

The Role of South African Competition Law in Supporting SMEs

Can David really take on Goliath?

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INTRODUCTION

One of the South African Competition Act's explicit purposes is to "ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy". The Act reflects the government's aims to incorporate particular public interest policies that reflect the changing socio/economic and political context within which the Act was promulgated. How has the Act been implemented and policy goals interpreted with regard to SMEs? How are efficiency-driven competition principles reconciled with SME considerations?^[2] Five years on, it is useful to examine how the Act has fared.

The ultimate goal of any competition policy is to enhance consumer welfare. The premise is that markets are not competitive where it can be shown that prices increase or the choice of product or service available to the consumer is limited as a result of monopolistic conduct. However the South African Act specifically mandates attention to SME interests. Therefore, South African competition law is in theory SME-friendly, insofar as it proclaims to protect SME interests by promoting access to markets as well as acknowledging their rights to participate in the economy. However, the enforcement of competition law may in reality sometimes be incompatible with SME interests. The difficulty is precisely that frequently the larger, integrated firm is more efficient than its SME counterpart. Large firms are able to leverage their relative strength in the market to source at lower cost and to achieve scale benefits which its smaller counterpart simply cannot match, thereby bringing down prices for consumers. Most sophisticated competition regimes adhere to a competition policy that protects competition itself (ensuring lower prices and greater product choice for consumers) at the expense of protecting individual competing firms, who may not be able to offer the lowest prices or widest choice. Whilst optimally, markets should ensure competitive prices and services, they also function properly if they eliminate inefficient players. But surely competitors – regardless of size - make up the fabric of competitive markets and therefore, too, deserve protection under competition law? This dichotomy is not always easy to understand and leads to misapplication of the Competition Act's provisions.

SMES AND THE COMPETITION ACT 89 OF 1998

The South African Competition Act 89 of 1998 ("the Act") became operative in September 1999. The Act lists a plurality of goals. Primarily, the Act seeks to maximise consumer welfare by efficiently allocating resources, whilst furthermore incorporating amongst its goals the furthering of certain socio-economic objectives. Two additional purposes of the Act, state specifically:

(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."*

The latter section is designed to cater for Black Economic Empowerment ("BEE") companies and the former, to SME's.^[3]

The New Act: Context and Background

The Competition Act's attention to SME and other public interest considerations reflects, amongst other goals, the post-Apartheid government's intention to ensure that "the participation of efficient small and medium sized enterprises in the economy was not jeopardized by anti-competitive structures and conduct." (OECD Peer Review: 2003)

South Africa has a unique economic history. Its exclusion from world markets for many years resulted in the development of an extremely protected economy during the earlier part of the 20th century. Government concessions, including subsidised inputs in industries such as manufacturing and agriculture, together with strict market controls, high tariffs, low levels of foreign direct investment and high levels of government ownership, have over the years, contributed to the creation of a highly concentrated economy. In layman's terms, this means that in many market sectors, few large firms hold considerable market power, measured in terms of their share of the relevant market. The aftermath of this is still evident today, particularly in manufacturing, agriculture and mining.

Today, higher concentration levels means that a few firms typically dominate most sectors of the economy and can potentially exert market power to the exclusion of other, especially smaller competitors. These large firms typically produce a large portion of industry output and are protected by high entry barriers. They may frequently control access to raw materials or other strategic resources or, if vertically-integrated, to more than one level of the supply chain. Small firms find it difficult to operate in or to penetrate such markets. A dominant firm's leverage in the market is often strategically used to push SMEs out of the market in order to capture market share, entrench market power and ultimately, drive prices up. Such exclusionary tactics may be surreptitiously invoked, such as refusing to supply the SME with vital inputs, manipulating pricing of such inputs or levying abnormally low prices on their own products or those of a vertically-integrated subsidiary, in order to force smaller competitors out of business. Since SMEs are highly susceptible to cash flow problems and lack economies of scale, it does not take long before they are driven from the market. In some respects, merely the reputation of larger, fully integrated competitors could well serve as a deterrent to entry to or growth within a particular market for SMEs.

In South Africa, SMEs tend to niche themselves by differentiating a product or targeting a specific market which enables them to compete more effectively. A legitimate pro-competitive response, many would argue. However, in a highly concentrated market context, even efficient dynamic new firms will experience difficulty in breaking into the market while such market structures would also prevent existing viable firms from growing and expanding their market reach. Frequently, once they start producing favourable returns, larger firms may look on this market as potentially lucrative and engage in anti-competitive or exclusionary conduct in order to grab market share from the smaller firm.

This explains why, in South Africa, accessing markets has been highlighted by many small business lobbyists and independent business proponents as the single biggest competitive challenge facing SMEs. They have highlighted the prevalence of monopoly capitalism and wealth centralization in South Africa as an inhibitor of robust market rivalry which constrains growth in South Africa and have appealed to the competition authorities to address these issues. To what extent have the competition authorities done so thus far?

