10 year review: Industrial structure and competition policy

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1. Introduction

Competition is at the heart of the liberal capitalist economic model. The fundamental proposition is that competition will yield economic efficiency and that it represents the exercise of economic freedom. Competitive rivalry between firms checks their ability to abuse consumers and induces ongoing improvement in their operations. The challenge of competition law is to address practices which have a negative effect on economic efficiency through raising prices and inhibiting competition (Hay, 1993).

In other words, competition is about markets working for the economy as a whole. The government's Microeconomic Reform Strategy has a similar focus, reflected in its vision for 'a restructured and adaptive economy characterised by growth, employment, equity, built on the full potential of all persons, communities and geographic areas.' The Strategy specifies that this requires:

- A geographic spread of social and productive investment
- An integrated manufacturing economy capable of high degrees of value added
- An extensive ICT and logistics system capable of speed and flexibility
- A high degree of knowledge and technology capacity
- Greater diversity of enterprise type and size
- Skilled, informed and adaptable citizens
- An efficient, strong and responsive state structure

Market outcomes depend on participation, and the valuation of goods and services exchanged through markets. This in turn reflects the structure of the economy. The structure of the economy is to do with the endowments of individuals and groups which enable them to participate in market exchange. In addition, powerful groups shape markets, influencing what can be exchanged and on what terms. Both size and position are therefore important for the relationship between industrial structure and market outcomes. And, the extent and nature of competition reflects the ability to participate in a market economy.

Competition policy has become part of the economic orthodoxy, as it seeks to remedy situations where competition is 'unfair' in that a large firm has market power, or there are agreements which seek to limit competition in order to enhance private returns which do not reflect productive capabilities. The measures typically included in competition policy seek to entrench a rules-based framework for economic activity, where legal decisions are taken against an objective standard enshrined in law and representation is through a court-like institutional structure.

What is industrial structure?

Industrial structure has at least three dimensions. First, economists use concentration ratios as horizontal summary measures of the number and relative size of firms in different sectors on the assumption that sectors include similar products. Second, structure takes into account vertical and conglomerate linkages, that is, the extent to which firms control production at different levels of supply and in related and unrelated activities. Third, industrial structure can also be understood at a more fundamental level to do with the nature and orientation of big businesses in particular and the way they interact. In this sense, industrial structure is part of the evolving capitalist model.

Economic development and the objectives and practice of competition policy

Competition is commonly discussed by micro-economists in terms of different market structures, against the benchmark of perfect competition where firms are all price-takers. But, competition itself relates to behaviour, in particular the degree and nature of inter-firm rivalry (Vickers, 1997). Dominant firms are able to make profits by constraining supply and raising prices above marginal (and average) cost. Where there are a small number of firms, they can collude rather than compete in order to collectively generate monopoly profits.

If such behaviour is set out in written documents governing, for example, agreements between firms to set prices and collectively govern output, then the implementation of competition policy can be reduced to a legal exercise. Competition laws do typically prohibit certain types of agreements. But, the reason for taking action against such agreements is essentially the economic outcomes of the behaviour embodied in them. And, the behaviour is just as damaging whether it is encapsulated in a written agreement or not.

Leaving aside the *per se* type prohibited agreements, the challenge of competition law is to address the practices which have a negative effect on economic efficiency through raising prices and barriers to competition (Hay, 1993). Yet, assessing this may be very difficult, especially in the presence of economies of scale, shocks to production costs, and multi-product firms. These and other concerns underpin what Phlips (1998) has termed the 'indistinguishability theorem'. That is, it may be impossible to tell whether a particular outcome is due to deliberate uncompetitive behaviour or is the result of non-collusive or price-taking behaviour given the conditions of the industry. At the very least, competition assessments are very information intensive, especially given the asymmetries which exist between the firm and the authorities and the lack of any incentive for the firms to reveal their nature to the authorities. Unless the competition authority is to become a regulator and determine acceptable price levels directly, then it must be able to distinguish conscious anti-competitive actions from the 'innocent' interplay of other factors.

If dynamic factors and externality effects are taken into account, then it has been argued that it is more appropriate to apply a concept of optimal rather than maximum competition (Singh and Dhumale, 1999). In this case, competition policy should be seen as part of industrial policy, following the examples of Japan and South Korea (Amsden and Singh, 1994). The active rivalry of firms and the impact on their investment and production decisions is encouraged as an integral part of working towards identified industrial development goals.

Competition and different business models

Management and economic history address the important role of competition within economic development from a somewhat different starting point to economics. In a management/business school analysis, a firm's strategy is fundamentally about its competitive position *vis-à-vis* its rivals. This position is due partly to the environment within which it operates in terms of access to inputs, its cost structure and so on, and is partly determined by its decisions. For example, vertical integration may be an important part of ensuring better access to key inputs than rival firms. Advertising to build a brand identity is part of maintaining leadership, distinguishing ones' product and deterring entrants (in each way reducing the negative immediate effect of competitive pressures on product price and revenue streams).

The orientation of big business and the ways in which they interact or compete are a central part of a country's development trajectory (Chandler, 1990; Chandler et al. 1997 and 1998). The internal organisational capabilities of firms are an essential element in the ways in which they adopt and exploit new technologies, and realise economies of scale and scope. For example, the development of just-in-time capabilities has been very important in being able to compete in terms of product development and quality. These organisational forms, which are often associated with Japanese firms such as Toyota and Canon, are part of managing product flow in order to compete (Best, 2001). Inter-relationships between firms within large corporate groupings in Japan and South Korea have enabled the support and co-operation to build dynamic competitive capabilities (Amsden 1989 and 1997a). However, competition *between* groups has been a very important disciplining and motivating factor in ensuring that inter-firm co-operation is part of constructive processes and not aimed at collusion and rent extraction with stagnating implications for the economy. The dynamic rivalry which constitutes competition is thus a very important element of Chandler's characterisations of different capitalisms.

The behaviour of firms and their inter-relationships cuts across the adoption of different production systems, the different business models governing firms and factors such as innovation and skills development (Best, 2001). South Africa's new industrial policy identifies utilisation of knowledge in production and effective employment of information and communications technologies as fundamental to building production capabilities. At the same time, the concentrated nature of many South African sectors and the high-mark-ups which have been reported (Fedderke, 2003) mean that the nature and extent of competition will influence the pressures to deploy such technologies. The industrial policy identifies competition as a driving force and competition policy as one of the tools by which greater competition can be encouraged. This is one of the expectations against which the implementation of competition policy will be assessed.

How are these issues addressed?

The paper addresses these questions by first giving a brief background on the South African economy and industrial structure before 1994. This is necessary as the orientation of the major corporate groupings and their control over different segments of the economy reflects the historical pattern of economic development. The period from 1994 to 2003 is then analysed in more detail in terms of the changing patterns of industrial structure at both sectoral and corporate level. The major conglomerates' operations and strategies are described in order to understand how they have responded to the new political dispensation, increased international integration, and the policy framework of the ANC government. It also discusses the development of black-owned and controlled enterprises. The paper then examines in detail the competition policy framework, and undertakes case studies of three selected sectors.

The analysis thus assesses the factors underlying the patterns of change in ownership and control, examines the importance of competition and rivalry, and evaluates the actual and potential role of the legal framework and institutions. In so doing it focuses mainly on industry, including mining. While information is presented on companies in other sectors, such as telecommunications and media, this is not the main focus.

2. Industrial and corporate structure and a brief review of recent history

There is little doubt that corporate ownership and control in the South African economy is highly concentrated. In the latest manufacturing census, for 46 per cent of the 57 main product groupings the largest four firms account for more than half of output, while in a further 35 per cent of groupings the four firm concentration ratio is between 0.25 and 0.50.[1] Concentration is even greater if measures of firm size are based on control, which is often exerted through minority stakes and holding companies, such that many different companies in a sector can be identified as being part of the same conglomerate grouping. Historically, six main conglomerate groupings have controlled the majority of (private) economic activity (Table 1). And, while the positions of the smaller conglomerate groupings have changed, the firms controlled by the four largest conglomerates have never amounted to less than half of the capitalisation of the Johannesburg Stock Exchange.

Table 1. Summary of control of JSE market capitalisation (% of total)[1]

	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2002[4]
Anglo American Corp	53.6	44.2	42.4	33.7	38.2	43.3	37.1	27.5	22.6	17.4	22.3	25.4
Sanlam	12.2	13.2	13.2	15.6	12.0	10.5	12.4	11.0	10.6	9.9	12.5	4.2
Liberty Life	2.0	2.6	3.7	4.7	6.2	7.2	7.3	11.1	11.9	9.5	7.1	3.2
Rembrandt/Remgro	3.8	13.6	15.2	14.6	15.5	13.0	7.8	10.6	9.9	9.0	10.4	13.7
SA Mutual/Old Mutual	10.6	10.2	10.4	14.2	10.7	9.7	11.2	10.2	11.4	8.8	10.6	13.3
Anglovaal[2]	2.1	2.5	2.9	2.9	3.4	3.6	2.9	3.0	1.5	0.8	0.7	
Black owned gps[3]	-	-	-	-	-	-	-	6.3	9.3	8.9	6.8	
Top 4 gps collectively	80.2	81.3	82.0	79.9	79.2	80.1	79.4	69.7	64.9	53.9	62.2	59.8

Source: McGregors (1999, 2000, 2003) <u>*Who Owns Whom*</u>

Notes: [1] Control is assessed by *McGregors* taking into account the various cross-holdings of shares that exist and may be associated with a relatively small direct shareholding in any given company.
[2] In 1998 the Anglovaal shareholding was split equally giving the Hersov and Menell families each control over 0.4% of the JSE capitalisation.
[3] The Black owned groups are identified as such by *McGregors* on the basis of all those companies which have significant black influence in their ownership. They are quite diverse, some deriving funds from Trade Union pension funds, others consisting of private individuals who acquired their own wealth or borrowed from commercial banks. McGregors did not include such an identification for 2002.
[4] Shares for 2002 were calculated from the identification of control, and the market capitalisation (for November 2002) given in *McGregors* (2003). The holdings of the Rupert and Hertzog families in Richemont and Venfin meant they were included under Remgro although the two companies are held separately.

The declines in the share of the major groupings reflects unbundling of, for example, Billiton,[2] SAB, AECI and Sappi, which were all associated with one of the major groupings up to 1995. These changes do not reflect decreasing concentration in particular sectors of the economy. And the decline has been arrested in recent years. The opening up of the economy through trade liberalisation has in fact seen increased concentration within many sectors. This is a result of consolidation, with inefficient firms closing down or being taken over, and of a closer focus by companies on their core activities. Economies of scale arguments in the context of international competitiveness have also been used in several sectors to support mergers and acquisitions.

[1] 1996 Manufacturing Census, *Statistics South Africa.*
[2] BHP Billiton alone accounted for 7.1 per cent of JSE capitalisation in 2002. SAB Miller accounted for 4.1 per cent and Sappi for 1.8 per cent. Evidently the value of these companies also reflects the big international mergers of SAB with Miller and Billiton with BHP.

The Anglo American Corporation remains by far the most important corporate grouping. While the market capitalisation of listed entities under its control declined in the second half of the 1990s as it underwent an extensive programme of unbundling, consolidation within core focus areas has led to the share increasing once more to reach 25 per cent in November 2002. It should be noted that the share of Anglo American also reflects its extensive international holdings, and therefore overstates its control of activity in the South African economy.

Changes in the shares of the smaller conglomerates shares also do not represent as important shifts as it may seem at first sight. For example, the fall in the share of Sanlam is due to primary control of Gencor and Impala Plats being identified in 2003 as resting with Remgro. But, both Sanlam and Remgro have held significant stakes in these firms and continue to do so. The implication is rather that there are strong links between these groupings which represents continuity rather than change.

The orientation of the main conglomerate groupings and their linkages with mining are still central to the development path of the South African economy. Some remain largely in the control of a small number of families. The extent of control over economic activity exercised by such a small number of organisations in South Africa was one of the main reasons for the prominence of competition policy in the ANC's economic programme as set out in the *Reconstruction and Development Programme* of 1994.

The evolution of South African Capitalism

In order to establish a framework for understanding the evolution of the South African capitalist model(s), it is important to first give an overview of the South African economy.

Corporate ownership and control in the South African economy was highly concentrated in the conglomerate groupings that dominated activity in mining, manufacturing and financial sectors (Fine and Rustomjee, 1996). These conglomerates played a crucial role in shaping the development path of the South African economy. More significantly, they had special linkages with the mining sector. Fine and Rustomjee argue that initially they dominated activities in mining and subsequently extended and broadened their control over all the other productive sectors including the financial sector. Mining has always been an important branch of the economy. In particular, gold had for a long time been the main driver of activities in this sector, but by 1994 the economy's dependence on gold had shifted to include a broader range of minerals in which one or more of the conglomerates controlled the production of each mineral. Coal and platinum are also of great importance.

Conglomerate control and dominance also extended into the manufacturing sector. It encompassed activities immediately downstream of the mining industry including mineral processing and chemical production. Industries that produced the key inputs for these sectors, particularly metals and engineering industries, were also characterized by conglomerate domination together with state-owned production (for example, Iscor). There were also close links with the financial sector. This served to reproduce and further extend conglomerate control of the other productive sectors.

However, it is important to note that the conglomerate control of the South African economy was not a new phenomenon. Rather, the corporate structure of the South African economy was typical of modern capitalism. The only significant difference was that the degree of concentration in South Africa was more acute than in other developing countries.

Another dimension of the South African economy was the state's role in fostering industrialization and shaping the development patterns in the country. State ownership and control of industry represented a small fraction compared to private capital. But, state ownership was particularly concentrated in sectors associated with minerals and energy. Clark (1994) argues that the state's involvement in the economy was one of the major tenets of the apartheid state. He argues that the state established corporations primarily to enhance government ownership and control of the key sectors of the economy. However, by 1994, the government had already initiated, and was in the process of implementing a privatisation programme that was driven by the government's need to reduce its spending and also promote efficiency in parastatals.

The conglomerate structures were similar to Chandler's characterisation of 'personal capitalism', with a relatively low level of evolution of managerial structures and with relationships between the groups characterised by co-operation and some contestation for position, but only a relatively low level of competition (Chandler et al., 1997). It can also be argued that there were elements of state entrepreneurial capitalism such as prevalent in South Korea after World War Two but obviously exploitative and to serve apartheid priorities.

Personal capitalism, Chandler argues (based on the British experience), was partly associated with continuing prominence of family owned firms. Several of the big conglomerates that dominate the South African economy have had very strong family control. For example, the Oppenheimer family controlled Anglo American, which was by far the most important corporate grouping in the country. Similarly, the Rupert and Hertzog families control the Rembrandt Group.

Amsden (1997b) uses the Chandler framework to describe a model of 'state entrepreneurial capitalism' based on the case of South Korea. She argues that in this model the government uses its power and patronage of the state apparatus to promote systematic capital accumulation. Among other things the government provides subsides, such as preferential credit and protection from foreign imports and investment. Political loyalty was a necessary condition for receiving lucrative incentives. But, rivalry between corporations was also actively promoted.

The capitalist model operational to 1994 combined elements of the personal and state entrepreneurial models. The government played a very active role in aiding Afrikaner capital, including Afrikaner conglomerates after 1948, while the English mining companies were strongly family-oriented. The National Party's industrial development policies used the state apparatus to strengthen Afrikaner industry in a process of contestation, and ultimately accommodation. Similarly, the government's prioritisation of state-owned enterprises was meant to entrench industrialization on Afrikaner terms and subsequently further the interests of the Afrikaner ethnic group. Clearly, this capitalist model was determined by Afrikaner nationalism.

Regarding the participation of the black entrepreneurs in the South African capitalist economy, their activities were severely handicapped and at times blocked by racial barriers directly erected by the apartheid state to protect the interests of the local ruling white bourgeoisie. Despite the fact that capitalism in South Africa had developed the forces of production to a level higher than anywhere else on the continent, the African business class remained relatively more backward than in the large majority of African territories. Their activities were only limited to the small retail industry in the townships, where they owned small retail outlets, and the taxi industry.

3. Changing patterns of industrial and corporate structure

As would be expected for a developing economy, the shares of sectors such as financial services and transport & communications have grown since 1994 (Figures 1 and 2). The share of manufacturing has in fact fallen over the period, while the share of mining in 2002 at 8 per cent of GDP was the same as in 1994. In terms of the returns from production going to capital and labour for the economy as a whole, the share of profit (as measured by gross operating surplus) has increased from 40 per cent of value added in 1994 to 49 per cent in 2002.

Figure 1. Shares in GDP, 1994

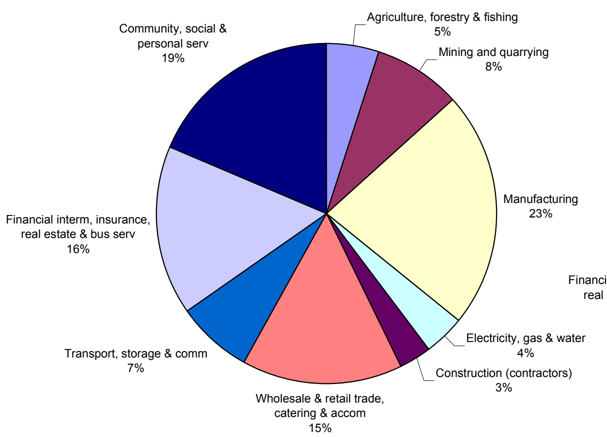
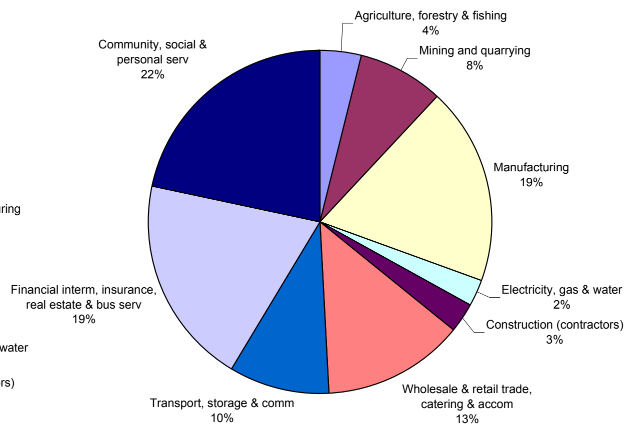


Figure 2. Shares in GDP, 2002



Source: South African Reserve Bank

Compounding the significance of mining, several heavy industrial sectors related to minerals processing have also increased their significance in manufacturing. The share of basic iron & steel has increased from 6.6 to 7.2 per cent of manufacturing output (from 1994 to 2001), the share of non-ferrous metals is also up from 2.2 to 3.6 per cent while the share of basic chemicals (largely produced by Sasol) has increased from 4.2 per cent in 1994 to 5.4 per cent in 2001.

But, is manufacturing industry more diversified overall? Using the Herfindahl-Hirschman Index to measure concentration across manufacturing sub-sectors reveals no change from 1996 to 2001, whether in terms of employment or value-added.[3] The significance of upstream heavy industry has changed little relative to manufacturing as a whole in terms of output or value-added. Sectors such as iron & steel and basic chemicals have, however, tended to shed labour at a more rapid rate. And, sectors such as plastics, other chemicals and motor vehicles have achieved growth rates higher than the average. Rather than assess data on the economic performance at the

[3] This is based on calculation of the sum of the squares of the shares of different subsectors in total manufacturing value-added and employment.

sectoral level, we now focus on ownership and control to understand the ways in which industrial structure has evolved.

3.1 Overview of changes in ownership and control since 1994

In recent years there has been a process of corporate restructuring, reflected in a significant increase in merger activity in the late 1990s. This has meant major changes in the rankings of listed companies, as reflected by market capitalisation, while at the same time the major conglomerate groupings have continued to dominate overall. Of the top 100 listed companies in 2002, 42 were not in the top 100 in 1998 (see Appendix Table 1). This suggests a dynamic corporate environment, in terms of both organic growth and acquisitions, which appears at odds with the entrenched positions of the major conglomerates. Closer analysis reveals a mixture of processes at work:

- The rise of firms in sectors which are growing in significance, such as telecommunications, services, finance, retail and healthcare which accounts for the rise of companies such as M-Cell, Venfin, Netcare, Afrox, Bidvest, Comparex, Aspen, Datatec, Copi, Mediclinic, Ahealth, Pick-n-Pay, Massmart, Truworths, Kersaf, Alexander Forbes, NAC and Abil.
- Listing of companies such as Old Mutual and Sanlam (following their demutualisation).
- Restructuring of conglomerates: Liberty, Anglo and Gencor to create separate companies of their different divisions such as Billiton; the unbundling of Iscor to create Kumba.

