Role of CCI in the Context of Emergence of Domestic Business Power Houses

By

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1. The Competition Act, 2002 (henceforth the Act) amended in 2007 and with this legislation the Competition Commission of India (CCI) was established and became fully functional by 2009 . On this occasion the Foundation Day of the SBI Academy, it is but appropriate to reflect on what is the envisaged role of CCI for as the largest commercial bank in the country SBI and CCI share common concerns but from different dimension. As a premier financial institution funding and financing of economic activities in conformity with the various laws that affect economic activity and post March 2009 definitely includes the Competition Act. The Commission is an expert body on competition and market functioning and as India now is emerging among the two fastest growing countries CCI and SBI have a shared interest.

2. CCI follows the MRTP but is not a legacy of MRTP. This distinction is significant in the context of today's topic 'CCI and its Role among the Emergent Business Power Houses'. MRTP was a product of the 'license raj' where the concerns were more on curbing monopoly rather than on promoting competition. Unfair and Restrictive trade practices were outcomes of the perception that markets failed and competition was invariably deleterious to the ordinary consumer. CCI on the other hand has been established under a different perception where experience of state failures and market failures has weighed in favour of the market. The market can play a critical role provided that market failures are prevented and markets made to function effectively. The Competition Act provides a formal and legal framework for ensuring competition and preventing abuse of market power and dominance in the Indian economy. The Act comes almost a decade after economic

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liberalization ushered in 1991 demarcating the paradigmatic shift from a closed economy model regulated and controlled to an open economy market oriented model that also needs to be regulated, but for competition.

3. The Act as stated is the outcome of economic liberalisation. This sets it out from similar Acts in other developed Western countries and also from the post-socialist countries of Russia and China placing the Commission in a unique position where interpretation and implementation of the law is concerned. The Supreme Court judgement on the role of CCI in a sense was a pointer to the envisaged role. The judgement is path breaking in that it not only defines the role of the Commission but in that it anticipates implementation of the competition law in a dynamic framework of innovation and growth as it dwells on the benefits of competition in a stamp of approval on market oriented economic development. To quote:

> The advantages of perfect competition are three-fold: allocative efficiency, which ensures the effective allocation of resources, productive efficiency, which ensures that costs of production are kept at a minimum and dynamic efficiency, which promotes innovative practices. These factors by and large have been accepted all over the world as the guiding principles for effective implementation of competition law. (CCI v/s SAIL & Anr., No. 7779 of 2010)

4. The SC Judgement is very relevant and provides a dimension that perhaps was not directly addressed in the preamble to the Act.

> "*An Act to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in India …..*"

Between the preamble and the Supreme Court judgment the dynamic role of the Commission is well articulated.

5. Taking a leaf out of the Supreme Court judgement the concerns of the Commission as regards emergent business houses suggests that the lens of competition is very different. It looks at competition not merely in terms of the number of players but more often in a Schumpeterian framework of 'creative destruction'. Benefits of competition are not merely of productive and allocative efficiency but also of static and dynamic efficiency. It makes the task of the Commission not only difficult but in a sense prescient especially in sectors and industry where the cycle of innovation and change is often a year or a couple of months. And space must be provided for innovation and change which a linear approach to competition and monopoly may not comprehend, a marked approach in line with economic liberalization and market orientation.

6. Legal interpretation must carry the weight of economic analysis and it is in this blending that when we look at the initial years of the Competition Act in US where the emphasis was on cartels and breaking of cartels the question uppermost is what is the likelihood of cartels being formed by emergent business power houses in India. Cartels are the forte of old business houses in products with low innovation and even demand. The concerns of new business houses are on dominating the market or in breaking old structures. Here again the standard format of traditional economics that of 'structure, conduct and performance' or, the use of standard concentration indices such as HHI may not be sufficient to comprehend the dynamics of these markets.

