

## **CARTELIZATION IN INDIAN AVIATION INDUSTRY: A CRITICAL ANALYSIS**

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### **INTRODUCTION:**

The Indian civil airline industry forms part of the top ten in the world, with a size of \$16 billion. Indian airline industry guarantees enormous development potential because of vast and developing working class populace, favourable socioeconomics, economic development, higher expendable earnings, rising yearnings of the working class, and largely low entrance levels.

Aviation industry everywhere throughout the world has been considered as an oligopolistic market i.e. dominated by a couple of firms, which, are sufficiently substantial enough to impact the size of the market, because of their policy restriction, and capital intensive nature.<sup>1</sup>

The conduct of any one firm in an oligopoly depends, overall, on the conduct of others. Along these lines, when they collude, oligopolistic firms may strategically avoid that conduct which is unfavourable to their general interest.

Government is finding ways for the promotion of healthy competition in different sectors and industries. As one of the measures toward this, Indian Institute of Corporate Affairs (IICA) an independent body working under the guidance of Ministry of Corporate Affairs (MCA) named Nathan Economic Consulting India Pvt. Ltd. (Nathan India) as specialists to carry out a extensive research on the competition and related issues in the Airline industry.

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<sup>1</sup> See 'Market Structure Of The Airline Industry Economics Essay' (*UKEssays*, 2018) <<http://www.ukessays.com/essays/economics/market-structure-of-the-airline-industry-economics-essay.php>> accessed 2 November 2018.

The Competition Commission of India ("CCI") plays an important role as a regulator in the regulation of Indian aviation industry and is enabled by the Competition Act, 2002 to prevent anti-competitive practices by the participants and ensure competition. The CCI has been engaged in scrutiny and investigations into various cases in the airline industry empowered to do so by Section 3 and Section 4 of the Act<sup>2</sup>. A couple of the issues managed by the CCI are discussed in this paper.

The primary motive behind framing cartels is to coordinate the arrangements of member parties to expand the profit.<sup>7</sup> Nevertheless cartels are considered to be anticompetitive practices by competition laws of most of the nations including the Competition Act of 2002 of India (from this time forward alluded as 'the Act'). This article revolves around the ongoing trend in commercial airline industry and will elaborate upon their inclination to create cartels everywhere throughout the world including India. For instance, on 16 October 2005, a group of 11 aircrafts met in Mumbai to create the Federation of Indian Airlines (FIA) which will give them a platform to discuss issues in the industry and create a lobby to mallet out solutions with the government. Be that as it may, at the first meeting the issues related to pricing were discussed, which was judiciously brought to the notice of the CCI, and thus the initial move towards cartelization had prematurely ended.

As per the Competition Act, 2002, the Competition Commission has been authorized to determine whether or not a combination would have or is likely to have an Appreciable Adverse Effect on the competition (AAEC) and in this way, CCI should assume a positive role in to prevention of occurrence of any anti-competitive agreement in order to ensure and maintain a healthy competition in the market

### **AIRLINE INDUSTRY: AN OLIGOPOLY?**

An oligopoly market is a place of limited competition wherein the market is shared by a small number of producers or sellers. Indian Aviation sector is an oligopoly market sector.

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<sup>2</sup> Competition Act, 2002.

Oligopolistic market or industries have proven to be inefficient since there are high barriers to entry and forms of collusion, which reduce competition and lead to higher costs for consumers.<sup>3</sup>

When the individual firm owners work together and act in concert with the aim of limiting or eliminating the competition and increase profits jointly they work in the model of a monopoly. They collude and hence the outcome would exactly be as the outcome of a monopoly. They choose the price quantity combination and stay in control of the output level that maximizes profits for them.

When sellers come together in an oligopoly to collude, they fix price and the oligopoly is diluted to form a monopoly.

A cartel is an boon to the concept of oligopoly wherein the competitions themselves, in an industry, collude, and enter into formal agreements and indulge themselves in undertakings such as price fixing and fixing of production quantity. In principle, a cartel formation may happen in any industry however; it is most efficient and suitable only in an oligopoly where there are few players. Cartels are more steady if the industry deals in perfectly substitutable good instead of differentiated product since it is easy to fix prices and control the supply. In such circumstances, if there were any shift in the market share of an individual member firm from the cartel, then it would be noticeable that such a dip is conceivably a direct result of change in prices made by another member firm.