If we examine the largest fifty industrials (including mining) fewer changes are evident, however, it also suggests quite a dynamic environment (Appendix Table 2). Since 1998 only six companies have retained top 10 positions. Anglo American remains the biggest grouping with market capitalization of R291.7 billion. The ranking also indicates the relative strength in mining and resources stocks. Mining groups still dominate the top 20 industrials with 9 firms. Companies that managed to enter the top 10 brackets since 1994 are all in the mining groups with the exception of Sappi, the paper and pulp manufacturer. It is evident that industrials sectors are concentrated in companies that are directly or indirectly in the resource stocks sectors with the exception of only few companies. A weaker rand since 2000 has also contributed to an increase in market capitalization and improved rankings of mining groups.

Much of the change in rankings of industrials and mining reflects unbundling and rebundling deals rather than dynamism as a result of greater rivalry and less concentration. In the top 10 companies, Billiton made the biggest move, up 4 places since 1998 to occupy second spot with a market capitalization of R149.6 billion in 2002 as a result of the merger between BHP to create the world’s biggest mining company. Richemont, which moved a place up, and Angloplat occupy the third and fourth spots respectively. Sasol, which completes the top 5 positions, moved two places up to number 5 in 2002 from 7 in 1994. Sasol has more than doubled its market capitalization since 1998 and this can be attributed to weaker rand since 2000, which resulted in higher crude oil prices.

Over the top 50, there are major industrial groupings in food and beverages, metals, engineering and construction, electronics, packaging, and chemicals. Big upward movers have also been in mining, such as Harmony, Gencor, Implats and Assmang. Other, non-mining, companies moving up strongly over the period are Barworld, Bidvest, Imperial, ABI, Illovo, Distell, JD Group, Reunert, Delta and Altech. This compares with declines for TigerBrands, Johnnic, Iscor, AECI, Kersaf, AVI, PPC.

The major patterns in mergers are now analysed in more detail.

3.2 Mergers and acquisitions

Despite the boom in international merger activity towards the end of the 1990s, studies suggest a high degree of scepticism should be employed when evaluating the supposed economic gains from mergers and acquisitions. Most studies find reduced profitability after mergers or at best no change (see, for example, Singh, 2002, and Gugler et al. 2002). The study by Gugler et al. found that no more than a quarter of mergers appear to increase efficiency, while a quarter increase profits by increasing the market power of the firms involved. Approximately half of all mergers fail in the sense that they trade-off increased sales for lower profits, or experience both lower profits and sales. The increase in M&A activity in South Africa in the 1990s, however, is also due to particular, South African specific, influences.

Mergers and acquisitions increased dramatically from 1994 to a peak of 1019 deals in 1998 (including those where the values are not disclosed) (Table 2). A small number of very large deals meant that the value of transactions continued to increase to a high of R502.4bn in 2001. This largely reflected the R223.2bn merger of Billiton and BHP and the R153.7bn restructuring and delisting of De Beers, both in 2001.

Table 2. Number of deals by size (where values were disclosed)

Size of deal	1994	1995	1996	1997	1998	1999	2000	2001	2002
>R1bn	4	5	18	35	48	42	52	24	36
>R500m	0	5	7	17	34	20	46	33	28
>R100m	22	24	48	93	142	148	112	118	118
>R50m	15	30	48	80	85	61	71	62	51
>R10m	51	70	101	169	186	184	150	149	125
<R10m	44	50	54	91	110	113	131	124	120
Total number	136	184	276	485	605	568	562	510	478
Total value (Rbn)		43.5	62.3	166.2	314.7	231.6	372.3	502.4	242.4
No value disclosed (no. of deals)			*247*	*193*	*414*	*346*	*440*	*387*	*305*

Source: Ernst & Young (various years)

Taking these deals into account, the main period of activity occurred in the late 1990s. While this coincided with an international boom in merger activity, the South African activity appears more closely related to major changes in the orientation and strategy of the major conglomerates.

A close examination of the pattern of activity reveals quite different types of deals and influences on activity. Changes in the importance of these influences enable identification of distinct phases in the evolving corporate structure. Broadly, the period since 1994 has been dominated by:

- conglomerate unbundling and restructuring;
- consolidation within sectors by conglomerates as part of ensuring stronger focus and better strategic direction, which has also increased concentration;
- internationalisation – mainly outward, by firms which have moved their primary listing overseas, and foreign acquisitions by South African listed firms; and
- black economic empowerment deals, first, through special purpose vehicles for financing and second, more recently, in areas where government policy has provided a specific impetus.

The importance of these patterns are evident from a review of activity.[4]

The major unbundling was started by Gencor from 1993 when it disposed of a range of non-mining assets and created Billiton. These processes represented a fundamental shift in the managerial mindset of South Africa's richest individuals and the corporates they controlled. The change was promoted by the realisation that the complex cross-holdings and pyramid ownership structures reinforced control of the main families through different levels of the conglomerates, but that they did not promote effective management of the different entities in the interests of profit maximisation. This meant that many were trading significantly below their net asset value. While Gencor embraced the unbundling rationale, according to Ernst & Young Anglo-American's directors (who largely represented the family, 'old boys club' approach to the firm) resisted for some years.

The second and related dimension to unbundling which ultimately pushed firms such as Anglo in that direction was a strategic goal to internationalise operations. It is important to recognise that despite sanctions conglomerates had substantial international operations already. Anglo-American's Luxembourg-registered Minorco held a range of assets for the Oppenheimer family valued at US$5.2bn[5] in 1997 (more than a third of the size of the Anglo-American Corporation), while the Rupert and Hertzog families owned Swiss-registered Richemont. But, the aim of becoming global players ultimately meant listing on the London Stock Exchange and submitting to

[4] This review draws on information from the annual publication by Ernst & Young, *Mergers and Acquisitions*.
[5] Data obtained from the *Financial Times* Extel data source.

both the rules of the LSE on ownership structures and the expectations of international shareholders.

The majority of unbundling (and related ‘rebundling’ or consolidation within sectors) ran until 1999 and the UK listings of Old Mutual, SAB and Anglo-American, joining the already-listed Billiton and Liberty International Holdings. In 1999 there were 60 deals classified by Ernst & Young (2000) as unbundling, accounting for R80bn compared with 40 deals in 1998 and 17 deals in 1997. By 2001, mergers and acquisitions had fallen sharply, especially if one takes into account that two deals (BHP-Billiton merger and the De Beers delisting) accounted for 75 per cent of the recorded value in that year.

The unbundling essentially meant a separation of the mining, industrials and finance activities of conglomerates, which had become so intertwined following the divestment of foreign companies such as Barclays Bank in the late 1970s and 1980s. In a sense, therefore, the opening up of the ownership structures and internationalisation has resulted in the rise in importance of mining once more, especially when coupled with the growing significance of platinum. By 2001, Ernst & Young (2002) found that resources firms accounted for 53 per cent of capitalisation of the JSE and financial services for 17 per cent, while two years previously each of these sectors had accounted for 33 per cent.

Unbundling can be identified at two levels. At the first, the conglomerates separated their major activities and broke-down the web of cross-holdings. Examples of this are the combination of Anglo’s gold interest in Anglogold, the merging of Anglo’s interests in financial services (notably in FNB) with RMB to form FirstRand, the de-listing of AMIC and Samancor, and the sale of interests in AECI, Bevcon and SAB. It also includes the separation of Anglovaal into AVI, Avmin and Avgold, and Liberty’s unbundling of interests in Bevcon, SAB, Edgars, Metro Cash, Adcock-Ingram and Premier.

At the second level, unbundling and restructuring has taken place within sectors with the break up of holding companies. This includes the unbundling by Malbak in 1997 of interests in Ellerines, Foodcorp, New Clicks, and South African Druggists. It also applies to the sale by Premier of non-core assets in MetroCash, Adcock Ingram and Millenium entertainment in 1998, and the sales by CG Smith of Tiger Oats, Illovo Sugar and Nampak in 1999. Ultimately, Bevcon, Premier, Malbak and CG Smith were all wound up and/or delisted.

Of the mergers of related businesses (the ‘rebundling’), the competition authorities have only blocked the most obvious. These include the planned mergers of Adcock Ingram and SA Druggists, AECI with Sasol, Joshua Doore with Ellerines, and Mondi’s acquisition of Kohler Cores & Tubes. Many mergers where firms are in related but not identical markets have been allowed, while restructuring itself has been accepted as a rationale for several mergers to be passed.

Examples of such mergers and acquisitions include Trident-Baldwins, Iscor-Saldanha, Nampak-Malbak, Aspen-SAD, and SAB-Rheem. As analysed below, the competition authorities have, however, increasingly taken a more sceptical view of vertical mergers.

Throughout the period there has been an ongoing process of outward internationalisation by South African companies. Two complementary processes must be distinguished in this – the primary listing of companies in the UK (Billiton, SAB, Anglo American, Liberty International, Didata and Old Mutual) and the series of acquisitions undertaken by South African firms. SAB and Billiton made a series of international acquisitions along with their UK listing before each merged with another major multinational. In Billiton's case the merger with BHP meant its listing moved to Australia (at the insistence of the Australian government) and the recent dismissal of its South African head, Brian Gilbertson, while the SAB-Miller merger meant the tobacco and beverages multinational Philip Morris took control. It makes little sense to view either of these firms as South Africa anymore. For example, SAB-Miller is the world's second largest brewer with interests in Rumania, China, Poland, the Czech Republic, UK, USA, Zambia, Tanzania, Mozambique and various South American countries.

International acquisitions include the six firms with primary international listings (as well as Investec with a dual listing) but also many other firms. For example, Sappi has interests on several continents, Pick'n Pay and Shoprite have bought chains in other countries, Sasol has made major international acquisitions and joint venture arrangements, as have a host of other companies such as Murray & Roberts, Barlows, Sage and Pepkor. Relatively few of these acquisitions have been in other African countries, although the expansion of South African firms across Africa has accelerated in recent years, particularly in sectors such as financial services and retail.

Inward investment in the form of M&A has fallen short of outward investment since 1998. However, there have been important deals in major sectors. These include acquisitions by major auto firms such as Toyota of the South African operations, acquisitions in chemicals by US multinational Dow of Sentrachem and Safripol, Parmalat's acquisition of Bonnita in 1998, Lafarge cement's purchase of Blue Circle from Murray & Roberts, and the acquisitions by German venture capitalist Claas Daun of close to half the capacity of the South African textiles industry (along with major interests in clothing, leather and furniture. The South African steel industry is now also effectively controlled by foreign multinationals with the acquisitions of 47 per cent of Iscor by LNM and Acerinox's ownership of Columbus Stainless Steel.

Together with the internationalisation of South African conglomerates these developments make the South African economy one of the most internationalised in the world. The implications of this are discussed further below.

The final major factor is that of increasing black ownership and control. This is discussed in more detail in section 3.3 below. But, it is worth noting that the first wave of BEE transactions essentially involved black ownership of assets using finance provided by the major institutions, sometimes to acquire assets which they had decided to unbundle in any case. Many of these deals became unwound when share prices failed to increase as had been expected (or fell sharply in some cases), and black ownership fell in 1998 and 1999 (Table 1). The second wave is more focused on specific sectors.

These developments imply that, while there has been a lessening in the concentration of ownership in the economy as a whole, there has been increasing concentration in many sectors. This is consistent with consolidation to improve companies' strategic positioning and market power, as well as factors such as achieving greater scale economies.

On the surface, the changes appear to represent a break with the past. But, many of the underlying reasons for the changes are strong threads of continuity in the basic sense that while conglomerate restructuring has been stimulated by the increasing openness of the South African economy, these changes are consistent with the conglomerates' evolving interests. Similarly, although the participation of black-owned corporate groupings does reduce concentration it can be argued that the limited and gradual nature of the extension of black ownership reflects the enduring influence of the conglomerates in adapting to the political changes. The established conglomerate groupings have been able to largely achieve a rebalancing of ownership on their own terms and to pursue their own objectives of restructuring and refocusing control, and shifting the location of ownership to international financial centres such as London.

3.3 The main conglomerates – restructuring and adaptation

The most important process of conglomerate restructuring is undoubtedly that of Anglo American due to its shear size (outlined below). Different paths have been followed by the other groupings. In many ways the trail was blazed by Gencor in creating Billiton which has become one of the world's biggest resources groups and with diminishing ties to South Africa. Old Mutual has also become a major international player, in financial services, with a series of acquisitions in the UK and its primary London listing.

By comparison Rembrandt (now Remgro) has retained extensive holdings in different sectors and remains controlled by the Rupert and Hertzog families. It has undergone a rationalisation in 2000 to simplify its control structure, including the separate listing of Venfin (a major shareholder in Vodacom) but retains interests in a wide range of sectors such as mining, health, beverages, finance, metal products, packaging, and food products. It also has major shareholdings in FirstRand, ABSA and Sage.

There are also still close linkages between Remgro, Sanlam and Old Mutual, principally through their interests in banking and financial services. Sanlam and Remgro have significant shareholdings in ABSA, and Old Mutual and Sanlam have stakes in Standard Bank. Nedcor's principle shareholder is Old Mutual, while Remgro is the major shareholder in First Rand. With the demise of the smaller banks, BoE, Saambou and PSG, and their acquisition by the big four banks, the financial sector remains highly concentrated and barriers to entry are, if anything, higher than before. This is not to argue that there is not contestation such as Nedcor's hostile bid for Standard Bank

Rembrandt Group

By far the most successful private Afrikaner company in South Africa, the origins of Rembrandt Group date back to the 1940s when the tobacco company Voorbrand, forerunner of Rembrandt Group Limited (Rembrandt) was started by Dr Anton Rupert (Fine and Rustomjee, 1996).

With the help of the Nationalist government, Rembrandt entered the South African cigarette and tobacco industry in 1948 and in the fifties expanded abroad through the establishment of various international partnerships. In 1972, the overseas tobacco interests of Rembrandt were consolidated in Rothmans International, which was listed on the London Stock Exchange. The further separation of local and overseas interests were effected in 1988 with the founding of Compagnie Financière Richemont AG (Richemont) – a Swiss-listed luxury goods group which also holds strategic investments in tobacco and direct retailing. Since the 1970s Rembrandt expanded its interests outside tobacco, wine and spirits with investments in various other economic sectors in South Africa, amongst which were banking and financial services, mining, cellular communication, printing and packaging, medical services, engineering and food interests (Remgro, 2003).

In 1995, Rembrandt and Richemont further consolidated their respective tobacco interests in Rothmans International, at the time the world's fourth largest cigarette manufacturer, which was then delisted, and then in 1999 merged these interests with those of British American Tobacco plc (BAT), the world's second largest cigarette producer. The investment in BAT is held through a joint holding company, R&R Holdings (Luxembourg), in which Rembrandt (now Remgro) and Richemont hold 33⅓ per cent and 66⅔ per cent respectively. The restructuring of Rembrandt was advanced a step further in September 2000 when the South African pyramid holding structure, consisting of four listed companies, was replaced by two listed companies only, namely Remgro Limited and VenFin Limited. Today, Remgro represents Rembrandt's established interests in tobacco; financial services, mining and industry, while the telecommunication and technology interests are accommodated in VenFin (Remgro, 2003).

Rembrandt (through Remgro, Venfin and Richemont) is most probably the biggest family-controlled business in South Africa. The Rupert and Hertzog families through their controlling stake have mananged to establish their presence in almost every sector of the economy. They control companies as diverse as Dorbyl, Rainbow Chickens, Total SA, Medi-Clinic and Transvaal Sugar while also having interests in ABSA, Nampak, FirstRand, British American Tobacco and Gencor.

Sanlam

When Sanlam was established in 1918, the company's goal was solely the economic empowerment of the Afrikaner and Sanlam along with Volkskas were without any doubt, the prime beneficiaries of the centralisation of capital aimed at by the state–led economic movement (Fine and Rustomjee, 1996). Sanlam serves as a major provider of life insurance, retirement annuities, savings products, unit trusts and trust services. From the early 1990's, as SA began to re-join the global economy, Sankorp began unbundling in order to unlock value in their non-financial interests. The company refocused on Sanlam's core business of financial services. While unbundling, Sankorp made headlines by forming New Africa Investments Limited (NAIL), a black empowerment project involving Metropolitan Life. This was one of the first BEE deals made in post-apartheid South Africa (Sanlam, 2003). McGregor's (2003) states Sanlam as being under the control of institutions, directors and the Public Investment Commissioner. Sanlam's main investments include a 23 per cent stake in ABSA, a 50 per cent share in SAFAIR as well as a controlling stake of 52.5 per cent in Santam.

Liberty Life

In 1958 Donald Gordon founded the Liberty Life Group in South Africa providing life insurance and products linked to equities and property. Liberty Life, was seen as English capital thus standing in opposition to the policy of Afrikaner economic empowerment followed by the state (Fine and Rustomjee, 1996). Liberty International plc was formed in 1980, initially as a listed subsidiary of Liberty Life. The Liberty Life Group, like its counterparts has also gone through a series of transactions aimed at restructuring and refocusing group interests. As it stands now, Liberty Group is effectively controlled by Stanbic, both directly and through Liberty Holdings. Liberty International plc, which is listed on the London Stock Exchange, is controlled by the Donald Gordon Family. With the unbundling, Liberty in recent times has fallen down the ranks of the top 100 listed firms. From a joint position of fourth in 1994 and 1998, Liberty International and the locally based Liberty Group now list 17th and 23rd respectively on the Financial Mail's Top 100 Companies of June 2002 (Financial Mail, 2002).

Old Mutual

Old Mutual, one of South Africa's oldest companies, started as SA Mutual in 1845. Old Mutual plc was listed on the London Stock Exchange in July 1999 and as it stands now is almost entirely owned by American and British banks. Old Mutual plc serves as the holding company of the Old

Mutual Group of companies, whose principal activities include life assurance, asset management, banking and general insurance (including 51 per cent of Nedcor). It also owns shares in AAC, Remgro, Sanlam and Liberty Group. And, it has extensive industrial interests with controlling stakes in companies as diverse as Barloworld, Nampak, and Murray & Roberts

Anglo-American

It is difficult to over-estimate the significance of the Anglo American Corporation (AAC) to the South African economy. It has dominated mining and much of industry for close to a century and was important enough for the National Party government to launch a Commission of Inquiry into its activities in 1964. Examples of companies linked with Anglo American included Toyota SA, SAB, Times Media, Caxton, Tongaat-Hulett, Mondi, FNB Holdings, Premier Group, AECI, Lion Match, OK Bazaars and Boart-Longyear.

In 1994 its activities stretched into almost every area of the economy as it had grown into a sprawling grouping with complex cross shareholdings between subsidiaries in a huge pyramid structure which collectively accounted for 43.3 per cent of the JSE's market capitalisation. The Oppenheimer family only directly owned 8.1 per cent but had ultimate control due to the structure of ownership. For example, De Beers Consolidated owned 38.6 per cent of AAC and 10 per cent of the Anglo-American Investment Trust, but De Beers was in turn controlled by Anglo through AAC's 29.4 per cent stake in De Beers Centenary, while the Anglo-American Investment Trust (52 per cent owned by AAC) owned a further 25.8 per cent directly of De Beers Consolidated and 23.4 per cent of De Beers Centenary. Further down the pyramid, 30 per cent of Mondi Paper Company was owned by AAC, but a further 17 per cent owned by De Beers and 53 per cent by AMIC (itself 49.9 per cent owned by AAC and 26.7 per cent by De Beers). At the level of financial institutions, First National Bank Holdings (originally Barclays Bank of South Africa) was 20 per cent owned by AAC and 24.8 per cent by Southern Life, while FNB Holdings itself owned 29.7 per cent of Southern Life in whom AAC also directly had a 40 per cent stake. These structures were similar at all layers, as well as existing between the major conglomerates at different levels (for example, the holdings of Liberty Life and JCI in South African Breweries through Beverage & Consumer Industry Holdings Ltd).

The linkages were also emphasised by the extent to which Directors and Chief Executives overlapped. For example, in 1997 Mr J. Ogilvie Thompson was Chairman of Minorco, AAC and Anglo-American Investment Trust, and Mr N. Oppenheimer was an executive deputy chairman of AAC and on the Boards of AAIT and Minorco (and was later appointed as head of De Beers). A narrow focus on ownership would therefore miss the control and co-ordination structures, while measuring concentration within each sector using firms' market shares does not reveal the level of concentration in the control over industrial production economy wide.

