Non-Confidential

CCM/MS/001

STUDY OF THE MARKET FOR CEMENT IN MAURITIUS

PRELIMINARY REPORT

22ND OCTOBER 2010

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1. Introduction

1.1 On 1st of July 2010, the Competition Commission of Mauritius (CCM) launched its first Market Study under section 30 (h) of the Competition Act 2007 which empowers the Executive Director of the CCM to undertake general studies on the effectiveness of competition in individual sectors of the economy.

1.2 A market study is not an investigation of restrictive practices (investigations of infringement of the Competition Act). The purpose of the study is to understand (and publicise) conditions of competition in a sector and the reasons for any lack of competition, and if necessary to recommend action by Government. Our focus is necessarily solely on competition. The CCM has no authority or expertise to investigate environmental matters, for example, or any alleged breaches of law other than the Competition Act. It would be for Government to take such wider concerns into account when considering any recommendations we might make.

1.3 The present study relates to the market for cement in Mauritius. We understand that the cement market is highly regulated in terms of prices being fixed by Government and import/export permit requirements for trade in cement. The study aims at assessing how the current regulatory framework and business environment affect the level of competition in the cement sector.

1.4 The study will take into account anticipated future developments in the market for cement, particularly the possible entry of new operators.

1.5 Thus far, we have received a detailed written submission from one cement importer (Holcim Mauritius) and have conducted interviews with cement importers, the STC, Government bodies and others. This preliminary report, issued at an early stage in our study, provides some background information on the market and some key questions for future investigation.

1.6 No conclusions have yet been reached. We expect to publish our initial findings from the market study in 2011. This report was drafted by the Executive Director of the CCM and investigative staff, and is not a publication by the Commission itself. The Commission will decide whether to endorse any report only at the end of the investigation.

1.7 We invite the views of interested parties on this preliminary report, and on competition in the cement sector more generally.

2. Overview of the Cement Sector

Background

2.1 Mauritius is a cement importing country. The country's estimated yearly consumption[1] of cement is around 650,000 tonnes per year, which correspond to roughly 500 kg per capita. The country imports ordinary Portland cement. Currently, there are no cement manufacturing plants[2] in Mauritius.

2.2 The cement market is highly regulated. Pursuant to law[3], cement is a controlled product and subject to maximum price controls. Trade in cement is also regulated; import and export permits are required.

2.3 There are three cement operators importing bulk cement in Mauritius; the State Trading Corporation (STC), a state-owned enterprise and two private operators, namely Lafarge (Mauritius) Cement Ltd (Lafarge Mauritius) and Holcim (Mauritius) Ltd (Holcim Mauritius). The estimated share[4] of imports for STC is 50% and the remaining 50% is shared between Lafarge Mauritius and Holcim Mauritius.

2.4 The cement market is likely to undergo major structural changes with the coming of new operators establishing cement manufacturing plants in Mauritius. Two cement operators, namely Binani Cement Ltd and Oriental Group (Mauritius) Industry Ltd, have recently obtained their Environmental Impact Assessment licences for manufacturing cement (grinding of clinker) in Mauritius.

Government Intervention in the Cement Market

2.5 Government decided to import cement, through the STC, in 1984. Prior to that, Lafarge Mauritius was the sole importer and distributor of cement in Mauritius. Holcim (Mauritius), formerly known as Ciment de L'Ocean Indien Ltee, started operations in Mauritius in 2000 in partnership with Gamma Civic, a local construction company.

2.6 We are given to understand that in the early 1980's; Mauritius was facing supply-side constraints which were negatively impacting on the construction sector. The sole importer of cement, Lafarge Mauritius, was not in a position to meet the country's demand for cement. Also, during that period the price of cement went up significantly.

2.7 In 1984, the STC started importing 25% of the country's total demand and remaining 75% was imported by Lafarge Mauritius. As from the year 2000, the STC's share of importation of cement has increased to 50% of the annual demand, currently estimated at 650,000 tonnes and the remaining 50%

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[1] Based on interviews with various economic operators in the cement and cement related sectors

[2] Binani Cement Factory (Mauritius) Ltd has been incorporated in May 2009 and Oriental Group (Mauritius) Industry Ltd in October 2009.

