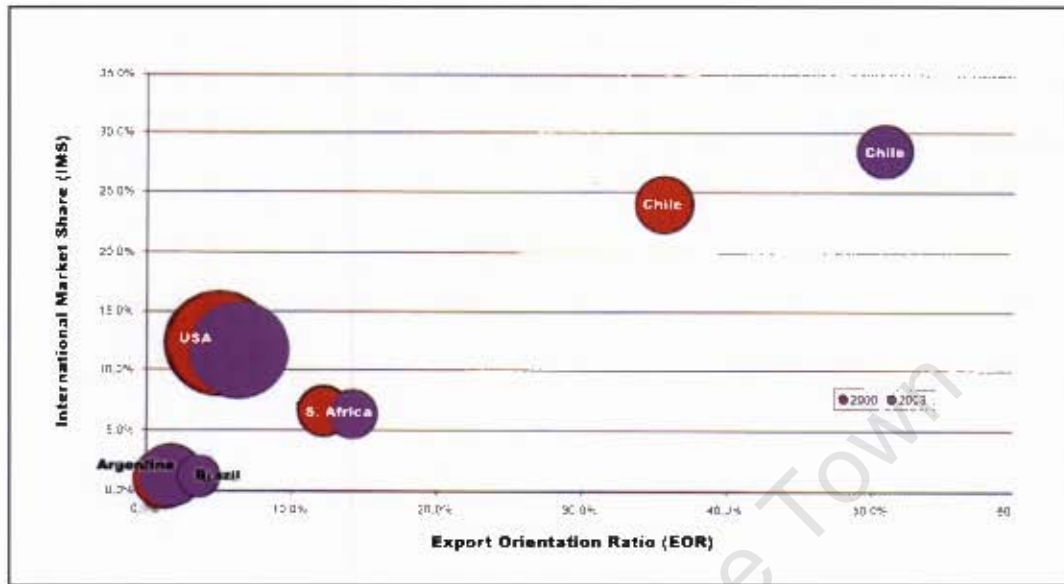
### 6.1 Introduction

The Chilean economy embraced free-market principles after the demise of the Pinochet regime at the start of the 1980s. The country has moved from a closed economy to a fully globalized economy. As a result, a very proactive Chilean government has signed 52 Free Trade Agreements (FTAs) that encompass 3.5 billion consumers for its export products (Bown, 2006). Chile's GDP is currently growing at a rate of 5%, and its grape export industry volumes at a rate of 7% to 8% per annum. The post-Pinochet Chilean government has been characterized by strong and stable institutions, transparency, enhanced civil liberties and an independent central bank (Bown, 2006). Chile saw the disruption caused by deregulation in South Africa as a major opportunity (Promar, 2001), and its exporters have been expanding their sales in what are historically considered South Africa's traditional markets, namely the UK and the European mainland.

The competitive position of the South African table grape export industry against the Chilean table grape export industry is illustrated in Diagram 6.1. In this diagram, the International Market Share (IMS) is plotted against the Export Orientation Ratio (EOR) for the various leading table grape exporting countries (NAMC, 2005). As a rule, the closer the country approaches the 'upper right' quadrant of the diagram, the more dynamic the export industry. And the bigger the circle representing the country concerned, the greater is its international share of the business. In this diagram, Chile would be classified as "best in class" with an improved position in the last three years. South Africa, tucked away in the bottom left quadrant has some way to go, with little progress having been made over the time period considered (i.e. 2000 to 2003).

The steady increase of Chilean grape imports into the UK in particular in the last five years, depicted in Figure 6.2, can be attributed to the global currency situation where a relatively strong sterling rate - against the dollar and the euro - has afforded Chilean shippers greater returns in the UK than in the USA or the European mainland markets (Leighton, 2006c).