It has long been international in reach, and has at times been the world's biggest gold, platinum and diamond producer. It has also run the world's most successful global cartel in the form of the De Beers Central Selling Organisation. Through Luxembourg registered Minorco it controlled a range of international minerals and forestry assets.

Simply due to its size, the restructuring of AAC has been the most significant process of change in the corporate structure of South Africa. From the initial unbundling of JCI in 1995 to the listing on the London Stock Exchange in 1999 and the final sale of its holding in SAB in 2002 it represents a major change in control in many industrial sectors. But, as emphasised above, it does not necessarily mean that concentration within sectors has lessened. AAC has clearly made a decision to focus in a number of core areas and has rationalised its ownership structure, removing many of the holding companies. It is now clearly a global mining house with interests mainly in gold, platinum and coal, but also has major operations in forestry, paper and pulp, as well as in iron and steel.

Some of the major developments are:

- Unbundling of JCI, to separate Anglo American Platinum (Amplats) in 1995.
- The merging of gold interests under AngloGold in 1997 and the restructuring of platinum holdings under Amplats in the same year.
- In 1998, Anglo merged its financial service interests of FNB and Southern Life with RMB to create FirstRand and then swapped its 15.3 per cent stake with Rembrandt for 7.1 per cent of Billiton and 11.3 per cent of Goldfields in 2000.
- After merging with Minorco in 1998, AAC listed on the London Stock Exchange in 1999.
- The de-listing of De Beers and the breaking of the AAC-De Beers cross-holdings in 2001, which meant the Oppenheimer's essentially having control of De Beers, but reducing their stake in AAC to 5.1 per cent and to a large extent losing control of AAC.
- Diversified industrial interests were unbundled, including AECI and Bevcon (with holdings in SAB)
- It looked set to take control of South Africa's main iron ore deposits through acquisition of stakes in Kumba and Avmin in 2002, but has withdrawn from Avmin following prolonged proceedings of the Competition Tribunal and Appeal Court.
- International acquisitions in minerals such as Colombia's Cervejon Centrale Coal and Cerrejon Zona Norte, Australia's Shell Coal, Chilean copper mines Empresa Minera de Mantos Blancos and Disputada, Australia's Acacia Resources and nickel producer, Anaconda
- International acquisitions in paper and pulp such as interests in Brazilian firm Aracruz Cellulose, Russian firm Syktyvkar Forest Enterprise, and French packaging firm La Rochette.

- Construction materials and aggregates in Europe include the UK's Tarmac and Spain's Mavike.
- While there has been talk of consolidation between Iscor and Highveld Steel and Vanadium (and Anglo's exit from steel), AAC's Scaw metals has operations in Chile, Peru, the Philippines, Canada, Australia and Italy.

Implications of restructuring and internationalisation

Both the international listings and the rationalisation of control structures suggest a stronger focus by conglomerates on performance and the share price. The focus on core operations also implies better monitoring of top management performance exemplified by hard-nosed chief executives such as Tony Trahar of AAC, as opposed to appointments from a narrow family circle. International shareholders will not accept trading at significant discount to a firms' net asset value for long periods of time.

While the change in orientation has been part of the international growth of formerly South African firms, it also suggests short-term profit maximisation which, taking into account greater concentration in sectors, means firms will be quicker and more effective at reaping the returns from their market power. The changing orientation also means that firms may adopt a higher threshold for investment. Shareholders are not going to be willing to see capital spent unless the returns in a relatively short-run period match up to the opportunity cost of capital.

It is accepted that the location of a company's head office is significant as it is an important indicator of, and influence on, their focus and strategic thinking. The Australian government's requirement for the BHP-Billiton merger that the firm's head office be moved to Australia is a sharp illustration of the value placed on location. The overseas listings of South African firms were justified on the grounds that firms would be better able to raise capital on international financial markets thus providing greater resources for investment in South Africa. This has not been the case with greater outflows than inflows of investment associated with the major firms since 1998, as well as the remittance of profits made in South Africa to foreign shareholders. The Rand is also one of the world's most traded currencies due mainly to very volatile portfolio capital flows. This is partly due to the dual listings and internationalisation of firms (which is not limited to the major conglomerates – Sasol's shares are now mainly held by US institutions).

The overseas listings also mean a weakening of the influence of government. Foreign listed firms are less likely to support corporate taxation in the interests of increased local expenditure on improved infrastructure. Foreign firms have much less interest in a national development project such as that being undertaken by South Africa.

As already noted, the unbundling process does not in itself decrease concentration within sectors and may increase it. The oligopolistic nature of most industries in South Africa has also been built on a range of institutional linkages such as the informal market-sharing agreements reported in many sub-sectors, for example chemicals (Crompton, 1995). Such understandings developed over time and nurtured by close personal ties which undoubtedly characterise the small group from which chief executives are drawn are difficult to measure but nevertheless significant. Information and trust are two of the most important requirements of collusion. While new entrants into sectors may have a major impact on the degree of rivalry and contestation in a sector, the barriers to entry are formidable as a result of the concentration and formal and informal links between incumbents, as well as the increasing vertical integration which has been one of the outcomes of conglomerate restructuring.

3.4 Competition and concentration – causes and effects

There has been a long running debate in the South African economic literature as to whether high levels of concentration have resulted in monopoly profits being attained. The findings by Fourie (for example, Fourie, 1996) and various collaborators suggest that profits have been associated with concentration, which broadly confirms the structure-conduct-performance paradigm. Leach (1992a and b) has critiqued such an approach and argued that higher profits reflect the efficiency of firms. In this framework, associated with Chicago economists, more efficient firms grow to become dominant in an industry. This appears difficult to sustain if one takes into account most work on the efficiency of South African firms which does not find them to be particularly efficient. Recent work by Fedderke et al. compares mark-ups in South Africa with the USA (Fedderke, 2003). They find that mark-ups are significantly higher in South Africa. But, when intermediate inputs are taken into account South Arican mark-ups are comparable. This type of analysis is bedevilled by difficulties with data, measurement of the cost of capital and assumptions about scale economies.

Economic theory and international literature on firm behaviour indicate that competition should be understood as the degree of rivalry between firms rather than the simple number of competitors. It is this behaviour rather than a static measure of structure which is important for realising the gains from competition. In this regard, the rivalry between the *chaebols* of South Korea, actively encouraged by government through explicit competition for government support measures, has been identified as important in their performance (Khemani, 1994, Amsden and Singh, 1994). One indicator of the dynamism resulting from such rivalry is that the ranking of the top firms has changed dramatically over time, although the share of the top 30 *chaebols* in manufacturing and mining has remained at about one third since the 1980s (Wise, 2000).

In their work on Japan, Sakakibara and Porter (2001) also emphasise the importance of understanding competition as rivalry. Rivalry both disciplines firms and induces dynamic improvements by them. Such effects are applicable to the use of BEE indicators in firms competing for government procurement or mineral rights. Complementing this, Singh (2002) argues for employing a concept of optimal rather than maximum (or 'perfect') competition in developing countries where economies of scale and learning effects often imply a small number of firms in an industry. What is important are influences on their behaviour rather than the simple number of firms.

3.5 Participation and ownership - Black economic empowerment

The notion of BEE can be traced as far back as the Freedom Charter of 1955, which states firstly that "the people shall share in the country's wealth" and that "the land shall be shared among all those who work it". The implementation of the RDP in 1994 provided a framework for addressing BEE. Among other things the RDP was seen as a policy which sought to mobilize all people and the country's resources toward the final eradication of apartheid and the building of a democratic, non-racial and non-sexist future (Pswarayi, 2002). Prior to the implementation of the RDP, workshops were held between representatives from the ANC and black business from 29-31 October 1993 at Mopani Lodge in Kruger National Park. The main elements of Mopani Memorandum of Understanding were that black business should establish mechanisms of co-ordination with the ANC and other relevant parties, affirmative action legislation should be introduced, and a black business caucus should be established in order that black business may make a greater impact on various forums regarding policy formulation. The agreement also called for a review of the leading criteria of state institutions in order to make them more responsive to the needs of black business as well as the restructuring of public corporations and parastatals in order to make them more representative of the South African population.

Following a resolution taken at the BMF National Conference in Stellenbosch in November 1997, the BEECom was formed under the auspices of the Black Business Council in May 1998. The mandate of the Commission was to develop an accelerated National BEE Strategy that would provide concrete recommendations for the future of black business. The BEECom submitted its long-awaited report, the Integrated National BEE Strategy to President Mbeki on 11 April 2001, the emphasis of the report being that our country would not be able to maintain high levels of economic growth without the intervention of the state towards the facilitation of BEE (Pswarayi, 2002).

The Black Economic Empowerment Commission in its report broadly defines black economic empowerment as "an integrated and coherent socio-economic process within the context of the national transformation programme which is aimed at redressing the imbalances of the past by substantially and fairly transferring the ownership, management and control of South Africa's financial and economic resources to the majority of its citizens" (BEECom Report, 2001). The objectives of BEE may also be defined in terms of how the ANC measures the success of BEE as set out in their 2002 conference resolutions. Five indicators are used:

- Ownership
- Operational participation and control within firms
- The transfer of skills to blacks, particularly in senior positions
- The contribution of firms to employment creation; and
- Whether schemes lead to an overall reduction in poverty and income inequality.

Most recently the Department of Trade and Industry has released a document outlining a strategy for BEE. This strategy is underpinned by four key principles, namely that BEE is broad-based; is an inclusive process; is associated with good governance; and is part of South Africa’s growth strategy (DTI, 2003).

Although BEE initiatives have been evident in almost all the sectors of the economy, there are a few that have been especially active, mostly due to government intervention through incentives and legislation. These include mining and services. This section will focus on the mining sector by highlighting a few of the significant developments in recent years, starting with the recent Mining Charter. We then review the rise and demise of JCI as well as the dominance of Mvelaphanda and ARM in recent times.

Due to its historical significance in the economy of South Africa, the mining sector is bound to play an important part in economic transformation. Recently, the introduction of the Mining Charter by government has prompted a flurry of dealmaking in the sector. Apart from its other implications, the Charter may signal a new, more successful path for BEE involvement in the mining sector; a path hopefully different from that of initial attempts made by BEE companies as shown in our example of JCI.

Mining Charter

Parliament passed the Mineral and Petroleum Resources Development Bill to nationalise mineral rights on June 26, 2002. Ownership of minerals has been transferred to the state in order to facilitate black ownership and participation in the mining industry. The Mining Charter sets out specific guidelines for BEE in the mining industry. For example, within 5 years, 15 per cent of each mine’s value to be owned by black empowerment groups and 40 per cent of management is to be black. In 10 years time, blacks should own 26 per cent of local assets and furthermore the mining industry is to help raise a R100 billion fund in order to facilitate this.

As has been the trend, in the last three quarters, government policy has played a significant role in stimulating BEE initiatives in mining, services and finance. The publication of the Minerals Charter, the Money Bill on royalties, the scorecard and the impending Financial Charter in many ways, have played a significant role in prompting BEE activities, especially in mining.

The Money Bill on royalties for mineral rights proposes charging:

- o 8 per cent on diamond sales
- o 3 per cent on gold, silver, and vanadium
- o 4 per cent on platinum group of metals
- o Coal intended for local use would be 1 per cent, as would sandstone, gravel, and clay, sulphur, sodium, ammonium sulphate, anthracite and bitumous coal.
- o Copper, iron, manganese and zinc are rated at 2 per cent and gemstones such as amethysts and sapphires are rated at 5 per cent.

The Bill includes special holding rules for diamonds as well as a range of exemptions and deductions to prevent marginal mines from closing down. The government has also unveiled the mining Black Empowerment scorecard. The scorecard is intended to be used alongside the new mining legislation and provides mining groups with clearly identifiable benchmarks against which to measure their progress. The publication of the scorecard was also meant to reassure investors in mining by bringing clarity to the new dispensation in South Africa.

JCI

African Mining Group, led by Capital Alliance Holdings, made history in 1996 by securing a 34,9% controlling stake in JCI from Anglo American and De Beers, becoming the first black group to control a South African mining house. The consortium included Co-ordinated Network Investments, Thebe Investment Corporation, African Renaissance Holdings, Corridor Development Corporation, Women's Development Bank Investments Holdings, Khotso Investment and Northern Corporate Investment Holdings. The deal was struck at R54.50 per JCI share, 12 per cent above the prevailing market price, placing a total value of R2.9 billion on the acquisition. Shortly afterwards, the deal was renegotiated with Anglo American, after AMG failed to raise the required capital. AMG ended up with an interest just above 11 per cent. While Anglo made the sell-off sound like an altruistic deal motivated by goodwill, the reality was that the consortium, led by Mzi Khumalo ended up paying substantially more per share than the going market rate. This was ironically due to a rival bid from fellow BEE company, New African Investements Limited led by Nthato Motlana and Cyril Ramaphosa. The deal had hardly been concluded when the price of gold experienced a dramatic slide, causing JCI's shares, with 70 per cent of its assets held in gold, to slump to a third of the purchase price. This caused the demise of JCI as a major international mining house just over a year after it came under the control of the black consortium. Mzi Khumalo was forced to resign as CEO, and the company announced it would sell off most of its remaining assets and give the money back to shareholders (Ernst and Young, 1996).

Mining

Lately, there has been some success in BEE initiatives in mining, with two groups, Mvelaphanda Holdings and African Rainbow Minerals (ARM) taking the forefront. In 2002, after a rapid acquisition spree, Mvelaphanda Holdings (Mvela) headed by Tokyo Sexwale, listed on the JSE through a reverse takeover of East Daggafontein in a R630 million deal. This capped a three year run that had begun with the purchase of Gem Diamonds. The listing gave Mvela a 70 per cent stake of East Daggafontein, which has a 57 per cent stake in a joint venture with Impala Platinum to recover platinum group metals in the East Rand. Mvela also controls 22.5 per cent of Northam Platinum. As platinum is not as volatile in the market as gold, Mvela is possibly in a more secure position than ARM (Financial Mail, 2002). In addition to this, Mvela has a number of interesting linkages especially with the Rembrandt Group and its subsidiaries. Examples of this include the financing deal concluded with ABSA Bank as well as the acquisition of 5 per cent of Northam from the Rembrandt Group.

African Rainbow Minerals, which is headed by Patrice Motsepe, gained recognition as an empowerment mining company of note when in November 2001 it was involved in the R2.2 billion acquisition along with Harmony Gold of four gold mining operations from AngloGold. The deal catapulted ARM into the world gold mining rankings, and underscores AngloGold's diminishing exposure to South Africa (Financial Mail, 2002). Recently however, ARM has been branded a sell-out with its merger with Harmony. By selling ARMgold, Patrice Motsepe converts 100 per cent control of a small gold company into a significant minority stake in a much larger company. Although there is little objection to the deal from a business point of view, many have lamented the loss it signifies to the advancement of BEE especially in the mining sector.

Different approaches to BEE

During the first generation of transactions beginning in the early 1990s, empowerment groups tended to follow a conglomerate approach to expansion. For a while the results were impressive, and companies such as Nail, Real Africa Investments and Worldwide Africa Investment Holdings grew from small beginnings to controlling in excess of 10 per cent of the market capitalisation of the JSE. But these companies have been subject to the same factors that have led to the unbundling of conglomerates the world over (Ernst and Young, 1998 and 1999). In the early stages the low levels of initial capital endowment of the black business community hampered empowerment. The result of this was a financing process that was highly geared and often dependant on problematic and complicated corporate structures. Financing consortia or 'special purpose vehicles' were used to compensate for the lack of capital by prospective owners leading to emerging BEE endeavours behaving more like investment funds than enterprises. New black owners were left highly indebted as a result of the global volatility of financial and equity markets in 1997. The Asian stock market crash of 1998 further exposed the weaknesses in this approach and the number of BEE transactions fell sharply (DTI, 2003). Lately, there has been a widespread view that BEE as it has been practised up to now is in intensive care. Since 1999 many of the listed conglomerates have had to restructure, thereby considerably reducing the percentage of the JSE market capitalisation that is black-controlled, but also resulting in focused, operational businesses that are more likely to be sustainable (Ernst and Young, 1998 and 1999).

By 2000, the model for BEE that was increasingly being used was that of the private equity route. This takes the form of a larger equity stake in smaller companies and, importantly, facilitates the most important aspects of empowerment – a direct role in management and appropriate skills transfer. Through a combination of equity and debt, the BEE group secures a major say in the running of the company and is not dependent on the movement in share price. In this way the deal acquires an operational focus – management relies on the business itself rather than the share price to service the debt. The biggest deals in BEE lately have all been unbundlings and reconstructions of the major BEE groups. Real Africa Holdings, Johnnic and New Africa Investments were all active in the M&A market. The dramatic reduction in the black-controlled percentage of the JSE is an indication that the same principles apply to BEE firms as to their counterparts – investors dislike control or pyramid structures and non-voting shares. Such conglomerates have typically traded at deep discounts to the net value of their underlying assets and are therefore ripe for unbundling (Ernst and Young, 2000).

Assessment

Many have argued that economic transformation has not taken place fast enough. BEE initiatives and successes although welcome, have been few and far in between. A way of validating these claims is to examine the progress of BEE by comparing it to similar initiatives. This review looks at two such initiatives, the first being the New Economic Policy of Malaysia introduced in 1970 as well as the growth of Afrikaner capital in South Africa from 1948 onwards.

The government of Malaysia introduced their New Economic Policy in 1970 with the aim of increasing the wealth and economic participation of ethnic Malays, the *Bumiputra*, while at the same time preventing the erosion of the political position that the Malays had already established. Malaysia's economic programme had two main elements: the first was the promotion of full productive employment of Malays as well as an extension of the supply of skilled Malay labour. The second element consisted of the gradual redistribution of assets. The target of the policy was that ethnic Malays should control 30 per cent of the economy by 1990. By 1990, the *Bumiputra* had increased their control of the economy from 2.4 per cent in 1970 to 20.3 per cent. Although not meeting the target, this was a significant increase in ownership given that forieng direct investment was promoted at the same time. More significantly, the incidence of poverty among the Bumiputra decreased from 56.4 per cent in 1970 to 23.8 per cent in 1990 (Rasiah and Shari, 2001). Strong economic growth was experienced and this allowed non-Malays to continue to gain with the New Economic Policy ensuring that all its citizens shared the benefits of economic growth (Thakurdin, 2002).

Looking at the history of the growth of Afrikaner capital, it is interesting to note the rate of change in ownership figures. Ownership in the commercial sector already stood at 25 per cent by 1949, up from 8 per cent in 1939. But, in 1949, Afrikaners just controlled 1 per cent of the mining sector. By 1960, in just eleven years, this figure stood at 22 per cent (Fine and Rustomjee, 1996).

The BEE model currently being followed seems to draw on certain aspects of the empowerment process of both the Bumiputra and the Afrikaners. Mechanisms that stand out are the use of levers from the government in terms of procurement, as well as enabling legislation. The use of pension funds is also prominent in the study of the growth of Afrikaner capital. All in all, the interventionist role of the State in all the cases seems to be a necessary condition for empowerment to progress. In addition, both the examples of empowerment programmes given, the proportion of the 'favoured' groups in relation to the rest of the population was not as significant to that of blacks in South Africa. The Bumiputera represented a very small majority in Malaysia while the Afrikaners in South Africa were a very definite minority of the population. Given the overwhelming majority of black people in the South African population, BEE seems to be progressing very slowly in comparison to the other two examples.

It is all very well to lament the slow progress of BEE but what is more useful is to suggest instruments to achieve the targets set out by government and business. Government in the DTI strategy outlines a number of policy instruments it intends to use in achieving its objectives. The first of these is the introduction of a broad-based BEE Bill into Parliament. The aims of this piece of legislation will be to allow the Minister of Trade and Industry to issue guidelines and codes of good practice on BEE as well as to establish a BEE Advisory Council to advise the President on the implementation of BEE and related matters. The second policy instrument government intends to use is that of regulation. The main regulatory measure that government plans to use is the 'balanced scorecard', which aims to measure progress made in achieving BEE by enterprises and sectors. This scorecard will measure the three core elements of BEE: ownership and control of enterprises and assets, human resources development and employment equity as well as indirect empowerment through preferential procurement and enterprise development. Other policy instruments to be used include the restructuring of state-owned enterprises, preferential procurement by government, institutional support mainly through the BEE Advisory Council and the use of partnerships and charters (DTI, 2003). In pursuing this approach to BEE, government as mentioned before, seems to have drawn on established measures which have been successful in other countries as well as at home.

