

# Cross - Border Competition: Implications for Sri Lanka

Case Studies of Pharmaceutical, Cement Markets and  
Shipping Lines Sector



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## **Case Studies of Pharmaceutical, Cement Markets and Shipping Lines Sector\***

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## List of Abbreviations

CAFTA	Consumer Affairs and Fair Trading Authority Bill
CASA	Ceylon Association of Shipping Agents
CCC	Ceylon Chamber of Commerce
CDDA	Cosmetics, Devices and Drug Authority
CFB	Central Freight Bureau
CIF	Cost, Insurance, Freight
CNS	Central Nervous System
CPA	Consumer Protection Act
CSC	Ceylon Shipping Corporation
CUTS	Consumer Unity and Trust Society
DFID	Department for International Development
DIT	Department for Internal Trade
EMC	Evergreen Marine Corporation
FOB	Free on Board
FTC	Fair Trading Commission
FTCA	Fair Trading Commission Act
FTSE	London Stock Exchange
GDP	Gross Domestic Product
GSK	Glaxo Wellcome SmithKline Beecham
GW	Glaxo Wellcome
HPI	Human Poverty Index
IEE	India Europe Express
IES	India Europe Service
ILFTA	Indo Lanka Free Trade Agreement
IPBC	India, Pakistan, Bangladesh, Ceylon Conference

IPR	Intellectual Property Rights
ISCES	Indian Sub Continent Europe Service
K Line	Kawasaki Kisen Kaisha
MCCL	Mahaweli Marine Cement Co. Ltd.
MISC	Malaysian International Shipping Management Ltd.
NHS	National Health Service
NRG	National Reference Group
NSL	National Security Levy
NYSE	New York Stock Exchange
OTC	Over-the-Counter
PCCL	Puttlam Cement Co. Ltd.
R & D	Research and Development
RCCL	Ruhunu Cement Co. Ltd.
SCI	Shipping Corporation of India
SKB	SmithKline Beecham
SLPA	Sri Lanka Ports Authority
SLSI	Sri Lanka Standards Institution
SPC	State Pharmaceuticals Corporation
SPMC	State Pharmaceuticals Manufacturing Corporation
TCCL	Tokyo Cement Co. Ltd.
TEU	Twenty-foot Equivalent Units
THC	Terminal Handling Charge
TRIPS	Trade Related Aspects of Intellectual Property Rights
YML	Yang Ming Line
ZIM	Zim Israel Navigation Company Ltd.
SLSC	Sri Lankan Shippers' Council

## FOREWORD

Competition policy is not a recent development as is evidenced by the ill-fated charter of the International Trade Organization, the UNCTAD “Set”, and the extensive work carried out by international agencies such as the World Bank and the OECD. The growing importance of the subject is also reflected in the increased number of countries enacting competition laws. Whilst in the early 1980s there were around 20 countries with competition laws, two decades later there are approximately 98 countries with such laws and this number continues to rise.

The recognition of competition law and policy as a vital element in economic policy stems from the shift away from state-led development to a greater reliance on markets, as reflected in measures such as privatization and liberalization. An important normative difference between state involvement in the management of competition for private sector-led development and state-led development lies in the extent of state intervention as well as in the objectives of state participation. Whilst in the latter the state assumes the role of direct provider, in the former the state is a facilitator and regulates with the objective of enhancing competition so as to ensure that the twin objectives of consumer and producer welfare are satisfactorily obtained. As such, the extent of state intervention should also be more muted and focused in the case of competition law and policy.

The ground reality in most developing nations however is far removed from this normative ideal of competition law and policy. The legacy of decades of state intervention is still prevalent and creates a mindset amongst practitioners that is more akin to micromanagement and control by the state than a desire to allow for the forces of the market to operate in a fair manner. At the other extreme, competition authorities lack the “political” power (better expressed perhaps as autonomy), the resources and the skills to control market players that indulge in anti-competitive practices. The situation is further aggravated by the notable absence of an informed civil society conversant with the nature of competition and the types of anti-competitive practices detrimental to consumer welfare.

Sri Lanka has not been immune to these problems as is clearly evidenced in its uneven record in the implementation of competition law and policy. The first steps towards enacting this policy came with the passing of consumer protection and competition legislation in 1979 and 1987, respectively, following the liberalization of the economy in 1977. Since then, there have been numerous and rather ad hoc changes to these laws, corresponding to political regime changes, and very little consistency in their application. The impact of the lack of policy continuity has been a high degree of uncertainty and a lack of confidence both amongst the industry and consumer circles as to the effectiveness of competition law. This reflects the general principle that the mere structural presence of a competition authority and competition law is of little consequence if it is not backed by strong political commitment to the principles of competition.

This publication addresses these shortcomings in the Sri Lankan context by looking at three case studies – pharmaceuticals, cement, and shipping – that touch on cross-border competition issues. Given the increased integration of the world economy — and particularly given the high degree of cross-border economic activity that Sri Lanka as an island economy participates in — the study reflects fundamental and very topical concerns that transcend the boundaries of the case studies themselves. This publication comes out of the second phase of the Comparative Study of Competition Law Regimes of Select Developing Countries of the Commonwealth (7-Up Project) undertaken by the Consumer Unity & Trust Society (CUTS), Jaipur, India, with the support of the Department for International Development (DFID), UK. The Institute of Policy Studies (IPS) and the Law & Society Trust (LST) participated as Sri Lankan country partners for the study.

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## 1. Introduction

Competition policy and legislation have assumed critical importance in the developing world over the past two decades, with the promotion of market liberalization as a means of growth and poverty reduction by the major international aid and trade institutions. As reflected in the case of Sri Lanka, which has seen successive waves of liberalization and privatization since 1977, these economic reforms have not been sufficient to unleash the forces of competition expected to bring about inclusive growth. Dominant entities that restrict competition have remained intact, particularly in the utilities sector, with privatization contributing to market concentration in several instances.

The 7-Up project, implemented by the Consumer Unity and Trust Society (CUTS), Jaipur and sponsored by the Department for International Development (DFID), UK, was an attempt to carry out a comprehensive comparative study of the competition regimes in seven developing countries of the Commonwealth,<sup>1</sup> with the objective of<sup>2</sup>:

- Evaluating the existing competition legislation and its implementation on a few basic principles such as budgets, composition and structure of the competition authority;
- Identifying typical problems and suggesting solutions on the basis of best practice;
- Suggesting ways to strengthen the existing institutional and legal structures dealing with competition issues;
- Assessing the capacity building needs of the government, its agencies and civil society;
- Helping to build constituencies for promoting competition culture by actively involving civil society and other influential entities in the project; and,
- Creating an advocacy group at national and international levels to pursue the necessary and required reforms.

Phase 1 of this project, which ran from December 2000 to September 2001, focused on the institutional and legal framework for competition in the selected countries – the Fair Trading Commission (FTC) and the Department for Internal Trade (DIT) and the Consumer Protection Act No.1 of 1979 (CPA), the Fair Trading Commission Act No.1 of 1987 (FTCA) and the draft Consumer Affairs and Fair Trading Authority Bill (CAFTA), respectively, in Sri Lanka. The findings of this phase revealed that whilst most countries recognize the need for sound competition policy and law that would enhance the economic efficiency and equity potential of the reform process, the framework for competition is weak. This owes to a host of factors ranging from hazy and *ad hoc* policy formulation or the absence of policy prioritization at the macro decision making level to poor regulatory governance at the institutional level and a lack of awareness of the dynamics of the competition process amongst civil society in general.<sup>3</sup>

The second phase of the 7-Up project, dealt with international competition issues concerning developing countries. Particular emphasis was given to anti-competitive practices that countries are exposed to in the process of globalization and to developing country interests in relation to multilateral discussions on competition policy. This phase was carried out by way of a questionnaire highlighting cross-border

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<sup>1</sup> The countries selected for the study were Kenya, Tanzania, Zambia and South Africa in Africa and India, Pakistan and Sri Lanka in South Asia.

<sup>2</sup> See project mandate of the 7-Up project at: <http://cuts.org/7-up-5-progress-report.htm>

<sup>3</sup> For more information on the Phase 1 findings for Sri Lanka, see LST & IPS (2002).

issues, targeting principal stakeholders involved in the national competition policy process and through the information gathered from three case studies with cross-border ramifications.

The following section of this report analyses the questionnaire results (the questionnaire is given in Annex 1) and describes the advocacy efforts carried out in Sri Lanka with respect to competition policy and law by specific stakeholders such as the Competition Authority, civil society, academia and the media. Sections 3 to 6 focus on the three competition cases chosen for Sri Lanka and Section 7 brings together the analysis in the previous two sections in an attempt to set out the key lessons coming out of Phase 2 of the project and maps out a proposed action agenda for key players such as the government/the Competition Authority<sup>4</sup>, consumer organizations, the chambers of commerce, academia, the media and civil society in general, to put in place and sustain an *effective* competition policy regime in Sri Lanka.

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<sup>4</sup> While the authors do agree that this report is dated in terms of the specific institutional arrangements that prevailed at the time of writing, we believe that the lessons on competition policy concerning Sri Lanka, that can be drawn from this report, remain very relevant.

## 2. Advocacy Initiatives

### ***The Phase 2 questionnaire: some insights on competition policy and competition culture in Sri Lanka***

This questionnaire, structured to elicit information on the level of awareness on domestic and international competition policy issues (with a particular emphasis on cross-border aspects), both in the Competition Authority and amongst stakeholder groups ranging from lawyers, economists and academics to chambers of commerce, consumer groups, trade unions and the media, was sent out by the Law & Society Trust and the Institute of Policy Studies to over 30 persons, with completed questionnaires being received from 19 people (excluding the two responses from Competition Authority officials). Given the sample size, a sophisticated analysis of the results is not possible; however, the questionnaire results are useful to the extent that they provide some indication of stakeholder perceptions of competition policy concerns in the country. Furthermore, there is no reason to believe that the results are systematically biased in any way.

The questionnaire results for the Competition Authority revealed the following:

- The law, though adequate for domestic competition concerns is inadequate for cross-border issues;
- The most prevalent anti-competitive practices in Sri Lanka are tied sales, abuse of monopoly / dominant power, resale price maintenance, and spread of misleading information. The fast moving consumer goods industry is the most affected by these practices;
- Whilst the officials were aware of anti-competitive effects on the domestic market by the international vitamins cartel, no action had been taken to stop this (in a similar vein, it was noted that although the GlaxoWellcome – SmithKline Beecham merger could have had an effect on the local market, no action had been taken to investigate the impact of the merger or to prevent the local subsidiaries from merging);
- There is no record of any export cartel operating in Sri Lanka;
- Anti-competitive practices were apparent in the shipping industry and the competition authority had taken action to prevent this;
- Dumping had been observed in the import of shoes but the authority had not taken any remedial action;
- The authority revealed that the Intellectual Property Rights (IPR) provision in the law had been invoked and named domestic companies as being the main offenders; and,
- Sri Lanka has not entered into any formal cooperation agreement with any other country; however, there are instances of *ad hoc* cooperation in training and technical assistance with respect to competition policy. The officials were of the view that cooperation was beneficial to a large extent and that further assistance in the future would be extremely useful.

The questionnaire results for persons other than the Competition Authority indicated a general convergence of opinion with regard to competition policy and law concerns. The main findings of the questionnaire (as also illustrated in the Charts in Annex 2) were that:

- A majority of the persons interviewed were familiar with Sri Lankan competition and consumer law;
- The general perception was that the problem was not in the law itself, but in its implementation;
- A very low percentage of those interviewed were aware of any cartels in the industries named on the survey. Although cartel-like behaviour has been noted in certain sectors (e.g., electric cables, cement, gas / petroleum and the airline industry) there is no firm documentation to prove this;
- In Sri Lanka, the biggest tenders are in the arms and construction industries and are controlled by the government to a large extent. The knowledge of bid rigging in Sri Lanka in these sectors is concentrated within a few professional circles (mainly lawyers and members of the Chamber of Commerce of Sri Lanka);

- There is low awareness of exclusive dealing in consumer durables. Respondents mentioned that there was a possibility of such practice, the examples cited were of the lubricants, flour, LP gas, tobacco and liquor sectors;
- Abuse of dominance has been noted most prominently in the tobacco and food and beverages sectors. Interestingly, some respondents referred to the village market as the locale where such abuse occurs most often. Other areas where this has been noted are the alcohol, gas, telecom and petroleum sectors;
- Unfair trade practices have been noted in the banking sector (many citing the case of the failed take over bid of Sampath Bank by Hatton National Bank). Other sectors mentioned include the gas, floor polish, and liquor industries;
- There is very low awareness of any anti-competitive effects by any of the international mergers / cartels mentioned in the questionnaire. No one was aware of the soda ash or of any other export cartel for that matter;
- Since Sri Lanka is an island nation there is no cross-border road haulage. However, over 60 per cent of those interviewed felt that there were anti-competitive practices such as rate fixing by multi-national firms in the shipping industry;
- There is a relatively high level of abuse apparent in the food and beverages industry - a common example cited was that of Prima, an international feed manufacturer. Another area where abuse was noted by a large number of interviewees was the Shell Gas monopoly, which dominated the market until recently;
- There is a relatively low percentage aware of bid rigging in either the construction or machinery industries. It was noted, that rigging is apparent in several public sector tender processes;
- In comparison to the dairy products sector, (where there is a low level of awareness by dumping<sup>5</sup>) the degree of awareness of “dumping” in the electrical goods sector, especially by China, with several items of varying quality and very low prices being available in the local market - is high. (However, one very interesting example cited with regard to this sector was that milk powder tested positive for radioactive substances was sold in the local market by an international organization; when the media revealed this, the company stopped distributing the milk powder in the local market and apparently shipped the remaining milk powder to another third world country in the region); and,
- The common thread that runs through all the answers to the survey is that the competition authority has not investigated, made public, or taken action where it ought to have.

### ***The National Reference Group meetings: a platform for advocacy***

The National Reference Group (NRG), consisting of various stakeholders such as politicians, competition authority officials, lawyers, economists, consumer groups, the chambers of commerce, trade unions, academics and the media, is an advocacy forum set up in all the project countries to raise awareness on competition policy and consumer protection issues and to help shape a healthy competition culture.

The highlights of the discussions at Sri Lanka’s NRG sessions were as follows:

- In Sri Lanka, the problem lies mainly with the implementation of the competition law and not with the legislation itself. The FTC is weak – and referred to as having “teeth that cannot bite” – not because it lacks legal powers, but because it lacks the authority to implement the law. It is commandeered by a Board of Directors, appointed by the Minister in charge of the FTC, with the Board being subject to frequent change according to the whims of politicians. The result is an institution that lacks initiative, legitimacy and accountability. The DIT suffers from similar problems.

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<sup>5</sup> It must be emphasised that these perceptions of “dumping” differ from the technical definition of price dumping as exporting a product at a price lower than the price charged in the home market and refer more to the loose definition of dumping as the export of cheap/poor quality products.

- The absence of independent sources of finance and the related inability to pay higher wages and attract qualified personnel is a serious obstacle to the efficient functioning of the Commission. Although appeals have been made over the years by the FTC for more funds, these requests have been turned down by the Treasury on the basis that the proposed Consumer Affairs and Fair Trading Authority (CAFTA), expected to attract donor funding, would resolve the problem of deficient finances.
- The setting up of CAFTA – an entity intended to handle both competition policy and consumer protection issues- has been in the pipeline for nearly a decade, with successive policy regimes placing it on the back burner for various political reasons. The priority for civil society groups at this juncture ought to be to push for the immediate establishment of CAFTA.
- The problem with regard to consumer protection in Sri Lanka is multifaceted. There is a lack of awareness on consumer rights amongst the general public. In addition however, even if a consumer were aware of his/her rights, there is no forum to which he/she can address complaints. Therefore, building up strong consumer organizations and disseminating information on competition policy and consumer protection is a priority. Options such as a tribunal commission or a consumer court system as in the case of India also need to be considered.

### ***Other advocacy efforts***

In general, there has been little meaningful advocacy work carried out by the competition authority, largely because of institutional lethargy due to a lack of independence and the paucity of funds. The single public document published by the Commission, its annual report, is rarely available for perusal since budgetary limitations do not allow for the printing of sufficient copies.

Advocacy by civil society groups with regard to competition policy and consumer protection issues has been imperceptible mainly because of the lack of organized consumer groups and the low level of awareness about competition policy issues amongst the general public. The civil war that has plagued the nation for over two decades has also had its toll on the level of priority accorded to issues such as competition policy.

The few advocacy activities that have been carried out have been initiated by the academia. The media has largely taken a reporting, as opposed to an advocating, stance, highlighting issues relating to competition and consumer concerns contained in publications or documents put out by the academic community. The contribution of the academic community is best reflected in the groundbreaking publication initiated by the Law & Society Trust in 1992 – *Consumer Protection and Fair Trading in Sri Lanka* – that recommended *inter alia* the amalgamation of competition policy and consumer protection activities, the separation of investigative and quasi-judicial functions, and the inclusion of powers on extra territorial jurisdiction in the competition authority's ambit (*Kelegama and Cassie-Chetty, 1993*). This report acted as a catalyst for a flurry of activities at the policy level, including the drafting of a new piece of legislation, the Consumer Affairs and Fair Trading Authority Bill. However, the time span of almost a decade between the pioneering document, the initial drafting of the law and its formal inclusion in the policy agenda indicates the degree of political interference that comes between policy formulation and policy implementation in this country.

More recently, the Institute of Policy Studies and the Law & Society Trust have made several representations to policy makers on CAFTA and on the state of consumer affairs in Sri Lanka. To a large extent the views expressed by these two research institutions reflect those of the NRG as well as those perceived to be best practice in other countries that have had to make similar choices relating to

competition policy and consumer protection issues. Two advocacy briefs prepared by these institutions for policy makers are attached in Annex 3 of this report. The report on the Glaxo Wellcome- SmithKline Beecham (GSK) merger in Section 4 was also a pilot study done to meet the competition authority's demand for sector analysis in the pharmaceutical industry.

### 3. The Competition Case Studies – A Brief Overview

The three competition cases reviewed under the second phase of the 7-Up project in Sri Lanka are:

- The impact of the GSK merger on the respiratory segment of Sri Lanka's pharmaceutical market;
- Legal and economic dimensions of Sri Lanka's cement market activities; and,
- Anti-competitive practices in the Sri Lankan shipping liner sector.

As reflected in the second phase questionnaire results, very few stakeholders are aware of the significance of cross-border competition concerns. As such, this is not an area that has provoked much public debate in Sri Lanka. It is also an area that has largely been ignored by policy makers. While the current competition legislation allows for the use of the effects doctrine in cross-border cases, this provision has been of little use in practice given the perception amongst policy makers and competition authority officials that it would be counter productive for a small island economy to challenge the anti-competitive activities of major players in the global market.

**The case study on the GlaxoSmithKline (GSK) merger** is one instance where such cross-border issues came into play. Glaxo Wellcome (GW) and SmithKline Beecham (SKB) merged to form GSK in the year 2000. GSK is considered a market leader and enjoys 7.3 per cent of the world's pharmaceutical market. Although in Sri Lanka, GSK enjoys 12 per cent of the total market share, the overall percentage is less indicative of competition concerns, given that the industry is made up of a number of individual products and product groups, which target separate groups of consumers. The case study focused on the respiratory market where GSK has leadership in 2 of 12 products and is the sole supplier of 3 products.

The competition concerns that arose in Sri Lanka due to this international merger are many. Firstly, it increased the suppliers' concentration in a relatively small domestic market. On the other hand, although the merger has taken place, the two companies still remain as legally separate entities (as an interim measure). The effect of such an arrangement on competition policy, especially with regard to anti-competitive practices such as collusive behaviour, is ambiguous and uncertain. Further, in Sri Lanka the role of a doctor is an important one that has a huge impact on the market; in most cases the concept of informed choice for a consumer is absent and there is an absolute reliance on what the doctor prescribes. Past practices of the bigger and better resourced pharmaceutical companies and especially that of Glaxo Wellcome has shown that the companies tend to 'win over' the doctors by offering them gifts for recommending their brands. There is more room for such practices with the creation of GSK, which will have a larger budget and more avenues for promotional activities.

The above-mentioned competition concerns were not analyzed or studied by the competition authority. While GW reported the merger and a preliminary report was prepared by the FTC, the request for further information was not complied with by GW. Although the FTC had the power to penalize them in such a situation, it refrained from further investigation; one reason being that the FTC was of the view that the merger was outside the jurisdiction of the authority. However, further research has unearthed reasons such as the premise that a local competition authority will have little clout in the face of an international merger and also a strong indication that there was considerable political resistance to the investigation of the merger. In general, an ineffectiveness of the FTC can be noted. This is seen in the GSK merger where the FTC stated that one factor which obviated further investigation was that it appeared to them there was no reason to suspect any anti-competitive practices. The same attitude can be traced through the other two case studies.

In the **cement case study**, the main issue was the international cement giant Holcim's acquisition of two local cement companies. The acquisition increased the market share of the company to 38 per cent. However, there were many new entrants to the market and there was no indication of any barriers to entry. Our research has shown that although there is no formal appearance of a cartel, there seems to be an informal arrangement among the companies.

Here again, there was not even a minimal level of action by the FTC. FTC claims that the mandatory pre-merger notification requirement under section 9A of the FTC Act was not complied with. However, Holcim states that it did report the acquisition to the FTC. The situation being thus, the FTC took no steps to ensure from their side that the law was abided with. It was also found out that many companies do not comply with the mandatory notification requirement.