At the point when firms in an oligopoly fix their individual prices and the supply quantity, while evaluating, they should consider what the other in the market are doing, for the price and quantity is inversely proportional to each other. In the event that every one of the players produce excessively, at that point the prices may take a dip and reach below the average total costs (ATC)<sup>4</sup>, causing all of them losses. In order to avoid this the firms can restrict amount to that level in the market, which resembles a model where the marginal cost id equal to marginal revenue for the whole of oligopoly market, which would result in profit maximization.

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<sup>3</sup> Choudhari, S., Dixit, R. and Tiwari, R. (2015). ISSUES AND CHALLENGES OF INDIAN AVIATION INDUSTRY: A CASE STUDY. Pezzottaite Journals, [online] 4(1), pp.1557-1563. Available at: <http://pezzottaitejournals.net/pezzottaite/images/ISSUES/V4N1/IJLSCMPV4N120.pdf> [Accessed 19 Oct. 2018]

<sup>4</sup> William Spaulding, 'Firm Production And Costs' (*Thismatter.com*, 2018) <<http://thismatter.com/economics/firm-production-and-costs.htm>> accessed 1 November 2018.

Analysing it from the point of view of Game Theory<sup>5</sup>, cartelization in an oligopoly may have prisoner's dilemma. Nonetheless, the firms have one advantage in this prisoner's dilemma — they as a rule comprehend what alternate firms did previously, so they can settle on amount and prices hinge on the hypothesis that they will act in the same manner in future. However, if the firm is mistaken to presume this, at that point they it is upon them to rectify their production schedules. Hence, the firms in an oligopoly attempt to eliminate this game of chance by creating a cartel, where they concert to produce a particular amount of yield, with the ultimate goal that they would all offer their products or services at maximised profits. Where firms have a background of working in concert, they can decide on a dominant strategy based on the decisions that other participant firms have made, in other words called a Nash equilibrium<sup>6</sup>.

In oligopoly, there is misallocation of assets and henceforth decrease in social welfare. Since a dominant firm has attained the authority to decides the prices and yield policies for the whole industry and other players in a tacit collusion with a goal to maximize the profits.

Thus, this price dominance is acts like a monopoly acting in concert to fix one price of the product and services. As stated above, when the participants in oligopolistic market framework concert with each other in collusion they are all the more like a monopolist and lead to restriction on outputs which leads to high prices for the consumers. Hence, it can be assumed that the oligopoly has a social cost attached to it which, the consumers pay when the market players act in collusion as a single unit.

### **FACTORS ADVANTAGEOUS TO FORM CARTELS IN INDIAN AVIATION:**

This article has already dealt with the nature of the Indian Aviation sector and how it supports cartelization. In this chapter an attempt has been made to enlist the factors which aid in formation of cartels in the Indian Aviation industry. The following characteristics contribute to the formation of a cartel:

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<sup>5</sup> Game theory is a particularly useful tool for understanding why firms and individuals make the decisions they do, and how the decisions made by one individual affects others, available at (2018) <<http://economics.about.com/cs/studentresources/f/gametheory.htm>> accessed 2 November 2018.

<sup>6</sup> (*Nlujodhpur.ac.in*, 2018) <[http://www.nlujodhpur.ac.in/downloads/competition\\_law\\_cirque.pdf](http://www.nlujodhpur.ac.in/downloads/competition_law_cirque.pdf)> accessed 2 November 2018.

• **High Entry and Exit Barriers** - Aviation Industry has high entry barriers. They are elaborated below:

1. The Capital investment requirement is high for the purchase of aircrafts. It could be replaced with the leasing of aircrafts but that also has high costs attached to it.

2. There are certain regulations that govern the entry into the market:

a) Route Dispersal Guidelines<sup>7</sup>-These constraint the profitability of airlines. The carriers are required to reserve a fix part of their capacities for routes where passengers are less which is making their operations impracticable and thus making the business less alluring to the new entrants.

b) Restrictions in the international flight- minimum 5 years of experience in the domestic airline industry and minimum fleet size of 20 aircrafts.

c) Minimum Equity and Fleet Requirements - for domestic operations is again increasing the entry cost.<sup>8</sup>

d) Slot Allotment Constraint – limitation on the capacity is to be seen as a key barrier to entry acting as an obstacle and increases the expense to entrants. The unavailability of required slots will have its effect on the profitability. Allocation of slot involves incumbency benefits.<sup>9</sup> When slots are, being allocated it is important that the airline has good strategically placed slots of high quality than to have a lot of slots which are at odd times and therefore result in high expenses and low passenger traffic.

