

WAL-MART STORES INC. / MASSMART HOLDINGS LIMITED

1st **SUBMISSION TO THE PORTFOLIO COMMITTEE ON ECONOMIC DEVELOPMENT**

15 July 2011

1. Introduction

- 1.1 Wal-Mart Stores Inc. ("**Walmart**") and Massmart Holdings Limited ("**Massmart**") hereby respond to the Call for Public Submissions from the Portfolio Committee on Economic Development ("**Portfolio Committee**"). Walmart and Massmart (the parties) are interested in also making an oral presentation to the Portfolio Committee.
- 1.2 The parties reiterate below their submissions to the Competition Commission ("**Commission**") and before the Competition Tribunal ("**Tribunal**"), and highlight the Competition Tribunal's findings, regarding the anticipated impact of the merger on the following:
- 1.2.1 employment;
- 1.2.2 local manufacturing; and
- 1.2.3 industrial and economic development.
- 1.3 Walmart and Massmart wish to preface their submissions by expressing a number of concerns regarding the process initiated by the Portfolio Committee, the timing of the process, and the context in which it is taking place.
- 1.4 The parties respectfully submit that the purpose of the Portfolio Committee's solicitation of public submissions regarding the Walmart/Massmart merger is unclear and the timing of which may be inappropriate at this stage. This is so since the transaction is still subject to proceedings before the Competition Appeal Court, a specialist division of the High Court. The Portfolio Committee's call for public hearings risks failing to pay due respect to the constitutionally entrenched separation of powers between the legislature and the judiciary.

- 1.5 In addition, the Economic Development Department ("EDD"), being the Department under which the Portfolio Committee falls, already asserted the right to participate in the merger proceedings before the Tribunal, during which proceedings it led the evidence of an expert witness, cross examined the parties' witnesses and made submissions to the Tribunal.
- 1.6 Furthermore, in conjunction with the formal competition law proceedings referred to above, the merging parties voluntarily participated in a number of initiatives related to the transaction, at the EDD's invitation, commencing in October 2010. These included meeting with, and providing information to, a panel convened by the EDD for the purpose of advising it on the likely implications of the proposed acquisition by Walmart of a majority stake in Massmart; and participating in social dialogue with the South African Commercial Catering and Allied Workers Union ("SACCAWU") and various stakeholders with an interest in the transaction.
- 1.7 Finally, leaving aside this particular transaction, a public comment procedure this late in the merger process, after the formal merger approval has been granted and the transaction has been implemented, creates uncertainty for existing and potential foreign investors who take into consideration Government's stance and the surrounding regulatory environment when deciding whether to do business in South Africa.

2. Employment

- 2.1 The merger's impact on employment was assessed in the merger proceedings in light of three considerations: possible retrenchments, conditions of employment and union relations. The parties submit that the merger will not result in primary or secondary retrenchments, worsening of employment conditions, or deterioration of trade union relations in South Africa. This was borne out by the evidence led at the Tribunal and the Tribunal's decision in relation to these issues. Each of these considerations is discussed in turn below.

Retrenchments

- 2.2 Firstly, Walmart and Massmart led evidence at the Tribunal hearing that refuted the trade unions' allegation that Massmart had, in the lead up to the merger, sought to make itself more attractive to Walmart as a target by

retrenching 503 employees during June 2010. The Tribunal accepted that these retrenchments were not "merger specific".¹ For ease of reference the Tribunal's reasons are attached to this submission.

2.3 Secondly, the evidence before the Tribunal was that Walmart intends to expand its operations and, in so doing, create jobs in South Africa, as it has done in every country in which it has entered to date. Indeed, in a broadsheet advertisement during June 2011, the parties stated that they expected to create 15 000 jobs in five years and spend approximately R60 billion on food (most of which will be locally sourced). Similarly, Massmart clearly articulated its public strategy of aggressive expansion through increasing the number of stores and consequently increasing the number of jobs in the company. Walmart's control of Massmart is expected to accelerate this process. While not all the employment gains are merger-specific, the relative sizes of Massmart's and Walmart's expansion plans make a significant portion of them a consequence of the merger.

2.4 In this regard, the Tribunal accepted that there is "no evidence from the internal documents of the merging parties that retrenchments at Massmart are contemplated as a consequence of the merger. On the contrary, there is evidence that suggests, given the expansionist ambitions of Massmart, the group expects employment to grow between 2011 and 2013. The merger is expected to expedite this expansion suggesting that new jobs are likely to be created more quickly as a result".²

2.5 Thirdly, although the opposing parties attempted to argue this point, there is no basis to support the allegation that for every Walmart job created, other jobs will be lost in the broader retail sector. Walmart intends to expand rapidly in the market by entering previously under-served communities. That will obviously expand the job market. Furthermore, even if there is no net job creation (which is denied), the replacement of informal sector jobs with formal sector jobs is beneficial. While there is no evidence that there will be any material decrease in domestic manufacturing arising from the merger (as explained in more detail in paragraph 3 below) even if job losses were to occur through domestic manufacture displacement or consolidation in the

¹ Tribunal's reasons at para 58.

