An Agenda for Opening up the South African Economy: Lessons from Studies of Barriers to Entry

Simon Roberts

June 2016

1. Introduction

The way the economy works in terms of microeconomic outcomes is the product of many small decisions and some big ones. There are also 'non-decisions', where the established trajectory continues because no decisions are taken to change its direction.

The studies of barriers to entry to the economy (supported by National Treasury) highlight the range of often mutually reinforcing microeconomic factors which stack-up to block greater participation in the economy by people as entrepreneurs/producers.[1] Taken together they warn against the temptation to look for a 'silver bullet' and instead highlight the need for concerted action across different fronts to alter the economic landscape. For example, finance is often highlighted as the main block to new businesses and, indeed, the sunk investments required to get commercially viable enterprises off the ground means finance obviously matters. But, providing development finance without addressing the other barriers to effective entry is likely to be a waste of money.

Unfortunately, the studies highlight that when big decisions are made they have generally gone along with the interests of the large incumbent(s). This has sometimes been linked to a BEE 'quid pro quo', where the state continues to protect the incumbent in exchange for more black suppliers or shareholding. These 'deals' in fact reinforce the dominant firm's power, as it is entrenched as the gateway to opportunities. Other interventions to open up markets have been piecemeal and unsurprisingly have had little impact.

Time for a sharp change of direction?

It is evident that South Africa is at a cross-roads. Continuing straight ahead is not sustainable. The existing structure of ownership and control excludes the majority and provides ammunition for those who argue that in reality the only way to gain access to wealth is through corruption and rent-seeking. Competition law has broken-up cartels and achieved lower prices for consumers but it has largely not opened up markets to entrants, nor can it, at least with the law as it currently stands. Yet, government often relies on the Commission to resolve these issues, where there are alternative levers that could have been used.[2]

[1] The barriers to entry studies are as follows: firm case studies of: Capitec, Fruit & Veg City, Soweto Gold, low cost airlines; and, sector studies of telecoms, agro-processing. There were separate papers on liquid fuels and mobile money, which are also drawn on here.

[2] This is the case with polymer pricing by Sasol where mining rights have a provision that local

While the high levels of inequality, poverty and unemployment clearly require actions which extend far beyond the scope of this note, there are important debates about competition and inequality (see Box 1). Meaningful access to economic opportunities through reducing barriers and proactively supporting rivals can play an important part in changing the structure of the economy.

We consider different options in this regard, as possible turnings that could be taken off the current path. In some areas we argue that a simple u-turn is required. For example, the decisions to favour a single incumbent and/or national champion should be reversed. This is the case with Telkom and SAA on the track record of the past two decades. Making Telkom the leader on broadband roll-out and continuing support for SAA are likely to be costly errors resulting in South Africa remaining behind in terms of broadband speed and price, and continuing to have high-priced flights to local and regional markets where SAA has market power.[3] While there may be a rationale for a state airline to keep prices down and increase availability of flights to smaller towns, the reverse has been the case in practice. It is rivals and not SAA who have reduced flight prices by around 30% and improved availability.[4]

Different decisions could also have been made in sectors such as beer where the liquor legislation continues to allow SAB to vertically integrate through the whole supply chain in exchange for their BEE programmes. Similarly, in fuel supply the incumbents have sought to prevent independent traders (including black owned and run businesses) from entering and expanding, including through influencing regulatory provisions.[5] There is a clear choice to be made here. Are black industrialists to be independent competitive businesses, or are they to be leveraged-in as partners of the incumbents and essentially subordinate to them? Our assessment suggests it cannot be both, no matter how tempting it is to think it might be so. If it is to be the former, then the studies demonstrate that material changes need to be made for market access to be meaningful in the absence of which firms are set-up to fail.

buyers of minerals and derivative products should not be discriminated against, and the main input is a by-product of fuel which is regulated, yet government requested the Competition Commission to investigate as excessive pricing. The finding of the Tribunal was overturned by the Competition Appeal Court on grounds of the evidence led on the appropriate rate of return to allow. In beer, legislation to vertically separate the supply chain was not passed and instead the competition authorities investigated. In healthcare instead of public policy being used to shape the market the issues were passed to the Competition for a market inquiry. In telecommunications successive abuse cases against Telkom related to issues that a more effective regulator would have addressed, and a number of years before the competition finding.

[3] Note that this is not an argument against state ownership.

[4] The airlines study illustrates the effect of the exit of 1Time, as well as the more recent entry of airlines such as FlySafair, on routes such as Johannesburg to George, compared to other such as Johannesburg to East London where such entry had not occurred. Prices and more frequent services have also, not surprisingly, been associated with changes in travel volumes. For regional routes there are similar issues. For example, Tanzania has opened up their market and as a result it is cheaper to fly Johannesburg to Lilongwe on Fastjet via Dar es Salaam (two flights of 3.5 hours and 2 hours) than direct on SAA (2 hours on a direct flight).

