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Title: **Entrepreneurship and Antitrust: An Annotated Bibliography**

Author: **Kyle Virtue**

Abstract:

This annotated bibliography of the literature on entrepreneurship and antitrust builds on AAI Working Paper No. 15-01 (March 2015). It updates the state of the economics, legal, and business literature in this dynamic and growing field.

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entrepreneurship, antitrust, competition, entry, growth, startup, innovation

Author Contact:

Kyle Virtue: Kyle.Virtue@gmail.com

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Entrepreneurship and Antitrust:
An Annotated Bibliography

Kyle Virtue[1]

I. Introduction

This annotated bibliography of the literature on entrepreneurship and antitrust builds on AAI Working Paper No. 15-01 (March 2015). It updates the state of the economics, legal, and business literature in this dynamic and growing field. In compiling the bibliography, relevant material was identified by conducting searches of Westlaw, LexisNexis, the Social Science Research Network (SSRN) Electronic Library (http://www.ssrn.com), and Google Scholar (http://scholar.google.com). Entries are listed in reverse chronological order by the date of publication. Accompanying each citation is a brief summary outlining the central points and arguments of the article. A direct link to the work is provided where available.

II. Bibliography

Christopher Koopman et al., ***The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change*****, 8 J. BUS. ENTREPRENEURSHIP & L. 529 (2015).**

This article calls for the end of many consumer protections that the authors view as unneeded regulation in light of the powers of the Internet. The purpose of the article is to highlight that imposing "outmoded regulatory regimes" on a variety of new services could harm the country's entrepreneurial spirit and consumer welfare.

Koopman et al. ask whether traditional consumer protection rationales, and the regulatory bodies that promote them, have a part to play in the "sharing economy" that has emerged in the United States over the last decade. The article defines a sharing economy as any marketplace that brings together distributed networks of individuals to share or exchange underutilized assets. In the United States one can see the rise of the sharing economy by looking at the success of entrepreneurial ventures such as Uber, Airbnb, and Lyft.

In the past, protecting consumers has justified regulations that correct for concentrated markets, price gouging, asymmetric information, and other "market imperfections." The authors argue, however, that these "market imperfections" are better addressed by innovation, not regulation. Imperfections and information problems create opportunities for entrepreneurs to develop more

[1] Research Fellow, American Antitrust Institute.

efficient processes through trial-and-error experimentations. It is the innovators, therefore, that can solve many of these imperfections.

The article also suggests that future market imperfections should be left to the corrective forces of the Internet, because the Internet has proven to be the best means of protecting consumer welfare. The article lists several problems with the current consumer protection regulatory regime and explains how that regime negatively impacts innovation. For example, regulatory bodies are prone to capture by well-connected and powerful incumbents, which creates an entry barrier for start-ups and entrepreneurs. The Internet and information technology markets have not only vastly expanded the range of goods and services but also the amount of information *about* those goods and services. Consumers can now offer feedback about products and expose abusive business practices. This has created a self-regulatory-type regime that has weakened the need for government intervention to protect consumers. And where bad behavior still exists, consumers can turn to private insurance, contracts, torts, and product liability law for *ex post* remedies.

Christopher L. Sagers, *Innovation and Entrepreneurship*, *in* HANDBOOK ON THE SCOPE OF ANTITRUST (ABA Book Publishing, 2015).

Christopher Sagers' handbook provides practical guidance on a wide range of issues that delimit current U.S. antitrust law. The handbook includes a chapter on how innovation and entrepreneurship affect the scope of antitrust law. Innovation and research often require collaboration between different firms. And firms engaging in this type of collaborative activity risk antitrust violations. However, U.S. policy has always been supportive of private innovation. In keeping with this policy, Congress decided to protect small businesses from legal liability for collaborative research and production by enacting certain legislation.

The chapter discusses three statutory protections that have helped protect entrepreneurs and innovative endeavors. First, the National Cooperative Research and Protection Act (NCPRA) provides protections for research and production joint ventures. Second, Congress amended the NCPRA to include Standards Development Organizations, which create standards for an industry. Third, the Small Business Act of 1954 grants certain exemptions to small businesses. The chapter provides a great overview of the scope, purpose, and content of each of these provisions.

Melissa Schilling, *Towards Dynamic Efficiency: Innovation and Its Implications For Antitrust*, 60 ANTITRUST BULL. 191 (2015).

