

## **Guidelines for Public Support for Revitalization in view of Competition Policy**

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Japan Fair Trade Commission

### **Introduction**

In Japan, various forms of public support for revitalization are provided based on a variety of policy objectives. However, public support for revitalization that is intended to revitalize enterprises, which are assumed to have exited the market. It may interfere with the market mechanism, in which, as a result of market competition, inefficient enterprises exit and efficient enterprises survive in the market, and thus may adversely affect market competition.

In order to minimize the effects of public support provided on competition in Japanese markets, these Guidelines are intended to identify matters, etc., that supporting organizations should consider in view of competition policy, in case they are required to provide public support for revitalization, with the proviso that the businesses of enterprises thus supported be revitalized.

It is advisable that supporting organizations should fully take into account these Guidelines and finalize details of public support for revitalization, after having closely studied and assessed the possible effects of public support for revitalization on market competition. Also, it should be done, if necessary, in cooperation with the regulatory authorities. Supporting organizations are expected to consult, as needed, with the Japan Fair Trade Commission, if they are to assess the possible effects of their public support for revitalization on market competition.

### **I Public Support for Revitalization, etc., Covered by these Guidelines**

In these Guidelines, the following terms shall have the respective meanings listed below:

#### **1. Public support for revitalization**

Public support for revitalization only refers to support for business revitalization, which corporations (including corporations in which the national

government has capital equity) incorporated under a special law and with capital financing from the Japanese government with a view to achieving various policy objectives provide, in order to enable enterprises experiencing business management difficulties as a result of market competition, in spite of still having effective business management resources, to recover their capacity and continue business operations (Note1).

(Note 1) Support for a rescue provided to enterprises facing financial difficulties due to natural disasters and other causes of force majeure shall be separated from the category of support provided to enterprises facing financial difficulties as a result of market competition. Thus, for the purposes of these Guidelines, support for rescuing enterprises affected by natural disasters shall not be included in the category of public support for revitalization.

## **2. Organizations for Public Support for Revitalization**

An organization providing public support for revitalization refers to a corporation that provides public support for revitalization.

## **II Basic Understanding of the Effects of Public Support for Revitalization on Competition**

### **1. Effects of Public Support for Revitalization on Competition**

To maintain the market mechanism, in which more efficient enterprises survive in the market, it is necessary for inefficient enterprises to exit the market when they become insolvent as a result of financial difficulties caused by market competition. In contrast, public support for revitalizing enterprises, which are assumed to have been exited the market, interferes with the market mechanism, and is likely to give rise to the harmful influences mentioned below, and to impact competition in the market concerned (Note 2).

① The survival of beneficiaries of public support for revitalization in the market, despite their inefficiency, will hinder the transfer of demand and human and material resources from inefficient enterprises to efficient incumbents or to new entrants. In addition, if inefficient beneficiaries gain a competitive advantage over efficient enterprises as a result of public support for revitalization providing leverage, the transfer of demand and resources to inefficient beneficiaries will

unduly accelerate.

② When enterprises facing financial difficulties anticipate that they will receive public support for revitalization, they are likely to have the expectation that that public support will allow them to survive in their market without efficient business operations. As a result, these enterprises will have fewer incentives to promote business more efficiently. This is what is called moral hazard.

(Note 2) Because of the risk of harmful influences such as those mentioned above in ① and ②, it is important that targeted policy objectives be achieved through assistance such as creating a business climate that facilitates market participation by new entrants wishing to take over a business that should be continued, rather than through revitalizing business by way of public support for revitalization.

## **2. Differences in Effects of Beneficiaries' Business Scale, etc. on Market Competition**

If assumed that other conditions such as the contents of support, etc. are equivalent, the effects of public support for revitalization on market competition will differ, depending upon scale of business such as sales and production, market share of beneficiaries and market concentration ratio (Note 3).