Diagram 6.1 IMS v EOR for South African v Chilean Grape Exports (and other major suppliers) for 2000 and 2003



NAMC (2005): Data sourced from FAO and USD

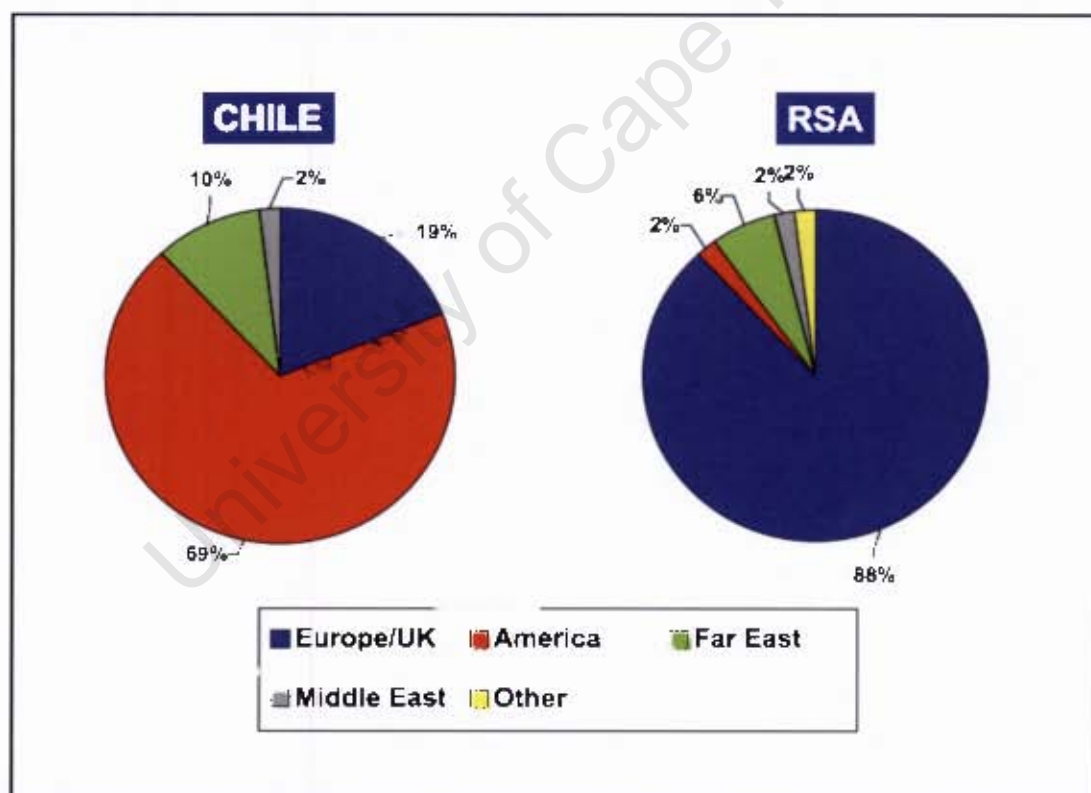
Figure 6.2 Chile's versus South Africa's Table Grape Exports to the UK: 1995 to 2005 (metric tonnes)



Data Source: SHAFTE (2006)

Chile's table grape industry exported the equivalent of 180 million 4.5kg cartons in 2004/5 (Bown R, 2006) - nearly four times the size of the South African table grape industry. According to Ferrandi & van der Merwe (2005) 69% of the Chilean volume was shipped to the American market whose size and geographical proximity makes it a natural first choice for Chilean producers; and 19% of its volume was shipped to Europe. The pie charts in Diagram 6.3 illustrate the market-spread difference between the Chilean and South African grape export industries in the 2004/5 season. It can be seen that South Africa has a far greater reliance on its European/UK market than Chile on its American market. Chile also has significant second and third markets in Europe and the Far East respectively; whereas South Africa's sendings outside of Europe appear very splintered amongst a number of regions.