The study on **Sri Lanka's liner shipping industry** focused on the levying of a terminal handling charge (THC) on all exports by the Ceylon Association of Shipping Agents (CASA). CASA accounts for around 94 per cent of active agents in the industry, handling around 90 per cent of the exports. Therefore, decisions taken by CASA directly affect the shipping industry in Sri Lanka.

The anti-competitive conduct arose from a circular issued by CASA, which directed all its members to levy a THC on all exports as a separate component of the freight charge. This was contrary to the usual practice of levying the fee on the buyer and several exporters' associations complained to the FTC that CASA was acting in a collusive manner with a view to maintain high costs. The exporters also voiced their grievances as the additional levy of THC prevents them from securing ocean carriage services at competitive rates. On the other hand, CASA has pointed out that there exist many justifications such as the costs incurred by ship owners and the prevalence of this activity throughout the world, to defend their stance.

In this case study too, the unenthusiastic position of the FTC can be seen. The action in this case was brought under Section 14 of the FTC Act, which provides for anti-competitive practices. The FTC in this instance, refused to take action against this alleged collusive behaviour. Their reasoning referred to the fact that the THC was applied to all exports, thus not having a negative effect on competition policy. The FTC went on to state that since the THC was not *added* to the freight charge (and treated as a separate component) it would have no impact on the competitiveness of Sri Lanka's exports. Such a finding indeed defies logic and merely reflects the apathetic attitude of the FTC.

The above decision was subjected to much criticism and at a further investigation by the FTC, THC was held to be anti-competitive. Following this decision, CASA filed an appeal to quash the decision stating that the FTC has no jurisdiction over international shipping lines. CASA later issued a circular stating that it no longer imposes THC but any such levy will be an agreement between the shipper and the shipping line. As at the time of writing, THC is being charged by the shipping lines and was subjected to an increase recently.

The two investigations made by the FTC in the above case reflect two important issues. In the first instance, the FTC refused to recognize THC as an anti-competitive practice, which clearly reflected the inadequacy of the role played by the competition authority. However, at the second investigation although the FTC held that the THC was an anti-competitive practice, it lacked the ability to ensure that the decision was enforced.

As seen in these three cases, the principal problems facing the competition authority in exercising its powers relate to political interference, the lack of sufficient resources and a lack of legitimacy. Moreover, no effort was made by the authority to explore the option of seeking foreign cooperation for resolving any of these competition cases – an option that would have facilitated economies of scope with regard to the regulatory inputs and expertise required to handle such competition cases. Another important aspect to consider, mainly from a law reform point of view, would be to provide for a more efficient mechanism to ensure the enforcement of the decisions of the FTC.

## 4. Case Study 1: A Preliminary Impact Assessment of the Glaxo Wellcome-SmithKline Beecham International Merger on the Respiratory Segment of Sri Lanka's Pharmaceutical Market<sup>6</sup>

### 4.1 Introduction

#### 4.1.1 *The International Merger*

GlaxoSmithKline was formed on December 27th 2000 and commenced trading with the symbol GSK on the London Stock Exchange (FTSE) and the New York Stock Exchange (NYSE) (Box 1 indicates some significant milestones in the merger process). The main rationale behind the merger was the need for a significant level of investment in the skills, technology and expertise necessary to generate sustainable long-term growth in an increasingly competitive environment. The successful completion of the merger of Glaxo Wellcome (GW) and SmithKline Beecham (SKB), created a world-leading, research-based pharmaceutical company with sales of £18.1 billion in the year 2000. Upon completion of the merger, the shareholders of Glaxo Wellcome were given 58.75 per cent and those of SmithKline Beecham 41.25 per cent of the newly formed entity.<sup>7</sup>

With headquarters in the UK and worldwide operations, GlaxoSmithKline (GSK) supplies products in over 140 markets around the world. The company is an industry leader with an estimated 7.3 per cent of the world's pharmaceutical market.<sup>8</sup> GSK has leadership in four of the five largest therapeutic areas – anti-infective, central nervous system (CNS), respiratory and gastro-intestinal/metabolic. In addition, it is a leader in the important area of vaccines and has a growing portfolio of oncology products. The company also has a consumer health care range comprising over-the-counter (OTC) medicines, oral care products and nutritional health care drinks, all of which are among the market leaders.

#### 4.1.2 *Domestic Merger Arrangements*

In Sri Lanka, GW is a public listed company, strong in the pharmaceuticals market and SKB is a private company that is a major player in the consumer products market. In January 2000, GW notified the competition authority – the Fair Trading Commission (FTC) – of the proposed international merger.<sup>9</sup> However, although the respective parent companies legally merged the following year, the two subsidiary companies continue to operate as separate legal entities, whilst sharing a common GSK logo. These interim arrangements are to continue, pending firm proposals on the merger of individual national operations being prepared by a special "integration team", jointly chaired by the respective heads of the local operations.

While maintaining separate legal identities, the domestic subsidiaries function as one entity for operational purposes with respect to most pharmaceuticals, following a post-merger restructuring process. In the local market, SKB focuses largely on consumer products such as Horlicks, Viva and

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<sup>6</sup> The author, Malathy Knight John, is currently employed as a Research Fellow at the Institute of Policy Studies (IPS). The excellent research assistance provided by Sanjiv Alles and P.P.A. Wasantha is gratefully acknowledged.

<sup>7</sup> [www.glaxowellcome.co.uk](http://www.glaxowellcome.co.uk)

<sup>8</sup> <http://corp.gsk.com/ehs/about.htm>

<sup>9</sup> Officials of the FTC consider this reporting of the proposed merger to be a sign of greater cooperation between the companies and the competition authority, given that in the previous Glaxo – Burroughs Wellcome merger, it was the FTC that had to initiate a request for information from the merging parties.

#### Box 4.1: Important Dates in the Merger Agreement

January 8th 2001	- Legal merger between the two companies
December 27, 2000	- GlaxoSmithKline PLC - commencement of dealings
December 20, 2000	- UK High Court sanctions merger
December 18, 2000	- US regulatory clearance obtained
December 12, 2000	- Completion planned for December 27, 2000
August 31, 2000	- SmithKline Beecham sells Kytril to Roche, Famvir and Vectavir/ Denavir to Novartis
July 23, 2000	- Senior executive appointments announced for GlaxoSmithKline– Part 2
July 5, 2000	- Publication of GlaxoSmithKline merger documentation
July 3, 2000	- Senior executive appointments announced for GlaxoSmithKline– Part 1
May 10, 2000	- Glaxo Wellcome and SmithKline Beecham announce consolidation of management, commercial and administrative sites in South-East England from ten sites to three for the combined GlaxoSmithKline PLC
May 8, 2000	- European Commission approves merger of Glaxo Wellcome and SmithKline Beecham
February 3, 2000	- GlaxoSmithKline executive team announced
January 17, 2000	- Proposed merger of Glaxo Wellcome and SmithKline Beecham creating the global leader in pharmaceuticals

Source: <http://corp.gsk.com/about/mergerinfo.htm>

Ribena and OTC drugs such as Panadol; it has an insignificant presence in the prescription drugs market. Subsequent to the international merger, SKB's prescription drugs segment was combined with GW's pharmaceutical portfolio while SKB retained its consumer products and OTC range.

Some other changes brought in to exploit economies of scale and scope and make the two entities more efficient are the joint sharing of resources like finance, human resources, information technology, purchasing and warehousing. The domestic merger arrangements have brought about very few job losses and any retrenchment of redundant workers was carried out by way of voluntary retirement schemes.<sup>10</sup>

#### 4.1.3 Scope and Limitations of Study

This study focuses specifically on the impact of the GSK merger on Sri Lanka's respiratory drug market. It is important to note at the very outset that the GSK international merger was not investigated by the FTC for reasons that will be expanded on in Section 4 of this report. The choice of the respiratory

<sup>10</sup> Sri Lankan labour law in its current form makes it very difficult to actually "lay off" workers.

market as a subject for this study was one made by the FTC and the author worked in close collaboration with the competition authority in carrying out this research.<sup>11</sup>

As such, this report is more than an academic exercise; it is an attempt to highlight practical competition policy issues relating to the sector. It is also an initial effort to meet the competition authority's demand for sound sector analysis. However, difficulties in securing reliable data from the target companies and their competitors, and the non-availability of sector-specific information or databases at the competition authority are a major limitation when conducting this type of research in Sri Lanka. This study therefore, should be viewed more as a preliminary exercise that sets out the general parameters to be further refined and tested rather than as a final conclusive one.

The study is structured as follows. The next Section 4.2 lays out the structure of Sri Lanka's pharmaceutical market and the regulatory framework governing it. It also describes the legal provisions dealing with international mergers and posits some competition concerns. Section 4.3 sets out an economic impact analysis of the GSK merger on the country's respiratory market, in line with the competition issues raised in Section 4.2. Section 4.4 deals with the competition authority's non-investigation of the merger and Section 4.5 concludes.

## **4.2 Sri Lanka's Pharmaceutical Industry**

### **4.2.1 Market Structure**

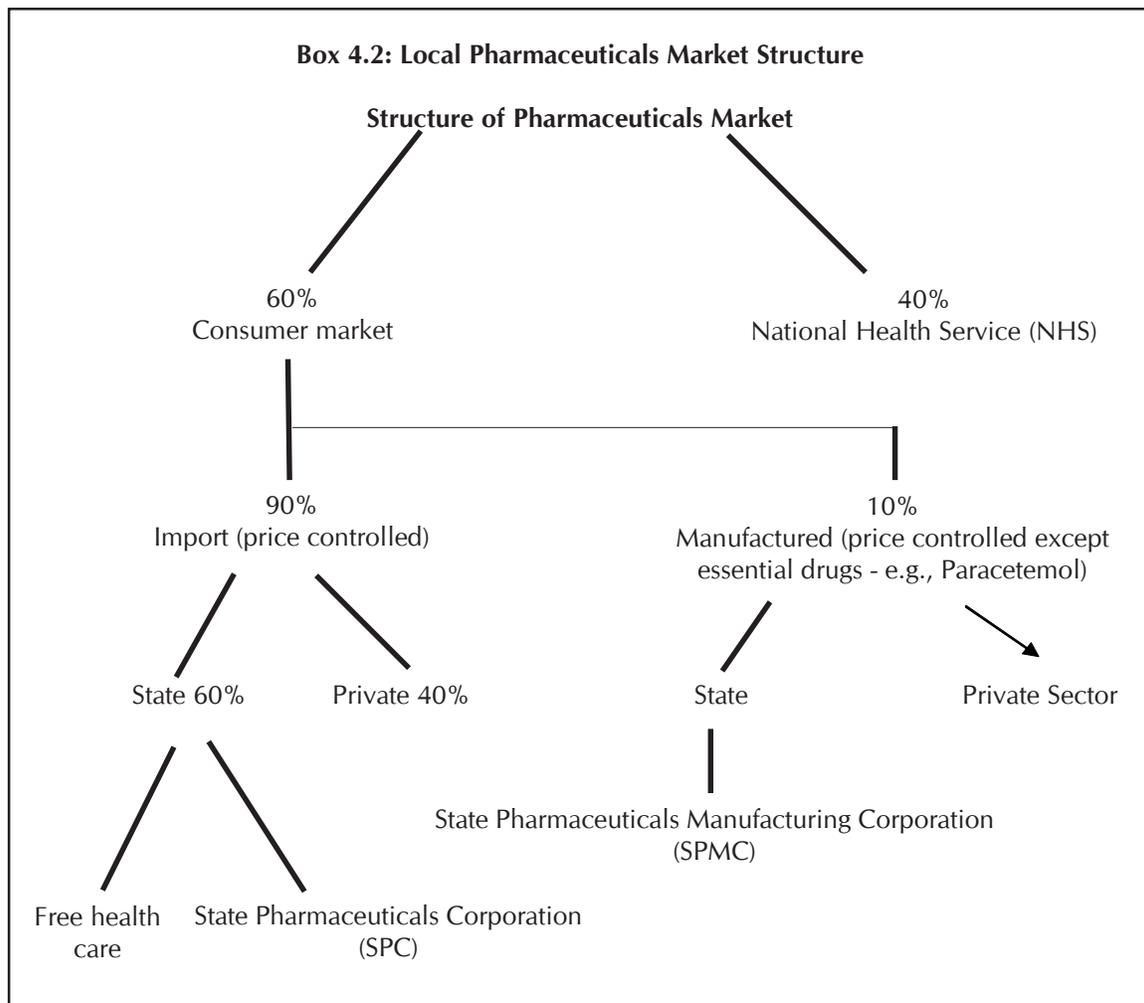
The relevant geographical market with respect to the pharmaceutical industry is sometimes subject to question, given the high degree of research and development (R & D) expenditure in the sector that transcends national boundaries. However, the position adopted in this study is that the geographical market for the sale of pharmaceutical products is the national market – in this case, the Sri Lankan market. The justification for this approach is that national health care, distribution and marketing systems and national approaches to price and quality regulations govern the sale of drugs. As mentioned above, the specific product market for this study is the respiratory segment, which will be dealt with in detail in the next section.

Box 4.2 illustrates the structure of the total pharmaceutical industry.

As outlined in Box 4.2, the consumer market relies mainly on imports with very few local manufacturers. The State Pharmaceuticals Manufacturing Corporation (SPMC) is the main manufacturer in the local market. The private sector consists of a few companies, the largest being GW, Astron and Gamma. However, out of these organizations only SPMC and Gamma manufacture drugs whilst the others serve mostly as repackaging and distributing centres.

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<sup>11</sup> The respiratory product market is delineated as such for practical reasons relating to data availability, rather than because it has been established a priori as a relevant market in a legal sense.



Source: Information gathered from interviews with industry representatives.

The state is also the largest importer of drugs controlling 60 per cent of the market, supplying most of the drugs to the National Health Service (NHS) for free health care, and the rest for trading by the SPC. The remaining 40 per cent of the market is controlled by the private sector. The main players in this arena are Bauris, Hemas, GSK and Astron.

According to industry representatives, the largest market share in imports by the private sector is held by Hemas and Bauris, dispelling any notion of GSK holding a monopoly market-controlling position in the pharmaceutical industry as a whole. This is largely due to the fact that GSK only imports its own products while the other organizations act as agencies for a number of companies, thus having a larger portfolio. GSK currently has approximately 12 per cent of the total retail market (prior to the operational restructuring process, GW held around 9 per cent of this market). However, it is important to note here that market shares for the industry as a whole are less indicative than those for particular market segments or product markets, given that the industry is made up of a range of individual products and product groups.

Growth in the industry averages approximately 4-5 companies per annum.<sup>12</sup> The small size of the domestic market and the dearth of capital for R&D expenditure are some of the reasons for the slow growth of this sector. Table 4.1 indicates the sourcing of pharmaceutical imports. As pointed out in this Table, there has been a shift from western to developing country imports in the last decade, with India accounting for a major share of these imports over the years.

**Table 4.1: Share of Pharmaceutical Imports by Origin (%)**

Country	1990	1995	2000
India	12.8	30.9	42.9
UK	15.3	12.8	9.5
Switzerland	6.1	5.2	5.6
Pakistan	6.0	3.8	4.5
Malaysia	1.9	4.3	4.4
Netherlands	1.8	3.1	4.0
Belgium	4.6	3.7	3.2
Germany	16.1	4.3	2.8
France	2.1	1.7	2.7
Ireland	0.2	1.2	2.5
Indonesia	1.1	1.2	2.4
Thailand	1.3	1.8	1.9

Source: Institute of Policy Studies (2001) citing Department of Customs, Sri Lanka.

#### **4.2.2 Regulatory Arrangements**

The pharmaceutical industry is regulated by three separate entities. The Fair Trading Commission sets the price of imported drugs using a drug pricing formula (shown in Table 4.2)<sup>13</sup>; the Department of Internal Trade (DIT) is responsible for price surveillance; and, the Cosmetics, Devices and Drug Authority (CDDA) registers imported drugs and looks into safety standards.

There are significant problems relating to the regulation of price and quality of pharmaceutical products sold in the Sri Lankan market that impact on competition in the industry. In practice, there is to a large extent, an overlapping of functions amongst these three entities that complicates the regulatory structure in the sector. In addition, the cost-plus formula shown above fails to regulate the price of drugs in the domestic market since the retail price is based on the CIF value, which is subject to change. There is also a high incidence of over-invoicing in the case of expensive drugs, to manipulate the CIF base.

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<sup>12</sup> Institute of Policy Studies, 2001.

<sup>13</sup> Prices of locally manufactured drugs are fixed by the FTC on a case-by-case basis. Prices are based on total cost with a staggered mark-up that operates on the amount of value-addition.

**Table 4.2: Cost-plus Basis Pricing of Imported Pharmaceuticals**

	(Percent)
Cost, insurance, freight (CIF)	100.00
Stamp duty (2%)	2.00
Clearing charges (3%)	3.00
National Security Levy	0.00 + <b>8.125</b>
Importer's cost & margin (25%)	105.00 + <b>8.125</b>
	26.25
Importer's price	131.25 + <b>8.125</b>
Wholesaler's margin (8.5% on importer's price)	11.16
Wholesale price	142.41 + <b>8.125</b>
Retailer's margin (16.25% on wholesale price)	23.14
<b>Retail price</b>	<b>165.55 + 8.125</b>

Note: The formula is with a National Security Levy (NSL) of 6.5%. If the CIF were Rs. 100/= the National Security Levy (NSL) would be  $(100 + 25\%) * 6.5\% = \text{Rs.}8.125$ .

Source: FTC.

This negates the objective of regulating drug prices, which is to ensure that the public has access to drugs at affordable prices.<sup>14</sup>

In a recent policy initiative, the government has decided to permit parallel imports of branded drugs with the aim of bringing down prices through increased competition. This move will be operative for an initial six-month period during which time the price control mechanism will not be used and the FTC will be expected to closely monitor the market to assess the efficacy of the new measures. The proposal to allow parallel imports has been vehemently opposed by companies such as GSK on the grounds that it could lead to the sale of counterfeit or substandard products in the absence of sound quality regulation.

Although these protests are linked to the inevitable erosion of the market power that these multinational companies have over particular branded products cannot be discounted, the dismal conditions that govern the quality regulation process are also a serious consideration. At present, approximately 2200 different drugs (3000 – 3500 different dosage forms) are imported and marketed in Sri Lanka.<sup>15</sup> The registration of a new drug takes almost one year and involves tedious bureaucratic procedures. This has led to an increased circulation of unregistered drugs that undermines the objective of quality regulation to ensure the supply of safe drugs to the public.

<sup>14</sup> Pharmaceuticals are the only products subject to price control in Sri Lanka.

<sup>15</sup> Institute of Policy Studies, 2001.

### 4.2.3 Legal Framework

Sri Lanka's current competition legislation – the Fair Trading Commission Act No. 1 of 1987 (FTCA)– provides for the investigation of “*the creation or possible creation of a merger situation*” under Section 13.<sup>16</sup> A merger is defined here as when “*a person, whether a body corporate or not, acquires or proposes to acquire, directly or indirectly, any shares in the capital or in the assets of a body corporate or of any other person, if, as a result of the acquisition or proposed acquisition such first-mentioned person would be, or be likely to be, in a position to control or dominate a market for goods or services; or in a case where such first-mentioned person is in a position to control or dominate a market for goods and services*”....there exists “*a competitor of the first-mentioned person....and the acquisition or proposed acquisition would or would be likely to substantially strengthen the power of the first-mentioned person to control or dominate that market.*”<sup>17</sup>

But the existence of a merger situation alone does not make a transaction contrary to the provisions of Section 13 of the Act; it must be inimical to public interest. The FTCA however, fails to set out what constitutes public interest, leaving this to the realm of ad hoc decision-making. Procedurally, all mergers and potential mergers have to be notified in writing to the competition authority and the FTC has the power to investigate mergers either on its own accord or on a complaint made. Although the law is strictly territorial in application, an international merger that could have an impact on the domestic market through the operations of its local subsidiaries – such as the case of GSK – can be investigated using the effects doctrine. The proposed Consumer Protection Authority Bill (CPA), which is set to repeal the FTCA, the Consumer Protection Act No. 1 of 1979 and the Control of Prices Act No.29 of 1950, envisages no major changes with regard to these legal provisions governing mergers.

### 4.2.4 Competition Concerns

This section looks at some general competition issues in the pharmaceutical industry that need to be taken into consideration when analyzing the impacts of the GSK merger on the respiratory market in the following section. First, the amalgamation of GW's and SKB's pharmaceutical operations increases supplier concentration in what is already a relatively small domestic market.<sup>18</sup> Further, given the fact that the two firms still maintain separate legal identities, the impact on competition in the industry is ambiguous and the possibility of the firms engaging in collusive behaviour does exist. It must be noted however, that it is not the prevalence of market power in itself, but rather the use of such power to engage in anti-competitive behaviour that is in question here.

The ambiguities surrounding competition in the pharmaceutical industry are further compounded by two other factors: the blurring of the distinction between prescription and OTC drugs and the role of doctors in brand drug-pushing in Sri Lanka. In the former instance, it is common for a local pharmacist not to rely on a prescription to distribute medicines. For instance, “prescription only” drugs such as Valium and certain antibiotics are freely available as OTC medication. This practice makes it difficult to ascertain the actual market share of a company in a particular market segment.

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<sup>16</sup> Government of Sri Lanka, 1987.

<sup>17</sup> *ibid.*

<sup>18</sup> Although data gaps prevent the calculation of a firm concentration ratio, competitors in the industry are of the opinion that the amalgamation would increase supplier concentration. Representatives of GSK also acknowledge this possibility.

