Government Gazette
Staatskoerant

REPUBLIC OF SOUTH AFRICA
REPUBLIEK VAN SUID AFRIKA

Vol. 681 25 March Maart 2022 No. 46093

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ISSN 1682-5845

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DEPARTMENT OF TRADE, INDUSTRY AND COMPETITION

NO. 1934 **25 March 2022**

competitioncommission
south africa

SOUTH AFRICAN FRESH PRODUCE MARKET INQUIRY

TERMS OF REFERENCE

DRAFT FOR PUBLIC COMMENT

25 MARCH 2022

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1. INITIATION OF AND LEGAL BASIS OF THE MARKET INQUIRY

1.1. The Competition Commission ("the Commission") will conduct a market inquiry into the South African Fresh Produce Market (the "Fresh Produce Market Inquiry"). The Fresh Produce Market Inquiry will be initiated in terms of section 43B(1)(a) of the Competition Act No. 89 of 1998, as amended ("the Act"), given that the Commission has reason to believe that there may exist market features which impede, distort or restrict competitiveness of the South African Fresh Produce Food Market. Public comments are invited on the scope of the inquiry, to be made by **25 April 2022**.

1.2. This Terms of Reference ("ToR") is published in terms of section 43B (2) of the Act read together with section 43B(4). In terms of section 43B(2) and section 43(B)(4) of the Act, the Commission must publish a notice in the Government Gazette announcing the establishment of the market inquiry at least 20 business days before the inquiry commences, *"setting out the terms of reference for the market inquiry and inviting members of the public to provide information to the market inquiry"* and *"must include, at minimum, a statement of the scope of the inquiry, and the time within which it is expected to be completed"*. In accordance with these provisions, this ToR sets out the scope as well as the expected timeline for the Fresh Produce Market Inquiry.

1.3. Although the ToR delimits the scope of the market inquiry as currently envisaged, additional and related matters not identified herein may arise during the conduct of the inquiry. If the Commission believes that the ToR should be amended in any way, either through the addition of new matters or exclusion of matters currently identified herein, the ToR may be amended in terms of section 43B(5) of the Act.

1.4. Upon completing the market inquiry and in accordance with section 43C of the Act, the Commission will publish a report of the inquiry in the Gazette and will also submit the report to the Minister of Trade, Industry and Competition.[1]

2. BACKGROUND TO THE SOUTH AFRICAN FRESH PRODUCE MARKET

2.1. Agriculture plays a significant role in the South African economy as it contributes to food production, job creation, raw material supply to agro-industrial and manufacturing sectors, as well as export-driven foreign exchange income. The Commission has

[1] Section 21(3) of the Competition Act requires the Minister to table the report at National Assembly.

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prioritised the food and agro-processing sector in its Prioritisation Framework since 2008 due to the sector being a source of staple food and the potential of the sector to create significant employment opportunities – thereby serving as a driver of inclusive growth in the South African economy.[2]

2.2. Essential foods are critical to the socio-economic well-being of a nation, and in particular to its poorest consumers for whom essential foods form a significant portion of household expenditure relative to other wealthier consumers. In the context of the Covid-19 health crisis, it has become clear that nutrition and affordable healthy foods are important for household health as well as maintaining a country's food security.

2.3. For the purposes of the Fresh Produce Market Inquiry, fresh produce includes unprocessed products such as fruit and vegetables, and forms an important part of South Africa's wider agriculture industry. The fresh produce industry makes an important contribution to South Africa's agricultural exports.

2.4. The main fruits produced and consumed in South Africa include apples, bananas, oranges (and other citrus), pears, avocados, and grapes., and the main vegetable include potatoes, onions, tomatoes, carrots and cabbage.