[3] Consumer Protection (Price and Supplies Control) Act 1998

[4] Based on meetings with various operators in the cement market.

is shared between the two cement companies, namely Lafarge Mauritius and Holcim Mauritius. The table below summarizes the share of imports for the three operators:

Table 1: Indicative Share of Importation of Cement in Mauritius (%)

Year	STC	Lafarge Mauritius	Holcim Mauritius
Prior to 1984	-	100	-
1984	25	75	-
1985-2000	50	50	-
2000-2003	50	25	25
2004-2005	25	37.5	37.5
2006	33	33.5	33.5
2007-onwards	50	25	25

Source: CCM, compiled based on factual meetings

Sourcing of Cement Imports

2.8 Lafarge Mauritius and Holcim Mauritius import cement directly from the trading arm of their parent company, namely Marine Cement Ltd and Holcim Trading Pte Ltd respectively. STC buys cement on the basis of international tenders. There are many manufacturers/suppliers of cement which participate in the international tenders launched by the STC; including Marine Cement Ltd and Holcim Trading Pte Ltd as well as cement traders like Emirates Trading Dubai and Itochu Singapore. The table below summarizes the award made in respect of the supply of cement to the STC for the period 2003 to 2010.

Table 2: Sourcing of Cement Imports by the STC

Period	Supplier	Contract Quantity (metric tons)
01 Mar 10 – 31 Dec 10	Marine Cement Ltd	250,000
01 Mar 09 - 28 Feb 10	Holcim Trading Pte Ltd	300,000
01 Jan 08 - 31 Dec 08	Emirates Trading Agency LLC (Dubai)	300,000
01 Jan 07 - 31 Dec 07	Marine Cement Ltd	200,000
01 Jan 06 - 31 Dec 06	Marine Cement Ltd	200,000
01 Jan 05 - 31 Dec 05	Marine Cement Ltd	150,000
01 Jan 04 - 31 Dec 04	Itochu Singapore	150,000
01 Jan 03 - 31 Dec 03	Holcim Trading S.A.	150,000

Source: STC's website - http://stc.intnet.mu

Processing and Distribution of Cement in Mauritius

2.9 The role of the STC is limited to the importation of cement. Once cement consignments ordered by the STC reach Port Louis, these are sold to the two private cement operators; Lafarge Mauritius and Holcim Mauritius. Unlike STC, these two companies have storage, packaging and distribution facilities. In addition, Holcim Mauritius is the only company to own and operate an inland cement unloading facility with its Kovako shore-unloader.

2.10 Lafarge Mauritius seems to have around 55% and Holcim Mauritius 45% market share in the distribution of cement in Mauritius.

2.11 The total cement storage capacity at the port area is around 95,500 tonnes; Lafarge Mauritius has 9 concrete silos with a total store capacity of 35 500 tonnes of cement and Holcim Mauritius 2 flat silos with storage capacity of 40,000 tonnes and 20,000 tonnes of cement.

2.12 Government decides on the volume of cement to be imported by the STC and the two private cement operators. We are given to understand that the STC sells the cement it imports in equal quantities to Holcim Mauritius and Lafarge Mauritius.

