An Empirical Analysis of the Interaction between Competitive Strategy, Market Share and Cpital Structure

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Abstract

This paper examines the impact of capital structure on the competitive position of firms in the product market, as measured by their market share. Theoretical predictions suggest that this impact depends on the type of competitive interaction among firms (i.e., Cournot or Bertrand competition). Hence, we classify a sample into Cournot or Bertrand competition based on an empirical measure of strategic substitutes and strategic complements. We present the evidence that firm's leverage has a positive impact on market share under both Cournot competition (as strategic substitutes) and Bertrand competition (as strategic complements). This result provides support for the most widely accepted version of the limited-liability effect of debt financing. Alternatively, the market share has a significantly negative impact on leverage regardless of whether firms' competitive interactions are substitutes or complements. This result implies that competitive firms restrict the use of debt financing. To conclude, these evidence suggest the following two facts. First, a firm's capital structure influences its future competitive position. Second, a firm's competitive position in the product market is important in determining its capital structure choice.

Keywords: Cournot competition, Bertrand competition, Strategic substitutes, Strategic complements, Capital structure

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