FDI POLICY IN E-COMMERCE: AN APPRAISAL THROUGH THE LENS OF COMPETITION LAW

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ABSTRACT

In a globalised world with E commerce marketplaces gaining prominence and drastic growth of major players such as Amazon and Flipkart, concerns regarding ownership, control, pricing etc. are surfacing. Pursuant to the same, Press Note 2 of 2018 was issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India modifying the policy on FDI in E Commerce, in an attempt to regulate the E Commerce market and curb the growth of anticompetitive practices. This paper critically analyses the FDI Policy and its impact on competition in the E Commerce market. The question is whether the policy, attempting to promote the traditional retail sector hinders the growth of a market at such a nascent stage. It infers that the policy doesn't serve the object behind the policy in terms of the ultimate benefit to Small and Medium Enterprises and growth restrictions for E Commerce players which ultimately affects the level of innovation in the market. It also notes that the present policy deviates from the existing standards of control, predatory pricing etc. established under the Competition Law regime. The paper concludes with important considerations for the holistic development of the E Commerce market in India.

INTRODUCTION

Innovation in a nascent market is particularly important to allow for competition to flourish within that market. In order to do so, a fine balance needs to be struck between granting a certain leeway to the players in the market and restricting anti-competitive practices.

Perhaps with this intent in mind, the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India issued Press Note 2 of 2018 ('the policy") on December 26, 2018 modifying the policy on foreign direct investment in E-Commerce.

The E-Commerce market, which broadly encompasses all business activities occurring over electronic networks, including the sale of goods and services, the transfer of funds, online marketing activities, and the collection and processing of data,[1] has seen a rapid development in recent years with the digital revolution in India. It has also witnessed the advent of Foreign Direct Investment via the marketplace model which has revolutionised the way in which the E-

[1] *Implications of ecommerce for competition policy*, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, (Feb 21, 2019), https://one.oecd.org/document/DAF/COMP/WD(2018)52/en/pdf.

Commerce market functions and provided an alternative to the conventional retail market and the brick and mortar stores for the consumers. On the other hand, certain dynamics within e-commerce markets may prompt or facilitate anticompetitive collusive and unilateral conduct by economic operators.

In light of the context set out above, the issue which arises for consideration is the extent to which the policy is effective in counteracting certain alleged anticompetitive practices spurting within the E-Commerce market or whether the policy, in an attempt to promote the traditional retail sector, hinders the growth of a market at such a nascent stage.

I. Bar On Dealing With Entities Over Which E-Commerce Entity Exercises "Control"

The policy gives rise to certain restrictions imposed on the basis on "control" exercised by an E-Commerce entity over a vendor.

On "control"

In light of these restrictions, the ambit of "control" becomes important. "Control" has been defined as deemed to exist if "more than 25% of the purchases of a vendor are from the market place entity".

A plain reading of the regulation seems to suggest that if an E-Commerce marketplace entity such as Flipkart purchases more than 25% of the inventory of a particular vendor such as WS Retail[2], it would constitute control. Another possible interpretation is that only 25% of the total inventory of a vendor can be sold through a particular E-Commerce marketplace entity as anything above that threshold would be deemed to constitute control and attract the restriction under the said policy.

A case can also be made out for a combination of both these interpretations that they ultimately lead to the same result. Control over the purchase of the inventory of a vendor would eventually translate to a restriction on the total fraction of the inventory that can be sold via an E-Commerce marketplace entity. This is further strengthened by the fact that investment by group companies is also included within the ambit. This implies that even if all the purchases are not made by the E-Commerce marketplace entity, investment by group companies would also be used to calculate the 25% threshold, effectively leading to the same result.

[2] In Re: All India Online Vendors Association and Flipkart India Private Limited, Case No. 20 of 2018.

Equity participation by E-Commerce marketplace entity

Apart from being out rightly ambiguous, the policy also creates further restrictions by including equity participation by E-Commerce marketplace entities as a metric for determining the extent of control exercised over vendors.

