Making Markets Work Effectively in India
Experience of the Competition Commission

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Preface

- India, is an economy in transition to fully market oriented open economy, the Commission faces several challenges apart from having to contend with the legacy of earlier industrial policies that shaped market structures.
- Market regulation by an independent Commission to make markets work effectively, is a new actor on the scene.
- In this lecture I will concentrate on a few cases and the subsequent Orders of the Commission that have not only raised several dimensions of market functioning but reveal divergent perceptions inevitable in comprehending the dynamics of markets in a transition economy.
- The few cases in my opinion posed challenges to the Commission in demanding innovative approaches than traditional economic analysis would suggest. The cases mainly relate to dominance and its abuse with one exception namely the cement cartel case.

Background to the Act

- Post independence markets were regulated – but regulated through the mechanism of ‘control and command’ termed the “Licence Raj”
- India adopted a mixed economy framework (public and private enterprises) and model of import substitution – trade controls, capacity controls
- Market structures that emerged in most industries were largely an outcome of government policy, not a consequence of free competitive firm interactions - muted competition.
- 1991 marked the crucial turning point when a clear and comprehensive shift was made in the policy stance towards economic liberalisation- move towards reliance on market forces.
- Economic liberalization shifted the divide between private and public in favour of a greater role for the private sector
  - through removal of entry barriers erected by the mechanism of licensing.
  - Markets as the mechanism for resource allocation replaced licensing.
  - Guided by the objective of improving efficiency, the new policy recognised the need for subjecting Indian industry to the forces of competition.

Background -contd

- The competition law regime in the country also underwent a paradigm shift in order to embrace the needs and challenges of the new economic order.

- The *structuralist* Monopolies and Restrictive Trade Practices (MRTP) Act gave way to the *conduct oriented* new competition law, the Competition Act 2002 which was enacted in 2003, amended in 2007, where under the Competition Commission of India (CCI) has been set up.

- As in most international competition laws, the Indian Act seeks to:
    - prohibit anti-competitive agreements, including cartels (S.3);
    - prevent abuse of dominant position (S.4); and
    - regulate mergers and acquisition above the specified threshold (S.5and 6)

- During the last three years, the CCI has received over 300 matters alleging violations of Sections 3 and 4 of the Act relating to anti-competitive agreements and abuse of dominance in diverse sectors such as stock exchanges, infrastructure, travel, automobile manufacture, real estate, pharmaceuticals, financial sector, publishing, manufacturing, mining and entertainment.

- With regard to mergers and acquisitions the century mark has been crossed. The Commission has passed final orders pertaining to Section 3 & 4 in more than 250 cases. Penalties have been imposed where warranted.

Background –contd.

- For new competition agencies a critical challenge lies in applying the law - learning from the international best practices without losing sight of specificities and needs of our economies.

- The Commission at this juncture is according utmost importance to the principles, rules and criteria that should underpin the application of the various provisions of the law in the Indian context.

- A good number of abuse of dominance or unilateral conduct cases. assessment of anti-competitive effects in such cases does not have a unified theory and therefore the decision making in such cases is complex.

- The unilateral conduct cases that we have handled so far have brought us face to face with many intriguing issues and questions that shall be vital in deciding our future course in evaluating such cases.

- Some of those issues and the ways in which they have been or could be dealt with.

Per se vis-à-vis Rule of Reason

Perspective of Competition Commission of India

- The Act is not rigidly 'per se' even with regard to cartels and other horizontal agreements - right for rebuttal exists
- Competition laws have constantly been evolving from 'market structure' to 'conduct of firms' to 'strategic behaviour'.
- For cartels circumstantial evidence is considered equally weighty as against the initial approach of definite evidence – backed with robust and rigorous economic analysis.
- In 'abuse of dominance' importance to be given to how the behaviour of enterprises affects competition and consumer interest - more complex than structural analysis.
- A presumption based approach widens the scope of Type I error (false positives) as against the simplicity of per se rules may provide certain degree of legal certainty
- As a matter of principle a particular conduct under investigation has to be tested against the touchstone of 'consumer harm or harm to competition.'