Fresh Produce and the Industry Value Chain

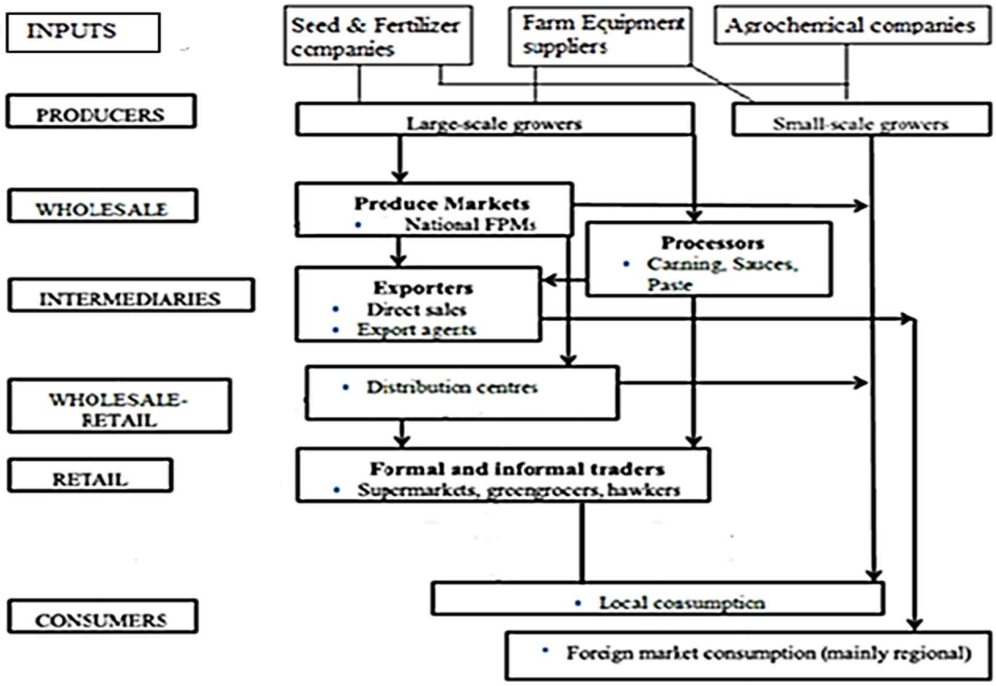
2.5. The figure below depicts the South African Fresh Produce Industry Value Chain from the input level to end user consumption:

(figure follows on next page)

[2] Competition Commission. 2020. Priority Sector Review 2017/2018 – 2018/2019.

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Figure 1: Provisional illustration of basic fresh produce value chain (using tomatoes as example)



Source: Sibomana, M.S, Workneh, T.S. & Audain, K. 2016. A review of postharvest handling and losses in the fresh tomato supply chain: a focus on Sub-Saharan Africa. Food Security 8: 389 – 404

2.6. The first key element in the fresh produce value chain is the input level. Significant inputs for fresh produce production are seeds, fertilizers, agrochemicals (herbicides, fungicides and pesticides), farm equipment, as well as irrigation equipment, form an important part of the fresh produce value chain as these inputs are integral to fruit and vegetable production.

2.7. Following the input stage, the next key segment of the value chain is production, which occurs for either fresh consumption or processed fruit and vegetable products. Commercial production occurs across small- and mainly large-scale growers that may supply various players in the value chain, including wholesalers, intermediaries, exporter companies, processors, and retailers.

2.8. After production, the next level of the value chain involves wholesalers and intermediaries. At this level, there are a number of different activities although at times

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farmers may do the activities themselves (especially bigger farmers) whereas other farmers may sell in bulk to processors/intermediaries or to fresh produce markets. For example, a larger farmer may package and sell to a fresh produce market. Others may sell to someone who packages and/or aggregates and sells to fresh produce markets themselves.

2.9. At the intermediary level of the fresh produce value chain, the processing activities add value to the raw product by increasing the shelf life of the fruit and vegetables. The bulk of fresh produce production in South Africa is sold fresh, while the rejected fruit and vegetables are sent to processing facilities to manufacture purees, pulps, preserves and juice concentrates.

