Combination Registration No. C-2018/05/571 Walmart's Acquisition of Flipkart

Through this quarterly publication, CUTS International intends to undertake independent examination of relevant competition cases in India (on-going as well as decided). The objective is to provide a brief factual background of the facts of relevant cases, followed by an analysis of the predominant issues, therein. This publication will expectantly help readers to better comprehend the evolving jurisprudence of competition law in India.

The issues have been dealt in a simplistic manner and important principles of competition law have been elucidated in box stories, keeping in mind the broad range of viewership cutting across sectors and domains. The purpose of this publication is to put forward a well-informed and unbiased perspective for the benefit consumers as well as other relevant stakeholders. Additionally, it seeks to encourage further discourse on the underlying pertinent competition issues in India.

Executive Summary

Emerging economies are increasingly becoming quintessential for the growth of the global E-commerce market.[1] One global estimate pegs India (27 percent), Philippines (51 percent), Colombia (45 percent), the UAE (33 percent) and China (27 percent) as some of the fastest growing e-commerce markets in terms of percentage growth.[2] With consumer demand slowly saturating in developed economies, major E-commerce firms are increasingly investing in emerging economies. India is no exception and recently, the American retail giant Walmart made an entry into the highly competitive Indian market by buying a controlling stake in Flipkart – the leading Indian E-commerce platform.

Considering Walmart's consistent but unsuccessful efforts of entering the Indian Business to Consumer (B2C) market in the past, this move marks a significant milestone for the company and officially pitches it against its leading competitor – Amazon in one of the fastest growing E-commerce markets in the world.

Naturally, the deal had to pass the scrutiny of India's competition regulator, which it eventually did, despite concerns being raised by third party representatives, such as traders' associations (both brick and mortar and online suppliers). The issues which were raised mainly included predatory pricing, preferential treatment given to specific E-tailers by Flipkart, indirect Foreign Direct Investment (FDI) policy circumvention and adverse impact on employment, entrepreneurship, small and medium scale enterprises.

However, these were considered to be out of the scope of the merger review process by the CCI and the combination was passed without laying down any conditions. In this edition, we try to critically assess the order of the Commission and explicate the highlights and lowlights of the underlying approach taken.

CCI's Order

I. Background

E-commerce in India is growing at an unprecedented rate. As per one estimate, the Indian e-commerce market is expected to reach US$64bn by 2020 and US$200bn by 2026. So much so, that the Indian market is set to surpass the US to become the second largest e-commerce market in the world by 2034.[3]

This possible growth trajectory, enabled by growing consumption and internet penetration has attracted the attention of investors on a global scale and enhanced the overall market potential. Recently, it also attracted the entry of the American giant – Walmart into the Indian E-commerce fray. In May 2018, Walmart acquired a majority stake in Flipkart (77 percent), thereby marking the world's largest deal in the E-commerce sector and increasing the direct competitive pressure on its rival – Amazon.[4] Walmart's previous attempts to enter the market were restricted to the Business to Business (B2B) segment, i.e. the wholesale cash and carry of goods, mainly because of India's FDI policy restrictions *vis-à-vis* foreign ownership in the multi brand retail segment.[5]

Despite some alleged concerns regarding the possible adverse effects of the deal on competition – that were raised by third party stakeholders, such as trade associations, retailers, etc. – the Walmart-Flipkart deal recently got the green signal from the Competition Commission of India (CCI). The stage is now set for renewed competition between the giants – Amazon and Walmart owned Flipkart, with Alibaba also close-by with its current and upcoming investments in Indian E-commerce space.

The order of the Commission has been summarised below.

II. CCI's Order

The Commission first measured the current business presence of both firms (acquirer – Walmart and target – Flipkart) in the Indian market. This step was crucial to the identification of possible overlaps (horizontal and vertical) in their businesses and subsequently, identification of possible adverse effects on competition arising from the combination.