4. A review of competition legislation and policies, 1994 - 2003

Competition policy is viewed as an increasingly important part of economic policy as economic liberalisation means that greater emphasis is placed on addressing inefficient market outcomes due to imperfect competition and abuse of market power

In South Africa, the high levels of concentration outlined above, and racially skewed ownership, underlay the inclusion of competition policy in the RDP as part of market-oriented mechanisms to increase participation in the economy:

> 'The RDP will introduce strict antitrust legislation to create a more competitive and dynamic business environment. Essential objectives of such legislation are to systematically discourage the system of pyramids where they lead to over-concentration of economic power and interlocking directorships, to abolish anti-competitive practices such as market domination and abuse, and to prevent the exploitation of consumers. Existing state institutions and regulations concerned with competitive policy must be reviewed in accordance with the new antitrust policy. The democratic government should establish a commission to review the structure of economic control and competition and develop efficient and democratic solutions. It must review existing policy in institutions with aim of creating more widely spread control and more effective competition. To that end, it must consider changes in regulation and management in addition to antitrust measures.'

In this section we briefly review the activities of the Competition Board which operated until 1999. We then outline the new Competition Act of 1998 (coming into force in 1999) and the operations of the competition authorities established by it. Through a review of the main cases addressed under the new Act we evaluate the impact of the legislation and the institutions, including through comparisons with other developing countries.

4.1 The Competition Board and competition act of 1979

The Maintenance and Promotion of Competition Act No.96 of 1979 provided for the review of 'acquisitions' which were defined in terms of the effect of a transaction in restricting competition.[6] It also covered restrictive practices and monopoly situations. The Competition Board charged with investigating competition issues was an administrative body without executive authority. It was housed within the Department of Trade and Industry and could make recommendations to the Minister who decided whether to accept or reject them (including on the action to be taken).

[6] The origins of competition legislation in South Africa lie in the Board of Trade and Industry's role at the beginning of the century, through the Board of Trade and Industries Act No.28 of 1923 (Legh, 1994).

The Act did not provide for compulsory notification of proposed mergers or similar transactions. Instead, the Competition Board reacted to complaints and it could also investigate any merger (so defined under the Act) if it wished to do so. As a result firms tended to consult the Board before hand in order to obtain a sense of whether it would formally investigate the proposed transaction, or condone the transaction. These processes could take different forms, from a short meeting to a brief assessment by the Board of information from the parties, which could be followed by a formal consultation with the Acquisitions Committee of the Board. If a case proceeded to the assessment, it was recorded by the Board as a consultation or a preliminary assessment. A formal investigation could then be launched if deemed necessary. There were very few formal investigations and at the most 42 preliminary investigations in one year (Table 3).

Table 3. Acquisition assessments, by the Competition Board

	1993	1994	1995	1996	1997
Preliminary assessments	41 (40)	42 (40)	34 (30)	24 (20)	35 (35)
Consultations	10 (10)	-	2 (2)	- [2]	- [2]
Investigations	3 (2)	3 (2)	3 (1)	6 (4)	2 (1)

Source: Competition Board *Annual Report*, various years.

Notes: [1] Numbers refer to total cases, that is, completed and uncompleted. Numbers in parentheses refer to cases completed in a particular year. This means that the same case may be recorded in two or more years if the investigation was carried over.

[2] In 1996 and 1997 preliminary assessments and consultations are grouped together.

Preliminary assessments are of whether a particular transaction could constitute an acquisition as defined under Act. These assessments normally follow from parties approaching the Board informally, in order to obtain clearance.

Consultations: Section 6(1)(d) of the Act provides that the Board may consult with any interested party in connection with any restrictive practice or monopoly situations which exist or may come into existence, or any acquisition which has been or is being made or proposed. Consultations are formal.

Investigations: Under Section 10(1)(b), the Board may investigate any transaction ("acquisition") whether effected or proposed. Investigations are also formal.

Acquisitions were defined in terms of transactions that had the effect of restricting competition. This was interpreted to limit the Tribunal to horizontal mergers between parties operating in the same market, implying that competition was viewed as the number of firms producing similar products, rather than a description of the behaviour of the firms or their ability to exert market power (which would imply including vertical acquisitions).

Under the Act, the Competition Board had wide-ranging powers to investigate any transaction which fell within the definition. Despite the scope for discretionary action being relatively wide, the Board largely relied on complaints from other parties, or on voluntary notification by the merging parties themselves. A relatively small number of mergers attracted the attention of the Board, and only a very few were assessed in any depth.

There are several possible reasons for the apparent paradox of the small number of investigations given both the wide-ranging powers the Competition Board had for investigating acquisitions and the increase in merger activity discussed above. First, the Competition Board conducted a significant proportion of its work through informal discussions with parties (see, for example, Competition Board, 1998a, p.16 on restrictive practices, and p.21 on assessments of Acquisitions).

In particular, the Preliminary Investigations into Acquisitions involved a mix of formal correspondence and discussions. Second, despite its ability to initiate investigations, in reality the work of the Board was complaints driven. Third, the Competition Board relied in almost all cases on information supplied by the parties. This is clear from the description of its own practice in the Board's Annual Reports, as well as Competition Board reports on formal investigations into restrictive practices and abuses of dominant positions (the SASOL/AECI report discussed below is one example).[7] Fourth, the Board had no effective monitoring capability to ensure that the concerns and conditions expressed in letters of clearance and public rulings were adhered to.

The nature of the formal and informal relationships of the Board with parties, and the norms and conventions which evolved through practice, to a large extent determined outcomes. This is illustrated by the changing practice of the Board in investigations after the appointment of new members to it by the ANC government, as is most evident in the Sasol/AECI and Adcock-Ingram/Pharmacare cases (Reports 68 and 73). These demonstrated the possibility for a stronger line on competition, under the original legislation and resources.

The Competition Board evaluation of the proposed merger of Sasol & AECI

To explore the practice of the Competition Board further, the investigation into the proposed merger of Sasol and AECI (Report No.68) is briefly reviewed. The Report argued that the Board is constrained to areas of activity where the companies are direct competitors and could not, for example, address issues put forward by the Chemicals and Allied Industries Directorate of the DTI which related to the various chemicals supply chains. However, the investigation made reference to market power, which the Report identified as central to merger analysis (p.6).[8] Citing cases in the United States, market power was identified as the ability to raise price above the competitive level, the power to exclude competition, and as a position of economic strength enabling an entity to hinder effective competition in being able to act to an appreciable extent independently of competitors and customers.

This approach was a forerunner of that under the new competition act of 1998. But, the narrow market definition in terms of product groupings did not reflect the broad definition of market power. Such a definition suggests examining products by function or use. As different grades of a chemical may have different uses, there may be even less competition than at first apparent. In addition, the existence of imports of, for example, polyethylene was used as evidence of a contestable market, and the imports reduce the market share of domestic producers, but these imports are of grades not available in South Africa. Where there is vertical integration, products are also often imported and distributed by the major domestic producers themselves, while in

[7] This also partly reflected the low level of information disclosure required by corporate governance legislation in South Africa.
[8] The Report identified the ultimate objective of merger analysis as 'to ascertain whether the merger will enhance market power, or facilitate its exercise, in a manner that will restrict or distort competition', further stating that '[i]n this sense,

fertilizers seasonal effects mean that trade flows reflect demand and supply imbalances over the year, rather than competition.

The presence of imports may also be evidence of the exertion of market power just up to the point where, despite transport costs and other barriers to trade, it becomes worthwhile importing. Evidence of this is provided by differentials between the prices firms charge in export markets and to domestic consumers. The Competition Board found this to be the case in chemicals, with prices in the domestic market based on import-parity pricing. In addition, Sasol admitted competition was greater in coastal areas than in Gauteng.

It is therefore very difficult to separate definition of a market from an understanding of market power, as the market definition should be based on the ability of buyers (or sellers) to choose an alternative source. In this respect, vertical relationships between producers of intermediate products and downstream distributors and manufacturers will impact on the ability of buyers to switch. While the Sasol/AECI investigation attempted to evaluate the market definitions presented by the parties, it still remained restricted to differentiation into product groups in terms of horizontal competition, rather than properly assessing the potential for substitution and the existing production of firms as the outcomes of corporate strategies (including the possible exertion of market power).

Restrictive practices and monopoly situations

In the 1979 Act 'restrictive practices' are defined to encompass 'any agreement, understanding, act or omission, and situation which restricts competition by having or likely to have the effect of *inter alia*, restricting the production or distribution of any commodity, enhancing or maintaining prices, preventing of retarding the introduction of new technology, and preventing or restricting new entrants into any market.' (Competition Board, 1996: 3). This is similar to what is covered in the horizontal and vertical restrictive practice provisions of the new legislation.

The 1979 Act also made provisions to address 'monopoly situations' defined as 'where any person, or two or more persons with a substantial economic connection, control in the Republic or any part thereof, wholly or to a large extent, the class of business in which he or they are engaged in respect of any commodity.' (Competition Board, 1996: 30). This relates more to structure than to conduct but, in practice, the Board addressed monopoly situations alongside investigations into restrictive practices.

The provisions of the Act were quite broad, but it did not specify any practices as *per se* unlawful conduct. All conduct or arrangements had to be investigated to determine if they fell within the legislation, and to identify if they were against the public interest. In restrictive practices, the

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market power and competition can be regarded as the inverse of each other'.

burden of proof lay on the Board to demonstrate that the practice was against the public interest. The burden lay on the parties where there was a monopoly situation.

After investigation and recommendations, the Minister could make a ruling on the ending of the practice or situation, including requiring divestment by companies. If companies did not comply with the ruling they could be subject to criminal prosecution. In practice the Board took on few cases, and the only real results were admission of guilt fines in a few instances. In 1986 a range of generically framed practices were declared unlawful namely: resale price maintenance, horizontal price collusion, horizontal collusion on conditions of supply, market sharing and collusive tendering. Firms had to apply for exemptions, perhaps the best known being the cement cartel. The proposed joint venture between Iscor and MacSteel for the exclusive export of steel through newly formed MacSteel International BV was approved after investigation subject to conditions and continues to this day. Under the conditions Iscor was required not to discriminate between customers in the local market on price or conditions other than justified by volume purchases, and its auditors were required to report annually on these matters to the Competition Board.

While the Competition Board received many complaints and became increasingly active towards the end of its life, its impact effectively depended on the political environment of the day given its position within DTI. The generally close relationship between large firms and the National Party government made it unlikely that major action would be taken against dominant firms. This progressively changed from 1994 with the prohibition of at least two major mergers. The informal nature of its investigations also meant that it is difficult to assess the Board's impact, and enabled firms to lobby to influence its deliberations.

4.2 The Competition Act of 1998

It was widely accepted that the previous competition law and the Competition Board established by it was ineffective (Fourie et al., 1995). Different reasons include the legislative provisions, the institutional framework and capacity, and simply the orientation of the National Party government.

After being on the ANC-led government's policy agenda since 1994 negotiations on a new law were undertaken in earnest in 1998, with the Act coming into force on 1 September 1999. The Act made provisions to establish a Competition Commission with primary responsibility for determining and investigating cases under the Act, and a Competition Tribunal to rule on most cases. A Competition Appeal Court was also to be established.

The negotiation and framing of the Act

Based on a Department of Trade and Industry (DTI) framework document, the principles of reform were negotiated between Government, Business and Labour representatives in the National Economic Development and Labour Council (NEDLAC) during 1998. The government position document clearly articulated the main rationale for new legislation, including the following:

> 'For example, current legislation does not address the extent of concentration of ownership nor market share..' (Executive Summary para.5)
>
> 'The 1979 Act was weakest when it came to addressing the high levels of horizontal market concentration. The Act contained no provisions against monopolisation per se, except in so far as it affected the 'public's interest', as defined by both the Competition Board and the Minister. Divestiture of parts of conglomerates (whether involuntary or voluntary unbundling exercises) was seen only as a penalty, and even then divestiture was extremely difficult to enforce.' (Section 3.3.2, p.16)

It appears as if the difficulty of enforcing measures such as these was, however, accepted in the new Act as well. As will be discussed below, the biggest change from the previous legislative framework is in fact in merger control. The new Act also represented a very significant change in making the institutions independent of government in a legal, rules-based, framework with separation of investigation from adjudication.

The increasing international integration of the South African economy was also a major influence on the negotiation of competition legislation, and on the law that was written.[9] At the same time, international competitiveness is one objective of the competition legislation. In addition, the Business constituency in particular made reference to the imperatives of globalisation, and argued strongly that structural remedies aimed at divestment would harm business confidence, as would measures which allowed discretion and judgement. Any deviation from internationally accepted 'norms' was argued to be damaging for the South African economy under the 'new' international global economic realities, and the dependence on internationalised corporations for future growth. These arguments ignored the particular circumstances of large South African conglomerates, including their historical origins and the various arrangements governing their control. The Labour constituency attempted to address structural concerns and issues of control directly, both in their original position document, and in their subsequent submissions to the NEDLAC forum. Labour also emphasised the need for employment to be taken into account in merger analysis, as was reflected in the Act.

The provisions of the Act itself were based on international experience and were drawn mainly from the examples of Canada, Australia and Germany. The provisions in the legislation addressing

[9] Deliberations were being held during 1998 and 1999 on competition law at the World Trade Organisation and UNCTAD. In addition, the free trade agreement being concluded in 1999 between South Africa and the European Union included a section on competition policy and positive comity (the sharing of information).

conditions specific to South Africa focused on businesses owned or controlled by historically disadvantaged persons (for example, Section 10(3)(b)(ii) of the Competition Act).

The Act deals with two main areas: prohibited practices (covered in Chapter 2 of the Act) and mergers (covered in Chapter 3). The prohibited practices are separated into restrictive practices (further distinguished as horizontal or vertical) and abuse of a dominant position. In Chapter 2 the Act also makes provision for the granting of exemptions to firms. Investigations into prohibited practices are initiated by the registering of a complaint, which may be made by the Competition Commission itself. The Commission then undertakes an investigation and presents its case to the Competition Tribunal, where the party(ies) may respond. Under the Act, all mergers over a certain minimum threshold (to be set by regulation) must be notified (an important change from the previous legislation). For mergers above a second, higher, threshold the Tribunal must make a determination based on the recommendation of the Commission and other representations. Mergers between the two thresholds (intermediate mergers) may be ruled upon by the Commission, whose decision can then be taken to the Tribunal by the parties if they wish.

Objectives

The objectives of the Act are broad, and take into account a range of concerns that will not necessarily be consistent with each other in the actual evaluation of cases. They are stated in section 2 of the Act, as follows:

> The purpose of *this Act* is to promote and maintain competition in the Republic in order-
>
> *(a)* to promote the efficiency, adaptability and development of the economy;
> *(b)* to provide consumers with competitive prices and product choices;
> *(c)* to promote employment and advance the social and economic welfare of South Africans;
> *(d)* to expand opportunities for South African participation in world markets and to
> recognise the role of foreign competition in the Republic;
> *(e)* to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and
> *(f)* to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.

There has been much discussion and criticism of the broad scope of the objectives.[10] To an extent the objectives reflect the differing pressures on policy-makers, and their prioritisation depends on the development of precedents from cases. When the criteria set out in the Act for

[10] See for example Reekie (1999)

evaluation of cases are examined it is evident that economic efficiency is the over-riding principle. This reflects the fact that the South African Act drew heavily from the Canadian legislation for provisions governing mergers and from Australian legislation for prohibited practices. This is reinforced by the cases which have been ruled on to date, although employment concerns have been taken into account in several merger cases.

The new institutions are independent of Government, in contrast to the previous Competition Board. Concerns over limiting the discretionary power of the competition authority also led to the separation of the Commission, the Tribunal and the Appeal Court.

In the new institutions, the President appoints the members of the Competition Tribunal on the recommendation of the Minister of Trade and Industry from among nominations following publication in the *Government Gazette*. The Competition Commissioner is appointed by the Minister (normally following a process of advertisement). Apart from appointments, the Minister only has a right to make representations on public interest grounds as a party to merger proceedings (Section 18 of the Act) or may make representations at hearings of the Tribunal where there is a material interest on the part of Government (Section 53).

Provisions

Section 16 of the Act sets out the statutory standard for merger evaluation. The processes for evaluating the mergers by the Commission and the Tribunal include assessing competition in the identified market taking into account the actual and potential level of import competition, ease of entry, countervailing power, dynamic characteristics of the market, as well as the removal of an effective competitor. Technological and efficiency gains that could offset any potentially anti-competitive effects resulting from the merger are also considered. Public interest issues may be taken into account, such as employment, the ability of small businesses or firms controlled or owned by historically disadvantaged persons to become competitive, and the ability of national industries to compete in international markets. These are, however, secondary concerns which may be set against competition implications if they are deemed to be very significant.

The prohibitive practices section of the Act contains provisions setting *per se* rules on horizontal agreements regarding price fixing, market division and collusive tendering meaning that a harmful effect does not have to be demonstrated in these cases (section 4). Agreements are defined broadly to include a presumption of an agreement where there are substantial common shareholders, directors or ownership interests in each other. Finding prohibited vertical agreements (section 5) however requires showing substantial prevention or lessening of competition (apart from minimum resale price maintenance which is subject to a *per se* rule).

The second area of prohibited practices is abuse of a dominant position which is essentially aimed at addressing the exercise of market power by firms in ways which harm consumers and economic efficiency. Dominance depends on a market share of more than 45%, or a smaller share if the firm has market power. A dominant firm is prohibited from charging an excessive price, refusing access to an essential facility, and engaging in an exclusionary act (of which several are specifically identified). Price discrimination is also prohibited by a dominant firm.

Exemptions for agreements or practices that are anti-competitive can be applied for, as outlined in section 10 of the Act.

The penalties that can be imposed are potentially quite onerous, with possible fines of 10 per cent of turnover and structural remedies (divestment) if the act or arrangement is continued.

Procedures

The Commission has 30 days in which to undertake an initial evaluation of an intermediate merger. For cases requiring detailed investigation the Commission can ask for an extension of a maximum of 60 additional days. For large mergers the Commission must submit a recommendation to the Tribunal within 60 days of receiving the merger notice or request an extension from the Tribunal of 20 days at a time. The mergers which have been notified and are under investigation are announced in the *Government Gazette* and parties are able to register a material interest and an intention to participate. The main trade unions organising in the merging firms must also be notified of the merger and have an opportunity to participate.

Investigations into prohibited practices start from an initial complaint which can be registered by the Commissioner or other persons. Where the complaint is made by another person, the Commission must decide whether or not to accept the complaint in terms of the Act. If the Commission decides not to accept the complaint the complainant has a right of appeal to the Tribunal. Following investigation of a complaint, the Commission must within one year either refer the complaint to the Tribunal or issue a Notice of Non-referral.[11] The Commission has wide ranging powers to request information and to undertake 'search and seizure' operations to obtain relevant information. When the investigation nears completion negotiations may be held with the party(ies) to settle the case without a formal hearing.

Competition Tribunal

The Competition Tribunal is composed of two full-time and eight part-time members from which three-person panels are drawn to adjudicate on cases. The members are drawn from a broad cross-section of the population of South Africa and have relevant qualifications and backgrounds

[11] This time period can be extended by the Tribunal on application from the Commission.

in economics, law, commerce, industry, public and consumer affairs. The Tribunal members are appointed by the state President following a public nominations process. The Tribunal is supported by a small secretariat.

When a matter is referred to it under the Act, the Tribunal must:

- authorise or prohibit a large merger, with or without conditions;
- adjudicate appeals of the Competition Commission's decisions on intermediate merges and exemptions;
- adjudicate complaints of prohibited conduct and impose remedies; and
- rule on orders for interim relief.

The Tribunal broadly operates in an inquisitorial rather than adversarial manner. It has the ability to request information and conduct further analysis through its research section in order to better understand an issue. In more complex cases the Tribunal has adopted the practice of conducting pre-hearing conferences to reach agreement on procedural issues.

The Tribunal processes are transparent and the hearings are open to the public. In this regard, parties must declare which information is confidential when they originally file their merger notification or complaint. After reaching a decision the ruling is published on the Tribunal's web site.

Groups with a material interest may register an intention to participate in hearings. In practice this has only happened in a small number of cases. Trade unions have participated in merger hearings where there was possible employment loss and government departments have made representations where cases have fallen within their policy ambit.

4.3 The effectiveness of the new competition legislation and institutions

The new Act therefore contains measures similar to the previous one but departs in major ways from it in several respects. In particular it follows the example in major industrialised countries (although not countries such as Norway or Japan) in going for a rules-based legalistic framework which requires strong evidence and analysis of the anti-competitive effects on efficiency if a practice is to be addressed, with the exception of the *per se* prohibitions. The separation of the institutions and their independence from government is perhaps the most significant change. This reflects the desire to guard against the discretionary exercise of powers by the institutions. But, it has also had the effect of long and drawn out legal proceedings in almost any substantive case.