2.10. In terms of the fruit industry, fruit that is used for processing accounts for only around 29% of total fruit production and is therefore seen as a residual industry that processes lower grade, fall-out or rejected fruits from the fresh fruit market. Processing plants buy fruit and vegetable inputs from fresh produce producers, and these companies may export their products under their own brand, as well as the buyer's brand.

2.11. The final stage of the value chain before the end produce reaches consumers for consumption is distribution and marketing, where the produce is distributed to various channels including supermarkets, small retailers, wholesalers such as the fresh produce markets, and food services. The fresh produce markets provide an outlet where large buyers are able to source fruits and vegetables, and where farmers are able to sell their produce. The fresh produce markets are covered in more detail in Section 5 below.

2.12. The fresh produce value chain, as depicted in the diagram above, also shows the general supply chain process of fresh produce from the view of small-scale farmers and large-scale farmers. Small-scale growers generally harvest their fresh produce and sell directly at the farm gate for local consumption or to intermediaries, while large scale growers transport their fresh produce harvest for washing and packaging in packing houses before distributing it to processing industries and fresh produce markets. Some large-scale commercial farmers also sell directly to large supermarket stores via contract farming.

2.13. The fresh produce industry has various forward and backward linkages to the rest of the

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economy and several key distribution channels which make the fresh produce value chain relatively complex. The food industry in general consists of a network of producers, wholesalers, distributors, processors, and retailers, with varying levels of vertical integration, serving the growing demand for fresh produce in South Africa, where each player has a role to play, including certain sources of supply and specific customers to serve.

2.14. The production and supply of fresh produce includes not only the growing of farmers, but also the production inputs of seed, fertiliser, fungicides, pesticides, and equipment for farming and irrigation needed to enable the crop to reach efficient yields. The perishable nature of fresh produce creates a dependence on logistics, where the storage and transport industry have close connections to the fresh produce industry.

2.15. Within South Africa's fresh produce value chain, there is vertical integration at this level with several producers, mainly large commercial farmers, handling activities like branding, storage, packaging and the transportation of their produce. The big supermarkets' supply chain and distribution activities are key parts within the fresh produce value chain and many national fresh produce markets also offer ripening, storage and refrigeration facilities.

3. RATIONALE FOR THE FRESH PRODUCE MARKET INQUIRY

3.1. The purpose of the Fresh Produce Market Inquiry is to examine whether there are any features in the fresh produce value chain which lessen, prevent or distort the competitiveness of the South African fresh produce market. The section that follows provides the basis upon which the Commission has reason to believe that there may be a feature or combination of features in the fresh produce value chain that prevents, distorts or restricts competitiveness of the fresh produce market.

Commission's studies in the fresh produce market

3.2. In November 2021, the Commission published a study on the levels of concentration in the South African economy.[3] The purpose of the Commission's concentration study was

[3] *Measuring Concentration and Participation in the South African Economy: Levels and Trends*, Main Report November 2021 ("the Commission's Concentration Study").

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to assess patterns of concentration and participation in the South African economy and revealed that whilst large farms make up just 6.5% of all farms in South Africa, they accounted for 67% of total income in 2017/18. The study further revealed that there has been a significant reduction in the number of farming units over the course of over two decades. In this regard, there were just under 58 000 farming units in 1993 and just over 40 000 in 2017, representing a decrease of 31%.[4]

3.3. At a provincial level, there was a decrease in the number of farming units across all provinces, with KwaZulu-Natal, Mpumalanga and Limpopo experiencing the largest declines in percentage terms. The study has not only revealed high levels of concentration but also an industry that is in decline in terms of farming units.

3.4. The picture is clearer when the analysis is more product specific. Using potatoes as an example, the study revealed that there was a 65% drop in the number of potato farmers between 1993 and 2008 and a gradual decline since then to 532 farmers in 2017, a trend that is consistent with the total decline in the number of farmers in the country.

