COMMON SHAREHOLDING AND CROSS-DIRECTORSHIP – A COMPETITIVE CONUNDRUM WHEN INVESTING

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"Victory is by nature insolent and haughty" Cicero

1. The South African economic landscape undoubtedly reflects concentrated ownership structures. An economy with this prevailing ownership model, in most economic sectors and corporate environments. Also, an economy that reflects cross-ownerships[1] and cross-directorships[2].

2. The Competition Tribunal of South Africa (**"the Competition Tribunal"**) has in various cases expressed its concerns as to the prevalence of cross directorships between competing firms and cross shareholding. However, it has recognised that in order to assess the effects thereof, an examination of the structural dynamics of the market and the nature of interaction and relationships between the competing firms has to be done to determine whether it exhibits co-operation rather than competition[3].

3. The natural concern raised by horizontal shareholdings as well as cross-directorships is that firms are less likely to compete vigorously with each other if they have common owners. Corporate governance emphasises that managers are disciplined to serve shareholder interests by a combination of, amongst others, executive compensation incentives, shareholder voting and legal duties.

4. It should be kept in mind that horizontal shareholders benefit less from competition among the firms in which they are invested[4]. Corporate structures are designed to make sure that managers primarily operate organisations in the interests of their shareholders. Thus, inevitably, increased horizontal shareholdings will structurally lead businesses to compete less vigorously with each other. In line with this theory, communication between the management teams of different organisations is not required, because each organisation's management has its own incentives to compete less in order to please its own shareholders.

5. In line with the above theoretical thinking, the acquisition of an equity share may start as a mere passive investment but end up constituting a valuable co-ordination tool through which information exchange can take place.

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1 Including a situation in which an investment company owns shares in two or more companies in the same industry. These shares may be substantial and controlling or may involve minority shareholdings. They may or may not be accompanied by an explicit strategic influence of the financial investor in the decision making of the firms in which it has financial interest.
2 Exists where the same individual serves as a director on the boards of two or more firms.
3 Primedia Limited/New Africa Investments Limited 39/AM/May06, Two Rivers Platinum Limited and Assmang Limited 54/LM/Sep01, Momentum Group Limited and African Life Health (Pty) Limited 87/LM/Sep05, Main Street 333 (Pty) Limited/Kumba Resources Limited 14/LM/Feb06 and Barmac (Pty) Limited/ATC (Pty) Limited and Aberdare Cables (Pty) Limited 70/LM/Aug06

4. Elhauge, *Horizontal Shareholding*, 129 Harvard Law Review 1267 (2016), https://ssrn.com/abstract=2632024

6. One should accept that the Competition Commission's economists will usually focus on financial (dis)-incentives, whereas the lawyers' attention will be caught by behavioural patterns and hard evidence. Despite the different emphasis in approach to analysing anticompetitive holdings, these theories may combine and therefore constitute a continuum of practices and anticompetitive effects. This is actually an important point to consider when considering and evaluating institutional investments holistically.

7. It could be said that South African competition law, as is the case in the European Union (EU), is more conservative in its economic predictions while more formalistic from a legal point of view. In particular, EU antitrust law and enforcement faces challenges in dealing with hybrid forms of ownership or financial structures in that merger control analysis depends on the legal notion of decisive influence and relies on explicit shareholders' rights rather than invisible forms of activism or coalitions whereas non-controlling financial holdings by either active or passive institutional investors are generally out of reach, as these do not constitute decisive influence.

8. In light of the South African economic structure, the Competition Commission and Competition Tribunal view common ownership by diversified institutional investors or passive investments as a potential concern.

9. The Competition Tribunal considered the strategic incentives which each firm possessed in relation to each other and whether or not such incentives were appropriately aligned to result in a collusive outcome previously. In this regard, the Competition Tribunal concluded that:

   "[A] theory of harm based on the passive investment in a rival leading to co-ordinated effect between rivals post merger, has not been established[5]."

10. Areeda/Hovenkamp[6] treatise expressly state:

    "a court's finding that the acquisition would probably tend substantially to lessen competition would necessarily mean that the acquirer so intended, objectively speaking. Consequently, its acquisition could not be solely for investment… No general warrant exists for treating an institutional investor differently from other investors, and particularly not if the institutional investor votes its shares or otherwise seeks to influence a corporation's decision making. Even index funds often seek to influence the behaviour of corporations in which they have an ownership interest… In the event that such an acquisition is deemed to threaten sufficient anticompetitive results to satisfy the statutory effects clause, it should be illegal under section 7."

11. Cross-ownership structures and cross-directorships do not necessarily signify competition problems. There may be efficiency-related reasons for cross-directorship structures, and there may be sound financial arguments for investors to invest extensively in companies in the same industry or for companies to hold shares in one another. Competition problems, however, may and do arise out of these structures.

5 Primedia Limited/New African Investment (Pty) Limited 39/AM/May06, at paragraph 121
6 Areeda & Hovenkamp, Antitrust Law 1204b

12. Competition problems commonly associated with cross-ownership in general are threefold:

    12.1 cross-ownership of firms with related commercial interests may increase the risk of exchange of competitively sensitive information. This may facilitate price-collusion or restrain capacity and volumes. Cross-directorships can play a similar role. Motta (2004) states as follows:

    "If a firm has participation in a competitor, even without controlling it, the scope for collusion will be enhanced. First and more obvious, if a representative of a firm is sitting in the board of directors of a rival firm, it will be easier to exchange information on the marketing and pricing policies, which makes it easy to monitor a rival's behaviour… an important facilitating factor for collusion[7]."

    12.2 cross-ownership structures may increase the ability to influence or control the strategic competitive decisions of a (partially) co-owned firm. This may be facilitated by cross-directorships[8]; and

    12.3 cross-ownership may change incentive structures of the management of the firms.

13. It is indeed true that ownership structures can result in complex and diffuse interrelationships between firms. It stands to reason that these structures may provide disincentives to vigorous competition so as not to disadvantage the investment holding companies' financial interests. It is only through an assessment of these relationships, considering the nature and extent of these relationships as well as the conduct and effects of the entities that find themselves in these relationships, that one can determine whether they do in fact lead to anticompetitive outcomes.

14. Companies need investors, and investors demand return on investment. Return on investment is only achievable through bold and exceptional investments. The investment victory achieved through successful investment should never be faltered by competition law transgressions.

15. Whether to invest and where to invest should always take into consideration competition law implications.

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7 M. Motta, "Competition Policy: theory and practice", (2004), Cambridge University Press, p. 144
8 Jose Azar, Martin C. Schmalz and Isabel Tecu, "Anti-competitive Effects of Common Ownership", (2015), Ross School of Business, paper no. 1235

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