The effectiveness of the institutions can be assessed in a number of different ways. These include the processing of cases, the sources of complaints and the enforcement of rulings. The accessibility of the institutions and their roles in terms of advocacy are also very important in assessing their impact. Awareness of the measures of the Competition Act will itself impact on the behaviour of firms, especially if they believe there is a credible threat of detection and remedy for actions which breach the provisions of the Act.

During the period from September 1999 to March 2002, a total of 728 mergers were notified to the Commission, of which 36 were large mergers on which Commission is required to make a recommendation for judgement by the Tribunal (Table 4). Eight mergers were prohibited.

Table 4. Summary of Commission cases, 1 Sept 1999 – 31 March 2002

Case type	No. of cases notified	No. of cases finalised	Total no. of investigators
Mergers	958	875	9
Complaints	329	240	7-10
Exemptions	17	14	1-4
Advisory opinions	272	263	2

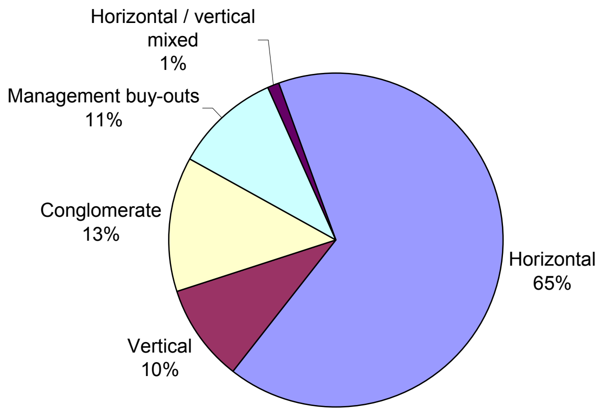
Note: * staff from other divisions were seconded to the Mergers Division to assist with the abnormally high case load that resulted from the notification of transitional mergers.
Source: Competition Commission Annual Reports 2000, 2001, 2002

4.3.1 Mergers

By far, the majority of the institutions' activities have been in merger analysis and adjudication.

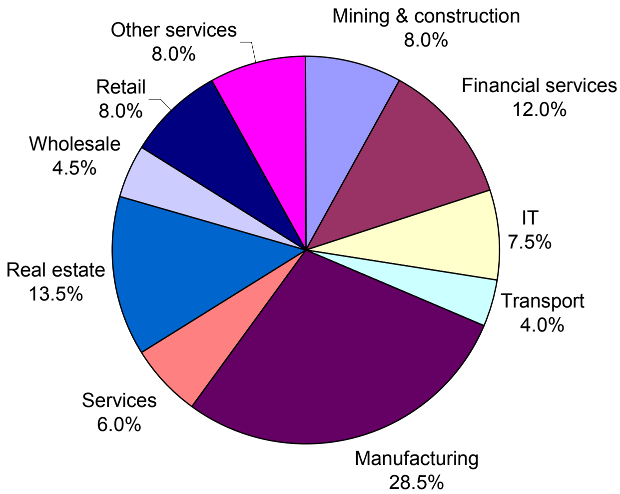
The majority of mergers have been horizontal in nature (Figure 3). And, the manufacturing sector has accounted for the largest share, followed by real estate, and financial services (Figure 4). Within manufacturing the main sectors registering mergers have been food, chemicals, and machinery and equipment.

Figure 3. Mergers by type, April 2001-March 2002



Source: Competition Commission, 2002

Figure 4. Sectoral breakdown of merger activity, April 2001-March 2002 (by number)



Source: Competition Commission, 2002

While only very few mergers have been prohibited by the Tribunal, or approved with conditions (Table 5), important precedents have been set. The success in setting such precedents means that it is less likely that parties will propose anti-competitive mergers, unless there are strong efficiency gains. In particular, the merger evaluations and judgements give an insight into how the different concerns of competition, economies of scale, international competitiveness and public interest factors such as employment are being taken into account.

Table 5. Mergers prohibited, or approved subject to conditions 1999-2003

Merging parties	Ruling	Reason/conditions
Bromor foods – Game	Approved subject to conditions	approved subject to maintaining brands
Joshua Doore – Ellerines	Prohibited	horizontal merger in concentrated market
Nasionale Pers – Educon	Approved subject to conditions	Approved subject to maintaining operations
Tongaat Hulett – Transvaal Suiker Beperk	prohibited	horizontal merger in concentrated market
Nampak – Malbak	Approved subject to divestment	Horizontal overlap in one market
Distell – SFW	Approved, with conditions	Horizontal overlap in one market
Nedcor – Standard Bank	Prohibited by Minister of Finance	horizontal merger in concentrated market
Iscor – Saldanha Steel	Approved subject to conditions	Failing firm justified horizontal merger, but conditions that firms must compete in local market
Mondi - Kohler	Prohibited	Vertical merger but prohibited due to possibility for foreclosure and collusion
Joshua Doore - Profurn	Approved subject to conditions	
Astral Foods – National chick	Approved subject to conditions	Horizontal & vertical merger with conditions on conduct, and divestment
Coleus (SAB) - Rheem	Approved subject to conditions	Vertical merger, subject to future divestment

We now examine the evaluation of horizontal and vertical mergers through review of the major cases.

Horizontal merger analysis

The possible anti-competitive effects of horizontal mergers are relatively straightforward as the combination of two firms making the same product will increase concentration. To the extent to which a significantly more concentrated structure means firms are more likely to behave anti-competitively there seems to be a fairly clear case for preventing such mergers. However, it is not necessarily easy to determine if firms are making the same types of products, and there are also gains from greater scale and synergies which may be realised from a merger. Moreover merger evaluation is based on a presumption as to what firms will do, and not what their behaviour has been (which is the purpose of prohibited practices provisions).

The prohibition of horizontal mergers (or allowing them subject to conditions) is where the new institutions have had the most obvious impact:

- In the ***furniture sector*** the Tribunal ruled against the merger between Joshua Doore and Ellerines Holdings (the two largest furniture retailers) on anti-competitive grounds. Of crucial importance was the local definition of the market, and that these stores provided extensive credit facilities to their customers, unlike many of their competitors. Small, independent furniture retailers could not be considered as competitors of these stores since small stores normally operate on a cash basis and not hire-purchase. Competition concerns were identified as the market shares of the merged stores would range from 40% to 60% in nine markets and would exceed 30% in the remaining three markets examined. And, since the market shares were based on the number of stores, rather than turnover, the above market shares understate the concentration levels in these markets. The conclusions also highlighted the impact on low-income consumers who do not have access to other forms of credit.

Although the Commission, in negotiations with parties, agreed to support the merger if 150 of the 650 stores were divested to a viable entity, preferably a black empowerment group, the Tribunal did not view these measures as sufficient to allow the merger.

- The ***sugar merger*** between Tongaat-Hulett and Transvaal Suiker Beperk was a direct combination of two horizontal competitors, with the justification put forward by the parties being the need to be big in order to be competitive. The sugar market is already very concentrated, being dominated by two main producers. This merger involved the takeover of the third largest producer by one of the big two, further entrenching concentration. This case also reflected the role of competition policy in regulatory change. The sugar sector has been highly regulated in the past, but is now being liberalised. The Tribunal believed that increasing concentration would have lessened the benefits of deregulation. The parties' response that prohibiting the merger deterred investment and reduced competitiveness, suggests that some in the business community have yet to come to terms with the new competition legislation.

- In the ***alcoholic beverages*** merger of Distell and Stellenbosch Farmers Winery the Tribunal identified a range of different markets within the broader product grouping. Their analysis was also significant in that it was made specifically from their analysis of the nature of the South African market. Based on this, the Tribunal ruled that the merger was anti-competitive in the proprietary spirits market.

- A similar conclusion was reached in the merger of ***packaging*** companies Nampak and Malbak. Identification of one area of overlap led the Tribunal to require divestment of that operation (in bubblepack).

- In several mergers, the judgements have included ***conditions***. In the decision on the merger between Bromor foods and Game, which related to energy drinks, the conditions related to maintaining the number of competing brands. A similar requirement to maintain competing operations was placed on Nasionale Pers and Edcon in relation to their provision of educational services. In both of these cases it appears that the conditions were not sustained, but the Tribunal's assessment of the Nasionale Pers-Educon case demonstrates how difficult it is to do this when other conditions are constantly changing which firms can legitimately claim affect their decisions.

- Although the proposed ***banking merger*** between two of the four main retail banks was not decided upon by the Tribunal as it fell within the jurisdiction of the Minister of Finance, the Commission's submission had an important influence on the Minister's decision. The Commission opposed the merger based on an analysis of the competition effects and a weighing-up of the arguments made for efficiency gains by the parties. In particular, the negative effects of the merger on personal users and small businesses were emphasised.

> The efficiency gains were found to be unconvincing and the employment losses that would result from the merger were also noted. The high profile nature of the case and the concurrence of the Minister's ruling with the Commission's findings were important in adding to the Commission's reputation.

In other cases, mergers have been allowed for ***efficiency reasons*** even where there may have been anticompetitive effects, and potential employment losses have not been elevated above other concerns. There have been two particularly notable cases in the steel sector, which is characterised by already very high levels of concentration (as discussed in section 6.1 below). In the merger of Trident Steel and Baldwins Steel (Dorbyl Ltd) the Tribunal granted approval due to the gains from plant re-organisation and cost-savings. These were specifically related to new investments which were to be made in the manufacture of steel body panels for the auto sector. Import liberalisation was significant in its decision, as was the potential failing of the target firm. The failing firm argument was also heavily relied upon in the Tribunal's allowing of the merger of Iscor and Saldanha Steel. Saldanha had made heavy losses ever since its opening. The merger was also accompanied by investment in improving its performance.

Vertical merger analysis

The greatest evolution in merger policy has occurred in respect of vertical mergers. While the presumption in horizontal mergers is that there are possible anti-competitive consequences, in vertical mergers by definition the firms are not competitors. International practice has been to approve them except in exceptional circumstances.

Several key decisions have been taken to prohibit vertical mergers on the grounds that they enhance market power because of the links between competing in a market and being able to source inputs or effectively supply customers. This is particularly important in the South African context given the history of conglomerate structures and the patterns described above of greater vertical integration by firms within sectors. To illustrate these issues we assess the proposed acquisition of Kohler Core and Tubes by Mondi before referring briefly to other similar cases.

The Mondi – Kohler Core and Tubes case and its policy implications

Cores and tubes are spirally wound paper tubes utilized as an inner core in various applications, for example, in the manufacture of products such as paper, board, steel, plastics and textiles. Kohler Core and Tubes (KC&T) has a 45% share of the cores and tubes market. Mondi is both a supplier to and purchaser of KC&T's products.[12] Sappi paper, Hulett Aluminium, Columbus steel and SA Nylon Spinners are KC&T's largest customers, representing 65% of its annual turnover. It

[12] Although, Framen, KC&T's rival supplied most of Mondi's own cores and tubes requirements.

is based on these dynamics that Mondi's intention to buy over KC&T was viewed as anti-competitive and hence prohibited by the Competition Tribunal.

In evaluating the proposed Mondi-Kohler merger, the Tribunal identified three major reasons for being critical of vertical mergers:[13]

- The potential to raise rivals' costs by means of foreclosure.[14]
- Where the merger increases the ability of rivals to coordinate conduct (horizontal coordination). This can be through exchanging competition sensitive information, particularly when the number of market participants is reduced.
- Where the merged firm can evade price regulation.

The first and second concerns were found to be present in this case. The Tribunal found that Mondi is a powerful player in the upstream core board market and also one element of a long standing duopoly spanning a significant number of markets within the broadly defined paper products market. In addition, Sappi and Mondi are both key input suppliers and customers of KC&T's cores and tubes products, making the Mondi-Kohler merger a very unusual transaction, given the fact that market power will be highly concentrated in the aftermath of the merger.

The Tribunal therefore envisaged the ability of the merged firm to foreclose the downstream market by denying to its non-integrated competitors the supply of the board essential in the manufacture of cores and tubes. The only alternative to Mondi's 'Ndicore' product is made by Sappi meaning Mondi's refusal to supply Ndicore to non-integrated downstream rivals would increase Sappi's market power and higher prices would have the direct effect of raising the costs of Mondi's rivals in the downstream cores and tubes market. Foreclosure will breed cooperation upstream as Mondi and Sappi will either tacitly or explicitly protect specific interests to uphold the duopoly characterizing their operations and make cartel 'cheating' easier to detect and discipline. The alternative buyer of KC&T, Sonoco (who wished to enter a joint venture with Kohler), would instead strengthen competition.

Other cases

- Similar questions to that of the Mondi-Kohler acquisition were raised in the acquisition of Rheem by SAB (through its subsidiary Coleus). Rheem is the dominant manufacturer of bottle tops and SAB is the major customer.[15] This merger was approved with conditions including that SAB ought to divest Rheem in the future, including the sale of a 40% stake to a BEE entity.

[13] In this the Tribunal drew from Riordan and Salop (1995).
[14] This is done by means of foreclosing access of key inputs to downstream customers (inputs foreclosure) or through foreclosing access to key customers to upstream competitors (customer foreclosure).
[15] This is especially so when taking into account SAB's strong ownership links with ABI bottlers of Coca-Cola products.

- The vertical merger of Frame and Seardel was approved by the Commission despite the firms being among the largest textile and clothing groups in South Africa respectively. In the context of projected supply shortages of yarn and fabric the preferential supply of textiles products by Frame to Seardel's clothing factories could have a negative impact on competition.

- The acquisition of National Chick by Astral Foods meant increased vertical integration in the supply of day old chicks to poultry producers. The presence of a second supplier and conditions against foreclosure led the Tribunal to approve the merger although the Commission had initially prohibited it.

Evaluation of merger assessments

The evolution of merger assessment has established important precedents. In general, the implications of the mergers for market power and economic efficiency has been the basis for rulings rather than competition for its own sake. The Tribunal has been sceptical of arguments that international competitiveness should support mergers which clearly increase concentration (as in the proposed Tongaat - Transvaal Suiker merger). International practice, mainly from US cases, has been drawn upon although South African specific market conditions have been emphasised in several key cases, such as the Joshua Doore – Ellerines and Distel – SFW cases. The analyses of recent vertical mergers have also indicated a willingness to consider competition issues beyond narrow measures of the extent to which horizontal mergers increase concentration.

In the earlier cases there appeared to be a bias towards a structural understanding of competition rather than to do with the behaviour of firms, with the Hirschman-Herfindahl Index (a measure of horizontal concentration based on market shareas) being used as a guide to whether a merger will have anti-competitive consequences. However, it must be borne in mind that the structural measures are only an indicator of behaviour and should not be applied too rigidly. This point has been emphasised by the Tribunal in its more recent judgements.

The examples of cases where the authorities have allowed mergers which on the surface are anti-competitive do indicate that they place broader efficiency concerns over and above a narrow consumer welfare focus. In the ruling on the Trident Steel and Baldwins Steel merger the Tribunal discussed the various efficiency considerations along with international precedent. While it acknowledged the difficulty in quantifying claimed efficiencies (especially dynamic ones), it set a precedent for judging the 'order of magnitude' in balancing the differing effects. The emphasis on efficiency is consistent with a concern over encouraging investment and the taking into account of employment (which has social efficiency effects were there is high unemployment).

But, in evaluating efficiency effects it is important to take into account appropriate alternatives to the merger which may also yield the same improvements. This implies taking into account alternative buyers for a firm. In this regard it is not enough to find that no other buyer is willing to pay more than an incumbent firm. A firm which sees market power gains (as well as efficiency gains) would be expected to be willing to pay more than a new entrant in an acquisition. Because the seller cannot find an alternative buyer at the price being offered does not, therefore, mean there would be no buyer (and the firm would fail). Alternative buyers may be interested if such a merger were prohibited. In addition, firms which are already closely related, such as Iscor and Saldanha, have much better information that the Tribunal. The rapidity with which Saldanha was turned around to become a very low cost and high quality plant questions the portrayal made by the firms as it being a choice between Iscor's takeover or closure. Although not a case of a failing firm, the decision by the Tribunal to undertake a close assessment of Anglo American's proposed takeover of both Kumba and Avmin, which would place it in control of South Africa's iron ore resources, ultimately enabled another buyer to come forward for Avmin. The IDC's determination to make representations before the Tribunal also played an important part. This occurred despite the Commission recommending the merger be approved.

Although it is early to make a proper assessment, there are also indications that the Commission will take into account ownership of firms in order to fulfil the objectives of the Act in terms of the advancement of historically disadvantaged persons. For example, in the proposed Joshua Doore – Ellerines merger a key condition for the Commission supporting the merger after negotiations was the divestment to a black owned entity. As acknowledged by the Commission it is, however, difficult for it to got out looking for suitable owners in cases such as this one. The Tribunal has, in general, taken a sceptical approach to arguments in support of mergers on the grounds of increasing black ownership where the mergers are clearly anti-competitive.

4.3.2 Prohibited practices

The Commission receives a great many complaints (329 complaints of prohibited practices between September 1999 and March 2002) but very few cases have been investigated and referred to the Competition Tribunal for adjudication. This is partly because some complaints are misguided or frivolous. There are also a large number of complaints which remained under investigation from one year to the next. Notwithstanding this, there has been little enforcement of prohibited practice provisions. Six cases have been settled by consent orders, mainly reflecting acceptance by firms of the provisions of the Act governing *per* se contraventions following the Commission's investigation. However, it is clear that there has been much less progress in addressing restrictive practices which are not outlawed outright in the Act.

Two main cases of prohibited practices have been ruled on by the Tribunal:

- Abuse of dominance by Patensie Citrus packing and marketing operation. The former co-operative required its former members (now shareholders) to sell to it. This was found to be an abuse of dominance given the size of the firm in its region.
- Minimum resale price maintenance by Federal Mogul. The firm was found to have effectively raised the price to a wholesaler who had been under-cutting competitors.

There are also several very important cases under investigation including allegations of excessive pricing of steel by Iscor, and of anti-retrovirals by major manufacturers.

Given the high levels of concentration and vertical integration reported on above, competition policy would be expected to make a major contribution in addressing the exertion of market power and collusion by firms. It must be remembered that dominant firms would be expected to use (or abuse) their position if they are profit maximising. Similarly, where there are very few competitors as in many industries in South Africa, there are large potential gains to be had by firms from colluding.

We can distinguish different reasons for the relative lack of progress in addressing such issues. First, it may be argued that the new Competition Act itself has deterred firms from abusing their market power, and that the liberalisation of the economy means that the South African economy is subject to international competition. This does not seem to be a strong argument. The very high levels of concentration and close relationships between firms suggest that abuse and collusion would be widespread, while the deterrence would be expected to depend on at a least a few high profile cases being brought. Although trade liberalisation increases import competition, as illustrated in the steel industry below, transport and related costs and non-price barriers such as lead times and the need for guaranteed supplies of inputs in many sectors suggest that the competitive effect of imports should not be over-stated. The number of cases prosecuted in other developing countries such as South Korea also suggests that anti-competitive practices are widespread.

Second, why have there been few complaints brought against dominant firms? Many complaints made have been about vertical restrictive practices. These complaints have often been brought by companies who have not themselves been awarded a contract, rather than from buyers who are negatively affected by the market power of the contracting parties. Competition policy provisions are not meant to protect individual competitors but the prevention of competition. Vertical arrangements are also generally seen as having efficiency effects. In many industries, buyers may be reluctant to bring cases as they know that they will have to continue to source inputs from the firms against which they are complaining during and after the case. South Africa also lacks well-developed consumer organisations. This indicates the importance of the Competition Commission in initiating complaints itself and undertaking an investigation.

Third, the information and analysis demands of bringing prohibited practices cases are very high. It is evident that, apart from situations where arrangements are *per se* illegal under the Act, the evidence required is very onerous. For example, this relates to the behaviour of dominant firms in abusing their market power, such as by charging excessive prices which are defined as prices which do not bear a reasonable relation to 'economic value'. A major research exercise is required to build a case to prove that a dominant firm is doing what one would expect it to. Similarly, in the absence of a written agreement, proving collusion requires demonstrating that charging the same price, or differentiating the particular products made, is not justified by production costs or legitimate market considerations. This type of case requires both a high degree of legal and economic expertise and the time to undertake the investigation. In the context of the available expertise to the Competition Commission, especially in economics, this is extremely difficult to do. By comparison, firms can afford to buy-in the best international expertise in the form of economists who routinely work on cases coming before the European Competition Commission or the USA antitrust authorities. Firms also have the incentive to do so given the magnitude of the potential penalties they are subject to and the size of the returns they stand to lose if they are in fact abusing their position. There is also an intrinsic asymmetry of information between the competition authorities and the firms themselves. Often it appears as if the Competition Commission relies on information supplied by the parties themselves instead of corroborating it from independent sources.