① When the absolute business scale of beneficiaries are large, the extent of the impact of public support for revitalization on competition becomes greater because the extent to which the transfer of demand and optimal distribution of resources from beneficiaries (inefficient enterprises) to their competitors (efficient enterprises) is inhibited, also becomes greater.

② If the market shares of beneficiaries are large, public support for revitalization has a major impact on competition for the same reason as mentioned in ① above.

③ In a highly oligopolized market where there are few enterprises and there is a high degree of concentration, if the market shares of each enterprise are almost same, the impact of public support for revitalization on competition becomes all the more substantial because the effects of the transfer of demand and distribution of resources to competitors, which are more efficient enterprises, are more direct. In this case, the smaller number of enterprises competing in the

market, the larger the impact of public support for revitalization on competition would be.

### (Note 3) Handling of Small and Medium-sized Enterprises

Because the absolute business scale of small and medium-scale enterprises is generally small, the impact of public support for revitalization provided for small and medium-scale enterprises on competition is considered to be limited. Therefore, the need to consider specific measures that minimize the impact of public support for revitalization on market competition is considered basically to be minor compared to other cases.

## **III Basic Understanding of Minimizing the Impact of Public Support for Revitalization on Competition**

### **1. Principles to be followed in minimizing the impact of public support for revitalization on competition**

In the light of the basic understanding described in II above, supporting organizations, after having carefully considered in advance the possible impacts on competition, should provide public support for revitalization in accordance with the following three principles, in order to minimize the impact on competition.

#### ① Principle of subsidiarity

Public support for revitalization should be provided to complement the functions of private sectors only in cases where, although business revitalization is necessary to achieve various policy objectives, the business cannot be revitalized smoothly only through the efforts of the private sector and, accordingly, public support for business revitalization has to be provided by supporting organizations.

#### ② Principle of minimum necessity

When public support for revitalization is necessary to achieve various policy objectives, it should be provided on a scale and with a method that are the minimum necessary for revitalizing the business concerned.

#### ③ Principle of transparency

In terms of taking account of the necessity for prompt disclosure and easy access to information, information on individual cases and on general matters

such as support standards or procedures should be disclosed as much as possible, so that the possible impacts of public support for revitalization on the market mechanism can be identified, and competitors of beneficiaries are able to submit their opinions regarding the possible impacts of public support for revitalization on competition and can take appropriate measures in response.

## **2. Understanding of the adoption of ex-post measures after starting public support for revitalization to restore competition**

In spite of the fact that based on the three principles mentioned in 1. above, public support for revitalization has been started by ensuring that the effects on competition are minimized, the beneficiaries may gain a greater competitive advantage than initially expected.

In these cases, it is not appropriate to take ex-post measures to restore competition, in order to minimize the effects of public support for revitalization on competition for the following reasons:

- ① These measures may impair incentives for beneficiaries to improve their efficiency in an effort to revitalize their businesses.
- ② These measures also may impair incentives for beneficiaries' stakeholders, including financial institutions giving loans to beneficiaries, to commit themselves to the revitalization of the beneficiaries' businesses.

## **IV Matters to be Considered in Assessing the Effects of Public Support for Revitalization on Competition and Adjusting the Contents to Minimize Such Effects**

### **1. Scale of support**

#### **(1) Assessing effects on competition**

Regarding the scale of support, as the scale of support increases, the effects of such support on competition also increase, irrespective of whether in terms of the absolute size of financial support, etc. or in terms of the relative size of financial support etc., compared to the beneficiaries' business scale.

#### **(2) Matters to be considered in minimizing the effects of support on competition**

To minimize the scale of support, the following matters, for example, should

be considered:

- ① It is within the minimum requirement to provide the scale of support that is sufficient to cope with incidental risks, etc. However, it is not within the minimum requirement to overestimate such risks and, accordingly, to add to the scale of support.
- ② In the light of the fact that public support for revitalization has pump-priming effects, it is appropriate to request beneficiaries beforehand to procure unilaterally, as much as possible, loans and capital increases from private sector financial institutions, etc.
- ③ It is necessary for supporting organizations to request beneficiaries' creditors to agree to sufficient debt forgiveness when beneficiaries have excessive debts. However, in terms of letting shareholders, among others, fulfill their responsibilities primarily, it is advisable to request them to carry the burden against the beneficiaries' losses in the form of a capital reduction, etc.