[5] See Paelo et al. (2015).

In addition to the studies of barriers to entry, recent studies of regulation in different sectors highlighted the blocks to renewable energy independent power producers as a result of a transmission structure whose governance is oriented to Eskom and its large coal-fired power stations rather than also having a forward looking agenda.[6]

Box 1. A note on competition and inequality

Inequality is mainly influenced by wealth and taxation. However, while there are many dimensions to inequality, the structure of the economy and barriers to entry and growth are important.[7] A lack of competition means entrenched incumbent interests can continue to earn high profits with low levels of investment and little effort and innovation. As Geroski and Jacquemin (1984: 22) noted, dominant positions can be entrenched and 'the *inequities* they create become institutionalized, creating long-term problems in the *performance* of the *economic system* which cry out for policy attention' [emphasis added]. One of the most internationally renowned economists studying inequality, Tony Atkinson, has recently argued that competition policy should explicitly take distribution into account, both for fairness considerations and because it will mean a more dynamic economy (Atkinson, 2015).

A productive and inclusive economy means that effort, innovation, and creativity are rewarded. Put differently, competition is fair. Performance competition means competing on offerings to consumers based on production capabilities rather than 'handicap competition' where firms seek to undermine their rivals (Gerber, 2010). Improved production capabilities result in increased productivity, improved quality and design of better products.

In South Africa, the evidence is that high profits are associated with lower productivity. Certainly, as a whole South Africa has had persistent and extremely high levels of concentration and poor productivity performance over the past two decades. At the same time, it has continued to record the highest levels of inequality in the world and very little, if any, redistribution of wealth aside from the considerable system of social grants.

Competition law and policy is about setting the rules for the market economy and the rules can be changed in order to shift the balance in favour of different outcomes, such as constructively opening up markets. It is not simply limited to enforcement against egregious offences such as hard core cartels that can be compared to racketeering or fraud. It also does not mean arbitrary actions against companies. The issue is whether the current rules mean the economy rewards effort, innovation and creativity. In economies with higher levels of concentration and less robust competitive self-righting mechanisms (such as higher barriers to entry) stronger policies may be required towards abuse of dominance (Vickers,

[6] See Mondliwa and Roberts (2014) for an overview and Montmasson-Clair and das Nair (2015) with reference to renewable energy.

[7] See North et al. (2009) on elements of creating 'open access orders', Acemoglu and Robinson (2012) on inclusive instead of extractive growth and Stiglitz (2015) on the need for more and better regulation of banks and monopolies.

2007; Brusick and Evenett, 2009). The balancing of the probability and costs of over and under enforcement (Type 1 and Type 2 errors) implies that different stances should be adopted across countries because of their different characteristics (Evans, 2009).

The competitive market mechanism should be evaluated in terms of its accomplishments in promoting individual freedoms (to produce, develop productive capabilities, and make autonomous choices), as opposed to the conventional framework of welfarist assessment (Sen, 1993).[8] Sen distinguished the 'opportunity aspect' relating to the range of choice, and the 'process aspect' which includes decisional autonomy not restricted by interference from others (Sen, 1993). Each of these is directly relevant for the choices made regarding competition provisions.

Is this a counsel of despair? The policy debates sometimes suggest there is little else that could be done. This is not correct. However, the improvements need to made across a number of areas which together will make a big difference, but individually will have little impact. This seems like a hard ask for government which tends to move slowly and with poor coordination.

We believe, however, there are many reasons for optimism. There have been important examples of entry and growth, some of which have been covered in the studies. Others include the impact of Sephaku's entry in cement, truly a case of an African industrialist (Dangote is the major investor) and one which has reduced cement prices by a substantial proportion making housing provision more affordable.[9] It is important to remember that Sephaku's entry was far from certain and was contingent on the 'use it or lose it' principle being applied to limestone reserves in Anglo-American's hand which meant they came up for sale and could be acquired by Sephaku.

The main point is, however, that the examples of significant entry are far too few and far too slow, and tend to be those with some 'insider' status such as Capitec in banking or Dark Fibre Africa in telecoms.

Ensuring impact will require cross-cutting interventions across government (national departments and institutions, as well as at provincial and municipal level), as well as clear signals from government about its seriousness. We recommend priorities, identify quick wins and highlight cross-cutting interventions such as amendments to the Competition Act and how to build a fund for higher risk lending to 'challenger firms'. We also consider a reorientation of

[8] Note, the emphasis on *individual* freedoms of Sen should be re-considered in terms of the impact on groups of discriminatory economic structure which makes a person's potential heavily influenced by where and in which community they come from.

[9] The ending of the cement cartel put downward pressure on prices, but Sephaku's entry made the really significant difference, again highlighting that competitive outcomes requires more than competition enforcement. Much of the price reduction highlighted in the recent World Bank review of competition is in fact associated with the impact of Sephaku, when the timing is taken into account.

government incentives and support measures.