Fourth, the rules-based framework enables the investigations of the Commission to be attacked by firms on procedural points and allows the 'legal gaming' by firms of the authorities to stall the investigation and adjudication of cases. It is not unusual for cases to take much more than a year for the substantive issues to be considered by the Tribunal, after various procedural points and appeals to other courts have been made. The Commission's first major investigation into horizontal restrictive practices, of alleged collusive behaviour in the cement industry, was challenged in court following a 'search and seizure' operation on 2 August 2000. Such operations are allowed under the Act where there are reasonable grounds to believe that a prohibited practice has taken place and where persons have information on the premises relevant to the practice. The search also only took place after information had been repeatedly requested by the Commission. Unfortunately, the Commission's decision to bring the press on the search was ruled to be incorrect and the Commission had to return all documents. There has not been a similar operation since.

Fifth, the Competition Commission may not be using its powers. The Commission has far reaching powers to collect information, including requesting firms to provide original documentation in which their business strategies are laid out. It is not clear that such powers are being utilised as firms appear to respond to requests for information with specifically written answers rather than their original documents.

Sixth, the capacity of the Commission relative to the workload inhibits progress. The Commission has to deal with a great many cases at once and relatively inexperienced investigators may have more than 10 cases at one time when a major case could require full-time attention to investigate properly. This has led the Commission to attempt to select which cases to focus on at an earlier stage, in a fast-tracking process.

Seventh, competition law and policy may not be the appropriate way to address the behaviour and orientation of large firms. To the extent that the above constraints are intrinsic to the operation of competition policy then it is simply idealistic to have much higher expectations in the short to medium term at least. If competition and rivalry are important for economic development then this suggests that other mechanisms need to be found to achieve the same goals. Different approaches are evident in developing countries such as the setting of performance requirements and careful monitoring of large firms. Some countries, such as Malaysia, do not use competition law and policy at all.

We now discuss the experience of selected countries as part of our overall evaluation of South Africa's competition policy.

4.4 Evaluation: Key issues and international comparisons

We cannot evaluate competition policy without being clear what are our expectations of its role. International comparisons provide one way of assessing the performance of the South African institutions and legislation.

The recent OECD peer review of South Africa's competition institutions (Wise, 2003) praised the South African competition authorities for sophisticated analysis that ranks alongside that of industrialised countries, although it observed that '[t]o a surprising extent, competition policy in South Africa is merger policy'. The highly concentrated nature of the South African economy suggests that addressing the behaviour of dominant firms is an important concern. The report further notes that the 'degree to which the Commission and Tribunal have concentrated on merger control would be unusual for new agencies in a developing, transition economy.' But, the report notes that it is understandable in the context of South Africa's level of development and that the 'focus on mergers carries forward the theme of correcting excessive concentration of economic power'.

If competition policy is a key mechanism to address the anti-competitive behaviour of large firms then this is an unacceptable conclusion. It ignores existing concentrations, as mergers deal with situations where concentrations are being developed while South Africa has an already highly concentrated economy. In addition, it is not clear that industrialised countries are necessarily the best comparators for South Africa.

The development of the competition policy discourse – international best practice?

Despite the appearance of consensus on an 'international best practice' in competition policy there is a diversity of experiences. This is true both among industrialised countries, with very different approaches in countries such as Japan and Norway, and amongst those developing countries with established competition authorities such as South Korea.

These different country experiences highlight the importance of moving beyond the formal legal framework in considering the competition policy choices made. In general, it is the criteria that are applied to evaluate behaviour, the implementation approach, and the overall level of commitment which are most influential (Hoekman, 1998). Country experiences also highlight the need to take into account country-specific factors.

Far from the emphasis on mergers which has prevailed in South Africa, many countries have focused more heavily on the behaviour of dominant firms. In developing economies engaged in processes of industrialisation considerations such as economies of scale, dynamic effects related to technology and positive externalities are all undoubtedly important. These concerns reinforce the need to address firm behaviour rather than being limited to changes in structure.

The experience of South Korea is a case in point. The Korean Fair Trade Commission's objectives are to encourage free and fair competition, prevent the concentration of economic power and thereby promote 'balanced development' (Wise, 2000). Most importantly, free and fair competition is defined broadly in the sense of a competitive industrial structure and the control of potential abuses and imbalances in the bargaining power between parties, specifically in subcontracting arrangements. The KFTC examines 'unreasonable' practices and 'unjustifiable' restrictions on competition as specified in the provisions of the Monopoly Regulation and Fair Trade Act enacted in April 1981. Under the law, the KFTC examines cases and then the committee of the KFTC deliberates and determines what measures will be applied. A specific measure used by the KFTC was the annual 'designation' of the largest conglomerates, or *chaebols*. Firms and groupings so identified were subject to close monitoring of their performance and restrictions on abuses of market dominance (Hur 2002).[16]

The broad framing of the provisions allows the KFTC considerable scope to examine and enforce corrective measures. The KFTC is a ministerial-level administrative organisation which functions

[16] The designation system of market dominating enterprises was abolished in 1999 and an approach based on assessing dominance in specific markets on a case-by-case basis was adopted.

as a quasi-judicial body. It establishes, implements and rules on competition cases under the law. The emphasis is on the powers of the KFTC rather than legal independence from government. Its autonomy from other branches of government comes from its head having the status of a cabinet minister and not falling under any government department, and it is well staffed in terms of both number (at more than 400) and expertise. Also important, perhaps, for its ability to exercise its power is the close links of the KFTC with the powerful Economic Planning Board, within which it fell until 1994 (Sanekata and Wilks, 1996; Wise, 2000).

Ensuring rivalry between the major *chaebols* in the interests of promoting their strong performance has meant the KFTC has been very active. While the share of the top 30 conglomerates or *chaebols* in manufacturing and mining production has remained at about one-third since the 1980s (Wise, 2000) dynamic competition processes have played a very important disciplining role (Khemani, 1994; Amsden and Singh, 1994). In the 20 years to 2001 the KFTC identified and addressed 332 cartels (OECD, 2002). In 2002 alone, 43 cases of cartels were detected and fines of $22mn were imposed (Lee, 2002). The KFTC has also specifically addressed the international 'hardcore' cartels identified by the OECD in markets such as vitamins and graphite electrodes.

In addition, the KFTC is responsible for a range of provisions securing a competitive environment for small and medium enterprises through monitoring subcontracting practices. This role is extensive - of the 3924 anti-competitive cases examined in 2001, 3130 were related to unfair subcontracting practices (OECD, 2002). While the emphasis has been on anti-competitive behaviour, it is notable that South Korea is only just moving to full pre-merger notification.

This suggests that competition policy should be in line with government's industrial policy as has been the case in South Korea and Japan, despite both countries having competition laws strongly influenced by the USA (Amsden and Singh, 1994). There are also countries which have achieved rapid growth, such as Malaysia, that have not prioritised competition policy. Alternative policy instruments have been used to impact on the behaviour of large companies.

By comparison, a recent survey of competition policy in Brazil found that too much attention has been paid to analysis of mergers, and that more attention is necessary on preventing damaging collusion by firms and abuse by dominant firms of their position (Clarke, 2000). With reference to Brazil, it has also been argued that it is important to avoid an overly legalistic approach in dealing with dominance due to issues of transition and industrial development under liberalisation (Stevens, 1995). For example, three steel producers, Usiminas, CSN and Cosipa were found guilty of price fixing in October 1999 and fined US$16.5mn (approximately 1 per cent of their revenues) (de Almeida, 2002). The firms appealed the decision of the competition authority to the Federal Court on the grounds that they had not been allowed to present their arguments before the authority prior to the application of the fine. A final decision was still pending at the end of 2002.

The recently enacted Chilean competition policy framework emphasises addressing acts deemed to restrict competition and the abuse of a dominant position.[17] The legislation provides for the creation of a National Economic Prosecutor's Office to investigate cases and represent the 'general economic interest' before the Resolutory Commission (a tribunal which adjudicates and makes orders). The Resolutory Commission consists of representatives of the Ministry of Economy, Development and Reconstruction, Ministry of the Treasury, a Dean of Law, a Dean of Economics, and is chaired by a Supreme Court judge. There are also regional and a central Preventive Commissions that report on competition matters in their geographical areas and advise on measures to be taken. No appeal can be made to the resolutions of the Resolutory Commission excepts for a specially defined protest in cases where the resolution orders the modification or dissolution of corporations, exclusion from holding professional or labour offices, or the application of fines.

The importance of appropriate implementation mechanisms is further highlighted by the many examples of countries with competition laws but no effective mechanisms for their realisation. The Philippines has had anti-monopoly laws since 1935 and the 1987 national constitution declares '[t]he State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed.' But there is no central agency to oversee the legislation and no administrative mechanisms to give effect to the provisions (CUTS, 2000). Countries with legislation that was not being implemented until the last decade include Mexico, Argentina and Brazil, highlighting the importance of political will and the appropriate institutional framework (Stevens, 1995). In countries such as Venezuela and Peru the competition authorities may be independent but their effectiveness is hampered by lack of resources and political economy factors within the countries (Rodriguez and Williams, 1998).

Summary and conclusions

The international comparisons suggest that appropriate and effective competition regimes must take account of the particular challenges facing a country as well as the institutional capabilities. US-style competition policy, drawing on large numbers of lawyers and economists, is not necessarily an optimal use of scarce expertise and will favour well-organised interest groups and large corporations (Stevens, 1995; Laffont, 1998). Given the information asymmetries in favour of the firms on which judgements are to be made, the provisions must allow agencies enough flexibility to make and enforce their determinations. There has instead been a tendency to over-emphasise the legal independence of competition authorities. In reality, the commitment of government is necessary for the effectiveness of competition institutions, regardless of the exact nature of their independence or autonomy.

[17] http://www.alca-ftaa.oas.org/cp_comp/eglish/dlr2/ldr2CHLe.asp

Key issues that emerge from our analysis of competition policy in South Africa are:

- Important progress has been made in addressing mergers with anti-competitive effects, and in an increasingly rigorous assessment of vertical mergers, including taking into account different dimensions of market power. Notwithstanding this, our analysis (and see the sectors in section 5 below) has found increasing vertical integration, including the mergers of Mondi and Consol, Nampak and Malbak, Frame and Seardel, Coleus (SAB) and Rheem, Afgri (formerly OTK) and Laeveld.

- Progress in addressing prohibited practices has been slow, and hindered by companies' ability to use litigious delaying tactics.

- The focus on mergers (largely by default given the very large workload) has negatively affected the ability to address the behaviour of already dominant firms.

- There has not always been effective monitoring of firms' compliance with conditions in mergers. This is damaging for the credibility of the institutions.

- Prohibited practices are very demanding to prosecute. They require information and strong analytical capabilities on the part of the institutions. The framing of prohibitive practices provisions need to recognise this, for example, in a clearer interpretation of excessive price increases as being those which are not related to costs.

- There is need for information to be more effectively collected and shared across public institutions which are responsible for influencing the behaviour of large firms. The decisions of these firms ultimately determine the outcomes in terms of output and employment and ensuring active rivalry between them is both an important check on their market power and a stimulus to their improved performance. The importance of rivalry is highlighted by the industrialisation experiences of countries such as Japan and South Korea which have large conglomerate groupings.

- Competition policy seeks to separate dominance and its exertion. For a firm this separation is not natural; efficiency, its competitive position and maximising returns from that position are integral parts of the same ongoing processes. It needs to be recognised that a dominant firm would be expected to be abusing its position if it is serving its shareholders. There therefore needs to be more effective measures to investigate and address such abuses.

- Addressing collusion largely depends on the capacity to mount effective investigations as the Competition Act contains strong provisions as to agreements between competing firms. The investigations require similar capabilities to those of South African Revenue Services or the Scorpions for investigating fraud or corruption. The Commission's capabilities would therefore be improved if mechanisms were developed for collaboration across these agencies, which are tasked with taking on offences of an economic nature.

- Small, medium and even large firms are unwilling to bring cases against dominant firms on whom they will rely in the future for inputs or markets. This is an intrinsic problem and is greater where there is most need for action. This places the burden on the Commission to initiate investigations where there are indications of prohibited practices occurring.
- The economic impact of competition policy depends on the deterrent effect as well as on actual cases. In merger investigation and review a reputation for effective assessment of the competition implications has been established meaning that firms are less likely to even propose anti-competitive mergers. However, it is difficult to sustain a case that dominance has been addressed in a meaningful way. The sector case studies reviewed below reinforce this point.

Recommendations

These findings suggest a range of possible measures which could aid South African competition policy in meeting the ambitious objectives set for it.

- Current interpretation of the law suggests that the Competition Commission is obliged to investigate every complaint and give full reasons for its decisions. While this may be desirable there is a clear trade-off with its ability to devote resources to investigating major cases. It must be remembered that the deterrent effect of successful prosecutions will have wide ranging positive implications for the behaviour of dominant firms and the willingness of potential complainants to come forward with information. To the extent that there is ambiguity, the Commission's discretion to decide which cases to focus on should be clarified.

- The importance of information suggests that there needs to be more effective co-ordination across government and public institutions for information sharing (subject to confidentiality concerns). This would be aided by a clearer policy direction from government as to where competition policy fits with government's strategic priorities. At present, the role of government is reactive in, for example, requesting an investigation into food prices after sharp increases. Strategic priorities could include:
    - A focus on the price and conditions of supply of material inputs in which South Africa has developed production capabilities such as basic chemicals, steel, aluminium, sugar etc.
    - A series of investigations into market conditions in the products which make up the majority of consumption expenditures of the lowest income quartile.
    - Regular monitoring of the changing structure and activities of the major conglomerates. This appears not to be systematically done anywhere in government despite the centrality of the strategies of these groupings for the development of the local economy. It is a function which could be undertaken in, for example, DTI or the Office of the President.

- Provisions could be made for the competition authorities to designate companies based on their overall size and/or position in important markets, as has been the case in South Korea, and also in Australia.[18] Under this firms could be required to provide information on an annual basis on their pricing and related practices, possibly through their external auditors.[19] This would relieve the Commission of important information gathering and provide an immediate deterrent effect for firms. The criteria for designation would necessarily be quite blunt (such as based on market shares by SIC codes) but could include some discretion for example, where firms had been found to have violated provisions of the Act or have a large market share and/or are vertically integrated in a particularly sensitive sector such as maize. It would amount to a 'triple bottom line' type of arrangement (although not necessarily for public reporting). The rationale for such an approach is the presumption that dominant firms should be maximising their possible returns if they are serving their shareholders (including through abusing their dominance) and that therefore that the gains from encouraging company strategies to emphasise rivalry rather than short term maximisation of margins are potentially huge.

- A clearer specification of the excessive pricing provisions to indicate abusive increases as being those not justified by cost increases (as was included in the Brazilian law).

- Measures to facilitate the investigation and prosecution of collusion such as 'whistleblower' provisions and leniency for the first firm to come forward with information in a suspected collusive arrangement.

[18] The 1983 Prices Surveillance Act enables the Australian Competition and Consumer Commission, where the government declares products or services, to examine prices with the objectives of promoting competitive pricing where possible and restraining price rises in markets where competition is less than effective.
[19] This is what the Competition Board required as a condition for approving the exclusive export marketing arrangement in the Iscor – MacSteel joint venture to form MacSteel International BV.

5. Sector case studies

5.1 Competition policy and efficiency in concentrated markets – the case of the steel industry

South Africa developed a strong steel industry as part of the strategy to be self-sufficient in key sectors. The development of the industry capitalized on the availability of mineral resources such as iron ore, chrome and coal. The state - through direct ownership of Iscor, provision of IDC finance and through a range of trade and industrial policies - has been the prime mover behind the development of the steel industry. Now the industry faces new challenges linked to global restructuring in what is a critical period. In the global arena, the International Iron and Steel Institute ranked South Africa as the 21st largest producer and 10th largest net exporter of steel in the world in 2000, with a production capacity of approximately 10 million tons. But, the size of the main producers, led by China, the USA and Japan, means that this represents just 1% of world production.[20]

Steel is a core input into many products as well as being essential for infrastructure. Industrialisation and steel production capabilities have therefore commonly gone hand-in-hand. The orientation in South Africa was strongly towards the local market, with exports viewed as a residual. This approach supported rapid growth in output in the last three decades. Production in 2000 was roughly six times that in 1970.

The iron & steel industry is dominated by Iscor which produced 71% of South African consumption of steel in 2001 (excluding stainless steel). Since being privatised in 1989 it has undergone a process of transition spurred by reduction of the tariff from 30 per cent in 1994 to 5 per cent in 1996. The transition involved rationalisation of production, a huge reduction in the numbers of grades and product types being produced and, in the last year, the purchase of 47 per cent of Iscor's equity by the world's second largest steel company, LNM, under a strategic business assistance agreement that provides for the option to acquire a further 10 per cent.

Iscor is now one of the very lowest cost producers of steel in the world. In 2002 the Vanderbijl Park plant of Iscor which makes flat steel products was ranked at 23rd out of 296 steel plants worldwide in terms of overall costs of production. Underlying indicators of cost competitiveness are even better with material costs ranked in fourth place out of 296 and total marginal costs ranked in fifth place.[21] Moreover, these cost advantages are likely to improve further, as Iscor has secured Rand denominated iron ore for 25 years from the Sishen mine in the Northern Cape supplied at cost plus a management fee.

[20] See Taka (2002), Makhaya et al. (2002) and Machaka and Roberts (2003) for more detail on the development of the steel industry.

By comparison, the labour-intensive downstream metal products is relatively under-developed and poorly performing in South Africa. In countries such as South Korea, Chile and Malaysia, the metal products sector is growing rapidly and is large relative to iron & steel. The cost of steel has a major impact on the competitiveness of metal products. Iron & steel accounts for 42 per cent of inputs to structural metal products and 38 per cent of inputs to fabricated metal products.[22]

But, pricing practiced by Iscor means that local metal products firms using steel receive no cost advantage from the developed nature of the South African steel industry and are subject to import-parity pricing despite the large surplus of supply over domestic demand for steel. We explore this issue further before briefly assessing the two major mergers in the sector in recent years.

Import-parity pricing and economic efficiency

It has been common practice for steel to be sold at 'import-parity plus'. This means that the price of locally produced steel is set at the international price plus the tariff and transport costs, and an additional margin to take into account the advantages of buying locally in terms of delivery time and technical support (see Table 6). As a result, prices received by steel producers in the local market can be as much as 65 per cent higher than those received 'ex-works' for exported product. Different (and higher) prices have even been charged inland to take account of the additional cost of transporting imported steel from the coast, even though the local steel is supplied relatively nearby. This practice, where the local prices are not related to the actual costs of production and delivery, but to the equivalent cost of importing, is defended by steel firms as being necessary to maximise 'value' from the local market in order to be able to support the operations as a whole given the much lower prices in the export market.

Table 6. Calculation of local and export steel prices, 2000 (per ton)

Local steel prices	Hot-rolled coil	Galvanised	Export steel prices	Hot-rolled coil	Galvanised
FOB Europe	$210	$400	Ex-works local price	$170	$358
+shipping to Durban	$30	$30	+ railage to Durban	R80	R80
+5% duty	$12	$22	+shipping to Europe	$30	$30
+railage to inland mkt	R80	R80		≈$210	≈$398
+5% local premium	$14	$30			
+delivery costs	R20	R20	FOB Europe	$210	$400
Ex-works local price	$280	$495			

Source: ABN AMRO, as in IDC (2000) *The South African Downstream Carbon Steel Industry*

From a business perspective, a firm will obviously aim to maximise returns from all markets. The issue is, however, that the demand in the 'high value' local market depends in turn on the performance of the steel using industries. Part of their performance depends on the overall levels of demand in the economy. But, part depends on their competitiveness – both against imports and in the export market. An imported metal product means a loss of South African manufacturing

[21] World Steel Dynamics, '2002 Flat Products World Cost Curve', May 2002.
[22] Statistics South Africa, *Supply and Use Table 1998.*

production and lower demand for South African steel. The optimal pricing decisions for short-term profit maximisation and long-term growth may therefore conflict.

