

## “Fair Competition for Good Corporate Governance”

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### **ABSTRACT**

Corporate governance and competition law may be perceived as strong collaborators to ensure that the enterprises behave in an ethical manner and do not follow unfair business practices. The Competition Act prohibits the prevalence of anti-competitive practices and SEBI LODR (Listing obligations and disclosure requirements) prescribes the corporate governance principles and the manner of adherence to the same. This paper outlines the connect between Competition and Corporate Governance and the framework of the competition governance in India and its effect on the economy.

### **I. KEYWORDS**

Corporate Governance, Competition, Compliance, Economy, Shareholders etc.

### **II. INTRODUCTION**

Corporate governance is a multidisciplinary field of study which covers a wide range of disciplines – accounting, consulting, economics, ethics, finance, law, and management.<sup>1</sup> Similarly, compliance with competition law is akin to ethical conduct in the external environment of the company, principally in the market place.

The main function of corporate governance is to make agreements that describe the privileges and tasks of shareholders and the organization. Governance refers specifically to the set of rules, controls, policies, and resolutions put in place to dictate corporate behavior. Proxy advisors and shareholders are important stakeholders who indirectly affect governance, but these are not examples of governance itself. The board of directors are pivotal in governance, and it can have major ramifications for equity valuation.<sup>2</sup>

Whereas, the primary objective of competition policy is to enhance consumer welfare by promoting competition and controlling practices that could restrict it. More competitive markets lead to lower prices for consumers, more entry and new investment, enhanced product variety and quality, and more innovation.<sup>3</sup> Overall, greater competition is expected to deliver higher levels of welfare, transparency and economic growth.

For competition laws and enforcement to be effective, businesses and other stakeholders need to understand the “rules of the game”. Competition laws need to be transparent and their enforcement predictable, and rulings on competition cases should be both consistent and

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<sup>1</sup> S. Li and A. Nair, “Asian corporate governance or corporate governance in Asia?” *Corporate Governance: An International Review*, vol. 17, no. 4, pp. 407-410, 2009.

<sup>2</sup> <https://www.investopedia.com/terms/c/corporategovernance.asp>

<sup>3</sup> OECD Report on Competition and Corporate Governance (2012)

based on non-discriminatory criteria. In other words, while each case is different, the decisions ought to be consistent with one another under reasonably similar circumstances.

As seen above Corporate Governance primarily concerns with the relationship between officers, directors and shareholders whereas, Competition policy primarily concerns with the relationship between corporations and other markets and mergers & acquisitions.

The result is, two relatively separate bodies of law, with at times competition policy stronger and corporate governance weaker and vice versa. This correlation assumes greater significance in the present time when governance failure is resulting into corporate frauds affecting the numerous stakeholders in the economy.

### **III. CORPORATE GOVERNANCE**

The initiatives taken by Government of India in 1991, aimed at economic liberalization, privatization and globalization of the domestic economy, led India to initiate reform process in order to suitably respond to the developments taking place world over. On account of the interest generated by Cadbury Committee Report, the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted Committees to recommend initiatives in Corporate Governance.

The primary purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. Corporate governance is the system by which companies are directed and controlled.<sup>4</sup>

The corporate governance framework should promote transparent and fair markets and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.

Under Indian regulatory regime, the Companies Act, 2013 gives adequate recognition to the principles of corporate governance and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR) is supposed to be a powerful tool for implementing the corporate governance by the listed companies. SEBI LODR prescribes key norms on board and senior management framework, disclosure and transparency mechanism, documentation, related party transactions, system formulation etc.

### **IV. COMPETITION**

In the absence of a generally accepted definition of the phenomenon of competition, it has to be regarded as the object fostered and protected by competition policy and law.

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<sup>4</sup> <https://www.icaew.com/technical/corporate-governance/principles/principles-articles/does-corporate-governance-matter>

The World Bank and OECD in its Report, broadly defines the competition is “a situation in market in which firms or sellers independently strive for the buyers’ patronage in order to achieve a particular business objective, for example, profits, sales or market share.”<sup>5</sup>

Competition creates greater opportunities for comparing performance; a more competitive environment where price elasticity of demand tends to be higher, induces greater efforts among workers and managers for cost reducing improvements in productivity since improvements could generate larger increase in revenue and profits; and a more competitive environment forces manager to improve efficiency, because more intense the competition, greater the chances for inefficient to be extinguished.<sup>6</sup>

In 2002, the Parliament of India enacted the Competition Act, replacing the Monopoly and Restrictive Trade Practices Act (popularly referred to as the MRTP Act) of 1969.