2. Key cross-cutting insights on significance of barriers to entry

In assessing barriers to entry we are generally looking beyond factors such as the need to have the appropriate production capabilities. We are considering commercial businesses with product and service offerings to be competitive, but which face barriers in being able to effectively compete. These need not be the same as the incumbent's offerings. Indeed, one of the important values of opening markets to competition is to enable entrepreneurs who are in touch with the preferences of important groups of consumers to bring products and services customised to these preferences. For example, Fruit & Veg City recognised the gap and provided an offering which emphasised seasonal local produce without the uniformity of appearance and packaging being adopted in the main supermarket chains.

The main types of barriers to entry identified are as follows:

- ***Routes to market***

  Manufacture of the good or supply of the service is often only the first step. It is critical that the business must be able to reach consumers. Examples include the following:

  - Banking services require people being able to obtain cash and make payments. Branches and an ATM network remain critical, however, allowing cash back at point-of-sale (supermarket tills), as has been possible for a number of years, means an ATM network can be by-passed while mobile payments opens up opportunities to use more cost effective solutions and points the way to substantially cheaper 'branchless banking' models. Many of the obstacles are regulatory and can simply be changed.

  - Beer has to be in fridges/coolers in taverns and bars, on draught (on the bar top), for consumers to buy it. The same applies to other products, such as cool drinks, as well as more broadly to display space in outlets. Exclusive arrangements typically in place mean that small rivals are shut-out from a large number of outlets. In some countries competition enforcement has addressed this, however, the South African Act requires demonstrating a *substantial* lessening or prevention of competition which has been interpreted as showing that there would have been lower prices and higher quantity supplied in the market in the absence of the conduct. Small rivals can often not prove their product would be cheaper and there would be more supply to the market as a whole, while large firms claim their conduct aids the efficiency and lowers costs in their own supply chain.

  - For supermarkets, the location is critical to reaching consumers. Exclusive leases are a straightforward block to accessing potential markets. The justification that it supports investment in shopping malls applies in some locations and for a period, but not to the ubiquitous practice for durations that last decades.

- For agro-processing companies the ability to access the major supermarkets is an important consideration. There are a number of practices which make it difficult for smaller brands to establish a presence, including category management practices of supermarkets where the organisation of a set of products in the supermarket is handed over to a lead supplier. For example, in milling products the smaller rivals struggled to get space on shelves and the 'gondola ends', the special displays at the end of rows which have much greater visibility and are exclusive to one supplier.[10]

- There are obstacles to trading grain which undermine the bargaining power of small millers. A few large traders dominate South African markets. The way the silos and SAFEX operate means that substantial deposits are required to be able to trade (reportedly of R1mn for accessing silos).

- Renewable energy independent power producers require access to the grid to be able to sell the power generated, such as in bilateral deals, or to Eskom and municipalities as buyers.[11] While investments are required to upgrade transmission infrastructure there have also been concerns around Eskom's incentives to undermine independent generators. This should not be equated with privatisation as energy generation could be by municipalities and other public institutions, as well as cooperatives and hybrid partnerships.

- ***Consumer awareness and switching costs***

Studies of consumer behaviour have highlighted the importance of perceptions and brand awareness, as well as the convenience of being able to switch. This provides the justification for advertising which can be a very large (and sunk) cost which needs to be incurred in order to enter. There is a public good aspect to providing independent information on the comparability of offerings (such as price comparison websites for bank charges) and for regulating *for* switching, with penalties if firms are obstructive.

Consumer inertia is substantial, including due to information asymmetries and convenience costs. Recognising the knock-on costs this implies in terms of weaker competition (and the potential exploitation by incumbents) is to realise the potential benefits from proactive interventions.

[10] These are also paid for by the supplier.
[11] See Montmasson-Clair and das Nair (2015).

Related to consumer behaviour and advertising are the costs associated with packaging, promotions and display.

- In consumer goods such as food products, the costs of packaging, advertising and display can be very large and are important for establishing brand awareness.

- The example of beer, as a consumer product, highlighted the advertising and promotional costs required to establish a brand and the scale economies associated with advertising expenditure which does not necessarily increase proportionate to sales but is necessary at low sales to establish the product in the market.

- National supermarket chains command advertising space and seek to channel footfall through promotions even while the price of the supermarket 'basket' is not necessarily cheaper. Lower prices of promotional products (or 'loss-leaders') may be outweighed by the other items a consumer purchases once having been attracted to the store.

- Promotions and advertising expenditures are very substantial in telecommunications and arguably obscure rather than assist in understanding the range of options of offer.

There are also direct obstacles and costs to switching in a number of products, these are most obvious in:

- Telecoms, where mobile network operators can make the switching process difficult and inconvenient even while number portability has been enforced. This is compounded by a range of strategies targeted at contract customers, in which Cell C's share is much smaller than in pre-paid, despite the MTN and Vodacom's prices being substantially higher in contract customers. There are a range of strategies such as on-net discounts which firms can use to lock-in the network effects which operate in telecoms.

