

Fact Sheet

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Bridging the gap between the wholesaler and the rural retailer A Massmart Initiative

South Africa's population has been urbanising at a rapid pace over the last few decades, but despite this fast growth around the country's main urban centres, at least 40% of the people still live in rural areas¹. This translates today into almost 20 million people, and South African retailers have been increasingly searching for ways to improve the servicing of this market and unlock its full potential. For both formal and informal retailers, rural areas present specific challenges in terms of infrastructure, income levels and customer needs.

This fact sheet will focus on one example illustrating how Massmart, one of South Africa's leading retailer groups, has been helping to bridge the gap between the wholesaler and the rural retailer. As a leading player in South Africa's basic consumer goods market, Massmart is one of a few large corporations selling products specifically needed and purchased by the lower income groups forming the base of the pyramid (BoP). Several of its chains are geographically distributed all over the country, providing Massmart with additional regional insight into the BoP segment, and making it well-positioned to contribute to socio-economic development while expanding its own business.

Situational information

a. Corporate ID²

Massmart was originally created in 1990 with the retail chain Makro as its founding member. Today it is a managed portfolio of nine well-known wholesale and retail chains including Makro, Game, Dion Wired, Builders Warehouse, Builders Express, Builders Trade Depot, CBW, Jumbo Cash and Carry and the Shield buying group.

Listed on the Johannesburg Stock Exchange (JSE), Massmart is the third largest distributor of consumer goods in Africa. It is the leading retailer of general merchandise, liquor and home improvement equipment

and supplies, and the leading wholesaler of basic foods. Its main shareholders are financial institutions and mutual funds, who together hold around 80% of Massmart's

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"Four billion low-income people, a majority of the world's population, constitute the base of the economic pyramid. New empirical measures of their behavior as consumers and their aggregate purchasing power suggest significant opportunities for market-based approaches to better meet their needs, increase their productivity and incomes, and empower their entry into the formal economy."

The Next Four Billion - Market Size and Business Strategy at the base of the Pyramid, 2007

¹ STATISTICS SOUTH AFRICA, Census 2001: Investigation into appropriate definitions of urban and rural areas for South Africa. Pretoria, 2003. <http://www.statssa.gov.za/>

² Source : www.massmart.co.za



b. Case background: the context of the rural retailer in South Africa

Consumer goods in South Africa are distributed at the higher end of the value chain by the wholesalers, who are mostly product-specific and tend to sell high volumes of a single product or range of products. These wholesalers then sell on to a network of retailers, who sell lower volumes of a larger variety of products.

In South Africa's economic context, retailers can further be classified as either formal (registered) or informal (unregistered). This is a crucial distinction, because much of the rural population is served by a network of informal retailers, unregistered and therefore not included in the country official economic statistics and not contributing to the country's tax base. South Africa's informal economy is estimated to represent about 28 % of GDP³, so by these estimates more than a quarter of the economic activity goes unrecorded and does not contribute to the country's tax base.

Informal retailers typically sell on a lower scale than formal retailers, and tend to display their goods on shop fronts or carry them from one place to another. The product mix is typically made up of food, beverages, clothing and footwear, cigarettes, and personal care items, which form the bulk of expenses made by the lower-income households through the informal sector⁴.

2. The untapped potential of the rural market: The Business Case for Massmart

There is a clear business case for Massmart to increase its exposure to the rural market, both from a quantitative and a qualitative point of view. Currently, about 75% of all shopping centres larger than 3000 m² are located in greater metropolitan markets, 14% in major towns and the remaining 11% in rural markets⁵. This leaves South Africa's large rural population underserved and outside the immediate reach of the main retailing outlets – and untapped potential from which Massmart and other providers of basic necessity goods and services can benefit.

Not only is the true size of the economy larger than official figures suggest, but in rural areas available evidence suggests that most economic activity is informal. For a group such as Massmart, this is an important consideration as it is in a good position to offer assistance at micro-level in bridging the informal economy with the formal economy.

On the quantitative side, improved distribution channels and better accessibility for the rural population can benefit Massmart and its suppliers in the form of increased sales and market share.