² Tribunal's reasons at para 39.

retail sector, these will be dwarfed by the positive secondary effect that the significant consumer gains associated with the merger would have on employment (lower consumer prices will lead to consumers having more disposable income, the spending of which will have a job-creating effect³). It is therefore overwhelmingly likely that the merged firm will create jobs, not only within Massmart, but in the broader economy as well.

2.6 Despite the clear evidence, accepted by the Tribunal, that the merger is not likely to result in retrenchments, the parties offered a voluntary undertaking, which was imposed as a binding condition by the Tribunal, that the merged entity must ensure that there are no retrenchments, based on the merged entity's operational requirements in South Africa, resulting from the merger, for a period of two years from the effective date of the transaction. The parties also undertook to give preference to the 503 employees that were retrenched during June 2010 when employment opportunities become available within the merged entity, and to take into account those employees' years of service in the Massmart Group. This was likewise imposed as a binding condition by the Tribunal.

2.7 It follows as a matter of law that these conditions, as well as the other conditions imposed by the Tribunal, are enforceable and that non-compliance with them could result in substantial penalties. Importantly, the voluntary nature of the undertaking (as opposed to it being legally required) also indicates the parties' commitment to the dual imperatives of job creation and retention.

Conditions of employment

2.8 There is no evidence that conditions of employment at Massmart will deteriorate as a result of the acquisition of control over Massmart by Walmart. The trade unions attempted to allege such deterioration by relying on Walmart's reputation as a "bad employer". The evidence led by the trade unions to this effect was primarily limited to isolated incidents which, even if they were true, cannot, without more, establish a factually-founded "reputation". This evidence was, in any event, highly unreliable and incorrect.

³ Tribunal's reasons at para.99.

- 2.9 Given the size of Walmart, as the largest private employer in the world with approximately 2.1 million employees, it is not unusual that it would have disputes with its employees from time to time, in various of the countries in which it operates. This does not make Walmart "a bad employer". To the contrary, Walmart led evidence at the Tribunal to the effect that -
- 2.9.1 Walmart has some of the lowest labour turnover among retailers in the UK, the USA, Canada and Chile;
- 2.9.2 employees in Chile have a very strong appreciation for Walmart's arrival in Chile;
- 2.9.3 the litigious employment complaints to which the trade union witnesses referred to in their evidence were in fact dismissed by the relevant courts.
- 2.10 In response to the contention that Walmart pays less than other retailers in the USA, Walmart tendered a confidential study entitled "Total Employment Opportunity at Walmart" which illustrates that in parts of the USA Walmart pays significantly more for entry level jobs and has higher wage caps than unionised retailers. Massmart also led evidence at the Tribunal that reducing employees' wages and working conditions would make no commercial sense. Massmart emphasised that a part of its strategy is to be the number one employer in retail so that it can attract and retain the best people and thereby effectively compete against its competitors. To achieve this strategy, Massmart believes it has to pay good money for good people.
- 2.11 Finally, witness testimony before the Tribunal indicated that Walmart is a responsible corporate citizen and complies with applicable legislation in the countries in which it operates. Walmart will comply with South African labour laws in this regard and, to the extent that it does not, employees will have recourse to the well-developed labour law regulatory environment in South Africa.

Relationship with trade unions

- 2.12 Walmart does not adopt an "anti-union" stance. It is correct that Walmart does not recognise unions in the USA, but only 5% of retail workers in that country are unionised. In countries which require companies to recognise

trade unions, Walmart recognises unions. For example, Walmart recognises 82 different unions in Chile and has positive relationships with unions in each market where they represent its employees. Indeed, Sofia Scassera, an expert witness from Argentina called by SACCAWU during the Tribunal hearing, acknowledged voluntarily that unions in Argentina welcomed Walmart to that country because they knew that Walmart would comply with the collective bargaining agreement with the unions.

2.13 Walmart further made it clear at the Tribunal hearing that it will adopt the culture of the country in which it operates, including in relation to union relations. Therefore, union relations are not likely to deteriorate post-merger - legally, factually or logically.