- In banking switching costs are also significant and consumers do not readily switch to rivals even where they may be offering cheaper prices and better products and services. In Capitec's case it is notable that first they attracted customers to micro-loans, while customers retained their own bank account if they were already banked. Customers were only converted to also use banking services once becoming familiar with Capitec through the loans. The very long time it took Capitec to be an effective rival is also significant, with very little progress from 2001 up to around 2008, before the take-off thereafter.

- ***Scale economies***

Economies of scale and scope apply where there are substantial fixed costs which do not increase with output, and common costs in the case of multi-product firms. The larger the scale of operation the lower are average fixed costs. Strictly speaking these may not be entry barriers as a firm can enter at a size which reaches minimum efficient scale if it can raise the finance to do so. However, a proportion of the costs are likely also sunk meaning they cannot be recovered if the firm exits. In addition, financial market imperfections mean that entrants who are potentially efficient competitors are unlikely to raise the capital required for large scale entry at the outset. These imperfections impact most on those potential competitors with a strong proposed offering and yet little finance of their own.

Scale and scope effects mean that strategies can be employed by incumbents to undermine the rival's access to segments of market demand meaning they operate at below installed capacity, so raising their costs.

Economies of scale have been highlighted as important across the case studies. These effects are obviously very large in mobile telecommunications and retail banking.

In supermarkets there are very large scale effects in distribution. It is estimated that supermarkets can obtain costs savings of up to 10% from suppliers in the form of distribution allowances, warehousing allowances and pallet discounts when goods are sold to a supermarket's distribution centre (DC) rather than direct store deliveries. Independents have been able to overcome this to an extent through buying groups, while fresh produce markets also play an important role.

In manufacturing activities such as dairy, poultry and beer, there are economies of scale in processing and packaging facilities. In poultry these effects are greatest in breeding and abattoirs which means independent broiler producers may be subject to market power at different levels of the value chain. In dairy production, the processing of value-added products necessary to diversify away from being reliant only on commodity milk production requires larger scale investments (in powdered milk, yoghurts and cheese).

- ***Learning effects, time to build footprint, reach scale and patient capital required***

Learning-by-doing effects refer to the range of internal practices and knowledge which need to be developed to be competitive and realise low costs. It is also necessary to take into account building the external relationships which are necessary such as building a distribution and retail footprint. As with economies of scale and scope, these are not barriers in their own right but reinforce existing advantages of incumbents and provide opportunities for them to undermine entrants. There are implications for the support and intervention required to realise greater competitive rivalry and open up meaningful access.

For example, in poultry, the systems and flow of production (from breeding stock at great-grandparent, grandparent and parent levels, through to broilers) means it takes three years or more to become competitive. This is reflected in the experience of an entrant (GFC) which is already vertically integrated into the production of the main components of feed. The incremental building of capabilities by Soweto Gold highlights a similar need for 'patient' finance to support the growth of brewing, packaging and distribution over a number of years.

The experience of Capitec suggests the time period in banking is more in the order of a decade. Similarly, while we talk of Fruit and Veg City as an entrant it is important to remember it started in the early 1990s and took close to a decade before it could make a significant impact, and then start moving to the supermarket format in the form of Food Lovers Market.

In airlines, it is important to be able to weather the volatility associated with fuel prices, as well as demand shocks. Where the state-owned incumbent has an advantage and has apparently subsidised its own low-cost carrier this has undermined the ability of independent rivals to obtain finance and make the necessary changes to respond to market conditions. In the medium term lower rivalry has meant higher prices and lower travel volumes.

- ***Vertical integration***

Vertical integration is another reality which is emphasised in a number of the case studies which leaves the entrant at just one level reliant on their rivals for key inputs and/or key markets. Again, this provides incumbents with a potential lever over entrants and smaller rivals to undermine them. Alternatively the rival has to enter simultaneously at the different levels as a vertically integrated operator, significantly increasing the entry costs.

  - In poultry, the successful entrants have also been those operating in feed and/or the supply of breeding stock. Competition cases have addressed restrictive vertical arrangements where these have undermined rivals. It is also interesting that full vertical integration is not necessarily the case for efficient production, as a more competitive market has seen vertical dis-integration of some companies and a focus on core competencies.

  - In telecommunications, the failure to implement local loop unbundling mean rivals to Telkom in delivering fixed line services, such as 'value-added network services' (VANS), have been dependent on the incumbent and main rival. The slow moving Telkom has undermined entrepreneurial activity across a range of these services. Long-running competition cases have slowly unlocked parts of these activities.

  - Eskom's integration has, as noted above, proved a major obstacle to independent power suppliers.

- Vertical integration into distribution has been highlighted in beer supply.

The implications are again that a pro-competitive approach to regulation is required, as well as possibly considering a value-chain approach to funding.