The Commission observed that Walmart was primarily engaged in the business of wholesale cash and carry of goods (B2B Sales) through its wholly owned subsidiary Walmart India Private Limited.[6] It also noted that the FDI restriction did not allow it to enter the multi-brand retail segment directly, and hence, it did not have a presence in B2C sales.[7] The Commission noted that wholesale B2B sales of Walmart are carried out in India through 29 *Best Price* stores and also through an E-commerce platform which is designed for members of *Best Price* stores only.[8]

Flipkart, however, offers services to consumers through their online E-commerce platform marketplace (B2C) and also facilitates wholesale cash and carry of goods through offline means (B2B).[9] Their online marketplaces include Flipkart.com, Myntra.com, Jabong.com, etc. which in effect act as intermediaries between retailers and consumers but do not hold their own inventory of goods.[10] In order to support this intermediation and make it more seamless, Flipkart also provides for related services, such as those related to online payments, advertising, logistics, etc.

After identifying their type of business presence in India, the Commission assessed the extent of competition that would be lost as a result of the combination.[11] This was done by delineating possible horizontal competition concerns that could arise as a result of horizontal overlaps in their businesses (combination of similarly situated businesses/competitors) and also competition concerns that arise due to vertical overlaps (combination between different levels of the production chain).

Horizontal overlaps

The Commission observed at the outset that there were horizontal overlaps in the wholesale B2B segment. However, considering the limited extent of the overlap and the relative insignificance (from the competition perspective) of market shares/presence of both parties in overlapping segments, the Commission concluded that there was no cause for intervention by stating, "The competition assessment of this transaction reveals that the parties are neither close competitors in the B2B sales nor have a combined market share that raises competition concern".[12]

This inference was drawn from the fact that the major focus areas of both companies in the wholesale B2B segment had no overlaps. While Flipkart's strengths in the cash and carry business lie in segment of mobile and electronics products, the operations of Walmart were more focused on groceries.[13] In segments where there were some overlaps (such as cosmetics, skincare, apparel and accessories, etc.), these were insignificant in front of the actual size of the markets and the combined value of sales was not enough to alter the current market structure.[14] As a result, the relevant market for the wholesale segment remained competitive and was left open.

Vertical overlaps

On account of vertical overlaps between Walmart and Flipkart, it was observed that both parties were not allowed to engage in direct B2C sales (only allowed to intermediate and sell to customers through online platforms without holding an inventory) due to the presence of a regulatory restriction which explains their absence in the B2C segment. Moreover, there was no vertical overlap between the wholesale B2B business of Walmart and the B2C online marketplace of Flipkart.[15] Hence, the Commission found no cause for concern in this regard.

In addition to looking at possible overlaps, the Commission also observed that the *status-quo* vis-à-vis the structure of the market would remain the same and no competitor was being eliminated in the relevant market. On the contrary, the combination of the two would have pro-competitive effects as it would render the Flipkart platform financially stronger and will enable the combined entity to compete effectively in the India's dynamic E-commerce market.[16]

Response of the Commission to third party representations

The Commission also received representation from trade associations, traders/retailers, etc. that collectively highlighted the concerns, such as: (a) predatory pricing practices of Flipkart (b) preferential treatment given to specific E-tailers by Flipkart (c) indirect FDI policy circumvention and (d) adverse impact on employment, entrepreneurship, small and medium scale enterprises, etc.

Upon consideration, the Commission concluded these concerns did not have a nexus to the competition dimension of the proposed combination.[17] This was because the nature of the issues was such that they were not relevant from the merger review perspective. The objective behind the merger review process is to identify and resolve possible competition issues that arise *due to or because of* the combination and not otherwise.

As the Commission could not go into the merits of these representations, it still left open the following alternatives that could be pursued by the third-party representatives: (a) issues related to FDI can be considered by the appropriate regulatory/enforcement authority; and recognising the importance of deep discounting and preferential treatment to select E-tailers as possibly valid competition concerns, they may merit examination but only from the perspective of possible anticompetitive vertical restraints under the Act and not under the process of regulation of combinations under Section 6.