The inclusion of equity participation as a distinct criteria for assessing control means that equity participation of any form, including minority investment, would also bar a vendor from selling its products on the platform of an E-Commerce entity. Minority shareholding is considered to confer control only in addition to the presence of additional rights such as veto power[3] or the right to a seat on the Board of Directors[4]. In the absence thereof, minority shareholding is not considered to be of a strategic nature so as to cause competition concerns.

Further, quantification of the threshold of equity participation at which bias would be exercised by E-Commerce entities towards sellers is also not possible, particularly in the absence of additional rights as set out above. If the intention is to curb the level of control exercised over sellers, it is not fulfilled since control can be exercised via indirect means as well such as via warehousing agreements as well as below the 25% threshold. Equity participation as a criteria not only deviates from the general trend adopted by the Competition Commission of India but also doesn't serve as an adequate check on the level of bias or control exercisable by an E-Commerce entity.

Impact on competition

In such a scenario, an absolute bar on the sale of products leads to more harms than benefits. It severely restricts the ability of an E-Commerce entity to invest in companies. Diversification of e-commerce entities is particularly important for diversification of portfolio and to build and sustain partnerships with brands (including foreign brands).

Further, it impedes the possibility of E-Commerce platforms venturing into the product market themselves. (For instance, the launch of a separate product line of "Amazon Basics" by Amazon). Such a restriction not only affects the profitability of E-Commerce entities but also hampers the overall level of innovation within the market. Innovation is required for a company

[3] In Re: Alpha TC Holdings Pte Limited, C-2014/07/192 , Consolidated Jurisdictional Notice under Council Regulation No. 139/2004 on the control of concentrations between undertakings
[4] In Re: Copper Technology Pvt. Ltd., C- 2017/ 08/525, In Re: Manta Holdings LP, C-2016/ 10/439, P5 Asia holdings investment (Mauritius) Limited, C-2016/10/452.

to stay competitive within the market. Moreover, a decrease in the level of innovation has an ultimate impact on the quality of products available in the market to the consumers.

II. <u>Exclusive Supply Arrangements Between Seller And E-Commerce Entity</u>

<u>Does not cause Appreciable Adverse Effect on Competition</u>

Exclusive Supply Agreements are governed under Section 3(4)[5] read with Section 3(1)[6] of the Competition Act, 2002. In order to bar an exclusive supply arrangement, it must be shown that the arrangement causes an Appreciable Adverse Effect on Competition ("AAEC"). An exclusive supply agreement entered into between a vendor and the E-Commerce platform has generally been considered to not cause an AAEC on account of it not leading to any entry barriers within the market.[7]

Further, in order to assess AAEC under Section 3 of the Act, reference must be made to the factors set out under Section 19(3)[8] of the Act. Accrual of benefits to the consumers is an important factor to be weighed against the potential harms accruing out of the arrangement. The Competition Commission, while doing so, has noted that the online portals provide an alternate distribution channel to compare the quality and prices of products and also provides additional benefits such as doorstep delivery etc.[9] Thus, a comparative must be drawn between the benefits and the alleged harms to assess AAEC and the CCI has always ruled against the alleged harms under similar circumstances. [10]

<u>Mandate vs. voluntary arrangement</u>

The policy provides that there shall not be a "mandate" by an E-Commerce marketplace entity on a seller to sell any product exclusively on its platform. A distinction has to be created between what is considered to be a mandate by a seller and what is considered to be a voluntary arrangement between the seller and the E-Commerce entity. The right of a seller to deal exclusively with an entity cannot lawfully be taken away. A voluntary choice to accept the conditions set out in an agreement or a case of consensual agreement without any compulsion

[5] S. 3(4), Competition Act, 2002, No. 12, Acts of Parliament, 2003.
[6] S. 3(1), Competition Act, 2002, No. 12, Acts of Parliament, 2003.
[7] In Re: Mr. Mohit Manglani and M/s Flipkart India Private Limited, Case No. 80 of 2014.
[8] S.19(3), Competition Act, 2002, No. 12, Acts of Parliament, 2003.
[9] *Supra* Note 7.
[10] *Id.*

does not amount to exclusive supply[11]. This is even more so when other players have also been provided an equal opportunity to enter into such arrangements. [12]

Therefore, as long as the agreement falls under the nature of a voluntary agreement, it should be permissible under the existing competition law regime.