3.5. The Commission's Concentration Study also found high and/or worsening levels of concentration in relation to potato seeds. The study found that "*The Commission's analysis on potato seeds shows that prior to a consent order between Wesgrow and the Commission at the beginning of 2020 regarding its most popular potato seed, Mondial, Wesgrow distributed four of the most popular potato seeds, which together accounted for 65.9% of the country's total potato yield in 2019/20. This represented a worsening of concentration from previous years"*.[5]

3.6. It is worth noting that the Essential Food Pricing Monitoring Report published by the Commission in August 2021 highlighted that the sharp decline in the number of commercial farms is indicative of the difficulties smaller farmers face in reaching the necessary economies of scale to decrease costs and maintain profitability. In this regard, the Report highlighted that "*the need for scale in commercial farming is partly tied to the adverse market structure facing small market players for inputs and outputs as both these layers of the value chain are concentrated with larger players able to exert*

[4] Commission's Concentration Study, page 33.
[5] Commission's Concentration Study, page 144.

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market power on smaller players. Such dynamics can negatively affect the transformation of the sector as potential new entrants (including emerging black farmers) struggle to become established and sustainable without entering at scale".

3.7. The information gathered by the Commission in the studies indicates that the cost of fresh produce has been increasing above inflation levels. For instance, according to the report published by the National Agricultural Marketing Council tiled "*The South African Food Cost Review*", the market prices for selected vegetables were on average higher in 2019, when compared to 2018. In nominal terms, the average increases in market prices per ton of cabbages, tomatoes, and potatoes were 9.6 %, 8.2 %, and 6.9 % respectively in 2019 compared to 2018. The average market price of onions was 8.8 % lower in 2019 compared to 2018. The fruit sector was also subjected to increase in prices. For example, the average market prices per ton of bananas, oranges and apples were 9.3 %, 8.3 % and 5.1 % respectively higher in 2019 than in 2018.

3.8. According to the studies, there is broad concern over price levels and volatility of pricing for fresh produce in South Africa. The studies show that the higher prices of fresh produce have a disproportionate effect on the poor and low-income earners who have to spend a far greater portion of their income to purchase essential products. A fuller understanding of the main drivers of the apparent high prices of fresh produce in South Africa is a critical area that this inquiry may address.

3.9. It is worthwhile to note that the Covid-19 pandemic also affected supply and demand within the fresh produce markets, with initial surges in pricing of some fresh produce and evidence of continued volatility in a market that has seen a number of events in the past two years. Beyond the observations from research on pricing and other market concerns for fresh produce – including for instance the series of Essential Food Pricing Monitoring Reports released by the Commission – there have been a number of complaints and/or investigations in the sector over previous years.

Price Gouging Investigations

3.10. For example, following the onset of the Covid-19 pandemic and the declaration of the state of national disaster, the Commission investigated a large number of complaints with respect to so-called price gouging conduct. Basic food and fresh produce products accounted for the vast majority of complaints and subsequent investigations.

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3.11. The Commission's records show that, of 1 254 excessive pricing investigations related to Covid-19, 713 related to basic food and fresh produce. Of these, 391 investigations related to basic food products and a further 322 relate to ginger and garlic for which significant price increases (some of more than 300%) were observed over the second wave of late 2020 and early 2021. This shows the importance of fresh produce, but in the same breath, the potential for abusive conduct where market circumstances change.

Challenges faced by the fresh produce farmers (especially emerging and small-scale farmers)

3.12. Various investigations and research conducted by the Commission in the fresh produce market in 2021 highlighted various challenges faced by fresh produce farmers, and emerging and small-scale farmers in particular. Some of the challenges relate mainly to insufficient finance and technical capabilities, a lack of operational knowledge, the inability to create scale economies, low bargaining power, a lack of market access and access to important production inputs (like quality seeds and fertilizers) which also limit farmers' ability to reach food safety levels accepted by retailers. Further aspects affecting small farmer production include poor infrastructure (such as limited storage facilities) and logistics (due to the poor condition of available transportation systems like road and rail), unsustainable farming practices which have caused the degradation of agricultural soils in South Africa.