This conclusion poses several concerns - from the lens of the overarching responsibilities of the regulator, which have been addressed in detail below.

Analysis

Highlight – Not too much ink spent in defining the relevant market (s)

First of all, it is good to see that the Commission did not spend much time or effort in defining the relevant market. It took a pragmatic effects-based approach towards the proposed combination and delved into market definition to an extent that was necessary for evaluation of the possible effects (horizontal and vertical) of the combination.

This is in consonance with the emerging shift in competition assessment generally, from a form-based approach towards an effects-based one. It can also be seen that the relevance of market definition itself might be fading away or being readjusted somehow in light of the manner in which multi-sided platforms in the digital economy function. Experts, such as Louis Kaplow put forth "the immodest claim that the market definition process is incoherent as a matter of basic economic principles and hence should be abandoned entirely".[18]

In the Indian context too, experts have questioned the legitimacy of the present tools applied to define the relevant market and propose that "abuse of dominance enforcement requires a shift towards adopting an effects-based approach, weighing the pro and anti-competitive effects and considering efficiency justifications".[19]

Having seen this incremental shift in the merger review process, it will be crucial for the recently established competition law review committee (set up by the Government of India) to also recognise that the applicability of the traditional enforcement tools and approaches might need readjustment.

Lowlight - Room for a more pro-active approach

It is often said that competition law has more to do with *economics* than it has to do with *law*. This is because it is based on the fundamental principles of economics and it is a facilitator towards that end. This entails automatically, that the each and every decision that a competition authority takes has to ideally be backed by economic reasoning. However, in the present case, it seems that the Commission has tended to take a purely legalistic and evasive approach towards the competition concerns that were highlighted by third party representatives, such as deep discounting and preferential treatment. Before, we explain *how* (in the subsequent paragraphs), it is important to flag a limitation of our critique – it is based upon a reading of the order alone and assumes that the Commission has not already taken *suo-motu* cognisance of the possible anti-competitive practices highlighted by the third party representatives.

Our critique chiefly rests on the claim that the Commission could have taken a more holistic and pro-active approach in the present case and should ideally not have interpreted the provisions of the Act in a *siloistic* manner. We say this because the Commission itself acknowledged the fact that, '*the limited concerns in the* *representations that* ***may merit examination from competition perspective*** *were deep discounting and preferential treatment to select e-tailers in online marketplaces of Flipkart'*.[20]

Despite having recognized the underlying economic merit behind the concerns and the possibility of adverse effect on competition, the Commission sought refuge under Section 6 by stating that because (a) "*the issues were not a consequence of the proposed combination*", and (b) "*they are already prevalent in the market even without the proposed acquisition by Walmart…*",[21] – thus, the "*review process cannot be a window to resolve concerns that are not incidental or arise from the proposed combination*".

By taking this approach, the Commission omitted to view the Competition Act's objectives in totality and chose to view it in two silos, i.e. enforcement of anti-competitive practices (agreements and abuse of dominance) and merger review. This compartmentalisation of the Act led the Commission to take an 'ostrich-like approach' and shy away from engaging with the underlying issues on merit. This obscured the advancement of the eventual objectives of the Act. Admittedly, the Commission could not actually address these concerns as the merger review process laid down in the Act did not allow it to do so – but that does not necessarily close all doors of opportunity from the enforcement perspective. There were in fact, two alternatives available with the Commission. We identify these below:

(a) Taking *suo-motu* action under Section 19 against Flipkart and initiating a preliminary investigation under relevant provisions of Sections 3(4) and 4 the Act. The Commission in fact, recognised this in the order and stated, "there is no bar on the Commission at any point of time to examine such issues under the relevant provisions of Sections 3(4) and 4 the Act", [22] Having recognised the possible merits of the issues and the absence of any statutory barrier, the Commission should have ideally taken *suo-motu* cognisance and ordered a thorough investigation.
(b) Applying basic and standard conditionalities on the newly acquiring entity to identify, resolve and report to CCI any continuing discrimination or exclusionary conduct between E-tailers. This could have been a precautionary measure and had the potential of immediately addressing (to the extent that is possible under the merger review process) the concerns related to possible vertical restraints which were raised by the third party representatives. In addition, such a proposed condition could have kept a check on possible discrimination between E-tailers without applying significant burden on the

entity. It could also have taken the resource burden of micro-monitoring the deal off the Commission and applied a practical and non-stringent obligation on the new majority stakeholders of Flipkart. Though the issues pertaining to possible discrimination were present before the combination and not a consequence of the combination, the Commission still had an opportunity to express its concerns with acquirers, thereby encouraging them to remain vigilant of any such behaviour.

The aforementioned possible alternatives imbibe the essence of a holistic perspective towards India's competition law and put forth a harmonious and cohesive reading of its provisions.

Conclusion

The Commission's analysis of the Walmart-Flipkart deal raises interesting legal issues specifically *vis-à-vis* the scope of merger review. One of the third party representatives, i.e. the Confederation of All India Traders (CIAT) still believes that there is a valid competition claim against the combination and have appealed to the National Company Law Appellate Tribunal (NCLAT). CAIT stated in its petition that the CCI ignored the predatory activities carried out by both Flipkart and Walmart in the past.[23]

Provided the Commission saw merit in the claims of predatory pricing (which it did, as highlighted above), it should have taken *suo-motu* cognisance of the issue. There was a clear chance to address issues when the opportunity presented itself. Moreover, it would have been encouraging to see the Commission take up a pro-active role in ensuring that acquirers address and report possible discriminatory and exclusionary practices, if at all they were being carried out. Failing which the affected third party representatives, could also have filed information under relevant provisions before CCI instead or in addition of appeal to the NCLAT.

Further, though the underlying merger review analysis was economically sound and focussed on the effects of the combination, there was some leeway for the Commission to levy precautionary remedies which could have helped in pre-empting the emergence of anti-competitive conduct and promoting competition.

In nutshell, the proposed combination could have been a trigger for the Commission to take a more pro-active role in analysing and shaping the E-commerce market and helping unlock its potential benefits for Indian consumers and suppliers.

Endnotes

1 https://www.businessinsider.com/the-global-ecommerce-landscape-report-2018-3-20?IR=T

2 https://www.paymentscardsandmobile.com/the-fastest-growing-global-e-commerce-markets/

3 https://www.ibef.org/industry/ecommerce-presentation

4 https://economictimes.indiatimes.com/industry/services/retail/softbank-ceo-confirms-walmart-flipkart-deal/articleshow/64093437.cms

5 India does not allow foreign ownership in multi-brand. For more, see http://dipp.nic.in/policies-rules-and-acts/press-notes-fdi-circular

6 Order of the Commission, Combination Registration No. C-2018/05/571, at p.3, available at https://www.cci.gov.in/sites/default/files/Notice_order_document/Walmart%20PDF.pdf

7 Ibid.

8 Ibid.

9 Ibid., at p.4

10 Ibid.

11 Ibid., at p.5

12 Ibid., at p.7

13 Ibid., at p.8

14 Ibid., at p.8

15 Ibid., at p.9

16 Ibid.

17 Ibid., p.10

18 Kaplow Louis, '*Why (ever) define markets?*' Available at: https://dash.harvard.edu/bitstream/handle/1/30013694/vol_12402kaplow.pdf?sequence=1

19 Payal Malik et. al., '*Legal Treatment of Abuse of Dominance in Indian Competition Law: Adopting an Effects-Based Approach*', available at https://link.springer.com/article/10.1007/s11151-018-9651-y

20 Supra Note P. 11

21 Ibid., p.11

22 Ibid., p.12

23 https://www.indiatoday.in/business/story/traders-association-files-appeal-against-walmart-flipkart-deal-here-s-why-1326172-2018-08-29

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