

Competition and Barriers to Entry

How do entry barriers affect competition cases?

Is a precise definition of entry barriers needed?

Do temporary impediments matter?

Do competition agencies focus on theory or on facts?

What is the difference between structural and strategic entry barriers?

Is evidence of past entry conclusive?

What are competition agencies doing to lower entry barriers?

For further information

For further reading

Where to contact us?

Introduction

Before a firm can compete in a market, it has to be able to enter it. Many markets have at least some impediments that make it more difficult for a firm to enter a market. A debate over how to define the term “barriers to entry” began decades ago, however, and it has yet to be won. Some scholars have argued, for example, that an obstacle is not an entry barrier if incumbent firms faced it when they entered the market. Others contend that an entry barrier is anything that hinders entry and has the effect of reducing or limiting competition. A number of other definitions have been proposed, but none of them has emerged as a clear favourite. Because the debate remains unsettled but the various definitions continue to be used as analytical tools, the possibility of confusion – and therefore of flawed competition policy – has lingered for many years.

More recently, other commentators have concluded that while the debate about defining entry barriers may be intellectually interesting, it is irrelevant to competition policy. What matters in actual competition cases, they argue, is not whether an impediment satisfies this or that definition but rather the more practical questions of whether, when, and to what extent entry is likely to occur.

Regardless of whether there is a consensus on a definition, or even whether the definition ultimately matters, it is undeniable that the concept of entry barriers plays an important role in a wide variety of competition matters because it is vital to the analysis of market power. Entry barriers can retard, diminish, or entirely prevent the market’s usual mechanism for checking market power: the attraction and arrival of new competitors. This *Policy Brief* looks at the effects of entry barriers on competition and the issues they raise for policy makers. ■

How do entry barriers affect competition cases?

Barriers to entry are important because they are relevant in virtually every kind of competition case other than per se offences such as participating in a hard-core cartel. It is necessary to consider entry barriers when assessing dominance, when determining whether unilateral conduct might deter new firms from participating in a market, and when analysing the likely competitive effects of mergers, to name a few examples. If a merger will substantially increase concentration to the point where a competition agency is concerned about possible anticompetitive effects, entry barriers matter because competition will not be reduced if new firms would enter easily, quickly and significantly. Consequently, agencies seeking to block a merger will usually need to show that entry barriers make quick, significant new entry unlikely. Similarly, establishing the presence of substantial entry barriers is usually necessary to prove that a high market share translates into market power in monopolisation and abuse of dominance cases. ■

Is a precise definition of entry barriers needed?

In recent years, several competition scholars have concluded that the debate about entry barriers should be considered irrelevant to competition policy. They argue that abstract, theoretical pondering on the definition of barriers to entry is unlikely to be very helpful in investigations and policy decisions. What matters in actual cases is not whether an impediment satisfies this or that definition of an entry barrier, but rather the more practical questions of whether, when, and to what extent entry is likely to occur given the facts in each case. Most competition agencies in OECD countries agree with that pragmatic view. ■

Do temporary impediments matter?

An impediment to entry does not have to prevent firms from entering a market forever in order to affect competition and consumer welfare; sometimes just retarding the arrival of new firms is enough. Therefore, entry conditions are usually analysed from a dynamic, rather than a static, perspective. Consumer welfare can obviously suffer if monopoly-level pricing persists indefinitely due to insurmountable entry barriers. But consumer welfare may still suffer if the barriers only have the effect of delaying entry, since the decline in prices likely to result from greater competition will be delayed, too.

Most often, the interesting question for competition authorities is not whether price will eventually equal the competitive level after new firms enter the market, but rather how long it will take for that to happen. There probably is no perfect place to draw a line between significant and insignificant delays, but many competition agencies have chosen two years as the appropriate benchmark in their guidelines. ■

Do competition agencies focus on theory or on facts?

Entry analysis goes beyond asking whether impediments exist and whether entry could conceivably occur. Typically, it also asks whether entry *would* occur and, if so, whether it is likely to happen quickly enough and to be substantial enough to fix the anticompetitive problem that is central to a case. Therefore, most competition agencies conduct factual and flexible case by case examinations of entry conditions in their matters rather than making formulaic or purely abstract inquiries about what constitutes a barrier to entry. Guidelines on entry analysis vary from jurisdiction to jurisdiction, but the central feature of many of them is an examination of whether entry will be likely, timely, and sufficient to remove concerns about possible anticompetitive effects in a given case. Placing the focus on those issues avoids the risk of incorrectly concluding that the mere possibility, or even the actual occurrence, of any new entry is enough in itself to make intervention unnecessary. ■

What is the difference between structural and strategic entry barriers?

Conditions that constitute entry barriers may be *structural* or *strategic*.