Diagram 6.3 Percentage Market Spread between Chile and South Africa (2004)



Source: Frudata (2005)

## 6.2 Natural Heritage

In terms of comparative trade advantage, Jonathan Gersh, MD of Delecta Fruits, insists that South Africans cannot ignore or resent the natural factor endowments inherited by Chile. Chile is effectively ring-fenced by the Atacama Desert in the north, the Andes in the

East, the Patagonian ice sheet in the south and the Pacific Ocean in the west. Such natural barriers afford Chile highly favourable phytosanitary conditions (Trade Latin America, 2006). Due to its idyllic geographical position, Chile enjoys a mild Mediterranean climate with high intraday temperature fluctuations, excellent soils, an abundance of water (and therefore hydroelectric energy) from its snow-capped mountains and suffers from relatively few pests and diseases. Consequently, the country can produce an array of fruits that possess very high brix (sugar) levels and require very few pesticides (Leighton, 2006c). At nearly 4000km long, Chile extends through a host of climatic zones that afford it a variety of opportunities to grow differing fruit types throughout the year. Sarel Joubert asserts that such versatile geographical and climatological assets provide early, middle and late growing regions in Chile that give its shippers a 33-week delivery period of grapes to all world markets, whereas South Africa only has a 26-week delivery period.

### 6.3 Government Support

The most prominent government institutions active in Chile's successful grape exporting campaign have been the Ministry of Agriculture, the Chilean Foreign Ministry and the Chilean Export Bureau, otherwise known as ProChile (Leighton, 2006c). The Chilean public sector has undoubtedly been a major contributing factor to the competitiveness of Chile's table grape export industry (and fruit industry as a whole). Meaningful initiatives include the following:

**Firstly**, assisting the industry in proactively accessing new export markets for its table grape producers like Mainland China,<sup>210</sup> Korea<sup>211</sup> and the Canary Islands for their table grape exporters. According to the FPEF's submission to the NAMC on the Review of the Marketing Act (FPEF, 2006a), Israel - and very recently China - are the only two countries to which South Africa has achieved new market access for its table grapes in the 10-year deregulation period. Market access to Israel for South African table grapes was achieved in 2001, and only for Thompson Seedless grapes. Very small volumes have actually been sent to Israel, which, according to

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<sup>210</sup> According to Mike Grobbelaar, certain production regions in Chile have free access into Mainland China, which makes their product more price-competitive than other countries' products (including South Africa). This access also takes pressure off Chilean volumes into other markets.

<sup>211</sup> Leon Van Biljon and Sarel Joubert both purport that Chile has been able to offload its deep red coloured grapes into the Korean market in a period where finding another market for them would be difficult. At the time of writing, SA had no official access to the South Korean market for its grapes.

industry statistics, comprises of roughly 25 000 4.5kg cartons per annum (DFPT, 2006).

**Secondly**, securing exemption from import duties, as is the case for the first eight million Chilean cartons delivered into the EU market.<sup>212</sup> South Africa's exports on the other hand currently attract a duty of 4.8% CIF.<sup>213</sup> John Mare (former SA Ambassador to several countries) notes that South African business is noticeably under-represented in the decision-making corridors of Brussels, and that EU trade negotiation competencies amongst South Africa's public sector officials are a shadow of their former self. As a result, Chile and other South American agri-competitors are securing more favourable tariff access to the EU - through bilateral agreements - at South Africa's expense (The Exporter, Feb 2006).

**Thirdly**, the Chilean fruit-export industry has historically raised \$9 million per annum to fund its promotional campaigns abroad (Manning, 2004). 50% of this funding is raised via an industry levy (of 3 to 5 US cents/carton), and the other 50% is gleaned from government coffers (NAMC, 2005). Chile has, according to Bown (2006), personnel dedicated to the promotion of Chilean fresh produce in seven Chilean industry offices around the world (namely in Japan, South Korea, Europe, USA, Mexico, Colombia and Chile). These promotions comprise a mix of activities, namely international trade fairs, points of sale in identified retail stores and major advertising campaigns.<sup>214</sup> According to Gustavo Yentzen (former ASOEX marketing manager for the US, Canada and Latin American markets), this advertising includes (1) a television campaign in the US and Canada that expanded from 16 cities in 2001 to 39 cities by 2006; and (2) retail point of sale advertising for cross-promotions of Chilean fruit, wine and salmon products (Trade Latin America, 2006).

