National Conference

on

State of Competition in the Indian Economy

'COMPETITION ASSESSMENT'

By

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BENEFITS OF COMPETITION

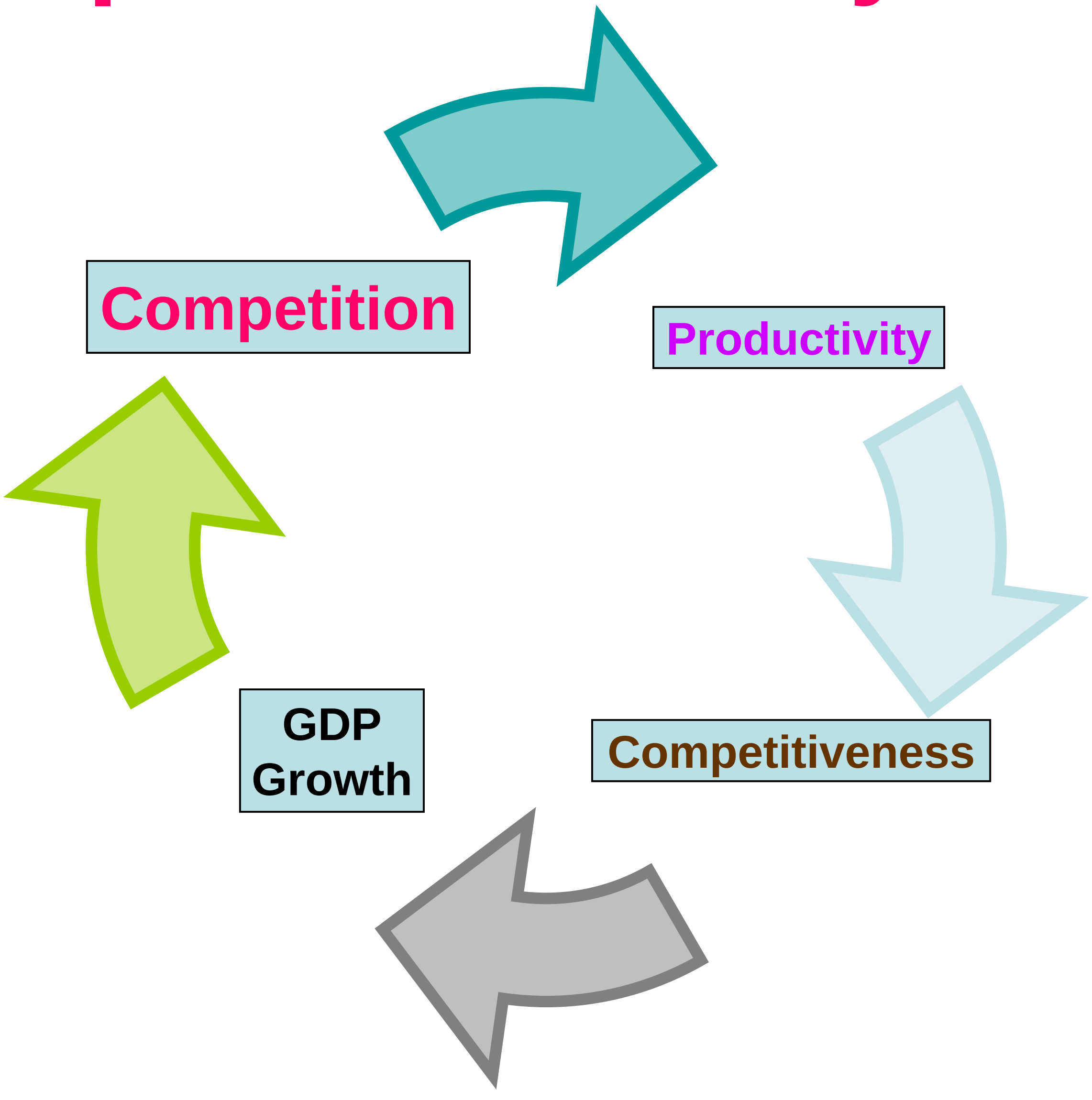
- On a question as to what makes a country rich or poor, the crucial insight given by a Mckinsey study is:-

  "the primary answer is the nature of competition in product markets. Competition is the mechanism that helps more productive and efficient companies to expand and take market share from less productive ones, which then go out of business or become more efficient."