• **Homogeneous products**

All the Airline carriers in the industry offer majorly the same service, i.e., scheduling and managing travellers from one destination to another. Only two types of carrier services exist such as full service and low cost carriers. The former takes travellers from one destination to

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<sup>7</sup> Government of India Order No. AV 11012/2/94-A.

<sup>8</sup> Aeronautical Information Circulars No. 08 of 2009.

<sup>9</sup> Airport Authority of India and Director General of Civil Aviation (DGCA) allot slots in accordance with the IATA worldwide slot guidelines. IATA Worldwide Slot Guidelines, available at IATA August 2011 (2018) <<http://80.168.119.219/UserFiles/File/w-slot-g.pdf>> accessed 2 November 2018.

another however with luxuries being offered such as food and entertainment<sup>10</sup>. The Low Cost Carriers (LCC), on the other hand, do not make a special effort to be able to provide such services.

#### • Similar Production Cost

The carriers' revenue goes into payment of fuel bills and its production cost is high. The Aviation Turbine Fuel (ATF) is the most expensive fuel in India when contrasted with other nations where such costs are less.<sup>11</sup> The taxes on the imports of ATF have made air travel comparatively costlier. Recently, aircrafts have begun charging a Congestion Cess of Rs 150 from travellers in spite of the Government's resistance. Carriers think that it's just and equitable to charge such a fee as they feel that a considerable measure of valuable fuel is squandered when the aircrafts hover in the air before they at last get a green flag to arrive at the congested air terminals. Be that as it may, legitimization of this cess is highly questionable to refute as buyers bear the most extreme brunt. Right off the bat, it is their destination to which they are not reaching on time for which they are also being charged deferrals further to add salts to the injuries. The market players always whined of structural dominance of the public sector undertakings such as Indian Oil Corporation or Bharat petroleum and so on, as the main Aviation Turbine Fuel (ATF) providers at the terminals<sup>12</sup>. The legislature as of late has endorsed request of carriers to mix competition in the ATF in order to bring public sector monopoly to an end. AAI has now endorsed Reliance Industries to set up ATF business in 25 non-metro airplane terminals.

#### • Capacity constraints

The industry does not carry excess capacity. The carriers have to make their demands years ahead of the years of their aircrafts are being delivered with a slack of 3-5 years<sup>13</sup>. Nonetheless, capacity building comes at a cost. Excess capacity would exist if airlines begin to charge

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<sup>10</sup> Supra note 6.

<sup>11</sup> Choudhari, S., Dixit, R. and Tiwari, R. (2015). ISSUES AND CHALLENGES OF INDIAN AVIATION INDUSTRY: A CASE STUDY. Pezzottaite Journals, [online] 4(1), pp.1557-1563. Available at: <http://pezzottaitejournals.net/pezzottaite/images/ISSUES/V4N1/IJLSCMPV4N120.pdf> [Accessed 19 Oct. 2018].

<sup>12</sup> See (2018) <<http://www.ilntoday.com/2013/03/structural-dominance-of-public-sector-undertakings-psusnational-oilcompanies-nocs>> accessed 27 October 2018.

<sup>13</sup> Supra note 6.

excessive rates. In the meantime, there can be full passenger load if the prices are fixed rationally. Capacity does come at a cost.

- Low product substitutability

Over the years, the consumers have come into a habit of using this mode of transportation as there exists no other faster mode in India that is more time-efficient.

- Concentration of market sellers

Cartels are parallel conduct are more probable in industries having less number of market participants<sup>14</sup>. This based on the fact that the expenses of creating a cartel and planning and checking its individuals' activities are lower, and it is easier to balance out the individual goals of member firms. Additionally, as per economic principles applicable in an oligopoly market, the organizations with similar market and cost structures are more likely to redirect or abandon the cartel membership and consequently there is minimal risk of any member leaving. The market share of all airlines is almost the same.