7. In this lecture an attempt is made to review the competition law and the three sections of the Act: Adverse Affect on Competition; Abuse of Dominance; Combinations (mergers & acquisitions)and thereafter to perceive probable competition issues in the context of the Act as regards emerging business power houses. At the outset in this lecture the scheme of structuring Indian industry is examined. The relevant

portions of the Competition Act will be highlighted to try and understand possible areas of concerns between the Act and business houses.

Competition in the Indian Economy

8. Let us first take a quick look at the visible trends and patterns of Indian industrial development. As in any other economy industrial structure is usually a layered structure with old industries giving way to new and emergent industries. Each layer is defined at a point of time by technology, transport costs, resource base and of course, the nature of industrial policy. Juxtaposed on the industrial structure are the objectives set forth in the preamble and the recent SC judgement. Interestingly each layer addresses competition issues in different ways distinguishing among the segments of the Act which could impact on the specific industrial layer. The earlier industries may attract different provisions of the Act by virtue of their expected economic behaviour and business orientation while emergent power houses have a completely different strategy.

9. Very briefly the macro picture of the economy. India is now a relatively open economy as weighted average tariffs are around 30% and the value of trade in goods and services are about 50% of GDP. A look at the growth rates show that GDP growth rates post-1991 and the beginning of economic liberalization, shot up from the traditional Hindu growth rate of 3% to register 5.7%. Post 2003 growth rates have averaged around 8.7% dipping to about 6.5% in the current year more on account of global recession. Post 2003 is the phase of openness and competitiveness. On an average the decade between 1990-91 and 2002-03 saw growth rate averaging more than 5%.

10. India's GDP is expected to grow by 8.5% this year and could grow even faster. Many predict that India's growth will outpace China's within three to five years. "China will rumble along at 8% rather than double digits; India will rack up successive years of 9-10% . For the next 20-

25 years it is predicted that India will grow faster than any other large country". (Comments from The Economist, Oct 2nd to 8th, 2010, 'A bumpier but freer road').

11. Several advantages weigh in India's favour. The first is the demography. Indians are young. The proportion of Indians aged under 15 or over 64 has declined from 69% in 1995 to 56%. India's working-age population as per the UN will increase by 136 m by 2020; China's will increase by a mere 23 m. Skill formation becomes an important factor.

12. India's second advantage is that the economic reforms of the early 1990's have unleashed an explosion of pent-up commercial energy. Tariff ramparts have been torn down. The licence raj system has given way to private dynamism that is forced to compete with the world's best. Many have discovered that they can.

13. Indian firms are increasingly global and sometimes world-class. (The Economist has given several examples in the article cited above. Arcelor-Mittal based in Luxembourg is the world's largest steel firm. Tata Motors, best known for making small car also owns Jaguar and Land Rover two luxury brands. Bharati Airtel, a mobile-phone firm with 140 m subscribers in India, is rapidly expanding into Africa too. Emergent India is driven by 45m entrepreneurs – energy of India's vast informal sector, and its ability to solve problems. Indian firms export a lot of services, but their primary focus is on the needs of domestic consumers. Indian shoppers demand goods that are cheap, rather than fancy. Indian "frugal innovators" oblige. Tata Chemicals and their water drinking filter that requires no owner can give family safe water for Rs. 30 per month.

14. A major constraint for realizing and sustaining the growth potential is the bottleneck from physical and soft infrastructure. In fact, the Budget

for FY2009-10 singled out for mention the establishment of the Competition Commission of India clearly indicating that while the budget expenditure is for immediate concerns of employment, poverty alleviation, food security the growth dynamics in the model of inclusive growth is defined by the extent competition forces are unleashed. Interestingly the Budget while asserting the role of competition in traditional sectors such as infrastructure envisaged in the public-private participation (PPP) framework has treaded new paths in stating:

"*The benefits of competition should now come to more sectors and their users and consumers. Now is the time for us to work on these aspects to eliminate supply bottlenecks, enhance productivity, reduce costs, and improve quality of goods and services supplied to consumers." (para 43- Budget Speech)*

15. Industry as it stands now consists of several layers or strands and it is possible to distinguish among the strands mainly on the basis of government policies that initiated a respective strand. Each strand has certain characteristics that could attract the provisions of the Competition Act. It is important to distinguish between the strands as there is a loose kind of pyramidal structure. It is from this base that several Indian global players have emerged.

