

# Covid-19 impacts on SME maize and dairy processors in South Africa

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## Key points

- **Despite exemption from lockdown restrictions, Covid-19 is having a widespread and severe impact on SME agro-processing firms in maize milling and dairy.**
- **The impacts are complex and varied, and run throughout supply chains. They include shifts in demand, disruptions to sales channels and logistics, reduced access to key inputs and services, and the difficulties of implementing measures to keep workers safe.**
- **Without assistance, many small firms will fail or be severely weakened. Large firms are better able to adapt.**
- **This will accelerate pre-existing trends towards greater concentration, with consequences for food system resilience and inclusivity.**
- **SME agro-processors must be supported. Measures include improving access to major retailers' shelf space, supporting alternative routes to markets (including through digital technologies), making public procurement more accommodating of small business, and improving emergency support measures to prevent business failures during the crisis period.**

## Context: food systems in question

COVID-19 is prompting widespread questioning of food systems and the ways efficiency and competitiveness have been previously understood ([Ruben et al., 2020](#); [IPES-Food, 2020](#); [Farley & Scherr, 2020](#)). Recent decades have seen increasing concentration among powerful large firms, the growth of complex global value chains underpinned by just-in-time systems, and pressure to deliver lower prices, higher levels of processing and greater convenience alongside retail supermarketisation. This creates challenges ranging from ecological sustainability to public health.

Covid-19 particularly highlights challenges with food system resilience ([United Nations, 2020](#); [IPES-Food, 2020](#); [Fraser, 2020](#)). Resilience requires diversity and appropriate policy support for inclusive food systems in response to COVID-19 ([IFPRI, 2020](#); [United Nations, 2020](#)). However, markets may undermine this with what has been described as 'toxic competition' ([Stucke and Ezrachi, 2020](#)). This points to the need to rethink 'market shaping' policies and value chain governance, and emphasizes the critical role of the state and collective action.

SME agro-processors are a foundational element of a diverse and inclusive food system, serving niche or otherwise marginalized markets not targeted by large agro-processors and creating manufacturing jobs in rural areas. However, enterprises in the midstream of food value chains are anticipated to be severely affected by COVID-19 ([Reardon et al., 2020](#); [Savastano, 2020](#)). The IIAP project investigated the impacts of the crisis on SME agro-processors in two value chains orientated towards the domestic market, by conducting phone interviews with 16 maize milling and dairy processing firms during the lockdown period. This builds on the extensive evidence base of over 100 interviews already compiled by the project. The firm-level information provides qualitative insights into the

***SMEs are the foundation of a diverse food system***

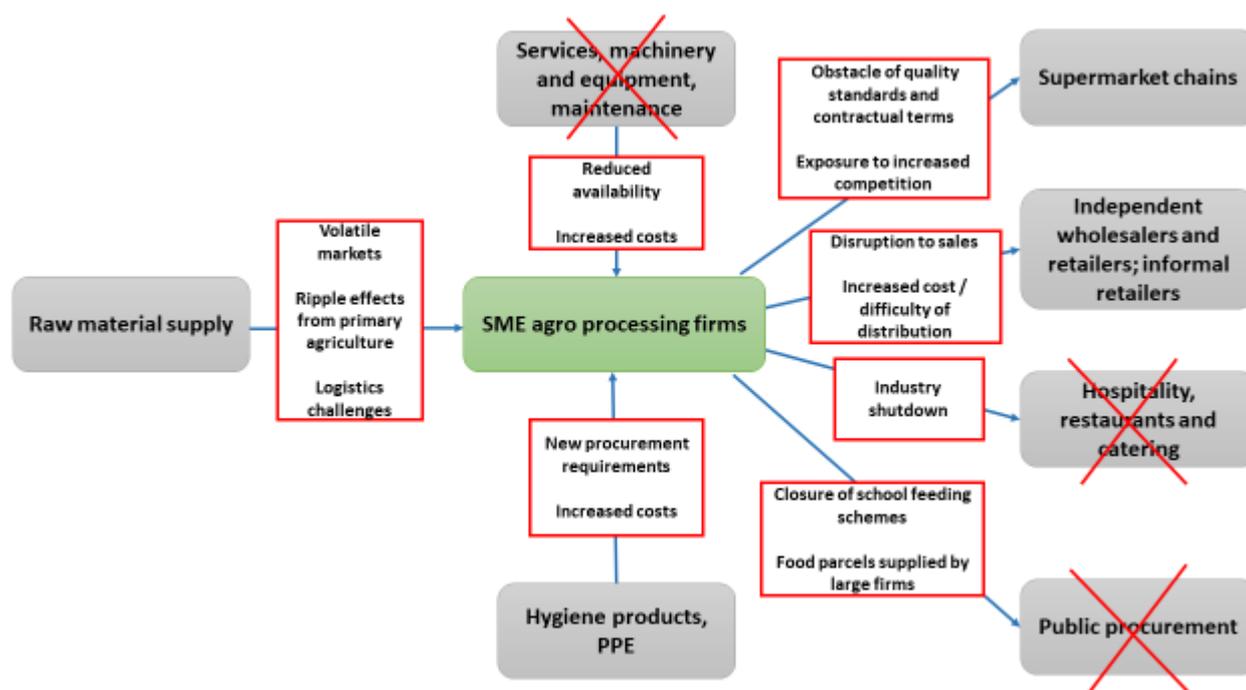
effects of the pandemic on SME agro-processors, the possibilities they have to adapt and innovate, and the enabling policies that are needed to ensure their sustainable participation in food systems.