Defining the Relevant Market

Relevant market-Definition

- The Competition Act 2002 defines the Relevant Market and lays down the criteria/factors which are to be looked into while delineating the relevant product and geographic markets.

- Article 2 (r), (s) and (t) of the Competition Act, 2002, define “relevant market” as:
  - *"**Relevant market**" means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets;*
  - *"**Relevant geographic market**" means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas;*
  - *"**Relevant product market**" means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.*

- The widely accepted test for delineating the boundaries of a product market - “hypothetical monopolist” test or the “SSNIP” test (a small but significant non-transitory increase in price).

- Data constraints can restrict use of SSNIP. The Commission delineates the market boundaries based on qualitative analyses of characteristics, price and intended use depending on information available.

- Three cases of market definition discussed - differentiated product industry; transportation sector; and real estate sector.

Relevant Market :Photochromic Lenses GKB 1

- Case of abuse of dominance in glass and plastic ophthalmic lenses - Transitions India, (joint venture in India between Transitions Optical Holdings B.V., The Netherlands and Transitions Optical Inc., USA)

- The core business model of Transition India is to purchase substrate (semi -finished lens) from its caster partners, process the substrate (i.e. apply the Photochromic coating), and to sell the finished goods back to the lens casters

- Ophthalmic lenses are available in various types in terms of material such as glass, plastic, polycarbonates etc, value addition in terms of colouring so as to reduce glare and prevent UV Rays and different coatings such as anti-reflective, hydrophobic and anti-resistant.

- Whether all the photochromic lenses form part of relevant market or the differences in material and consequent differences in characteristics and price lead to delineation of glass photochromic lenses (GPL) and plastic photochromic lenses (PPL) as distinct markets- GPL and PPL, have certain advantages as well as disadvantages

- The decision on delineation of relevant market required assessment of consumer behaviour and the underlying preferences – a market survey helps and in its absence to note that generally there appeared to be a preference for lighter and unbreakable lenses.

Photochromic Lenses GKB
2

- The speed of transition from light to dark and vice versa is faster in case of PPL - important characteristic would naturally contribute substantially to the consumer preference in favour of PPL

- Price differences between the two products, as a factor in consumer choice, were also examined - Indian consumers are acknowledged as being generally very price sensitive.

- The price of GPL starts from as low as US$1.25 and PPL starts from around US$20. While no doubt the growing Indian middle class tends to suggest the possibility of a market continuum.

- Commission concluded that the continuum exists on an intra-product basis and not inter-product basis and exclusivity prevails.

- Behavioural economics also seem to suggest that price differences do not act as a competitive constraint, as the perception of higher quality of PPL may not be in proportion to the differences in prices.

- Characteristics of the products, factors relevant to demand decisions, importantly price and the lack of competitive constraints reflected by price differences between PPL and GPL, the Commission concluded that the market for Plastic Photochromic Lenses in India was the relevant product market in this case.

Relevant Market in Housing DLF
1

- Defining the relevant market of a housing project in Gurgoan by DLF. DLF Ltd. was providing services of a developer/builder within the meaning of “service” given under section 2(u) of the Act

- The next point to be determined was whether these services, provided by DLF Ltd. to the informant, are of a distinct nature *“by reason of characteristics … their prices and intended use”* as stipulated in section 2(t) of the Act

- The nature of service being provided by DLF Ltd. in the context of the instant case was described as services of developer / builder in respect of “high-end” residential building in Gurgaon

- Two important components of service definition with regard to characteristics of the underlying physical asset that required interpretation, viz. “high-end” and “residential”. The third component, viz. “Gurgaon” related to “geographic market”

- Terms like “high-end” or “affordable” are relatively subjective and therefore it was felt necessary to establish a clear and logical interpretation of the term “high-end”. Whether “investment” or “own residence” decision centres on locational preference of the purchaser and this preference is generally not interchangeable or substitutable

Relevant Market in Housing DLF 2

- “high-end” is not a function of size alone - a complex mix of factors such as size, reputation of the location, characteristics of neighbourhood, quality of construction and ability to pay most important amongst all objective differentiators of a customer’s characteristics