The promotional programmes are annually reviewed, adjusted and improved according to overseas customer advice. The slogan "*Chile, All Ways Surprising*" is used to reflect Chile's diverse geography, its modernity, the efficiency of its institutions, and the entrepreneurial spirit of its people (Bloomfield, 2006). This type

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<sup>212</sup> According to the FPJ (Leighton, 2005), Chile's free trade agreement is sometimes construed as a double-edged sword. On the one hand it has given Chilean exporters an advantage over their competitors; but on the other hand, it has increased the amount of internal competition between Chilean shippers to the EU, to their own detriment.

<sup>213</sup> This was the duty paid in the 2004/5 season (although this duty started at 15% many years prior to this). The import duty is being reduced annually by 10% and will be entirely scrapped by 2009.

<sup>214</sup> According to Gustavo Yentzen (former ASOEX marketing manager for the US, Canada and Latin American markets), this advertising included (i) a television campaign in the US and Canada that expanded from 16 cities in 2001 to 39 cities by 2006; and (ii) retail point of sale advertising for cross-promotions of Chilean fruit, wine and salmon products (Trade Latin America, 2006).

of fund-raising, the positioning of staff on all the continents around the world and the promotional activities described above are in stark contrast to the absence of any such generic promotion strategy in the South African table grape export industry during the deregulated period.

**Fourthly**, considering the current plight of South Africa's ports, it is worth noting the innovative steps that the Chilean port authorities are taking to improve the overall competitiveness of their ports. The Chilean port of Valparaiso is a good example where project "ZEAL" involves the establishment of a pre-port facility (11km from the actual port site) designed to take logistical and operational pressures off the existing port. The value-add in the pre-port facility includes storage facilities; cargo services; transport and distribution infrastructure; container depots; fiscal, health and sanitary installations for government inspection authorities; parking facilities; and improved traffic flow into the port and directly on to the ships (Leighton, 2006c).

#### **6.4 Leadership of ASOEX (Chilean Exporters' Association)**

The Association of Chilean Exporters has played a central role in developing Chile's competitiveness. According to the FPJ's supplement on Chile (Leighton, 2006c), Ronald Bown, the President of ASOEX maintains that Chile's prominent competitive position in relation to its competitors is a result of 'high levels of entrepreneurial skill; a professional workforce; low levels of corruption; a market-driven economy that fosters competition; a respect for the law; very strong public institutions; high levels of transparency with information; and coordinated promotion programmes worldwide'. Bown further alludes to a well-organized industry that has shunned the shackles of bureaucracy, that has prioritized research and training, and that has realistically assessed its potential in terms of a balanced international presence. The chief objectives of ASOEX have been to:

- Establish two important and active institutions. Firstly, the Fruit Development Foundation (FDF) is a non-profit organization that works closely with a number of universities and research institutions. Its primary goal is to bring the worlds of science and commerce together for the benefit of the industry (Leighton, 2006d). Secondly, OTIC AGROCAP provides training opportunities to the Chilean fruit sector, not only in the traditional technical and marketing fields, but also in teaching the English language and emotional intelligence skills like teamwork, stress control and leadership

skills. OTIC AGROCAP also works in conjunction with the University of Chile to ensure a steady stream of agronomists and logistics engineers into the industry (Leighton, 2006d). In South Africa, DFPT Research is responsible for the transfer of researched information to the producers. In terms of training, the South African fruit export industry - including the grape export industry - has no training institution like OTIC AGROCAP in Chile. What training is done in the South African table grape industry is outsourced to service providers. It is also done on an ad hoc basis - mostly for the benefit of historically disadvantaged South Africans - and in an uncoordinated way between the various fruit kinds.

