Competition among the Big and the Small with Different Product Substitution*

Lijun PAN†
School of Economics, Nagoya University, Japan

Makoto HANAZONO‡
School of Economics, Nagoya University, Japan

April 20, 2015

Abstract

This paper employs a linear monopolistic competition model to revisit the impacts of the large firm's entry in the context of a mixed market structure where large and small firms coexist. In our model, the large firm determines both the range of product varieties and the quantity of each variety while the small firm produces only one variety of output and freely enters the market. We argue that the different substitutablitities between the products of large firms and those of small firms play a critical role in determining the impacts exerted by the entry of the large firm. If the products of large firms and those of small firms have different substitutablitities, the entry of the large firm may cause a rise or a fall of the incumbent large firms' output, price and profit, depending on the comparison of the substitutability within large firms and small firms and the substitutability across these two types of firms. In addition, the entry of the large firm may be harmful to cosumer welfare and social welfare. Our welfare analysis implies that it may be reasonable for the government to conduct the regulation against the entry of large firms in local markets.

Keywords: big firms, small firms, product substitution, entry behavior, market impacts

JEL classification: D21, D43, L11, L13

*This is an ongoing research and still a work in process. We are grateful to Professors M. Fabinger, J. Li, K. Kawamura, and especially Professor K. Shimomura for their helpful comments.

†School of Economics, Nagoya University, Japan. Email: pan.lijun.nu@gmail.com

‡School of Economics, Nagoya University, Japan. Email: hanazono@soec.nagoya-u.ac.jp