- To take into account the income or expenditure levels of the customer base – all factors together create a distinctly identifiable residential unit that is not substitutable in an economic sense

- Users / buyers of ‘high-end’ accommodation demand quality, ambience and are willing to pay significantly higher prices to meet their requirements - paying capacity of the growing upper middle and rich classes

- From the cost perspective it is quite logical to accept an apartment costing Rs. 2 – 2.5 crores ($20 – 25 million) as “high-end” in the Indian socio-economic reality

- The relevant geographic market Gurgaon was seen to be the relevant geographic market - is not easily substitutable - geographical characteristics such as proximity to Delhi, proximity to Airports and a distinct brand image

- Since a residential property is by nature immovable, its geographical location is amongst the foremost factors for consideration.

Arshiya- Transportation Logistics Industry 1

- Railway services and railway infrastructure in India is a legal monopoly, owned by the central government
- Policy of selective privatization of railway operations through PPP arrangement in containers trains a function given to the container train operators (CTO) retaining passenger and goods train as a monopolist
- Private container train operators alleged that Indian Railways along with CONCOR, one of the CTO (partly government-owned) have abused their dominant position individually and also have entered into anti-competitive agreement to the detriment of other CTOs
- Argued that Indian Railways and CONCOR are a group entity (a claim not accepted by the Commission) and that the relevant market for the purpose of competition assessment is 'market for rail services in India'
- What constitutes relevant market – is it the market for railway infrastructure, movement of goods through railway network or movement of containers etc?

Arshiya- Transportation Logistics Industry 2

- Argument that road and rail, as a medium of transportation, had limited substitutability depending upon the various factors like type of goods to be transported, distance, time
- Data available in the public domain suggested that overall market share of roads was far in excess of rail.
- Market share was nearly equal in many commodities that were predominantly carried over rail.
- Indian Railways had stopped operating the container trains suggesting that general wagon trains were altogether functionally different from the container trains.
- An overarching point in determination of the relevant market is the fact that a container can be placed over any vehicle, independent of the medium of transportation. In view of these facts, the relevant market was defined as movement of containers in India.
- Consequently assessment of competition was required to be conducted in containers since only that mode has been opened to container train operators.

Issues to Ponder

- Some unresolved issues not necessarily germane to the Indian context regarding the correct test and methodology for defining relevant market - what is noticeable in the 3 cases cited the Commission has not applied the SNNIP test on account of
  - Characteristics of certain sectors will not always permit the application of the SSNIP test, (e.g., where quality of service, and not price, exerts the greater influence on customer choice) as in the case of DLF;
  - Biased and wrong interviews - typically interviews concentrate on the largest customers, competitors, and suppliers - infra-marginal biased to conclude that the markets are narrow resulting in an erroneous conclusion,
- Where the standard well known methods of determining substitutability are rendered ineffective for reasons such as non-availability of data, irrelevance of price as a competitive parameter, or contradictory empirical findings:
  - In stock markets, we noted, since the exchange trading fees are such a small part of the overall cost of acquiring securities – will not incentivize the players to shift to another segment. The cross elasticity of demand will be very less (close to zero) in this case
  - In high technology Industries the ability of customers to utilize specific high technology products in their businesses is often based on whether that product satisfies technical and economic criteria, rendering even qualitative analysis of the substitution possibilities difficult rendering SNNIP test of 5% not sufficient
  - With highly differentiated products, price and performance variations can be very substantial and markets may appear to be fragmented, with many customized products tailored to specific users and/or applications
- Need to avoid Type 2 errors – Cases cited innovative, rigorous with economic analysis used