#### **APPRECIABLE ADVERSE EFFECT OF CARTELS UNDER COMPETITION ACT, 2002:**

Cartels are considered to be one of the most harmful types of anticompetitive behavior. It is seen that they don't really offer actual benefits be it economic or social which might give a valid justification for the losses that they tend to create towards the consumers and the society as a whole.<sup>15</sup> Therefore, they are destined in all the anti-trust laws and are considered to be a crime in some of the countries.<sup>16</sup> Seasoned cartel operators know that their actions are unlawful which basically means that they conduct their day to day business in secret and go a long way to keep their unlawful agreements hidden from the public at large.<sup>17</sup>

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<sup>14</sup> Preeti Mechan, A Project Report on Cartels In Aviation Industry, Internship Project Report, Competition Commission of India, New Delhi available at (2018) <<http://cci.gov.in/images/media/ResearchReports/PreetiInt200711.pdf>> accessed 2 November 2018.

<sup>15</sup> William Baxter, 'NYSE Fixed Commission Rates: A Private Cartel Goes Public' (1970) 22 Stanford law review.

<sup>16</sup> OECD Report, Nature and Impact of hard core Cartels and Sanctions Against Cartels Under Competition Laws of Nations, 5 (2006). OECD Report, Nature and Impact of hard core Cartels and Sanctions Against Cartels Under Competition Laws of Nations, 5 (2006).

<sup>17</sup> Supra note 14.

Cartels have inbuilt distinctiveness that adversely affect the economy. The simulated price rise which is visible in all the cartel cases, prove this very fact. The eventual sufferers of cartelization are the consumers and various business houses. Cartels do not just create monopoly over the price of a particular product but they also restrict various other private market players to enter in the market. Such cartel formation would prove to be difficult and unsustainable if there is an effective competition in the market.<sup>18</sup>

Cartels are a type of horizontal anti-competitive practice. The operation of cartels is considered to be very complex and is varied with respect to the number of participants and according to the nature of the market. There are also situations where there is no obvious collusion between the members of the cartel but they take action in such a manner that seems to portray collusive behavior in accordance with the already existing market forces.<sup>19</sup>

Generally, agreements like these are not per se void but the rule of reason is applied. At the same time, such agreements are illegal when the sole motive of the cartel is to maximize the profits by the means of fixing the price, dividing the markets which as the result cause an adverse effect on market's output, prices and quality of goods and services.<sup>20</sup>

Agreements which are most likely to cause Appreciable Adverse Effect on Competition (AAEC) are considered to be anti-competitive agreements. The Competition Act, 2002 talks about the two kinds of anti-competitive Agreements i.e. horizontal agreements and vertical agreements. Vertical agreements are agreements or strenuous practices entered by two or more different companies which for the purposes of the agreement, work at a dissimilar level of the production and distribution chain and it lays down conditions with respect to the parties purchasing or relating to the sell and resale of the particular goods and service.<sup>21</sup>

On the other hand, horizontal agreements are the agreements which imply a co-operation amongst the 2 competing businesses which work at the same level in the market. It is an assumption that any horizontal agreement will have AAEC i.e. Appreciable Adverse Effect on

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<sup>18</sup> Supra note 5.

<sup>19</sup> Abir Roy, *Competition Law In India* (1st edn, eastern book house 2008).

<sup>20</sup> Supra note 9.

<sup>21</sup> See, the European Commission's Guidelines on Vertical Restraints (2000/C 291/01) available at [http://europa.eu/legislation\\_summaries/other/126061\\_en.htm](http://europa.eu/legislation_summaries/other/126061_en.htm) (Last visited October 24, 2018).



Competition and is per se void but at the same time, for vertical agreements, rule of reason is to be used.<sup>22</sup> Cartels come under the horizontal agreements and hence, they are considered to have AAEC. Since, showing that AAEC exists is an important factor before declaring any agreement void, in case of horizontal a greement the burden shifts to the enterprise / person against whom the charges are framed.<sup>23</sup>

Cartelization is a kind of horizontal agreement that is presumed to have AAEC under Sec 3 of the Competition Act. Since, for busting a Cartel is different from investigating other infringements under the act, under Section 46 of the act, CCI is empowered to give less penalty to the members of the cartel which cooperate with the investigation.

