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Foster fair markets and tighten competition laws to achieve transformation

Eddie Rakabe 31 Jan 2018

COMMENT

South Africa has been mulling over the need for structural economic reforms to promote growth and employment, and social and economic transformation, but progress is lagging.

That there is no consensus about the broad shape of reform became clear at the 54th ANC national conference in December.

Going into the conference, two constructs dominated the discourse over the vital interventions needed. There were spirited calls to "disintegrate" (white) monopoly capital, which is regarded as the key impediment, with (radical) economic transformation — which for the most part meant changing the structure, ownership, management and control of the economy.

We now know that the conference discussion about these two constructs dwelt on their composition rather than on the practical aspects and instruments needed to drive change. Thus the opportunity was missed to provide a diagnosis of monopoly capital and its implications for ordinary citizens and the broader economy, including how best to address it.

The ANC's Strategy and Tactics document's primary concern with monopoly capital relates mainly to super-profits, import parity pricing, entry barriers and greed, but it stops short of explaining why this is undesirable for the broader economy. The document lacks analytical depth and as a result may fuel public doubt about the soundness of the policy concepts.

Monopoly capital is about the nature of public and private companies' behaviour and the organisation of industry, and how these affect investment, production and consumption decisions. It is the manner in which the market or economy is structured.

A widely accepted definition of monopoly capital is of a "highly concentrated or vertically integrated" market structure, referring to the dominance of few large firms within particular sectors of the economy. This is illustrated by the fact that 50% of South Africa's gross domestic product, estimated at R2-trillion in 2016, is generated by 1% of the country's firms.

Companies employ several tactics to remain dominant in the market and to prevent the entry of new players. This enables them to make huge profits, which are in turn reinvested in upstream and downstream supply chains to assert market power. This structure results in the concentration of profits and capital by a few people at the top, and prejudices the welfare of consumers by limiting choice, thwarts the growth of small businesses and, most disturbingly, entrenches income inequality and stunts overall growth.

Those calling for policies to transform the economic structure are justified. But policies are not a wish list; they are systematic, scientific and aspirational statements of intent backed by rigorous research. Policymakers seeking to dismantle market concentration must understand and analyse the behaviour of dominant firms in the local environment, review available remedies and design a coherent set of policies to achieve the desired market structure.

South Africa's retailers provide a perfect example of understanding how firms can entrench their market power to the detriment of overall development.

From a distance, the sector appears to be fairly competitive, comprising small independent retailers and five big retailers, with a combined market share of 60%, but the market operates as a single system.

In recent years, there has been an unprecedented expansion in retail, driven in part by high consumer demand and shopping mall development.

To be fair, these expansions have benefited the customer by making cheaper groceries and services available near where people live. More importantly, retail expansion has the added benefits of direct and indirect employment.

Bearing these benefits in mind, it would seem inconceivable to alter the structural make-up of the consumer goods sector, particularly in underserved areas.

However, when the retail sector is viewed as a system, it does pose a developmental risk, especially for a country where there is such uneven development.

As a system, big retailers are constantly asserting their dominance by building more branches. These retailers' ultimate aim is to capture consumers and make it impossible for new players to enter the industry.

With their deep pockets, they employ marketing strategists to plan expansion based on the disposable income of unsuspecting consumers and, once captured, consumers are limited by who they can buy from and, therefore, are susceptible to price abuse.

Furthermore, wherever the big retailers set up shop, they engage in obscure uncompetitive dealings. These powerful "privileged markets", to use the International Monetary Fund's deputy director David Lipton's description, use central procurement systems, and the retailers all buy from a group of a few vertically integrated suppliers.

In essence, the only competition that takes place is superficially between retailers and not between the products on their shelves.

The retailers’ products are dominated by the brands provided by these suppliers, who sometimes enter into exclusivity arrangements with big retailers to increase dominance. It remains hard to find more than three or four competing brands for any consumer item.

In some cases, two brands of the same product are even produced by one supplier. This is referred to as product differentiation, which creates a false sense of competition.

New and small suppliers who wish to secure shelf space have to navigate a costly process of complying with unreasonable slotting allowances; they have to pay for shelf space and for advertising; they have to carry the risk of over-stocking and breakages; and they even have to agree to be paid after 30 days.

Exclusivity is further entrenched by standards requirements and lease agreements used by anchor tenants to preclude competitors from renting space in complexes.

South Africa’s road infrastructure, low backhaul rates and massive warehousing facilities exacerbate dominance by enabling retailers to source and store goods hundreds of kilometres away from outlets even if alternative products are available locally.

For their part, retailers find it cost efficient to source from big suppliers, who can meet scale requirements and distribute from a central point.

But, from a broader development perspective, these market practices exacerbate disparities between mature and infant firms.

So South Africa needs an inclusive growth and development strategy, which is not only premised on reconfiguring the management, control and ownership of the economy. Fostering fair markets should be at the centre of transformation and should entail a fundamental tightening of competition laws and an investment in market intelligence to inform the design of policies for supporting new market players.

The current Competition Commission market inquiry into the entry of retail giants into the townships is a good starting point but it requires complementary and market-sensitive local planning and economic development policies, broad-based black economic empowerment, small business development and industrial policies.

Eddie Rakabe is a researcher at the Financial Fiscal Commission. These are his own views

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