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VERTICAL INTERGRATION

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Index

- Introduction
- Benefits of competition
- Tools for implementing the law
- Horizontal agreements
- Vertical agreements/integration
- Mergers and acquisition
- Types of vertical integration/agreements
- Benefits/reasons for vertical integration
- Prohibited vertical agreements
- Vertical agreements not prohibited
- Theories of harm
- Conclusion

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Introduction

- The mandate: - responsible for the prevention and redress of anti-competitive practices in the economy: as well as removal of constraints on the free play of competition in the market.

- This is done through the following powers entrenched in the Act: Investigations (Sec 25-31); Market Inquiries/Research (Sec 49); Mergers and Acquisitions (Part X); and Advocacy

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Benefits of competition

- Attracts wider choice of goods and services – to consumers
- competitive prices
- encourages innovation
- improved quality products and services
- Effective Competition Law inspires International confidence for a particular economy

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Tools for implementing the law

This is a law that promotes or maintains market competition by regulating anticompetitive conduct / behaviour of companies.

Implementation of Competition Law is dealt with through the following:

1. **Horizontal agreement** *(Section 25, 27, & 29)*
2. **Vertical agreement** *(Section 26, 27 & 29)*
3. **Conducts under Sections 25, 26, and 27 will not apply to interconnected enterprises (subsidiaries)**
4. **Abuse of dominant market position** *(Section 30)*
5. **Mergers and acquisitions** *(Part X)*

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Horizontal agreement

- It is an agreement between enterprises each of which operates, for the purpose of the agreement, in the same market and would therefore normally be actual or potential competitor in that market. (Sec 2*b*)

i.e. between producers or between wholesalers or between retailers dealing in similar kinds of products.

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Vertical agreement/integration

- Vertical integration/agreement means an agreement between enterprises each of which operates, for the purposes of the agreement, at a different level of the production chain and relates to the conditions under which the parties may purchase, sell or resell certain goods or services. (Sec 2*b*) i.e., having presence both at the Upstream and downstream markets.
- For example, an agreement between a Sorghum Miller and a Grocery Retailer qualify to be a vertical agreement.
- It is business strategy adopted widely in the current era.

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Mergers and acquisitions

Mergers occurs when one or more enterprises directly or indirectly acquire or establishes direct or indirect control over the whole or part of the business of another enterprise. *(Section 52(1))*

Ways

- Purchase or lease of shares, an interest, or assets of the other business in question; or
- Amalgamation, Joint Venture or other combination with that enterprise.

Types of Vertical Integration

- Forward Vertical Integration – production to distribution stages. *i.e., upstream to downstream market* (can happen through organic growth or acquisition)
- Backward Vertical Integration – production to raw material stages. *i.e., downstream to upstream* market (can happen through organic growth or acquisition)
- Conglomerate – businesses that operate in completely different markets e.g., grocery retailer acquiring a group of hotels.

Vertical integration has been studied by economists over the years, and found to be somewhat a double edged sword.

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Benefits/reasons for Vertical Integration

- Increased competitiveness – differentiation from competitors
- Greater process control – more control over the supply value chain
- Increased market share
- Decreased costs - efficiency

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Prohibited Vertical agreements

- Sec 26 prohibits – Resale price maintenance – RPM
- Sec 27 prohibits: Agreements that limits or controls production, market outlets, or access, technical development or investment; applying dissimilar conditions to equivalent transactions with customers hence placing them at a competitive disadvantage; Giving conditions that indicate that customers/or suppliers cannot deal with other suppliers.

Vertical agreements not prohibited

- Sec 27(3) – exempts professional rules as prescribed in the schedule
- Sec 29 exempts interconnected enterprises or subsidiaries

Theories of harm

The most common theories of harm towards vertical integration are **foreclosure** and **margin squeeze**.

- Foreclosure occurs when a dominant upstream firm outright refuses to deal with downstream firms that compete with its subsidiary.
- It can also take subtle forms where downstream competitors are made to sign exclusionary contracts. An example of foreclosure will be where an upstream firm (also present in the downstream) that has a sole license for an essential input that is required in the down stream market refuses to supply downstream competitors, or decides to sell to them at a higher price.

Theories of harm cont….

- Margin squeeze occurs when an upstream firm sells an input for which there are no good economic substitutes to firms against which the upstream firm also competes with in the downstream market.
- It arises where the margin between the downstream retail price and the wholesale price charged for an input is too small to allow a firm to survive as a retail competitor.
- A common example is a vertically integrated firm that engages in both manufacturing and retail markets, and has market power at the manufacturing level, and competes with non-integrated rivals at the retail level.

Theories of harm cont….

- Both Foreclosure and Margin squeeze only apply to dominant firms. These are forms of abuse of a strong position in the market.

Economic harm brought by Vertical Integration

- Vertical integration increases barriers to entry by increasing sunk costs. In that sense, to enter the market at any stage of production will prove difficult.
- As such, markets will become highly concentrated overtime as less and less entities enter the markets.

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Economic harm brought by vertical integration cont…

- For existing players, a vertically integrated firm my cut supply of an essential input to its competitors or charge a higher price on that essential input required by its competitors in the lower stream market.
- As such, existing players (especially downstream market) could be driven out of the market hence strengthening its grip on the lower stream market.
- Ultimately the vertically integrated firm will be able to charge higher prices without any competition restraint.

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Economic harm brought by vertical integration cont…

- When a firm becomes vertically integrated it supplies itself instead of sourcing inputs from outside.
- This leads to loss of market by suppliers since their produce will not have a market.
- At times the vertically integrated firm can buy lower quantities and lower prices from the suppliers.

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Conclusion

- Vertical Integration may be good for the economy. But it may also be bad
- Therefore, it is important for any economy to have strong structures in place in order to deal with business strategies of this nature and benefit the economy at large.

Thank you

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