From an economic efficiency standpoint, the opportunity cost of supplying one more unit of steel to the local market is the revenue foregone from exporting one unit less. The practice of import-parity pricing therefore amounts to a tax on downstream firms to support the upstream steel producer. Given the very large excess of supply over demand (exports have amounted to between 40 and 50 per cent of output), the enforcement of import-parity pricing requires segmenting exports from supply to the local market to prevent international buyers of South African steel reselling into the local market to benefit from the higher prices. This segmentation is achieved through an exclusive export agreement between Iscor and MacSteel International BV (in which Iscor is a 50 per cent shareholder). The agreement requires all exported steel to go via MacSteel International to ensure that it is shipped offshore. The Competition Board approved the agreement in 1995 subject to conditions preventing discrimination between customers except as might be justified by different volumes purchased. It is not clear that these conditions are being met.

International consolidation in the steel industry due to low prices in recent years has been used as the justification for mergers of South African producers. This means that there is even less likelihood of local competition and of pricing which reflects costs of production. It is also important to remember that internationally it is firms in high cost regions such as the European Union and North America which have been going bankrupt and merging. In low cost developing countries such as South Africa conditions are quite different. Indeed, as capacity is reduced in industrialised countries it is expected that production would gradually shift to developing countries.

Merger of Iscor and Saldanha Steel[23]

The Saldanha project was conceived as a way to expand production of steel in order to use the high quality iron ore produced at the Sishen mine. However, delays in the project meant large cost over-runs and Saldanha's entry into markets just when steel prices crashed as a result of the crisis in Asian economies in the late 1990s. In addition, an agreement with Iscor had meant that Saldanha was only allowed to supply the export market (apart from sales to Duferco for further beneficiation, which could not then sell the resultant product in the local market). This effectively meant that Iscor viewed Saldanha as a competitor otherwise the agreement would not have been necessary. Iscor and Saldanha both produce hot rolled coil.

In the merger Iscor sought to acquire the remaining 50 per cent of Saldanha steel owned by the IDC. While the Competition Commission argued that the two firms did not sell in the same market and that there was therefore no competition implication of the merger, the Competition Tribunal

[23] Competition Tribunal report on the Large Merger between Iscor Limited and Saldanha Steel (Pty) Ltd, 4 April 2002.

approved the merger largely on the grounds that Saldanha was a ‘failing firm’ at risk of closure. After the merger improvements to Saldanha’s operations quickly improved its performance and output increased significantly while costs fell. The Competition Tribuna also ruled that Duferco should not be impeded from selling the beneficiated steel from Saldanha into the local market, although it is not clear that this is being complied with.

Trident Steel’s acquisition of operations of Baldwins Steel[24]

In December 2000 Trident steel was allowed by the Competition Tribunal to acquire three plants for flat steel decoiling and cut-to-length products. These plants make and sell improved surface finish (ISF) and non-ISF products for the auto and other sectors. ISF steel is specifically for the auto sector and is used for the outer body panels of vehicles. Trident acquired 50 per cent of Baldwins non-ISF capacity, however Baldwins was only operating at 40% capacity in this product, and therefore argued that the competitive situation in this market was unchanged by the merger (which the Tribunal accepted). There is also a third major competitor, MacSteel, which had a market share of 15 per cent.

In the ISF market, the sale by Baldwins meant that it exited this market. Prior to the merger Trident and Baldwins each had a market share of 35 per cent, meaning that the merger resulted in an entity with 70 per cent for ISF outer blanks with the remaining share of the domestic market supplied by imports. According to the Tribunal, the ISF market requires sophisticated technology and large capital investments. Moreover, the imported products are not perfect substitutes for the domestic production, due to imports being in the form of completely-knocked-down packages or already embodied in completely built up units. The Motor Industry Development Programme (MIDP) incentive scheme and significant tariffs on imports also create further disincentives to import. Customer interviews reported as part of the competition authorities’ investigations confirmed that imports were generally not based on price considerations. Furthermore imports take much longer to procure, a significant disadvantage in the just-in-time production process used by auto assemblers.

The Tribunal therefore concluded that the merger was likely to substantially lessen competition in the ISF market. The approval of the merger therefore rested with counter-balancing efficiency gains, the onus of proof of which rested with the merging parties. Given the difficulties of measurement, the Tribunal discussed the competition and efficiency effects in terms of ‘order of magnitude’. And, the Tribunal ruled that the South African competition Act required ‘dynamic efficiencies, production efficiencies ranging from plant economies of scope and scale to research and development efficiencies that might not be achieved short of a merger’. They were, however,

[24] Competition Tribunal (2001) ‘Report on the large merger between Trident Steel and Dorbyl Ltd for the acquisition of three operations of Baldwins Steel’.

ambivalent about whether the gains must be passed onto consumers, provided there was strong evidence of the efficiencies existence.

Three types of efficiencies were considered:

- plant efficiencies
- supply efficiencies
- volume discounts

The main efficiencies arose from the better capabilities of Trident, meaning that they could more effectively (with lower scrap rates) process Iscor's steel. Moreover their lines were being under-utilised, meaning that it was cheaper to increase production on this line than to upgrade Baldwins line, which was designed primarily for pressing, to do the necessary processing functions more effectively. In addition, Baldwins produced evidence that their production lines had been running at a loss for the previous two years. The merger therefore allowed plant-level re-organisation and specialisation, with the use of the Baldwins' production line for pressing. Additional supply efficiencies arose from scale benefits in making single orders to Iscor. The parties further argued that they would be better able to negotiate volume discounts, but the Tribunal did not view this as an efficiency.

These efficiencies, which essentially boil down to scale economies and specialisation, led the Tribunal to approve the merger in the absence of good quantifiable evidence on the basis of the 'order of magnitude' and the possibility of imports as an ultimate price restraining effect.

There are several questions outstanding on the Tribunal's assessment:

- It is unclear whether the gains really are dynamic. Dynamic gains come from pressures to make ongoing changes, as well as to invest in new and better technologies. This is spurred by rivalry, but also may require scale economies. While there are undoubtedly pressures to upgrade production capabilities in the auto sector (such as the need to introduce dual-phase steel), these factors are not necessarily clear in this instance.
- The savings in terms of capital expenditure are also not clear. If it is a viable business, then why was Baldwins not making the investment itself? Also, it is unclear why Trident was only operating at 40% capacity if it was more efficient?
- The lack of alternative buyers appeared to be accepted on the grounds that Baldwins plant had been making losses. This argument does not necessarily follow.
- The competitive pressures from imports are very doubtful, from the Tribunal's own arguments.

Summary

The basic iron & steel industry is a good example of the challenges to policy to address firm behaviour and industrial development. As a key input with low production costs its pricing has a very significant impact on the competitiveness of downstream firms, which are also generally more labour-intensive than the steel producers. At present, the cost advantages to steel production are not being passed on to the buyers of steel. This is to be expected from firms with significant market power due to their size relative to the local market and the high barriers to entry. The policy challenge is how to ensure that the desirable outcomes which would result from rivalry between firms are achieved in such an industry. The production efficiency effects from greater consolidation in the sector in no way suggest that the negative allocative efficiency effects of pricing based on market power in the local market will be ameliorated.

5.2 Paper – vertical integration and horizontal concentration

This sector is fully integrated from seedling to final product, linking forestry, paper and paperboard manufacturing to converting operations. The integrated nature of the sector is evidenced by the strong upstream-downstream linkages through the stages of producing paper and pulp products and also by the fact that most firms in the industry are suppliers and consumers. Sappi and Mondi dominate activities and are largely suspected of colluding. The two account for about 98% of the production capacity of paper and paperboard in South Africa, while only four entities, including the two big players in the sector, Sappi and Mondi, control all the commercial forestry in the market. Such oligopoly tendencies highlight the degree of concentration that exists in the sector. The concentrated nature of the sector is mainly due to substantial barriers to entry such as huge capital investment requirements, economies of scale, ownership of raw material and additional costs incurred in the importation of plants and equipment. The operational flow table below illustrates the extent of connectivity that prevails in the sector.

Table 7. The paper production pipeline and major firms

Production Line	Product	Producers/Owners
Raw material	Forestry Pulp	Mondi, Sappi, state and private individuals Mondi and Sappi
Intermediate products	Corrugating paper	Sappi, Mondi and imports
Paper conversion	Corrugated sheet board, carton board, fine paper and tissue	Sappi, Mondi, Nampak, Kimberley Clark and others

In South Africa, the sector is involved in the manufacture of a wide variety of paper and pulp products. Newsprint, uncoated paper and paperboard, tissue paper, uncoated kraft and paperboard, composite paper, carbon paper, wall paper and cigarette paper are just a few examples of paper and paper products produced in South Africa, while, mechanical wood pulp, semi-chemical wood pulp, chemical wood pulp, etc constitute examples of pulp products manufactured. There are also a host of wood products, not considered in this paper. While there are a number of downstream manufactures of paper and pulp products led by Nampak and the American-owned Kimberly-Clark, Sappi and Mondi account for a disproportionately large proportion of upstream supplies thus implying that their decisions directly impact on the performance of the industry. These dominant players own interest in a host of other companies or have contractual agreements with key downstream players, further entrenching the level of concentration and integration that give reason for a constant monitoring of the behavior of these firms by competition authorities. Find below the ownership stakes of key players in the industry.

Table 8. Shareholders of key players in the pulp and paper industry

	Anglo American	JP Morgan	PIC	Old Mutual	IDC	Bank of New York	Remgro	CMB Nom	Sanlam Main account
Mondi	100								
Sappi		13.2	6.4		8.3	17.8			3.3
Nampak		3.1	11.7	6.6		1.1	13.6		3.4
Malbak							50.4	26.5	

Source: McGregor's 2003

Profile of companies

Sappi

Sappi Ltd is an international forest products firm ranked in the top 20 pulp and paper manufacturers in the world. It is the world's leading producer of fine paper and the leading manufacturer of paper and pulp in South Africa. Its global sales were R39.3 billion in 2002, up from R33.2 billion in 2001. In South Africa, Sappi's leading shareholders are the Bank of New York-17.8 per cent and JP Morgan Chase -13.2 per cent (Table 8). By market capitalism, it was the 23rd and 13th SA giant in 2001 and 2002 respectively. Having grown from a totally South African based company, it now has manufacturing assets in eight countries on three continents and customers in over 100 countries around the world. In 1998, the Sappi group was restructured into a fine paper company and a forests products company with head offices in London and South Africa respectively.

38 per cent of the group's shareholders come from South Africa, which inclusive of other African countries only accounts for 13 per cent of group sales and 21 per cent of net operating assets. Sappi dominates the world paper and pulp industry in a number of respects. By market share, it is a leader in the sales of fine paper to the European (20 per cent), North American (28 per cent) and African (60 per cent) markets. Sappi Saiccor based in South Africa has the largest global market share (15 per cent) in the sales of dissolving pulp. Sappi owns 50 per cent and 54 per cent of the South African containerboard and uncoated fine paper markets respectively.

Fine paper has a total capacity of 4.2 million metric tons annually, constituting 85 per cent of the company's total turnover, 59 per cent of the group operating profits and 81 per cent of the group's net operating assets. The world's largest producer of dissolving pulp, Sappi forests products also produces pulp and commodity paper products. Sappi is approximately 70 per cent self-sufficient in pulp. Its worldwide chain of operations employs about 25 000 people mostly in Europe, North

America and Southern Africa while its South African operations employs approximately 18 500 people.

In Southern Africa, it operates the following mills: Cape Kraft, Tugela, Enstra, Saiccor, Adamas, Stanger and Ngodwana of which the Adamas, Enstra and Stanger mills are based in South Africa.

Mondi Ltd

Mondi Ltd, a wholly owned subsidiary of the Anglo American group is a large producer of pulp, paper, packaging board, sawn-timber and related products with an annual turnover of approximately R10 billion. Mondi's divisions include Mondi Paper, Mondi Recycling, Mondi Cartonboard, Mondipak, Mondi Kraft, Mondi Timber and Mondi Forests. Mondi Ltd, like Sappi, operates in both the up and downstream paper products markets. Upstream, Mondi is a major supplier of inputs from its forestry and pulp divisions to be used in the downstream manufacturing of paper and paper products. Some of the downstream operations include the production of recycled paper from recovered magazines and newspapers; office paper recommended for all copies, faxes and printers; carbonless copy paper; uncoated woodfree paper; pulp; graphic paper; packaging papers; converted packaging; SC mechanical paper and telephone directory paper.

Mondi has over the years been growing its size through direct investment into numerous companies in which it has an interest, or through the acquisition of existing concerns. In the 1990's for instance, Mondi bought over Consol's paper packaging division as the latter in conjunction with unbundling decided to refocus the company's resources into glass containers and plastic packaging. It owns a controlling interests of approximately 87.9 per cent in the Russian paper mill, Syktyvkar, owns Neusiedler in Europe, just to name a few of its foreign operations. In South Africa, its paper and pulp manufacturing facilities are located at Richards Bay, Piet Relief, Felixton and Marabank. There is an additional mill in Springs responsible for the production of the groups carton board products. The Richards Bay Mill responsible for the production of hardwood and softwood kraft pulp, white top and kraft linerboard is the largest followed by the Merebank mill and that in Springs.

Concentration indicators

Table 9 and 10 confirm the view that Sappi and Mondi collectively dominate a range of important market segments in the paper and pulp products industry and that their market shares are not only of similar sizes in most of these markets but jointly form a formidable force to influence decisions in the sector. This also explains why the Competition Commission has always scrutinized any merger in which any of these two dominant firms is involved. In several sub-markets up and downstream, they each control more than a 45% market share which according to the Competition Act of 1998 gives the Commission reasons to sustain a presumption of dominance.

Table 9. Paper and paperboard production capacity, 1998

Company	All grades capacity, thousand of metric tons	Percentage of total production capacity
Kimberly-Clark	50	2.07
Mondi Limited	1126	46.51
Nampak Limited	102	4.21
Sappi Limited	1098	45.35
Others	45	1.86

Source: Paper Manufacturers Association of South Africa Report (1998)

Table 10. Estimated market shares in selected product segments

Product	Estimated market share of Mondi	Estimated market share of Sappi
Uncoated woodfree		
Cut sheet	54%	46%
Converting grades	38%	62%
Newsprint	62%	38%
Cartonboard	38%	38%

Source: The merging parties, record page 131 and 132 as found in the Competition Tribunal Report in Case No: 06/LM/Jan02

Downstream players

Many firms operate in the paper and pulp downstream sector with Nampak and Kimberly-Clark being the major players. Malbak used to be a strong contestant in the downstream market until the Commission's ruling in June 2002 permitted Nampak to acquire it, subject to one condition - the disinvestments of Malbak's Kohler Packaging Ltd's bubble pack insulation machine where substantial market power was going to result post-merger (Competition News, 2002). Some of the reasons advanced for the merger include: adapting to the global trend in which packaging customers in the food, beverage and retail sectors were consolidating, implying Nampak had to do likewise, in order to seek critical mass, economies of scale and bigger facilities, as pre-conditions for survival and this was equally going to help accommodate export customers.

The attractiveness of this acquisition was accounted for by weak domestic demand in the local market, and the fact that a significant portion of Malbak's turnover was offshore. The merger resulted in greater concentration of power in the industry, as Nampak undoubtedly became the dominant player in many sub-markets downstream. Mondi's acquisition of Consol further weakened competition in the packaging market downstream. There are however many other small companies involved in the manufacturing and conversion of paper products, whose annual production capacity of paper and paperboard in South Africa is estimated at just 2 per cent of the aggregate value.

Nampak is a leading downstream player in the paper and pulp industry ranked as 39th in terms of market capitalization in South Africa. It is also Africa's largest packaging manufacturer and rivals Kimberly-Clark in tissue manufacturing. The group has 17 divisions made up of 130 business units, with operations in 10 countries involved in the manufacture of a range of metal, paper and plastic packaging products. It is highly diversified, producing a wide range of primary and secondary packaging, from beverage and food cans to bulk corrugated containers and plastic retail checkout bags. The group also produces fluting and test liner from waste paper. It is the country's leading converter of corrugated containers. The group's improved performance is indicated by the fact that productivity per employee increased from 100 in 1997 to 141 in 2002, the number of permanent employees increased from 16361 in 1997 to 18062 in 2002 and net profits from R419.30 million in 2001 to R657.1 million in 2002. With the acquisition of Malbak, Nampak now owns and runs the domestic leader of cores and tubes, Kohler Cores and Tubes which is a division of Kohler Ltd, a subsidiary of Malbak.

Kimberly-Clark is a world-class company with nearly one-fourth of the world's population using its products. Its global sales are estimated at some $13.6 billion pa. Its Africa and Middle East operational headquarters is based in Bedfordview, South Africa. It sells a full range of products including infant and childcare, incontinence, KC professional, family care and feminine care products. In paper it is one of the two leading downstream manufacturers of tissue. In South Africa, it has production sites in Cape Town and Enstra and distribution centres in Durban, Port Elizabeth and Roodekop.

The two principal determinants of competition in this industry are thus, the highly integrated nature of industry participants up and downstream, and the high levels of concentration with Sappi and Mondi operating a near duopoly upstream, Nampak and Kimberly-Clark doing same downstream in markets not dominated by the two upstream players. This characterization has got major competition policy implications given the fact that the dominant parties may, based on common interest, collude or mutually agree on some common principles and/or practices in order to derive the benefits that come with horizontal agreements some of which may include, lessening competition, increasing prices, restricting input supplies to non-integrated firms, to name a few.

5.3 The maize supply chain – structure, linkages and corporate control

The operations of the maize market, liberalised since 1996, have been hailed in some quarters as 'an elegant example of the efficiency of the free-market system'[25]. Aside from an ideological position on markets, economic efficiency needs to be critically evaluated in both social and private terms. Furthermore, while government regulation has been dramatically reduced, concentration at different levels of maize supply and distribution suggests there is governance (or regulation) of the supply chain by private institutions.

[25] Hochfeld and Esselaar writing in *Business Day*, 29 November 2002. Hochfeld is MD of Hochfeld Commodities and deputy chairman of the Cereals SA Oilseeds and Trading Association, and Esselaar is Sales Director of Spitz.

In the past, the maize market was controlled by the Maize Board, which apart from regulating the market also set a uniform maize price. In 1996 the maize market was liberalised and the Maize Board was abolished. One of the most important consequences of the abolition of the Maize Board is that prices are now allowed to fluctuate according to both local and international conditions. Another significant change that has taken place since liberalisation has been the restructuring of the main agents within each level of the maize supply chain, thereby impacting on the levels of concentration in the market.

Governance and control of value-chains

Although there are a great many farmers producing maize, there are several further stages in the processing, distribution, packaging and retail of maize meal. A focus on the 'real markets' rather than ideal text-book constructs means taking account of the sources and exercise of power at the different stages of what has been called the maize filière (Bernstein, 1996), or value-chain. Each of these stages involves some transformation of the product. Economies of scale and barriers to entry at different stages may mean that there are only a few agents operating at some of these stages and some agents are vertically integrated.

Moreover, the need for long-term linkages through the different levels of the chain in order to be able to co-ordinate operations from production through processing and distribution means that the 'governance' of the value-chain will reside in the dominant firms in the chain (Kaplinsky, 2000). The chains are characterised by horizontal concentration in trading, exacerbated by the importance of access to finance given the volatility in prices, and shifts in control downstream from wholesale to retail. The importance of access to the major brands' distribution and marketing networks in the food industry means that the value-chains for food products are increasingly becoming buyer-driven (Raikes and Gibbon, 2000).

Understanding the operation of maize markets therefore means assessing the dynamics at different levels of the value chain. As will be discussed, the removal of price controls happened in conjunction with the transformation of the large, white, agricultural co-operatives into private companies with the main farmers as shareholders. As argued by Bernstein (1996), this ensured that the barriers to the facilities of the former co-operatives were raised at just the point where government policy was shifting to support the development and growth of black farmers. Concentration of the established white farmers has also continued to increase significantly.

Concentration in the Maize Market

Concentration levels are important in that they are an indicator of the degree of oligopoly in the market and also because they may serve as a sign of anti-competitive practices. This section will cover aspects of concentration at the level of farms, millers as well as silos. The maize market generally operates on four levels. The first level is that of the maize farmers who plant the crop, harvest it and then deliver it to the silo owners and sell it to the traders. Maize is then kept in the silos until it is distributed to the milling companies who process the maize, and sell to retailers.