The role of doctors in driving market segmentation and brand promotion is also a serious issue in Sri Lanka. The concept of informed choice for the consumer is absent in this industry; instead, consumers tend to rely blindly on the drugs that doctors prescribe to be the most appropriate. Therefore, for all practical purposes it is doctors that function as the “distribution channels” for pharmaceutical companies; and it is the companies that have deeper pockets and can “win over” the doctors by offering a number of gift items for recommending their brands that emerge as the big players in the industry. This strong doctor-company nexus and the lack of informed choice for the consumer makes the pharmaceutical industry in Sri Lanka a seller’s market.

There is a noted instance where GW actually gifted an apparatus to a local hospital, which only operated using their products (tied sales). In fact, industry specialists and representatives claim that GW has a reputation for distributing a lot of promotional items, such as airline tickets, to doctors. It is possible that the use of such strategies will increase with the merger of the two companies, given that GSK would have a larger budget / more avenues for promotion than before.

A related concern with respect to the consumer is whether the average consumer is price or quality sensitive with respect to pharmaceutical products. Here there have been contradictory claims in the industry with GSK representatives asserting that the consumer is price sensitive and other industry specialists asserting that the consumer really has very little choice and depends almost entirely on the doctor’s recommendation. GSK’s claims relate to what they perceive as “low-quality, low-price” competition from Indian pharmaceutical products and from the generics marketed by the SPC.

Another complaint voiced by GSK and other multinational pharmaceutical companies operating in Sri Lanka, such as Astra Zeneca, is that they are subject to unfair competition due to companies that are agents for Indian principals like Cipla not complying with the TRIPS agreement. The counter argument put forward by these smaller companies is that these Indian drugs are immune to the patent law until 2005, which is the transitional period offered to all countries under TRIPS, and that the marketing of these cheaper branded products is vital in a country like Sri Lanka (where per capita income is a mere US \$ 841 and the Human Poverty Index (HPI) is approximately 20.3).<sup>19</sup> However, the whole TRIPS debate and the impact that this Agreement would have in the medium to long-term has yet to be seriously addressed by Sri Lankan policy makers.

#### **4.3 Effects of the Merger on the Respiratory Market**

The objective of this section is to set out a preliminary economic impact assessment of the GSK merger on Sri Lanka’s respiratory market, taking into consideration the competition policy issues relating to the pharmaceutical industry raised in the previous sections. Before going into the specific questions to be analyzed here, it must be noted that there have been no complaints made to the FTC or to the DIT regarding any increase in price or deterioration in quality of GSK’s respiratory products following the merger.

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<sup>19</sup> Given that Sri Lanka’s drug manufacturing sector is very small and that it imports most of its pharmaceutical requirements from India, this patent immunity has an impact on pharmaceutical prices in Sri Lanka. Sri Lanka’s obligations under TRIPS are to extend the patent period on pharmaceuticals from 15 to 20 years and to get the national intellectual property legislation in line with TRIPS requirements. (Although this was to have been completed by December 1999, the exercise is only nearing completion now)

### 4.3.1 Respiratory Market Structure

A description of Sri Lanka's respiratory market segment is given in Tables 4.3 and 4.4. As indicated in Table 4.3, the respiratory segment has a significant share of the country's total pharmaceutical consumption.<sup>20</sup> Further, as shown in Table 4.4 respiratory imports by the state as against private sector imports have increased from 1999 to 2001 because of a policy of aggressive product marketing adopted by the government.

**Table 4.3: Respiratory Segment as a Percentage of Total Pharmaceutical Imports**

Year	Total pharmaceutical Imports (Rs. Million)	Value of respiratory Imports (Rs. Million)	Respiratory segment As a % of total Pharmaceutical imports
2000	6365	376	5.9
2001	7565	314	4.15

Source: Calculated from SPC data.

**Table 4.4: State and Private Sector Shares in Respiratory Market (%)**

Year	Private sector imports (Rs. Million)	State sector imports (Rs. Million)	% of state as against private sector
1999	1256	66	5.25
2000	316	60	18.98
2001	236	78	33.05

Source: Calculated from SPC data.

Table 4.5, which details some aspects of GSK's respiratory segment profile, indicates that this segment is an important component in GSK's local operations. It must be noted here that the numbers for the respiratory segment given here pertain to GW's respiratory portfolio; SKB does not have a respiratory range. GSK representatives claim that the increase in the respiratory segment share of total company imports from 13.9 per cent to 44.5 per cent following the merger is due to some successful line extensions and the introduction of some new products.

Given that product-specific details provide a clearer picture of key competition policy issues such as market leadership, price behaviour, substitutability, contestability etc. the next section looks at the particular product range marketed by GSK.

<sup>20</sup> As stated earlier on in this report, the country's pharmaceutical manufacturing base is relatively insignificant when compared to its pharmaceutical imports. A simplifying assumption is also made here that all pharmaceutical imports are sold and consumed.

**Table 4.5: GSK Respiratory Segment Profile**

Year	Respiratory segment as a % of total company imports	Respiratory segment as a % of total company revenue	Respiratory segment as a % of total company pharmaceutical revenue
1999	11.8	NA	NA
2000	13.9	6.3	7.5
2001	44.5	NA	NA

NA = not available.

Source: Calculated from SPC data and from GW Annual Reports.

### 4.3.2 GSK Respiratory Product Profile

A list of GSK's respiratory products and their competing brands and companies is given in Table 4.6. As indicated in this Table, GSK has market leadership in two and a monopoly position in three of the twelve products that it sells in Sri Lanka. Further, GSK's respiratory product market is closely contested by just four companies: Bhurani, City Health, Emerchemi and the SPC. An important factor that must be noted here is that there are no overlapping products from GW and SKB in this segment since SKB does not have a respiratory range. This also implies that the merger in itself is likely to have little impact on competition in this segment in the short-term; the impact over the long-term depends on the extent to which the combined R & D capabilities of the two companies enhances GSK's product strength in the respiratory market. The next section evaluates the short-term impact of the merger on the respiratory market in greater detail.

**Table 4.6: Respiratory Products Sold by GSK and Competing Companies**

GSK product	Competing brand	Competing company (local agent)	GSK market rank
1. Becotide Inhaler	Beclate Inhaler	Cipla (City Health)	7
2. Becloforte Inhaler	Clenil Fotre	Cheisi (Bhurani)	5
3. Becodisk	1. Beclate 2. Cycloson	1. Cipla 2. Pharbita (Emerchemi)	6
4. Flixotide	Flohale	Cipla	8
5. Serevent	1. Salmeter 2. Serobid	1. Dr. Reddy (Emerchemi) 2. Cipla	14
6. Seretide	None	None	
7. Flixonase	Budecort	Pharbita	6
8. Volumatic Spacer	Cipla Spacer	Cipla	1
9. Babyhaler	None	None	
10. Ventodisk	Cybutol	Pharbita	NA
11. Ventolin	Salbutamol – generic product	SPC	1
12. Volmax	None	None	

NA = not available.

Source: Information compiled from SPC database and from interviews with GSK and competing company representatives.

### 4.3.3 Competition Policy Issues in the Respiratory Market

#### Pricing

Tables 4.7 and 4.8 show percentage price changes for particular GSK products and price variations between companies, respectively.

A noticeable feature in the price trends shown in Table 4.7 is the percentage increase for all these products in the 2000-2001 period. However, although these price changes coincide with the operational amalgamation of GW and SKB, it is very likely that the increases are due to the depreciation of the Sri Lankan rupee following a policy decision in January 2001 to move to a floating rate regime.<sup>21</sup> The argument that the price increases were caused by these external factors rather than by the merger is further strengthened by the fact that the relatively greater price change of 24.28 per cent is seen in the case of the drug Serevent which, as shown in Table 4.6 above, has a market ranking of only 14 as opposed to Ventolin for which GSK has market leadership in Sri Lanka.

**Table 4.7: Price Trends for Some Specific GSK Respiratory Products (% change)**

Item	1997-1998	1998-1999	1999-2000	2000-2001
Becotide Inhaler (Beclomethoson Oral Inhaler 50 MCG / 200Ds )	- 15.07	7.35	9.27	17.34
Serevent (Salmeterol Inhaler 25 MCG / 120Ds)	3.72	7.57	3.83	24.28
Ventolin (Salbutamol Respiratory Solution 10 ML)	6.57	9.87	10.11	17.34

Source: SPC database

As pointed out in Table 4.8, there is a huge price difference between GSK brands and Indian brands and generic products. This is evident even in the case of the drug Serevent that has a relatively weak position in the market. As such, this price difference could stem from the fact that the Indian principals who market their products in Sri Lanka do not have to deal with the patent issues that confront the other multinational companies as of now.

Given the price differential in these segments there is little evidence of any collusive price leadership behaviour. Moreover, GSK's unit prices are applicable across the board indicating that price discrimination is also not practised within the Sri Lankan national market. The question then is, how

<sup>21</sup> The degree of depreciation in the six-month period from June-December 2000 was about 14 per cent and the degree of depreciation from January to December 2001 was approximately 11 per cent.

does GSK compete in these segments given the clear price advantage that companies such as Cipla have? At present, GSK focuses on brand identity and loyalty to market its products and caters to only a small segment of society, the more affluent income group, whilst companies such as Cipla and Emerchemi use their price advantage to capture a larger share of the market. The picture that emerges therefore is that GSK actually has a relatively weak position at present in Sri Lanka's respiratory market. It is only in the long run, when any R&D impacts of the merger kick in and after 2005 – which is when the transitional period given to all countries under the TRIPS Agreement ends – that the impacts of the amalgamation can be better assessed.

**Table 4.8: Price Variation between Companies for Selected Respiratory Products in 2001 (unit price in Sri Lankan rupees)**

Item	GSK	City Health (Cipla)	Emerchemi	SPC
Becotide Inhaler (Beclomethoson Oral Inhaler 50 MCG / 200Ds )	318	208	NA	NA
Serevent (Salmeterol Inhaler 25 MCG / 120Ds)	1044	272	224	NA
Ventolin (Salbutamol Respiratory Solution 10 ML)	115	NA	NA	22 (for 15 ML)

\* Unit prices are calculated as an average over a 12-month period

NA = Not applicable.

Source: SPC database.

### ***Substitutability and contestability***

As pointed out in Table 4.6 above, there are only three products out of GSK's twelve-product portfolio for which there are no competing brands in Sri Lanka: Seretide, the Babyhaler, and Volmax. Therefore, the availability of substitute products does not appear to be an issue here. Moreover, the fact that competing companies have a significant price advantage over GSK at present, that affordability is a key factor when marketing a product in a developing country like Sri Lanka, and that quality differences between cheaper Indian brands like Cipla and GSK products are minimal, suggest that this will continue to be the case in the short-term at least.

The degree of contestability depends on the possibility of competition among existing and potential firms for the market; this implies that barriers to entry must be minimal. Is this the story in GSK's respiratory product range? Generally, the most significant barrier to entry in the pharmaceutical industry stems from a company's R & D capacity and from patent provisions. It is too soon after the merger to evaluate the extent to which the joint R & D capacities of GW and SKB constitute a barrier to entry.

Moreover, as mentioned above, patent provisions are not a barrier to entry at present, given that it is relatively easy for Indian companies to copy these products and market them in Sri Lanka.

Another particularly important barrier to entry in the Sri Lankan context is the role that doctors play in marketing and distributing branded pharmaceutical products. Although as mentioned above, GSK has deeper pockets and more avenues to cement the doctor-company relationship, in practice it appears that competing companies are as aggressive in their attempts to “win over” doctors and have been as successful in selling their products through these channels. Again however, it is too soon after the merger to assess the joint strength of the two companies in adopting this marketing strategy to increase their market position in particular product lines.

***The bottom line***

As is seen from the preliminary impact analysis in the sections above, there is little evidence that the GSK merger has had any anti-competitive effects on the respiratory market as of now. However, given the potential for greater R & D capacities and product extensions and differentiation as the internal effects of the merger kick in, and the ending of the patent immune period in 2005, the results could be vastly different in the long run. Some policy issues and challenges to be considered in regard to possible future developments in the sector are looked at in the concluding section of this study.

**4.4 Role of the Competition Authority in the Glaxo Wellcome-SmithKline Beecham Merger**

The FTC did not go beyond the initial stages in investigating the GSK merger, although GW reported the proposed merger in January 2000. Following this notification, a preliminary report of the merger was prepared by officials in the competition authority and handed over to the Secretary General of the Fair Trading Commission. The officials had requested several items of documentation from the companies to prepare this initial report, but the required information was not sent to the Commission. Although the authorities had the power to penalize the companies for not complying with their requirements, they refrained from doing so and from pursuing the request for documentation. The justification given by the FTC is that they had sufficient market information and experience to prove that there was no reason to suspect any anti-competitive behaviour.

The Commissioners turned down further investigation allegedly due to the fact that the merger was outside the jurisdiction of the authority. This is despite the fact that the law grants the Commission the power to investigate any merger or proposed merger.<sup>22</sup> The real reasons behind this decision are blurred owing to the fact that there are no minutes of the meeting where the Board of Directors approved the decision. Also, due to the fact that there is a low institutional memory, it is hard to follow the internal workings of the FTC. However, there are indications from conversations with ex-Commissioners that the decision was made based on the premise that the local competition authority would have little clout in the face of an international merger. There are also strong indications that there was considerable political resistance to the investigation of the merger.

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<sup>22</sup> If, in a hypothetical scenario, the case had been investigated and the merger found to operate against the public interest, the Commission could have ordered the division of the business by the sale of its assets or of any part of the undertaking as set out in Section 15 of the Fair Trading Commission Act No.1 of 1987.

As is evident from the origins of this study and from the cooperation that the author has received from the competition authority in carrying out preliminary research for this study, it appears that the FTC is receptive to help from outside agencies. Discussions with officials in the Commission indicate that there is a demand for regional or international cooperation to analyze such cases. A perusal of the FTC's Annual Reports also indicates that both financial and skilled human resources are scarce in the organization.

What emerges therefore is that a plethora of factors ranging from a lack of funds and professional expertise to political interference and apathy led to the non-investigation of the GSK merger. Currently, the FTC's principal source of funding is the monies allocated by Parliament. However, in 2000, the annual budget of the FTC was a mere 0.00363 per cent of GDP, indicating the futility of relying entirely on the national budget for FTC funds.<sup>23</sup> The proposed Consumer Protection Authority Bill, which is set to replace the FTC and the DIT with the Authority and the Council, is not likely to ameliorate this situation given that the staff of the former organizations is to be absorbed into the latter. Further, the Ministry in charge of these entities has shown little interest in terms of funding and providing human resources since the proposal to merge the FTC and the DIT was brought in 1995.

Recently, representations were made to the new, more proactive Minister in charge of these entities by the research organizations that the author is allied to, to source a proportion of required funds through a registration fee for companies registered under the Business Names Ordinance. It was suggested that the fee ought to be very moderate and should be based on an incremental method depending on company turnover or profit. The rationale for this proposal is that a more efficient and proactive competition authority would promote greater competitiveness in the market and remedy consumer grievances more effectively – a benefit that will be enjoyed by the economy as a whole. However, this proposal is being vehemently opposed by the private sector represented by the Chambers of Commerce on the grounds that they will gain little or no advantage by paying such a fee.

#### **4.5 Conclusion**

This study constitutes a preliminary effort to assess the impact of the GSK international merger on Sri Lanka's respiratory market. As stated in the introductory section of this report, a paucity of data prevents a more in-depth analysis of this case. However, the findings from this study provide a framework for further analysis of this sector and for further research in this area. Moreover, these findings are a useful source of information for the competition authority in any future investigations of this case.

The key questions raised in this study relate to pricing behaviour, substitutability of products and contestability of market segments. Issues of overlapping products between the two companies were also considered here. The findings of the study indicate that the horizontal merger between GW and SKB has had little impact on Sri Lanka's respiratory market in the short-term. However, these results could be very different over the long-term when the internal benefits of the merger, such as enhanced R & D capacity, begin to take root and when certain external factors, such as the ending of the patent immune period for Indian products in 2005, come into play.

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<sup>23</sup> Central Bank Annual Report, 2000.

As discussed in Sections 4.2 and 4.3 above, competition policy concerns over the long-term in the pharmaceutical industry ranges from prices and quality to issues of informed choice, informational complexity due to the blurring of OTC and prescription products, and the strategy of using doctors as distribution channels for branded products. The analysis in these sections points to the imminent need for policy makers to address issues surrounding the TRIPS Agreement that have an impact on the pharmaceutical industry. Given the fact that a majority of Sri Lankan consumers fall into the low-income category for instance, it is important to take counter measures to deal with the possible increase in prices of pharmaceutical products after 2005. Whilst the current policy decision to allow parallel imports is a positive step in this direction, implementing this measure without taking steps to beef up the regulatory and quality control agencies in this sector, will have a disastrous impact on the consumer public.

## 5. Case Study 2: Legal and Economic Dimensions of Sri Lanka's Cement Market Activities<sup>24</sup>

### 5.1 Introduction

This case study on the cement market in Sri Lanka focuses on the events that took place during the recent past concerning competition issues. An international merger affecting the local market has not taken place in the recent past. The main activity that took place was the international cement giant Holcim's acquisition of Puttlam Cement and Ruhunu Cement, the effects of which will be discussed in detail. The competition authority's intervention into the activities of the cement market has been minimal. Difficulties in obtaining reliable information due to lack of databases at the competition authority may have affected the clarity of this report.

Section 5.2 of this study will make a preliminary assessment of the structure of the cement market, regulatory arrangements and set out the mergers that took place. Section 5.3 will analyse the applicable legal framework while section 5.4 will highlight some competition concerns. Section 5.5 of this study will set out the role played by the competition authority.

### 5.2 Structure of the Market

In the Sri Lankan cement market, approximately 10 players are currently competing with each other for the market demand of around 2.7 million tons and which has a growth rate<sup>25</sup> of about 8 per cent. The players include, *inter alia*, Puttlam Cement Co.(PCCL), Ruhunu Cement Co. (RCCL), Mahaweli Marine Cement Co. (MCCL), Tokyo Cement Co. (TCCL), Ceylinco L&T Cement Co., Ambuja Cement Co., Lanka Cement Ltd. and several other importers of bagged cement who vary from time to time. The following table illustrates the name of the company and the name by which their product is sold.

**Table 5.1: Products Marketed by Companies**

Group Name	Company	Product Name
Holcim Group	Puttlam Cement Co. Ltd.	Sanstha / Sevana
	Ruhunu Cement Co. Ltd.	Sanstha
Mahaweli Marine Co. Ltd.		Mahaweli Marine/ Mahamera
		Mitsui / Samudra / Atlas
Tokyo Cement Co. Ltd.	Larsen and Toubro Ceylinco (Pvt.) Ltd.	Ceylinco L & T Cement
	Ambuja Cement Co. Ltd.	Ambuja
	Lanka Cement Ltd.	Kankesan

Source: Authors elaboration.

<sup>24</sup> The author, Pubudini Wickramaratne Rupesinghe is an Attorney-at Law & Researcher, Law & Society Trust.

<sup>25</sup> "Gujarat Ambuja kicks off operations in Sri Lanka" by Suresh Nair, September 2000.

The structure of the cement market could be best analysed by considering different types of manufacture and sales. Four such methods have been identified in the cement market. The first type covers the case where the total manufacturing process and packaging is done in Sri Lanka. The second type covers the case where clinker is imported from abroad and is ground and packed in Sri Lanka. Thirdly, cement powder is imported and only the packing is done in Sri Lanka. The fourth type covers the situation where bagged cement is imported to Sri Lanka.

At present, only PCCL has an integrated plant whereby the entire process of manufacturing and packaging is done in Sri Lanka. Mitsui and Sanstha Cement produced by RCCL fall under the second category where clinker is imported and is ground and bagged in Sri Lanka. Products falling under the third category include Mahaweli Marine, Mitsui, Sevana, L&T, Kankesan and Ambuja. Products that fall under the fourth category are not regular and vary from time to time depending on the price fluctuations of the international market. Some of the bagged products which are being imported to Sri Lanka at present are Mascons and Saviya cements.

The market share held by each of the companies during the period 1994 – 2001 is illustrated from the following table:

**Table 5.2: Market Share Held by the Companies as Percentage.**

Group	Product	1994	1995	1996	1997	1998	1999	2000	2001
Holcim	Sanstha – Puttlam	29	28	28	29	28	22	21	21
	Sanstha – Ruhuna	12	12	10	7	13	9	11	12
	Sevana	0	0	0	5	7	6	7	5
<b>Total</b>		<b>29</b>	<b>28</b>	<b>28</b>	<b>34</b>	<b>35</b>	<b>37</b>	<b>39</b>	<b>38</b>
TCCI	Mitsui	15	15	15	17	15	11	11	12
	Samudra <sup>26</sup>	0	0	0	0	0	0	0	0
	Atlas	0	0	0	0	0	8	7	8
<b>Total</b>		<b>15</b>	<b>15</b>	<b>15</b>	<b>17</b>	<b>15</b>	<b>18</b>	<b>18</b>	<b>20</b>
MMCL	Marine	26	27	30	27	24	14	12	20
	Mahamera	0	0	0	0	0	7	5	0
<b>Total</b>		<b>26</b>	<b>27</b>	<b>30</b>	<b>27</b>	<b>24</b>	<b>21</b>	<b>17</b>	<b>20</b>
L&T	L&T	0	0	0	0	0	0	9	13
Ambuja	Ambuja	0	0	0	0	0	0	4	8
Lanka Cement	Kankesan	0	0	0	0	0	0	0	0
Other Imports		17	18	16	15	12	23	14	2

Source: Fair Trading Commission and players in the market.