Inter and Intra brand competition

Inter brand competition is the competition that exists between brands while intra brand competition is one which exists within the same brand i.e. between retailers of the same brand.

The primary aim of antitrust laws is to protect inter brand competition.[13] While an exclusive supply agreement entered into between sellers and an E-Commerce entity may have a negative impact on intra brand competition that exists between online and offline retailers of substitutable products, it is likely to have a positive impact on inter brand competition.

Vertical restraints have dual characteristics of simultaneously reducing intra brand competition and stimulating inter brand competition[14]. Vertical restraint imposed by a single manufacturer may give rise to significant inter-brand competition despite the lessening of intra-brand competition.[15] By diminishing intra brand competition, distributors are likely to turn to investment in customer service and post-sales support.

These aspects gain significance when it comes to high technology products such as mobile phones or other electronic equipment. The idea is that as technology increases in complexity, consumers will likely require more guidance from vendors of high technology products than from vendors of other types of products. Superior customer service is integral to providing sufficient information to customers purchasing or dealing with technology.[16] Considering that exclusive supply agreements are usually entered into with sellers dealing with high technology products makes the increase of inter brand competition all the more relevant. Therefore, the restriction on exclusive dealing arrangements without proof of any concrete harms arising out of the same, hinders inter brand competition much more than an exclusive dealing arrangement itself.

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[11] Ajay Devgn Films V. Yash Raj Films Pvt. Ltd., (2012) SCC OnLine Comp AT 233, Fx Enterprise Solutions India Pvt. Ltd. and Ors. vs. Hyundai Motor India Limited, (2017) SCC OnLine CCI 26.
[12] Consumer Guidance Society V. Hindustan Coca Cola Beverages Pvt. Ltd., 2012 SCC OnLine Comp AT 175.
[13] Business Electronics Corp. v. Sharp Electronics Corp., 485 U. S. 717, 726 (1988).
[14] GTE Sylvania 433 U.S. 36 (1977).
[15] State Oil Co. v. Khan, 522 U.S. 3 (1997), Leegin Creative Leather Products, Inc v PSKS, Inc 551 US 877, Kyle Colonna, *Recognizing the Importance of Intrabrand Competition in High Technology Markets: The Problem with Large Retailers & Vertical Territorial Restraints*, 4 CASE WESTERN RESERVE JOURNAL OF LAW, TECHNOLOGY & THE INTERNET(2013).
[16] *Id.*

Further, the argument that it protects intra brand competition is also not tenable. While it has been recognised that online and offline markets do not form two different relevant markets but merely provide different channels of distribution of the same product, it cannot be denied that there exists a certain level of competitive advantage that rests with online retailers such as E-Commerce entities in the form of discounts and the overall shopping experience. This advantage enhances competition within the overall retail market by increasing the competitiveness of offline retailers. Offline retailers are pushed to improve their services and the shopping experience provided to consumers on account of the low switching costs of switching to an online retail platform[17], thus promoting innovation and quality within the market.

The protectionist view adopted via the policy not only hinders this very holistic competitive process but also does little to protect intra brand competition since prohibition of exclusive supply agreements does not deal with the inherent disadvantages of the offline retail market vis a vis the online market. Until these disadvantages are overcome leading to a more efficient market, protectionist measures would serve no purpose in attempts to make the brick and mortar stores more competitive or efficient.

III. Fair and Non-Discriminatory Criteria and Influence on Sale Price

On "Predatory Pricing"

E-commerce entities in India have a bundle of services to offer to all its vendors and sellers, including but not limited to fulfilment, logistics, warehousing, advertisement/ marketing, payments, financing etc., as per the policy. The wide array of services that it provides is driven by market forces and level of sales and demand in the market, and accordingly accommodates the scale thereof.

