

Cost-reducing investment or quality-improvement investment

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Abstract

This paper analyzes whether the competitive firms select the cost-reducing investment or the quality-improvement investment by assuming the increasing marginal production cost. This paper uses a product differentiation model like Dixit (1979). In addition, it is assumed that the consumer has a common preference for the quality of goods. As a result, the following results were obtained. When the preference of quality by a consumer is small, the cost-reducing investment is always profitable. When it is large, the quality-improvement investment is always profitable. When it is medium, for small degree of product differentiation, the quality improvement investment is profitable; for large degree of product differentiation, the cost-reducing investment is profitable; for medium degree of product differentiation, the multiple asymmetric equilibrium comes true.

Keywords: cost-reducing investment, quality-improvement investment, product differentiation

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