<sup>26</sup> The market share held by Samudra cement is given as 0 per cent due to the fact that the product entered into the market in 2002. It has been included in the table only for the purpose of indicating the current players in the market.

The market share held by Samudra and Kankesan cements are given as 0 per cent for the reason that the products entered the market in 2002. They have been included in the Table only for the purpose of indicating the current players in the market. The coloured cages indicate the market share held by RCCL before its acquisition by Holderbank (the details of which will be dealt with below) and has not been added to the total market share held by the Holcim Group.

An evaluation of the above Table shows that many players have entered the market within the past 5 years. They include Sevana cement, which entered the market in 1997, Atlas and Mahamera cements in 1999, and L&T cement in 2000. Samudra and Kankesan cements entered the market in 2002. It is also noteworthy that the percentage of bagged imports has gradually reduced except in 1999 when it has recorded its highest market share of 23 per cent, which was due to large-scale importation of low priced cement from countries such as Indonesia, Thailand and Malaysia. In 2001 it has recorded its lowest market share of 2 per cent. The fluctuation of the market share is attributed to the varying prices in the international market.

### **5.2.1 Geographical Considerations**

Different cement brands have strong markets in different parts of the country and this is most often as a result of the cement plant of that particular company being in that locality. For example, Mitsui cement dominates the Central, North Central and the Eastern Provinces and their plant is situated in Kandy, in the Central Province. Sanstha cement has a strong market in the Western, Central and North Western Provinces while Ambuja has a strong market in the Southern Province where its plant is situated. There is no evidence of a planned market sharing.

### **5.2.2 Pricing**

The ongoing power crisis in Sri Lanka has a bearing on the pricing of cement. High cost of power and energy has posed difficulties to local manufacturers. As such, a price difference exists between the products that fall under the first and second categories above in which either the entire process of manufacturing or a substantial part thereof is done in Sri Lanka, and those which fall under the third and fourth categories, where no or less work is done in Sri Lanka.

### **5.2.3 The Regulatory Framework**

The cement industry is regulated by three separate bodies, namely, the Fair Trading Commission (FTC), the Department of Internal Trade (DIT) and the Sri Lanka Standards Institution (SLSI).

The cement industry does not come under the price control arm of the FTC and only attracts its price revision powers. Accordingly, the FTC could review the price of cement, hold an inquiry and if it finds that the price is unreasonable and that it is necessary to encourage competition by allowing imports, it could recommend to the Minister that the customs tariff be lowered to encourage imports<sup>27</sup>. In the second half of 2001, the import tariff for cement was significantly lowered from 15 per cent to 9 per cent. However, this was not done in accordance with a recommendation by the FTC and the FTC is not aware of the lowering of tariffs.

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<sup>27</sup> Section 23 of the Industrial Promotions Act. No. 46 of 1990.

In the proposed Consumer Protection Authority Bill, the price control arm of the Consumer Protection Authority has been extended to cover ‘any goods or services’, thereby covering cement as well. This is a significant change from the present position where only pharmaceutical products are under price control of the FTC.

The Department of Internal Trade is responsible for price surveillance and other aspects of trade regulation while the Sri Lanka Standards Institution is responsible for quality control. In terms of the Consumer Protection Act<sup>28</sup>, the Commissioner of Internal Trade is empowered to issue directions according to which the SLSI would announce the standards and specifications for articles. Despite several attempts, the author has not been able to obtain the said directions from the DIT.

The approval of the SLSI has to be taken before cement can be sold in Sri Lanka. Cement manufactured wholly or partly in Sri Lanka can have the sign of the Sri Lanka Standards Institute, namely, the SLS sign on the product. Accordingly, Ambuja, Mitsui, L&T, Marine, Sevana, Sanstha, Ruhunu and Atlas cements have the SLS sign on the product. However, bagged imports are not entitled to have the SLS sign on the product, but must obtain the approval of the SLSI before they are being sold in Sri Lanka. The SLS 107 is the specification for cement quality control adopted by the SLSI. The specifications provide that the comprehensive strength of cement, determined in accordance with BS EN 196: Part 1 should conform to the following table.

**Table 5.3: Comprehensive Strength of Cement**

Strength Class	Early Strength		Standard Strength	
	2 day N/mm <sup>2</sup>	7 day N/mm <sup>2</sup>	28 day N/mm <sup>2</sup>	28 day N/mm <sup>2</sup>
32.5 N	-	z 16	z 32.5	z 52.5
32.5 R	z 10	-		
42.5 N	z 10	-	z 42.5	z 62.5
42.5 R	z 20	-		
52.5 N	z 210	-	z 52.5	z 72.5
62.5 N	z 20	-	z 62.5	-

Source: Puttlam Cement Company Ltd (PCCL).

Sanstha and Marine cement claim to have a higher standard than that required by the SLSI. In the eyes of the consumer, quality is ascertained very much with reference to the product name. Accordingly, quality wise, consumers prefer the ‘well-known’ brands such as Marine and Sanstha resulting in a bearing on the price. For example, Sanstha cement is sold<sup>29</sup> at LKR 365 while Mahaweli Marine and Samudra are sold at LKR 340 and Mascons is sold at LKR 328. The range of price difference is also a result of the difference of manufacturing as set out in section 5.2.2 above.

<sup>28</sup> No.1 of 1979.

<sup>29</sup> The above prices are as at April 2002.

### **5.2.4 Mergers and Acquisitions**

One of the main events that took place in the cement market in the recent past is the acquisition of Puttalam Cement Co. and Ruhunu Cement Co. by Holderbank. The Swiss based cement giant Holderbank which currently occupies the second slot in the world market for the supply of cement, concrete and aggregates has a strong market presence in over 70 countries. Holderbank changed its corporate name to Holcim in January 2002 and its local subsidiary is now known as Holcim Lanka Ltd.

PCCL which was government owned, was handed over to the Thavakkal Group of Pakistan under the government's privatization programme. The Holderbank acquisition of PCCL took place in 1996.

Holderbank acquisition of RCCL, which was owned by Yasodha Industries of Japan, took place in 1999. Puttalam Cement had a strong market hold especially in the Western Province while Ruhunu Cement's strong market was in the Southern Province. The main objective of the acquisition could be identified as Holderbank's need to capture the market of RCCL in the Southern Province and further to prevent RCCL from distributing their products in the Western Province in which PCCL had a strong market. Holderbank established the Galle Cement Co., which had a packing plant in the Galle port (in the Southern Province), in which imported cement powder was bagged and sold mainly in the Southern Province. Competition with the Galle Cement Co. forced the sale of RCCL, which was bought by Holderbank.

After the Holderbank takeover of PCCL, its products continued to be marketed under the 'Sanstha' brand name. However, RCCL's products which were earlier marketed under the name of 'Ruhunu Cement' was changed to 'Sanstha Cement' after the takeover.

Holcim acquisition of Ruhunu Cement has increased their market share to a total of around 38 per cent during the period 1999-2001. It is evident from Table 5.2 above that Holcim Group had the highest market share during this period. However, Table 5.2 shows that despite the increase in Holcim's market share, during the period 1999-2001, several products such as Atlas, Mahamera and Ambuja have entered the market during that period. As such, although Holcim holds a dominant position in the market, it is difficult to say that it has created any significant entry barriers.

## **5.3 Legal Issues**

### **5.3.1 Provisions Relating to Merger Situations**

The law which applies to merger situations is contained in Section 13 of the Fair Trading Commission Act<sup>30</sup> (FTCA).

Section 13 provides that a merger situation exists *when a person, whether a body corporate or not, acquires or proposes to acquire, directly or indirectly, any shares in the capital or in the assets of a body corporate or of any other person if:*

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<sup>30</sup> No. 1 of 1987.

- a) as a result of the acquisition or the proposed acquisition, such first mentioned person would be or likely to be in a position to control or dominate a market for goods or services; or
- b) in a case where such first mentioned person is in a position to control or dominate a market for goods or services,
  - i) there is or is likely to be a competitor of the first mentioned person; and
  - ii) the acquisition or proposed acquisition would substantially strengthen the power of the first mentioned person to control or dominate the market.

Section 13(2) sets out the test for determining ‘the control and dominance’ of the market. Section 13(2) provides that *the first mentioned person shall be deemed to be in a position to control or dominate a market:*

- a) *if a body or two or more such bodies together, whether corporate or not, that is related to such first mentioned person, is / are in a position to control or dominate a market for goods or services; or*
- b) *if such first mentioned person and a body corporate that is, or two or more such bodies corporate each of which is related to such first mentioned person together are, in a position to control or dominate a market for goods or services.*

Accordingly, if companies B and C either on their own or together, are in a position to control or dominate a market for goods or services, and is/are related to company A, the company A is deemed to be in a position to control or dominate that particular market. Similarly, if company X and company Y which are related, or companies X, Y and Z which are related, are in a position to control or dominate a market for goods or services, then company X is deemed to be in a position to control or dominate that particular market. Reference in Section 13 to ‘control or dominate a market for goods or services’ include control or domination as supplier or as an acquirer of goods or services in that market.

### **5.3.2 Grounds on which a Merger is Approved or Denied**

The existence of a merger situation in terms of Section 13 alone does not attract sanctions of the competition authority, instead, it must be contrary to the public interest. Accordingly, a proposed merger which gives the acquirer a position of control or dominance in the market will be struck down by the Fair Trading Commission (FTC) only if it is against the public interest. Despite the importance placed on the public interest test, the Fair Trading Commission Act<sup>31</sup> (FTCA) fails to set out a comprehensive guideline as to what considerations should be taken into account when determining whether the merger is contrary to the public interest. Instead, it provides<sup>32</sup> that the FTC should take into account all matters that are relevant to the matter under investigation and that it should give special regard to:

- a) maintaining and promoting effective competition between suppliers of goods and services;
- b) promoting the interests of consumers with respect to price, quality and variety of goods and services;
- c) promoting through competition, the reduction of costs, the development and the use of new techniques and products and facilitating the entry of new competitors into existing markets;
- d) maintaining and promoting a balanced distribution of industrial activity and employment; and
- e) maintaining and promoting competitive activity in export markets.

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<sup>31</sup> No. 1 of 1987.

<sup>32</sup> In Section 15 (1) (a) of the FTCA.

These specifications only indicate the factors to be taken into account by the FTC and do not give adequate guidance as to the meaning of the term 'public interest'. Past experiences at the FTC show that this is a thoroughly inadequate guide to the meaning of the term 'public interest'.<sup>33</sup>

## **5.4 Competition Concerns**

### **5.4.1 Effects of the Merger**

As is evident from Table 5.2 above, MCCL and PCCL have been leading the market till 1996 and have had a fairly equal market share till then. It is notable that till 1996, MCCL marketed only Marine cement while PCCL marketed only Sanstha cement. However, with the introduction of Sevana cement in 1997, the Holcim Group (which had by that time taken over PCCL) was able to increase its market share to around 34 per cent and with the takeover of RCCL in 1999, it was able to further increase its market share to around 39 per cent. MCCL however, has not been able to maintain its market share. Even with the introduction of Mahamera cement in 1999, MCCL has been able to secure only around 19 per cent of the market share. It is difficult to state that MCCL's drop in market share is a result of Holcim's dominant position in the market due to the takeover of PCCL and RCCL.

It is also notable that several new products such as Atlas cement marketed by the TCCL group, Mahamera cement, L&T cement and Ambuja cement have entered the market during the period 1999-2001. As such, it is unlikely that the takeover of RCCL by Holcim has created significant entry barriers to the market. Moreover, several other players have stated that the merger has not had any adverse effect on their market position.

Control or dominance in the market gained by the takeover of PCCL and RCCL by Holcim per se does not make the merger invalid in the eyes of the law. As illustrated in the preceding section, the control or dominance should be contrary to the public interest for the FTC to take action. However, the FTC has not investigated into these acquisitions.

### **5.4.2 Cartel**

The manner of existence of the Cement Industries Association has created suspicions as to whether there is cartelization in the industry. According to information received from different cement companies, the Association consists of the General Managers of cement companies. However, the Association does not have an office or administrative staff and it is uncertain as to what powers and functions it carries out. According to the information received by the researcher, the meetings of the Association are scheduled when a company feels that another company/ companies are behaving in an 'anti-competitive' manner. The General Managers are said to 'sort out' the matters at the meetings. It was also found that usually before a price increase, every company informs the other companies about the increase and the amount by which it proposes to increase the price. However at times, a group of companies may increase prices without informing the others and at such times, at the meetings

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<sup>33</sup> An example can be drawn from the plastic water tank market where the dominant player deliberately reduced the price with the assistance of other players in order to prevent a competitor from entering the market. Although in the longer term the result would be an increase of the price after eliminating the competitor, the FTC could not rule that the price should be increased to enable the competitor to enter the market as there was a prima facie benefit to the public by the reduction of prices.

of the Association, problems relating to such 'anti-competitive practices' are 'sorted out'. This too is an 'unspoken agreement' between the companies.

It is noteworthy that the competition law does not provide specific provisions to cover cartels.

The suspicion is further aroused by the reluctance of many cement companies to give interviews to the researcher. When asked about information on any anti-competitive activities carried out in the cement market by other players, the most frequent answer is that there are no anti-competitive practices or that they are unable to reveal details of such conduct. Only a few companies provided the information required. The researcher is of the opinion that while individual players carry out their own anti-competitive activities, as a whole they decline to comment on or reveal the activities carried out within themselves in the market.

### **5.4.3 Monopolization**

Under the FTCA, monopoly position is determined in terms of a 'prescribed percentage' announced by the Minister on the recommendation of the FTC.<sup>34</sup> The prescribed percentage for cement is 40 per cent. Accordingly, a company having more than 40 per cent market share could attract the monopoly provisions of the FTCA. At present, none of the players have the required market share to attract the provisions of Section 12. However, had the Holcim bid to acquire Larson and Turbo, India, succeeded, Holcim Lanka would have the benefit of the L & T packing plant in Piliyandala and were expecting to increase its production volumes by 100,000 metric tons at the end of the year 2001. This would give them an approximate market share of 51 per cent and would attract Section 12 of the FTCA. However, monopoly position *per se* is not contrary to the FTCA and it must operate against the public interest for the FTC to step in and remedy the situation.

### **5.4.4 Impact of the Free Trade Agreements**

The impact of the Free Trade Agreements that Sri Lanka entered into with different countries in the recent past is speculated to be adverse to the local cement market. The Indo Lanka Free Trade Agreement (ILFTA), which was entered into in December 1998, is seen to be the most adverse.

India's attempts to make the Sri Lankan government to agree to grant greater preferential duty for bulk export of cement under the ILFTA has troubled the local manufacturers. At the Joint Ministerial Committee meeting held in New Delhi in June 2002, India has requested Sri Lanka to increase the Margin of Preference from the present level of 20 per cent to at least 50 per cent in respect of bulk cement and to reduce the import duty to 5 per cent from the present rate of 8 per cent. The import duty for bulk cement from outside India is 10 per cent.<sup>35</sup>

The local industry base their opposition on the ground that the value addition of the present Indian players in the market is only around 6 per cent while that of the local industry such as Holcim and

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<sup>34</sup> Section 12 of the FTCA provides that a monopoly situation exists in relation to the supply of goods in Sri Lanka if the prescribed percentage of goods of that description is supplied by or supplied to (a) one and the same person; (b) members of the same group of interconnected bodies corporate; or (c) members of the same group consisting of two or more persons.

<sup>35</sup> "Death-Knell for Lankan Cement Manufacturers", Daily Mirror, 03.07.2002.

Tokyo Cement is around 90 per cent and 45 per cent respectively.<sup>36</sup> They claim to be of higher value to the economy due to their heavy investments in expanding their capacity and due to employment opportunities provided to locals.

In a market such as that of the cement market in Sri Lanka where the supply exceeds the demand<sup>37</sup> tariff adjustments have to be made with caution. Already, bulk and bagged cement imports are popular because of their cheap rates despite higher import tariffs. With the further reduction of tariffs for Indian imports under the ILFTA, Ambuja and L&T will have greater advantage in the market. However, the issue to be addressed at this point is the long-term effects of such tariff reductions on the competitiveness of the market as well as the survival of the local cement industry.

### 5.5 The Role of the Competition Authority

Regrettably, the FTC has not played a significant role with regard to the issues in the cement market set out above. The only instance where it has made an active interference is in 1995 when it examined the abnormal prices of cement in the local market, which had gone up to LKR 435/- per 50 Kg bag. At the investigation it was revealed that there was a shortfall of production as well as imports, which resulted in the high prices. With the decision to remove the import duty, the prices gradually reached its normal level and after discussions with companies, it was agreed to price mark the product indicating the maximum retail price on the bag. The CIT issued directions accordingly.

The FTC claims that the Holcim acquisition of PCCL and RCCL were not notified to it under Section 9A of the FTCA, which requires mandatory pre-merger notification.<sup>38</sup> The counter claim of Holcim is that they have complied with the provisions of the FTCA.

Despite the mandatory pre-merger notification requirement, non-compliance with this provision is common. In such a situation, the FTC can inquire into it on its own motion and demand representations from the parties. The FTC has not done so in this case. Had the acquisition been notified by Holcim, the FTC would be required within 21 days of such notice, to either state that it has no objection to the proposed acquisition or that it will communicate its decision after an investigation into the matter.

The main reason for the FTC's inaction in this matter is the lack of staff and financial resources. Although the FTC is empowered to commence investigations on its own motion, this is a rare occurrence. Currently, the FTC is equipped with only half its approved cadre and functions without an investigating officer since 1996. The post of Senior Economist has been vacant for four years till year 2000 and the post of legal officer being vacant till 2001. The high number of vacancies is a result of the low priority it is given by the Ministry since the proposal to merge the FTC and DIT was brought in 1995. Further, the FTC has difficulties in recruitments due to low salary scales and benefits provided to its staff when compared with that of the private sector. More attractive benefits cannot be provided

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<sup>36</sup> Ibid.

<sup>37</sup> The current demand is around 2.5 million metric tons while the industry capacity (installed and under construction) is around 4 million metric tons.

<sup>38</sup> Section 9A provides that every person whether a body corporate or not who proposes to acquire shares in the capital or assets of a body corporate or any other person, the acquisition of which may result in the creation of a merger situation in terms of Section 13, shall give notice of the proposed acquisition to the FTC not less than thirty days prior to the date of the proposed acquisition.

to its staff as the FTC is entirely dependent on the Treasury for its funding. The FTC's budget for the year 2000 had been a mere 0.00363 per cent of the GDP.<sup>39</sup>

Moreover, there is lack of incentive on the part of the officers as well as commissioners of the FTC. The initial investigation into legal and economic aspects, which is done by the officers of the FTC, takes 2-3 months. The delay occurs once the case is referred to the Commissioners. Recent changes in the composition of the Commissioners and the lack of interest on their part have contributed to delays in final determination of cases under investigation. The Commission was reconstituted recently with the appointment of new Commissioners who are proactive in consumer protection and competition issues and it is hoped that their interest would vitalize the activities of the FTC.

It is unlikely that the present situation with regard to funding would be remedied by the proposed Consumer Protection Authority which seeks to replace the FTC and DIT as the Authority too, is dependent mainly on funds allocated by Parliament. At a discussion with the Minister of Commerce and Consumer Affairs relating to the proposed Bill, representations were made by consumer and non-governmental organizations that other forms of funding should be looked at. One such representation is for the companies registered under the Companies Act and the Business Names Ordinance to be registered under the proposed Act upon the payment of a registration fee. However, this proposal was vehemently opposed by the Chambers of Commerce. Subsequently the Board of Directors of the FTC, who were present at the said meeting, had made representations to the Minister unanimously rejecting the said proposal. An attempt made by the officers of the FTC to secure funding from foreign agencies have also been weakened by the said opposition of the Chambers of Commerce and the Board of Directors of the FTC.

## **5.6 Conclusion**

As stated in the foregoing section, this study is a preliminary assessment of the competition related activities in the cement market in Sri Lanka. The scarcity of data and the lack of willingness of many cement companies to divulge necessary information have prevented a detailed and in-depth assessment of the case. The effort made by the FTC to obtain information relevant to this study from the cement companies was encouraging; however the required data was not forthcoming.

At present, Holcim takeover of PCCL and RCCL does not raise a major competition concern. However, moves by Holcim in the future to increase its market share would raise a cause for concern as they would then be attracting the monopoly provisions of the FTCA. With the rising power crisis resulting in high prices of local products and the lowering of customs tariffs, the effect of increased bagged imports coming into the country would have to be monitored. While this could be in the interest of the consumer, strict standards should be maintained to ensure the quality of such imported products.

As discussed in Sections 5.4 and 5.5, serious anti-competitive conduct would follow from any cartelization in the industry if the FTC's minimal role with regard to activities in the cement market continues. Accordingly, the consumer would be the ultimate victim if policy decisions are not taken to strengthen the regulatory authorities to ensure their active involvement in issues relating to the cement market.

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<sup>39</sup> Central Bank Annual Report, 2000.

## 6. Case Study 3: Anti-Competitive Practices in the Sri Lankan Liner Shipping Sector<sup>40</sup>

### 6.1 Introduction

#### 6.1.1 Anti-competitive Practices

As markets become more liberalized, resources should be allocated more efficiently through the market mechanism. However, as a result of liberalization anti-competitive practices may also arise in the market. These anti-competitive activities can be a significant constraint to efficient resource allocation.

