Competition
and Development

THE POWER OF COMPETITIVE MARKETS

Consumer Choice at the Corner Store

Costa Rica's competition authority fines Coca-Cola.

The benefits of competition policy are not always clear to the average consumer. But people in Costa Rica noticed when a competition authority ruling forced Coca-Cola makers to change their practices. The highly visible case is helping to build political will to tighten the legislation.

In the beginning, there was Coca-Cola – or there might as well have been, given the product's huge place in the Costa Rican psyche and economy. Many Costa Ricans were therefore understandably surprised when the Coca-Cola Interamerican Corporation — the Coca-Cola Company's Costa Rican subsidiary — and its bottler, Panamco Tica, were scolded and sanctioned by the national competition agency in 2004.

"Most people here think that these kinds of companies cannot be sued, that they have too much power," says Agustina Cobas, a reporter with *La República* newspaper in San José.

The case before the Comisión para Promover la Competencia (CPC) started as a battle between giants. Rival beverage manufacturer PepsiCo, two of its subsidiaries, and their Costa Rican bottler filed a complaint in 2001 against the Atlanta-based Coca-Cola Company, Coca-Cola Interamerican Corporation, and Panamco Tica. The Pepsi companies claimed that the Coca-Cola makers were engaging in anticompetitive agreements between companies at different points on the production chain — in this case between manufacturer and retailer. The country's 1994 competition legislation, the first in Central America, prohibits these practices.

During the same year, three national soft drink and juice makers — La Mundial, La Cruz Blanca, and La Flor — also joined the suit. The competition agency agreed to look at the following charges: imposing resale prices and minimum purchase volumes on retailers; requiring their vending

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The Coca-Cola case provides a reminder that competition law can have a direct impact on consumer choice.

machines and refrigeration equipment to carry their products exclusively; requiring some stores to carry their products exclusively; tying the sale of one product to the sale of another; and charging different prices to different buyers.

A complex case

To rule against Coca-Cola, the CPC had to have proof that the defendant had substantial market power and had engaged in activities that were illegal under the competition law, and that these activities had anticompetitive effects.

To measure market power, it turned to the parties in the case for information. “It was atypical because normally it is the CPC that has to provide the burden of proof of wrongdoing,” notes Pamela Sittenfeld, who was the executive director of the CPC during the investigation and who led an IDRC-funded study on competition in Costa Rica.

All parties turned over reports on their sales, market and product characteristics, distribution systems, and client and consumer relationships. The CPC also approached the companies’ clients countrywide for information on such issues as the defendants’ price, marketing, and sales policies. Finally, it invited the parties to present their cases before the CPC.

The case, notes Sittenfeld, marked a milestone for Costa Rica’s competition legislation. During the two years it took to resolve it, it became notorious, she said. It involved multinationals; it was complex; and there were mountains

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The case established that “companies with large market shares like Coca-Cola and its bottler must walk softly.”

of paperwork that required a lot of time and resources to appraise. “The arguments used by the different parties were very sophisticated,” Sittenfeld says. Injunctions upon injunctions were filed before the Constitutional Court.

One thorny issue was the CPC’s categorization of the product market. Using the information obtained from the participants in the case, the CPC lumped non-alcoholic carbonated beverages with canned and bottled fruit juices, arguing that these products were substitutes for each other. The information had shown that a price increase in one product meant that the demand for it would fall against demand for the other product.

“This was highly controversial. The carbonated beverage market was very concentrated and Panamco Tica had more than 85 percent of it,” Sittenfeld recalls. When defined by the CPC to include all non-alcoholic beverages, Panamco Tica had a lesser, though still significant portion of the local market, at 74 percent.

High market entry barriers magnified the Coca-Cola bottler’s market power. The CPC concluded that the intensive distribution necessary for this kind of impulse-buy product, the strength of the established brands, and the substantial advertising investment needed to enter the market were all barriers to market entry.

A landmark verdict

The CPC fined Panamco Tica for obligatory pricing and exclusivity agreements. Sales agreements with retailers included clauses on suggested retail prices: some even obliged Coca-Cola vendors to stick to the listed price. According to the CPC, this hindered intra-brand competition between different establishments selling the same products and restricted retailers’ freedom to establish their own prices.

Sales contracts also prevented retailers in some areas from stocking competing brands. The CPC ruled that these exclusivity agreements reduced competition and restricted market entry to new participants. It told the Coca-Cola bottler that, given its market share, such behaviour was unjustifiable.