The primary goal of the Act, as stated in the preamble, is ‘...*keeping in view of the economic development of the country ... to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect interests of consumers and to ensure freedom of trade ...*’.<sup>7</sup>

## **V. PRODUCT MARKET COMPETITION AND CORPORATE GOVERNANCE**

At the fundamental level, greater product market competition has a positive correlation with better corporate governance because competition pushes the management to take prudent decisions that are ultimately in the interest of shareholders.<sup>8</sup> Further, the stringency of competition review of an enterprise can have an effect on the patterns of ownership and control of the enterprise.<sup>9</sup> Illustratively, in Warsaw, a ‘U’ shaped relationship was seen between ownership structure and performance of the enterprises.<sup>10</sup> This was explained by the fact that good competition and corporate governance reinforced each other. Thus, both high competition in the market and the resulting thrust on corporate governance mechanisms increased the performance of the firms in the market.<sup>11</sup>

Another interesting conclusion was reached in the context of manufacturing firms in the European Union (‘EU’) where competitive environment was found to cause lower insider ownership and more dispersed stake among outside shareholders.<sup>12</sup> Thus, competition led to the diffusion of stake from inside the enterprise to diverse ‘outside’ shareholding, because

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<sup>5</sup> OECD report “*A framework for the design and implementation of competition law and policy*”

<sup>6</sup> Nickel et. al. – “Competition and Corporate Performance”

<sup>7</sup> Competition Act of 2002. Retrieved 3 March, 2016 from [http://www.cci.gov.in/sites/default/files/cci\\_pdf/competitionact2012.pdf](http://www.cci.gov.in/sites/default/files/cci_pdf/competitionact2012.pdf)

<sup>8</sup> Franklin Allen & Douglas Gale, Corporate Governance and Competition 35 (Wharton Financial Institution Center, Working Paper 28, 1999).

<sup>9</sup> Angela Wigger, Towards a market based approach: The privatization and micro-economization of EU antitrust law enforcement in The Transnational Politics of Corporate Governance Regulation, 98 (HenkOverbeek, Bastiaan van Apeldoorn & Andreas Nölke (eds.), 2007).

<sup>10</sup> See Irena Grosfeld & Thierry Tressel, Competition and Corporate Governance: Substitutes or Complements?

<sup>11</sup> Grosfeld & Tressel, supra note 28; Hee Sub Byun, JiHyeLee, KyungSuh Park, How does product market competition interact with Internal Corporate Governance?

<sup>12</sup> [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2356526](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2356526)

competition obliterated the need for a large shareholder to monitor the agency costs.<sup>13</sup> Closer home, two studies have found the beneficial effect of competition on corporate governance by concluding that higher insider ownership in the firm increased productivity only when there was fierce competition in the product market.<sup>14</sup>

Both sides of the research suggest something common, i.e. policymakers focused on improving corporate governance must broaden their horizon. This would involve improving the competitiveness in the industry through better appreciation of antitrust law and its interaction with corporate governance mechanisms.<sup>15</sup> This relationship between product market competition and corporate governance could be used beneficially to frame wholesome policies that address both the agency cost and boost competition in the market.<sup>16</sup>

## **VI. THE CONCEPTUAL CONNECT BETWEEN CORPORATE GOVERNANCE AND COMPETITION**

Perfect competition in the real world is a myth. The market is characterized by imperfect competition, consisting of entities that strategically work towards maximizing their bottom lines and for this purpose restrict the opportunities available to their competitors. Such distorted competition results in exploitation of consumers and imposes significant economic and social costs on society. In the long run, such imperfect competition is not sustainable from the point of view of inclusive economic growth. There is a need for all entities having the capacity to influence competition (most of whom are companies) to behave in a responsible manner by at least complying with the prevailing regulatory framework in letter and spirit.

Competitive markets allow a nation's resources to be used to best effect in the production of goods and services. For example, both theoretical and empirical research in recent years has emphasized the productive and dynamic efficiency gains from competition.<sup>17</sup> Competition gives firms continuing incentives to make their production and distribution more efficient, to adopt better technology, and to innovate.<sup>18</sup> These sources of productivity improvement lead to growth<sup>19</sup> and poverty reduction.