16. In a very broad sweep the first strand relates to industries which grew under the umbrella of protection and licenses granted under the Industries Development and Regulation Act and of course tariff barriers. Some of these industries remained in the exclusive privilege of the public sector such as steel (with the exception of TISCO) while others saw both public and private sector investment with many in the private sector that grew to be giants such as cement, tyres, fertilizers. For convenience let us label them as **Tier 1**. Tier 1 industry has a large number of Trade Associations as is to be expected in old industries.

17. The seventies saw the emergence of new industrial houses some of which overlapped with Tier 1 sectors promoted and nurtured by institutional finance mainly IDBI and IFCI. The blend of old and new industrial houses have helped to build a base for India's industrial growth. In this category the emergence the basis of a diversified financial structure with the development of different financial institutions also emerged. These constitute **Tier-2** industries.

18. Among **Tier-2** industries specific mention needs to be made of the Pharmaceutical industries and a special place is reserved for the growth of pharmaceuticals. Indian Pharmaceutical industry is well developed under an earlier IPR and continues to display remarkable growth rates.

19. Economic Liberalization and globalization saw the blooming of knowledge and IT industry that lead Friedman to define the world as flat. At one end of the spectrum giants like Infosys, Wipro, TCS lead the march with smaller perhaps exclusive firms on the other end. The second tiers of such companies including BPO's are also making waves both within and outside the country. This is **Tier -3**. Included within this category is the potential for 'jugaad'. The Indian 'jugaad' or frugal economy is the unique contribution of India to the world of innovation.

20. **Tier -4** is the surging informal economy which has its own jugaad. The informal economy which calls for inclusive growth.

21. Each layer sustains the next layer. But the emergent business houses are really those of Tier 3 and some spill-over from Tier 2, especially pharmaceuticals, bio-tech etc which grew under a different patent act. In these four tiers private investment in infrastructure which include telecom and transmission towers, power generator are not included for infrastructure is the base for all rapid industrialization.

22. What is the role of the Commission in the new emergent business power houses? As stated early emphasis of Commissions in the US or EU may not represent the perfect role models. First and foremost, 'jugaad' of India has to be pushed. Secondly, gains of a protected environment have to be sustained while ushering in competition. Lastly, the benefits of competition and efficient market functioning have to spread to several sector especially the social sector where state failure and intervention are getting acute. In this category fall both hard and soft infrastructure. Let us look at the provision of Competition law.

Competition Act, 2003

23. The Competition Act consists of four sections whose operative focus is on forces that have 'appreciable adverse impact on competition' AAEC as it is known in the literature.
    i. Section 3—Agreements that cause or are likely to cause appreciable adverse effects on competition within India;
    ii. Section 4—Abuse of dominant position defined in terms of position of strength in a relevant market which enables it to prevent entry, fix prices etc.
    iii. Section 5&6—Regulating combinations i.e. on mergers and acquisition (M&A).
24. The relevant sections of 3 and 4 must be read in conjunction with Sections 19 (3) and 19(4). These two subsections provide under the Act the force of holistic approach to anti-competitive behaviour.

Section 3

25. The most interesting of collusive agreement are cartels. World over cartels are considered as the most pernicious form of anti-competitive behaviour and top the agenda for competition commissions. In fact, the competition law in US and Canada had their genesis in cartels and secret collusive agreements giving rise to the phrase "anti-trust". Cartels have all the ingredients as Khemani a noted authority on the subject observed of "conspiracy, collusive agreements and cartels …such behaviour is what is akin to "robbery".