3.13. Other challenges include climate change increasingly affecting crop production levels due to more severe weather such as droughts or heavy rainfall.

Government's efforts to assist small scale farmers

3.14. The agricultural sector plays a vital role in terms of job creation and poverty alleviation given its ability to create opportunities for individuals that are mainly HDPs. According to the Department of Agriculture, Land Reform and Rural Development's 2020/2021 Annual Report, the sector has not been spared from the devastating impact of Covid-19 during 2020 and as a result the Department had to step up its efforts to provide the much needed and urgent support to communities who are reliant on agriculture as a source of their

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livelihoods. The Department had to mitigate the challenges brought by the pandemic and their effect on smallholder and communal farmers, with the provision of the much-needed support. The support was given in the form of vouchers that farmers could use to purchase agricultural inputs toward the 2020 winter production cycle. The Covid-19 support initiative reached 15 681 farmers, at total value of R563 million.

3.15. In the Commission's view, the recovery and promotion of small-scale farmers will require targeted intervention to address limitations and challenges predating 2020.

Conclusion

3.16. The Commission is of the view that the Fresh Produce Market Inquiry is essential in order to understand the state of competition within the industry, the market features affecting price outcomes, and the challenges currently faced by farmers (especially small-scale and emerging farmers). More broadly the importance of the sector to both the economy and employment, and the nutrition and welfare of its citizens gives further weight to the need for such an inquiry.

3.17. The Commission is of the view that the Fresh Produce Market Inquiry's main objectives are in line with and in support of the objectives of the Act as outlined in section 2 of the Act, which provides that:

"the purpose of this Act is to promote and maintain competition in the Republic in order-

(a) to promote the efficiency, adaptability and development of the economy;
(b) to provide consumers with competitive prices and product choices;
(c) to promote employment and advance the social and economic welfare of South Africans;
(d) to expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic;
(e) to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy;
(f) to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons; and
(g) to detect and address conditions in the market for an particular goods or services,

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or any behaviour within such a market that tends to impede, restrict or distort competition in connection with the supply or acquisition of those goods or services within the Republic."

4. SCOPE OF THE FRESH PRODUCE MARKET INQUIRY

Introduction

4.1. Consistent with section 43B of the Act, the Fresh Produce Market Inquiry will focus on fresh produce markets, with the aim of identifying features that may impede, restrict or distort competition and market outcomes.

4.2. The Fresh Produce Market Inquiry will focus on particular issues at each layer of the value chain. Specifically, the scope of the Fresh Produce Market Inquiry will cover aspects from the sale of fresh produce by the farmer to the customer (the retailer, processor or export market). The interaction of retailers and end consumers will not be considered (as this was previously covered by the Grocery and Retail Market Inquiry). The sale and distribution of processed products by food processors will also be excluded from the inquiry.

4.3. Furthermore, where concerns and market feature are specific to certain fresh produce, the Fresh Produce Market Inquiry will only focus on those of the largest and most important fresh produce items.

4.4. The Commission has identified four *broad* themes which cover the features that may impede, restrict or distort competition and market outcomes. The themes are as follows:

4.4.1. ***Efficiency of value chain*.** This theme is focused on determining how the value chain and differing levels of concentration at various levels and route to market impact prices and efficiency with a focus on the fresh produce market;

4.4.2. ***Market dynamics and impact of key inputs for growers*.** The key inputs for growers include seeds, fertilizers, agrochemicals (herbicides, fungicides and pesticides) and farm equipment. Many of these inputs are imported or priced

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based on international bases and can lead to significant cost effects at the grower. This theme is focused on the upper end of the production value chain;

4.4.3. ***Small and HDP growers and participation.*** This theme centres on the lower end of the production value chain. Specifically, the inquiry will consider the barriers to entry specifically facing small and HDP growers and issues around access to fresh produce markets or retailers through contract farming; and

4.4.4. ***Barriers to entry in relation to the regulatory environment.*** This theme would focus on the broader regulatory environment which prevails in the fresh produce industry.

