Price Leadership in a Homogeneous Product Market

Daisuke Hirata*

Graduate School of Economics, University of Tokyo

and

Toshihiro Matsumura†

Institute of Social Science, University of Tokyo

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Abstract

Existing studies of asymmetric duopoly show that price leadership by a lower cost firm is beneficial for both firms if cost difference between firms is large (dominant leadership). We reexamine Ono's (1978) pioneering work on price leadership. Ono assumes that the follower undercuts the leader's price and that the leader meets residual demand. We endogenize the follower's price. We find that, in contrast to the existing studies, mutually beneficial price leadership by the higher (lower) cost firm may arise (cannot arise). We also find that price leadership by the higher cost firm is mutually beneficial when the cost difference between firms is small.

JEL classification numbers: L13, C72

Key words: price leadership, price undercutting, cost differences, increasing marginal costs

*Corresponding author: Graduate School of Economics, University of Tokyo, 7-3-1, Hongo, Bunkyo-ku, Tokyo 113-0033, Japan. Phone and Fax:(81)-3-5841-4932. E-mail: ee076041@mail.ecc.u-tokyo.ac.jp

†E-mail: matsumur@iss.u-tokyo.ac.jp