The CCI has taken the view that since the products available online and at any brick and mortar outlet shall be the same, to the consumer, the two act as separate channels of the same relevant market and not as separate relevant markets altogether and are therefore substitutable to one another[18]

The policy has inserted this clause to curb the practice of 'deep discounts' being followed by the E-Commerce marketplaces. It is pertinent to understand that discounting is a part of retail, both online and offline and shall be driven by market forces solely. The biggest criticism of the marketplace model is that it is accused of 'predatory pricing'[19], as it charges considerably lesser prices from the offline retail store. However, the conduct does not amount to predation, as the

[17] In Re: Mr. Ashish Ahuja and Snapdeal.com through Mr. Kunal Bahl, CEO, Case No. 17 of 2014.
[18] *Id.*
[19] S.4, Competition Act, 2002, No. 12, Acts of Parliament, 2003.

e-commerce market is significantly nascent in India with only 2.9% of the market share till 2018[20]. Most courts seem to believe that a market share of less than 40 to 60 per cent, at the outset of a predatory campaign, is generally too small to create the requisite "dangerous probability of success."[21] Furthermore, it does not appear that any one player in the market is commanding any dominant position at this stage of evolution of market in India.[22] CCI displayed similar reluctance to interfere in "nascent digital markets" as they do not constitute to be a dominant player in the relevant market.

There are several players in the online retail market which have been arrayed offering similar facilities to their customers. Consumers on the marketplace-based e-commerce platforms will direct that such platforms are merely an alternate distribution channel to offline distribution (or brick and mortar stores).[23]

The policy bars the E-Commerce entities providing marketplaces to influence the sale price of goods, whereas the multisided nature of online platforms, whereby cross-subsidies between participant groups are an efficient feature of the business model, complicates the predation analysis. To the extent that such pricing is considered legitimate, the mere fact that the platform charges below marginal cost on one side cannot provide decisive evidence of predation.[24]

The buyers and sellers usually develop preferential relationships based on loyalty and strategic reasons and shall be given the freedom in the market to define that relationship as giving discounts by itself is not anti-competitive in nature, as it promotes competition in the market and drives other players to also provide similar terms at the time of sale. The features of an E-Commerce marketplace permit them to pass on such efficiencies to consumers in the form of lower prices[25].

By such regulations, the government is taking up a task to micromanage businesses and altering the growth prospects of a market bound to attract huge capital investments and create jobs for the citizens. The E-Commerce entities are not in a position to dominate the entire online and offline marketplace, and have no intention to indulge in predatory pricing, thus such influence

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20 *Indian E Commercre Industry Analysis,* IBEF.ORG, (Jan 2019), https://www.ibef.org/industry/ecommerce-presentation.
21 Oliver E. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE LAW JOURNAL 284 (1977).
22 *Supra* Note 2.
23 *Id.*
24 *Supra* Note 2.
25 Svend Albaesk, *Consumer Welfare in EU Competition Policy*, EC.EUROPA.EU, http://ec.europa.eu/dgs/competition/economist/consumer_welfare_2013_en.pdf

exercised by them is purely to foster their own performance rather than eliminate competitors[26] from the market.

Possibility of maintaining a Fair and Non-Discriminatory Policy

An exclusive arrangement between a manufacturer and an e-portal is not likely to create any entry barrier as competitive constraints exists for its products illustrated on the marketplace for sale through exclusive E-Commerce partners. Like mobile phones, tablets, books, camera etc., are neither alleged nor seem to be trodden by monopoly or dominance. Further, it does not appear that because of these exclusive agreements any of the existing players in the retail market are getting adversely affected, rather with new e-portals entering into the market, competition seems to be growing.[27] Thus, imposing such regulation upon the marketplaces to be 'fair and non-discriminatory' will rather prove to be anti-competitive as previously mentioned, such arrangements are voluntary and equally available to all sellers.