CCI has the power to inquire into any cartel on the information received by any person, customer or a trade association under Section 19 Of the Act. At the same time, to prevent false information, there is a very high fine. Cartels are seen to be very secretive in nature and hence, it is very difficult to detect such activities and to conduct proper investigation. While dealing with cartels, the CCI focuses on proving that such a cartel exists rather than finding out its impact on the market.<sup>24</sup> The director general under Section 41(2) of the Act has the same powers as the civil court under Civil Procedure Code, 1908. Because of this, he has the authority to issue summons, demand documents, take evidence etc. he also has the powers of the inspector under section 240 of the companies Act, 1956.

### **Case Studies:**

#### **1. Kingfisher-Jet Airways Agreement on Code Sharing**

The Competition Commission of India began the investigation in the alleged case of airline cartelization by the way of code sharing agreement between the two airlines. Jet Airways and Kingfisher together control a market share of close to 60 percent.<sup>25</sup> Apart from this combination there are only small market share holding airlines excluding Air India. So this combination

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<sup>22</sup> Somya Suman, Competition Law and Cartelization, Internship Project Report, Competition Commission of India, New Delhi available at [http://www.lawyersclubindia.com/articles/print\\_this\\_page.asp?article\\_id=543](http://www.lawyersclubindia.com/articles/print_this_page.asp?article_id=543) (Last visited october 24, 2018).

<sup>23</sup> Supra note 16.

<sup>24</sup> Supra note 4.

<sup>25</sup> See, < <http://www.dnaindia.com/report.asp?NewsID=1111855>> (Last visited October 25, 2018)

might have been detrimental to the importance of the consumers and to the very character of the competition law. According to the DG report, the agreement breached section 3 and section 4 of the Competition Act and that they abused their dominant nature. But according to the CCI, there was no anti-competitive practice / cartel in this particular case.

In any case, it tends to be said that such unions may demonstrate impeding to rivalry in the relevant market as the fundamental target of a collision is to reinforce or extend the adjusting part's market nearness and to rethink or combine their situation in forcefully aggressive worldwide condition.

Airlines unions advantage the buyer by offering consistent travel and administrations between a more broad scope of city sets, decrease in voyaging time, joint parlours and co-appointment of Frequent flier projects. In any case, on other hand, a union can altogether diminish rivalry on covering constant courses and covering interfacing courses where the partnered carriers were once primary contenders. The two aircrafts could shape an imposing business model, for all intents and purposes executing a wide range of rivalry in the flight sector. This code sharing assentment would result in development of a cartel and may likewise result in a maltreatment of dominance. But as said before that standard of reason should be connected instead of only a hypothetical tenet or standards of cartelization that restricts industry practice, for example, code sharing as such.

## **2. Air India's Involvement in Fuel Surcharge Raising Cartel<sup>26</sup>**

Between 1999 and 2007, it was found that the airlines had conspired to raise fuel surcharge rates for air cargo to-and-from Korea. In this case, 54 airline executives were summoned from all around the world for investigation and a joint investigation was conducted with foreign anti-trust authorities. It was found by the regulator that the conspiracy happened on outbound shipments from Korea and inbound shipments to Korea from Hong Kong, Europe and Japan. In the local markets, the airlines overcharged by \$5.71 billion by the way of imposing fuel surcharges during the 8 year period. This was not discovered till 2006 when authorities from Europe and US investigated their airlines due to the high fuel cost and the competition from low cost carriers.

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<sup>26</sup> See, <<http://www.thehindubusinessline.in/2010/06/23/stories/2010062350180900.htm>> (Last visited october 25, 2018)

In 2007 situation worsened as more airlines were inspected and charged for various anti-competitive practices. European Commission fined various airlines for fixing freight service prices. British Airways paid billions of dollars because of the fine as the UK and the US competition authorities held it responsible for price fixing during the period 2006-07. It was found by Korean Federal Trade Commission (KFTC) that 21 airlines had conspired to raise the fuel surcharge rates including Air India. India's national carrier was not prosecuted by Korean Fair Trade Commission for the ongoing situation. Air India was not penalized by the Indian Antitrust Authorities even when there was a definite proof of Air India's involvement in the price surcharge.