2.14 Nonetheless, to allay the trade unions' concerns relating to union recognition, the parties made two voluntary undertakings, which the Tribunal adopted as legally binding conditions. The first undertaking is to continue to honour existing labour agreements and the second undertaking is not to challenge the status of SACCAWU as the largest representative union within Massmart for three years.

2.15 Relating to the trade unions' demands for centralised bargaining and a closed shop agreement, the Tribunal accepted that it was Massmart's position prior to the merger to refuse these demands and that there is no evidence "that this policy has been formulated in conjunction with or in anticipation of the merger with Walmart."⁴ As such the Tribunal held that "protecting existing rights is legitimate, creating new rights is beyond [its] competence [as a competition regulator]"⁵

3. Local manufacturing

3.1 Walmart and Massmart submit that the merger will not detrimentally affect the local South African manufacturing sector. Walmart's global procurement capabilities are not aimed at placing pressure on local suppliers to reduce their prices or at fostering import substitution. The merger will also not have

⁴ Tribunal's reasons at para 67.

⁵ Tribunal's reasons at para 68.

the effect of forcing Massmart's competitors to import post-merger in order to compete with Massmart. Each of these points is discussed in turn below.

Price reducing pressure on local suppliers

- 3.2 Walmart's competitive advantage lies not in pressuring local suppliers for lower prices at the factory gate, but rather through its ability to extract efficiencies from its supply chain. Walmart led evidence of these efficiencies at the Tribunal hearing. Walmart described these efficiencies to include intellectual property and systems capability to forecast demand, organise efficient production and transportation of goods, and reduce waste. Walmart achieves this by working with its suppliers and sharing with them its world class systems and disciplines. Through this close working relationship with Walmart, local suppliers will have an opportunity to glean tested efficiency enhancing techniques which they can use to develop their own capabilities.
- 3.3 Local procurement is being, and will continue to be, pursued by Massmart and Walmart because it makes commercial sense to do so.

Import substitution by Massmart

- 3.4 In respect of the allegations that the merged entity will turn to direct imports due to Walmart's global procurement capabilities, there is no factual basis for the contention that, as a result of increased scale, Massmart will post-merger be able to source significantly more, or cheaper, products globally than it currently does. The Tribunal accepted that, while it may be argued that the merged entity may procure more imports post-merger, the extent of this has not been established.⁶ The parties submit that the extent to which Massmart will change to direct imports post-merger will not be significant for the reasons set out below.
- 3.5 Firstly, Massmart procures more than 90% of its general merchandise products, and 99% of its food products, from locally-based suppliers. Similarly, Walmart sources the vast majority of its products locally in the countries in which it operates – more than 90% in Mexico, India and Chile, and 95% in China. This illustrates that the strategy of both Massmart and

⁶ Tribunal's reasons at para 100.

Walmart is to focus on local procurement to the extent that it is economically feasible.

- 3.6 Secondly, to the extent that Massmart already imports certain products and may do so in the future, it is relevant that the Tribunal found that "it is common cause that the merged firm is not the largest procurer of merchandise; its rivals are considerably larger in most segments and there are also a number of other firms in these segments that have the capacity to import and do so presently."⁷ The fact that South African retailers already engage in direct importation shows clearly that they have the ability to do so. When they choose not to do so, it is because of a number of significant benefits to sourcing domestically-produced products.
- 3.7 More particularly, Massmart explained during the hearing before the Tribunal, that the domestic procurement strategy is not borne of a sense of patriotism, but rather determined by fundamental economic considerations. These considerations include innate competitive advantages in production, the strength of local preference for domestic brands, the minimum quantities that can be viably imported, the magnitude of transport and storage costs, the degradation of product quality in transit, the importance of security of supply, and the extent to which local servicing and support are required. Shoprite's evidence at the Tribunal mirrored this exposition.⁸
- 3.8 Massmart further emphasised that, as the acquisition of Massmart by Walmart will not have a material impact on these fundamental economic determinants, the basic procurement patterns currently seen within the Massmart businesses are unlikely to be significantly changed by the transaction. Simply put, local procurement is being, and will continue to be, pursued by Massmart and Walmart because it makes commercial sense to do so.
- 3.9 Further evidence that supported the contention that the merger will not lead to significantly greater amounts of imports includes the following -

⁷ Tribunal's reasons at para 116.

⁸ Tribunal's reasons at para 94.