Substantive Protection for SMEs

SMEs and Merger Control

The ability to merge provides the small, successful firm with the opportunity to sell out to a larger firm and re-channel the proceeds into other ventures. In recognition of this, the merger process under South African competition law has been made more flexible vis-à-vis those smaller firms who are acquired by a larger firm and enable cash-strapped SMEs relying on the investment of larger companies to grow and therefore compete equitably in the market. This flexibility is important in a context where the government seeks to encourage SME growth and transition up the ranks of the formal sector.

When larger companies merge, structural changes may occur in a market which consolidates market power in a particular sector in the hands of the merged entity, often to the exclusion of other, smaller competitors. Under the merger provisions, the Act sets out an array of factors to consider to determine whether competition in the market will be “prevented or substantially lessened” and therefore whether the merger should be prohibited, approved or approved with conditions. Under the Act’s public interest provisions, the authorities must also consider whether the merger can or cannot be justified on substantial public interest grounds. These include - the transaction’s effect on employment; on a particular industrial sector; **on the ability of small and black owned firms** to be competitive and, finally, on the ability of South African business to be competitive internationally.

To date, no transaction has been determined on grounds of public interest alone. Notwithstanding this, several mergers, notably two in the furniture industry, decided on purely competition grounds, did pay homage to SME interests through the imposition of conditions in their favour. These conditions have typically taken the form of directions to large companies to continue to deal fairly with and not discriminate against SME rivals.

SMEs and Prohibited Practices

In a relatively small, highly concentrated economy, enforcement of the prohibited practice provisions of the Act is one area where the Act has the potential to assist those SMEs aggrieved by anti-competitive practises by larger firms. Prohibited practices are those anti-competitive infringements of competition law perpetrated by large powerful companies. They are prosecuted under the Act either as restrictive agreements which have the effect of substantially preventing or lessening competition in a market (Sections 4, 5) or as abuses of a dominant position including exclusionary acts and price discrimination (sections 8 and 9).

The abuse of dominance provisions outlaw a range of exclusionary acts which are most likely to be perpetrated vis-à-vis SMEs or smaller market participants as existing firms or new entrants seeking access to markets.

How Successful Have SMEs been?

Research has shown that most of the prohibited practices complaints lodged with the Commission have been by small businesses. Over its five-year history, two complaint referrals brought before the Competition Tribunal happened to have been initiated by SMEs and were both granted. However, in proportion to the number of complaints lodged by SMEs, there have been relatively few complaints involving SMEs successfully prosecuted before the Tribunal. Unfortunately, the absence of data does not allow one to comprehensively determine to what extent prohibited practices vis-à-vis SMEs are being perpetrated in specific sectors or not.

SMEs have more readily succeeded in restrictive practice cases based on outright prohibitions of the Act. These are regarded as blatant competition “sins”, such as price fixing, resale price maintenance and market division. SMEs prevail in these cases because experience has shown that the anti-competitive effects of this type of conduct are so well

established, that the Act does not require the complainant to actually prove a substantial prevention or lessening of competition in a market.

The other category of complaint in respect of which SMEs typically succeed, are those based on abuse of dominance infringements, more especially, those outlawing conduct which excludes competitors. However, once again, the majority of SME complaints are dismissed by the Commission for lack of merit or withdrawn.

Why are so few SME cases referred or pursued to finality?

a. Practical Constraints

Time constraints –SMEs usually cannot afford to wait the prescribed year period for the Competition Commission to investigate the complaint. Though they can apply for quick or “interim relief”, despite the fact that SME cases almost always entail the real likelihood of the SME exiting the market pending finalisation of the investigation, there is a huge discrepancy in the number of SME cases the Commission investigates and those in respect of which interim relief is applied for by SMEs.

Cost - SMEs decline to approach the Tribunal directly for relief due to the spectre of an adverse costs order against them if the matter is ultimately dismissed by the tribunal. All too frequently SMEs lack sufficient resources to employ sophisticated senior counsel or to pursue the matter to finality and it is later withdrawn. A well-resourced legal team can extend matters for years on end, expending huge amounts, sums which SMEs can simply not sustain. Therefore most SMEs, in the absence of a certain outcome, display unwillingness to commit the requisite funds to pursue the matter to finality.

Accessibility – Despite the existence of an informal structure and prosecutorial authority to support interest groups, this has not been the practical effect. Intimidatory tactics are common, it is not unknown for large companies to boycott an SME’s business as a direct result of their pursuing a complaint against them, or even as a result of their giving evidence against them. The upshot is that there have only been a handful of occasions on which SME groups have intervened or participated in merger or prohibited practice hearings before the Tribunal. In fact, there has been more representation by labour and empowerment groupings than by SMEs. The competition authorities are therefore disadvantaged by not having the benefit of first-hand market-place information from independents and SME trade associations to gain a true reflection of the dynamics of a particular market place.