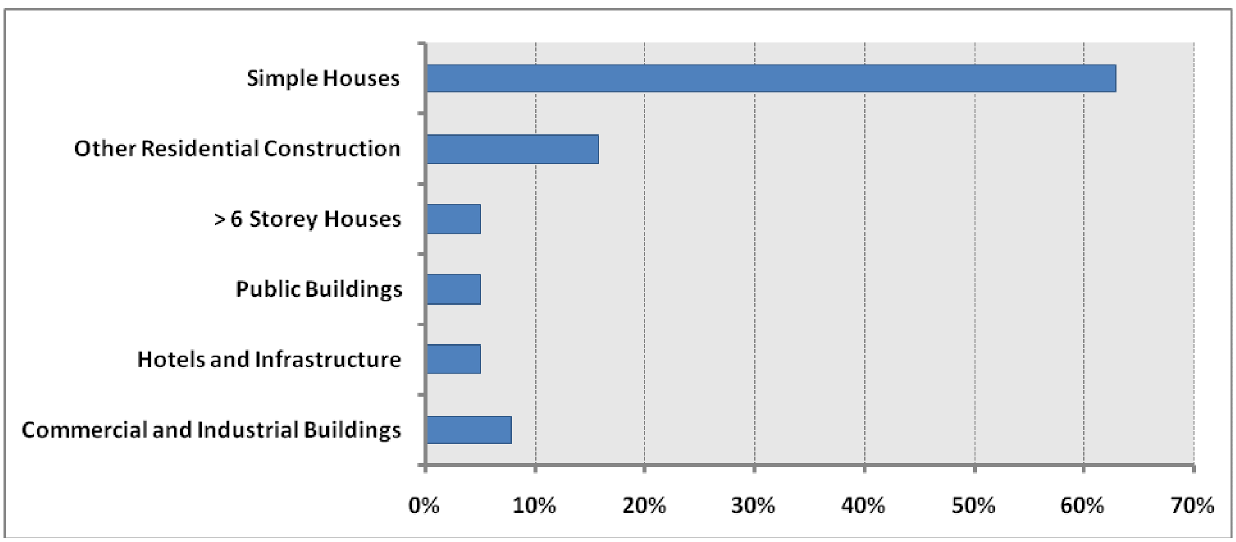
2.13 Both companies have their own bagging plant, situated at the port area. With its three bagging lines, Lafarge Mauritius claims to have capacity of 5000 bags per hour in ideal conditions.

2.14 Cement is sold in bags of 50 kg and 25 kg as well as in bulk. Bulk cement is sold to companies in the construction industry for the purpose of manufacturing ready-mixed concrete and mortar. It is estimated that 40% of cement is distributed in bulk and the remaining 60% in bags.

2.15 Annual cement consumption is about 630k-680k tonnes, which represents around 500 kg per capita. The per capita cement consumption is high, at a level equal to that in industrialized economies, but the composition is different. Private cement consumption in Mauritius is high compared to industrialized economies, but infrastructure consumption low.

2.16 Cement is used for commercial and industrial buildings, hotels and infrastructures, public buildings, houses and other residential constructions. The estimated shares of cement consumption for the different categories are shown below:

Table 3: Use of cement by category



Source: Holcim Mauritius

Types of Cement

2.17 Currently the local market for cement is restricted to ordinary Portland cement (CEM 1) Grade 42.5. Based on interviews with market players and the pattern of consumption, it appears that there is a high rate of mortar application. For instance, more than 60% of cement is used for simple houses and the mortar application rate for simple houses is 35%. For other commercial and industrial buildings, the mortar application rate is around 15%. This implies that there is a good market for lower strength cement types, i.e 22.5 and 32.5 and not necessarily 42.5.

New Entrants

2.18 Binani Cement Ltd has announced its cement manufacturing plant with a capacity of 1 million tonnes of cement, targeting both local and export markets. Also, the Oriental Group (Mauritius) Industry Ltd has announced the capacity of its cement manufacturing plant to be 200,000 tonnes for the purpose of the Jin Fei Economic Zone project. Other local companies, including the Mauritius Chemical & Fertilizer Industry (MCFI) Group, Holcim Mauritius and Lafarge Mauritius are also contemplating the setting up of cement manufacturing or blending plants in Mauritius.

3. Regulatory Framework

3.1 Cement, amongst other specified products, is a controlled product under the Consumer Protection (Price and Supplies Control) Act 1998 (Consumer Protection Act). The wholesale and retail prices of cement may be fixed by the Government. The Consumer Protection Act also empowers the Minister responsible for consumer protection to make such regulations as he thinks fit for this Act and for the purpose of regulating trade, supply and prices.

