Soweto Gold

Born eKasi. Brewed for all.

In 2010, when Ndumiso Madlala decided to bring a new beer called Soweto Gold to market, his experience as a chemical engineer and as a master brewer for SAB and Brandhouse meant he knew what he was doing.

Yet while his initial strategy was to create a beer able to compete in the mass market, funding agencies feared he would not be able to compete with the incumbent giants in the industry and as a result, he could not secure funding.

Instead, his entry point into the sector was with a craft beer, produced under license until 2014, when he and his partner in Mad Mead Brewing Company opened the doors to their Soweto-based brewery, Ubuntu Kraal. This brewery produced and supplied a portfolio of five beers, with Soweto Gold Superior Lager as its flagship brand.

Soweto Gold's entry into the liquor value chain was exactly what the Liquor Act of 2003 sought to achieve – to turn around a history of exclusion. Here too was an example of the kind of entrepreneurship and investment that the Black Industrialist Programme was designed to support.

Soweto Gold made good inroads into the craft beer market; but it faced a range of competitive challenges. These were compounded by the fact that it had no canning or bottling facilities at Ubuntu Kraal and was selling the beer mainly in kegs, available to customers on tap. While it was able to outsource some of the canning and bottling, it needed to invest in its own bottling capacity in order to grow – but after many attempts, it was unable to raise finance to do so.

At least partly for this reason, in October 2017, Mad Mead Brewing Company sold all its assets and intellectual property to the Soweto Brewing Company – a wholly-owned subsidiary of Heineken.

For Heineken, the real value of Soweto Gold lay in its brand as a truly local beer, which it believes it can position in mass markets to compete with the lower-end beers of South African Breweries (SAB), with the intention of developing Soweto Gold as an international brand also. To these ends, huge investments in marketing Soweto Gold have started – including advertising on Soweto's iconic cooling towers.

As part of its series on Township Economies, CSP explores the case of Soweto Gold – a beer produced by the first commercial-scale, black-owned, township-based brewery in South Africa. Yet, in 2017, just as Soweto Gold seemed poised for growth, all assets and intellectual property in its underlying company were sold to Heineken – the second largest beer supplier in South Africa's highly concentrated beer sector.

At many levels, this is a success story of significant value-creation, from a brand based on Soweto's iconic township identity. Entrepreneur Ndumiso Madlala's dream for Soweto Gold to become a mass-market brand – and even an international brand – is being realised. Yet the 'black industrialist' who initiated the company is no longer its owner – and although the craft beer is still produced in Soweto, mass production now takes place in Sedibeng.

While Heineken might make inroads into SA Breweries 80% market-share – this would represent a shifts in market-share between the two biggest players rather than opening up competition in the sector in more significant ways.

This case study raises many questions - about the challenges faced by new entrants in highly concentrated sectors, but also about how we define 'success' in relation to township economic development and the trade-offs represented by this particular case. These issues are explored further here, drawing from research undertaken for CSP by the Centre for Competition, Regulation and Economic Development (CCRED).

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R10 million total capital cost of Soweto Gold

IDC provided a 7-year interest-free loan of **R3,5 million**

Beer industry dynamics in South Africa

Under apartheid, black South African were excluded from obtaining liquor licenses, which excluded them from the production or retailing of liquor. At the point of transition to democracy, the beer industry was a virtual monopoly.

Policy discussion focused on various forms of unbundling, intended to create new opportunities for asset creation for black entrepreneurs.

Yet at present, high levels of concentration persist. In beer manufacturing, total volume is accounted for by the following three firms: SAB Ltd (80.1%), Heineken South Africa (Pty) Ltd (10.9% and Brandhouse Beverages (Pty) Ltd (8%). While the craft beer segment has grown to 215 brewers, they control less than 1% of the total beer market.

In the mass market for beer, volumes drive economies of scale and competitiveness in relation not only to production, but also distribution and marketing. So while an SAB black economic empowerment (BEE) programme 'unbundled' aspects of distribution to a network of owner-drivers, their contracts require them to distribute only SAB products. This means smaller producers cannot piggy-back on SAB's economies of scale, while independent distributors struggle to fill a truck-load with non-SAB products: negatively affecting costs of distribution for SAB's competitors.

Despite the dominance of the big players, micro-breweries have been able to carve out niche markets; with **entry costs calculated at around R4 million for a production capacity of 10,000 litres per week** (CCRED 2018). Yet although they are not competing directly with the mass market for beer, dynamics in the industry as a whole affect their scope for growth.

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Brandhouse Beverages (Pty) Ltd

8%

Benefits from the Heineken investment

Heineken is investing significantly in taking Soweto Gold to the next level as a brand, positioning it in competition with SAB's mass-market beers. Some of the implications of this are as follows:

- Bottling and canning is now done by Heineken.
- Significant investment is made into marketing; this includes a R3 million investment in the branding of one of Soweto's iconic cooling towers, which has significantly increased the beer's profile in Soweto.
- Heineken fridges in bars and taverns are Soweto Gold branded, with the beers in prime position at eye-level.
- The beer now has access to Heineken's distribution networks.

While mass production takes place in Sedibeng, the craft beer is still brewed at Ubuntu Kraal.

The alcohol trade is one of the most highly regulated businesses in the cities – including in townships. It also faces particular financing dynamics, with many development finance entities and agencies precluded from funding alcohol-related businesses.

The Soweto Gold experience

For Soweto Gold, the decision to locate in Soweto was part of building a brand identity, leveraging off Soweto's iconic status; the intention was also to be close to a significant market for beer. Yet ironically, it proved hard to break into the Soweto market, with the main demand for Soweto Gold coming from more affluent areas such as Sandton, Rosebank and Parktown. There were a range of specific difficulties confronted.