- Provide market intelligence to its members and customers through two products: (1) an online market information system offering regularly updated strategic market intelligence; and (2) the publication of the highly revered Expordata Yearbook (Leighton, 2006c). This book is jointly published by ASOEX and Decofruit and contains detailed information on weekly, shipped figures of more than 500 Chilean exporters and 1500 importing companies. The South African Table Grape Industry's (SATI) attempt to provide crucial, real-time shipping information to its producer and exporter fraternities has been hamstrung by an under-performing central database. Internal competition amongst IT service providers, uncooperative shipping lines, poor levels of EDI and insufficient upgrading of the industry's central database system during the deregulated period have all contributed to a below-average provision of strategic information. This state of affairs has undoubtedly hampered the industry's international competitive position.
- Use its membership of prominent fruit institutions in its major markets (like the Produce Marketing Association [PMA] in the USA and Freshfel in Europe) not only as an effective mouthpiece for its members, but also as an opportunity to 'change perceptions, heighten profile and instill a sense of collective pride in its members' (Leighton, 2006d). Chile has industry personnel positioned on all of its major customer continents around the world that constantly promote the interests of the industry and feed back market intelligence to their constituencies. As already mentioned earlier, the South African table grape industry does not have marketing personnel abroad, and so industry representation and market feedback is not achieved.

- Develop its own Good Agricultural Practice protocol – ChileGAP – that has been accorded equivalent status to the sectoral standard in the EU, namely EurepGAP (Leighton, 2005a). This bold initiative instituted a ‘uniform system of compliance with the major quality specifications put forward by the principal markets for Chilean fruit. It facilitated a single procedure for auditing and certification making it easier and more cost-effective for growers to market their fruit’ (Leighton, 2006c). Various South African industry associations have separately debated this concept at Board level, but it has been stymied by the anticipated costs involved in rolling out such a programme. ASOEX, through its presidency of the Southern Hemispheres Association of Fresh fruit Exporters (SHAFFE), has helped promote the global harmonization of standards to ensure that Southern Hemisphere growers don’t bear the costs of having to be certified by up to 15 different standards (Leighton, 2006d).
- Promote, through its alliance with ProChile, Chilean fruit across the globe under the slogan “World Class Fruit”. South African fruit has enjoyed no such branding up until 2006, and precious few, small-scale promotional activities.

## 6.5 Industry Maturity

The Chilean grape export industry has had over 20 years of operating in a free-market environment. Certain aspects of Chile’s industry are therefore considered by many GEF members to be ‘more mature’ than the South African table grape export industry. The following issues are put forward by the leading South African export houses that corroborate this perception:

- Sarel Joubert says that Chile has passed through the stage of grower bankruptcies and has since evolved into an industry dominated by grower-shippers and by multinational companies (MNCs) that have integrated backwards into buying farms. Five grower-shippers (namely David Del Curto, Dole, Del Monte, Unifrutti and Chiquita), four of which are MNCs, now control 80% of Chile’s grape exports. According to the NAMC (2005), these leading MNCs have established marketing relationships with their European and American importers, and have moved away from commission-based

selling to fixed, minimum guaranteed pricing strategies. Leon Van Biljon feels that this grower-shipper Chilean system is more sustainable than the marketing agent system in South Africa, in that the grower-shipper owns, leases or rents the farms, and is therefore guaranteed his own product volumes. Leon Van Biljon further adds that the Chilean farms are like factories, and do not carry the same cost structures as the 'lifestyle farming' still so characteristic of many South African grape farms. The Chilean grower-shippers co-load ships, and qualify for substantial shipping rebates, which are larger than the South African's shipping rebates, according to Mike Grobbelaar. These grower-shippers can defend themselves against lower prices in the markets due to the large product portfolios that they carry, and the potential cross-subsidization that they can afford. There also appears to be a more integrated approach between Chilean producers and exporters than their South African counterparts. With the emergence of the smaller-sized Chilean producer-exporters, big and small Chilean exporters have somehow managed to channel their internal competitiveness better than South Africans in the eyes of some of their common customers (Leighton, 2006c).