Assessment of Dominance and Abuse

Abuse of Dominance –Stock Exchanges 1

- A controversial but interesting case of 'Abuse of Dominance' involved two major stock exchanges in India in the Currency Derivatives Segment of stock - Violated Sec. 4(2)(a)(ii) predatory (unfair); 4(2)(e)- (leveraging)
- Predatory :
  - Transaction fees, principal source of revenue for stock exchanges, was waived off by NSE in its Currency Derivatives segment
  - kept membership deposits unjustifiably low and waived the admission fee entirely
  - MCX-SX is unable to levy such fee in its only segment i.e. CD segment leading to significant losses.
- Leveraging:
  - NSE subsidizing losses in CD segment from revenues of other Segments
  - fee waiver and other concessions in CD segment adopted as an exclusionary device to kill competition and competitors
- The dominant view was NSE was found guilty of contravention of Section 4 of the Competition Act, 2002.
  - Zero Pricing is predatory (unfair) and NSE was not able to substantiate Zero Variable Cost in CD Segment
  - Markets are not nascent to justify Zero Pricing as a tool
  - Leveraging as NSE was dominant in Other Segments of Stock Exchange to sustain zero pricing policy in CD Segment long enough to outlive the competition and pro tect the CD Segment.

Abuse of Dominance – Stock Exchanges 2

- The alternate view was premised on the fact that in dynamic markets, anticipating or adjudicating on anti-competitive behaviour carries the risk of being arbitrary defeating the purpose of intervention

- The distinct features of network industry and the arguments were based on the principles of network economics:
  - An inverted "U" demand curve that permits multiple equilibria allowing for sudden and significant expansion of network size.
  - A constant or low marginal cost can see a new entrant expand his market with the introduction of new to better technology which further decreases his cost.
  - The pace of market expansion is much faster in network industries as compared to non-network industries, more on account of the explosive nature of network effects

- Market structure in a network industry is characterized by high inequalities of market shares and profits. Strong network effects normally tend to create natural oligopolies

- While the firms incur substantial initial cost, it recovers the same by offering unique value added services or by diversifying the product offerings. Various business strategies to reap quick benefits include inter-alia fixed cost recovery through value added schemes, flexible pricing policies etc.

- In such fluid and dynamic framework, anticipating or adjudicating on anti-competitive behaviour carries the risk of being arbitrary defeating the purpose of intervention.

Abuse of Dominance –Stock Exchanges

3

- Network effects (externalities) for exchanges implies that value to users on both sides of the platform (traders and investors) increase as the number of players grow - depth and liquidity reduces bid–ask spread and the related risk and uncertainty inherent in such markets

- Leveraging an inevitable part of zero pricing with possible recoupment of losses at a later stage - both consequences of the deterministic approach

- Detailed analysis of the market structure there did not appear to be much possibility of recoupment of stated current losses

- Evidence of market share of the three players were almost equal showed that MCX-SX had a slight edge over NSE - indicates that enterprises are competing on non-price parameters such as, liquidity and depth did not gain credence

- More significantly it was difficult to apprehend consumer harm under zero pricing ,in anticipation of future recoupment

- The case represented the classic response of where the majority view moves on the assumption that "*winner takes it all*" : the assumption a large stock exchange would but use its strength i) to leverage into another market; ii) to set zero prices to capture all consumers and iii) prevent any new entrant

- The case provided insights into how dominance is rendered redundant when externalities of network facilitated by innovation and technology in the fast growing digitalised world.

Case of Price Discrimination
Loyalty Discount and Volumes Discount
1

Issue of price discrimination and its alleged impact on competition Sec 4 (2) (a) – unfair or discriminatory pricing

- Kapoor Glass v/s Schott Glass India Pvt Ltd a dominant international player who had also a joint venture in downstream ampoule manufacture.

- Two markets – upstream (glass tubes) and downstream (ampoules) FDA approval important

- The allegation pertaining to imposition of unfair/discriminatory price in sale of glass tubes was directed at the two kinds of discounts :
  - i) volume/target discount;
  - ii) loyalty discount.

  Price discrimination was therefore directed to both the upstream and downstream markets.

- The Competition Act, 2002 prohibits discriminatory pricing by a dominant enterprise. However, the criteria for assessment of discriminatory pricing have not been laid down in the Act

- The dominant view considered the financials of the aggrieved parties to establish whether there has been any financial injury caused due to the discount policy of the OP and based on EBIDTA concluded that the policies of the OP in being discriminatory in favour of JV created conditions that constrained the competitive ability of competitors.