- 3.9.1 The vast majority of products sold by Massmart are branded products which Massmart cannot import directly even if it desired to do so. Branded products, whether locally manufactured or locally sourced, have to be sourced from the rights (brand) holder in South Africa.
- 3.9.2 Massmart would be able to bypass the local office of the Multi-National Supplier (based on Walmart's international relationship with it) only to the extent that such local office already imports the product.
- 3.9.3 In any event, each Multi-National Supplier makes the decision as to where it will manufacture its products. Retailers (including the parties) have no influence over this decision.
- 3.10 Thirdly, Massmart was already very well-sourced pre-merger and could have imported products if it so wished (as it already did in relation to certain products). Walmart's global procurement systems are not likely to have any material effect on Massmart's current import-domestic procurement equilibrium. It is therefore overwhelmingly probable that the vast majority of domestically manufactured products currently sold by Massmart will continue to be sourced from local manufacturers post-merger, and that the merger will not bring about any change in the existing equilibrium in that regard.
- 3.11 Fourthly, there is no basis whatsoever for the concerns expressed by the South African Clothing and Textile Workers' Union ("**SACTWU**") that Massmart will, post-merger, have a materially detrimental effect on the clothing and textiles manufacturing sector in South Africa. Massmart has a minute market share of less than 1% in the retail sector in relation to these product categories. It has no ability to foreclose suppliers from the market. Even in the unlikely event that Walmart's influence on the merged entity was to increase the size of that market share tenfold in the next five years, it would still not have that ability. In respect of SACTWU's concern relating to the existing suppliers of Massmart (as opposed to the local manufacturers in general), it is trite that competition laws do not (and should not) protect individual firms from the rigours of competition.⁹

⁹ Tribunal's media release dated 31 May 2011, at page 2.

- 3.12 Finally, any increase in direct importation is likely to arise not through substituting imports for local manufacture but through displacement of low value-adding intermediaries who were already importing the product. It is possible that agents who imported non-branded products into South Africa could be displaced by a Walmart agent. Obviously, a shift from importation through agents to direct importation (or importation through a Walmart agent) will have no effect on the levels of local manufacturing. Indeed, the removal of inefficient intermediaries from the supply chain is more likely than not to enhance consumer welfare.
- 3.13 Insofar as indirect imports are concerned, local suppliers do currently and will post-merger make their own decisions as to whether to import a product or produce it locally. That is not a decision in which retailers (including the parties) play a part and is beyond their control.

Import substitution by Massmart's competitors post-merger

- 3.14 The opposing parties argued before the Tribunal that post-merger Massmart will be able to procure products globally at a price which is significantly different to that available to the other large South African retailers, which may in turn force the latter to turn to imports in order to compete. The parties submitted at the Tribunal that there is no basis for such an allegation.
- 3.15 The evidence at the Tribunal showed that it is a fallacy that scale is determinative of ex-factory gate prices. Provided the retailer in question has achieved a sufficient scale, which all the large South African retailers have¹⁰, then there is very little advantage gained by further increases in scale as regards the prices that can be obtained from international suppliers. This is also confirmed by the findings of the UK Competition Commission grocery investigation in 2008.

¹⁰ Tribunal's reasons at para 95.

- 3.16 In light of this, and the issues set out in paragraphs 3.3 to 3.12 of this submission, it cannot plausibly be argued that other large retailers will be forced to increase imports in order to compete with Massmart.

Condition

- 3.17 Although the parties do not consider there to be any legal basis for the imposition of any procurement related conditions to this merger, to allay the concerns related to displacement of local manufacturers, the parties volunteered as a binding condition to establish a programme aimed exclusively at the development of local South African suppliers, including SMMEs, funded in a fixed amount of R100 million to be contributed by the merged entity and expended within three years from the effective date of the transaction. This programme will be administered by the merged entity, advised by a committee established by it and on which representatives of trade unions, business (including SMMEs), and the Government will be invited to serve. The merged entity will report back to the Commission annually about its progress. In addition, the merged entity will establish a training programme to train local South African suppliers on how to do business with the merged entity and with Walmart.
- 3.18 The parties reiterate the Tribunal's findings that a local procurement quota, which was contended for by the opposing parties, is an inappropriate remedy against any concerns relating to local manufacturing¹¹, which concerns (in any event) have not been established by the opposing parties. The Tribunal found that -
- 3.18.1 the proposed "system created would create massive complexity, opportunity for evasion or manipulation, balanced against dubious utility";¹²
- 3.18.2 the parties' arguments that such a procurement condition would render the country in breach of its international trade commitments under several trade instruments to which it is a party may well be correct;¹³

¹¹ It bears mention that the parties' concerns around the imposition of a local procurement quota were communicated to the EDD (and other stakeholders) during the course of the initiatives described in paragraph 1.6 of these submissions.

¹² Tribunal's reasons at para 110.

