

Unclassified

DAF/COMP/GF/WD(2015)22

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

02-Oct-2015

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Global Forum on Competition

DOES COMPETITION KILL OR CREATE JOBS?

Contribution from South Africa

-- Session I --

This contribution is submitted by South Africa under Session I of the Global Forum on Competition to be held on 29-30 October 2015.

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JT03383004

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DOES COMPETITION KILL OR CREATE EMPLOYMENT?

-- South Africa --

Introduction

1. South Africa has high unemployment which continues to pose a serious challenge for the country. Unemployment has persistently remained high, increasing from 22% in 1994 to 25% in 2014 while the expanded unemployment definition places this at a constant 35% over the same period¹. South Africa, like many developing economies, faces many challenges including, *inter alia*, high levels of unemployment, poverty and inequality. The product of these social ills is partly underpinned by inefficiencies arising from high levels of market concentration and skewed ownership and economic participation patterns.

1. Background to employment considerations

2. In order to provide context, it is important to first set out the background to the design and adoption of the South African competition law framework and how the incorporation of public interest factors such as employment came to explicitly feature in the regime. South Africa's historic economic policies, of state ownership, protection, and import substitution, differed from what is often found in transition and developing country situations. In 1994, the newly-elected democratic administration was faced with the mammoth task of re-shaping the South African economy into one that would, *inter alia*, include the majority into the formal economy after centuries of marginalization due to repressive laws.

3. Dealing with the legacy of the economic distortions of the past, needed a unique approach. Competition policy was identified as one of the instruments to correct the faults of the apartheid system and to promote policy goals of employment and empowerment. The balancing of public interest considerations against traditional competition law principles is at the centre of competition policy. Hence, the Competition Act's general purpose, to "promote and maintain competition," is supplemented by six goals, one of which relates to promoting employment.

2. Balancing employment considerations in merger regulation

4. In merger regulation, the first issue which must be assessed is whether the merger "is likely to substantially prevent or lessen competition." If the competition analysis indicates a problem, the next step is to determine whether technological, efficiency, or other pro-competitive gains would be likely to offset the anti-competitive effects—and would not likely be obtained absent the merger. A merger may also be

¹ Statistics South Africa, (2014), Employment, unemployment, skills and economic growth: An exploration of household survey evidence on skills development and unemployment between 1994 and 2014. Available at: http://www.statssa.gov.za/presentation/Stats%20SA%20presentation%20on%20skills%20and%20unemployment_16%20September.pdf.

approved, or disapproved, based on “substantial public interest grounds.” The public interest grounds include the effect on employment.

5. The effect of mergers on employment can be ambiguous. This is because mergers sometimes result in productive or allocative efficiencies and/or cost optimisation. Part of this process may entail a shedding of jobs or introduction of new technologies, which may result in the shedding of jobs, in order to arrive at the aforesaid efficiencies and optimisation. However, there are also instances wherein, for various reasons, mergers are concluded in anticipation of increases in productivity and demand and therefore additional employment opportunities will be created. The South African experience has shown both these patterns.

3. Employment effects arising from mergers

6. We briefly discuss and set out below the lessons derived from some of the key cases relating to the South African approach to employment in mergers.

The Metropolitan Holdings Limited (“Metropolitan”) and Momentum Group Limited (“Momentum”)

7. This is a landmark case in South Africa as it establishes the principle of connecting job losses and efficiencies in merger processes. The Tribunal conditionally approved the acquisition of 100% of the issued ordinary share capital of Momentum by Metropolitan. The Tribunal first assessed the competitive effects and concluded that the merger was unlikely to substantially prevent or lessen competition in any relevant potential market. Both firms were active in the broader financial services market including insurance, medical aid, retirement fund administration, asset management and the provision of rental property. While the post-merger market shares in many of the identified markets were in the region of 20 - 30% it was found that there were many other sizeable as well as smaller players that would exercise a competitive constraint on the merged entity.