## **2. Period and frequency of support**

### **(1) Assessing the effects of support on competition**

As far as the period of support is concerned, as the period of support increases, the effects of support on competition also increase.

Regarding frequency, repeatedly providing support has a larger impact on competition compared to support provided on a once-only basis, in the sense that the former is likely to impair incentives for beneficiaries to improve their business efficiency (A case that is likely to give rise to moral hazard).

### **(2) Matters to be considered in minimizing the effects on competition**

- ① The period of support should be as short as possible and, as a matter of principle, such support should not be extended.
- ② Public support for revitalization should be provided, as a matter of principle, on a once-only basis, and should not be repeated each time beneficiaries face financial difficulties.

## **3. Method of support**

## (1) Assessing the effects of support on competition

Among the methods of providing support are: ① liquidity support including loans and debt guarantee, etc. (Note 4), as well as financial support such as capital injections through the acquisition of shares, etc.; ② non-financial support in terms of assisting coordination among creditors and dispatching experts. Directly through the fulfillment of beneficiaries' capital needs and indirectly through complementing the beneficiaries' creditworthiness, etc., these supports will contribute to enhancing the beneficiaries' competitive advantage, so they will impact market competition.

Especially in the case of capital injections among methods of providing financial support, because there arises no question of repayment, unlike the case of liquidity support, and also because it contributes to complementing the beneficiaries' creditworthiness, the impact on market competition will become all the greater.

Organizations for public support for revitalization are required to make decisions on the contents of support in accordance with the three principles mentioned in III-1. above, irrespective of whether such support is provided in the form of financial support or in the form of non-financial support. In the case of non-financial support, the impact on market competition is indirect and diversified, compared to the case of financial support. Therefore, in (2) below, key points are discussed and summarized focusing on financial support.

(Note 4) Liquidity support means financial support provided by supporting organizations in the process of supporting business revitalization to ensure the financial liquidity of beneficiaries when it is difficult for the beneficiaries to continue business operations due to a shortage of operating capital etc.

## (2) Matters to be considered in minimizing the effects of support on market competition

When supporting organizations are to provide financial support, they should, taking into account matters to be considered such as scale of support as described in 1. above and the period and frequency of support as described in 2. above, thoroughly verify the beneficiaries' financial conditions, precisely understand what kind of support is required for the beneficiaries, and take into account the following points in order to ensure that the contents of financial support are appropriate:

① In providing financial support, the scope of use of funds provided shall be limited to the extent which is necessary for revitalizing the beneficiaries' businesses.

② The method and contents of financial support shall be decided in the light of the fact that public support for revitalization has a pump-priming effect as mentioned in 1 (2)② above.

③ In providing liquidity support, interest and loan guarantee fees should be imposed in compensation for that support, and the conditions to be imposed, including the levels of interest and loan guarantee fees, should be similar to the conditions imposed by private-sector financial institutions, etc., in order to minimize the effects of such support on market competition (Note 5).

④ Capital injections have a larger impact on market competition than liquidity support. Therefore, before providing a capital injection, its necessity should be carefully verified (Note 6).

Even if the need for a capital injection is recognized, supporting organizations should first seek investors in the private sector and inject capital into beneficiaries on only the part where it is impossible to find investors in the private sector, because capital injections have a great impact on competition.

(Note 5) When supporting organizations provide beneficiaries with liquidity support, imposing interest or loan guarantee fees on beneficiaries strengthen an incentive for them to seek to repay loans at the earliest possible time, and thus contribute to the early revitalization of the beneficiaries' businesses. Also, the smaller the differences are between levels of interest rate and loan guarantee fees for liquidity support from supporting organizations and those of loans from private-sector financial institutions, etc., the smaller will be the impact on competition.