Structural barriers have more to do with basic industry conditions such as cost and demand than with tactical actions taken by incumbent firms. Structural barriers may exist due to conditions such as economies of scale and network effects. Sometimes it is possible to quantify these kinds of barriers because it is known in advance how much it will cost to build an efficient plant or to purchase necessary inputs.

Strategic barriers, in contrast, are intentionally created or enhanced by incumbent firms in the market, possibly for the purpose of deterring entry. These barriers may arise from behaviour such as exclusive dealing arrangements, for example. It can be substantially more difficult to measure the difficulties that such behaviour can impose on potential entrants than it is to measure the height of structural barriers. Furthermore, it is not always easy to determine whether strategic behaviour should be viewed as fostering or restricting competition in the first place. Based on the experience of competition agencies, some strategic behaviour may be designed to thwart competition by raising entry barriers, which can help incumbent firms to maintain their market shares. In other instances, however, strategic behaviour may result in the retention of market share because it is efficient, even though it also happens to raise entry barriers. Competition authorities sometimes face the difficult problem of determining which conduct is pro-competitive and which is anti-competitive when both types of conduct would raise entry barriers.

Continuing with the example of exclusive dealing, it is often considered to promote competition and consumer welfare by encouraging retailers to give better service and more information to consumers. “Too much” exclusive

dealing by incumbents, however, could be deemed a barrier to entry if it leaves potential entrants with so few retail distribution outlets that they cannot enter and compete effectively in the market.

Some types of impediments can fall into either one of these categories, depending on the particular facts of the case. Statutory/regulatory barriers, for example, could be considered either structural or strategic depending on whether incumbent firms played a role in persuading the government to create them. Similarly, sunk costs are typically structural but could be considered strategic if incumbent firms are responsible for creating or enhancing them, such as by integrating vertically and thereby forcing potential entrants to do the same thing. ■

Is evidence of past entry conclusive?

Evidence of past entry, or the lack of it, can be helpful in assessing entry conditions in a market. Such evidence is not usually considered determinative by itself, though. Previous instances of entry do not necessarily prove that entry was easy, that it was competitively significant, or that it is likely to happen again.

Furthermore, current potential entrants may not face the same market conditions that previous entrants faced. By the same token, long periods without entry do not necessarily prove that entry barriers are high, or that significant entry is unlikely in the future. Instead, such patterns may indicate that a market is very competitive or that it is in decline and that it has therefore been unattractive to potential entrants.

Nevertheless, the history of entry in an industry can provide useful information about the likelihood and nature of entry in the future. If market conditions have not changed appreciably since the historical period being used for comparison, for example, then it may make sense to draw some inferences about what is likely in the future based on that period. While such evidence may be relevant, though, it is usually considered inadequate for making final conclusions. ■

What are competition agencies doing to lower entry barriers?

Some competition agencies have pro-actively taken aim at entry barriers that were unnecessarily created by government regulation. They have done so by issuing reports that study the regulations' effects on competition, identify less restrictive alternatives, and advocate appropriate changes. In regulated sectors, licensing procedures, territorial restrictions, safety standards, and other legal requirements may unnecessarily deter or delay entry. In some cases, these regulations seem to be the result of lobbying efforts by incumbent firms to protect their businesses. In other cases, incumbents find ways to take advantage of existing, complex regulations

to thwart entry, such as by using the regulations as the basis of litigation against entrants. Competition agencies in Ireland, Mexico, the United Kingdom, and the United States, for example, have published reports that highlight such problems in various markets including banking, contact lenses, federal auctions, and wine. ■

For further information

More information about this Policy Brief and the OECD Competition Division can be obtained from Jeremy West, e-mail: jeremy.west@oecd.org, tel.: +33 1 45 24 17 51, or see www.oecd.org/competition.



For further reading

OECD (2005), **Barriers to Entry**, (Best Practices Roundtable), available at www.oecd.org/daf/competition/documentation under "Best practices".

OECD (2004), **Merger Remedies**, (Best Practices Roundtable), available at www.oecd.org/daf/competition/documentation under "Best practices".

OECD publications can be purchased from our online bookshop:

www.oecd.org/bookshop

OECD publications and statistical databases are also available via our online library:

www.SourceOECD.org

Where to contact us?

OECD HEADQUARTERS

2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD Berlin Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN

OECD Tokyo Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD Mexico Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560 MEXICO, D.F.
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.oecd.org/centrodemexico

UNITED STATES

OECD Washington Center
2001 L Street N.W., Suite 650
WASHINGTON DC. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
Toll free: (1-800) 456 6323

The OECD Policy Briefs are prepared by the Public Affairs Division, Public Affairs and Communications Directorate. They are published under the responsibility of the Secretary-General.