4.5. In light of the above, the scope of these terms of reference will centre around specific issues relating to each of these themes.

Theme 1: efficiency of the value chain

4.6. The national fresh produce markets ("FPMs") form an important part of the price-making, distribution and marketing of fresh produce in South Africa. These markets comprise a single integrated node within a much larger fresh-produce value chain and are often affected by variables that influence the flow of produce, including receiving, selling and dispatching of goods.

4.7. The role of a FPM is to allow for equal trade opportunities for both large scale, commercialised producers and smallholder farmers producing small quantities of produce. The markets serve as a marketing channel for producers as they provide an accessible mechanism via which to connect those who grow food (like small-scale and emerging farmers) to those who consume it.

4.8. There are 21 FPMs in South Africa, with the four largest markets in Johannesburg, Tshwane, Cape Town and Durban. The medium-sized markets include Mangaung, Springs, East London, Pietermaritzburg and Port Elizabeth. The smaller markets include Kimberley (Sol Plaatjie), Matlosana, George, Mpumalanga, Mthatha (Kei), Nelspruit, Vereeniging, eMalahleni, Mooketsi, Polokwane, Vanderbijlpark and Matjhabeng.

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4.9. The FPMs charge fees for their service and producers also pay agents that operate in the markets. Furthermore, beyond the market are distribution and other logistical fees in order to reach the retailer, wholesaler, trader, food service provider or processor.

4.10. However, FPMs are not the only route to market as wholesalers, traders and processors may also engage in direct contracting with producers. There is less transparency on the extent of this practice and the price-setting in these contracts.

4.11. Farmers have raised concerns regarding the widening of wholesale to retail margins which has been evident in the Commission's analysis of wholesale-retail margin data, as a clear and sustained growth in margins was seen over period considered in the Commission's Food Pricing Monitoring Reports. The seeming disparity between farm prices and retail prices further raises questions as to the distribution of risk and profits in the value chain. The Commission has previously also questioned the wide disparity in pricing across FPMs nationally.

4.12. The objectives of the Fresh Produce Market Inquiry include *inter alia* an inquiry into whether features of the post-farm gate value chain hinders competition, the participation of SMEs and HDP producers, and contributes to higher than necessary food prices. The following specific aspects relating to competition and the efficiency of the value chain:

4.12.1. FPMs:

- The price setting mechanisms which pertain to the fresh produce markets and the role of agents;
- The liquidity of FPMs and the role of information in impacting on liquidity and pricing;
- Price dispersion across FPMs nationally;
- FPM and agent fee determination; and
- Onward logistics and logistics fees including any price discrimination.

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4.12.2. Other market contracting

- Competition for national and local direct sales and contracting, as well as price determination including buyer power;
- Agent, logistics and wholesale / trader fees and markups and the basis

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for their determination; and

- Retailer markups and their determination .

Theme 2: Market dynamics and impact of key inputs for growers

4.13. South Africa is a net exporter of agricultural products, but it imports a large share of the inputs required to produce the surplus of products. The Covid-19 pandemic has highlighted many agricultural stakeholders of the importance of fully functional supply chains which facilitate continued food production and has shown the country's vulnerability in terms of its input costs in an environment which is exposed to exchange rate fluctuations.

4.14. As indicated above, key inputs for growers include seeds, fertilizers, agrochemicals (herbicides, fungicides and pesticides), and farm equipment. Many of these inputs are imported or priced based on international bases and can lead to significant cost effects at the grower.

4.15. The objectives of the Fresh Produce Market Inquiry includes an inquiry into the following specific aspects relating to the market dynamics and impact of all key input for growers:

4.15.1. The costs of all inputs for farmers and its impact on overall pricing producer costs and pricing;

4.15.2. The main drivers of cost levels and increases (such as market structures, high concentration, intellectual property or other external factors);

4.15.3. The role of intermediaries and distributors in the provision of seeds, and the determination of markups for such intermediaries;

4.15.4. The existence of price discrimination in the sale of inputs; and

4.15.5. The role (or lack thereof) of cooperatives and public sector agricultural support (including the Agricultural Research Council) in the provision of competing inputs including open seed varieties.