Schilling begins her article with the statement: "Innovation is one of the most powerful drivers of increased human welfare available to us. Innovation enables the development of new products, the improvement of processes, and the creation and improvement of social institutions." She believes antitrust law must promote *dynamic efficiency* by encouraging innovation and entrepreneurship. The article begins with a description of the innovation process for a typical business. Schilling emphasizes that most innovations involve long time horizons and great uncertainty. We must be cognizant of this when managing dynamic efficiency in antitrust enforcement. She also notes that in order to maximize innovative efficiency in most industries, there must be a range of firm sizes. Small startups, for example, are often necessary to keep pressure on large players by engaging in smaller niche innovation projects.

The article describes three examples of how the antitrust bar can use knowledge of how innovation works to manage dynamic efficiency in antitrust enforcement. First, she recommends we shift our thinking from market concentration to thinking about firm size distributions. Most industries require a distribution of firm sizes in order to remain innovative because different kinds of organizations have different incentives and capabilities to perform different kinds of innovative tasks. A market analysis that focuses just on market concentration is blind to the benefits that different types of companies provide to a specific market. Certain industries, given their structure and firm characteristics, might benefit from more organizational slack under the antitrust laws than others. Second, she recommends we look at how innovation decisions affect Hatch-Waxman and automatic substitution laws in pharmaceuticals. Third, we should figure out how to encourage temporary collaborative agreements among firms that foster innovation.

Dina I. Waked, *Antitrust Goals in Developing Countries: Policy Alternatives and Normative Choices*, 38 SEATTLE U. L. REV. 945 (2015).

This article discusses antitrust's role in innovation and entrepreneurship as it applies to developing countries. Waked provides an in-depth discussion of the challenges developing countries face in creating an effective antitrust enforcement policy. She emphasizes that developing countries need to develop an antitrust policy tailored to their economic, social, and political backgrounds. In other words, developing countries should be careful not to "copy-and-paste" antitrust regimes from the Western world to their own. To avoid this, countries must engage in a two-step inquiry. First, identify the antitrust enforcement goal(s) it wishes to pursue. Second, identify a market structure and antitrust regime that can achieve those goal(s).

Regarding the first step, many scholars, including Waked, believe that developing countries should "enforce their antitrust laws with . . . long-term growth and overall productivity in mind." Therefore, the antitrust goal of developing countries should be to promote dynamic efficiency, research, innovation, and entrepreneurship. This is because the most important source for improving a country's economic well-being is entrepreneurs and their ability to reduce costs through innovation. To that end, antitrust policy can comfortably fit within a developing country's broader agenda of promoting the growth of innovation through entrepreneurship.

Wilfred Dolfsma & Gerben van der Velde, *Industry Innovativeness, Firm Size, and Entrepreneurship: Schumpeter Mark III?*, 24 J. EVOLUTIONARY ECON. 713 (2014).

In this article the authors set out to tackle an important question: which type of firm most promotes industry innovativeness? The article notes that there have been two answers to this question, both of which were advanced by Joseph Schumpeter. Schumpeter first answered the question by claiming that industries with a large number of small entrepreneurial firms are more innovative. This has been labeled the Mark Schumpeter I position. His second answer was that industries dominated by large incumbent firms are most likely to be innovative. This is called the Mark Schumpeter II position. Studies have found support for both positions, creating what the article calls the Schumpeterian Innovation Puzzle. This article advances the research in this field by offering another position. First, the authors argue that established small firms should be considered a separate category than new entrepreneurial firms. Then the authors conclude that industry innovation is highest in industries where there are a lot of *established* small firms compared to industries with large firms or industries with a high concentration of new startups (Schumpeter III).

The article provides a clear discussion of how different firm sizes can have an effect on innovation. Industries with large companies may benefit from economies of scale in R&D, and therefore they can be expected to be more innovative (Schumpeter II). However, large firms tend to have a strong bureaucratic system, which can hinder knowledge transfer. By contrast, newly established firms tend to have an entrepreneur and employees who are more motivated to innovate. Therefore, industries dominated by new, entrepreneurial ventures can be expected to be more innovative (Schumpeter I). But small, established firms have the advantages of a startup and have also been able to accumulate important skills. Therefore, the new Schumpeter III position might be the most conducive to innovation.

The authors conclude that small firms "consistently, positively and significantly contribute to industry innovativeness." Industries with large firms are significantly less innovative than industries where small firms dominate. At the same time, entrepreneurial startups do not have a significant effect on innovation.