- Sarel Joubert claims that Chile uses relatively few importers in the EU market giving them a distinct advantage over the scores of importers that are used for South African product.
- A strong feature of the Chilean industry has been the quality of its communication and information flow from its shippers to the EU importers (Promar, 2001). Chile has developed a culture of information sharing which, according to Sarel Joubert, yields more advantages than disadvantages - especially considering the impact that oversupply and misinformation have on prices in the markets. Knowledge in advance, for example, enables shippers to re-route fruit to potentially more profitable markets. Hubert Leclercq maintains that Chile learnt the hard way that if they didn't achieve total transparency on what volumes the UK supermarkets were capable of taking from their exporters, the supermarket buyers would use the lack of information to leverage their buying power and over-procure from Chilean suppliers.
- Chile has also developed more market-related quality standards than South Africa. According to Mike Grobbelaar and other GEF members, Chile's 16mm

Thompson berry size in the UK market is cosmetically superior to the South African's 15mm Thompson berry size. Chile refrains from sending class 2 fruit into the EU market, and instead funnels it off to the wine industry and the local Latin American markets (Promar, 2001). Due to a lack of spending power, South Africa's SADC region unfortunately does not afford the same opportunity, and instead class 2 fruit still finds its way to the EU market, though mostly to the European Mainland.

- Leon Van Biljon states that Chilean exporters are given the responsibility of inspecting their own fruit in a quality management system rather than an end point inspection system like that currently implemented by the PPECB. An industry requires a lot of self-discipline to ensure that product quality is voluntarily achieved in line with market standards. Whilst there can be no doubt about the cost-effectiveness of the Chilean quality control system compared to the South African one, the likelihood of Chileans taking short-cuts on quality control measures must be considerable.
- According to two major importers in the EU (Hage in Holland and Fruchthansa in Germany), who have worked with both Chile and South Africa as supplying countries, Chilean product is now very competitive with South African product because of: (1) the way in which individual Chilean exporters conduct their businesses; (2) the fact that they work with an extremely wide range of product specifications; (3) their ability to adapt their specifications to the needs of the market; and (4) the transparency with which they share information, making it a very useful planning tool for importers into the EU (Leighton, 2006c).

## **6.6 Innovation**

Whilst the Chilean table grape export industry cannot claim to necessarily have a more innovative culture than its South African counterpart, certain Chilean initiatives over the years suggest that a more progressive, entrepreneurial spirit has prevailed in that country. The following Chilean initiatives demonstrate this point:

- According to Sarel Joubert, Chile developed the perforated bag which put a stop to berry burst (formerly a common problem in closed bags) and sulphur burn (which occurred on the newer varieties like Red Globe). Whilst South

Africa has now adopted this technique, Chile had the first mover advantage for a substantial period of time.

- The Chileans have recently introduced the polypropylene carton to replace the cardboard box, which was being weakened by the fumigation process (necessary for eradicating the black widow spider prevalent in Californian vineyards in particular). Snaploc Chile is a packaging company that recently invested US\$50 million in a factory in Chile to manufacture polypropylene cartons (to move away entirely from the traditional corrugated cardboard carton). It combines the fibre-injection and extrusion moulding technologies that produces a tough, water-resistant carton that does away with the need for glue and staples (Trade Latin America, 2006).
- According to Louis Kriel (snr), when the American and the UK consumers pioneered the red and white seedless markets back in 1983, the Chileans immediately started planting these varieties. As a result, they soon edged the South African seeded varieties out of the American market. History is repeating itself as the Chileans once again capitalize on the opportunity of supplying the UK market with the newly developed black seedless variety, Autumn Royal. Introducing a new variety into an already crowded market is no easy task, but successfully doing so will fill one of the last missing pieces of the seedless jigsaw puzzle in the UK market (Leighton, 2006c).
- With regard to the development of new varieties, Chile's agricultural investigation unit (Inia) has been developing its own homegrown portfolio of new grape varieties. Two new varieties - Illusion and Isela - are now ready for commercial release.<sup>215</sup> Key characteristics have been deliberately developed in these cultivars to fulfill technical, commercial and political needs (Leighton, 2006c). This again is in clear contrast to South Africa's lack of new varietal development. Mike Grobbelaar notes that the last South African variety produced was the unsuccessful Regal seedless, and that the Israelis, Egyptians and Americans are also showing competitive advantage over South Africa in new varietal developments. The demise of the ARC is, in Louis Kriel's (snr) opinion, symbolic of the government's lack of