Since poor business choices of Air India are not rebuffed by the market similarly as poor choices of other private air bearers. Terrible business choices of all private air bearers are rebuffed by holders of the company's obligation while Air India is just responsible to the Indian government. This social security net diminishes Air India's motivating force to contend similarly as other private Indian bearers. Keeping up the feasibility of the national transporter is imperative, anyway special treatment decreases the national bearer's motivating force to contend and settle on sound business choices. Besides, with the end goal to boost Air India to end up a less fatty and more aggressive specialist organization, the national bearer might be mostly privatized. Additionally, to demonstrate India's responsibility and well behaved state of mind towards Declarations/Memorandum of Understanding (MoU) marked by India with BRICS and different nations for global participation in anti-trust issues.

### **3. Cartels for Charging High Ticket Pricing:**

The Competition Commission of India received a complaint in September 2013 from the Air Passengers Association of India (APAI), which suspected that airlines were acting as cartels to push the ticket prices. Chennai-based APAI approached CCI after a recent hike of 25 per cent in air fares by almost all the carriers.<sup>27</sup>

Competition Commission of India's Chairman Mr. Chawla said that CCI would require more data from APAI to continue further, as the value developments were observed to be an element of free market activity amid its prior tests. CCI Chief additionally said that this issue has been

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<sup>27</sup> See, < <http://beta.livemint.com/Companies/xJ1ocj3GvXDmPI5aBU5DSK/CCI-to-probe-high-airfares-for-5thtime.html> > (Last visited October 25, 2018).

investigated over and over, in light of the fact that the upward and descending developments in ticket costs have for sure been observed to be pair. In the meantime, the costs had likewise been observed to move pair with the powers of interest and supply, or, in other words market should work and consequently no proof could be seen of any cartelization. In the main seven day stretch of September, every local transporter climbed their particular admissions by around 25 percent after a precarious ascent in fuel costs. The climb was first reported by ease transporter Spice Jet and pursued by different players like Jet, Air India, Indigo and Go Air stuck to this same pattern.

Despite the fact that this issue has simply started and off by a long shot to its last assurance, it is hard to remark indisputably on the probability of cartel framed among the aircrafts to climb the ticket costs since it would require normal financial confirmations to ensure that cartel exists and along these lines fulfill rule of reason.

### **Combating the stumbling block faced in India:**

There are numerous issues which India or so far as that is concerned any arrangement of Competition law which the world would confront; like the degree to which the one-sided lead of firms with market power ought to be controlled, the degree to which exchanges can be adjusted, the value which another player or client should pay to get to an essential facility, the connection between Intellectual Property and competition law and to what degree should a merger be precluded. A one-point arrangement of every one of these issues is investigated and watch is out for agreements between autonomous firms which smell of confinement and build up a chain of importance and seriousness of cartelization included and set up corrective arrangements as needs be which may add up to detainment for the more genuine offences. Some other approach questions incorporate whether assents ought to be accessible against people and in addition organizations and the degree of mercy which can be given to Whistle blowers from inside the cartels.

### **CONCLUSION:**

After understanding the working of Indian Airline Industry and different case studies, it can be said that there are probable areas of cartels in airline industry like code sharing which is not cartel per se but can be a mode of anti competitive practice. Secondly, Air Turbine Fuel (ATF),

dividing of routes, air ticket price manipulation, etc are some of the areas on which competition law has to keep a check on cartel formation.

Subsequent to having a superior perspective of various air carrier cartel cases in various locales it tends to be seen that whether an airline is national carrier or a private carrier that nations have managed them brutally as well as instilled them with criminal risk in most pessimistic scenarios. Another purpose of perception is that the wards have not just taken the harm to their economy alone yet additionally the harm that happened in different nations where the cartel worked.

Under Competition Act, 2002, Commission is enabled to decide if the mix would have or is probably going to have an Appreciable Adverse Effect on the competition (AAEC) and in this way; CCI should assume a proactive job in the support of fair competition and keep any anti-competitive activities from happening. With the progression of time various players would surely endeavour to enhance their piece of the overall industry and productivity. In the event that cartels are not crushed at incipiency it will take us back to the period of imposing monopoly delighted in by the State air bearers and thus there will be deficiency of low cost airlines in India. There's urgent need to formulate sector specific competition rules and policy according to the needs of industry in India.