8. However, the merger gave rise to one public interest consideration – loss of employment. The merging parties submitted that the merger may lead to up to approximately 1000 job losses (from the initially contemplated retrenchments of approximately 1500 employees) as a result of redundancies and the need to improve efficiencies in the merged entity post-merger. The Tribunal approved the merger subject to a moratorium on merger-specific retrenchments for a two year period with terms that clarified the conditions on the merged entity².

9. The parties sought to dispel concerns around these potential job losses by submitting that there was a plan to redeploy, retrain, offers of early retirement for affected staff members; natural attrition and business growth as mitigating factors. This, according to the parties, would reduce the number of potential job losses to 1000 from the earlier envisaged 1500 job cuts.

10. The Tribunal’s factual assessment reveals the importance of clearly articulating how the envisaged employment loss figures were determined and how these are linked to expected public (and not

² The imposed conditions read as follows:

- MMI Holdings, the merged entity, shall ensure that there are no retrenchments in South Africa resulting from the merger for a period of 2(two) years from the effective date of the proposed transaction.
- The condition in 1 shall apply to the 204 senior management positions set out in the table on page 242 of the record.
- Metropolitan and Momentum must circulate the condition in 1 and 2 above to all their employees within 7 days of the date of this order.

private) efficiencies post-merger. The Tribunal found that the parties were unable to show ‘*a rational connection between the efficiencies sought from the merger and the job losses claimed to be necessary.....*’ There was a recognition, however, that this more considered approach to justifying job losses is only reserved for mergers where expected losses are of significant magnitude.

11. It was the Tribunal’s view that any negative impact on public factors cannot be arbitrarily arrived at without establishing a clear connection between the envisaged negative impact and whatever claimed efficiencies. Further, the Tribunal emphasised that while a negative impact on employment may be clearly connected to a particular claimed efficiency this does not discharge the parties of their duty to show that the employment losses can be justified for a reason that is public in nature to offset the public interest in preserving jobs as a result of the merger.

12. Essentially, this case introduced the principles of justification in terms of “rationality” and justification in terms of “public interest”. The Tribunal ruled that when a substantial public interest concern has been raised, the merging parties bear the burden of justification. This means that the evidential burden shifts to the merging parties to rebut the net conclusion that a merger may not be justifiable on substantial public interest grounds. The Tribunal was, however, careful to point to the confines in which the burden of proof would fall on the merging parties. This involved a scenario where the employment loss was substantial and the short-term possibilities of re-employment, for a significant number of the affected employees, were limited. The Walmart/Massmart merger, as will be discussed further below, shows that the evidentiary burden on the parties is such that they cannot make claims of potential effects on public interest that are not substantiated by either documentary or oral evidence. Indeed there must be sufficient particularity on the claimed potential effects with supporting evidence on how these were arrived at.

13. The Tribunal set the evidentiary test to include proof that a reasonable process has been followed in determining the number of jobs to be lost and that ‘*the public interest in preventing employment loss is balanced by an equally weighty, but countervailing public interest, justifying the job loss and which is cognisable under the Act.*’³

14. This means that even if the merging parties raise efficiency grounds to counter or explain the envisaged job losses, this is not sufficient. Rather such job losses must be justified on the grounds that are public in nature to countervail the public interest in preserving jobs. In other words, even though the merging parties may demonstrate a rational connection between the proposed employment losses and a particular efficiency claim such as savings deriving from the job cuts, this would not be sufficient if the efficiency gain is a private one and not public in nature. It further argues that Section 12A of the Competition Act is structured such that private efficiency gains can only be considered as an offset to anticompetitive effects and not public interest.

15. In terms of the design of remedies in relation to employment effects, this is one of the first cases in which the Tribunal not only limited the number of retrenchments (to the stated number proposed by the parties) but also introduced the concept of moratoriums on retrenchment, for a specified period (in this case two years), on retrenchments. Second, the Tribunal also required that the merging parties must put in place a fund to provide for the training and re-skilling of the affected employees in order to ensure that these employees can be re-employed elsewhere or become self-employed.

16. This case has since been used as precedent in other cases including the Walmart / Massmart merger discussed below.

³ Metropolitan Holdings Limited and Momentum Group Limited, Case no: 41/LM/Jul10, para 70.

