Opening Remarks of Deputy Commissioner, Hardin Ratshisusu at the seminar on:

Development funding for a growing and inclusive economy: Promoting entry and addressing concentration through development funding

5 September 2018, University of the Witwatersrand, Johannesburg

Greetings

Good morning ladies and gentlemen and welcome to this seminar on the role of development funding in creating a growing and inclusive economy.

Before we begin I would like to extend a special welcome to DDG Mabitjie-Thompson of the DTI and DDG Mkhumane of the Department of Small Business Development and thank them for taking time out to join us here today. I would also like to welcome the many representatives from the various development funding institutions, particularly the IDC, Land Bank, NEF and SEFA for also taking time to join us here today. Finally, I would also like to extend a very warm welcome to the representatives from other government departments and agencies, academia, business and labour.

Introduction

We are here today to discuss the interface between competition policy and development funding in addressing South Africa's developmental and transformation objectives.

Yesterday the country watched as Statistics South Africa announced that we have descended into a technical recession, with a decrease in real GDP for two consecutive quarters by 2.2% and 0.7% respectively.

Data, however, indicates that South African GDP growth rates between 2016 and 2017 have been relatively stable. For example, in the second quarter of 2016, the GDP growth rate was 3.1%, while in the second quarter of 2017 the economy grew at a slower pace of 2.8%.[1] [2] It is only in the second quarter of 2018 that the South African economy slipped into a technical recession

[1] Accessed from: http://www.statssa.gov.za/?p=10775 [04 September 2018].
[2] Accessed from: http://www.statssa.gov.za/publications/P0441/GDP_presentation-Q4_2016.pdf [04 September 2018].

One of the main contributors to this economic decline is the decrease in the economic activities in several sectors, such as agriculture, transport, trade and manufacturing. For example, agricultural production dropped by 29.2% in the second quarter of 2018, in addition to a 33.6% decline during the first quarter. However, it is accepted that this severe decline was as a result of the drought experienced in the Western Cape which had a significant impact on crop harvests.

Manufacturing activity fell by 0.3% driven by a fall in the production of electrical machinery and transport equipment (including motor vehicles). The trade industry has also experienced a consecutive negative quarterly growth rate declining by 1.9%.[3]

Despite the negative economic developments in the agricultural, transport, trade and manufacturing industries, certain sectors of the economy have attained positive growth rates during the second quarter of 2018. These include mining and construction, which grew by 4.9% and 2.3%, respectively. The mining growth rate was a result of an increase in the production of commodities such as platinum group metals and copper, while the growth rate in the construction sector was driven by an upsurge in non-residential buildings and construction work activities.[4]

The reason why I bring these statistics to your attention is that we all sit here with a vested interest in the sustainable growth of our economy. I also do this in recognition that we all, either as policymakers, business, funders or regulators have a role to play in contributing to our inclusive growth.

Challenges of concentration and barrier to entry

The concern of persistent incumbency remains a great regulatory concern for the Commission. A recent study undertaken by the Commission on market concentration showed that 70% of the sectors in the South African economy have dominant firms.[5] These dominant firms are likely to play a gatekeeping role in the economy, raising barriers to entry and hindering the expansion of firms, specifically small, micro and medium enterprises (SMMEs) and firms owned by historically disadvantaged individuals (HDIs).

The results of the study show that notwithstanding almost 20 years of competition regulation post apartheid, concentration in the South African economy remains persistently high. This

[3] Accessed from: http://www.statssa.gov.za/?p=11507 [04 September 2018].
[4] Accessed from: http://www.statssa.gov.za/?p=11507 [04 September 2018].
[5] Buthelezi, Mtani and Mncube (2018). "The extent of market concentration in South Africa's product markets". Competition Commission South Africa, Working Paper CC2018/05

notwithstanding the regulatory interventions of breaking up cartels and imposing significant administrative penalties, some prosecution of abuse of dominance cases and vigorous merger regulation. To provide some context, the Commission currently has over 100 cartel cases under investigation as well as 80 in prosecution and has levied approximately R7 billion in fines over the years for cartel contraventions.

In a recent Business Day article, Professor Simon Roberts of the University of Johannesburg opined that,

> *"While economists can debate whether concentration has actually increased over the past two decades, this is to miss the point. It is clear that the high levels of market concentration have not substantially diminished, as pointed out by many different reviews. And, according to both the OECD and IMF, SA has maintained among the highest levels of corporate profitability compared with other emerging market economies, while fixed investment levels have been poor. There are certainly other factors as well as weak competition in explaining the poor investment rates. But, the issue is not whether competition law is the silver bullet (it is not), but what kind of competition regime will stimulate productivity improvements, investment across the economy and a greater spread of economic activity. It needs to be a regime that exposes incumbents to challengers, to spur them to improve their offerings and invest in better capabilities. Competition law must prevent incumbents from raising obstacles to entrants so they can maintain a quiet life and continue to earn profits simply from their incumbency. Rivals bring new products and business models. Fair competition spurs efficiencies and entrepreneurship…"*

Faced with these challenges, it is clear that competition enforcement alone will not eliminate barriers to effective competition.