In most countries with an international liner shipping industry, regulations on shipping industries are subject to certain conditions and may be applied differently to inward and outward bound services. There are some trading economies, especially in Asia including Sri Lanka, which are not regulated in any way. In most instances, liner shipping is completely and unconditionally exempt from competitive rules in these countries.

Anti-competitive practices which occur in the liner shipping sector can be grouped as follows:

1. Participation in conferences
2. Capacity stabilization and discussion agreements
3. Consortia<sup>41</sup>

The aim of conferences is to arrive at uniform common freight rates. According to the *Organization for Economic Co-operation and Development Report (OECD, 2001)*, there are around 150 liner conferences operating throughout the world, with membership ranging from two to as many as 40 separate lines. Analysis of available data indicates that in the late 1990s, conferences accounted for approximately 60 per cent of twenty-foot equivalent units (TEU) of capacity in the trade. However, due to various reasons the conference share has been declining steadily in recent years. For instance, in the 1970s, the “Far East to Europe” conference accounted for 85 per cent of the capacity in the Europe Far East trade; in 1990 this share had dropped to 57 per cent. It has since risen to approximately 60 per cent (OECD, 2001).

The second main anti-competitive activity is the “capacity stabilization and discussion agreement”. In most countries such as Australia, Japan, New Zealand and the United States, conferences or individual members of conferences are allowed to enter into agreements with non-conference shipping lines. Capacity stabilization agreements attempt to control freight rates and regulate capacity, while discussion agreements attempt to reach an understanding among conference and non-conference operators.

The third anti-competitive activity is the consortium, which is an agreement among liner shipping companies aimed primarily at combining their services by means of various technical, operational or commercial arrangements. Most often, consortia arrangements can offer advantages to participating shipping companies through cost reductions derived from economies of scale. Consortia may be

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<sup>40</sup> At the time of writing, the author, P.P.A. Wasantha was employed as a Research Assistant at the Institute of Policy Studies (IPS).

<sup>41</sup> Theoretically, a consortium can be an anti-competitive activity. But in the practical sense, it cannot be regarded as an anti-competitive activity as consortia arrangements are made in order to derive cost savings and thereby be in a position to offer attractive rates to the trade.

composed entirely of independent lines or they may be members of the same conference. In some cases, conferences have members that participate in several consortia, and there are consortia composed of both conference and non-conference lines. Generally, a consortia addresses the rationalization of container shipping service operations.

Apart from the above-mentioned practices, global alliances are common in the shipping sector. This entails the establishment of co-operative agreements on a global basis among a group of companies. In some jurisdictions, global alliances are treated as just another consortium or carrier agreement. The pivotal year in alliance formation was 1995. The pattern of mergers and alliances have changed dramatically since 1995. However, global alliance agreements apply only to one trade route and not to different carriers on various trade routes. They generally apply to the same carriers over certain major routes, which can be seen as global.

### ***6.1.2 Scope and Limitations of the Study***

This study focuses on anti-competitive practices occurring in the Sri Lankan shipping sector. The lack of previous studies and the unavailability of company data is a major limitation when conducting this type of research. The Central Freight Bureau (CFB) does not maintain liner-wise records. The Sri Lanka Ports Authority did not like to reveal company information, and the companies were also averse to giving data. As a result, most of the information had to be obtained by interviewing the Ceylon Association of Shipping Agents (CASA), the Sri Lanka Ports Authority (SLPA), and representatives of the shipping agents. As a result of the absence of sufficient data, much of the study is based on aggregate values.

The study is structured as follows. The next section lays out the structure of Sri Lanka's shipping industry, the main shipping liners and their agents in Sri Lanka. Anti-competitive practices and their effects are evaluated in the same section. Section 6.3 provides the legal and regulatory position of the shipping industry, and section 6.4 concludes.

## **6.2 The Shipping Industry in Sri Lanka**

While there are many sectors in the shipping industry in Sri Lanka, it is generally conceded that the majority of shipping activities can be divided into two main groups.

1. The tramp market
2. The liner market

The tramp carriers ply the ocean carrying cargo for its owners or on contract for others. This market services the transport needs of both dry and liquid bulk production. These companies, generally, do not offer scheduled services. Clearly the economics of maintaining a consistent, scheduled service with a commitment to a particular trade route are quite different to those of selling a service to the highest bidder in an open market where the terms and conditions are negotiated for each voyage or period of time.

In contrast, liner-shipping companies offer scheduled services, move containers, and provide transport services to third party logistics service suppliers and cargo owners, whose markets are increasingly global in scope. Vessel cargo owners only purchase the space necessary at a particular point in time by sharing the vessels with many others. Reliable liner shipping helps manufacturers buy components

from many sources, accumulate them in a less expensive location for assembly, and ship the final product to another place to be sold. As far as the Sri Lankan shipping industry is concerned, liner services play a leading role in international trade.

### 6.2.1 Liner Shipping Industry

Liner shipping is an industry that is concentrated and self regulated through institutions called conferences, consortia, and in recent years, alliances. The role of a few major carriers has increased drastically over the last several years. The 20 carriers by capacity on offer controlled 38.8 per cent of TEU capacity in 1990 (Brooks, 2000), and 72 per cent by 2001, and the five largest operators account for 34 per cent of the fully containerized fleet capacity (OECD, 2001).

	Company	Total TEUs
01	Maersk	627,152
02	P&O Nedlloyd	341,985
03	Evergreen/ LloydTriestino	290,343
04	Mediterranean Shipping Co Ltd	242,405
05	APL	238,982
06	Cosco	197,131
07	Hanjin	179,424
08	NYK	142,263
09	K Line	143,386
10	Yangming	142,075
11	OO CL	136,797
12	CMA Com	135,134
13	Mitsui-Osk line	125,168
14	Hyundai	133,786
15	Zim	123,359
16	Hapag - Lloyd Container line	116,901
17	Senator	112,824
18	CSOL	103,898
19	United Arab Shipping	58,393
20	SCL	55,584

Source: OECD Report 2001.

The following shipping liners and their agents play a significant role in Sri Lanka's import, export and transshipment activities.

**Table 6.2: Top Liner Operators and Agents in Sri Lanka**

	Company	Agents
01	Maersk	Maersk Lanka (Pvt)Ltd
02	P&O Nedlloyd	P&O Nedlloyd Keels (Pvt)Ltd
04	APL	APL Lanka (Pvt)Ltd
05	Evergreen	Green Lanka Shipping Ltd
06	Hanjin	Navigation Maritime Colombo (Pvt) Ltd
07	NYK	NYK Line Lanka (Pvt) Ltd
08	K Line	ABC Shipping (Pvt) Ltd
09	YML	Asha Shipping Ltd
10	OOCL	Sri Lanka Shipping Corporation Ltd
11	CMA Com	CMA- CGM Lanka (Pvt) Ltd
12	Mitsui-Osk line	Mitsui OSK Lines Lanka (Pvt) Ltd
13	Hyundai	Shipping and Cargo Logistics (Pvt) Ltd
14	ZIM	Star Shipping Ltd
15	Hapag - Lloyd Container line	Freudenberg Shipping Agencies Ltd
16	LT	Triestino Lanka Shipping Ltd

Source: CASA.

In addition to the top liner operators above, the following two lines and their agents are also important in foreign trade in Sri Lanka.

**Table 6.3: Other Major Liner Operators and Agents in Sri Lanka**

	Company	Agents
01	SCI	Asha Agencies Ltd
02	MISC	MISE Agencies Lanka (Pvt) Ltd

Sources: CASA.

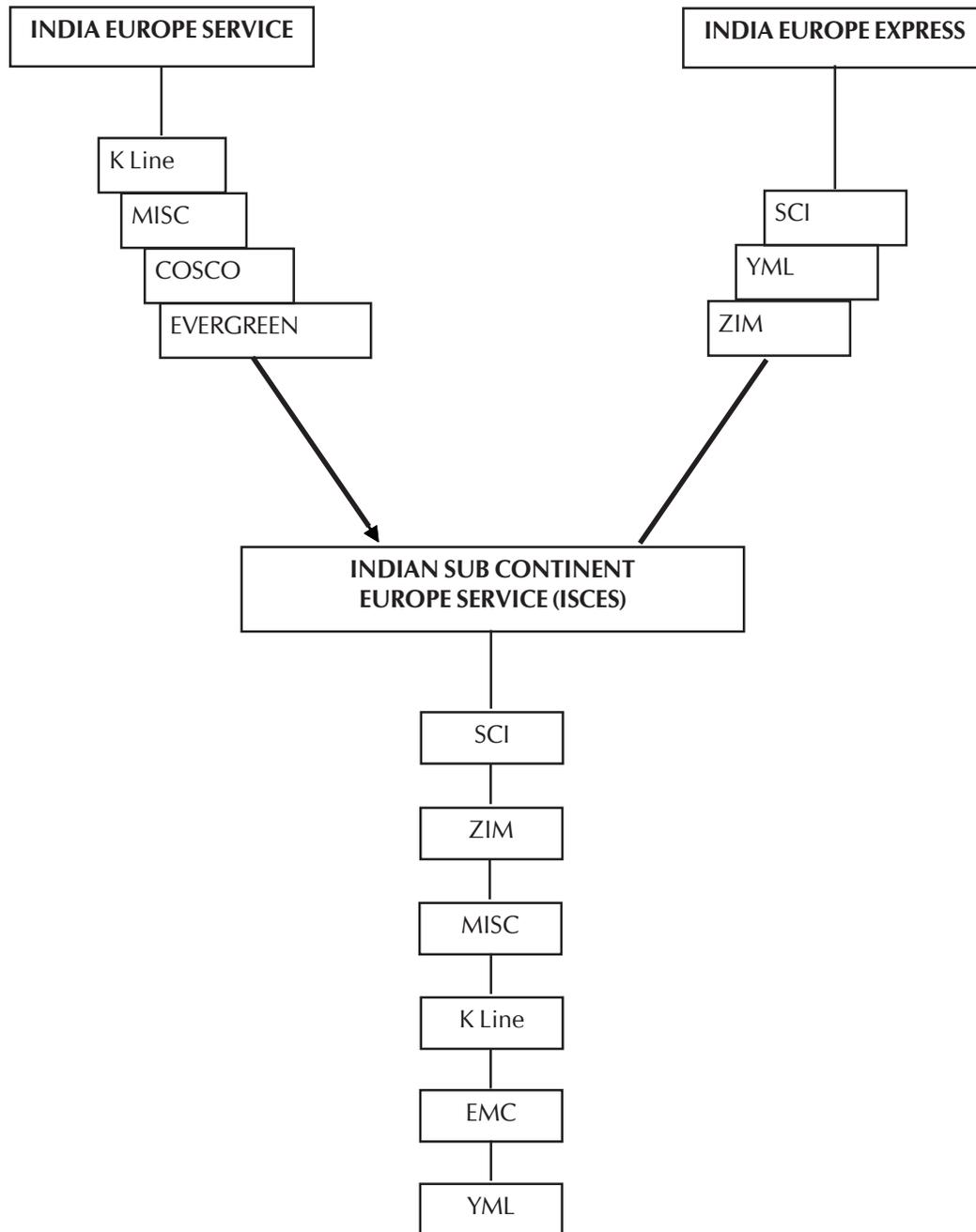
### 6.2.2 Domestic Anti-competitive Practices

Although the above mentioned anti-competitive practices prevail in the world shipping sector, only a few cases have affected the Sri Lankan shipping sector. These are discussed below:

#### a. Consortia

A consortium is an agreement between liner shipping companies aimed at supplying jointly organized services. In many cases, members of a consortium are also members of a conference, e.g., members of the Indian Sub Continent Europe Service (ISCES) are also members of India, Pakistan, Bangladesh, Ceylon Conference (IPBC). One of the major consortia whose agents play a significant role in Sri Lanka is illustrated in Chart 6.1.

Chart 6.1: Indian Sub Continent Europe Service (ISES)



By launching the “Indian Sub-Continent Europe Service”<sup>42</sup>, all of the partners have reiterated their commitment to providing quality service at affordable costs to the shippers, as well as offering space guarantee and attractive rates when it commences its service or voyage from Colombo itself.

<sup>42</sup> China Ocean Shipping Company (Cosco), did not participate in the new consortium (ISCES).

There were two consortia before the formation of ISCES:

1. India Europe Service (IES) which comprises four liners: K Line, MISE, Cosco and Evergreen
2. India Europe Express (IEE) which comprises SCI, YML, and ZIM

These two consortia were reconstituted into a new consortium called Indian Sub Continent European Service, which started operation on the 06th of January 2002. Seven ships of approximately 2650 TEUs size are deployed by the service, with all lines contributing to the following vessels.

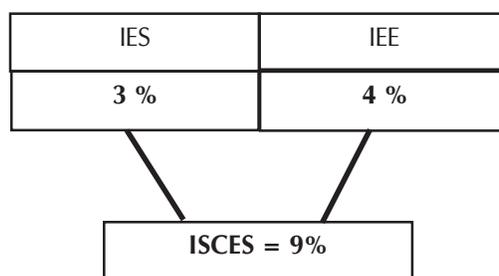
**Table 6.4: Number of Vessels**

Liners	Number of vessels
Shipping Corporation of India (SCI)	2
Zim Israel Navigation Company Ltd (ZIM)	1
Malaysian International Shipping Management Ltd (MISC)	1
Kawasaki Kisen Kaisha (K Line)	1
Evergreen Marine Corporation (EMC)	1
Yang Ming Line (YML)	1

Source: Asha Agencies Ltd.

The market share of any large consortia provides a clearer picture of key competition policy issues such as price fixing, market leadership etc. When a consortium owns a higher portion of the total export, import or transshipment market, the general rate may be determined by it. If we take into account the market share of the above consortium, we can estimate the following figures.

**Chart 6.2: Market Share<sup>43</sup> of the Consortium**



Source: Representative shipping agents in Sri Lanka.

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<sup>43</sup> Market share was calculated by using the number of containers handled.

**ISCES** is a major consortium functioning in Sri Lanka and its market share is significant in import and export as well as transshipment. However, the figure above indicates that the market share of the new consortium (ISCES) has slightly increased over that of previous consortia. The growth of total import and export volume in Sri Lanka can also contribute to such a trend of the market share in a particular consortium.

As a result of this consortium (ISCES), the cost of bearing cargo has decreased. One way of squeezing cost, especially in the shipping industry, is through consortia. This is because this sort of operational co-operation enables its member to reduce operational cost by increasing their service offerings, whilst maintaining competition. For instance, the changes in the route for ISCES enabled them to reach their destinations in a shorter time. The shipping agents of ISCES in Sri Lanka are given below.

**Table 6.5: Sri Lankan Shipping Agents in ISCES**

Line	Agents
SCI	Asha Agencies Ltd
ZIM	Star Shipping Ltd
MISC	Malship (Ceylon) Ltd
K Line	ABC Shipping (Pvt) Ltd
EMC	Green Lanka Shipping Ltd
YMC	Asha Agencies Ltd

Source: CASA.

A group of companies can serve as an agent for several shipping lines. For instance, Asha Agencies Ltd, functions as the agent of SCI and YML. However, this consortia arrangement has offered advantages to participating shipping companies through cost reduction and by providing a stable price environment for shippers. As a result, they are protected from excessive rate variability. The main disadvantage was the lack of sufficient cargo transported, as was pointed out by Mr. Prasanna—the General Manager of Asha Shipping Agents. The Sri Lankan market is quite small when compared to other countries. As a result, its export and import volume is also small. However, according to Mr. Prasanna, around 59 per cent of cost reduction has been recorded after the consortia agreement.

Other than ISECS, Grand Alliance and New World Alliance are the major consortia whose agents are in Sri Lanka. The shipping lines and Sri Lankan agents of these consortia are as follows.

**Table 6.6: New World Alliance**

Line	Agents
APL	APL Lanka (Pvt) Ltd
Hyundai	Shipping and Cargo Logistics (Pvt) Ltd
MOSK	Mitsui OSK Lines Lanka (Pvt) Ltd

Source: CASA.

**Table 6.7: Grand Alliance**

Line	Agents
MISC	Malship (Ceylon) Ltd
NYK	NYK Line Lanka (Pvt) Ltd
HLAG	Freudenberg Shipping Agencies Ltd
P&O Ned	P& O Nedlloyd Keells (Pvt) Ltd
OOCL	Sri Lanka Shipping Co Ltd

Source: CASA.

The market shares of the above mention of consortia are as follows.

**Table 6.8: Market Share**

Name of the Consortia	Market Share <sup>44</sup>
New World Alliance	2 %
Grand Alliance	4 %

Source: Interviews with industry representatives.

In the Sri Lankan shipping industry, the Indian Sub Continent Europe Service (ISCES) functions as the leading consortium. But, there is a higher level of competition among the other consortia. For instance, competition between the New World Alliance and Grand Alliance has become intense over the last few years as these consortia continually aim to provide the best service. However, the market share of a consortium is likely to continue fluctuating as new services are introduced and some existing services are revamped as a result of this competition.

Theoretically, a consortia agreement is an anti-competitive activity as it prevents the competitive behaviour among the liner shipping companies. If there was a higher level of competition among liner shipping companies, freight rates would have dropped rapidly. However, in the Sri Lankan market, the reduction in costs has directly benefited our exporters and importers.

#### **b. Ceylon Association of Shipping Agents (CASA)**

Of the total number of agents who actively participate in the shipping industry, around 94 per cent are members of the Ceylon Association of Shipping Agents (CASA). CASA members export and tranship around 90 per cent of the total quantity of exports. As a result, although decisions taken by CASA are for the benefit of its members, it can have a significant impact on the Sri Lankan economy.

Membership of CASA is restricted to individuals and bodies, private and public quoted companies, carrying on regularly the business of ships' agents in any port or ports of Sri Lanka on a licence issued by the Director of Merchant Shipping under the Licensing of Shipping Agents Act No. 10 of 1972, as amended, and regulations published thereunder.

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<sup>44</sup> Market share for 2001 was estimated by using 6 months data.

Given that Sri Lanka does not have local ship owners, shipping agents offer the services of foreign shipping lines for the transport of goods and services to and from the port of Colombo. The geographical market is limited to the export destinations of the main exports of Sri Lanka, which include the Middle East, Europe as well as the former Soviet Union countries.

### **Practices of CASA**

To this date, there has only been one case that has come within the purview of the Fair Trading Commission (FTC) with respect to CASA decisions. This was the "Levy of the Terminal Handling Charge (THC) other than as a Component of Freight Rates by the Ceylon Association of Shipping Agents".

CASA issued a circular with regard to the THC at the request of its members' principals/shipping line, by directing all its members to levy a THC on all exporters as a separate component of the freight charge. The usual practice in Sri Lanka has been to charge the THC from the buyer. The breakdown of the THC is as follows:

- A charge of US \$61 per 20-ft container
- A charge of US \$ 98 per 40-ft container

The estimated additional revenue of US\$ 7 million is a land based cost, which is recovered for the principals/ shipping lines and not for the agents. The THC represents the expenses incurred in bringing the container from the container yard onto the ship. It is completely different to the freight charge which involves the shipper's charge for carrying goods from one port to another. The shipping agents argue that the THC accounts for the costs incurred when bringing goods onto the ship, and thus it is a cost that must be incurred by the exporters. Traditionally, the THC is a universal charge levied at all ports and is paid by the exporters.

The Ceylon Shipping Corporation (CSC) probably absorbed the land-based cost at the inception of containerization as an incentive to convert break bulk into containerization. With the liberalization of the shipping industry in 1990 the situation changed. New companies have been forced to absorb this cost.

The complaint regarding the THC and the actions of CASA was brought before the FTC by the Ceylon Chamber of Commerce (CCC) and several exporter associations including the Garment Exporters Association in March 1997. The argument was that the CASA was acting in a collusive manner to maintain high costs. The specific allegations against CASA were as follows:

- The THC, which is in addition to the competitive freight rates, is anti-competitive in relation to the ocean freight market, and is effectively preventing exporters from securing ocean carriage services at competitive rates.
- There was no justification for the levy, and any mandatory levy of the THC would result in the distortion of the freight rates quoted and charged by shipping lines in a freely competitive freight market.
- Only those exporters operating under Free on Board (FOB) basis will be seriously affected by this levy.
- The failure of the THC to be incorporated into the freight rates as an outright increase would have made it possible to recover the cost from the buyers. However, since it was imposed as a separate surcharge, buyers will be unwilling to incur such a cost, resulting in the exporters bearing the burden of this levy.

The observations of the CASA in response to these allegations are presented below:

- THC is reasonable/justifiable and a global practice.
- THC is basically a land based cost directly reflecting on the charges imposed by the Sri Lanka Ports Authority (SLPA) and minimum tariffs charged by the Association of Container Terminal Depot Operators.
- Since there are diverse types of shipping contracts, and given that the THC is to be recoverable on a pre-paid basis, it is a uniform process. This is the practice in most parts of the world.
- THC is totally transparent and is a calculable charge based on the actual expenses incurred by the carrier.
- Freight is the remuneration payable for the carriage of goods over the ocean and THC is an expense incurred by the carrier on land and therefore it should be recoverable by the shipper.
- Freight charges are computer based on a multitude of facts and THC, if imposed as a component of freight, would distort the actual freight charge.
- The term THC is not an anti-competitive practice contemplated within the meaning of the Fair Trading Commission Act (FTCA, 1987).
- The THC is not likely in any manner to prevent or distort competition in connection with shipping services in Sri Lanka. Each of the shipping services in Sri Lanka are free to quote their own ocean freights, while the THC relates to the individual port cost recovery which is applicable to all shipments.