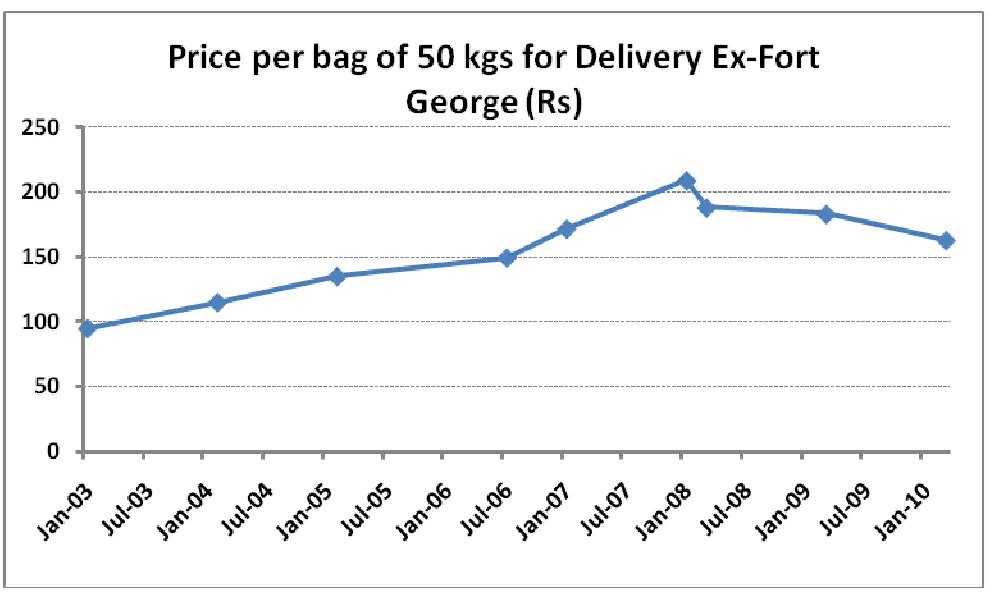
Pricing Mechanism

3.2 The fixing of the price of cement is done under the Consumer Protection (Consumer Goods) (Maximum Price) Regulations 1998, where every person who imports or manufactures cement shall apply to the Minister to fix the maximum price of the product.

3.3 The retail prices of bagged cement (50 kg and 25 kg) are fixed but that of bulk cement is not. Around 40% or 220,000 tonnes of cement is sold in bulk. We are given to understand that the regulated price of bagged cement constrains the price of bulk cement.

3.4 The retail price of bagged cement (50 kg bags) was first fixed by the Consumer Protection (Control of Price of Taxable and Non-Taxable Goods) Regulations 1998. These regulations were subsequently amended to include 25 kg cement bags. From time to time, amendments are bought to these regulations to reflect new prices, as fixed by the Government. The chart below shows the price of cement per bag of 50 kg for delivery at Ex-Fort George for the period 2003-2010. This price is adjusted for transportation costs and thus the price of cement across the country differs by that amount.

Chart 1: Evolution of cement price



Source: Ministry of Commerce

3.5 The pricing structure of cement is defined under the Consumer Protection (provision for Incidental Matters) Regulations 2006. As per these regulations, the Permanent Secretary of the Ministry for Consumer Protection may, in respect of cement (bulk or bag) or any other controlled goods, by written direction, provide for –

(i) the price structure ;

(ii) the collection by an importer an amount under the items "Price Equalisation Account" and "Exchange Loss Recovery Account"; and

(iii) the collection of an amount under the Rodrigues Subsidy.

3.6 The pricing structure of bagged cement (50 kg and 25 kg) includes the following items:

(i) CIF price of cement obtained by the STC on the basis of international tenders;

(ii) Cement unloading charges;

(iii) STC administrative charges;

(iv) Price Equalisation Account;

(v) Rodrigues Subsidy

(vi) Gross margin allowable to the private operators; and

(vii) VAT 15%.

3.7 The CIF price obtained by the STC on the basis of international tenders is used in fixing the retail price of bagged cement.

3.8 The unloading fee (currently USD 9 per ton) is added to the CIF price when the cement consignments from STC are on conventional vessels. The unloading fee is for the services of the Holcim's Kovako shore-unloader.

3.9 For the year 2010, USD 0.40 per ton is included in the price structure to allow STC to cover its administrative expenses related to the importation of cement.