Massmart in a few Figures:

- Sales for 2007 : R 34.8 billion
- Total number of employees : 26,000
- Active in 14 countries in sub-Saharan Africa.

In qualitative terms, targeted and visible assistance offered to informal retailers would also bring benefits for Massmart in the form of improved brand recognition of its store chains and public recognition for its involvement in bringing socio-economic benefits to local communities.

3. The challenges

Informal and formal retailers in rural areas face a number of challenges to operate as sustainable profit-making entities:

a. Poor and inadequate infrastructure

Most rural areas have a poor network of roads, limited access to electricity and at times no access to telecommunications lines and masts. These factors determine the accessibility of an area to prospective retailers. Infrastructure therefore has a direct impact on product availability and demand.

b. Lower population density and lower average income levels

The lower population density and lower average income levels in rural areas mean relatively low sales volumes, and therefore the small retailer is clearly a more economically viable distribution channel as opposed to wholesalers.

There are fewer opportunities for economies of scale and profit margins tend to be lower than in high-density urban and peri-urban areas. This means that any sustainable involvement will have to take into account the likelihood of comparatively large commitment of resources for a lower outcome. From this point of view the Corporate Social Investment made by Massmart in support of the informal rural retailer needs to be seen as a long-term commitment, so-called "patient capital" with significant returns over time.

³ SCHNEIDER Friedrich, Size and measurement of the informal economy in 110 countries around the world, Canberra, July 2002, p6. Paper available on http://rru.worldbank.org/Documents/PapersLinks/informal_economy.

⁴ LIGHTHELM André, Measuring the size of the informal economy in South Africa 2004-2005, Bureau of Market Research, University of South Africa (UNISA), Pretoria, February 2006, p2

⁵ MEDANI Sheny, The impact if HIV/Aids on rural shopping centers, in Market Decisions, Johannesburg, March 2004. <http://www.marketdecisions.co.za/article05.html>

c. Proper Identification of market-specific needs of the rural population

There are a number of benefits to Massmart chains in conducting a Market specific needs assessment of the rural population these include:

- Reduced costs incurred by the rural consumer
- Improved access for the rural consumer to good quality merchandise that does not compromise the core offering of the product, especially with regards to health and hygiene products.
- Increased buying power of the rural consumer as they save on travel expenses
- Meeting the needs and wants of this specific rural community

Conducting a rigorous needs assessment which captures the necessary information ca likely poses the challenge.

d. Increasing food and energy prices

In the current context of rapidly rising food and energy prices Massmart chains will find themselves under high political and economic pressure to minimize the price impact on consumers. This is likely to reduce margins and increase the existing difficulties of operating in the rural environment.

4. The Response: the Asante Rural Container Store pilot project ⁶

Faced with the challenges mentioned above, Massmart has responded with initiatives that address the core issues:

- How to provide more affordable products for less to the rural communities forming part of the BoP
- How to create sustainable new businesses in these areas, creating wealth and thereby reducing the income gap between rural and urban areas.

One of several schemes piloted by Massmart in this regard is the Asante rural container store project. The project was recently kickstarted with a R3 million start-up capital injection from Massmart's CBW stores division. This capital aims eventually to fund

the creation of around 30 container-based stores in rural areas⁷. At this stage, the project is still in its pilot phase, and to date three Asante container stores have been launched within a 100 km radius of Durban. In line with Massmart's overall philosophical approach toward social responsibility, the project is directed specifically towards rural women, given their recognised role in acting as role models and key vectors in improving socio-economic conditions.

The container stores come fully stocked with merchandise and are ready-to-function, equipped with essentials such as cash tills and electric generators. The unit cost of such containers is R 100,000.