However THC has been increased over the last five years as follows.

Duration	20' US \$	40' US \$
1997.05.01-1997.06.09	61.00	98.00
1997.06.10-1999.01.01	71.00	114.50
1999.01.02-2001.04.30	86.00	138.00
2001.05.01-to date	115.00	184.00

Source: Central Freight Bureau.

Within this five-year period, shipping agents raised THC by 88 per cent and 87 per cent for 20' and 40' respectively. According to Mr. Samarasingha, an operational manager of NYK Line, CASA has issued only one circular in 1997 regarding the THC. After that, CASA has not been directly involved with this practice. This means that although CASA initiated THC, the above-mentioned increases were imposed by individual shipping agents and not by CASA. As initial THC rate was not enough to cover handling cost and given the increases in operational cost over the last few years, it was necessary to increase THC.

The issue of the THC together with other ancillary charges, (which were not treated as part of the freight rates by the shipping liners and were charged separate as non-negotiable items), has been a matter of concern for the shippers' council of the region. It is stated that the shippers' council has maintained that the exclusion of the THC from basic freight rates has resulted in a situation where the freight charges by the carriers do not represent the true costs. The common grievance amongst the shipper bodies was that the lines / conferences and stabilization agreements do not conduct meaningful consultations with shippers prior to the imposition of a rate increase / surcharge.

### c. Conference Activities

A conference is an association of liner companies operating under an agreement to provide services on common trade routes, and which collectively agree on rates and terms of service. Changes of the conference and non-conference exports in Sri Lanka are illustrated in the following table.

Year	Conference number of tonnage (000)	Percentage value	Non-conference number of tonnage (000)	Percentage value
1995	1394	36	2478	64
2000	1091	27	2951	73

Source: Data from interviews with industry representatives.

Market share is an indicator, which may offer some insight into whether competition exists in the marketplace. Conference share has declined somewhat in recent years while the independent operators' (non-conference) share has grown. Thus, in 2000, the non-conference share of the Sri Lankan liners carried a larger component of both liner imports and exports than conference liners. Table 6.10 compares the conference and non-conference share of the Sri Lankan liner trade.

In the 1990s, the competition among the carriers from Colombo to various ports continued. As a result, freight rates dropped rapidly in 1997. This caused the major carriers to increase their freight rates through conferences. Such rate increments are as follows:

- As a measure to enhance their revenue, a general rate increase from Colombo to UK and the North continent / Scandinavian ports by a quantum of US \$ 75/20' and US\$ 100/40' from July 1998.
- A leading carrier from Colombo to the United States imposed a very high general rate increase to this destination, with effect from 01.01 1999 by a quantum of US \$ 750 for a 20', US\$ 1000 per 40'
- A similar increase was experienced by the major carriers to the West Coast of USA by a quantum of US \$ 675/20' US\$ 900/40' in the same year.

Most probably, when conferences increased their price, non-conference liners also adjusted their charges. These high increases had a severe impact on the commodities of low FOB values such as fibre. As a result, members of Sri Lanka fibre trade made several representations to the authorities to the effect that their USA buyers have notified that they have no alternative but to source all their coconut fibre requirements from Mexico as such high rates cannot be borne by this low value commodity.

The beginning of the year 2000 was also marked by several announcements of rate-increases in major regions of USA, Canada, UK, Europe and Australia.

The shippers' associations also made representations to the authorities that the "consultation procedure" has not worked, since negotiations / discussions on the impending rate increases have not been conducted prior to notice of increases. Therefore, they stressed that certain legislations should be made to establish a procedure to combat the unjustified increase in freight rates imposed by carriers.

Meanwhile, the shipping lines operating from Colombo gave notice of a minimum rate increase. Details are as follows:

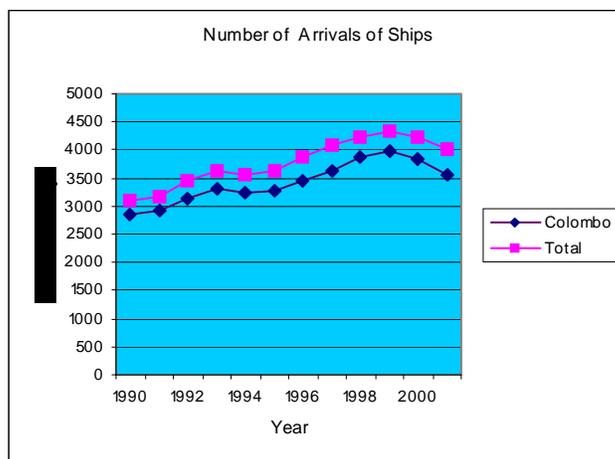
- From Colombo to Australia at US \$ 900/20' and US \$ 1800/40' with effect from 01.03.2000.
- The major lines operating from Colombo to USA / Canada were also notified of an overall rate increase by a quantum of US \$ 300 / 20' and US \$ 400 / 40' with effect from 01.05.2000.
- Another notice of a General Rate Increase (GRI) can be seen in 2000 when the lines operating under India, Pakistan, Bangladesh, and Ceylon Conference (IPBC) recorded a GRI from Colombo to UK, Europe, and Scandinavia by a quantum of US \$ 150/20' on all commodities, with effect from April 2000. Further notice was given on the UK, Europe Trade for GRI at US \$300/20' with effect from 01.09.2000.
- A GRI was applied by lines serving the region such as UK, Europe, Scandinavia, Mediterranean and Westbound by a quantum of US \$ 150/20' with effect from 01.03.2000.

Although the shipping lines at various stages announced rate increases on several trade sectors, the increased rate never held in Sri Lanka even for 2-3 weeks. For example, the rate to Europe in 1995 was US \$ 1550/20' as compared to US \$ 750 in October 2002. This rate decrease was a result of higher competition in the sector and also due to market forces (demand and supply).

### ***Effects of fixing freight rate on the Sri Lankan export market***

As result of the expansion of the shipping industry, the number of ships that arrived in the country has drastically increased over the last 10 years, out of which the Colombo port bears around 90 per cent.

**Chart 6.3: Number of Arrivals of Ships**



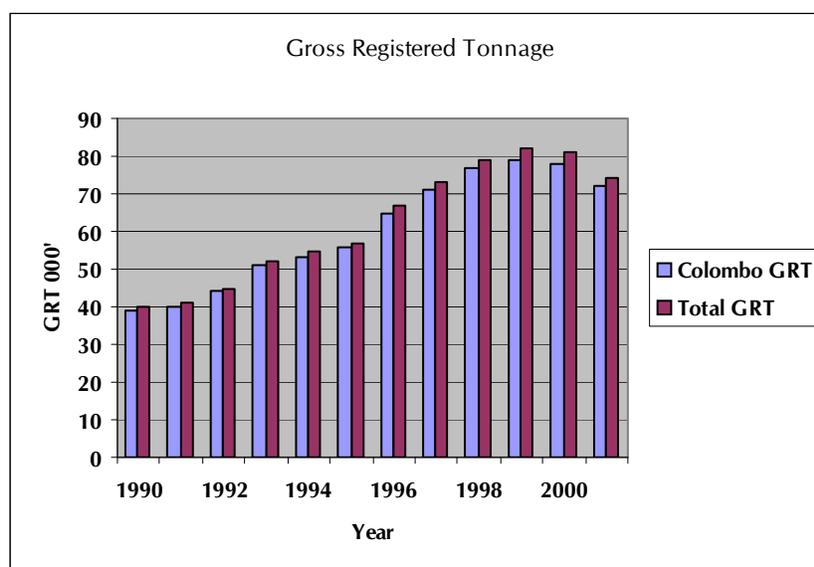
Source: Sri Lanka Ports Authority.

Although much price-fixing was done through conferences, the number of ships that arrived has been increasing over the last decade.

**Table 6.11: Loaded Container Flows**

Year	Transshipments (Number of container 000')	Total Loading (Number of container 000')	Transshipments as a % of total loading
1990	205.2	296.1	63
1991	234.7	333.6	70
1992	224.7	335.9	67
1993	293.6	426.0	69
1994	332.3	483.8	69
1995	349.6	522.8	67
1996	487.4	670.9	73
1997	615.0	840.5	73
1998	598.5	862.2	69
1999	575.1	849.8	68
2000	563.6	868.1	65
2001	579.2	860.6	67

Source: Sri Lanka Ports Authority.

**Chart 6.4: Gross Registered Tonnage (GRT)**

Source: Sri Lanka Ports Authority.

Gross registered tonnage has increased drastically over the last ten years. The overall numbers of containers in Colombo over the last 10 years indicate signs of rapid growth. Domestic cargo contributed to this increase whilst the transshipment volume accounted for 65 per cent of freight tons.

There is no clear evidence that any anti-competitive activities have tended to decrease the exports of Sri Lanka.

### **6.3 Regulatory Arrangements**

The law relating to competition and market behaviour in Sri Lanka is not comprehensive. Currently, issues relating to monopolies, mergers and acquisitions, and anti-competitive behaviour are handled by the Fair Trading Commission (FTC) set up in 1997, while the Department of Internal Trade (DIT) established in 1979 takes up issues relating to consumer protection. There is no regulator in the shipping sector. Before liberalization in 1990, there was some degree of supervision of the shipping sector by the Central Freight Bureau. But at present, though one can complain to the FTC, the authority or the power of this body is limited as demonstrated by the case that is presented in this paper.

The issues that need the attention of the regulator within the shipping industry are the price and frequency of the service. Price is very important for low value cargo like fibre products etc. Even though the shipping lines formulate the freight rates, due to the heavy competition among the lines in the aftermath of the liberalization of the sector, there prevails a relatively low freight rate.

#### **6.3.1 Further Liberalization**

A further step in the liberalization of the shipping industry was the proposition by the Sri Lankan government to allow 100 per cent foreign ownership in the shipping agency business. But the Sri Lankan Shippers' Council (SLSC)<sup>45</sup> was totally opposed to this policy. At present foreigners can own up to 40 per cent equity stake in the shipping agency business. Since last year there has been lobbying from the foreign principals to request the government to allow 100 per cent control.

In the mid 1990s too, there was a similar proposal, but it was opposed by both local shipping agents and shippers. According to the SLSC Chairman Ravi Rathnapala, the proposal was rejected as foreign principals and investors in the shipping industry are already treating Colombo as a high cost centre<sup>46</sup>, and allowing them 100 per cent control would be a disaster for the exporters and importers in particular and for the economy in general. CASA too was against it.

Although SLSC is expected to lobby against the imposition of the THC on exports, THC is not unique to Sri Lanka. This charge traditionally is a global practice. Despite repeated protests and assurances, the THC continues to cause some impact on the competitiveness of exporters. SLSC has also urged the government to bring in legislation to make it mandatory to incorporate the THC in the freight rate.

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<sup>45</sup> SLSC was established in 1996 and became Asia's first national shippers council. It comprises 14 chambers of commerce and trade associations whose membership accounts for 95 per cent of the export trade.

<sup>46</sup> Daily News 24.06.2000.

### **6.3.2 Legal Issues**

The action in relation to the THC levied by CASA was brought within the purview of the FTC under Section 14 of the FTCA.

Section 14 of the FTCA makes reference to anti-competitive conduct that is defined as, “when a person in the course of business, pursues a course of conduct which is likely to have the effect of restricting, distorting or preventing competition in connection with the production, supply or acquisition of goods or the supply or securing of services in Sri Lanka”. The charge of anti-competitive practice alone is not enough and it is essential to prove that such a practice established under Section 14 is against public interest under Section 15(1)(a). The grounds under which the FTC will approve the anti-competitive conduct is based on whether the FTC finds that the anti-competitive conduct is not against the public interest as under Section 15(1)(a).

The FTC has the capacity to initiate an investigation on any matter relating to Sections 12, 13 and 14 of the FTCA; that is, Monopolies, Mergers and Acquisitions, and anti-competitive conduct, either based on its own volition or based on complaints made to it by an aggrieved party under Section 10 of the FTCA.

In consideration as to whether the anti-competitive action is against the public interest and whether the FTC should intervene in the market to remedy the situation, the FTC has the option of taking into account “all matters that are relevant” as per Section 15 (1)(c) of the FTCA. Thus, the ambit and the issues that have to be considered are vast, giving the FTC a wider margin to decide upon for particular cases.

### **6.3.3. Decisions or Lack of Decision by the Competition Authority**

There was an initial observation by Mr. Ramalingam, a Consultant of the Ministry of Commercial Affairs, which stated that the THC was a levy that was to apply to all exports of containerized cargo, and thus was applicable to all exporters. The statement of the FTC further stated that there was no question of the THC having or likely to have the effect of restricting, distorting, or preventing competition in connection with the supply or the securing of services in Sri Lanka. The FTC further stated that if the THC had been added to the freight rates it would have had an impact on the competitiveness of Sri Lankan exports in the international market. There is no evidence to suggest how this reasoning was reached. However, they added that this was not a situation to which the definition of an anti-competitive practice in section 14 of the FTCA would apply.

This finding of the FTC was criticised, and the same matter was taken up by the FTC for further investigation in 1998. The manner in which the FTC has opted to proceed under this second investigation is to primarily focus on the THC being charged as a mandatory, unilateral local levy for FOB shippers only. At the conclusion of this second investigation it was held that the THC was an anti-competitive practice resorted to by CASA, and was operating against the interest of the exporters, which was also against public interest. On the 30th of March 1998, the FTC directed CASA to remove the THC and freight handling charges on FOB exporters.

Following the order by the FTC, CASA filed an appeal against the order, stating that the FTC has no jurisdiction over international shipping lines. In addition, CASA has issued a circular to all its members

that CASA would no longer impose a mandate among all of its members to impose the THC, but to treat the matter thereafter as a commercial transaction between shipper and the shipping line.

There was no regional or international co-operation extended to the FTC to assist in the analysis of this case. Given that the individual shipping lines are still enforcing the THC, and that the THC was also increased subsequently, the decision of the FTC was not enforced either in letter or in spirit.

#### ***6.3.4 How Did the Authority deal with these Problems?***

The FTC did not deal with all of the problems that were put forward by both CASA and the CCC, but was instead selective in its approach. Further, the complacency of the FTC in making sure that its decision was implemented, or the inability of the FTC to pursue an alternative avenue to ensure that the THC was removed for the purpose of enhancing competitiveness, hints at the lack of the proactive nature of the FTC.

The main reason for the inefficiency of FTC is that, although the Fair Trading Commission (FTC) was given enough power to handle anti-competitive activities, they were not given enough infrastructure facilities to implement their decision. For instance, Government allocation of funds for the FTC is scarce. As a result, the FTC was unable to attract the services of qualified people in the country who would have ensured FTC's efficient service to the country.

### **6.4 Conclusion**

The shipping transport sector is already relatively liberalized compared to other service sectors in Sri Lanka, and even so, further liberalization in the domestic shipping market is receiving increased attention. Sri Lankans do not have the ownership of major shipping lines, but around 112 shipping agents actively participate in this industry. However, in the increasingly concentrated shipping market, the scale of investment being made by international shipping lines is huge, and it is increasingly difficult for developing countries to keep pace with it. Noticeably, global carriers have been focusing attention on providing competitive shipping services in terms of frequencies, transit time, and price and thereby the shipping industry appears to have benefited. For countries, which are becoming increasingly reliant on the provision of efficient third party shipping services, maintaining a competitive environment is of paramount importance and it is also clear that in the future the shipping industry will be shaped by a more liberalized environment.

Although consortia arrangements are theoretically an anti-competitive practice, it has offered advantages by cost reduction. As a result, the shippers do not pay much attention to increases in the freight rate. And also consortia have offered new services and extended the services of their shipping agents in Sri Lanka.

As competition increases in many trades, a declining trend of the conference activities can be observed over the last decade in the world shipping industry. Most probably a decline will also be seen in the freight rate even though conferences attempt to fix the rate. This provides evidence that traditional rate-fixing at a conference no longer seems to be able to ensure a stable rate. On the other hand, conference member liners frequently determine their rate according to the market forces of demand and supply.

The THC is charged on all exports theoretically, but what governs the trade finally is the market forces. Given that this particular levy was initiated in 1997, one of the first expected signs of change in this market would be the type of freight contract that was offered by exporters, the tendency being that many of the exporters offer contracts that do not attract the THC. Thus, it may be expected that more contracts under Cost Insurance and Freight (CIF), may be offered as opposed to FOB.

Given that most of the existing FOB contracts would indeed be subject to this levy, there would be an impact on exporters in the form of an increase in the cost of Sri Lankan exports. This increase may render some Sri Lankan exports to be un-competitive in the world market, affecting the trade volume and the trade revenue of Sri Lankan exports. The extent of this impact on the local economy will depend on the rate of response of the Sri Lankan exporter to this initiative by CASA. There is no evidence that can provide a glimpse on the manner in which this THC has had an impact on the export volume and the export performance of the Sri Lankan exporters.

## 7. Lessons and Agenda for the Future

As reiterated throughout this report, the major obstacles to the implementation of effective competition policy relate to institutional deficiencies (such as lack of independence, legitimacy, accountability) at the level of the competition authority and to the lacuna in consumer interest organizations at the civil society level. Encompassing all these deficiencies are the pervasive political interference factor and ubiquitous bad governance practices that characterize Sri Lanka's socio-political milieu.

What does this reveal in terms of priorities for the future? What ought to be done – or more realistically what can be done – to enhance institutional independence and governance and minimize political interference? A possible strategy could be as follows:

- Enhance institutional independence and minimize political capture by sourcing funds from outside the government;
- Attract skilled persons and persons capable of effective leadership to the Commission by offering salaries comparable with that of the private sector; this would resolve to a large extent issues of regulatory capture;
- Beef up training activities at the Commission and create networks with competition authorities in other countries;
- Engage the existing NRG forum in awareness raising activities relating to competition policy and consumer affairs; and,
- Use the regional consumer affairs network under the 7-Up programme to train and galvanize the inactive and apathetic consumer entities in Sri Lanka.

## Annex 1

(1)

**Competition Concerns in the Globalizing Economy**  
(Questionnaire for Stakeholders Other Than Competition Authority)

<b>1 Identification Particulars</b>		
<b>A.</b> Name of the country		
<b>B.</b> Name :	Serial No./Code No:	
<b>C.</b> Professional association	Government Dept. Consumer Org. /NGO Business/Chamber of Commerce Competition/Regulatory Authority Trade Union Academia/Media Any other (specify)	<input type="radio"/> <input type="radio"/> <input type="radio"/> <input type="radio"/> <input type="radio"/> <input type="radio"/> <input type="radio"/>
<b>2</b> Are you familiar with:		
<i>A</i>	[Country specific competition law e.g. MRTP Act]?	Yes <input type="radio"/> No <input type="radio"/>
<i>B</i>	[Country specific consumer law e.g. COPRA]?	Yes <input type="radio"/> No <input type="radio"/>
<i>C</i>	Do you think competition law is useful and necessary for the country?	Yes <input type="radio"/> No <input type="radio"/>
<i>D</i>	Are the provisions of the law adequate to deal with:	
<i>i</i>	National competition concerns?	Yes <input type="radio"/> No <input type="radio"/>
<i>ii</i>	cross-border competition concerns	Yes <input type="radio"/> No <input type="radio"/>
<i>E</i>	Do you think that the law is effectively enforced?	Yes <input type="radio"/> No <input type="radio"/>
<b>3</b> To the best of your knowledge, have there been cases of the following anti-competitive practices in your country?		
<i>A</i>	<b>Cartels</b>	
<i>i</i>	Cement	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Shipping/ Road haulage	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	Pharmaceuticals	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iv</i>	Other sector(s) -----	
<i>B</i>	<b>Bid-rigging</b>	
<i>C</i>	<b>Exclusive dealing</b>	
<i>i</i>	Consumer durables	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Other sector(s) -----	
<i>D</i>	<b>Abuse of dominance</b>	
<i>i</i>	Food and beverages	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Pharmaceuticals	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	Tobacco	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iv</i>	Other sector(s) -----	
<i>E</i>	<b>Unfair trade practices</b>	
<i>i</i>	Banking	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Other sector(s) -----	