Mário Raposo et al., ***The Influence of Competitiveness and Regulations on Entrepreneurial Activity in Emerging and Advanced Economies*****, 24 REVISTA INNOVAR J. 113 (2014).**

The purpose of this research paper is to explore the link between business regulations, market competitiveness, and entrepreneurship in emerging and advanced countries. The authors note that as a result of globalization, deregulation, and outsourcing, many countries have transitioned from a "managed economy" to an "entrepreneurial economy." They also note extensive empirical research that shows a positive correlation between social and economic development around the world and the growth of entrepreneurship. The article's central questions are the following: (a) How are regulations related to or how do they influence the competitiveness of a country and its entrepreneurial activity (established firms and new firms)? (b) does competitiveness itself influence entrepreneurial activity in different economies?; and (c) do established firms influence the formation of new firms? The authors use data from 41 different countries to answer these questions.

The data showed that regulations that made doing business more difficult had a negative impact on competitiveness. Surprisingly, however, such regulations do not have a negative impact on entrepreneurial activity. The data also showed that established firms have a positive influence on the formation of new firms. The authors recommend that governments adapt regulations and processes that maximize the development of entrepreneurial opportunities, eliminate obstacles to entrepreneurial activity, and offer incentives for investment.

Mitja Kovac & Patricia Kotnik, ***Self-Assessment System: Detrimental Effects Upon Entrepreneurial and Innovative Activity*** **(Faculty of Economics, University of Ljubljana, Working Paper, 2013).[2]**

This working paper discusses the intersection of competition law and entrepreneurship from an international perspective. Kovac & Kotnik address the European Union's "self assessment system"—which makes companies responsible for assessing whether their agreements violate

[2] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2221811.

European Union Competition Law—and how the prevention of information exchange within that system negatively impacts innovation and entrepreneurship.

The authors emphasize that the future of economic growth depends on robust innovation and entrepreneurship. And one of the main drivers of innovation is information exchange. The authors fear that the EU's self-assessment system could hinder innovation because it limits information exchange. This leads to inefficient risk shifting and increased transactional costs because of greater uncertainty when making business decisions.

Ketan Jhaveri, *Disruptive Equilibrium: Antitrust for an Innovation Economy* (Working Paper, 2011).[3]

In this working paper, Ketan Jhaveri discusses the shortcomings of current antitrust analysis as it is applied to dynamic, innovative industries. Jhaveri claims that antitrust is too focused on advancing short-run consumer welfare by controlling price and output effects when it should be more concerned with how innovation and entrepreneurship affect long-run consumer welfare. Put simply, Jhaveri claims that "antitrust needs to be premised on a conception of competition that is less Detroit of yesterday and more Silicon Valley of today."

Jhaveri seems most concerned with how merger analysis often involves narrow and static market definitions that do not fully account for "fringe firms" and disruptive entry; those actors that seem to be "out of bounds" of the current playing field. Antitrust law should help maintain a disruptive model. And antitrust practitioners should incorporate disruptive business model innovation into their merger analysis and be on the lookout for innovation waves that could potentially upset the existing competitive game to the benefit of consumers.

George Priest, *Advancing Antitrust Law to Promote Innovation and Economic Growth*, *in* THE KAUFFMAN TASK FORCE ON LAW, INNOVATION, AND GROWTH, RULES FOR GROWTH: PROMOTING INNOVATION AND GROWTH THROUGH LEGAL REFORM (2011).[4]

The Kauffmann Foundation convened a number of legal scholars and social scientists to discuss ways to achieve sustained economic growth in the aftermath of the United States' worst economic downturn since the Great Depression. This meeting led to a report titled *Rules for Growth: Promoting Innovation and Growth Through Legal Reform*. It contains essays outlining growth-promoting policies. George Priest's essay explains how antitrust law can spur innovation and help achieve economic growth.

Priest writes that "[t]he effective implementation of antitrust law is central to the promotion of innovation and to the achievement of economic growth." Priest believes that today, antitrust law falls short of achieving broad affirmative effects on innovation. He blames the development of antitrust law from the 1940s to the mid-1970s for this, particularly the Supreme Court's creation of a number per se rules against certain business practices. These decisions led to a "spirit of the law" that was hostile to economic growth. Beginning in the mid-1970s, with John Paul Stevens' nomination to the Supreme Court, these obstacles to economic growth began to crumble.

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[3] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1753023.
[4] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1757982.