- 3.18.3 the local procurement conditions create an unjustified asymmetry in that they would target a firm that has no market power in any relevant market in South Africa while not affecting its larger rivals;¹⁴
- 3.18.4 the procurement conditions would likely affect the merged entity's ability to provide customers with the lowest possible prices.¹⁵
- 3.19 The Tribunal favoured the condition proposed by the parties on the basis that "instead of insulating local industry from international competition for a period, [the condition] seeks to make local industry more competitive to meet international competition."¹⁶

4. Industrial and economic development

- 4.1 The evidence before the Tribunal, in the form of research relied on by witnesses for both Walmart and SACCAWU, clearly illustrates that the merger is likely to result in significant pro-competitive and consumer welfare benefits in the form of significantly lower prices for consumers. In every country in which it operates, Walmart's primary objective is to save people money so that they can live better. The studies show that Walmart's prices are up to 20% lower than the other supermarkets in the countries in which Walmart operates.
- 4.2 The Commission, in its recommendation, accepted that "Walmart's entry to South Africa will enhance competition and result in consumer benefit".¹⁷ Likewise, the Tribunal stated in its press release that it accepts that the likely outcome of the merger will be lower prices "based on Walmart's history in bringing about lower prices."¹⁸ The Tribunal also accepted that "the likely consumers who will benefit most from the lower prices associated with the merger are low income consumers".¹⁹

¹³ Tribunal's reasons at para 112.

¹⁴ Tribunal's reasons at para 114.

¹⁵ Tribunal's reasons at para 115.

¹⁶ Tribunal's reasons at para 120.

¹⁷ Commission's recommendation at p. 22.

¹⁸ Tribunal's press release at p. 2.

¹⁹ Tribunal's Reasons at para 99.

- 4.3 The parties led evidence at the Tribunal hearing that Walmart's significant global experience and capabilities will enhance Massmart's growth strategy, which is likely to significantly increase competition in the retail sector, particularly in relation to the retailing of food. Similarly, Walmart's experience in own-label products will enhance Massmart's strategy of promotion of its own-label products. This will provide an enhanced opportunity for smaller suppliers to grow on the back of Massmart private-label volumes, without having to invest substantial amounts to develop, build and promote brands of their own, and without having to secure their own distribution networks.
- 4.4 The parties submitted to the Tribunal that the transaction is expected to allow Massmart to accelerate the development of its retail offer, including expanding the provision of perishable foodstuffs and private-label products. Therefore, one might expect the merger to offer more opportunities for small domestic suppliers of foodstuffs to expand their businesses, including as private-label suppliers, and to do so earlier than might otherwise have been the case. This is on the basis of Massmart's procurement data, which shows that the supply of food is generally an area where small local suppliers have considerable advantages over imports.
- 4.5 There was significant unchallenged evidence before the Tribunal that local suppliers are likely to benefit from opportunities to export products through Walmart post-merger. One would expect the best of the small South African suppliers to have opportunities to export goods via the Walmart network of stores elsewhere in the world. This has been the experience in Chile where the entry of Walmart has significantly increased the levels of exports for Chilean suppliers.
- 4.6 Aside from the above-described development opportunities that are expected to arise from the merger, the condition tendered by Walmart and Massmart to develop local South African suppliers and SMMEs will also support significant economic development in South Africa.
- 4.7 In response to SACTWU's submissions that the merger will adversely affect the textile and white goods manufacturing industries which, in turn, will adversely affect economic development, the parties submit that the challenges faced by these industries in South Africa are long-term trends

and that imports already constitute a substantial proportion of goods sold in these sectors. These are trends that are already in existence and are not merger-specific. In any event, it would not be appropriate for industrial policy to seek to protect industries that operate in areas in which South Africa has no comparative advantage.

5. Conclusion

- 5.1 The parties submit that a substantial body of evidence was led before the Tribunal that the merger will have positive, or at least net-positive, effects on the three considerations in respect of which the Portfolio Committee seeks comment.
- 5.2 Furthermore, the transaction was investigated thoroughly by the Commission, and duly considered and approved by the Tribunal based on submissions made by all interested parties that participated in transparent and inclusive proceedings. It is also now subject to an appeal pending before the Competition Appeal Court.
- 5.3 In light of the foregoing, the process of public engagements after the Tribunal handed down its decision and while this decision is subject to an appeal, seems highly irregular. This course adopted by the Portfolio Committee creates uncertainty and may inadvertently have adverse effects on foreign direct investment (with knock-on implications for South Africa's economy, including job creation). This is all the more so when it is raised on an ad-hoc basis without clear procedural and substantive parameters.
- 5.4 Thus, while Massmart and Walmart make the above submissions in response to the call for public submissions by the Portfolio Committee, they reserve their rights to challenge the constitutionality of the process.