Since the deregulation of the maize market, there has been a substantial decline in the number of farmers. Although the exact number of farmers involved in maize is not available, a reasonable estimate can be made by taking into account the fact that the Department of Agriculture sends out 3800 crop estimate questionnaires to maize farmers. There has been a long-term decline in the number of operational farms. According to Bernstein (1996), the total number of white-owned farms declined from approximately 104 000 in 1960 to 70 000 in the early 1980s and 59 000 in the late 1980s. In the mid-1980s it was estimated that 40 per cent of gross farm income was generated by only six per cent of white farms. The top three silo companies who between themselves control 72 per cent of the market capacity are OTK, NWK and the Senwes Group (SWK). The main owners of milling companies in South Africa are Tiger Oats Limited, Premier Group Limited, Pride Milling Company and Pioneer (McGregors, 2002). OTK and Senwes also own milling operations. There are 17 members of the National Chamber of Milling, which represents the main milling companies (National Chamber of Milling, 2002). The largest four firms accounted for 42.5 per cent of output in 1996.[26]Since liberalisation, traders have played an important part in the workings of the maize market. Although farmers can sell their crop straight to millers, most small farmers prefer selling through traders. There are four main traders of maize in South Africa. These are Cargill (a US multinational), Dreyfuss (a French multinational), OTK and WJ Morgan, with Cargill probably being the most influential.

The Extent of Market Power in the Maize Market

The South African Competition Act of 1998 defines market power as “the power of a firm to control prices, to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers” (Competition Act, Act no. 89 of 1998, 1. (1). (Xiii)). To determine whether any firms hold market power in the maize market, we therefore have to see if any of them contain characteristics described in the definition.

A recent trend in the agricultural sector has been increasing economies of scale. As has been mentioned before, the number of farms in South Africa has been drastically declining since the early 1980s. At the same time, the ownership of silos has become more concentrated. The buying up of small farms and silos has lead to a situation where oligopoly conditions exist in the maize market. The existence of oligopolists is usually a precondition for collusion and we can see that this may be the case in the South African maize market.

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[26] 1996 Manufacturing Census.

A recent development in the maize market has been the organizing of producers into associations that reflect their interests. Examples of these are GrainSA for farmers and the South African Chamber of Milling for millers (Naledi, 2002). Although issues of research and development may be dealt with in such interest groups, it is quite reasonable to expect that there is a lot of other information exchanged between members. In an industry such as this, where for example all milling companies stand to benefit from the farmers obtaining low prices for their crop, there is also a motive for members of interest groups to come together and devise strategies to maximize their revenue potential, either by making sure that prices stay down or are pushed up.

Vertical Integration

Vertical integration describes the extension of ownership and control over operations along a production chain. An example of vertical integration in the South African maize market would be the fact that Metro, a large food wholesale company which supplies most black retailers, is owned by Premier Group Limited, one of the corporate giants of milling (Bernstein, 1996). Backward integration into production of the input ensures supplies and reduces the cost of coordinating activities at different stages of production. This puts potential new entrants at a cost disadvantage and increases their sunk costs.

The three large companies operating silos extend their operations from the large farmers, which are the main owners of the companies, through storage, trading and milling. OTK in particular is a major trader. The main firms are also involved in other activities concerning the operation of the maize market. In the past, these companies had the responsibility of distributing Land Bank loans to farmers. These loans were for the purpose of financing the purchase of inputs needed for production – seeds, pesticides, machinery, equipment and fertilizers. Although the Land Bank no longer provides these loans to them, they have secured other sources of finance and still act as creditors to farmers. One of the conditions of these loans is often that farmers have to carry out repayments in the form of crops in lieu of cash. This leads to a situation where the companies who are the main suppliers of production inputs are also the main receivers of the resulting output. Because these silo companies provide inputs to a large number of farmers they are able to purchase these inputs in bulk and therefore save on the input costs. It is debatable how much of the discount is passed on to the farmers and how much is retained by the silo firms for themselves (Amin and Bernstein, 1996).

It is important to recognise, however, that the firms operating the silos do not necessarily own the grain which is stored. Owners, whether farmers or traders, pay fees for the grain storage. But, the silos do also have a very important role as market-makers, posting prices for the purchase of grain. This function and the way in which information is shared amongst them requires further investigation. As already noted, it is also the vertical integration and combination of related activities which makes the silos so pivotal in the market. An example of this vertical integration at the level of silo ownership can be seen with the case of OTK.

OTK has been in operation for 77 years. It was originally known as the Oostelike Traansvaalse Landbou Ko-operatiewe Vereeniging and was established with the main aim of handling grain produced by its members. The company listed on the Johannesburg Stock Exchange in November 1996 under the name OTK Holdings Limited. OTK was renamed Afgri in July 2002, largely in attempt to signify the company's transformation from a regional co-operative to an agricultural services business operating all over Africa.

This is a vertically integrated group, which undertakes activities in the four main sectors:

1) Supply of agricultural inputs, equipment and services
2) Agricultural produce handling
3) Storage
3) Agricultural produce processing

Afgri owns 59 retail branches and supplies producers with various agricultural input commodities and services. The kinds of crop produced in Afgri's service area, the so-called highveld area of Mpumalanga, are mainly sunflower, dry beans, maize, wheat and cotton. Afgri's four divisions focus on the following areas:

1. *Afgri Capital* provides business and risk management solutions, which include finance, short term and crop insurance and advisory services, to farmers, traders and agricultural processors.
2. *Afgri Products* manages the grading, handling, storage and trading of agricultural products through its logistics, trading and risk management business. It also provides farmers and agri-processors with hedging facilities and services. This division manages all the secondary agricultural processing businesses of Afgri, namely Seed marketing, Animal feeds, Clark cotton and its broiler interest in Earlybird Farm.
3. *Afgri Requisites* markets and distributes an extensive range of products and farming requisites produced by third parties, including mechanization equipment such as tractors and farm equipment and services.
4. *Afgri Services* sells agricultural science and technology to producers.

The role of competition policy

The sharp rise in food prices and maize in particular led to the Minister for Trade and Industry calling upon the Competition Commission to examine 'pricing policies in the South African economy' and whether price increases had been 'opportunistic'. At the same time the National Treasury commissioned a study into the agricultural sector to ascertain what underpinned the sharp price hikes. In this section we review the study undertaken by the Competition Commission and reflect on the role of competition policy in issues such as this.

As identified in the analysis above, there are significant levels of concentration at the trading, storage, milling and retail levels. In addition, the price rise included an exchange rate effect (which impacted on both the export-parity and import-parity prices) and a jump from the export-parity to above the import-parity level. There is furthermore vertical integration of some firms (especially OTK/Afgri) from the farming through to storage and trading.

The Commission's investigation found that the 'food price inflation does not appear to have been caused by anti-competitive conduct.' Instead the price rises were attributed to the monetary policy accommodation of the inflationary pressures arising from the Rand's sharp depreciation towards the end of 2001. This was a somewhat surprising conclusion as interest rates were raised sharply and monetary policy exerted a significant contractionary effect on the domestic economy. In addition, the inquiry found that retailers had only passed on the price rises (in part or in full) and had not increased profits as a result of market power in price setting.

The role of competition policy? - Impotence and inappropriate theory.

The Competition Commission's conclusion that the maize price increases are not due to market power is questionable. But, of greater concern is the failure to collect information enabling a better understanding of the factors underlying the pricing of maize at different levels of the supply-chain from farm-gate to shop-shelf. The Commission is uniquely placed to obtain information from companies due to the powers in its Act.

Under the Competition Act, proving the exertion of market power constituting abuse of a dominant position is very difficult. 'Excessive pricing' requires demonstrating that the price does not bear 'a reasonable relation to the economic value of the good or service' and that it is above such an economic value. Three and a half years after the Competition Act came into force this has not been shown in any case. Indeed, there has not been any substantive prosecution of firms under the abuse of dominance or collusion provisions. Given the very high levels of concentration in the South African economy this is somewhat surprising.

In the maize market it has been demonstrated that there are three firms which control the majority of silos and four traders account for most of the trades (by volume traded) on SAFEX. Milling of maize meal is also very concentrated while there is vertical integration of a firm, OTK, from farming through trading, silo management and into milling. It may be difficult to demonstrate that the extreme price rises are not related to changes in the 'economic value' as required by the Competition Act in order to demonstrate abuse of dominance. This is as much a reflection of the onus of proof under the Act and economic theory underpinning the legislation as of the actions of the Commission. But, the Commission signally failed to analyse information on:

- the appropriate geographic definition of the market;
- the implications of regional shortfalls given the nature of markets in countries such as Zimbabwe and Zambia and differentiation of genetically modified maize;
- the behaviour of the main firms in the market, especially the traders and ex-cooperatives linking farming with silo storage;
- why maize prices rose in advance of the exchange rate depreciation; and
- the nature of vertical integration and price determination.

Given the huge welfare impact on consumers of the maize price rise, these flaws are striking. Regardless of whether evidence would have been sufficient to take a case before the Competition Tribunal, the Commission could at least have shed light on the nature of the various markets at different levels of the supply chain, and firm behaviour. For example, such information might have allowed an evaluation of the extent of speculative behaviour. Such behaviour may be expected in a price inelastic market dominated by a small number of traders where news on weather and production can have such an important influence on pricing. The static economic theory employed by the Commission does not allow for strategic behaviour and interaction between firms, but the information they could collect would in itself be a public service in furthering our understanding of such issues. The Food Price Monitoring Committee established by government certainly needs to get to grips with these issues.

6. Conclusion and recommendations

The South African economy has historically been highly concentrated, with close interaction between the major conglomerate groupings and the state. These groupings developed around the exploitation of minerals and resources, and diversified into related manufacturing activity. The levels of concentration mean that the development of the South African economy is closely related to the orientation and strategies of a small number of corporations.

In the past ten years there have been major changes and important elements of continuity. The liberalisation of the economy and outward internationalisation of the conglomerate groupings (notwithstanding the existing extensive international operations of some) has stimulated far-reaching unbundling of their diversified operations. This underpinned the huge amount of merger activity in the late 1990s up to 2001. At the same time as corporate restructuring has reduced the family-control characterising many of the conglomerates, so the interventionist role of the state has also diminished. This suggests firms that are more shareholder driven and linked into the international economy in terms of operations and ownership.

The unbundling has not, however, necessarily reduced concentration within any given sector. Indeed, there has been a 'rebundling' of operations by the major groupings around core focus areas. In mining this has accompanied the regaining of the sector's 1994 share in the local economy and the international growth of the major firms. In industry, consolidation has seen the growth of groupings such as Remgro, Barlows, Bidvest, Aveng and Nampak. These firms have also increasingly become international. Domestically, in many sectors there are clearly one or two major players, often vertically integrated from material inputs through to manufacturing.

The changes serve to further emphasise the importance of rivalry as a disciplining force on the behaviour of dominant firms. Dynamic competitive pressure restrains possible abuses of downstream purchasers such as the charging of higher prices. It also induces ongoing improvements in products and processes. This is an important lesson from the East Asian economies where the positions of the main groupings constantly changed and the government explicitly encouraged rivalry between the main firms.

Despite unbundling, the four biggest conglomerates continue to account for more than half of the capitalisation of the Johannesburg Stock Exchange, although several of the biggest firms cannot correctly be described as South African given their global operations and foreign listings. Changes in the rankings of firms by capitalisation are due more to the rise of sectors such as telecommunications, and the unbundling process, than real dynamism in firms' performance. In this regard, the continued low levels of investment in South Africa are particularly worrying.

Black economic empowerment based on finance arranged through special purpose vehicles and facilitated by pyramid arrangements was quite unsuccessful as the JSE declined in value. The share of black ownership on the JSE has started to rise once again in recent years, and on a quite different basis. It has been spurred by the mining charter as well as the growth of firms in diverse sectors but still remains low. Experience of other countries such as Malaysia points to the importance of government levers to promote changes in ownership and control.

The sector case studies reinforced the patterns observed at the economy level. In iron and steel, the dominance of the formerly state-owned Iscor means local users of steel pay significantly higher prices than those earned on steel exports, and no competitive advantage is thus derived from having a local steel industry. This is the case despite a process of liberalisation and adjustment which has seen Iscor being acquired by the second largest steel multinational in the world. In paper and pulp the established firms, Sappi and Mondi, continue to dominate and have succeeded in growing their global operations. Consolidation in packaging and paper products has also seen the growth of Nampak through acquisitions, including of Malbak. Similar patterns have occurred in maize with former co-operative OTK now a vertically integrated private firm with major operations from agricultural inputs, storage, and trading through to milling and production of animal feed.

The new Competition Act of 1998, based on international 'best practice', was explicitly aimed at addressing the behaviour of large firms. But, the institutions established under the Act have focused largely on mergers. While the institutions have established a reputation for rigorous merger analysis and have perhaps blocked further consolidation within sectors they have to date signally failed to come to grips with practices such as collusion and abuse of dominance. The conditions in the South African economy and the well-established relationships between firms imply that these practices are likely to be widespread and damaging to the economy. The reorientation of the major conglomerate groupings will only serve to heighten the incentives to pursue short-term profitability to meet share-holder expectations.

The demands of implementing the Act are great and it will take some time for the experience and capacities required to be developed. Crucial to the process is better information gathering and analysis on an ongoing basis. An assessment of cases and of the diverse competition regimes, especially in developing countries, suggests several areas for attention.[27]

- An organisation within government ought to be tasked with monitoring the decisions and operations of the major conglomerates and industrial groupings. This applies to determining the impact of industrial policies more broadly on firms' decisions and not only to competition policy.

[27] See also the conclusions to section 4.

- Additional corporate governance legislation to increase the reporting/disclosure requirements of firms is necessary.

- Mechanisms to facilitate more effective collection and sharing of information across public institutions that engage with firms are necessary, especially in sectors identified as priorities.

- Provisions to designate or declare firms which are overwhelmingly dominant in key sectors (as exist in Australia and South Korea) would enable both more effective investigation through easier access to information and a greater ability to take action on practices such as excessive pricing.

- Stronger links of the investigating agencies charged with addressing economic offences such as the Competition Commission and SARS in order to support prosecution of collusion. 'Whistleblower' provisions would also encourage the provision of information.

- A clearer specification of excessive pricing provisions to indicate price increases which are not cost-related.

- The unwillingness of small companies to make complaints against their dominant suppliers indicates the need for the Commission to independently investigate industries where abuse of dominance is likely.

Lastly, the continuing levels of concentration means that the evolving capitalist model will depend on the changing orientation of a few large firms. This will in turn heavily influence the performance of the economy and the extent to which the participation of historically disadvantaged persons increases. In addition to directly addressing the behaviour of firms through competition policy, the use of performance requirements and criteria for firms can foster rivalry and promote government's policy objectives. The rapid response to the mining charter, which essentially sets up non-profit criteria on which firms will be judged (or in other words compete), demonstrates the effectiveness of such an approach. Other sectors are clearly different, but the value of rivalry in inducing changes in behaviour is equally applicable.

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Appendix Table 1. Top 100 listed firms

Name	Market capitalisation 2002	Rank 2002	Rank 1998	Rank 1994
Anglo	291.7	1	1	1
Billiton	149.6	2	7	
Richemont	124.2	3	6	5
Angloplat	101.2	4	16	
Sasol	74.3	5	5	8
SAB Plc	64.9	6	2	3
Angold	57.3	7	53	21
Old Mutual	56.1	8	-	-
Gfields	46.4	9	33	16
Implats	39.2	10	81	43
FirstRand	37.6	11	10	18
SBIC	36.2	12	8	11
Sappi	36.1	13	63	17
Remgro	31.1	14	12	10
Nedcor	30.0	15	9	24
Lonmin	26.8	16	44	31
Libint	26.2	17	4*	4*
M-Cell	21.7	18	77	-
Sanlam	21.4	19	-	-
Absa	17.7	20	13	41
Harmony	17.6	21	-	121
Gencor	16.0	22	86	7
Liberty	15.7	23	4*	4*
Kumba	14.6	24	-	-
Barworld	13.6	25	29	33
Investec	13.5	26	17	69
Didata	12.8	27	18	-
Bidvest	12.8	28	26	100
RMBH	12.1	29	22	77
Imperial	10.4	30	21	80
Tigbrands	9.7	31	23	30
Venfin	9.0	32	-	-
Lib-Hold	8.0	33	-	15
Johnnic	7.1	34	30	9
Steinhoff	7.0	35	-	-
BoE	6.7	36	32	-
ABI	6.7	37	64	88
Tongaat	6.2	38	40	52
Nampak	5.6	39	35	29
Corohld	5.4	40	38	-
NAC	5.2	41	-	-
Dbn-Deep	5.1	42	-	-
Alexfbs	4.9	43	-	-
PicknPay	4.9	44	73	103
Avgold	4.7	45	122	-
Inhold	4.4	46	-	-
NIBH	4.4	47	-	-
Iscor	4.2	48	68	22
M-&-F	4.0	49	42	81
Santam	3.9	50	90	130
Netcare	3.9	51	136	-
Afrox	3.9	52	59	70
Reunert	3.8	53	120	68
Northam	3.7	54	-	-
Avmin	3.7	55	88	-
Energy	3.7	56	94	44
Wes-Areas	3.6	57	93	72
AVI	3.6	58	79	28
Woolies	3.6	59	46	-
Shoprite	3.6	60	56	109
Wooltru	3.5	61	37	27
PPC	3.5	62	84	48
Metcash	3.4	63	61	97
Tigon	3.3	64	133	-
Discovery	3.2	65	-	-
Comparex	3.0	66	-	-
Abil	3.0	67	-	-
Aveng	2.8	68	-	-
Assmang	2.8	69	146	114
Delta	2.7	70	-	-
Illovo	2.7	71	95	120

Aspen	2.6	72	-	-
Datatec	2.5	73	103	-
Copi	2.4	74	-	148
Distell	2.3	75	116	117
Medclin	2.3	76	142	-
Caxton	2.3	77	-	-
M&R Hold	2.3	78	91	38
Pikwik	2.2	79	-	-
Truworths	2.2	80	-	-
Massmart	2.2	81	-	-
Altech	2.1	82	132	126
JD Group	2.1	83	74	123
Naspers	2.1	84	52	94
Supr Group	2.0	85	82	-
Ahealth	2.0	86	-	-
CTP	2.0	87	111	-
AECI	1.9	88	96	51
Kersaf	1.8	89	100	62
NuClicks	1.8	90	121	145
Palamin	1.8	91	124	89
Trencor	1.8	92	78	82
Hiveld	1.7	93	-	60
HLH	1.7	94	-	96
Malbak	1.6	95	117	42
Foschini	1.6	96	72	47
OTK	1.6	97	137	-
Captall	1.6	98	76	-
Aflife	1.5	99	60	-
Unitrans	1.5	100	-	139

Source: Financial Mail

Notes: A rank between 100 and 150 is given where applicable for 1998 and 1994
* Before the unbundling Liberty group was ranked fourth in 1998 and 1994.

Appendix Table 2. Top 50 listed industrials (including mining)

Name	2002 market capitalisation (Rbn)	Rank 2002	Rank 1998	Rank 1994
Anglo	291.7	1	1	1
Billiton	149.6	2	6	-
Richemont	124.2	3	5	4
Angloplat	101.2	4	9	-
Sasol	74.3	5	4	7
SAB Plc	64.9	6	2	3
Angold	57.3	7	30	17
Gfields	46.4	8	19	13
Implats	39.2	9	48	33
Sappi	36.1	10	35	14
Remgro	31.1	11	8	9
Lonmin	26.8	12	25	24
Harmony	17.6	13	-	91
Gencor	16.0	14	6	50
Kumba	14.6	15	-	-
Barworld	13.6	16	17	26
Bidvest	12.8	17	15	75
Imperial	10.4	18	11	60
Tigbrands	9.7	19	12	23
Johnnic	7.1	20	18	8
Steinhoff	6.9	21	-	-
ABI	6.7	22	36	66
Tongaat	6.2	23	23	40
Nampak	5.6	24	20	22
Dbn-Deep	5.1	25	-	-
Avgold	4.7	26	74	-
Iscor	4.2	27	40	18
Afrox	3.9	28	33	53
Reunert	3.8	29	73	52
Northam	3.7	30	-	-
Avmin	3.7	31	52	-
Energy Africa	3.7	32	56	-
Wes Areas	3.6	33	55	55
AVI	3.6	34	45	21
PPC	3.5	35	49	37
Aveng	2.8	36	-	-
Assmang	2.8	37	92	84
Delta	2.7	38	-	-
Illovo	2.7	39	57	90
Datatec	2.5	40	63	-
Copi	2.4	41	-	-
Distell	2.3	42	69	87
M&R Hold	2.3	43	53	30
Altech	2.1	44	81	96
JD Group	2.1	45	43	93
Naspers	2.1	46	29	70
Spur Group	2.0	47	47	-
AECI	1.9	48	58	39
Kersaf	1.8	49	60	48
Palamin	1.8	50	76	-

Source: Financial Mail

Notes: A rank between 50 and 100 is given where applicable for 1998 and 1994
The table excludes De Beers (now delisted).