Access to start-up capital

The total capital cost of Soweto Gold was R10 million, of which the Industrial Development Corporation (IDC) provided R3,5 million as an interest-free loan repayable over seven years. This was drawn from their Agri-Fund, created from the penalty paid by Pioneer Foods for cartel activity in the bread and flour markets. The balance of funding was sourced in Europe and from investments by the two partners.

Access to bar-space

Most Soweto Gold beer was sold as draught beer, delivered to bars and taverns in kegs. It costs approximately R20,000 to install a keg in a bar or tavern and breweries compete for space at the bar where customers can see it – which is particularly important when the product is less well know. The costs of installing kegs limits the numbers of taverns smaller players can afford to reach; with larger players sometimes offering additional incentives to have their kegs placed prominently.

Access to fridge space

The issue of fridge space is of such importance that it has been a focus of Competition Commission rulings. For example, SAB typically offers free fridges to taverns. In the past, this was on condition that the fridges were only stocked with SAB products. Even if their competitors could afford to offer free fridges, few taverns have enough space for a limitless number of fridges. This practice of providing exclusive-use fridges was however outlawed by the Competition Commission as part of the conditions of the ABINdev/SABMIller merger; with at least 10% of space needing to be made available for other products. Yet few taverns are aware of this.

Ndumiso Madlala, founder of Soweto Gold

Costs of distribution

70% of beer sales are in taverns and shebeens and in a context in which SAB delivers directly to them, they expect the same from the micro-brewers: who do not, however, have national distribution systems. For its canned beer, Soweto Gold did, however, enter into a distribution agreement with Shoprite Checkers, which gave it some national presence.

Marketing

Brand recognition is a top driver of sales and advertising matters; so do scale economies. So, for example, the same total amount spent on advertising will cost much less per beer for SAB than it will for Heineken – even more so for small brewers. Soweto Gold relied mainly on viral marketing through social media and the internet.

Access to expansion finance

Soweto Gold needed to invest in its own bottling and canning facility to take the company to scale. It applied for funding from the Industrial Development Corporation (IDC) in 2015 but the application was declined as Soweto Gold could not provide matching funding. The National Empowerment Fund (NEF) did not approve their application as alcohol was not a priority industry; other applications were also unsuccessful.

Discussion

Various government policies are aimed at increasing competition in the South African economy and at reducing barriers to entry for black industrialists. The Soweto Gold story offers a case study that illustrates just how hard it can be to break into highly concentrated sectors, with incumbents having strong advantages. The challenges faced by new entrants include the following:

- The cost advantages of existing economies of scale, which lower unit costs – not only in production, but also in relation to the costs of marketing, in a context in which new entrants have to build brand awareness.
- The ability of incumbents to use their existing market power to block market access for new entrants in a myriad of ways.
- The lobbying power of large conglomerates when policy or regulation seeks to disrupt current advantages.
- Access to finance. While dominant firms often have capital available, new entrants face a double bind: without capital, their ability to access loan finance is also constrained. In order to access capital, they often have little choice but to sell equity - diluting their returns. In addition, loan finance is expensive – adding a cost burden when they can least afford it.

Soweto Gold faced all of the above problems; it overcame many of them, but was still unable to secure finance for expansion. Its experience raises a number of questions for policy.

- To what extent do development finance institutions (DFIs) in South Africa have the right combination of financing instruments required to enable new entrants to succeed? And the necessary level of risk appetite?
- Are 'abuse of dominance' provisions in competition legislation sufficiently effective? These provisions are intended to prevent dominant players from abusing their position to limit or deny market access to rivals.
- What other instruments are available to support new entrants?

Policies in relation to many of these challenges are outside the remit of metro governments. Yet in developing strategies for township economies, it is vital to understand the implications of high levels of concentration in the economy and how the competitive context may impact on new entrants. In addition, however, there are roles that metros can play:

- **Supermarket shelf space:** Supermarkets are an important route to market for most fast-moving consumer goods. Can municipalities use zoning regulations as a tool to ensure that supermarkets make shelf-space available to black-owned and/or small enterprises?
- **Awareness and compliance:** many township taverns appear not to be aware that fridges provided by a supplier cannot be for the exclusive use of their products only. Metros can play a role in building awareness of this – including amongst suppliers - and even, perhaps, in ensuring compliance.
- **Facilitation of access to national incentives:** Investment Promotion Agencies at the sub-national level may also have a role to play in matching business with potential investors, as a means to access to finance.

What is 'abuse of dominance'?

The Competition Act tries to limit the potentially negative impacts of high levels of concentration in the economy on competition. One of the instruments for doing so is through the clause on 'Abuse of Dominance.'

While firms are not prohibited from having a dominant position in a given market, they are prohibited from abusing that dominance. What does that mean?

According to the Competition Commission, abuse of dominance may include excessive pricing of goods or services, denying competitors access to an essential facility, price discrimination (unjustifiably charging customers different prices for the same goods or services) and other acts that exclude their competition (such as refusing to supply scarce goods to a competitor, getting suppliers or customers not to deal with a competitor, charging prices that are below cost so as to exclude rivals, bundling goods or services, or buying up a scarce input that is required by a competitor).

It is, however, hard to prove abuse of dominance; it requires extensive legal and economic analysis, and only a few cases of abuse of dominance have been successful.

For more on the Soweto Gold case study, see Bell, J. & Mondliwe, P. (2018) *Soweto Gold: Born eKasi. Brewed for all: A Case Study*
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