Moreover, legal practitioners take centre stage thanks to affluent larger companies. Competition law is regarded as highly specialised and the pool of legal expertise is small. SMEs are frequently unable to find legal representatives prepared to undertake a complex competition law case. Those existing legal specialists who usually act for large corporates, charge fees unaffordable for SMEs.

b. Lack of Merit

Where they are aware of the existence of the Act, many SMEs lack practical knowledge as to how the substantive provisions of the Act can be implemented. What is clear is that most SMEs share a consistent ignorance and paucity of familiarity and understanding of the competition authorities, their role and how the Act’s procedures could be invoked to protect them.

In particular, SME complainants frequently misunderstand the requirements of proof necessary to sustain a claim of anticompetitive conduct. Even if a larger player is perpetrating an anti-

competitive practice against an SME, defective or incomplete filings ensure the case is thrown out. In particular, SMEs tend to frame their complaint as a commercial claim, based on personal or pecuniary harm suffered and neglect to focus on injury to competition in general. Similarly, where they rely on abuse of dominance claims, SMEs frequently fall short of proving either dominance, or fail to build up a sufficient case to establish abusive conduct. Despite the fact that SMEs will confront the market power of dominant firms in most sectors, it is not an offence simply for a firm to be dominant in a particular market sector without corresponding *conduct* that is shown to be anticompetitive.

Competition cases involve complex legal and economic arguments and are difficult to understand unless legally represented. Since many complaints of alleged anti-competitive conduct entail severe repercussions, including large fines and associated civil claims, particular evidence must support allegations of anti-competitive conduct. The competition authorities have been cognizant to adopt a hard line against the Act being invoked frivolously, as a bargaining or pressure tactic by disgruntled competitors seeking to obtain undeserved concessions from larger rivals, which would impede the normal competitive workings of the market. This is because they strive, as all new competition authorities do, for uniformity and certainty of legal rules in order to establish and consolidate their jurisprudence. Since inter-firm rivalry is generally advantageous to the consumer, it is not always easy to distinguish exclusionary conduct from beneficial competition and business need to know where they transcend this line.

c. The Tension between Competition Law and SME Interests

Complaints relying on those sections of the Act wherein the SME must prove a substantial prevention or lessening of competition in a particular market are rarely successfully invoked by SMEs. In any defined market, an SME will typically hold a market share of 10% or less, therefore there is unlikely to be a *substantial* prevention or lessening of competition if the SME exits the market.

The failure by SMEs to properly substantiate cases before the competition authorities reflects a fundamental tension between competing policy goals – protecting the consumer from high prices and limited product choice versus protecting the SME from competitors acting anti-competitively towards them. For instance, though an SME may face heavy-handed treatment by a larger rival, the same rival may be able to offer its product more cheaply than the SME. The mandated attention to SME interests in the Act creates a dilemma at Competition Law of which class of rights to protect at the expense of the other. Certain classes of anti-competitive conduct can be justified if the accused firm can prove any technology; efficiency or other pro competitive gain outweighing the anti-competitive effect of that conduct. In other words, large integrated firms can legitimate their alleged anti-competitive conduct on the basis of so-called efficiency claims, because efficiency necessarily entails lower prices and consumer welfare is enhanced.

Successful SME cases

Does that mean that SMES are always denied relief if a larger competitor can prove efficiencies? What about those SMEs that have the potential to generate greater cost savings and efficiencies who are frequently intimidated out of the market or simply denied entry to it by their rival's anticompetitive conduct? There have been cases where pure competition principles and SME-enhancing interests have converged. These are cases where the particular conduct resulted in both consumer welfare being undermined, whilst at the same time being exclusionary of competitors. Though responding parties almost always attempt to justify anti-competitive conduct on the basis of efficiency benefits, the competition authorities have been alive to the prospect of the efficiency defence being misappropriated as a justification for monopolization. In fact in several decisions, the Competition Tribunal has recognized that the possibility exists that large

dominant firms are disincentivised from becoming more efficient, specifically because of an absence of competition in their particular sector.

CONCLUSIONS

From a policy perspective, there is enough scope in the Act and the competition authorities are sufficiently empowered to accommodate concessions for SMEs and to interpret the goals of the Act in such a way as to develop a unique SME-related jurisprudence. Though many strict competition advocates might not approve of these goals, their incorporation in the Act nevertheless serve to steer the minds of the competition authorities towards SME interests which enable them to be consistently mindful of and conscientised to the needs of smaller competitors. However thus far, the South African competition authorities have applied an orthodox competition-focussed approach. Public interest and SME considerations have not determined any decision. These interests have instead been given effect to incidentally, in pursuance of pure competition goals.

