

## COMPETITION POLICY AND LAW: LESSONS FOR SMES IN APEC DEVELOPING ECONOMIES

The Philippine Competition Commission (PCC) was created under the Philippine Competition Act (PCA). The PCA, or the Republic Act No. 10667, was enacted in July 2015 providing a basis for improving competition practice in the Philippines. The PCC is mandated to conduct inquiries, investigate cases involving anti-competitive agreements, abuse of dominant positions, and anti-competitive mergers and acquisitions. It is also within their remit to impose administrative sanctions for violation of the PCA and engage in competition advocacy.

This Policy Note is based on work completed under the *Capacity Building for Small and Medium Enterprises (SMEs) on Competition Policy and Law (CPL)* project sponsored by Asia-Pacific Economic Cooperation (APEC). The analysis is based on a literature review and focus group discussions (FGDs) conducted with government agencies and regulators, SME representative associations, and selected SME business owners. The opinions here are those of the authors and do not necessarily represent those of the PCC.

### Overview of competition policy and law issues for SMEs in APEC

There is an increasing focus on small and medium enterprises (SMEs) as an engine of sustainable economic growth. Within the 21 Asia-Pacific Economic Cooperation (APEC) member economies, SMEs account for over 97 per cent of all enterprises, employ over half the workforce, account for between 20 and 50 percent of GDP, and drive up to 35 percent of the value of total exports.<sup>1</sup> However, SMEs cannot succeed when they do not have a fair chance of competition against larger and more established foreign and domestic rivals.

The adequate provision of competition policy and law and establishing a 'level playing field' is vital in promoting opportunities for SMEs to grow.

There is significant diversity in the status of competition policy and law within APEC member economies. This diversity ranges from the independence, maturity, and capability for competition authorities, to the legislative base for enforcing anti-competitive practices and policy environments for promoting competition. There are lessons that can be drawn up from competition policy and law experiences across the APEC region, wherein some of these are relevant to both the Philippines and other developing APEC member economies.

In the Philippines, these lessons could be particularly relevant for the Philippine Competition Commission (PCC), given that it is a new institution and recent research has identified that competition authorities reach their

peak effectiveness following their own natural evolution only after about 70 years.<sup>2</sup>

### Policies that affect SME development and competitiveness

The contribution that SMEs make to the economy within higher-middle and lower-income economies varies. In many of the higher-income economies within APEC, SMEs tend to account for a relatively large share of companies and employment, with the notable exception of Japan, where SMEs account for the least number of companies and employment. Conversely, the middle- and lower-income economies tend to have fewer SMEs and lower employment.

The SME sector in the Philippines remains underdeveloped with low number of enterprises and level of employment, compared to other APEC member economies.

Within the APEC region,<sup>3</sup> a number of policies have been identified that influence the ability of SMEs to compete in markets.

These include a broad range of factors such as quality measures related to institutional framework, access to support services, regulation, access to finance, technology transfer, international market expansion, entrepreneurial education and SME political representation. The following section outlines the four priority areas.

#### Business regulation

Business regulation represents one of the most important policies affecting

<sup>1</sup> APEC, (2015) APEC 2015 SME Summit, Innovation and Big Ideas: Pushing Boundaries. Available at: <http://www.apecsmesummit2015.com/>

<sup>2</sup> Bryane Michael and Mark Williams, (2015). "The Cost of Antitrust Law to Malaysia's Financial Services Sector", Ideas. Available at: <https://ideas.repec.org/p/zbw/esprep/107402.html>

<sup>3</sup> Japanese Ministry of Economy, Trade and Industry, (2015). 2014 White Paper on Small and Medium Enterprises in Japan. Available at: [http://www.chusho.meti.go.jp/pamflet/hakusyo/H26/download/2014hakusyo\\_eng.pdf](http://www.chusho.meti.go.jp/pamflet/hakusyo/H26/download/2014hakusyo_eng.pdf)

SMEs' competitiveness. Many APEC member economies still over-regulate businesses, with evidence showing that more competitive economies have less, or better, regulation.

Complex and burdensome registration and licensing systems directly influence the 'ease of doing business'.<sup>4</sup> This creates a disproportionately high barrier to entry for SMEs compared to better-resourced and larger rivals. It is not surprising that Hong Kong and Singapore consistently rank in the highest category of places to do business, as setting up and complying with legal and administrative rules are quick and efficient. In Hong Kong, establishing a business only takes a single day, but it takes up to 28 days in the Philippines.<sup>5</sup>

If APEC member economies wish to promote SME growth and the economic benefits that flow from a vibrant SME sector, they need to consider their own rankings and performance indicators, and seek to reform their internal processes to simplify, quicken, and cheapen the steps needed to register and operate an SME.