- Strong competition policy is not just a luxury to be enjoyed by rich countries but a real necessity for the countries striving to create democratic market economies. (**JOSEPH STIGILITZ**)

- Competition is a key driver to competitiveness
- Positive correlation exists between competition, competitiveness, productivity and GDP growth

Competition the key driver



WHAT IS MEANT BY ‘COMPETITION’

- Is the market competitive ?
- The issue is that of ‘effective competition’ and not ‘perfect competition’ in the text book sense
- Effective Competition is seen in terms of:
  - Rivalry among firms
  - Absence of restraints
  - Where no firm can influence the market place
- **In reality, however, the existence of ‘effective competition’ has to be defined in terms of outcomes or the effects for/on the consumers**
- **Absence of ‘effective competition’ results in ‘market power’ which is likely to be abused to the detriment of consumer interest.**

MARKET POWER

- ***Market power is defined as the "ability of a firm or group of firms to raise price, through the restriction of output, above the level that would prevail under competitive conditions and thereby to enjoy increased profits from the action"***

  > *Exercise of market power leads to lower output*
  > *The increase in price must lead to an increase in profitability*
  > *Market power is exercised against the benchmark of the 'outcome' under conditions of effective competition*

APPRECIABLE ADVERSE EFFECT ON COMPETITION (AAEC)

- The philosophy guiding 'competition analysis' shifted from:
  - > Treating structure as *per se* bad

    To

  - > Treating certain types of conduct as bad

    To

  - > Judging acts based on their 'Effects'
- Competition Act, 2002 frowns upon act(ion)s that have 'appreciable adverse effects on competition' (AAEC)

COMPETITION ASSESSMENT

- Competition assessment can be:
  - Of a specific product, <u>*or*</u>
  - Of a specific sector, <u>*or*</u>
  - Of the economy as a whole
- Here we speak of specific products, in terms of relevant market
- ‘Appreciable adverse effect’ is the what is looked at
- ‘Presumptive’ logic and ‘rule of reason’ are applied
- Assessment has to be against the bench mark set by the law in force
- In India the bench mark is (the provisions of) the Competition Act, 2002

PREAMBLE OF CA 2002 STATES:

“keeping in view the economic development of the country”,

- **to prevent practices having appreciable adverse effect on competition;**
- **to promote and sustain competition in trade and industry:**
- **to protect the interest of consumers;**
- **to ensure freedom of trade carried on by the participants in markets in India;**
- **Objectives to be achieved through the establishment of the Competition Commission of India (CCI).**

MAIN FEATURES OF COMPETITION ACT, 2002

With the above objective, the Act:

- Prohibits Anticompetitive Agreements.
- Prohibits Abuse of Dominant Position.
- Provides for Regulation of Combinations, and
- Enjoins Competition Advocacy

[Sections 3, 4, 5, 6 and 49(3)]

ANTI-COMPETITIVE AGREEMENTS - 1

- Agreements having appreciable adverse effect on competition in market in India are void

Presumptive logic

- Agreements between competitors - including ‘Cartels’- (horizontal agreements) ***presumed*** to have *appreciable adverse effect* on competition
    - price fixing
    - sharing of market
    - limiting production, supply
    - bid rigging/collusive bidding
- ***Presumption Vs per se***
- ***Treatment of JVs; efficiency enhancing JVs:***
- ***Treatment of Production for Exports***

(Section 3)

ANTI-COMPETITIVE AGREEMENTS - 2

‘Rule of reason’

(i) **Other Horizontal Agreements**

(ii) **Vertical Agreements:** Agreements between enterprises at different stages of the production, distribution etc. chain

(burden of proof of appreciable adverse effect on competition lies on the prosecutor).

- **These include:**
  - **tie-in arrangement,**
  - **exclusive supply agreement**
  - **exclusive distribution agreement**
  - **refusal to deal**
  - **resale price maintenance**
- List not exhaustive
- Treatment of IPRs in Section 3 on Agreements (3.5.1); And Exports

APPRECIABLE ADVERSE EFFECT ON COMPETITON (AAEC)

- While determining whether an agreement has AAEC under Sec 3 the Competition Commission shall have due regard for the following factors:
  - creation of barriers to new entrants in the market
  - driving existing competitors out of the market
  - foreclosure of competition by hindering entry into the market
  - accrual of benefits to the consumers
  - improvements in production or distribution of goods or services
  - promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services

DOMINANT POSITION

- **'Dominant position' means position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to –**

    (i) operate independently of competitive forces prevailing in relevant market; or

    (ii) affect its competitors or consumers or the relevant market in its favour

- **Not dominance, but its abuse is prohibited**
- **Dominance not based on any arithmetical figure, but on factors prescribed in Section 19 of the Act**

FACTORS TO BE CONSIDERED IN DETERMINING DOMINANCE - 1

Dominant position linked to a host of factors

- Market share of enterprise
- Size and resources of enterprise
- Size and importance of competitors
- Commercial advantage of enterprise over competitors