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Theme 3: small and HDP growers and participation

4.16. Farmers play a crucial part of the country's fresh produce value chains as they form the production stage of many sector value chains and are thereby a crucial part of the country's food supply and food security.

4.17. The agricultural value chain in South Africa seems to be highly industrialised and characterised by the super-commercialisation of production via large-scale farming as well as concentrated upstream inputs and concentrated processing. The existing 'large-scale or nothing' dynamic in food chains may serve to limit the scope for small-scale participation in farming.

4.18. South Africa's commercial agricultural value chain seemingly shows trends of declining participation by commercial growers and increasing levels of concentration for inputs and outputs. The sharp decline observed in the Commission's Concentration Study in the number of commercial farms may highlight the difficulties smaller farmers face in reaching the necessary economies of scale to decrease costs and maintain profitability.

4.19. Where small emerging farmers do exist, there may still be barriers to scaling from small to larger growers, such as access to finance, infrastructure and routes to market, which could provide the necessary scale to become more efficient, expand output and reduce prices. Small emerging farmers may also have an important role in countering food insecurity and the volatility in food markets.

4.20. The Fresh Produce Market Inquiry will inquire into the following specific aspects relating to the participation of small and/or HDP growers, where not already covered in the other sections:

4.20.1. Funding markets and financial support;
4.20.2. Input support (including role of cooperatives);
4.20.3. Market access (including contracting directly with retailers, food service, traders and processors);
4.20.4. Price discrimination for inputs;
4.20.5. Buyer power for sale of outputs;

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4.20.6. Spatial aspects to SME / HDP production;

4.20.7. Access to land;

4.21. Where applicable the market inquiry will draw on specific case studies relating to small and/or HDP growers, specifically relating to growing of the most common fresh produce such as potatoes, onions, tomatoes, and cabbage.

Theme 4: Barriers to entry

4.22. The food and agro-processing sector has been of particular importance to the Commission as part of its prioritisation framework, considering previous studies finding a negative impact that high and increasing staple food prices have on the majority of South Africans. The sector has a long history of regulation and anti-competitive behaviour in the post-liberalisation period, and is characterised as highly concentrated with few significant firms active at the processing and retail levels of the food value chain.

4.23. More broadly, the Commission's previous and more recent concentration studies have shown that high levels of market concentration in the country's agricultural sector persist, and that market power in the South African context can create barriers to entry. This may have negative impacts towards the development of competitive produce market environments as new and small players may not be able to challenge incumbents, efficient firms are not able to grow and expand, and firm investments and innovations suffer.

4.24. This theme would seek to consider the barriers to entry in the fresh produce industry and whether and to what extent they influence the levels of concentration. The scope would include assessing the current regulatory environment as well as identifying areas where regulation may be required in order to improve competitive outcomes. This includes the state funding (including the Land Bank), public agricultural research, agricultural extension services and sanitary/phytosanitary regulations.

5. MARKET INQUIRY TIMELINES AND PROCESS

5.1. The public is invited to submit comments on these draft Terms of Reference by **25 April 2022**. Written submissions can be sent to ccsa@compcom.co.za for attention of Ms.

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Mapato Ramokgopa. All submissions will be reviewed, and a final Terms of Reference published by the Commission.

5.2. The Fresh Produce Market Inquiry will commence 20 days after the publication of the final Terms of Reference and the final report will be completed within 18 months as per the statutory requirements of section 43B(2) and 43B(4)(a) of the Act respectively. Details on the administrative phases of the inquiry along with Guidelines for Participation will be made available on the Commission's website once the final Terms of Reference are published. At that point, members of the public and businesses will be invited to provide written representations and information to the inquiry.

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