## Cross-Border Competition: Implications for Sri Lanka

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<b>4</b>	Are you aware of any anti-competitive effects <i>in your country</i> from the following:	
<b>A</b>	<b>International cartels</b>	
<i>i</i>	<i>International vitamins cartel</i>	Yes o No o Don't know o
<i>ii</i>	<i>International seamless steel tubes cartel</i>	Yes o No o Don't know o
<i>iii</i>	<i>International cement cartel</i>	Yes o No o Don't know o
<i>iv</i>	<i>Other (please specify) _____</i>	
<i>v</i>	Was any action taken on any of these by the Competition Authority?	Yes o Which? _____ No o Don't know o
<hr/>		
<b>B</b>	<b>International mergers &amp; acquisitions</b>	
<i>i</i>	<i>Gillette-Wilkinson</i>	Yes o No o Don't know o
<i>ii</i>	<i>CocaCola-Cadbury Schweppes</i>	Yes o No o Don't know o
<i>iii</i>	<i>BAT-Rothmans</i>	Yes o No o Don't know o
<i>iv</i>	<i>GlaxoWellcome-SmithKline Beecham</i>	Yes o No o Don't know o
<i>v</i>	<i>Other (please specify) _____</i>	
<i>vi</i>	Was any action taken on any of these by the Competition Authority?	Yes o Which? _____ No o Don't know o
<hr/>		
<b>C</b>	<b>Export cartels</b>	
<i>i</i>	<i>Soda ash</i>	Yes o No o Don't know o
<i>ii</i>	<i>Other (please specify) _____</i>	
<i>iii</i>	Was any action taken on these by the Competition Authority?	Yes o No o Don't know o
<hr/>		
<b>D</b>	<b>Anti-competitive practices in regional cross-border service provision</b>	
<i>i</i>	<i>Road haulage</i>	Yes o No o Don't know o
<i>ii</i>	<i>Shipping</i>	Yes o No o Don't know o
<i>iii</i>	<i>Other (please specify) _____</i>	
<i>iv</i>	Was any action taken by the Competition Authority?	Yes o Which? _____ No o Don't know o
<hr/>		
<b>E</b>	<b>Abuse of dominant market position by a foreign firm</b>	
<i>i</i>	<i>Banking</i>	Yes o No o Don't know o
<i>ii</i>	<i>Pharmaceuticals</i>	Yes o No o Don't know o
<i>iii</i>	<i>Food and beverages</i>	
<i>iv</i>	<i>Other (please specify) _____</i>	
<i>v</i>	Was any action taken by the Competition Authority?	Yes: which? _____ No o Don't know o
<hr/>		
<b>F</b>	<b>Bid-rigging by a foreign firm(s)</b>	
<i>i</i>	<i>Construction</i>	Yes o No o Don't know o
<i>ii</i>	<i>Machinery</i>	Yes o No o Don't know o
<i>iii</i>	<i>Other (please specify) _____</i>	
<i>iv</i>	Was any action taken by the Competition Authority?	Yes: which? _____ No o Don't know o
<hr/>		
<b>G</b>	<b>Dumping</b>	
<i>i</i>	<i>Electrical goods</i>	Yes o No o Don't know o
<i>ii</i>	<i>Dairy products</i>	Yes o No o Don't know o
<i>iii</i>	<i>Other (please specify) _____</i>	
<i>iv</i>	Was any action taken by the Competition Authority?	Yes: which? _____ No o Don't know o

(2)

**Competition Concerns in the Globalizing Economy**  
(Questionnaire for Competition Authority Members/Officials)

<b>1. Identification Particulars</b>		
A. Name of the country		
B. Name :	Designation	
2 A Which of the anti-competitive practices, you think, are more prevalent in your country? (Multiple response possible)		
	Cartels/price-fixing/market sharing	<input type="radio"/>
	Bid-rigging	<input type="radio"/>
	Tied-up sale	<input type="radio"/>
	Exclusive dealing	<input type="radio"/>
	Abuse of monopoly/dominant power	<input type="radio"/>
	Resale price maintenance	<input type="radio"/>
	Unfair practices/misleading information	<input type="radio"/>
	Any other (specify)	<input type="radio"/>
B Which sector/industries you think are more affected by anti-competitive practices?		
	Pharmaceuticals	<input type="radio"/>
	Cement	<input type="radio"/>
	Transportation	<input type="radio"/>
	Financial sector	<input type="radio"/>
	Fast moving consumer goods	<input type="radio"/>
	Any other (specify)	<input type="radio"/>
	Any other (specify)	<input type="radio"/>
C Are the provisions of the law adequate to deal with:		
i National competition concerns?	Yes <input type="radio"/> No <input type="radio"/>	
ii cross-border competition concerns	Yes <input type="radio"/> No <input type="radio"/>	
D Do you think that the law is effectively enforced? Yes <input type="radio"/> No <input type="radio"/>		
<b>3 Are you aware of any anti-competitive effects in your country from the following:</b>		
<b>A International cartels</b>		
i International vitamins cartel	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>	
ii International seamless steel tubes cartel	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>	
iii International cement cartel	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>	
iv Other (please specify) _____	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>	
v Was any action taken on any of these by the Competition Authority?	Yes <input type="radio"/> Which? _____ No <input type="radio"/> Don't know <input type="radio"/>	
vi If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>	
vii If, yes, what was the result?		
viii Did the action taken succeed in preventing the anti-competitive practice?		

<b>B</b>	<b>International mergers &amp; acquisitions</b>	
<i>i</i>	<i>Gillette-Wilkinson</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	<i>CocaCola-Cadbury Schweppes</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	<i>BAT-Rothmans</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iv</i>	<i>GlaxoWellcome-SmithKline Beecham</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>v</i>	<i>Other (please specify) _____</i>	
<i>vi</i>	Was any action taken on any of these by the Competition Authority?	Yes <input type="radio"/> Which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>vii</i>	If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>
<i>viii</i>	If, yes, what was the result?	
<i>ix</i>	Was the merger of the subsidiaries allowed?	Yes <input type="radio"/> No <input type="radio"/> Yes but conditional <input type="radio"/>
<i>x</i>	If conditional, then what were the conditions	No price increase <input type="radio"/> No scaledown/stop production <input type="radio"/> No asset stripping <input type="radio"/> No labour shedding <input type="radio"/> Any other (specify) <input type="radio"/>
<i>xi</i>	Did the action taken /condition imposed succeed?	
<b>C</b>	<b>Export cartels</b>	
<i>i</i>	<i>Soda ash</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	<i>Other (please specify) _____</i>	
<i>iii</i>	Was any action taken on these by the Competition Authority?	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iv</i>	If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>
<i>v</i>	If, yes, what was the result?	
<i>vii</i>	Did the action taken succeed in preventing the anti-competitive practice?	
<b>D</b>	<b>Anti-competitive practices in regional cross-border service provision</b>	
<i>i</i>	<i>Road haulage</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	<i>Shipping</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	<i>Other (please specify) _____</i>	
<i>iv</i>	Was any action taken by the Competition Authority?	Yes <input type="radio"/> Which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>v</i>	If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>
<i>vi</i>	If, yes, what was the result?	
<i>vii</i>	Did the action taken succeed in preventing the anti-competitive practice?	
<b>E</b>	<b>Abuse of dominant market position by a foreign firm</b>	
<i>i</i>	<i>Banking</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	<i>Pharmaceuticals</i>	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	<i>Food and beverages</i>	
<i>iv</i>	<i>Other (please specify) _____</i>	
<i>v</i>	Was any action taken by the Competition Authority?	Yes: which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>vi</i>	If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>
<i>vii</i>	If, yes, what was the result?	
<i>viii</i>	Did the action taken succeed in preventing the anti-competitive practice?	

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<i>F</i>	<b>Bid-rigging by a foreign firm(s)</b>	
<i>i</i>	Construction	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Machinery	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	Other (please specify) _____	
<i>iv</i>	Was any action taken by the Competition Authority?	Yes: which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>v</i>	If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>
<i>vi</i>	If, yes, what was the result?	
<i>vii</i>	Did the action taken succeed in preventing the anti-competitive practice?	
<i>G</i>	<b>Dumping</b>	
<i>i</i>	Electrical goods	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Dairy products	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	Other (please specify) _____	
<i>iv</i>	Was any action taken by the Competition Authority?	Yes: which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>v</i>	If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>
<i>vi</i>	If, yes, what was the result?	
<i>vii</i>	Did the action taken succeed in preventing the anti-competitive practice?	
<b>4</b>	<b>Intellectual Property Rights</b>	
<i>i</i>	Is there any specific IPR provision in the law of your country?	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Has this provision ever been invoked?	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	Is there any incidence of abuse of IPR monopoly rights in your country by:	Domestic companies <input type="radio"/> Foreign companies <input type="radio"/> None <input type="radio"/>
<i>iv</i>	Was any action taken by the Competition Authority?	Yes: which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>v</i>	If not, why?	Unaware <input type="radio"/> No power <input type="radio"/> No resource <input type="radio"/> Political <input type="radio"/>
<i>vi</i>	If, yes, what was the result?	
<b>5</b>	<b>Cooperation</b>	
<i>i</i>	Has your country entered into any formal agreement with any other country?	Yes: which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>ii</i>	Is there any instance of <i>ad hoc</i> cooperation?	Yes: which? _____ No <input type="radio"/> Don't know <input type="radio"/>
<i>iii</i>	What was the nature of the cooperation?	Sharing information <input type="radio"/> Technical assistance <input type="radio"/> Any other <input type="radio"/>
<i>iv</i>	How useful was the cooperation?	To a large extent <input type="radio"/> To some extent <input type="radio"/> Of no use <input type="radio"/>
<i>v</i>	Would more cooperation be useful?	Yes <input type="radio"/> No <input type="radio"/> Don't know <input type="radio"/>

Annex 2

Chart 1

Are you familiar with?