## SMEs in milling and dairy: disruptions from Covid-19

Power in the South African food system lies with big businesses. In dairy and milling, the top 10 largest enterprises account for 71.6% and 75.9% of total income respectively ([StatsSA, 2017](#)). Food processing SMEs play a critical role supplying more localized and under-served markets, providing rural employment, and linking to other small businesses. In maize and dairy, food processors target independent wholesalers, buyer groups, and informal spaza shops, or alternative routes to market like direct sales to local communities, school feeding schemes, and catering. They typically struggle to access national supermarket chains due to the onerous conditions. Their positioning has made the SMEs particularly vulnerable to shocks from COVID-19.

As essential businesses food processors were permitted to operate throughout lockdown, and staple foods like maize meal and basic milk products continue to be demanded. Aggregate milk production levels were maintained, with output in April 2020 2.8% less than the year before due to adverse farm economics rather than direct Covid-19 impacts ([Milk Producers Organisation, 2020](#)). Maize meal production in April was 25% higher than the same month in the years 2017-2019 ([South African Grain Information Service, 2020](#)). Average consumer prices for maize meal and milk remained relatively stable during the initial lockdown period ([StatsSA, 2020](#)). However, behind this aggregate picture of relative stability, our interviews suggest SMEs in these industries nonetheless faced a range of challenges throughout their supply chains. These are summarised in Figure 1 below.

**Figure 1: Supply chain disruptions for SME agro-processors**



During lockdown, supermarkets' sophisticated distribution systems enabled them to operate smoothly, while panic buying diverted sales towards large retailers with higher stock levels. However, the retail routes to market relied on by most SMEs are less well-resourced and sophisticated. The lockdown disrupted small retailers, especially informal spaza shops. Although travel restrictions encouraged localized daily shopping, smaller retailers faced difficulties sourcing transport services, particularly given reliance on manual loading/unloading.

SME processors' sales reps were unable to visit stores to manage stock.

Financial strains faced by independent retailers and other debtors resulted in defaults on payments for goods or requests for extended repayment periods by debtors. Worst affected are SMEs reliant on non-retail sales channels. The cessation of school feeding schemes, and effective closure of the restaurant, hospitality and catering industries had severe impacts on producers specialising in these channels. However, it is very difficult to switch into supermarkets where demand has remained strong.

All dairy processing SMEs interviewed suffered major sales reductions, of between 20% - 66%. A majority of the millers interviewed reported lower revenue, with some closing down. The disruption to normal sales channels compels SMEs to seek alternatives. However, switching to mainstream supermarket retail as an alternative means competing head-on with large companies. This requires investments to meet higher standards and to build capabilities. While there are large-scale food parcel procurement schemes, none of the companies we interviewed had been able to access these, with respondents reporting that large companies were winning the bids. The responses reflect longer-standing challenges for SMEs with public procurement that our project has been researching, including exclusive standards and the use of middlemen.