One observation from the Commission's study found that there were dominant firms in sectors that have been prioritised by the Commission, including:

- Intermediate industrial products
- Food and agro-processing
- Telecommunications
- Transport
- Pharmaceuticals
- Financial services
- Construction
- Mining and

- Energy.

Over time, the competition authorities have undertaken innovative remedial action following enforcement proceedings as well as in merger regulation. The remedies were generally geared towards addressing entry, increasing participation and promoting innovation.

An example of these interventions was as a result of Wal-Mart/Massmart merger in which the parties established a R240 million Supplier Development Fund to assist in developing South African suppliers, particularly SMMEs that were black-owned and local manufacturers of products.[6] Other similar funds have been created since including the Agro Processing Competitiveness Fund, the AB InBev Fund, the Coca-Cola Supplier Development Fund and the Media Cartel Fund with parties committing over R3 billion, all of which are aimed at supporting entry into these markets.

The Commission's interventions have however not been limited to these remedies, and we have in a number of markets fostered competitive market structures by busting cartels, regulating mergers and conducting market inquiries. For instance, in 2007, the Commission prohibited a proposed merger between Pick n Pay and Fruit & Veg City based primarily on the fact that Pick n Pay and Fruit & Veg City were effective potential competitors and big purchasers of fresh produce. The competitive constraint between these two companies meant that they are likely to continue competing vigorously through prices and quality to the benefit consumers. In prohibiting the merger, the Commission forced Pick n Pay and Fruit & Veg City to continue being competitors. This resulted in the substantial growth of Fruit & Veg City illustrated by Food Lover's Market brand stores increasing from just 2 in 2007 to 75 in 2016 and the rolling out of 220 Fresh Stop stores during the same period.

Another example was a cartel in the cement sector. Following an investigation of the four main cement producers, namely PPC, AfriSam, Lafarge and NPC in 2008, the Commission settled with 3 of these firms and continued its prosecution of one. The cartel encompassed price fixing as well as systematic market division. Following the Commission's intervention, an African Competition Forum and World Bank Study reported that prices and margins had declined steadily since the breakup of the cartel. Estimates suggest that the price difference between the cartel and non-cartel periods was approximately between 7 and 9%. This translates to an estimated total savings to South African customers in the range of R 1.1 – R 1.4 billion a year. Apart from the financial benefits, firms have been penetrating regions where they were previously inactive. For example, prior to the investigation, PPC was allocated the Western

[6] The Competition Appeal Court ordered that a maximum amount of R200 million be allocated by Massmart over a 5 year period. This amount is over and above the R40 million already allocated by Massmart.

Cape but Afrisam has since entered that market. The Northern Cape was split 75% and 25% between Afrisam and PPC during the cartel years, but Lafarge has since gained market share in the area.

In 2013 the Commission and Telkom entered into a settlement agreement following an investigation and finding that Telkom had abused its dominant position in the upstream infrastructure market. Part of the settlement encompassed an administrative penalty in the amount of R450 million. Most importantly, the settlement also included the structural and functional separation of Telkom's business into wholesale and retail as well as the implementation of a Transfer Pricing Programme. These remedies were subsequently extended following the merger of Telkom and BCX in 2014 to 2020 and included Telkom's provision of fibre.

Even in the market inquiries conducted by Commission, starting with Banking Inquiry and in more recent inquiries such as the LPG inquiry, the Commission has introduced interventions aimed at addressing concentration and lowing barriers to entry.

The Commission has noted over the years the impact of these interventions on entry and expansion of competitors including SMMEs in these sectors. SMMEs have had access to markets, support services and especially much-needed funding. These interventions have also had an impact on employment by creating new jobs. Another key result that the Commission has noted is the impact on transformation as more firms owned by HDIs were able to enter and participate in markets.

We as the Commission continue to see investment in targeted markets as the way to ensure competition that will lead to lower prices and product choice for consumers as well as the promotion of employment and greater participation by all South Africans in the economy. This is particularly important as the markets are constantly evolving, and in recent times with the fourth industrial revolution through big data, artificial intelligence and blockchain technologies.