Walmart Stores Inc (“Walmart”) and Massmart Holding Ltd (“Massmart”)

17. The Tribunal’s decision to conditionally approve this merger raised a lot of controversy and sparked a debate about the future use of public interest in competition policy. The target firm, Massmart, was a local wholesaler and retailer of grocery, liquor and general merchandise, and the acquiring firm was Walmart, the largest retailer in the world. This merger raised employment concerns by both organised labour and government given Walmart’s reputation of antipathy towards labour unions, among other concerns.

18. In assessing the impact on employment, the Tribunal concluded that there was no evidence of potential retrenchments resulting from the merger but rather that there was the likelihood that there may be employment gains achieved going forward. While reaching this conclusion, based on documentary evidence, the Tribunal was cautious in this for two reasons. The first being that documentary evidence and indeed the parties did not clarify whether the envisaged employment creation would take place locally or in other markets given the merged entity’s intentions of expanding into other African markets. Secondly, Massmart’s divisional employment practices meant that while some divisions may be expanding others may be contracting thus giving a mixed picture of effects on employment.

19. The Tribunal was comforted by the parties’ undertaking that there will be no retrenchments in South Africa, arising from the merger, for a period of two years and that there was very little obvious likelihood of redundancies post-merger. These undertakings were made an order of the Tribunal, subject to which the transaction was approved.

20. This merger also raised an interesting element relating to pre-emptive retrenchments by target firms. The intervening parties argued that the retrenchment of 574 full-time employees by Massmart prior to the finalisation of the transaction between the parties was implemented in anticipation of the transaction and aimed at making Massmart attractive to its prospective suitor i.e. Walmart. The Tribunal found that the alleged pre-emptive retrenchments were unrelated to the proposed transaction and that it was satisfied that the employment concerns raised were adequately addressed by the conditions imposed.

21. However, the Competition Appeal Court (the “CAC”), following an appeal on a number of issues by the various interveners, held that the evidence before it demonstrated that these retrenchments were indeed in anticipation of the contemplated merger. Accordingly, the CAC held that the Tribunal’s employment conditions in this regard were inadequate and ought to be modified to compel the merging parties to reinstate or re-employ the 574 retrenched employees who were subject to the pre-emptive retrenchment process. Further, the CAC held that the retrenchment moratorium condition cannot exclude unreasonable refusals to be redeployed given that the Tribunal had erroneously found that the likelihood of such redeployment occurring was low.

22. This is of interest in South Africa because it relates to the timing of retrenchments when firms are contemplating mergers and acquisitions and to what extent such retrenchments can be considered to be merger specific and therefore necessitate actions by competition authorities.

23. The issues considered in relation to employment did not end with the preserving of existing jobs but, for the first time in South Africa, extended to how the merged entity would engage with organised labour in future. Given Walmart’s reputation of antipathy towards organised labour and Massmart’s divisional approach to labour negotiations, labour unions sought additional conditions that would introduce centralised bargaining and a closed shop. The Tribunal was satisfied with the imposition of a condition compelling the merged entity to honour existing labour agreements and acknowledge existing labour unions as such. These arrangements existed pre-merger and therefore would not be affected by merger.

Other cases

24. The Unilever/Robertsons⁴ merger dealt with the rights conferred upon employees and their representatives in terms of the Competition Act. The Nedbank/Imperial Bank⁵ merger suggested that a quantitative approach to establishing substantiality was not sufficient. The Ashton Canning and Tiger Brands⁶ merger dealt with issues around different skills and which skill types the competition authorities should be most concerned about. It also suggests the type of qualitative analysis that ought to be performed in order to determine whether the impact of the merger on employment is substantial or not. This case raised issues around the employees' ability to be re-employed in the short term, seasonality in jobs, employment opportunities within particular regions and sectors. The Bucket Full/ Cartons and Labels Business of Nampak Products⁷ transaction dealt with the issue of merger specific retrenchments. The BB Investment and Adcock Ingram⁸ merger also dealt with the issues of merger specific retrenchments and the justification in terms of complete information requirements.