- ***Regulation***

  Regulation itself can be a barrier, such as where onerous licencing conditions block entry. In banking, applications for licences from major supermarkets and telecommunications firms appear to have been turned down. Similarly, banking regulations have prevented the growth of mobile money transfer by mobile network operators.

  Ineffective regulation has also played an important part. This is where some potential important wins can be made such as in the area of telecommunications, as we discuss below.

3. How important are the barriers?

In the studies undertaken here, the success of some entrants points to the magnitude of the effects through simple 'before and after' assessment. The impact of entry indicates what is at stake if entrants are blocked or undermined, as well as pointing to the much greater benefits that could have been realised if entry had been faster and wider in reach.

The impact assessments of cartels around the world have typically found mark-ups of 15-25% over what a competitive price would be.[12] Higher mark-ups have been found in several South African studies.[13] This does not take into account the effects on quality and variety, nor does it place any value on the benefits to the economy of wider participation in terms of production.

It is worth remembering that the point of a cartel from the perspective of its members is to behave like a monopoly (or a dominant firm with substantial market power). Several of our studies have considered where incumbents have substantial unilateral market power while others have found that entry barriers have shielded a small group of 'insiders' from competition who can tacitly coordinate.

The studies suggest similar orders of magnitude to the cartel mark-up calculations. In services (banking, telecoms) which are at the core of economic activity the mark-ups imply very wide-ranging effects on economic participation. While changes to bring more competition have brought improvements, the point is that these could have been earlier and bigger. Even apparent success stories such as firms with the advantages of Capitec and FVC took a substantial period (around a decade or more) to get to the market presence where they had a material impact. The experiences also point to the much wider impacts which could be realised.

- Capitec's existence as an effective rival has realised major savings for

[12] See the papers by Connor which draw together studies from around the world.

[13] Khumalo et al. (2014), Mncube (2013a and b).

consumers estimated at close to R20bn annually (based on a comparison of charges in 2014 against 2010).[14] It has also stimulated the extension of services to the previously unbanked.

- Similarly, in telecommunications both in mobile and fixed line services, the greater competition in recent years highlights just how damaging the blocking of entrants has been. South Africa's broadband has been poor and expensive and is becoming more so relative to our peers. The reduction in mobile call termination rates through enabling Cell C to be a more effective competitor induced the two lead MNOs to reduce rates, realising a consumer saving estimated to total R47bn from 2010 to 2015, just for the subscribers of Vodacom and MTN. There has been a strong response in terms of much greater telecoms usage.

- The impact of FVC is more difficult to quantify, however, it is evident that it provided a cheaper basket of products and a wider range of choice. Each person who elected to shop at FVC was obtaining lower priced food than they would otherwise have done (including because they were now able to conveniently source fresh produce which may have been a lower perceived quality). There have been large benefits also in the response from the major chains. FVC is reported to have been able to sell fresh fruit & vegetables at 20-25% lower prices than the national chains due to direct procurement from the municipal markets and cost containment measures. The implication is greater demand and market opportunities for farmers.

- In agro-processing, the entry in poultry of CBH after a competition case ensured it could bring in a new breed led to around R1bn of consumer savings per annum relative to the previous years. Similarly, Lethabo milling undercut the main maizemeal brands by 35% when it first entered.

- Competition between airlines has direct benefits for travellers in terms of lower prices and greater frequency of flights.

4. What can be done, by whom?

A critical insight is that interventions need to be on a number of fronts as they are mutually reinforcing. Just as the barriers have a cumulative effect, so addressing one area in isolation will make little difference. This is perhaps most evident in the area of finance, long highlighted as an obstacle to entrants. Our analysis indicates that providing development finance to firms without considering the challenges such as routes to market will mean the companies are set up to fail and the funding provided will be lost.

In short, we propose a policy platform aimed at opening access through a broad raft of complementary measures.

There are a number of rules which determine how markets work. The rules are

[14] Recognising the importance of finance, the UK is working to support 'challenger banks' to bring greater rivalry to the big four established banks in that country (http://www.ft.com/intl/cms/s/0/d2520afa-8b78-11e4-ae73-00144feabdc0.html#axzz3bVko6jM8).

in the form of national economic regulation (such as banking, telecommunications and energy), the Competition Act, and local regulations such as governing urban planning. These can tip the balance in favour of one side or the other. Incumbents have a natural advantage in shaping the rules in their favour through influencing the terms of the debate and more direct lobbying. Note, this is not about more or less regulation, but different regulation. In some cases regulations blocking entry can be removed, in others, proactive regulation *for* competition may be required given market failures and intrinsic obstacles. For example, it is necessary to ensure entrants have access to essential facilities and to enable consumer switching on a timely and efficient basis.

