Barriers to Entry and Exit

A *barrier to entry* is something that blocks or impedes the ability of a company (competitor) to enter an industry. A *barrier to exit* is something that blocks or impedes the ability of a company (competitor) to leave an industry.

In general, industries that are difficult for new competitors to enter may enjoy periods of good profitability and limited rivalry among competitors. Conversely, industries that are easy to enter attract new companies into the industry during periods of profitability. So, rivalry among competitors can be intense. On the other end, industries that are difficult to exit have more rivalry than industries that are easy to leave.

Some of the common barriers to entry and exit are listed below.

Typical Barriers to Entry

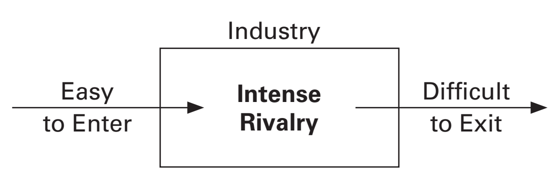
- **Economies of size –** The need for a large volume of production and sales to reach the cost level per unit of production for profitability is a barrier to entry.
- **Capital intensive** – A large capital investment per unit of output in facilities tends to limit industry entry.
- **Intellectual property –** Patents and other types of proprietary intellectual property are very effective in limiting industry entry.
- **High switching costs –** The tendency for buyers of an industry's products to be reticent about switching to a new supplier tends to limit entry.
- **Established brand identity –** Industries dominated by branded products are difficult to enter due to the large amount of time and money required to create a competing branded product.
- **Permitting requirements –** Industries where permitting and licenses are required to establish production tend to have limited entry.
- **Government standards –** Industries where rigid industry standards exist tend to have limited entry.

Typical Barriers to Exit

- **Investment in specialist equipment –** Investments in specialized equipment that cannot readily be used in other industries tends to be an impediment to leaving the industry.
- **Specialized skills –** Highly specialized skills by industry participants that cannot be utilized in other industries tend to be an impediment to leaving the industry.
- **High fixed costs –** High levels of dedicated fixed costs tend to be an impediment to leaving an industry

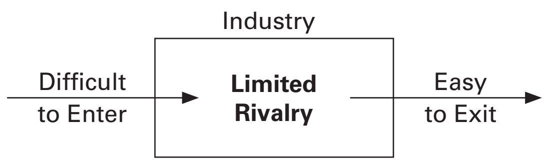
If we combine entry and exit, we can predict industry rivalry, stability and profitability. As shown in Figure 1, an industry that is easy to enter but difficult to leave has intense industry rivalry and low profitability. At the first sign of excess profitability in the industry, competitors flock to the industry. However, when profitability falls, it is difficult to leave the industry so profitability remains low.

Figure 1. Industries that are easy to enter but difficult to exit



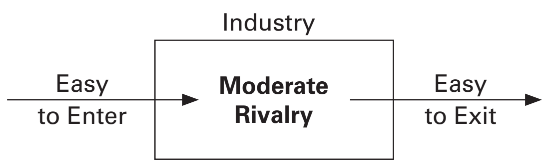
Conversely, an industry that is difficult to enter but easy to leave is shown in Figure 2. It has limited industry rivalry and tends to have good profitability. Competitors have a difficult time entering the industry during times of good profitability. However, during period of low profitability, competitors leave the industry easily.

Figure 2. Industries that are difficult to enter and easy to exit



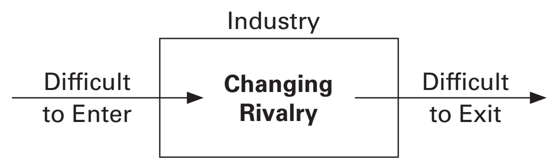
Industries that are easy to enter and easy to exit are shown in Figure 3. The size and composition of the industry is fluid and changes easily. Supply responds quickly to changes in demand and prices tend to stabilize. Rivalry is moderate due to the easy flow of businesses into and out of the industry.

Figure 3. Industries that are easy to enter and easy to exit



Industries that are difficult to enter and difficult to exit are shown in Figure 4. The size and composition of the industry is static and changes slowly. Supply changes slowly due to market signals so price responds strongly to changes in demand. The amount of rivalry can change radically due to changes in demand.

Figure 4. Industries that are difficult to enter and difficult to exit



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