4. Trends in employment considerations in merger review processes

25. Table 1 below shows the total number of mergers finalised and the percentage of merger cases that were approved with employment conditions over time as a proportion of the mergers finalised.

Table 1. Employment conditional approvals as a proportion of all mergers considered in the period 2006 to 2015

	2005 /06	2006 /07	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12	2012 /13	2013 /14	2014 /15
Total mergers finalised	394	410	480	458	208	220	282	327	329	374
Employment conditional approvals as a % of all mergers finalised	1.02%	0.00%	0.42%	0.22%	5.29%	5.45%	2.48%	3.36%	2.13%	8.56%

Source: Commission's Annual Reports (2005/06-2014/15)

26. Table 1 above shows that the total number of mergers that were conditionally approved on the basis of employment considerations, as a proportion of total mergers finalised, ranged from 1 to 12 percent during the relevant period. It appears that although employment considerations are an integral part of the merger review process in South Africa, a relatively low percentage of mergers are approved subject to employment conditions. It is noteworthy that no merger has ever been prohibited on the basis of employment.

⁴ Unilever South Africa Proprietary Limited and Robertsons, case no: 2014Oct0610.

⁵ The Nedbank Limited And Imperial Bank Limited, Case No: 2009Oct4710.

⁶ Tiger Brands Limited and Ashton Canning Company Proprietary, case No: Ltd 46/LM/May05.

⁷ Bucket Full Proprietary Limited and Cartons and Labels business of Nampak Products Limited, Case No: 2013Nov0580.

⁸ BB Investment Company Proprietary Limited and Adcock Ingram Holdings, Case No: 2014Apr0124.

27. In addition, the consideration of employment in mergers shows a pro-cyclical pattern rising when there are challenges in the economy and declining when the economy appears to be doing well or on up-bound. For example, it appears that during the 2006/2007, at the height of the commodity price boom, employment conditions in merger transactions were relatively minimal. However, as the economy contracted from 2009/10 onwards as a result of the global economic recession, employment conditions in mergers picked up. This indicates that the competition authorities in South Africa are responsive to the broader economic dynamics of the country.

28. Broadly, the employment conditions imposed generally seek to save or minimise the number of job losses to be incurred as a result of mergers or at the very least prolong the pending retrenchments for a specified time period; require the merging parties to provide support and assistance to the affected employees in the form of funding for re-training and up-skilling programmes in order to ensure that these employees can be re-employed elsewhere or become self-employed. In identifying those employees eligible for such training programmes, the competition authorities have regard to the skills levels of the employees (low skilled employees, who are in most cases, more likely to be retrenched are generally beneficiaries of such schemes), the region of the country in which the employees are based and the prospect of re-employment elsewhere⁹.

29. For illustrative purposes and due to lack of data, Table 2 below sets out the net employment effects arising from mergers in the 2013/14 and 2014/15 financial years.

Table 2: Net employment effects from (employment related) conditional approvals for the period 2014 - 2015

Employment effects	2013/2014				2014/2015			
	Losses	Savings	Gains	Net outcome	Losses	Savings	Gains	Net outcome
	584	2231	2429	4076	2594	5340	126	2872

Source: Commission's Annual Reports (2013/14-2014/15)

30. Table 2 above shows that there were some mergers which resulted in employment losses (denoted by losses); some which resulted in existing jobs being preserved as a result of the Commission's interventions (denoted by savings); and some which resulted in new jobs being created as a result of commitments made by firms (denoted by gains). The net employment effects have been determined by combining the number of jobs preserved as well as those created by merging parties and deducted the number of jobs likely to be lost as a result of mergers considered. It is noteworthy that although the overall net effect on employment is positive, this is largely as a result of jobs preserved through the competition authorities' interventions as opposed to new employment creation. In addition, the employment effects observed are not permanent in nature as the conditions are prescribed for a limited period and thereafter the merging parties are under no obligation to maintain the jobs saved or created.

5. Employment effects arising from other enforcement activities

31. As previously indicated, the South African experience shows that the appropriate design and application of remedies in enforcement activities can potentially give rise to positive employment effects. In this regard, the widely publicised settlement agreement between the Commission and Pioneer Foods

⁹ Competition Commission Annual Report, 2010/11.