By being willing to impose merger conditions which create a fair and level playing field for independent SMEs, as well as by outlawing exclusionary conduct, the competition authorities have protected the integrity of the competitive process. However, competition law can only facilitate access to markets but once there, South African SMEs still confront many obstacles, due to the legacy of an enduringly concentrated market structure. Relaxation of market structures will take some time as big business adjusts to market liberalisation and the inevitable relinquishing of market power.

In the meantime, a prevailing culture of dominance where abusive conduct is accepted as normal business practice still endures. Certainly the low volume of abuse of dominance cases before the competition authorities suggest that this might be the case. In South Africa, the effect of abusive market conduct on small firms' ability to compete is less discernable and often disguised by monopolistic firms on the basis of pro-competitive or efficiency arguments. It is precisely because the history of monopolistic conduct in South Africa is so subtle, yet pervasive and entrenched, that SME claims of exclusion and harm will have to be ruthlessly interrogated by the competition authorities in the future.

The policy tensions will no doubt be further refined as the Act's other prohibited practice provisions are in time tested by more Davids against their sector Goliaths.

WHAT NEEDS TO BE DONE

How can the SME goals in the Act be further translated into meaningful practical reality? The practical problems encountered by SMEs before the competition authorities are symptomatic of SMEs position in the economy at large. It is recognized that competition policy can only assist SMEs within the framework of a broader, workable government policy vis-à-vis small business. Fundamental issues need to be addressed such as access to resources and facilitating and incentivising SMEs' to mobilize and consolidate themselves. A reformulated SME strategy is underway, but it will take time before the effects filter into the market place. A coherent policy that blends skills, development and finance for SMEs would empower and strengthen the position of SMEs generally in the economy.

In the meantime, at the level of the competition authorities, procedural problems can be addressed to make the Competition Act more accessible for SMEs and to invite SME applications, rather than deter them. Most certainly competition authorities have to be wary of making it more difficult for SMEs with inflexible, drawn out and cumbersome processes. Fast-tracking SME prohibited practice investigations, even if they at first glance seem to lack merit, is one option.

The Commission must continue to play a central and vital advocacy role in delivering the Act to SMEs. Establishing an SME case database, disseminating interpretive guidelines and case studies indicating what factors the competition authorities take cognizance of, would encourage certainty and clarity of the Competition Act's provisions and mechanisms. It would also undoubtedly spur SME involvement in both merger and enforcement matters and avoid creating a "pro-big business" culture.

Intimidation is another factor underestimated by the competition authorities. A policy which affords some protection to SME complainants wanting to give evidence or participate in merger or enforcement proceedings free of intimidation should be invoked. A good case can be made for lobbying for a victimization provision to be included in the Act. This should allow for equivocal, decisive and swift follow up recourse and would go a long way towards encouraging SMEs to participate in the process.

Fundamentally, the competition authorities need to encourage SME trade or sector associations, as in other countries, to not only bring complaints on behalf of SMEs, but also to ensure a presence in merger and restrictive practice hearings, thereby consolidating their might behind and raising the profile of individual SME complainants. The bringing of complaints by networks of SME organizations, would lend credence to and fortify allegations of harm to the competitive process. SMEs desperately require the ability to access and galvanize the requisite legal skills and financial resources, which assistance should be comprehensive and sustained. The presence of this support would undoubtedly address many of the practical problems, obviate threats of intimidation, remove unreasonable time delays and relieve interpretation and evidentiary difficulties, ultimately making the Act more "user friendly" for SMEs.

No doubt all these policy issues will play themselves in coming years and it will be telling to see how the competition tribunal addresses them. Sometimes however, it is useful to go back to those goals that were espoused in the beginning....

It is important for the attainment of all the objectives of the new legislation that the Competition authorities retain a clear perspective on the various (and at times contradictory) interests at play within the broader business constituency. It is important that simple administrative procedures be adopted so that the Competition authority can be accessible to small and emerging businesses, it should not be a terrain for the assertion of big business interests. (Creamer: 1998)

^[1] The author writes in her personal capacity and her views should in no way be attributed to those of the Competition Tribunal

^[2] This paper is a summary of a modified version of a paper prepared for 48th ICSB World Conference "Advancing Entrepreneurship and Small Business" 15-18 June 2003, Belfast, Northern Ireland. It was presented under the theme of government policy for entrepreneurs and SMEs. A subsequent addendum to this paper is a work-in-progress by the author.

^[3] SMEs in South African competition law are defined in accordance with the National Small Business Act. Many of the cases which come before the competition authorities are brought by formal SME entities. Therefore this paper focusses on such formal micro, small and medium-sized enterprises[3].