(Note 6) Capital injections by supporting organizations are subject to the regulation of business combinations by the Japan Fair Trade Commission under the Antimonopoly Act.

(Remarks) Method by which supporting organizations dispose of shares and other assets acquired in the process of a capital injection when their public support activities are to be terminated



Upon termination of their support activities, supporting organizations willing to dispose of shares and other assets obtained in the process of a capital injection can choose the method of an auction of management rights, in which they select a beneficiary's sponsor through competitive bidding, or they can choose the method of listing their shares and assets on a stock market or on a financial instruments exchange.

In these cases, if enterprises other than the beneficiaries are to acquire the shares concerned, they are subject to regulation of business combinations by the Japan Fair Trade Commission under the Antimonopoly Act.

#### **4. Concurrent Application of Public Support for Revitalization and Legal Liquidation**

##### **(1) Assessing the effects on competition**

Business revitalization includes legal liquidation proceedings such as civil rehabilitation and corporate reorganization proceedings to be undertaken in accordance with legal procedures under the supervision of a court. In some cases, both public support for revitalization and legal liquidation are applied concurrently.

In these cases, the functions of public support for revitalization and those of legal liquidation partially overlap in terms of support for business revitalization. So, concurrent application of legal liquidation and public support for revitalization may result in excessive support beyond the extent necessary for business revitalization, and such concurrent application may have a greater impact on competition than otherwise.

##### **(2) Matters to be considered in minimizing the effects of public support on competition**

The concurrent application of public support for revitalization and legal liquidation should involve a thorough prior examination of their necessity. Basically, such necessity is considered to exist in cases where it is necessary to take advantage of the proper functions of legal liquidation for business revitalization. For example, the following are such cases:

① Cases where necessity exists to prevent the spread of risk of off-the-book debts (liabilities not listed on the balance sheet) and to determine the amount of beneficiaries' liabilities.

② Cases where it is difficult to ensure the consent of all creditors on a rehabilitation plan needed for business revitalization and, accordingly, it is

necessary to obtain such consent with a majority vote of creditors.

③ Cases where coordination among creditors must cover a diverse range of multiple creditors including financial creditors, such as providers of loans, corporate bond creditors, and commercial trade creditors, etc.

④ Cases where it is necessary to prevent assets of beneficiaries necessary for continuing their businesses from being seized due to compulsory execution procedures relating to individual claims.

Moreover, when the necessity for concurrent application of public support for revitalization and legal liquidation does exist and there is a concurrent application, it is appropriate to strictly adjust details of public support for revitalization in the light of effects resulting from legal liquidation, as well as by taking into full account the possibility that such concurrent application may lead to excessive support in terms of the contents of public support for revitalization, in order to minimize the effects on competition.

#### **5. Measures to be taken in cases where effects on competition that cannot possibly be ignored remain, in spite of the fact that specific details of support have been adjusted**

In spite of the fact that supporting organizations have made efforts to minimize the effects of public support for revitalization on market competition by strictly adjusting specific details of support, there may be cases where effects on competition that cannot possibly be ignored may remain.

In cases where such concerns persist, in order to remove in advance the harmful influences, it is appropriate for supporting organizations to consider measures they may take for minimizing effects, in addition to adjusting specific details of support, if necessary, in cooperation with the Ministries and Agencies under whose jurisdiction the businesses of beneficiaries falls.

Such measures for minimizing effects include, for example, the following:

① In cases where the absolute business size and market share of beneficiaries are expected to be large and they are expected to gain a significant competitive advantage due to such support, behavioral measures to restrict their business activities, such as restricting their investments in new production facilities and new business sectors for a certain period, may be taken.

② In cases where the beneficiaries' absolute business size and market share

are large when specific details of support are finalized, and where they are expected to gain a significant competitive advantage due to public support for revitalization, which can serve as leverage upon its completion, structural measures to reduce in advance the beneficiaries' production capacity within the market, such as transferring certain businesses and disposing of certain production facilities, may be taken.