"Nevertheless," says Priest, "modern antitrust law, however liberated from rules inhibiting economic growth, still falls short of the broader affirmative effects that antitrust law might achieve."

Priest goes on to recommend ways that antitrust law might be able to dynamically rather than statically promote economic growth. For an example, he suggests we should look at the effects of prolonged antitrust prosecutions on innovation. We should also eliminate growth-retarding subsidies and protections at the federal and state levels; reanalyze the intersection of antitrust law and patent/copyright law; and enhance our understanding of the operation of network industries.

Philip J. Weiser, ***Innovation, Entrepreneurship, and the Information Age*****, 9 J. TELECOMM. & HIGH TECH. L. 1 (2011).**

In this article, Philip Weiser discusses the role of entrepreneurship in the information age and how competition policy provides the foundation for innovation. Weiser begins by explaining that the entrepreneurial spirit is deeply rooted in United States history and this spirit continues to grow. The United States' strong venture capital system and emphasis on entrepreneurship in higher education are both contributing factors to this growth. But the most influential driver of innovation in the United States has been the information age, which has helped to democratize innovation and spur competition between countries.

Entrepreneurs are vital to economic growth because they engage in "disruptive entry," a practice of introducing disruptive technologies into an industry that, over time, challenges incumbents' products or services. Incumbent firms will often respond to disruptive entry by asking regulators for help or engaging in anticompetitive conduct. Antitrust policy helps thwart incumbents' anticompetitive efforts by preventing the emergence of dangerously concentrated markets, ensuring entry barriers are low, and helping to keep incumbent firms' market power in check. For these reasons Weiser calls antitrust law a "friend of the entrepreneurs."

Weiser believes the biggest challenge antitrust enforcers face is fashioning an effective competition policy that helps the development of disruptive entry. Antitrust enforcers must work hard to identify the relevant areas of competitive concern, evaluate whether or not the antitrust laws were violated, and devise appropriate remedies where a violation is found.

Geoffrey A. Manne & Joshua D. Wright, ***Innovation and the Limits of Antitrust*****, 6 J. COMPETITION L. & ECON. 153 (2010).**

In this article, Manne & Wright discuss how Frank Easterbrook's error-cost framework can and should be applied to industries where innovation is an important part of the competitive landscape. Easterbrook's error-cost framework recommends that we adopt an antitrust enforcement policy that attempts to achieve welfare maximization by reducing the costs attributable to false positives, false negatives, and antitrust administrative costs. The error-cost framework is most beneficial in innovative industries because business and product innovations typically involve novel business practices. When certain business practices are less understood, there is a greater risk of creating false positives. The nature of innovative industries demands greater use of safe harbors and rules that provide certainty for firms than in standard product market cases that do not involve innovation.

After introducing the principles of the error-cost framework, the article discusses the relationship between antirust error and innovation. Manne & Wright conclude by proposing five ways to filter out pro-competitive business conduct under Easterbrook's framework in highly innovative industries. For example, they propose a rule of *per se* legality for new product introductions because aspects like the social benefit of the innovation and market definition are not yet understood. They also propose requiring direct proof of actual anticompetitive effect for monopolization, consummated mergers, and horizontal restraints.

Michael Carrier, INNOVATION FOR THE 21ST CENTURY: HARNESSING THE POWER OF INTELLECTUAL PROPERTY AND ANTITRUST LAW (Oxford University Press, 2009).

Carrier's book begins by emphasizing the almost universal principle that innovation plays a significant role in economic growth. He believes, however, that innovation has been threatened in recent years and part of the blame can be put on the U.S. legal system. The antitrust, copyright, and patent laws have not done enough to foster innovation and in some instances have even stifled it. The book begins with a primer on the major areas of law discussed in the book, but its main focus is the relationship between innovation, patent, antitrust, and copyright laws. According to Carrier, one of the biggest impediments to innovation-focused legal reform is the inability to accurately value the benefits of innovation, forcing economists to revert to measures of static efficiency, which are more cognizable, and away from dynamic efficiency.

Carrier then proposes nine reforms that he believes will help protect and promote innovation. He offers three with regard to antitrust specifically. First, Carrier suggests changing market analysis, particularly in the pharmaceutical industry. He criticizes the current way the pharmaceutical market is analyzed because it misses several factors important to competition in this industry. Second, he proposes that all standard-setting activity, with a few exceptions, should be analyzed under the rule of reason. Third, Carrier argues that reverse payment settlements should be presumptively illegal.