For most Costa Ricans, beverage coolers epitomized the case. Coca-Cola makers gave retailers refrigerators displaying the soft-drink logo, on condition that only the company’s products could be stored in them. While this provision may seem understandable, the CPC noted, the

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Costa Rica's 1994 competition legislation, the first in Central America, prohibits monopolistic practices.

exclusive refrigerators restricted competitors' market access and reduced consumer choice in very small establishments where there was room for just one beverage cooler. If there was sufficient space for additional equipment, then the practice was allowed, the agency said.

Sanctions followed immediately. Although both Coca-Cola Interamerican Corporation and Panamco Tica were held responsible, fines were imposed only on the bottler because "they were the ones who were actually committing the infractions in the market," Sittenfeld says.

The CPC ordered the Coca-Cola Interamerican Corporation to take corrective measures, says Isaura Guillen, Sittenfeld's successor as CPC executive director. "Coca-Cola was told not to issue directives or guidelines to its bottler to perform actions that were anticompetitive."

Panamco Tica was fined about US$80 000 for imposing resale prices and was ordered to discontinue the practice. The CPC ruled that a company with substantial market power should make it clear that its clients were not obliged to follow the price lists.

Another US$80 000 fine was levied for negotiating product exclusivity in stores and an order was issued to remove such clauses from all contracts. The CPC also ordered Panamco Tica to discontinue the policy of refrigeration equipment exclusivity in small establishments.

The case set several important behavioural parameters for companies in Costa Rica. "It established that companies with large market shares like Coca-Cola and its bottler must walk softly," Guillen says.

"And," Sittenfeld adds, referring to the ruling on exclusivity agreements, "it established the concept of physical barriers to competitiveness that was not very clear in the law."

More teeth needed

The case also highlighted some of the problems inherent in the competition law. Indeed, Costa Rica's Promotion of Competition and Effective Consumer Protection Law displays many of the characteristic problems of the region's early legislation to encourage competition. IDRC-funded research on competition policy in Central America, which included the Costa Rican study, helped to identify these limitations, as well as the type of legislation and competition authorities best suited to the political, legal, and cultural realities of each country and the region as whole.

One of the problems with the Costa Rican law is that it leaves out many sectors, says Claudia Schatan, head of the International Trade and Industry Unit at the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC) in Mexico, who led the six-country research effort. "It has a huge number of exceptions," she notes. "Public enterprises and certain cooperatives, such as milk and sugar, cannot be sued."

For Sittenfeld, however, the most important drawbacks of the law deal with merger issues and the ability to collect information to resolve cases. "Companies do not have to notify the CPC before mergers and there are no adequate measures to analyze these types of transactions," she explains.

"The CPC also needs to broaden its investigation abilities because now it can only ask for information, public or confidential, from the parties involved in a case. It cannot seize documents or carry out raids on offices, for instance, tools which would prove useful to the Commission in the future." In the Coca-Cola case, she explains, the CPC relied on information provided by the company, but companies under investigation have no incentive to turn over information that could be held against them.

Many of the Costa Rican law's shortcomings are currently being addressed in proposed legislation that the CPC is developing. "We are looking at many of the shortcomings to make the law more effective and give us more investigative tools," Guillen says.

The challenge for small agencies

With or without the legal changes, cases like this one will challenge small agencies, such as the CPC in Costa Rica, which relies on a staff of 15 to hand down about 60 resolutions a year. "Resolving cases involving these companies absorbs a lot of the agencies' resources. It is not a matter of independence, or technical capability, but rather a matter of the number of people that an agency can throw at these cases. This is what directly affects the ability to hand down resolutions," Sittenfeld says.

One of the criticisms leveled at the CPC during the Coca-Cola case was the amount of time it took to issue a verdict. But, Guillen notes, it was a large case with many legal challenges and a lot of paperwork.

As the CPC works on getting its proposed law through the legislative assembly, the Coca-Cola case provides a reminder that competition law can have a direct impact on consumer choice. The CPC has ruled and published opinions on competition in such areas as sausage-making, roof sheeting, trucking, and national passenger airlines. But it is the bottles of Pepsi and a national soft drink brand like La Mundial in a store's Coca-Cola refrigerator that shows consumers what competition looks like at the end of the line.

This case study was written by Debra Anthony, a writer in Mexico City. It is based on the ECLAC research report, Ventajas y limitaciones de la experiencia de Costa Rica en materia de políticas de competencia: un punto de referencia para la región centroamericana*, by Pamela Sittenfeld.*

The views expressed in this case study are those of IDRC-funded researchers and of experts in the field.

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