Other interventions by the government in these sectors are also key to ensuring entry and greater participation. An example of such intervention is the Black Industrialists Scheme (BIS) which has provided financial assistance to 100 black industrialists, in addition to that 48 companies were helped to improve their market access. It is foreseen that a further 100 black industrialists will be assisted over the next two years.

The role of development funding

Development funding, as an important industrial policy tool, has a significant role to play in ensuring the achievement of the country's socioeconomic and developmental goals. At the same time, DFIs have a significant role to play in ensuring that their financial interventions in markets promote competition through investment decisions allowing for entry which would increase consumer choice and challenge incumbency. In fact, I would argue that DFIs, in making their financing decisions, need to be deliberate in ensuring that beneficiaries are promoting competition and not merely digging in their heels to entrench their incumbency.

No doubt there are complexities in making these determinations including employment, stakeholder accountability and prudential management. This, however, does not negate the fact that in addressing the challenges faced by South Africa, there needs to be brave and fundamental changes in how regulators, including the Commission, as well as DFIs, do things.

Lessons from other jurisdictions

Some of the fastest growing economies in the world have utilised the tool of development funding to build their economies. In particular, BRICS countries also utilise development funding like South Africa to achieve development goals, deal with market failures, provide public goods and infrastructure, ensure efficient social resource allocation and tackle economic volatility. They also tend to focus on financing projects that support SMMEs.[7]

Lessons learnt from our BRICS counterparts as well as the East-Asian economies (including Korea, Taiwan, Malaysia and Japan) are indicative of the importance of an integrated policy approach to the role of DFIs, not only in relation to different government departments and agencies but also the private sector, to achieve a shared developmental agenda.

This is more so in circumstances where South African stakeholders, especially entrepreneurs and owners of small and medium enterprises often cite adequate funding as a critical barrier to entry hindering their participation in the economy.

A look at the achievements in other jurisdictions is a stark reminder that, like competition policy, development funding exists to ensure that the promotion of employment, advancement of social welfare and general the growth and sustainability of the economy.

---

[7] Accessed from: http://www.oecd.org/dev/41302068.pdf.

Concluding Remarks

Notwithstanding the interventions of the competition authorities and other government programmes, market concentration remains high, inhibiting entry and the development of SMMEs and firms owned by HDIs. In addressing this challenge, I believe that it is necessary to have a concerted approach that will steer our interventions towards achieving inclusive growth and development.

The country can no longer afford to see economic participation being limited to a few incumbents and that is why I hope that this forum will be the beginning of a meaningful dialogue that aims to address some of the challenges faced by policymakers and DFIs and identify opportunities for better efficiency and results.

It is a critical time for the competition authorities as the Competition Amendment Bill which aims to expand the mandate, and the powers of the competition authorities to address high levels of economic concentration in South Africa is top of mind.

At the same time, I cannot overemphasise the need for deliberate policy interventions that will assist in addressing market concentration, such as the Black Industrialist Scheme I have referred to earlier. Further the implementation of critical practical steps could include:

- Opening up of routes to markets and addressing barriers to entry
- Funding entry of rivals in concentrated markets and not just a narrow focus on jobs
- Economic regulation that supports new entrants and innovation
- Transparent monitoring and measurement of the impact of the work of the DFIs to minimise duplication and
- Addressing concerns raised by stakeholders regarding funding terms and structures for development funding.

I believe these points and others will be discussed in today's panel sessions, so I will leave it at that.

As I conclude, I draw encouragement and inspiration from President Cyril Ramaphosa, who in a speech in November 2017, highlighted the need *"to massify the creation, funding and development of black-owned small businesses, township businesses and co-operatives."* [8]

He further stated that:

> *"it is unacceptable that our economy is dominated just by five banks, when we could have focused banks like the Women's Development Bank or a small and medium*

[8] Accessed from: https://www.biznews.com/thought-leaders/2017/11/14/ramaphosa-new-deal-for-sa

enterprise bank, a stokvel bank, a construction bank or well-run community banks. We must give urgent attention to a multi-billion-rand fund, which has contributions from investors, the financial sector and big business to provide much more funding to start-ups, micro businesses, innovative technology solutions and export-oriented businesses. Crucially, black economic empowerment requires that we deconcentrate the ownership and control of our economy. A compact among all key stakeholders is necessary to give effect to this objective. As stakeholders, we need to open up corridors of economic opportunity, activity and progress for all our people to participate in the development of our country…"

I hope these words will inspire us all through today's proceedings to consider and find solutions that will enhance future collaborative efforts between all the stakeholders represented for the benefit and welfare of all South Africans.

Thank you.