However, measures that impose restrictions on price setting in the beneficiaries' business operations should not be taken as a matter of principle, because such measures are likely to have the effect of directly limiting market competition.

It is appropriate that whether or not measures for minimizing effects should be taken, their specific details and the timing of implementation should be determined when the support is finalized, because implementation of the measures for minimizing the effects is likely to impair incentives for beneficiaries to improve the efficiency of their businesses through their own business management efforts, and to impair incentives for stakeholders of beneficiaries to commit themselves to the revitalization of the beneficiaries' businesses.

## **V Ensuring Transparency in Supporting Procedures to Minimize the Effects of Public Support for Revitalization on Market Competition**

### **1. Basic Understanding**

Ensuring transparency in general both in substantive aspects such as disclosure by supporting organizations of adjustments to specific details of the support as described in I - IV above, and in procedural aspects, such as supporting organizations' disclosure of general standards for examining the provision of public support for revitalization and procedural flows, as well as ensuring transparency of a specific nature, such as disclosure by supporting organizations of information on individual and specific support cases, these modes of transparency will be conducive in terms of minimizing the effects of support on competition.

### **2. Specific measures for ensuring transparency in support procedures**

It will be appropriate for supporting organizations to undertake, for example, the following as specific measures to ensure transparency:

① Supporting organizations should basically disclose general standards of the examination and procedural flows for providing public support for revitalization, and should actively disclose the implementation process of public support for revitalization to improve the predictability of beneficiaries, their competitors, and their stakeholders supporting the beneficiaries.

② In cases where the effects on competition are considered to be substantial, including those cases where absolute business size and market share of beneficiaries are substantial, as well as where concurrent application of public support for revitalization and legal liquidation takes place, the contents of the support plan and the assessment of the effects of the plan on competition shall be announced insofar as possible, by ensuring that the smooth revitalization of the businesses of beneficiaries may not be impaired by damage caused by harmful rumors and misinformation, with a view to ensuring the transparency of specific and individual plans for public support for revitalization. Furthermore, in assessing the effects on market competition, opinions shall be obtained from the beneficiaries' competitors and business entities having transactions with the beneficiaries, etc., to the extent that such does not impair business revitalization concerning conditions of the market and possible effects from which beneficiaries' competitors may suffer as a result of the provision of the public support for revitalization.

## **VI Relevant business regulations, etc.**

### **1. Basic Understanding**

When regulatory agencies take administrative action including approval and licensing for beneficiaries and their competitors in connection with public support for revitalization, they are advised to minimize the possible effects of such actions on the competitive environment.

In particular, in cases where the beneficiaries and their competitors operate under official regulatory regimes, yet the beneficiaries will gain a significant competitive advantage through public support for revitalization, which will serve as a form of leverage, regulatory agencies may take administrative actions, etc. with a view to correcting the negative effects of public support on competition and ensuring a climate for market competition.

In these cases, it is appropriate for regulatory agencies to monitor market conditions, by obtaining the necessary information from supporting organizations and beneficiaries, with a view to evaluating the effects that public support for revitalization might have had on competition. It is also advisable that, if deemed necessary as a result of such a monitoring exercise, regulatory agencies should examine their administrative actions, etc. with a view to ensuring a climate for market competition by stimulating competition, while impairing in no way incentives for beneficiaries to improve their efficiency through their own business management efforts.

## **2. Response of Regulatory Agencies**

Based on the idea mentioned in 1 above, alternative actions that regulatory agencies shall take to promote competition may include, for example, the following:

- ① In cases where enterprises must get an approval or get licensed for their entry into the markets, participation of potential new entrants shall be promoted through the proper exercising of such authority for approval and licensing.
- ② Action should be taken to enable competitors, including new entrants, to use facilities that are essential for business operations with ease.

(End)