26. Why is a cartel pernicious?

    i. It increases prices to consumers
    ii. Reduces consumers choice
    iii. Nullifies all the benefits of competition including innovation and other cost reducing measures

27. It is a well established fact that cartels normally are more likely to arise in industries when sellers are few, products are similar and demand is relatively stable or falling and costs of production are uniform. The 'burden of proof' is very high in the case of cartels. It is in the context of finding evidence since cartels being illegal are secretive in their strategy, the concept of leniency provision has emerged. Based on the famous 'prisoners dilemma' of game theory the intention of this innovative instrument to detect cartels is to incentivise a 'leak' or perhaps in the language of detective films find a '*mole*'. Perhaps it is this excitement of secrecy with all the trimmings of 'cloak and dagger' atmosphere that provide the charm to cartel detection.

28. Under section 3 joint ventures can come under the proviso of exemptions if such agreements increase efficiency in production, supply, distribution, storage, acquisition or control of goods or production of services. The proviso does not necessarily suggest that joint venture is outside the scanner of CCI and include:

    - Tie-in arrangement
    - Exclusive supply agreement
    - Exclusive distribution agreement
    - Refusal to deal
    - Resale price maintenance

29. Examples abound in this area and more often dealers have restrictive clauses imposed by manufacturers. Can they all be considered as anti-competitive? Reference will here be to Section 19(3) where due regard is paid to creation of entry barriers; deriving out competitors; foreclosure of competition set against efficiency, important in

distribution promotion of technical, scientific and economic development.

30. Another case of vertical agreement which can fall on the border line is with regard to exclusive dealing which can have both anti competitive as well as pro competitive effects. Section 3 (5) relating to six IPR Acts normally protects the rights of joint ventures from being considered as anti competitive. The rider to note what is considered reasonable or unreasonable remains open for judgement.

31. Illustration of unreasonable restrictions arising out of IPR is given below:

(i) Patent pooling is a restrictive business practice

(ii) Tie-in arrangement is yet another restrictive business practice

(iii) An agreement forbidding a licensee to compete or to handle goods, which compete with the patentee's

(iv) An agreement which restricts competition in R&D or prohibits a licensee to use rival technology.

(v) A licensor may fix the prices at which the licensee should sell

(vi) A condition imposing quality control on the licenses patented product beyond those necessary for guaranteeing the effectiveness of the licensed patent.

(vii) Imposing a trade mark use requirement on the licensee is prejudicial to competition, as it could restrict a licensee's freedom to select a trade mark

(viii) Undue restriction on licensee's business could be anti competitive

(ix) Limiting the maximum amount of use the licensee may make of the patented invention.

Section 4

32. Section 4 looks at the issue of Dominant Position from the angle of the ability of the firm to indulge in anti competitive practices and therefore, it is stated that a firm is in a dominant position if it has the ability to behave independently of its competitor, customer, supplier and finally the ultimate consumer. The important point is to establish the existence of dominance in the relevant market where relevant market is with the reference to either the product market or geographic market. In establishing the abuse of dominant position the Commission shall make reference to Section 19(4) and therefore this Section unlike that of section 3(3) is based on 'rule of reason' test.

33. Dominant position in the Monopolies and Restrictive Trade Practices Act (MRTP) was with reference to market share a methodology not adopted by the Commission and prefers to define market share in relation to market control. A dominant firm for instance can have a large market share but does not have any overt or obvious economic power or commercial advantages over its competitor on account of the factors (i) no special advantage in terms of brand name; (ii) inability to erect entry barriers. But generally market share is a critical factor for abuse of dominant position. In the EU, market share of 50 per cent is taken to imply dominance except in exceptional circumstances. In UK, 40% market share was regarded as sufficient to establish dominance in the case of Virgin/British Airways.

34. Dominant position arises when there is a technological advantage or a technological lead on account of size and resources of the enterprises. There are some very interesting cases in the literature on the question of how through licensing a dominant position gets created. A standard example is that of Bayer^{AG} a major global supplier of insecticides outside USA. Bayer gave patent rights of its new product to SC Johnson and Sons, a dominant supplier in US. The Department of Justice challenged this licensing arrangement and the Court decided

that Bayer should offer the patented ingredients to other manufacturers also.