Additionally, existence of the powerful economic force, 'network effect' within this market does not seem to affect entry or expansion by the players equipped with strategies capable of attracting existing networks[28]. The online marketplace platform such as Amazon or Flipkart, offers a platform for buyers and sellers to deal in goods and services. The sellers are interested in selling on the platforms with increasingly high number of buyers to get access to a wider market to sell its products. However, the possibility and ease of accessing these marketplaces and easily comparing prices across different portals constrains the power of different sellers to act independently of the market forces. Absence of switching costs between different networks and different sellers in the relevant market limits the constraints exerted by the established networks on newer entrants.[29] Thus, the mandate imposed to maintain an equidistance policy with all the vendors is restricting the free play of market forces to apply in the relevant market. Since the conduct of these E-Commerce marketplaces in the relevant market has not been held as predatory by the CCI, it will not result in exclusion of sellers as existing supply can be an indication that access was given at a fair condition and/or because the relationship-specific investments made by the seekers needs to be protected.[30]

Priority and Preference of Vendors

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26 Wandoo v. Commission, (2003) CAT 5, 1007/2/3/02.
27 *Supra* Note 7.
28 In Re: Fast Track Call Cab Pvt. Ltd and ANI Technologies Pvt. Ltd., Case No. 6 & 74 of 2015.
29 *Supra* Note 28.
30 *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OFFICIAL JOURNAL OF THE EUROPEAN UNION, (2009).

The marketplaces that gave certain sellers priority or the 'fulfilled' criterion in exchange for a price, is due to the responsibility taken by the E-Commerce marketplace to personally take guarantee of their products and services. The intention behind such a tactic is to ensure that the customers that refrain from shopping online are convinced about the product quality. The recurrent use of consumer reviews and rating systems (which displays the products accordingly) within online retail platforms increases the ex-ante information available to potential customers, thus increasing confidence levels in both the retailer and the underlying product. [31]

It is being feared that quality and product variety available on e-commerce platform markets may deteriorate over time, because providers that have been receiving priority earlier may be disadvantaged and exit the market in the long run. Over-regulation and hasty interventions can lead to stifling of developing technologies[32]

Furthermore, the priority and dominance claims shall not be made in isolation by the other sellers. The allegations need to take into account factors such as network effects, economies of scale, access to relevant data, and competitive pressure from innovation, multi homing and switching costs[33] before alleging the sellers, vendors and marketplaces of anti-competitive behaviour. Following a fair and non-discriminatory policy by the marketplaces will not take away the abovementioned perks available to certain sellers, as they tend to empower them irrespective of such regulations. The real winner in application of this policy are the big-time retail store operators such as Reliance, Walmart etc. that will still continue to offer great discounts with the support of FDI and funds available at their disposal, without uplifting the SMEs as intended by the DIPP.

IV. <u>Responsibility of The Seller for Post Sales Services</u>

<u>Customer Satisfaction</u>

By literal interpretation of this clause mentioned in the policy places an additional burden on the sellers who, up until now, were enjoying the post-sale services given by the market place including returns, refunds, grievance redressal, customer support etc. Providing such services is what makes the e-commerce marketplaces an attractive and lucrative business arena as the sellers/ vendors do not have to personally invest their capital in training and hiring personnel for customer relations, follow up for feedback and maintain relations.

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[31] *Supra* Note 1.
[32] In Re: Matrimony India Ltd. And Google LLC, Case Nos. 07 and 30 of 2012.
[33] *Business Models and Regulation of Foreign Investment,* 29 NLSI REV 121 (2017).

The veil of such marketplaces has allowed them to focus on sales and expansion, without diverting their resources to other activities. This policy will thus disincentivize the small and medium sellers to sell through an online platform as they will have to incur additional expenses to maintain their personal brand loyalty and customer satisfaction and also throws away the time and resources invested by the E-Commerce marketplaces by thoroughly training their personnel on hard and soft skills with respect to customer relation, installations of products, efficient pick-ups alongside other post sale services provided to sellers and vendors to promote and ease their sales.