FACTORS TO BE CONSIDERED IN DETERMINING DOMINANCE - 2

- Vertical integration
- Dependence of consumers
- Dominant position as a result of a statue
- Entry barriers
- Countervailing buying power
- Market structure and size of market
- Social obligations and costs
- Contribution to economic development
- Any other factor

ABUSE OF DOMINANCE - 1

- Imposing unfair or discriminatory price or condition in purchase or sale
- Limiting production or scientific development to the prejudice of consumers
- Denial of market access in any manner
- Conclusion of contract subject to supplementary obligations
- Use of position in one relevant market to enter into or protect other relevant market

ABUSE OF DOMINANCE - 2

- List of Abuses in the Act are exhaustive
- No action if an ‘act(ion)’ is not covered in ‘list’
- Abuses are of two types:

  > Exploitative (predatory pricing, e.g.)

  > Exclusionary

  (interference with competitive process)

  – No concession in case of abusive use of intellectual property
  – Appreciable adverse effect on competition (AAEC) need not be proved

REGULATION OF COMBINATIONS

- Combination is a broad term: includes merger, amalgamation, acquisition of shares, acquiring of control
- ***The Act takes a liberal view***
- High threshold limits – only big ticket combinations subject to regulation
- Voluntary notification regime
- Commission to decide in 90 working days, else combination is *deemed approved*
- Commission can take, upon its own knowledge or information, action within 1 year after combination

RELEVANT MARKET

Relevant market is based on:

- **Relevant product market; and**
- **Relevant geographic market**

RELEVANT MARKET

Relevant Product Market - 1

- Relevant product market is the smallest set of close substitutes

- Determination of substitutability of products:

  - ❑ **Demand side substitutability- shift of demand to competing product on price rise**

  - ❑ **Supply side substitutability- shift of production to meet demand**

Relevant Product Market - 2

(Competition Act, 2002)

In determining 'Relevant Product Market', CCI is required to consider:

- Physical characteristics or end-use of goods
- Price of goods or service
- Consumer preferences
- Exclusion of in-house production
- Existence of specialized producers
- Classification of industrial products

Relevant Geographic Market - 1

- Relevant geographic market can be defined as the area in which products are available at approximately the same price given transport costs and any increase in demand can be met from neighbouring areas profitably
- Elzinga - Hogarty test to determine relevant geographic market:
  - **LIFO (Little In From Outside)**
  - **LOFI (Little Out From Inside)**

Usually both should be at least 90% to define the relevant geographic market – shipment data required

RELEVANT MARKET

Relevant Geographic Market - 2

(Competition Act, 2002)

In determining 'Relevant Geographic Market', CCI is required to consider:

- Regulatory trade barriers
- Local specification requirements
- National procurement policies
- Adequate distribution facilities
- Transport costs
- Language
- Consumer preferences
- Need for secure regular supplies or rapid after-sales services

COMBINATIONS

- Combination covers
    - ❑**Merger**
    - ❑**Acquisition**
    - ❑**Amalgamation**
    - ❑**Acquiring control**
- Any combination which causes or is likely to cause appreciable adverse effect on competition (AAEC) is void

VOLUNTARY NOTIFICATION & HIGH THRESHOLD

- While Agreements and abuse of dominance are prohibited, combinations are regulated
- Indian Combination regulation liberal
- High threshold limits

If combining parties are in India:

- **Combining parties' assets in India > Rs 1000 cr or turnover > Rs 3000 cr**
- **If combining parties are a group, assets in India > Rs 4000 cr or turnover > Rs 12000 cr**

If any of the combining parties are outside India:

- **Assets in India and outside India > US$ 500 m or turnover > US$ 1500 m**
- If any of the combining parties belong to a group and any one of them is outside India, assets > US$ 2 b or turnover > US$ 6 b

APPRECIABLE ADVERSE EFFECT ON COMPETITON (AAEC)

Market definition

- AAEC has to be determined in the relevant market

AAEC - COMBINATIONS

DETERMINING FACTORS - 1

Factors to be considered to determine AAEC in the Relevant Market (Competition Act, 2002):

- Actual and potential competition through imports-imports/trade agreements
- Entry barriers- sunk cost/technological lead
- Concentration level - CR, HHI
- Countervailing power
- Likelihood of increase in prices or profit margins
- Effective competition after combination

AAEC - COMBINATIONS

DETERMINING FACTORS -2

(Competition Act, 2002)

- Substitutes – actual or potential
- Market share
- Removal of vigorous and effective competitor or competitors in the market
- Extent of vertical integration
- Failing business
- Nature and extent of innovation
- Contribution to economic development
- Whether benefits outweigh the adverse impact

THANK YOU

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