3.10 For the purpose of fixing the prices of bagged cement, the exchange rate used to convert the USD CIF price into MUR (Mauritian Rupee) is fixed for a year. The Price Equalisation Account is included in the pricing structure of cement to create a contingency fund to compensate for any losses resulting due to fluctuations in exchange rate.

3.11 Rodrigues subsidy is provided for by way of regulations made by the Minister under Section 35 (2) (b) of the Consumer Protection (Price and supplies control) Act 1998. The Rodrigues subsidy is a fixed amount levied on each bag of cement sold in Mauritius to cover the transportation costs of bagged cement by ship to Rodrigues. The grant is collected by an importer of bulk or bag cement. The rationale behind this financial backing is to maintain the same price of cement in Rodrigues, as that prevailing in Mauritius.

3.12 Gross margin, which is fixed by the Government after consulting the private operators, along with the VAT at 15% are taken into account before arriving at the price of bagged cement.

Import and Export Controls

3.13 Pursuant to law[5], the Minister for Consumer Protection may make such regulations as he thinks fit for the purpose of regulating trade, supply and prices on controlled products. Trade in cement is subject to trade regulations. Import permit[6] and export permit[7] are required for the importation and exportation of cement. We are given to understand that under the current regulatory framework, the Ministry of Commerce (MOC) allocates import permits to the two private cement operators on a residual basis. STC is currently importing 300,000 tonnes of cement (around 50%) of the country's annual requirement and the MOC issues imports permits for the remaining 50% to Lafarge Mauritius and Holcim Mauritius.

3.14 We are given to understand that the assessment of the annual requirement of cement is done by the MOC. The private cement operators are consulted prior to finalizing the figure. The volume of cement to be imported by the STC is decided by the Government. We understand that the STC volume is set to allow a tender of sufficient quantity to obtain a competitive price on the international market for cement.

[5] Consumer Protection (Price and Supplies Control) Act 1998
[6] The Consumer Protection (Control of Import) Regulations 1999
[7] The Consumer Protection (Export Control) Regulations 2000

4. Competition Issues

4.1 In a competitive market, prices and output are determined by the forces of demand and supply. The advantages of a competitive market are*, inter alia*, encouraging firms to innovate, expand and adopt cost effective production techniques. Competitive markets also help in achieving lower prices, more choice and better quality to consumers.

4.2 If the scope for competition is constrained, then some of these benefits will be lost. To have a truly competitive market, sellers must be free to set different prices, with choices by consumers rewarding those with the best offers and penalizing those with the worst. It must also be possible for more successful firms to expand sales, taking market share from their less-successful rivals. In the longer term, new potential suppliers must be able to come into the market, possibly displacing less efficient existing players. And ultimately, suppliers which are unable to compete effectively must be allowed to fail. No real-world market is perfect, but without these basic elements the competitive process cannot produce good outcomes.

4.3 The cement sector in many countries is subject to government regulations, many of which limit one or other of these conditions for competition. However, it must be recognized that there are *inherent* limitations on the likely level of competition in an unregulated market for cement, particularly in a smaller market because of the need for large scale production for the industry to be efficient. As a result, the sector is often dominated by a few multinational firms. This industry has a history of being found by competition authorities to have engaged in price-fixing and other abuses of competition law, at the national and international levels. This probably reflects the characteristics of the product itself: a bulk, undifferentiated commodity produced under conditions of economies of scale[8].

4.4 We understand that in Mauritius, the intention of the Government in intervening[9] in the cement market is to ensure security of supply and for local consumers to benefit from competitive cement pricing. Government intervention on the cement market takes place through three interlinked, mechanisms:

(i) Retail Price controls on bagged cement;

(ii) Imports of cement by STC; and

(iii) Import Controls.

4.5 It is important to understand how the current regulatory framework fits together in achieving its objectives. In particular, we have to assess whether the existing regulatory framework is promoting or distorting competition in the cement market.

[8] Other industries such as chemicals, paper and aggregates, with similar physical characteristics, also have a long history of cartel actions by competition authorities.