35. Even if an enterprise is in a dominant position it is important to establish that dominance has lead to abuse and in this instance the most common abuse is with regard to predatory pricing. Predatory pricing is when a dominant player fixes the price of his product less that the long run average costs. Sustaining these cuts in prices maybe difficult in the long run, unless the intent is to cover up losses by profits elsewhere. I am told this is a business strategy often adopted as the entrepreneur is interested not in profits but building up sales with an eye of equity valuation. 'Predatory Pricing' is an ironic situation where competition which results in price cuts is seen as a strategy to restrict competition rather than as an outcome of competition. It is, therefore, a difficult situation for it requires assessing whether the decrease in price is on account of competition or is a deliberate strategy to restrain competition. Under these circumstances the Regulation of the Commission to capture in a simple and yet comprehensive manner varied business models and business strategies without being deterred by unnecessary details is perhaps the most appropriate and preferred approach. Rebates and discounts as a form of pricing strategy of dominant firms can also come under the scanner of Competition Law.

Section 5 & 6

36. This section has yet to be notified but the section really deals with:
    - Threshold limits for acquiring control; for mergers and acquisition
    - Time limits for cases
    - Confidentiality
    - Assessment of market dominance and its abuse
37. Threshold limits under the Act

    Acquisition and acquiring control – assets of value of more than Rs. 1000 crs or turnover more than Rs.3000 crs with aggregate of

assets more than $500m including at least Rs, 500 crs in India and turnover more than $1500m including at least Rs. 1500 crs in India; Group to which referred – assets of more than Rs 4000 crs in India or turnover of more than Rs 1200 crs; In India or outside in aggregate the assets of more than $2 b including at least Rs. 500 crs in India or turnover more than $6b including at least Rs 1500 crs in India.

Merger or amalgamation – the enterprise after merger or amalgamation may have either in India, assets of the value of more than Rs. 1000 crs or turnover of more than Rs. 3000 crs or
In India or outside, assets of value of more than $ 500 m and at least Rs 500 crs in India, or turnover more than $ 1500 m including at least Rs. 1500 crs in India.
These limits are very wide by several international standards but supposedly under review with the proposed amendment to the Act.

38. Time Limit – for cases which do not fall into the category of dominant position with the likelihood of abuse cases are to be cleared within 30 days and for other cases clearance are to be within 210 days. These limits are also supposedly under revision.

39. Confidentiality – a very critical factor in any M & A.

40. Assessment of dominance - Largely most M&As do not come under the above thresholds and even if they do, the Commission intervenes only if the M&A is expected to result in a dominant position in the Indian market and with the possibility of abuse.

Emergent Business and the Act

41. Section 3 (1) (2) and (3) are more likely to be in Tier 1 and a few Tier 2 industries. Case laws in US have shown that cartels are likely to occur in cement, steel, sugar, flour, tires, electrical equipment, lysine,

vitamins etc. As is obvious cartels are more likely in Tier 1 industries that either because of technological factors or fear of competition these industries do have a tendency for cartel formation. This sector includes bother public and private sector enterprises. Competition Act does not distinguish on the basis of ownership.

42. Cartels need not always be secretive. Trade associations can also be cartels and their activities can result in anti-competitive behaviour when they cross the boundary to indulge in anti-competitive acts. By fixing pricing which are often published in the name of benefiting the consumer, or by other marketing restrictions the consumer is denied the benefits of competition. Several Commissions have come out with guidelines on do's and don'ts for trade associations. Tier 1 industries again are more prone to well established trade associations.

43. Cartel operations are also part of bidding when there is bid rigging or collusive bidding. This is an aspect is of tremendous concern for bidding is considered as a mechanism for introducing competition in:
    a. large infrastructure projects which are now on public-private partnership projects
    b. infrastructure projects that are natural monopolies
    c. public procurement.