Competitive business environment and appropriate good corporate governance in substance have a very close nexus, much more than what is apparent in its form, with competition

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<sup>13</sup> Id.

<sup>14</sup> Ekta Selarka, Corporate Governance, Product Market Competition and Firm Performance: Evidence from India in *Corporate Governance in Emerging Markets: Theories, Practices and Cases*

<sup>15</sup> Giroud & Mueller, *supra* note 38, 330.

<sup>16</sup> Sahithya Muralidharan and Chaitanya Deshpande, *Scope for Intersection Between Antitrust Laws and Corporate Governance Principles Vis-À-Vis Cartels Deterrence in India*, 9 NUJS L. Rev. 93 (2016)

<sup>17</sup> Uchida and Cook, in Cook et al. (2007) p. 311

<sup>18</sup> As Metcalfe and Ramlogan suggested in Cook et al.(2007) "the best competition policy is a pro-innovation policy". P. 21

<sup>19</sup> A recent publication of the UK Office of National Statistics (2007) identified five key drivers of productivity. One was competition, while another, innovation, is strongly influenced by competition. Studies within DFID and elsewhere, such as Dollar and Kraay (2001) of the World Bank have shown a strong positive correlation between economic growth and poverty reduction

influencing. While profit making is justified and should be allowed being the basis of economic activity, profiteering should be prevented. Reasonable profit making will allow new parties into the market resulting in better supply position, but lower prices leading to lower profitability.

All corporate activities ultimately have a common point, the consumer. Sustainable Corporates understand that consumer welfare and interest should form the basis of their marketing and management strategy. This in turn requires ensuring free and fair competition, which can be achieved by a company which ensures rational allocation of economic resources, availability of goods and services of acceptable and good quality at reasonable prices. The ultimate focus is to provide a just and fair deal to the consumers. Corporate Governance rules have to factor these principles and rules to ensure that they achieve the country level responsibilities and objectives set for itself.

“Competition is a key driver of innovation, in open and competitive markets, firms are driven to adopt more efficient production, and to offer new and improved products and services to customers.”<sup>20</sup>

For instance, Apple has been known for their innovative moves since the days of Steve Jobs, when he unleashed the first iPhone to the tech market. But recently, experts feel they haven’t been creative enough with their updated features with the criticism falling at their decision to remove the headphone jack from their latest mobile device, but they have provided solutions to their previous models’ issues such as better battery power, a more powerful processor, rugged features and more. They are trying to compete with Samsung and Sony, who have built several rugged premium handsets in the past, while continuously perfecting their products.<sup>21</sup>

Thus, over a period of time, only fair competition with a proper governance framework to deal with competition is sustainable on a long-term basis.

## **VI. CONCLUSION**

Competition law and corporate governance regimes have been viewed as serving different purposes and address the problems of different stakeholders, i.e., shareholders and consumers. However, there is increasing scholarship arguing for the meaningful interaction of both laws whereby the competition policy views anti-competitive actions from the viewpoint of shareholder interest because such conduct is inherently linked to the internal functioning of the company, which is regulated by corporate governance norms.

Businesses should conduct and govern themselves with integrity, and in a manner that is ethical, transparent, and accountable.<sup>22</sup> One of the core elements of this principle provides that the Governance Structure should take responsibility for meeting all its statutory

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<sup>20</sup> John Pecman, Commissioner of Competition at a workshop of emerging competition issues.

<sup>21</sup> <https://www.edisonawards.com/news/competition-drive-innovation/>

<sup>22</sup> Principle 1 of the National Guidelines on Responsible Business Conduct

obligations in line with the spirit of the law, enabling fair competition and ensuring it treats all its stakeholders in an equitable manner.

The main objective of competition law is to promote economic efficiency using competition as one of the means of assisting the creation of market responsive to consumer preferences. Corporate governance and competition law complement each other and aim at balancing the interest of all the stakeholders of the social and economic system. Competition law compliance has an important role in setting the high standards of the corporate governance in the corporate sector. The provisions of the Act are generally applicable to the large conglomerates and the total implementation of corporate governance practices is expected from the said economic entities.