Network Effects

Network effect means that a product/ service becomes valuable with the increase in the number of users. It is an advantage which accrues to all online platforms, as with every review or rating by each consumer, it becomes more valuable for every subsequent consumer. The consumer pool created in a marketplace benefits all the sellers. Retailers are more willing to pay to list their products on a marketplace with a higher customer base, and advertising revenues provide established e-commerce retailers with an additional income source which can be used to fund service improvements and to reduce retail prices to consumers.

However, with the advent of the policy, an essential feature which benefits all buyers and sellers will take a toll, as the marketplace will no longer be responsible to develop consumer base and focus on their satisfaction. This will further disincentivize them to perform better as the customer satisfaction is no longer their responsibility, ultimately affecting the sales of all small and medium sellers.

Network effects benefits all the big marketplaces, due to existence of greater number of buyers and sellers. However, it is not an entry barrier for other sellers to sell through these online stores as no significant costs preventing consumers from switching between different sellers and stores. Thus, buying and selling over one marketplace, does not preclude the use of another.[34]

E-commerce service system equips SMEs with professional capabilities that only big marketplaces can afford to develop, and post-sale services tends to be an important one. Multi-stakeholders organize a dynamic service ecosystem, including creative ideas, design, raw materials, manufacturing, channel, platform, third-party service providers and end users. The ecosystem is featured by "large platform, small front end and various species"[35], but with the

[34] In Re: Meru Travel Solutions Pvt. Ltd. And M/s ANI Technologies Pvt. Ltd., Case No. 25-28 of 2017.
[35] Inclusive Growth and Ecommerce: China's Experience, UNCTAD.ORG (April 2017), https://unctad.org/meetings/en/Contribution/dtl_eWeek2017c11-aliresearch_en.pdf.

onset of this policy, the benefits of network effects and inherent features of marketplace will not be accrued to the sellers, as they will be held personally responsible for each and every good or service provided by them irrespective of their capacity or nature of the product.

CONCLUSION AND SUGGESTIONS

A fine balance between E-Commerce regulation and fostering competition needs to be struck for the overall development of the market and the economy. While it is critical to protect SMEs and the traditional retail market, such protection cannot be brought about at the cost of E-Commerce players. The present policy fails to provide a level playing field to all the players within the retail market, whether foreign or domestic. It is likely to deliver a huge blow to the level of capital investment and jobs in the E-Commerce market.

Under such circumstances, adopting a policy geared towards fostering greater price transparency in the E-Commerce market might be better suited to create a more fair and non-discriminatory market. Greater price transparency not only facilitates "shopping around" by consumers, but it also enables other retailers to track more effectively the prices charged by their rivals and allows suppliers to monitor retail pricing (in particular, to identify deep discounting).[36]

Further, equity participation as a criteria used for determining control hampers the growth and investment prospects of E-Commerce players, without providing any tangible benefits or an adequate check on the existent bias towards vendors by E-Commerce marketplace entities. In order to ascertain control, the existing antitrust jurisprudence can be applied under which minority shareholding confers control only under certain circumstances. In the absence of such a case, penalising E-Commerce entities for their intent to invest and diversify inhibits their growth and competitive process in the overall market.

In a global market such as the one we live in today, emphasis needs to be placed on strengthening the domestic market and enabling it to compete with foreign players rather than policies inhibiting the growth of foreign players. The focus needs to shift from a protectionist view towards one which fosters competition and policies catering towards such a view. The marketplace based E-Commerce model is a relatively nascent and technology driven market. Policies aimed at micromanaging such a market can quickly turn into one which stifles both innovation as well as competition within the market. It is imperative to navigate such murky waters carefully lest the policy in itself turns anticompetitive.

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[36] *Internet Platforms and Non Discrimination*, CENTRE ON REGULATION IN EUROPE, (Dec 5, 2017), https://www.cerre.eu/sites/cerre/files/171205_CERRE_PlatformNonDiscrimination_FinalReport.pdf.