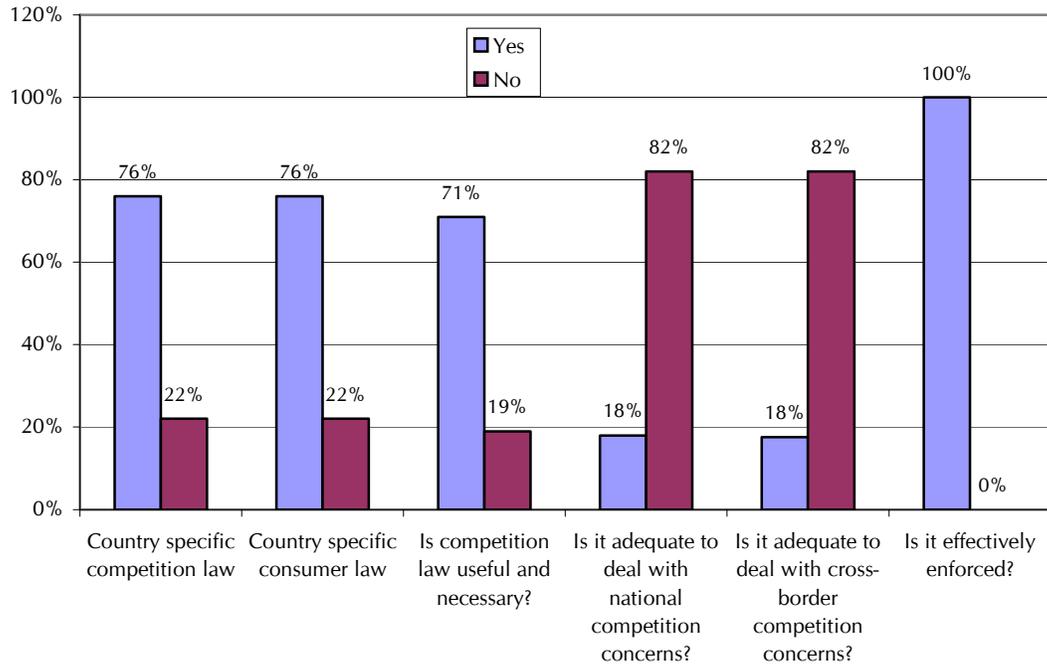


Chart 2

Awareness of cartels in Sri Lanka

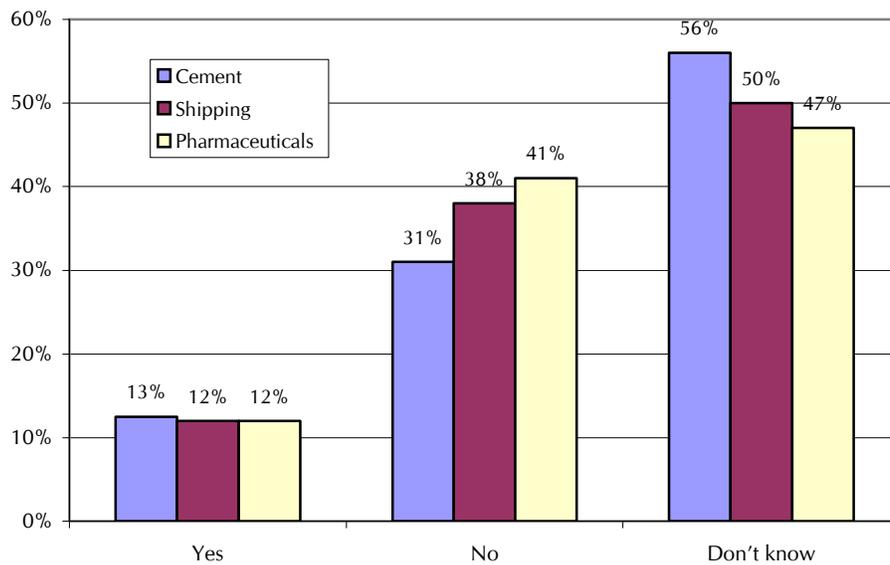


Chart 3

## Awareness of bid rigging in Sri Lanka

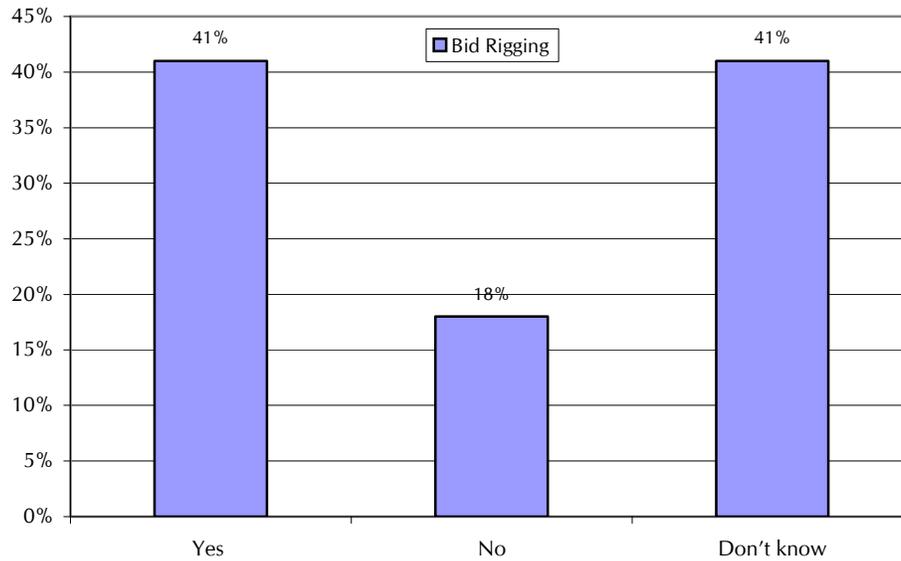


Chart 4

## Awareness of exclusive dealing in consumer durables in Sri Lanka

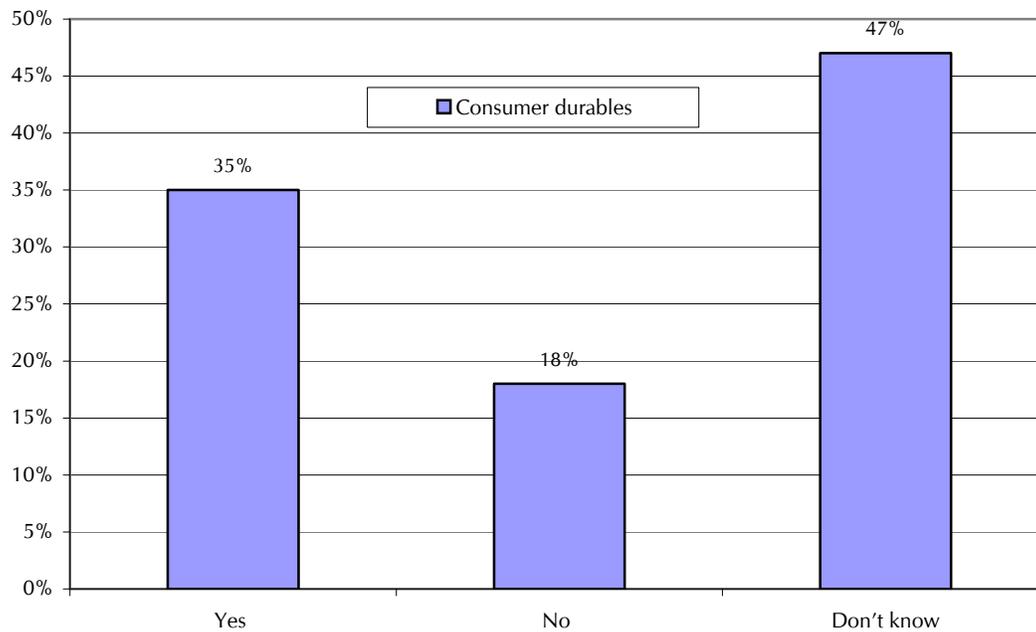


Chart 5

Abuse of dominance

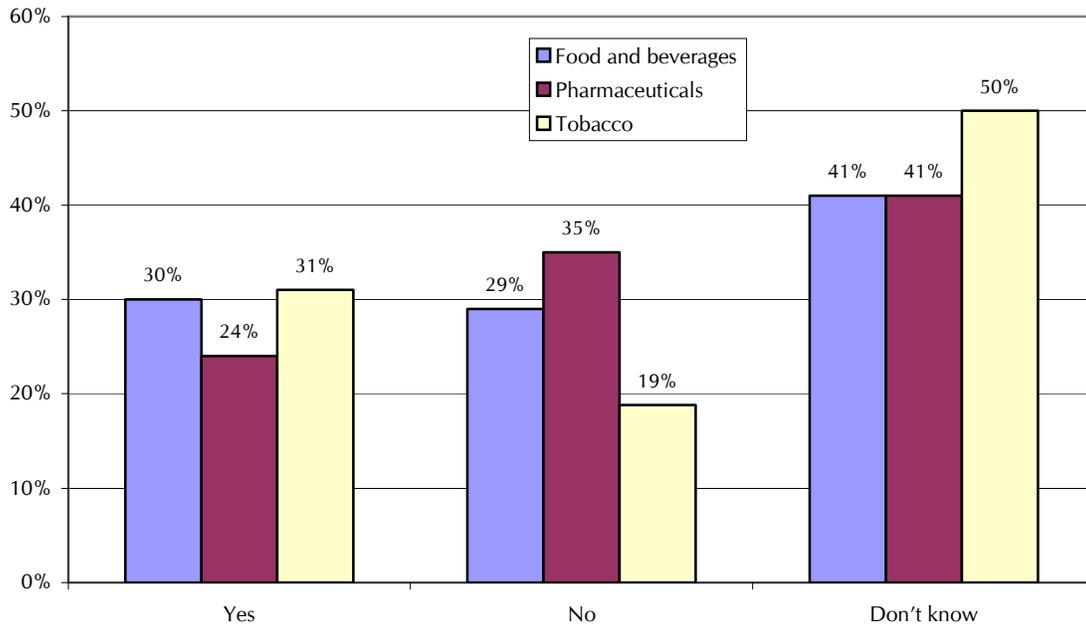


Chart 6

Unfair trade practices in the banking sector

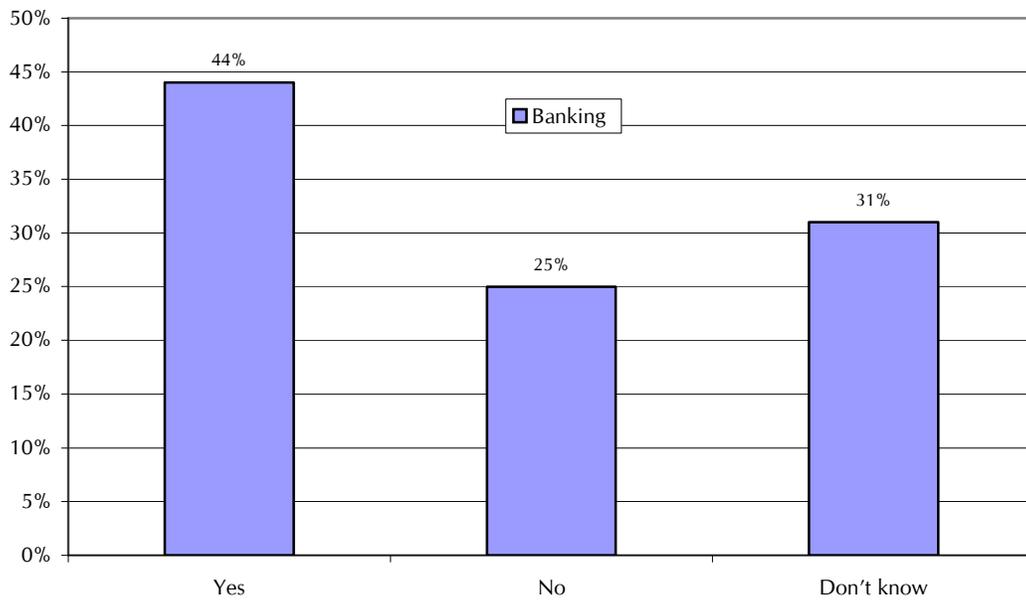


Chart 7

Awareness of anti-competitive effects in Sri Lanka

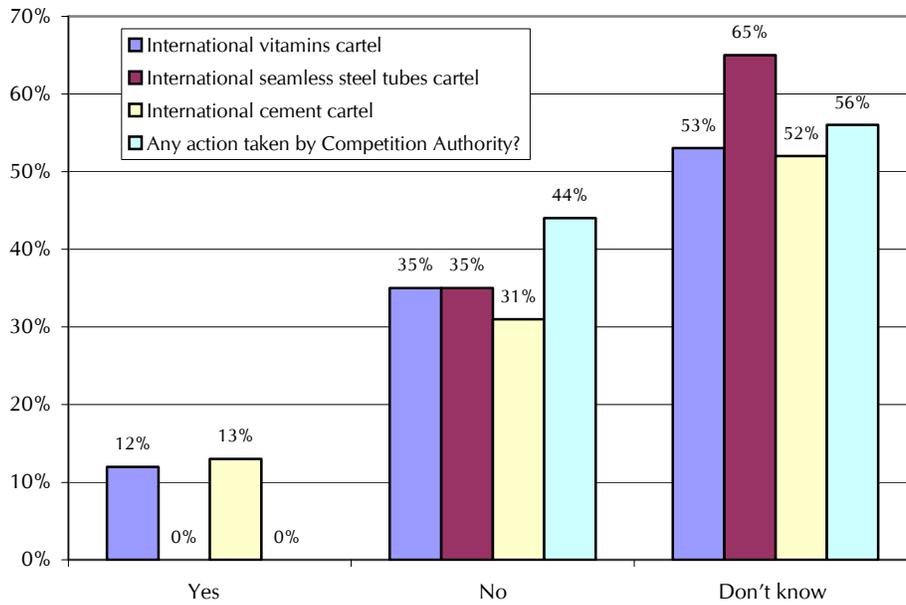


Chart 8

Awareness of international mergers and acquisitions

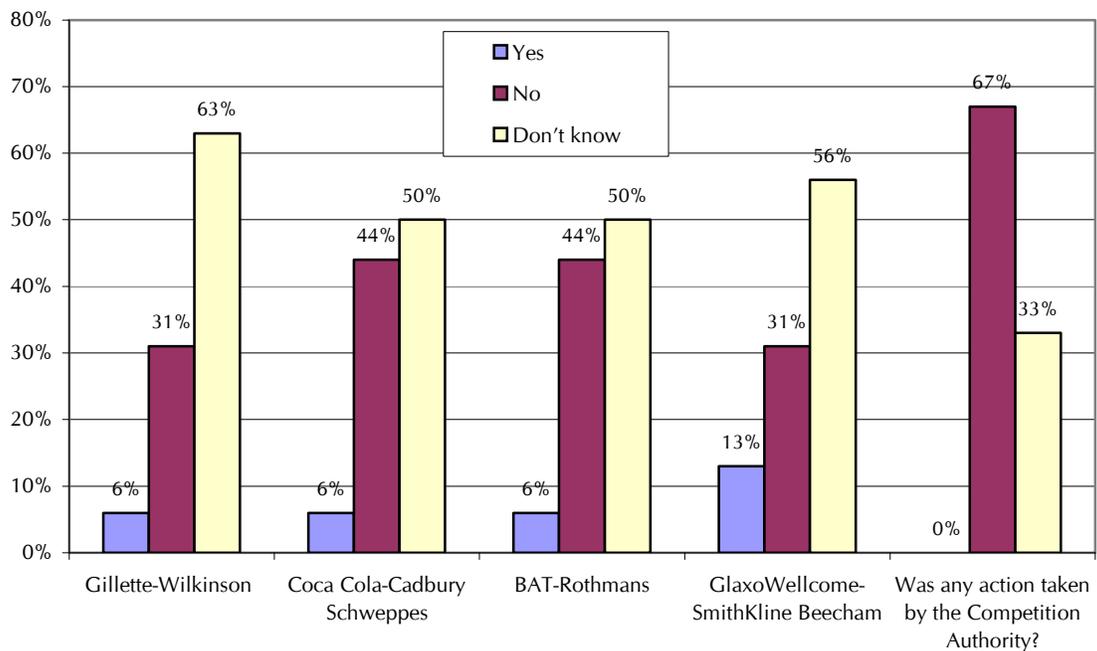


Chart 9

Awareness of export cartels in Sri Lanka

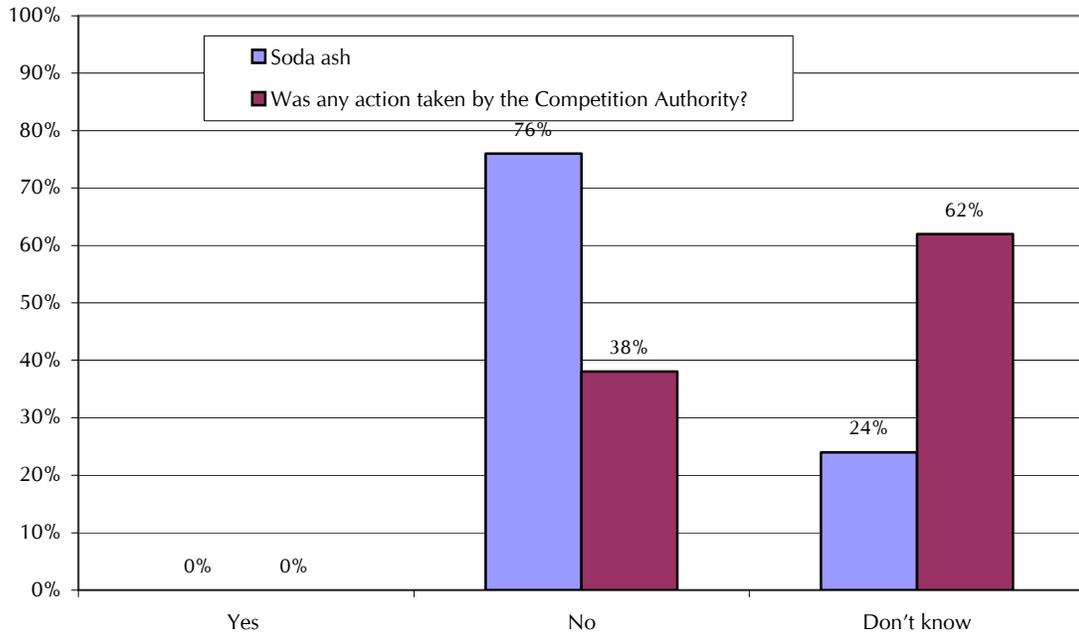


Chart 10

Anti-competitive practices in regional and cross border service provision

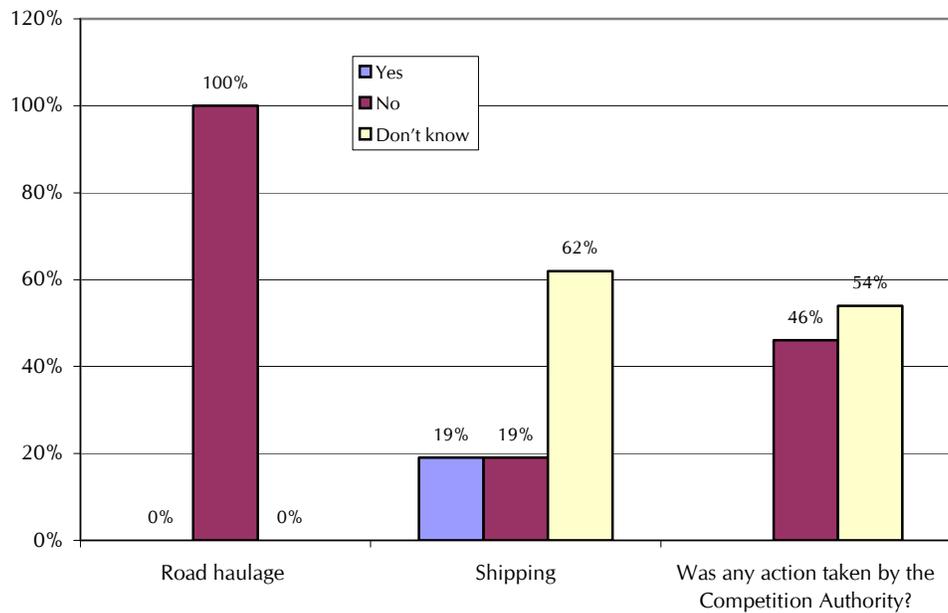


Chart 11

## Abuse of dominant market position by a foreign firm

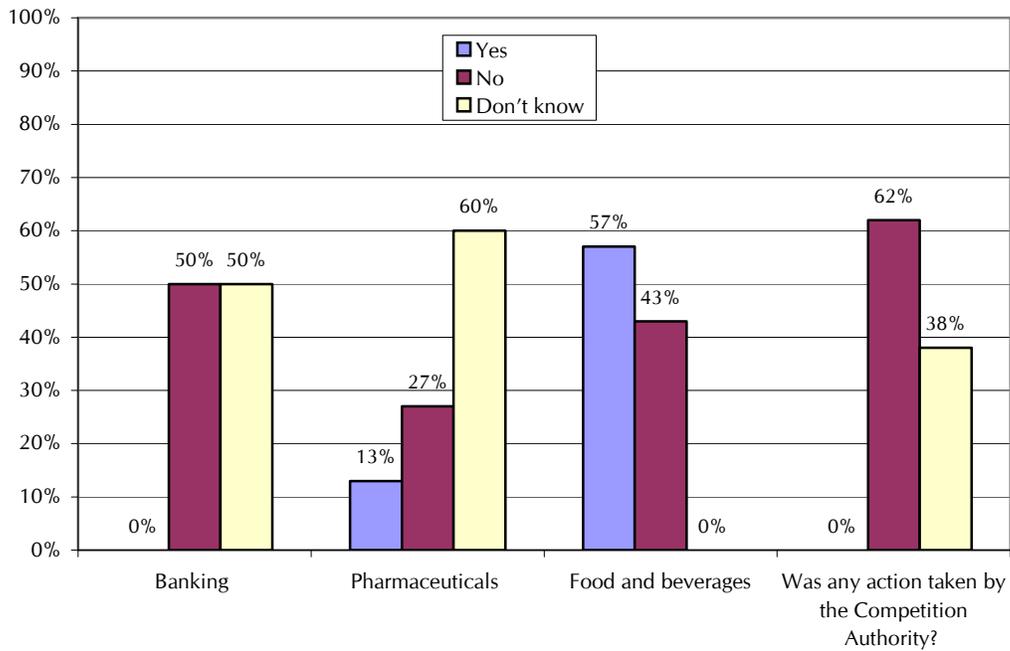


Chart 12

## Bid rigging by a foreign firm

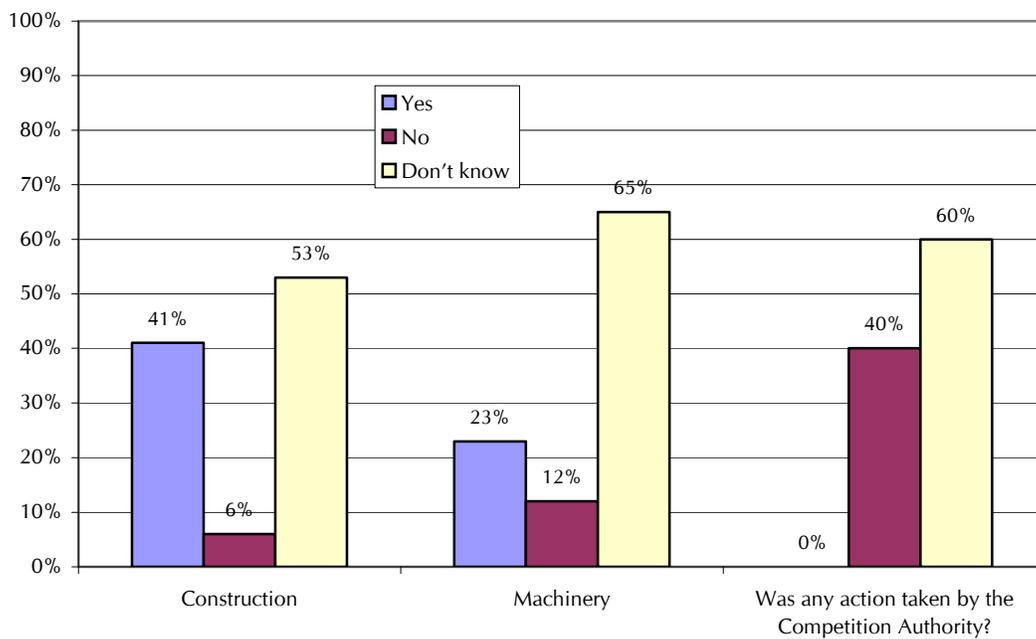
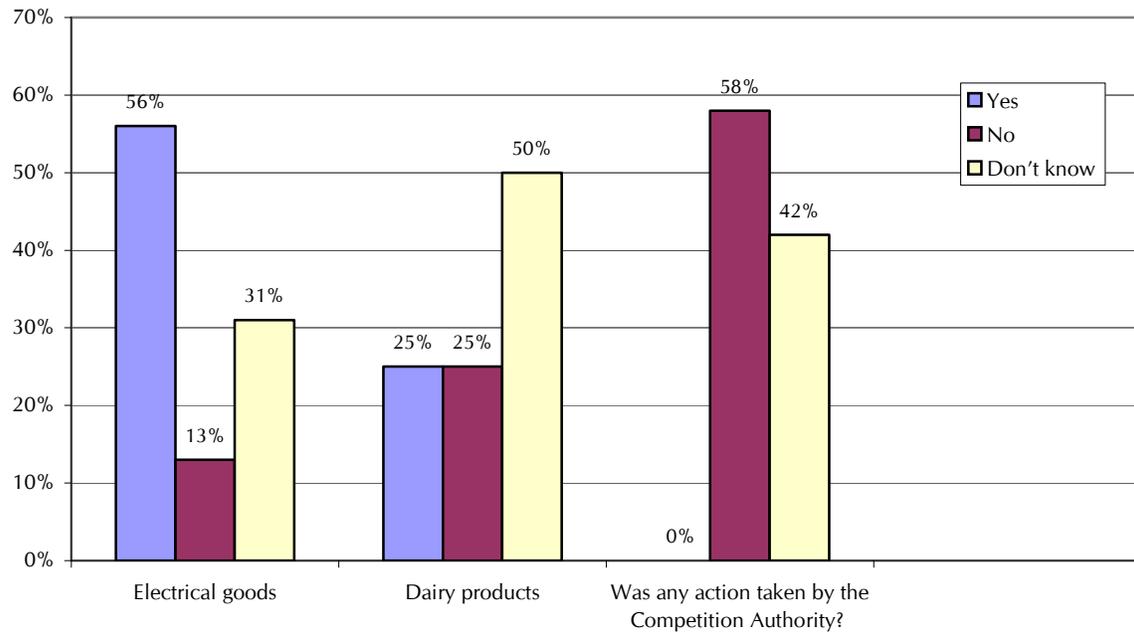


Chart 13

Awareness of Dumping



## Annex 3

### Document 1

#### **Competition policy and consumer protection in Sri Lanka: some urgent issues**

Our advocacy efforts are based on the fundamental premise that a healthy competition culture helps to:

- Enhance consumer welfare;
- Promote fair trading and check undue concentration of economic power;
- Achieve economic efficiency; and,
- Enhance economic development - a necessary condition for poverty reduction.

The three areas that we focus on to bring about a healthy competition culture are:

- Administrative/institutional [Fair Trading Commission (FTC) /Department of Internal Trade (DIT)/ Consumer Affairs and Fair Trading Authority (CAFTA)];
- Legislation (CAFTA Bill);
- Consumer organizations/national discussion on competition policy by civil society/societal awareness of competition policy and consumer protection.

#### Administrative/institutional

- Our publications have dealt with the main problems with regard to the FTC and the DIT in detail; as such, this note only highlights a few priority issues.
- Dearth of skilled staff/expertise: Why?
- Paucity of funds for basic functions. According to our calculations: FTC budget is a mere 0.00363 per cent of the government's budget.
- Solution? We believe that CAFTA has to have other independent sources of funds to supplement what it can get from the Treasury, if it is to work effectively. Our strong recommendation is that a fund be maintained through a charge from companies or businesses (registered under the Business Names Ordinance). The fee can be moderate and be based on turnover or profit. Companies already registered need not be re-registered to make the payment, thereby reducing administrative costs.
- There should be provision for greater cooperation between the competition authorities of the region, for exchanging information on particular cases – for instance, cross-border cases such as international mergers, hardcore cartels etc., or for training activities.

#### Legislation

- The CAFTA Bill must have a section inscribing Consumer Rights, as is the case in the Indian legislation.
- Professional services must be included in the Bill.
- The CAFTA Bill must precede the Public Utilities Commission Bill in enactment.

#### Consumer organizations/national discussion on competition policy/general societal awareness of competition policy and consumer protection issues

- A survey we did for research purposes revealed that a majority of the Sri Lanka community was ignorant on issues such as anti-competitive practices, cross-border abuses, consumer rights etc.

- The principal reason for the lack of awareness/discussion – we feel – is that the existing consumer organizations are inactive.
- Discussions with these organizations revealed that they are not able to function effectively due to a lack of funds.
- However, we also feel that the lack of funds is only a part of the problem; there is also an urgent need for capacity building; to train personnel in these organizations – to expose them to the basic “nuts and bolts” of consumer rights and protection, to equip them with the skills to reach out to consumers at all levels of society.
- It maybe a good idea to look into the viability of consumer courts (India) in Sri Lanka.

## **Document 2**

### **1. Why should competition policy and consumer protection be brought under one body?**

#### Concept

- Strong and effective competition promotes benefits to the consumer and enhances productivity.
- Accordingly, the job of CAFTA is to make markets work well for consumers – when markets work well and there is open, fair and vigorous competition, consumers have the power of choice; when markets fail and anti-competitive practices (and monopolies and mergers etc.) prevail consumer interests are undermined.

#### Practical issues

- Economies of scope – given the tight complementarity between competition regulation and consumer protection, there is a high degree of commonality in regulatory inputs such as public hearings, cost and impact assessment studies etc.
- Resource scarcity – in the Sri Lankan context of scarce regulatory skills/expertise, it is impractical to conceive of two separate bodies handling competition policy and consumer protection issues.
- Past lessons – the unhappy experience that Sri Lanka has had with two bodies – the FTC and the DIT – with overlapping and duplication of functions, points to the need for amalgamation as in the case of CAFTA.

#### Best practice

- *The UK experience:*
  - ♦ The UK has several competition bodies that firms have to encounter: The Office of Fair Trading, the Competition Commission, the Secretary of State for Trade and Industry, (the European Commission), a number of sectoral regulators (Ofgem: energy, Ofwat: water, Oftel: telecom, ORR: railway, CAA: air traffic, Ofreg: gas and electricity in N. Ireland).
  - ♦ (The point here is NOT the number of bodies – the size of the UK market and the level of economic activity and the available regulatory expertise may well justify such an approach). The point is that all these bodies simultaneously emphasize the importance of competition and competition regulation in promoting consumer interests.
- *Australia:*
  - ♦ The Australia Competition and Consumer Commission (note the terminology) handles anti-competitive and unfair market practices, mergers/acquisitions, product safety/liability and consumer protection work.

## 2. Why should Part III of the CAFTA Bill be included in this legislation/ under the mandate of the competition and consumer affairs body?

### Concept

- As argued in the previous sections, competition policy/competition regulation and consumer protection must be brought under one body.
- Accordingly, monopolies, mergers and anti-competitive practices, the subject of Part III are also inextricably linked to the mandate of protecting consumer interests.

### Sectoral regulators and competition regulator

- The demarcation of the line of responsibility between sectoral regulators and the competition regulator has been a perennial problem in almost every jurisdiction.
- However, it must be expected that the sectoral regulator has greater industry expertise whereas the competition regulator has greater expertise in handling competition regulation – in this case, monopolies, mergers and anti-competitive practices.
- As such, the competition regulator (CAFTA) must take the lead in handling these issues – in order to ensure regulatory consistency across the whole spectrum of the economy – with provision to consult with the sectoral/industry regulator in the case of the particular sector/industry that comes under the latter's mandate.
- The issue of ex-ante and ex-post regulation is irrelevant in this case as the CAFTA Bill provides the mandate to look into the “existence or possible existence of monopolies, mergers and anti-competitive practices”.

### Best practice

- *The UK experience*
  - ◆ The 1998 Competition Act provides for concurrent powers between the Office of Fair Trading (which has the mandate to regulate monopolies, mergers, and anti-competitive practices and looks into consumer interest issues) and industry regulators to ensure that the two bodies are obliged to consult before taking action and to ensure consistency in casework. The only exception is that the Office of Fair Trading is solely responsible for issuing guidelines on penalties and procedural rules.

## **INSTITUTE OF POLICY STUDIES**

The Institute of Policy Studies of Sri Lanka (IPS) is an autonomous, national Institution for research into economic policy, established by an Act of Parliament in 1988. It formally came into operation in 1990. The mission of the institute is to contribute to the prosperity of a democratic and united Sri Lanka, and to the enhancement of the quality of life of its people by supporting and informing policy-makers through independent, high quality, research-based analyses of medium and long-term national policy issues. Though closely linked to the policy-making establishment, its financial and administrative independence enables IPS to be an authoritative, independent voice on Sri Lankan economic policy.

## **LAW & SOCIETY TRUST**

The Law & Society Trust, (LST), established in June 1982 under the provision of the Companies Act of 1982, is a non-profit making body committed to improving public awareness on civil and political rights and social, economic and cultural rights, and equal access to justice. The LST has taken a leading role in promoting cooperation between government and society within South Asia on questions relating to human rights, democracy and minority protection, and policy agenda for the next decade. The Trust attempts to use law as a resource in the battle against underdevelopment and poverty, and is involved in the organization of a series of programs aimed at members of the legal community, including publications, workshops, seminars and symposia.

## **CONSUMER UNITY & TRUST SOCIETY**

Established in 1983, Consumer Unity & Trust Society (CTS) started off as a consumer protection organization in Rajasthan, India. Since then, it has been working in several areas of public interest at the grassroots, national, sub-continental and international levels. These activities have now crystallized into five programmatic centres and three resource centres, which cover issues ranging from empowering rural people, to advocacy on multilateral trade, to consumer protection broadly covering health, safety and sustainable consumption. CUTS also comprises of a unit specially focused on competition, investment and economic regulation.