The perishability of raw materials and links to primary agriculture are also a complicating feature of agro-processing businesses, particularly so in dairy where profit margins are generally low (1.1% net according to [StatsSA \(2017\)](#)). Reduced demand from SMEs with blocked routes to market means unused raw milk being wasted. Many SMEs are integrated 'producer-distributors' with dairy herds and some have started selling surplus milk to rivals or plan to retire herds. Large processors with buyer-power can secure lower raw milk prices from farmers.

While demand for maize meal has remained strong, SMEs face difficulties sourcing raw material and reaching new customers, given the channel disruptions. There have also been major challenges of the effects of the adverse Rand-Dollar exchange rate movement increasing maize prices which they have not been able to pass on to retail customers. SMEs have lower procurement capabilities and are less able to hedge, exposing them more severely to adverse market conditions. Millers typically have net profit margins of less than 5% so small cost increases can have a major impact ([StatsSA, 2017](#)).

Interviewees further reported severe difficulties securing parts and repair and maintenance services, with disruption in other supply chains having serious knock-on effects for food producers. Most interviewees stressed difficulties with cost and availability of PPE and sanitizers, and compliance with hygiene regulations. Indeed, our prior research has found regulatory compliance to be a major burden for SMEs in normal circumstances.

All dairy processors interviewed also reported major employment impacts. Millers' employment impacts were less severe but still significant, with multiple firms reporting layoffs and reduced hours. For staff remaining at work there were challenges with firms having to source transport services and change shift patterns. Administration staff and business owners have been forced to take pay cuts.

## **Access to support measures: complexity and confusion**

Government's approach to supporting SMEs is a top-down and regulatory approach, with complex applications and qualifying criteria, and costs that smaller businesses struggle to meet. The measures are also fragmented and confusing. Employers had attempted to avoid redundancies, and the [Unemployment Insurance Fund \(UIF\)](#) provided a lifeline here with most interviewees being able to access it. Interviewees saw the other forms of government and private sector support instituted to support SMES ([tax relief](#), various programmes by the [Department of Small Business Development](#), [commercial bank support](#) etc.) as much less accessible. Many firms were only loosely aware of what was available, or were disinclined to apply through (sometimes mistaken) beliefs about eligibility, for example relating to [BEE requirements](#). This suggests clarity of communication around support measures could be improved. Medium-sized firms with revenue >R100m are excluded from

key schemes like tax relief, but may lack the ready access to bank credit and capital markets that larger firms benefit from. Notably, firms in difficulty were reluctant to take-on commercial debt, arguing that despite the loan guarantee scheme, interest rates are offputtingly high.

***Government support needs to be bottom-up, and not impose additional costs on SMEs***

## Implications: SME support during and after COVID?

Without greater support, many SMEs will not survive. Many that do will be severely weakened. Notably, a majority of the firms interviewed reported halting planned investments. As multiple interviewees suggest, adaptation is going to require significant changes to business models which come at a cost. The following measures should be prioritised:

**1) Commitments by the main retailers to offer preferential shelf space for SMEs.** SMEs struggle to access the main supermarket chains, and they are forced to compete with large food processors for shelf space in the main chains. Support in this regard can include setting aside a proportion of shelf-space for SMEs and introducing local procurement policies at preferential terms.

**2) Strengthening alternative routes to market.** The routes to market that SMEs primarily sell through need to be supported through strengthening infrastructure and ensuring enabling regulations in peri- and non-urban areas to service small and independent suppliers. Public procurement also has huge potential to support SMEs and can provide the consistent revenue streams that they need, but it needs to be reconfigured and managed in a way which is more accommodating of small businesses' needs. The **digitalisation of value chains** and the use of 'food technology' can [help SMEs access multiple routes to market](#), including a wider range of retailers and new opportunities in catering and hospitality. However, appropriate policies and regulations need to be crafted to create a competitive digital space and to curb concerns of market power of dominant platforms.

**3) Improved emergency support.** The application processes to support schemes need to be streamlined and simplified and access conditions broadened, in particular to provide support for medium-sized firms. Commercial bank loans are inappropriate for SMEs in severe difficulties, and grant finance should continue to be available to prevent business failures. Government should also provide assistance with PPE and sanitizer procurement, in addition to training and advice on how to adapt business process to new hygiene requirements.

The implications for South Africa's food system are far reaching, as the exit of SMEs exacerbates high levels of concentration and reduces diversity, with consequences for social inclusion and food system resilience.

***Resilient food systems are diverse food systems***



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