De Beers – Rulers of the Diamond Industry

The Rise and Fall of a Monopoly

William Yu
A Brief Overview of the Diamond Industry

- Diamond market is estimated to be $30B / year
- Diamonds have no practical use to the normal person
  - Jewelry diamonds would be worth $2-30 if used industrially
- The price of diamonds do not actually reflect their true scarcity (or lack of)
- Price of diamonds have remained surprisingly stable
De Beers

• Historically owned 85% share of the diamond market

• Owns both mines and main distribution system, Central Selling Organization
  – Mine and trading companies owned by subsidiaries with generic names

• Known for influencing supply and demand to control prices
Tactics to Control Supply - Distribution

• Majority of diamonds from mines sold to De Beers
  – External buying offices compete with purchasers buying from outside

• Company sells them 10 times a year at “sights”
  – De Beers has sole power to determine how many diamonds to sell and at what price
  – Vast amounts of research done

• 125 - 250 “sightholders” invited to CSO to purchase diamonds
The Iron Hand of De Beers

• Sightholders virtually powerless at sights
  – Can only accept or reject boxes
  – Not allowed to negotiate
  – Not allowed to sell to retailers who will lower prices
  – Must give De Beers information about market and inventory
  – De Beers has the right to come and audit them

• Diamond supply is their punishment/reward
  – "Perhaps you've been slightly naughty, but let's see what we can do next time." - said to a disappointed sightholder who disobeyed the rules
Israel Incident

• In 1970s, Israeli merchants hoarded diamonds during a period of high inflation to try to profit
  – Created a shortage, driving prices up

• De Beers was concerned they no longer had control of supply in market
  – Once the hoard was dumped into market, prices would drop and they would no longer be “rare”
Israel Incident Continued

- To force Israelis to sell their inventories, De Beers:
  - Charged temporary surcharges at CSO, to create sudden price fluctuations and make speculation risky
  - Allocated 20% less diamonds to Israelis
  - Banned Israeli sightholders from sights
- Israelis ending up selling their stocks and following De Beer’s orders
Anticompetitive Tactics

• If price of diamonds are falling, De Beers will:
  – Hoard inventory by selling less
    • Accumulated $2B in diamonds in 1984 after allowing prices
ten to rise too much and a sudden sell off in the market and $5B
  in 1990s
  – Charge higher prices to sightholders
• If new suppliers emerge, it will:
  – Flood the market with similar diamonds at below
  market prices
Zaire Incident

• Zaire was not satisfied with CSO’s sales conditions
• Decided to sell on the industrial diamond free market
• De Beers responded by flooding the market with similar diamonds at below market prices
• Zaire came back to De Beers to ask for readmission into cartel
  – De Beers accepted and offered even worse terms
Controlling Demand

• Highly effective advertising
  – Over 70% of American women own at least one diamond
  – Done through movies, magazines, celebrities, even British Royal Family
  – Used to shift focus on types of diamonds company wants to sell

• “A Diamond is Forever”
  – Campaign used to convince people not to sell or buy used diamonds
Antitrust Violations

• In 1994, US Dept. of Justice charged De Beers and General Electric for conspiring fix prices of industrial diamonds

• Two companies allegedly provided advance notification to each other about the prices of their goods
Antitrust Violations

• Any De Beer’s employees entering US were supposed to be arrested
  – Company has conducted business through intermediaries since 1945

• In 2004, the company plead guilty and paid a $10M fine
  – Allowed to operate directly in the US
Losing its Grip on the Market

• In 1990s, several events happened:
  – Soviet Union collapsed, weakening partnership
  – Huge Argyle mine in Australia broke off from cartel
  – New mines in Canada discovered
  – Increasing popularity of synthetic diamonds

• Market share fell from 85% to 65%
The Aftermath

• Stopped trying to control market and instead focus on using its marketing and brand
  – Spent $180M on marketing in 2004
• Partnered with Louis Vuitton to open retail outlets
• In 2003, earned sales of $5.5B and income of $676M
Conclusions

• De Beers one of the most successful monopolies in history
• Used numerous tactics to successfully control supply and demand
• Monopoly fell apart when it could no longer stop other entrants
Sources

- http://www.economist.com/printedition/PrintFriendly.cfm?Story_ID=2921462
- http://news.bbc.co.uk/1/hi/business/3892333.stm
- http://edwardjayepstein.com/diamond/prologue.htm
- http://www.danforthdiamond.com/education/diamonds/4cs/debeers_info.htm