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Executive Summary of the Roundtable on Barriers to Exit in Competition

Annex to the Summary Record of the 132nd Meeting of the Competition Committee held on 3-4 December 2019

3-4 December 2019

This Executive Summary by the OECD Secretariat contains the key findings from the discussion held during the 132nd Meeting of the Competition Committee on 3-4 December 2019.

More information related to this discussion can be found at
http://www.oecd.org/daf/competition/barriers-to-exit.htm

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Executive Summary of the Roundtable on Barriers to Exit in Competition

By the Secretariat[1]

The Competition Committee held a roundtable discussion on Barriers to Exit on 4 December 2019. Based on the background paper prepared by the OECD Secretariat, written submissions from delegates, and the contributions by expert panellists and delegates to the discussion, the following key points emerged:

1. Barriers to exit can have an adverse effect on the level of competition, hinder innovation and change, be an important driver of productivity slowdown, and negatively impact economic growth.

Barriers to exit, like barriers to entry, decrease the market discipline mechanisms of the competitive process to relocate resources from one market or firm to another according to changing conditions. This can lead to less efficient firms staying in the market. As a result, resources (both financial and human) are trapped longer in existing firms instead of being relocated to their most efficient use. This can make it difficult for more efficient firms to expand, and could crowd-out the growth of more innovative firms.

The most common type of exit barrier in the literature is sunk costs, i.e. an investment that cannot be recovered in the event of market exit; in particular, sunk costs may affect exit as firms may delay exit until the investment is recovered. Another closely related type of exit barrier is the cost associated with cutting long-term contracts short. Other examples of barriers to exit include government intervention such as efforts to rescue failing firms, regulation such as environmental regulations requiring site cleanup, labor related costs such as redundancy pay and pension liabilities, and ineffective bankruptcy regimes. Many of these measures are designed with specific policy goals in mind (e.g. social, environmental, stability policy goals). Therefore, the key point is whether these policies are effective and proportionate, and in particular, whether these policies create unnecessarily high barriers to exit.

Barriers to exit interfere with the market discipline mechanism. They may lead to overcapacity issues, higher concentration, misallocation of resources, and affect the type of market entry. Competition authorities may be required to intervene in affected markets or advocate to government agencies to reduce unnecessarily high barriers to exit. Competition authorities can achieve this by advising or collaborating with regulators and other government agencies in the policy design to avoid, or minimize, adverse effects on competition.

Policies related to entry and exit complement each other: policies designed to improve entry by reducing administrative burdens on start-ups are only effective in boosting productivity growth in countries where barriers to exit are low.

2. Barriers to exit is a topic unexplored in competition and rarely considered in anticompetitive agreements or in abuse of dominance cases. Notwithstanding,

[1] This Executive Summary does not necessarily represent the consensus view of the Competition Committee. It does, however, encapsulate key points from the discussion, the delegates' written submissions, and the panellists' presentations.

barriers to exit are sometimes relevant, in particular in the context of market investigations, although they are often framed as barriers to entry.

In the context of mergers, barriers to exit, although rarely taken into account, could affect all types of theories of harm. However, many mergers regime focus on the incremental impacts of the merger on competition, compared to the counterfactual in which the merger did not occur. It is rare that a merger would in itself increase or decrease barriers to exit so these barriers are often taken as given in both factual and counterfactual scenarios. The strict approach to the application of the failing firm defense is also relevant in this context, as it may act as a barrier to exit preventing inefficient firms from exiting. In such cases, competition authorities should focus on whether efficient or inefficient assets remain or exit the market.

Barriers to exit are rarely considered in anticompetitive agreements cases, whether because agreements rarely affect barriers to exit, or because they are considered to be given in both the agreement scenario and the no-agreement counterfactual. However, there are agreements, such as crisis cartels, which do raise exit barriers.

As for abuse of dominance cases, the common theory of harm involves the exclusion of rivals. In this context, competition authorities employ the “as efficient competitor test” to assess whether the dominant firm is using its power to exclude a competitor that is at least as efficient as the dominant firm, or one that is less efficient. In principle, the use of this test ensures that the framework for assessing dominant cases does not in itself act as a barrier to exit. In reality, the test allows the dominant firm’s own cost to be used, so cases rarely need to consider the efficiency of the actual competitors that may be excluded from the market by the dominant firm.

3. Barriers to exit do not always have the effect to prevent new entry but they can delay exit from the market.

Taking into account the empirical evidence from the steel industry from early 1970’s to 2000’s, the presence of exit barriers (in the form of specific physical assets, severance pay, pensions liabilities, and environmental remediation) did not deter entry into the market. However, such barriers contributed to the very slowly adjustment of the industry’s overcapacity issue.

Firms in the steel industry underwent both types of bankruptcy – reorganisation and liquidation. Although reorganisation helped some firms to survive for quite a long time, they were eventually liquidated, with some assets being sold to other firms, which in turn merged with other firms or were liquidated as well. In this regard, the failing-firm defense makes the most sense in stable or growing industries because in declining industries the goal is to have capacity exit in order to allow prices to rise and help surviving firms. However, pressure on competition authorities to allow horizontal mergers in such markets is the greatest, even though such mergers do not always work.

4. Bankruptcy laws and their interaction with anti-trust law can affect the ability (or difficulty) of firms to exit an industry.

Bankruptcy law and antitrust law share the goal of promoting efficient allocation of resources, but they can have conflicting applications. Bankruptcy law may provide distressed firms with a rapid solution including the sales of assets through mergers to minimise uncertainty, costs, and maximise the value of the firm. However, such a mergers may raise competitive concerns, which are incompatible with antitrust law. Both laws have different perspectives: bankruptcy is a backward looking procedure, dealing with a problem that arose before and with downstream investors and creditors; a rapid solution is required.

Merger control is forward-looking and focused on future harm to competition and consumers; the analysis takes longer and can be costly.

These conflicts may lead to inefficient resolution of financial distress, when an optimal merger from a bankruptcy standpoint is blocked on antitrust law grounds; or to suboptimal antitrust enforcement when courts pressured to make quick decisions fail to apply antitrust law. Both regimes are compatible when the conditions of the failing-firm defence are fulfilled, but the conditions are very strict and not simple to satisfy. These conflicts stress the importance of cooperation between regulatory authorities, especially in cases involving large firms, when large assets and sums of money, and many employees and creditors, are affected. Cooperation may contribute to finding optimal solutions in such cases; otherwise, the risk of misallocation of resources will increase.

5. Barriers to exit have an impact on efficiency, innovation and productivity. In particular, barriers to exit play an important role in the creation of "zombie" firms, and can affect allocative efficiency, firm dynamism, and productivity.

Barriers to exit are pointed out as one of the factors to explain the growing number of "zombie firms" (i.e. firms that should exit the market or be restructured, but instead remain active while being in a bad financial state) in a number of countries. Zombie firms have a direct impact on productivity growth and business dynamism. Over time, the number of zombie firms has increased, even after the 2008 financial crisis had ended, and they have become less productive relative to non-zombie firm. The number of zombie firms affects reallocation of capital to firms, thus affecting productivity growth. It also showed that low productivity firms' productivity growth may be improved by more efficient technology diffusion.

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