As reflected in Table 1, the Philippines ranks below many other regional APEC member economies in relation to ease of doing business.

APEC member economies such the

**Table 1 – Overall ranking on Ease of Doing Business survey among selected APEC member economies**<sup>6</sup>

Economy	Rank
Brunei Darussalam	72
Chinese Taipei	11
China	78
Hong Kong	4
Indonesia	91
Japan	34
Malaysia	23
The Philippines	99
Republic of Korea	5
Singapore	2
Thailand	26
Viet Nam	82

Philippines cannot address competition issues until they remove distortions arising from excessive business regulation.

### Tax policy

Tax policy and procedures directly influence competition in APEC member economies. High taxes can diminish markets at the margin and have the potential to make SME expansion and competition too costly. High tax rates significantly reduce the profit motive for competitive business activity. Such drains on profit prevent more SMEs from starting up or expanding, with high tax rates correlated with low counts of SMEs as a proportion of all businesses and the proportion of SME workers to total employment. The Philippines falls into the upper range of tax rates, potentially demotivating SME employment and market participation.<sup>7</sup>

In addition to tax rates, where the government's administrative procedures for assessing and payment of taxes due are perverted by corrupt officials who 'skim' a percentage of tax paid in cash.

Tax payment procedures could be simplified and automated by utilizing new financial technology so that SMEs can efficiently make payments electronically. This would not only reduce government administrative costs, but also eradicate cash-dependent corrupt practices.

A shift towards pro-competition tax policy in the Philippines will be an important part of efforts to improve implementation of competition policy.

### Financial and banking policy

Financial and banking policies represent important areas in determining the extent of SME competition in the APEC region. Firms can only compete in markets with access to capital. However, numerous APEC member economies have set hurdles for SMEs looking to raise money. For example, approximately 25% of SMEs are unable to obtain finance in the Philippines.<sup>8</sup> As noted in Policy Note 4: Infrastructure, Competition and SMEs, while some banks have pro-SME policies, the SMEs cannot take advantage of them as they do not have collateral that is acceptable to banks to secure the desired loans. Policies that disadvantage SMEs from obtaining finance can distort competition away from the SME sector.

**“The adequate provision of competition policy and law and establishing a ‘level playing field’ is vital in promoting opportunities for SMEs to grow.”**

<sup>4</sup> World Bank, (2017). Doing Business – Why it Matters in Starting a Business. Available at: <http://www.doingbusiness.org/data/exploretopics/starting-a-business/why-matters>

<sup>5</sup> World Bank, (2017). Doing Business – the Philippines. Available at: <http://www.doingbusiness.org/data/exploreeconomies/philippines>

<sup>6</sup> World Bank (2017). Doing Business. Available at: <http://www.doingbusiness.org/>

<sup>7</sup> World Bank, (2013). Philippine Development Report: Creating More and Better Jobs. Available at: <http://documents.worldbank.org/curated/en/895661468092965770/Philippine-development-report-creating-more-and-better-jobs>.

<sup>8</sup> Rafaelita Aldaba, (2012). Small and Medium Enterprises' (SMEs) Access to Finance: Philippines, Philippine Institute for Development Studies Discussion Paper 2012-05.

<sup>9</sup> Korean Monopoly Regulation and Fair Trade Act, Chapter 3 Restriction of the Combination of Enterprises and Control of Economic Power Concentration; this chapter contains very detailed regulations aimed at anticompetitive interconnected intragroup transactions.

## Big business practice

Within developing countries, conglomerates can often be problematic when it comes to allowing access to markets for SMEs. Conglomerates produce large revenues that are often reinvested through subsidiary companies in other domestic sectors, where by cross-contracting between subsidiaries, other businesses are excluded. In the Philippines, certain conglomerates are now expanding outside their core areas. While this might promote competition among conglomerates, it may intensify the exclusionary effects by the extension of network effects of intra-group contracting, thus preventing external firms from competing for these business contracts.

In countries where this problem is particularly acute, for example in the Republic of Korea, specific legal provisions have been enacted to attempt to deal with the concentration of economic power in the hands of a few key players.<sup>9</sup> In Japan and Korea, the competition law has specific provisions that target 'unfair contract terms' between large and small firms, recognizing that unequal bargaining power can lead to anti-competitive outcomes.<sup>10</sup> In this way, both countries have attempted to level the playing field in favor of the SME sector.