Case of Price Discrimination Loyalty Discount and Volumes Discount 2

- The alternate view on the economic basis of discriminatory or non-discriminatory found no discrimination and more significantly noted that competition downstream was not affected by discounts

- Concept of ‘anonymous’ and ‘non-anonymous’ applied to characterize discounts as the first step towards assessing price discrimination

- On the criteria of ‘anonymity’ and on the economic basis of discriminatory or non-discriminatory where discounts were concerned and found no discrimination

- Even with regards to loyalty the variations in discount depended entirely on the willingness of the downstream manufacturers whether to mix Chinese imported glass or not

- Since competition downstream was not affected and since performance was not related to the extent of discount no Abuse of Dominance could be established

- EBIDTA had no correlation to discounts - EBIDTA margins revealed that the operating profits of all the companies were very different hinting at differences in efficiencies in operations as observed in trend analysis of sales

Issues to Ponder

- Reflecting on the two cases of dominance and its possible abuse raises several issues that need pondering

- When is it that a company is ever able to act entirely independently of its competitors strategy existing or potential ? Is size the determinative factor for ensuring abuse ?

- The minority Order of NSE which focussed on the new frontiers of business namely, network economics where business strategies and pricing decisions do not follow a straight linear path, will confront competition authorities more as business and transactions go ‘ virtual’

- A second set of concerns that emerge from actions where firms often offer discounts, reducing prices etc., on grounds of sustaining in the market and when do these pricing strategies signify anti-competitive.

- Does mere dominance preclude a firm from offering discounts that benefit consumers?

- Pricing discrimination per se is not anti-competitive , only when the discrimination is ‘non-anonymous’ that alarm bells tend to tinkle.

Cartels and Circumstantial Evidence

How to establish a Cartel
Case of Cement Cartel

- Cartels are:
  - Regarded as most pernicious form of anti-competitive behavior.
  - Fix Prices; fix quantities; divide the market;
  - Economics and Data Analysis critical.

- Cartels are normally associated with industries where:
  - technology is homogenous and not subject to change
  - were demand is relatively inelastic
  - more often in what can be termed as industries fawned by the earlier protected and licensed regime

- Use of concentration indices – most popular the HHI Index. Limitations of the Index:
  - May not apply in oligopolistic industries
  - Few numbers with a high HHI not necessarily a cartel

- Price parallelism to establish cartels but requires careful analysis
  - Price parallelism in most oligopolistic industries
  - the cartel is a temporary phenomenon
  - spontaneous market response of prices falling in line.
  - To be seen with reference to capacity utilization and cost conditions

- Concrete evidence of an ‘agreement’ to fix prices/quantities is critical - legal requirement

Cement Cartel Case

Circumstantial evidence and robust economic analysis

- The cement industry clearly displayed all the features of oligopolistic structure

- Parallel behavior was noticed, not only in terms of prices but also in terms of production and dispatch. Price correlations confirmed price parallelism.

- Correlation between the cement production index and cement price index over the last 15 years. A clear change in pattern was observed in the year 2002-03 onwards. While the cement production was growing at the same CAGR, the CAGR of cement price increase saw a great increase. Interestingly 2002-03 was the year which saw a decline in cement prices.

- The Commission noted that the Cement Manufacturers Association (CMA) had a system of collecting the information regarding prices from the various companies for submission to a different department of government - the cement prices increased after every meeting of CMA

- Price and dispatches parallelism was also taken as an evidence of collusion among the market players. The excess capacity maintained by the cement firms also hinted towards collusive practices

- 11 companies totally fined Rs.6300crs. The penalty on cartel is up to 3 times the profit of each member OR up to 10% of the turnover of each member for the period such behavior continued

Conclusions

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 al over the world as the guiding principles for effective implementation of competition Law. (CCI v/s SAIL & Anr., No. 7779 of 2010)

- Concerns of the Commission as regards emergent business houses suggests that the lens of competition is very different

- Competition is not merely in terms of the number of players but more often in a Schumpeterian framework of 'creative destruction'

- Commission need to be prescient especially in sectors and industry where the cycle of innovation and change is often a year or a couple of months - space must be provided for innovation and change in line with economic liberalization and market orientation.

- The nagging doubt as before all competition authorities is "Did we get it right" and whether the dynamism of the market is not sapped of its competitive vigour on account of over enthusiasm.

Thank You