[9] National Assembly Debate No. 5 of 27.03.2007

Regulation of Cement price

4.6 Considering the price controls on bagged cement, we will seek to answer the following questions:

(i) Does the current system of price controls distort the market for cement?

(ii) What would be the advantages and disadvantages of removing price controls?

(iii) Do the importers compete (on non-price factors such as reliability of delivery) in the regulated segment of the market?

(iv) What (if anything) does pricing behaviour in the unregulated sector of the market tell us about likely outcomes were price controls lifted for bagged cement?

4.7 We need to understand how the price of bulk cement (which is not directly regulated) is set in practice, in particular:

(i) Whether the regulated price of bagged cement constrains the price of bulk cement?

(ii) Do Lafarge Mauritius and Holcim Mauritius compete on price by undercutting the regulated price? If not, why not?

STC Intervention in the cement market

4.8 STC currently imports half of the country's requirement for cement. We understand that the original intention was to ensure that there are no artificial shortages on the market. We also understand that the tenders help to establish a competitive price for cement, to assist in setting the price control at the right level. We will seek to answer the following questions:

(i) Is the use of a State Agency to import cement still necessary to prevent artificial shortages? Can competition, and the application of competition law, replace the safeguards provided by the imports of STC?

(ii) Are there any alternative ways of determining a competitive price for wholesale cement, to use in setting retail price controls?

(iii) Does STC's allocation of its imports to Lafarge and Holcim distort the market, for example by reducing their ability to capture business from one another? Might it provide a coordinating mechanism for market sharing? Could the cement simply be sold to them in a competitive process?

Import/Export controls

4.9 As noted above, in a competitive market it must be possible for suppliers which best meet customers' demands to expand, at the expense of those suppliers which are not so successful in the market. A rigid system of import controls might prevent this, diminishing the incentives to compete (a supplier will not compete to win a customer from a rival if it will not be able to import cement to supply that additional customer). The CCM will examine:

(i) Why are import quantities controlled? Do they 'bite' in practice, preventing companies from importing as much cement as otherwise they would?

(ii) On what basis are import quotas allocated? Are import quotas flexible, in that companies winning more customers are able to secure a higher quota to supply those customers?

(iii) What would the effect be of liberalizing imports of cement, by removing import controls (for suppliers meeting acceptable environmental and other standards) or by making the arrangements more flexible so that import quotas do not in practice constrain suppliers?

Types of Cement

4.10 We need to understand the conditions for lower strength cement not being supplied on the local market.

(i) Does the restriction on the availability of different types of cement arise from the regulations? What is the reason for it?

(ii) Is the purpose of importing only Grade 42.5 to simplify the setting of the regulated prices? If so, what are the costs of this?

New Entrants

4.11 We are not going to assess or in any way comment upon any environmental issues or the possible control of new entry on environmental grounds, as these matters are outside the scope of the Competition Commission.

4.12 However, it will be important for us to consider how any new entrants are likely to affect the conditions of competition of the local cement market.

4.13 We would like to assess how conducive the current regulatory framework is for the new private operators, and what the alternatives might be. More generally:

(i) Is the existing system of price controls, STC purchases and import controls consistent with an environment in which significant new entry has occurred?

(ii) Are there any economic grounds (as opposed to environment grounds) for limiting the entry of new importers or producers?

Other issues

4.14 In its submission, Holcim Mauritius has raised concerns about some of the ways that the STC operates as a commercial player, which it claims might distort competition. For example, STC is provided with foreign exchange services by the Bank of Mauritius, rather than by commercial banks. We have not investigated this specific point. However, as it does not seem to us that STC really competes with the commercial importers in any meaningful sense, there does not at this stage appear to us to be a distortion (given the existing industry and regulatory framework). However, we will explore this and other issues raised by Holcim as the study continues.

5. Next Steps

5.1 The CCM will continue with the market study. We welcome comments by interested parties on any of the issues raised in this report, or any other matters of relevance to competition in the cement sector.

5.2 The draft report of the market study will be issued for consultation with the various stakeholders and interested parties.

5.3 The Final report will be submitted to the Commission in 2011 and the Commission will decide on whether to make any recommendations to Government.

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