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<sup>215</sup> As an example, Illusion has been developed (with the consumer in mind) as a large-berried, seedless grape with a very fruity, muscatel flavour. It has a post-harvest survival period of 25 days making it ideal for the distant European market. It is a very early variety with very high yields - 4000 cartons per hectare - and is easier to prune and handle than other grape varieties. It can be grown in the Valparaiso region close to the major port, which minimizes transport costs. Chile has been overly dependent on California for its varieties, and Illusion offers Chile an opportunity to 'trade' its home grown varieties with California's varieties, or to become self-sufficient should Californian royalties become restrictive in any way (Leighton, 2006d).

commitment to the industry since 1994.<sup>216</sup> To add insult to injury, Louis Kriel (snr) cited the emigration of highly qualified technical staff - trained with South African taxpayers' money - to competitors such as Chile, Argentina and California.

- Chile's table grape export growth to the UK is largely due to its strategic growth in Crimson seedless. This Chilean 'red revolution' has (1) caused the upliftment of the entire category; (2) enabled the Chileans to extend their season beyond the limits of their green grapes; (3) allowed retailers to maintain their price points; and (4) enabled buyers to remove some of the less reliable product from Chile's competing sources (Leighton, 2006c). Diagram 6.4 demonstrates the rise of the 'red revolution' (Crimson Seedless) in the Chilean portfolio of grape products. Essentially the growth of this variety went from 1% in 2000 to 11% by 2004 of the total Chilean production portfolio.
- The Chileans invented the forced-air cooling method (to pre-cool grapes on entering the pack house), which greatly reduced the time - and therefore cost - it took to get grapes on temperature.<sup>217</sup> The longer grapes stand in the pack house for cooling, the more congestion is experienced, especially in the peak intake weeks. Product needs to move through the system as fast as possible, and if faster cooling can de-congest the pack house sooner, bigger facilities do not have to be built (which would be an added cost). South Africa has largely adopted this technique now, but its systems remained antiquated for many years until it did so.
- Sarel Joubert claims that Chile has also demonstrated superior techniques in the storage of their grapes. They look at controlled atmosphere treatments, and at picking the best crop to store while moving the inferior product to market as quickly as possible. Like the Chileans, South Africans need to adopt the mindset of storing their product in the market (rather than in cold stores back in South Africa). It is more flexible though more expensive to do so, and the right varieties with the right post harvest

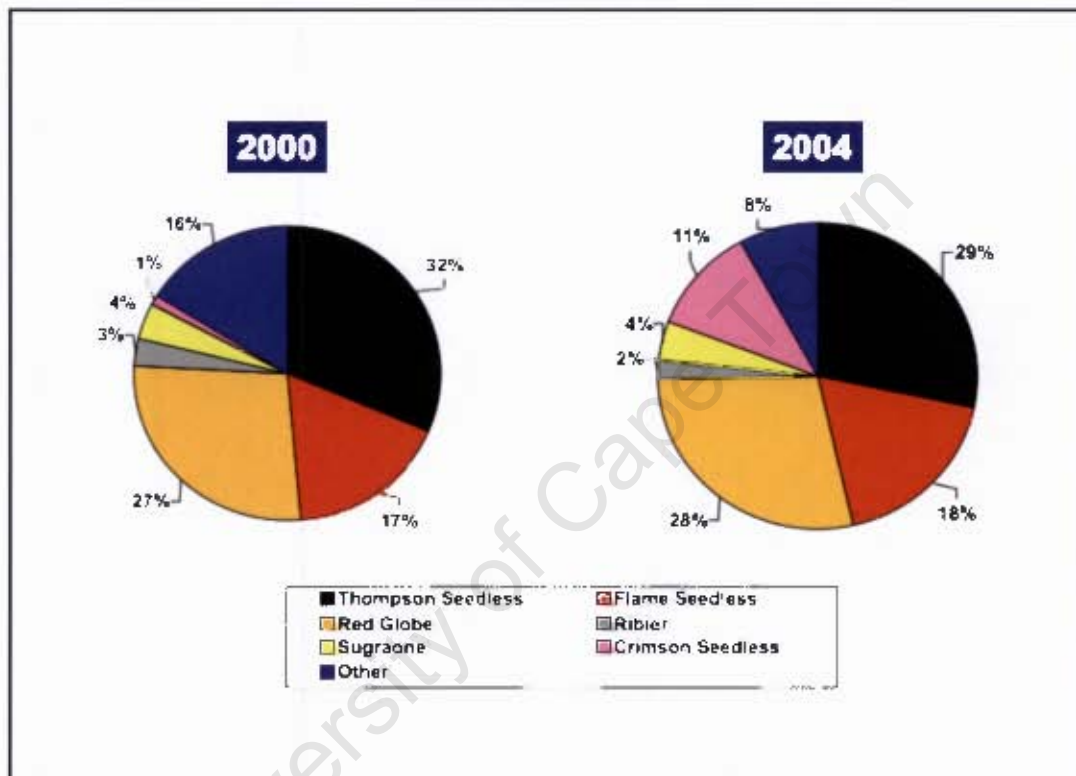
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<sup>216</sup> It should be noted that while South Africa as a country has not produced new varieties through any of its research institutes during the deregulated era, private enterprise has achieved notable exceptions. In this regard, At Hoekstra and Quinton van den Bergh, both producers, have developed commercial varieties for their own accounts.