44. Public procurement is a priority area as it affects the entire economy , the common man often and accounts for between 20-30% of GDP. Significantly cartels in public procurement are not merely restricted to public sector activities which are commercial in nature but also social activities such as education, health, PDS etc. An important aspect of Competition Act, 2002 is that social sectors and government departments are also under the purview of competition extending the scope and dimension of competition to areas that affect the "Aam Admi". The definition of enterprise which includes government departments, PSUs with the only exceptions arising from sovereign functions. The formal rules that govern procurement, the way in which

an auction is carried out, and the design of the auction itself can all act to hinder competition and help promote or sustain bid-rigging conspiracies.

45. While a lot of attention has been drawn to the issue of bid rigging in public procurement my own concern is in the bidding process of large infrastructure projects. As a general observation large infrastructure projects or projects in areas of natural monopoly such as transmission networks, bandwidth networks are now in the realm of private players. Bidding is accepted as the most appropriate mechanism for introducing competition. Since these are large projects the numbers of players tend to be limited. To this aspect is the concern that projects are not saddled with 'fly by night' operators.

46. Networks are capital intensive and the sunk costs can be entry barriers. With well developed financial markets sunk costs are no longer associated with entry barriers. Instead user charges can emerge as entry barriers. Nevertheless, the aspect of such costs and user charges can provide rich ground for collusive bidding. Design of model concession agreements by the Planning Commission is aimed at preventing collusive bidding.

47. A look at the different sections of the Act shows that is Section 4 – dominance and abuse of dominance; Section 5&6 relating to M & A and section 3 (5) are the three sections which are likely to be the area where emergent business power houses are likely to fall into the ambit of competition law.

48. There has been a spurt of activity in M&A. As per one set of estimates (Ernst & Young report as quoted in the *Financial Express*., July 2, 2010) for the quarter ending June 2010 deals worth $16.9 billion were made. They include both outbound and inbound. The outbound deals are in oil and financial services. The inbound deals are mainly in

pharmaceuticals and industrial products. Of course the data did not include the Bharathi-Zain/Airtel deal which is outbound.

49. For illustration let us take the case of pharmaceuticals and competition issues. The pharmaceutical industry of India has matured over the years into a major producer of bulk drugs, rated among the top five in the world. The industry is largely concentrated in the production of 'generics' on account of the Process Patent Law introduced in the seventies (repealed under the recent TRIPS Agreement). India has since been able to establish technological capability for manufacture and supplying of generic drugs. This 'generics capability' of India has attracted worldwide attention. A noticeable surge in mergers and acquisitions with either a foreign company seeking a stake in an Indian counterpart or vice versa reflects the attractiveness of what has been called as the 'platform of capabilities'. For pharmaceuticals sections 5 & 6 and Sec 3(5) are the appropriate sections to take a look.

50. It is interesting to observe the responses of a matured generics player to competition, where large numbers of patents are expected to expire in a few years time. For instance, cases reported by media and newspapers, provide glimpses of how Indian companies have taken legal measures to refute claims of multinational drug majors for extension of their patents.

51. For the Commission, Sec 4 that of dominant position and its abuse raises a number of methodological issues especially in defining markets for instance in network industries as technological developments are such that several markets or products emanate form one computer platform. A narrow definition may result in dampening the potential of high tech industries. A broad definition would leave the field open for monopolistic tendencies.

52. In a very loosely structured manner the following observations are made:

a. Tier 1 – Section 3 These are industries with greater tendency for cartels;
b. Tier 2 - Section 3(4) vertical integration and in the case of pharmaceuticals and IPR industries Section 3(5) and Sec. (5) and (6);
c. Tier 3 – Sec 4 abuse of dominance and possibly Sec (5) & (6) as emergent business power houses go for mergers and acquisition either outflow or inflow.

53. The Commission approach as stated is holistic, proactive and prescient.