4.1 Regulating for competitive rivalry

The regulatory provisions in network industries such as telecommunications and banking should be changed to favour rivals. In mobile telecommunications regulations can allow for services based competition by Mobile Virtual Network Operators, while ensuring a fair return on the infrastructure investments of the MNOs. Spectrum allocation can be made through transparent auction processes set-up to encourage entrants while raising funds for the firms.

Local regulations at the municipality level can open up basic facilities such as poles and ducts throughout towns and cities to those wishing to cable.

In energy, including electricity and gas, the historic bias has been to the major incumbents on the promise that they would invest and ensure security of supply. This bias has come at a substantial cost. Independent traders and suppliers have been blocked from pipelines and port facilities. In electricity generation, rivals have not necessarily had access to the grid on an equal footing.

4.2 Amendments to the competition act

A country's competition regime can be understood as an 'economic constitution' of a country as it is the high level framework for markets (Gerber, 2010). The South African Competition Act embodied a number of trade-offs which were the result of negotiation of the legislation in Nedlac. The most important of these is the inclusion of public interest conditions in mergers while the abuse of dominance provisions are weaker than, for example, in Europe. The big business negotiating team perceived this as an exchange – a concession being made on one hand (in mergers) to achieve their main objective on the other (weak abuse of dominance provisions).

The alternatives for the abuse of dominance provisions are clear. The European approach, followed by most of the world, is to have an over-arching prohibition of abuse of a dominant position with a non-exhaustive specification of different types of conduct which might constitute an abuse. The EU Guidance on Enforcement Priorities for abuse of dominance sets out steps in determining whether the undertaking(s) are dominant and whether the conduct represents an abuse. The undertaking is entitled to compete 'on the merits' but has a *special* *responsibility* not to allow its conduct to impair genuine undistorted competition. Individual competitors are not protected but rather the competitive process, and dominant undertakings are burdened with additional responsibilities in this regard.

On the grounds that this would create uncertainty for dominant firms as investors, the South African Act watered this down. The Act specifies particular and discrete forms of conduct which constitute an abuse of dominance and has a catch-all provision for which there is no penalty for a first offence. Moreover, as the Act allows for an efficiency defence by the dominant firm, the Competition Commission will generally have to prove that the conduct had the effect of substantially lessening competition such as to outweigh any claimed efficiency rationales.

Countries such as Japan and South Korea adopted particular approaches to competition in line with their industrial policies. The objectives of the South Korean Fair Trade Commission (KFTC) are to encourage free and fair competition, prevent the concentration of economic power and thereby promote 'balanced development'. This is because the early stages of rapid industrialisation were viewed as 'unbalanced', requiring an active competition policy addressed at dominant firms in that country. The mandate of the KFTC therefore includes evaluating 'unreasonable' practices and 'unjustifiable' restrictions on competition (Fox 2003; KFTC, 2011).

The difference in the approach adopted in these countries is well explained by Kyu-Uck Lee (1997, as cited in Fox, 2002), who observes the following regarding competition law and policy in Korea:

> 'Competition is the basic rule of the game in the economy. Nevertheless, if the outcome of competition is to be accepted by the society at large, the process of competition itself must not only be free but also conform to a social norm, explicit or implicit. In other words, it must also be fair. Otherwise, the freedom to compete loses its intrinsic value. Fair competition must go in tandem with free competition. These two concepts embody one and the same value. This may be the reason that competition laws of several countries such as Korea and Japan clearly specify 'fair and free competition' as their crown objective. . . . I believe that the abstract notion of fairness rests, inter alia, on equitable opportunities, impartial application of rules and redemption of past undue losses. . . . Fairness, then, does not imply absolute libertarianism but instead takes the form of socially redefined freedoms.
>
> Viewed from this perspective, the polemic whether competition laws should aim only at enhancing economic efficiency rather than at promoting some social policy goals such as fairness may appear to be irrelevant. After all,

> efficiency is intrinsically not a value-free concept.
>
> …[I]n a developing economy where, incipiently, economic power is not fairly distributed, competition policy must play the dual role of <u>raising the power</u>, within reasonable bounds, <u>of underprivileged economic agents to become viable participants in the process of competition on the one hand</u>, and of establishing the rules of fair and free competition on the other. If these two objectives are not met, unfettered competition will simply help a handful of privileged big firms to monopolize domestic markets that are usually protected through import restrictions. This will then give rise to public dissatisfaction since the game itself has not been played in a socially acceptable, fair manner.' (emphasis added)

The choices can be simply framed as follows.

- ***Does the law address harm to the competitive process or just the effect (interpreted as outcomes) of competition?***

The South African law provides for effects-based tests, while harm to the competitive process implies valuing participation and the intensity of actual and potential competition in its own right. The latter approach implies wording such as the lessening, prevention and distortion of competition would be used.[15] The South African Act effectively privileges as complainants large rivals (likely to be multinational firms) who are able to demonstrate a significant effect. Potentially efficient smaller firms have little, if any, chance of demonstrating a significant effect. The participation of this class of rivals has no merit in itself (due to e.g. bringing different choices to consumers) and, by their nature, they will probably grow incrementally and are likely to enter through targeting a market or consumer segment and hence not be impacting across the market. They will also not achieve cost efficiencies until they reach minimum efficient scale. As *potentially efficient* competitors, the effects are speculative.