<sup>217</sup> A two to three day saving was achieved with this new process, which is the difference between a consignment of product making it to the port to be loaded onto a vessel, versus having to wait for another five or more days for the next vessel to dock in port. Of course the earlier the vessel to the market, the fresher the product will be.

treatments are needed to achieve this. Storing gives ways and means of surviving in a difficult period, especially when the prices are not satisfactory or when there's too much product in the market.

**Diagram 6.4 Growth of the Chilean Crimson Seedless in four years (2000 to 2004)**



Source: Ferrandi & van der Merwe (2005)

## 6.7 Conclusion

In the light of what has been written in this appendix, the following key success factors have launched Chile into a dominant supplying position of fresh fruits, and therefore table grapes: an 'open door' policy on inward investment; strong public and private sector linkages; a strong research and development base; an active exporters' association supported financially by government; continuous generic promotions in key international markets; a well balanced portfolio of products; successful market access negotiations; significant investments in post-harvest technology; and a clear market-led mindset. Bown (2006) in his speech to the South African industry listed the following additional success factors: growers and exporters working strongly together in areas of mutual interest; high levels of domestic competition; long-term decision-making by Boards representative of all

stakeholders; and a desire across the industry for excellence in everything that is done. Finally, the few success factors not mentioned above but also covered by the President of Fedefruta - the Chilean Fruit Growers' Federation – include: political stability in Chile with low levels of corruption; a law abiding population; and the constant effort by everyone in the industry to improve productivity at all levels (Bloomfield, 2006).

University of Cape Town

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**Joubert, Sarel.** 2005. Grapes Business Unit: Capespan.

**Kriel, Louis (senior).** 2005. Retired from CEO of Unifruco.

**Le Roux, Jan.** 2005. Managing Director of the Le Roux Group.

**Leclercq, Hubert.** 2005. Managing Director of Katope Cape (Deciduous Fruit Division).

**Pieterse, Samuel.** 2005. Managing Director of EXSA.

**Powter, David.** 2006. Owner of The Grape Company.

**Scholtz, Hanno.** 2005. Managing Director of The Grape Company.

**Smit, Francois.** 2005. Manager: Grapes, PPECB.

**Strauss, Marthinus.** 2005. Head of Grapes Business Unit: Capespan Exports.

**Van Biljon, Leon.** 2005. Head of the Grapes Division: Dole South Africa.

**Van Nes, Jan.** 2005. Commercial Manager of SAFE.

**Van Wyk, Riaan.** 2005. Managing Director of Colors.

University of Cape Town