## Enforcement

Effective enforcement of competition laws requires a deep understanding of the market structure and behavior of market participants in a specific economy. As the PCA is fairly new and the PCC has only been recently established, the challenge is to ensure that its enforcement actions are informed by these factors. In varying degrees, a number of APEC-member Asian economies are characterized by oligopolistic market structures throughout the stages of development of their competition laws and policies.<sup>11</sup>

As the PCC continues its advocacy and enforcement activities, and based on market data gathered, it should issue specific regulatory guidelines, as may be authorized by the PCA, to guide behavior of market participants. If the PCA is determined to be

inadequate to address oligopolistic market structures, the Philippines should consider amending the PCA to include specific powers to tackle these oligopolistic market structures. Provisions that allow intervention by the competition agency to level the playing field, where tight oligopolistic market structures impede competition or where unfair trading conditions are imposed on the SME sector may be appropriate. The imposition of unjustified discriminatory trading condition and excessively long credit periods have a very negative effect on SME cash flow and profitability. Japan and the Republic of Korea have specific 'unfair' trading laws and special laws on conglomerate oligopolies to specifically benefit the SME sector.<sup>12</sup> Other APEC member economies should also consider whether they also need to consider amending their competition laws to deal with similar problems in their economies to support their SME sectors.

## Lessons for the Philippines

As a new institution, the PCC will take time to mature and establish its credibility. However, identifying relevant lessons from the APEC region could provide the PCC some guidance on how to fast track this process.

**The PCC should focus its attention on priority areas.** While it is important to understand the competition environment at a holistic level, there is a risk of resources and capabilities being used ineffectively if the PCC plans too many activities at the start. The PCC should focus on priority areas. The PCC is advised to:

- Advocate the reform of issues related to business regulation;
- Promote a pro competition tax policy and public procurement policies;
- Improve competition awareness in government and the SME sector including trade associations;
- Consider whether statutory amendments are needed to specifically deal with the conglomerate oligopolistic market structures and 'unfair'

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<sup>9</sup> Article 2, paragraph (9) (v) Japanese Antimonopoly Act; see Guidelines Concerning Abuse of Superior Bargaining Position under the Antimonopoly Act. Available at: [http://www.jftc.go.jp/en/legislation\\_gls/imonopoly\\_guidelines.files/101130GL.pdf](http://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines.files/101130GL.pdf); also Art.23 Monopoly regulation and Fair Trade Act and Guidelines for the Review of Unfair Trade Practices, KFTC, 12 August 2009. Available at: <http://www.ftc.go.kr/eng/solution/skin/dohtml?fn=de27efc48139690012ebc0aacb7b54592e17ade804f6d610fd478a10eb9077e7&rs=/eng/files/data/result/files/bbs/2014/>

<sup>10</sup> Mendoza, Ronald U., Lai-Lynn Angelica Barcenas and Padmini Mahurkar, (2013). "Balancing Industrial Concentration and Competition for Economic Development in Asia: Insights from South Korea, China, India, Indonesia and the Philippines," *Journal of Reviews on Global Economics*, 2, 248-277.

<sup>11</sup> Article 2, paragraph (9) (v) Japanese Antimonopoly Act

commercial contract terms imposed on SMEs by larger trading partners; and

- Consider whether there is a need to create courts, specially mandated to hear and decide on civil and criminal cases on competition.

Based on the experience of other APEC member economies and given the performance of the Philippine economy in these areas, improvements would likely benefit SMEs significantly.

With regards to enforcing the prohibitions contained in the PCA in relation to anti-competitive agreements, abuse of dominance and the anti-competitive mergers, **PCC should concentrate on cartel enforcement in respect of purely local cartels.** This is especially important in the raw materials sector, building supplies, fertilizers, and land transport as well as bid-rigging in the public procurement market. Active promotion of the leniency program would allow the PCC to more easily prosecute active cartels, or in conjunction with the Department of Justice. However, this should not be an immediate priority given the complexities of criminal cases in the Philippines.

**The PCC should work with the APEC Secretariat and other APEC member economies in sharing their experiences.** At a basic level, this should include recording lessons learned and evaluation of key policies and activities. It could also include the commissioning of studies to identify lessons applicable to the larger competition community.

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