- ***Do anti-competitive effects have to be substantial?***

In examining the (possible) anti-competitive effect, is it specified as 'substantial? This has been interpreted as requiring demonstration that prices would be lower and quantities supplied would be higher absent the conduct.[16] Or, are the effects also understood in qualitative terms such as the range of choices on offer to consumers, and whether competition has been distorted in blocking rivals without due justification? In many other countries, the test is not subject to the additional

[15] This is in line with the European Union approach.

[16] See the Competition Appeal Court decision in SAB case.

hurdle of substantial, meaning simply an implied test of materiality (or at least non-trivial).

It should be noted that an approach which adopts the restriction, prevention or distortion of competition as a standard does not mean efficiency-enhancing restrictive arrangements are outlawed. Rather, arrangements which undermine the competitive process have to be justified.

The difference this makes is perhaps most evident in exclusive supermarket leases in shopping malls. These distort competition by completely blocking rivals from the malls, including single-line rivals such as butcheries. The durations of 20 years and more extend beyond any reasonable efficiency justification to protect investment by an anchor tenant. The Competition Commission would have to show, however, that the anti-competitive effect is substantial meaning that a) competition between the three main chains, Shoprite, PnP and Spar is not intense, and b) that competition from smaller rivals is thus important for prices to consumers.

By comparison, under a 'prevention, restriction or distortion of competition' test the arrangements are problematic and the onus is on the firms to prove how long and the nature of exclusivity that is required for the efficiencies claimed. In effect, the South Africa Act does not follow through on its objectives when the particular provisions are specified.

Similarly, in a number of jurisdictions including Europe, Chile, Mexico and Singapore the competition law has opened up fridge/cooler space to rivals in soft drinks and beer. It is common for dominant incumbents to provide retailers with free fridges in which only their products can be stocked. In small outlets with limited space this can result in quasi-exclusivity. Coca-cola has agreed in a number of countries to open up 20% of the fridge space to rival brands in such outlets in order to settle competition cases.

The introduction of the market inquiry provisions in South Africa do provide for assessing the prevention, restriction or distortion of competition but there are no binding actions or sanctions that result from inquiries. Follow-through by other branches of government with relevant powers is critical. For example, urban planning can impact on supermarket location and rivalry.

4.3 Development finance, venture capital, and patient capital

Financing entry and expansion is a critical part of the puzzle. In particular, the barriers identified above point to the need for 'patient capital' given the time to build the scale and reach required to be competitive in many areas, and the appetite for risk in financing rivals taking on powerful incumbents. The studies also raised the issue of financing rivals at different levels of a value chain.

The ability to take a long-term view is already an important characteristic of the IDC, although more can be done in terms of the IDC's understanding of market and industry specific dynamics and the requirements of smaller businesses. As with the allocation of incentives, it is easier to lend for investments by incumbents which would likely have been made anyway.

A bigger change can be made in providing finance for riskier investments. In this regard, it must be born in mind that increasing competitive rivalry has gains which go far beyond the returns to the entrant. The impact on market prices and dynamism affects customers of all the firms. This suggests support for entrants is warranted where there is a substantial risk involved. The question is how to finance this, and how to evaluate the applications.

On the first, the experience with the funds from the Pioneer Foods competition settlement is a possible model which can be developed. Penalties from competition cases could be channelled into a development finance fund for rivals and entrants, especially black industrialists. This is in line with the objectives of the Competition Act in opening up the economy to participation by all.

In terms of the second question on the evaluation and criteria to be followed, it is important to assess the potential for firms to be effective competitors, with the offering, scale and expertise required. The point is to provide the long-term finance for the necessary learning and capability development. There is learning also in the financing evaluation and monitoring involved. Finance should not therefore be provided to just one or two entrants but to those who meet the criteria, in the recognition that some will inevitably fail but, it is not possible at the outset to predict which, and the contestation between rivals is part of the process.

In addition, it must always be kept in mind that finance, without the complementary measures to address the range of barriers to entry and growth, will not be an effective intervention.

4.4 Supermarkets and routes to market

The area of retail, and supermarkets in particular, is so important that it warrants a special focus. Supermarkets are the route to market for a wide range of suppliers.

In terms of opening up supermarket rivalry, addressing exclusive leases is critical. This can be through the market inquiry resulting in legally enforceable undertakings by incumbent supermarkets to either not enter into leases with exclusivity clauses, or mandate the reduction of the duration and scope of the clauses in instances where such leases have already been entered into.