(Pty) Ltd (“Pioneer”) in lieu of its involvement in cartel conduct in the milled wheat and milled white maize markets in South Africa is instructive¹⁰.

32. The cases related to cartel conduct which included all the major players in the milled wheat and milled white maize markets including Tiger Brands, Pioneer Foods, Foodcorp, Godrich Milling and Premier. The Commission’s investigation revealed that at various stages during the period 1999 to at least 2007, the respondents engaged in price fixing arrangements in terms of which they agreed at both national and regional levels to, *inter alia*, fix the prices of the concerned products. The Commission found that through these price fixing arrangements, Pioneer and its competitors prevented and/or limited price competition amongst themselves in relation to pricing of white maize products.

33. While other members of the cartels concluded consent order agreements with the Commission, Pioneer was the only firm that opted to fight the case before the Tribunal. Following a protracted litigation process, Pioneer was found guilty of cartel conduct and fined an amount of R500 million and subjected to a number of behavioural commitments. Part of the settlement agreement included, *inter alia*, the establishment of an Agro-processing Competitiveness Fund (the “APCF”) to the tune of R250 million.

34. The objective of the APCF was to facilitate increased competition, growth, job creation and development in agro-processing through the provision of the designated funding to non-dominant market participants in the agro-processing and beverages sector. This was because the competition authorities had found that the competitive effect of the cartel conduct did not only result in harm to consumer welfare, more so given that the products concerned were essential foods in South Africa, but also extended to stifling entry and expansion by competitors, particularly small and medium enterprises, in these markets.

35. Table 3 below shows the employment effects arising from the implementation of the APCF.

Table 3: Job creation through the APCF

	Start-up	Expansion	Total
No of enterprises funded	8	21	29
No of jobs created	969	1 297	2 266

Source: Commission’ internal impact assessment study

36. The Commission recently conducted an impact assessment of the APCF which sought to determine whether the objectives of the fund were achieved. From an employment perspective, it appears that the APCF led to the creation of an estimated 2 266 jobs, comprising 969 jobs created by start-up firms who were beneficiaries of the fund and an approximate 1 297 jobs created through the expansion of existing enterprises.

6. Conclusion

37. The process of competitive rivalry can have both positive and negative effects on employment as demonstrated by the South African experience. The South African competition framework allows for the consideration of employment effects arising from mergers and acquisitions.

¹⁰ *The Competition Commission vs Pioneer Foods (Pty) Ltd*, case no: 15/CR/Feb07.

38. The review of employment consideration in merger processes indicates that a relatively low percentage of mergers are approved subject to employment conditions, notwithstanding the fact that employment effects are considered in all mergers under review. It is noteworthy that the pattern of employment conditions in mergers shows a pro-cyclical pattern, rising in times of economic hardship and declining when the economy is on an upward trajectory. This is indicative that the competition authorities are sensitive and responsive to the obligations prescribed in the Competition Act while also being mindful to not over-enforce arbitrarily. There have also been instances wherein the design of remedies in the context of cartel enforcement has led to the creation of jobs. This is an important area in which the role of competition authorities can be further explored as the design of remedies must not only aim at restoring the competition lost as a result of the conduct but can also allow for positive externalities on areas such as employment, where appropriate.

39. The case studies discussed above demonstrate that competition authorities in South Africa have designed a framework by which the employment effects of mergers and acquisitions are assessed. In order to give guidance on the manner in which employment (and/or other public interest factors) is considered in merger review, the Commission has also developed a set of guidelines which are currently under consideration by stakeholders. Briefly, these guidelines indicate that the Commission will adopt the following steps when analysing employment (and/or other public interest factors) provisions:

- i) determine the likely effect on the employment (and/or other public interest factors);
- ii) determine whether the alleged effect on employment (and/or other public interest factors) is a result of that merger or is merger specific;
- iii) determine whether these effects are substantial;
- iv) consider whether the merging parties can justify the likely effect on employment (and/or other public interest factors); and
- v) consider possible remedies to address any likely negative effect on employment (and/or other public interest factors).