

# CRCAL's New Guideline on Barriers to Entry

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The competitive assessment of mergers and firms' conducts requires an understanding of whether the threat or the actual entry of new competitors in the market is likely to limit the ability of the incumbent firms to exert market power. The Guidelines on Barriers to Entry (BTEs) written by Paolo Buccirossi illustrate the elements that a competition authority needs to consider in examining the entry conditions that characterize a relevant market. They hinge on the economic literature on the subject matter and on international best practices, as set out in the merger guidelines issued by several competition authorities.

Even though in the academic literature the definition of BTEs has been the subject of a long and still not completely settled debate, competition authorities have developed a pragmatic and consistent approach. This is based on the need to ascertain whether, on a factual ground, the competitive threat coming from potential competitors, or from a fringe of smaller rivals, is sufficient to prevent one or more firms from altering the competitive process and harm consumers.

Entry may be defined as the decision of a firm to start offering products that it did not offer before or serving groups of customers or territories that it did not serve before. Entry is usually triggered by the prospect of earning economic profits. This may be due to the existence of market power. In particular, an alleged anticompetitive conduct or a merger that would result in lower output and higher prices can attract new firms in the market. However, not all instances of entry have the ability to cure the competitive problem created by the conduct or the merger. Competition authorities, in considering whether a supply-side response is apt to eliminate a competitive concern, focus on three aspects: 1) the likelihood of entry; 2) the sufficiency of entry in terms of magnitude and scope; 3) the timeliness of entry.

Hence, BTEs may be defined as those factors that may: 1) impede the entry of new competitors in the market; 2) force new competitors to enter the market at a lower scale, with a reduced range of products or with a less attractive commercial proposition; or 3) delay the entry of new competitors in the market.

BTEs are frequently classified as: legal or regulatory BTEs; structural BTEs; and strategic BTEs.

Legal or regulatory BTEs involve all those factors that can impede, delay or reduce the scope of entry and that stem from the application of laws, regulation, administrative acts and any other form of public intervention in the market.

Structural BTEs are those factors that negatively affect the likelihood, sufficiency and timeliness of entry that stem from the technological means required to produce the relevant products and effectively sell them to the relevant customers, together with the existing and foreseeable market conditions prevailing in the relevant market, as well as in the upstream and downstream markets.

Strategic BTEs are those factors that can impede, delay or reduce the scope of entry that are created by the incumbent by adopting specific and avoidable strategies.

Although this classification may help finding whether the incumbent in a relevant market is protected by the existence of BTEs, competition authorities should resist the temptation to adopt a simplistic checklist attitude. A more appropriate approach would be to develop a “theory of entry” which requires investigation of:

- which are the firms that may attempt to entry or to expand their reach;
- how this attempt may occur;
- what is the likelihood that the new entrant or the fringe competitors will have access to the resources and technology that are necessary to produce the relevant products or to increase its production;
- what is the likelihood that customers will divert their purchases from the incumbent to the new entrant, taking into account the characteristics of the commercial offer of actual and potential firms and also the foreseeable reaction of the incumbent;
- how long this entry or expansion will take to produce material effects on consumers’ welfare.

The first step of the analysis of entry consists in understanding which firms are more likely to enter the relevant market. Typically potential competition may come from:

- (i) fringe firms already in the market;
- (ii) firms that sell the relevant product in adjacent geographic areas;
- (iii) firms that produce products with machinery or technology that is similar to that used to produce the relevant product;
- (iv) firms that sell in related upstream or downstream markets;
- (v) firms that sell through similar distribution channels; or
- (vi) firms that employ similar marketing and promotion methods.

These firms may differ in the level of investments that they have to undertake in order to make their entry/expansion decision effective and this will affect the likelihood and timeliness of entry. Therefore it is reasonable to restrict an entry analysis to those firms that are best placed to contest the incumbent’s position.

When there is no sufficient information to ascertain exactly the potential new entrants, it is advisable at least to identify the categories of firms that could potentially enter the relevant market and perform the analysis on these categories.

Once identified the potential entrants, a competition authority should assess the available evidence to understand whether these firms (or categories of firms) have actually the ability and the incentive to enter the relevant market in a timely manner and on a sufficient scale to make the risk of market power exploitation by the incumbent less likely.

Important evidence may derive from the analysis of previous instances of entry. It is unlikely that a competition authority will conclude that substantial BTEs exist if the market experienced frequent and successful examples of entry. Similarly, it is probably inappropriate to conclude that BTEs do not exist if previous attempts to expand production by fringe rivals or to enter the market always failed. However, evidence on past events should never be considered determinative, both if entry occurred and if it did not.

Valuable information on the existing entry conditions can be drawn from internal documents of the industry players and of potential competitors. These are particularly revealing if prepared independently of the investigation with the aim of making commercial decisions. These documents provide a reliable account of the commercial opportunities that new firms foresee, the hurdles that they need to overcome to take advantage of them, the market segments that they may choose to contest, the likely scale of production, the range of products they intend to offer and the timeframe in which an entry decision can be implemented. Also the incumbent's internal documents can be very informative in that they may describe to which extent it considers the possibility of new firms challenging its market position a real risk.

When internal documents are not available, a competition authority may seek to obtain the relevant information by interviewing the various market players. Generally, the customers' point of view is a reliable source of information because customers share with the competition authority the interest in maintaining a competitive market, without impeding mergers or business practices that improve the efficiency of suppliers.

The market researches provided by independent analysts are another valuable source. Although these studies often concern economic sectors or industries that are broader than antitrust markets, they contain precious information on the likely dynamic evolution of these sectors and may help in identifying the firms that are more likely to start offering the relevant products and the factors that may affect this commercial decision.

A proper theory of entry requires organization of all of these elements in a convincing story able to stand against the available evidence. This type of analysis is case-specific and competition authorities need to adapt it to the characteristics of the markets and of the conducts under investigation.