In other countries, measures have been largely been put in place under the competition regime. In the UK, the Competition Commission made an order to this effect in its Groceries Market Investigation Order of 2010 following recommendations for an investigation from the former Office of Fair Trading. In Australia, following the inquiry by the ACCC, the major supermarket chains, a wholesaler and other retailers *voluntarily* provided court-enforceable undertakings which phased out exclusive lease provisions over a number of years.

Urban planning by municipalities can have a major impact in ensuring open and flexible retail space and a mix of formats, as well as tackling exclusivity directly through planning policies. In other countries, such as Australia and the UK, urban development has played a key role in opening up markets in retail to wider participation and ensuring competition to incumbents. This requires municipalities to play a role in opening up markets, possibly under guidance from national government and the competition authorities.

The contribution of fresh produce markets in providing market opportunities to both farmers and retailers needs to be fully appreciated. They are an alternative to the private distribution arrangements of the national chains who would otherwise have even greater power as the route to consumers for farmers, and able to extract terms from the exercise of this power. Indeed, the example of FVC and the potential for further expansion of independent retailers indicates that support should be provided to fresh produce markets to expand their position, recognizing the spin-off economic benefits. In simple terms, rivalry from FVC has meant significantly lower prices to consumers and a greater range of options for suppliers.

In more expansive terms, local sourcing targets could be agreed with retailers, with a focus on small and medium manufacturing businesses, learning the lessons from the Massmart Supplier Development Fund. The playing field for smaller players and new entrants can be somewhat levelled by mandating or facilitating voluntary codes of conduct between producers, wholesalers and retailers. From the perspective of small and medium suppliers, such codes of conduct serve to protect them against possible abuse of market power of large supermarkets. This is similar to what has been done in the UK, through the UK's Groceries Supply Code of Practice which stipulates that retailers are required to comply with the Groceries Market Investigation Order of the former Office of Fair Trading. This Code is enforced in the UK by an independent Groceries Code Adjudicator, set up specifically to oversee the relationship between supermarkets and their suppliers and housed within the former OFT.

In Ireland, there are plans to institute a mandatory Code of Conduct in the grocery sector, to be overseen by the Department of Enterprise, Trade and Employment. In Spain, a new act focusing on measures to improve the functioning of the food chain was promulgated in 2013 which uses a mixed model of regulation and self-regulation (through voluntary codes of conduct) to govern commercial relations between the agents in the food chain.

4.5 Reorienting government support

The system of incentives for investment by smaller businesses does not appear to be working well. Many firms reported that accessing the incentives was time consuming and cumbersome. The firms thus tended to access incentives using consultants for the investments they would be making in any case. The incentives did not change their decision. There are also obvious linkages between development finance and government incentives which need to be strengthened.

There are a number of factors related to the effectiveness of incentives and the way they impact on competition. Some of the issues are simply to do with the complexity of the programmes and the challenges small firms face in accessing them. In addition, the lessons from the case studies are that a deliberate emphasis should be placed on supporting competitive rivalry and, where large incumbents benefit most from incentives, on clear, monitored conditions which take competition concerns into account. Improved transparency and reducing complexity can also aid in monitoring incentives linked to such conditions.

Second, there is a very important role for local government which may often be overlooked. The access to infrastructure and physical space is a critical aspect of being able to supply goods and services and reach consumers. In the case of telecommunications metros can open up ducts and poles to lower the costs of rivals putting in fibre cables. In retail, the configuration of retail space and planning requirements is potentially a strong lever to ensure that large incumbents cannot lock out smaller rivals. Fresh produce markets have also played an important role in the growth of independent chains and in ensuring they can source from diversified farmers.

5 Summary and quick wins?

The agenda for opening up access to the South African economy should rest on three main legs:

- Changing the *ex ante* rules of the game in **economic regulation** to favour entrants and ensure incumbents can be effectively challenged. Steps take in fuel and gas should be built on to enable independent suppliers access to key facilities. In telecommunications, the allocation of spectrum must take into account fostering greater rivalry, while local governments can open up ducts and poles to rival providers. In finance, regulations to support mobile money and branchless banking will widen opportunities. Measures also include soft regulation such as codes of conduct for supermarket chains.

- More effective *ex post* **enforcement** against anti-competitive conduct which excludes smaller rivals. Amendment to the Competition Act to ensure that the competition process is protected and the ability of smaller participants and black industrialists to enter and grow can be given weight in decisions.

- Proactive **enabling measures** to support rivals. This includes a lower interest and higher risk development finance fund from competition penalties aimed at financing entrant. Development finance should also consider the different levels of the value chain (as the IDC has begun to do). Complementary measures at local government to configure space and open up critical infrastructure to rivals.

There are a number of quick wins here. Each of the briefs based on the separate studies contain a longer list of proposals specific to the sector in question.

It is notable that in several markets entrants have come from elsewhere on the continent (such as Sephaku/Dangote in cement and Choppies in supermarkets). The potential for African industrialists to be part of opening up access to create a more dynamic economy, and the links to regional integration, should not be forgotten.

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