Each container store is run by a team of 3 women who relay each other on a shift basis, thereby extending opening hours in order to service the community in an efficient way. In most cases, the women will have had some level of previous experience as informal retailers, but that is not necessarily the only criterion as the approach is one of identifying women who are generally assessed to demonstrate potential and drive and who serve as role models in the community. The 3-women team is coached by an experienced retailer, who receives a salary from CBW and whose role is to assist and oversee the development and management of the container stores. In terms of this arrangement, biweekly meetings are held between the ladies and the coach in order to provide training and assistance on the essential aspects of running the stores, such as:

- Cash flow
- Stock management



In addition to this coaching concept, three more elements differentiate the Asante store pilot project from existing container store projects:

- They are designed to be clustered in the vicinity of existing CBW outlets, enabling these established outlets to act as warehouses to the container stores;
- The container stores are stocked directly by CBW, thereby eliminating the costs and logistical difficulties encountered by some rural container stores where stocks need to be replenished from the outside;
- They benefit from Massmart's massive buying power as a group, making the pricing structure of goods on sale extremely competitive

Deeper insight in the BOP: Googable Resources

A Classic:

The Fortune at the Bottom of the Pyramid

C.K. Prahalad and Stuart Hart (2002)

Recent Reports:

The Base of the Pyramid Protocol: Toward Next Generation

Erik Simanis and Stuart Hart (2008)

The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid

Allen L. Hammond & al. (2007)

⁶ The information contained in this section has been kindly provided by Mr Brian LERONI, Massmart Group Corporate Executive, Telephone interview, 02 June 2008

⁷ PERSONAL BEST, Massmart Internal Magazine, CBW Rolls out R 3mn rural store chain, Issue 8, February 2008, p4

⁸ PERSONAL BEST, Massmart Internal Magazine, CBW Rolls out R 3mn rural store chain, Issue 8, February 2008, p4

At this stage, the ladies running the stores earn an average income of R 1500 to R 2000 per month, based on current monthly turnover figures of about R 30,000 to R 40,000. For the stores to be viable in the long term, sales need to reach around R 60,000 to R 70,000 according to CBW's calculations.

While CBW is not giving itself any absolute objectives at this stage to evaluate the success of the scheme, the aim is eventually to see the existing Asante outlets becoming profitable within a period of 18 to 24 months. Ideally, the Asante stores should then also be able to raise finance from outside financial or rural development institutions, with CBW possibly standing surety as a further measure to ensure the success of the scheme. The final stage would be reached when the store managers are in a position to raise sufficient finance to buy back the container stores from CBW.

While the Asante pilot project cannot be accurately described as a micro-franchise, the model does draw on some of the advantages of franchising: the aspirant retailer can benefit from the brand recognition, marketing experience and financial umbrella of an established retailing and wholesaler network, and in return Massmart as a group benefits from an increased foothold and market penetration in a growing market. Through this model it is able to bring both affordable convenience shopping to the BoP segment of the rural community, while helping develop new markets for Massmart's wholesale business and assisting in the creation of new micro-entreprises.

Ultimately, the larger aim of supporting the container store concept is to see the formation of new clusters of neighbourhood micro-businesses serving the needs of the community and empowering people through employment opportunities and the spending of their purchasing power closer to home⁹. Such businesses would typically be hairdressing salons, mini-restaurants, mini-bakeries, butcheries and the like, as well as more sophisticated products such as financial and telecommunication services.

Conclusion

Given its size and the currently limited access to basic goods and services there is clearly huge untapped economic potential still to be unlocked in the rural market. Massmart's approach aims to exploit this potential in a mutually beneficial and sustainable manner. The container approach offers a practical, cost-efficient way of addressing medium-term needs of the rural population.

It is only part of the answer though: any large scale socio-economic benefits to the BoP will come through a long-term strategic development approach involving the communities themselves, government and the private sector. Furthermore, the desirability of bringing easier and cheaper access of basic necessity products to rural populations also needs to be carefully weighed against the risk

of destroying existing economic activity such as subsistence farming, as recently pointed out in an opinion piece published in Business Report⁹.

The importance of bringing socio-economic benefits to the rural population cannot be overemphasised, as success in this area has a direct positive impact on the rest of the country: by bringing opportunities and improved living conditions to rural populations, there is less incentive for these groups to migrate to urban areas already under huge economic strain to provide employment and facilities.

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9. PERSONAL BEST, Massmart Internal Magazine, CBW Rolls out R 3mn rural store chain, Issue 8, February 2008, p4

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