ENTRY BIASES IN COURNOT MARKETS WITH FREE ENTRY

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ABSTRACT

Entry biases determine whether free entry is desirable. This study examines entry biases in a Cournot market by comparing the number of free entry equilibrium firms to the number of social optimum firms.

First, a homogeneous good market with linear demand is studied. Second, non-linear demand is introduced to the homogeneous good market. Third, non-homogeneous good market is examined under the assumption of identical firms, and lastly the study is extended to non-homogeneous good market with non-identical firms.

It is established that there are two kinds of entry biases in the homogeneous goods market. First, free entry may lead to excess entry relative to the socially optimal level. Second, free entry may lead to the wrong type of firms in the market compared to the socially optimal type.

In non-homogenous goods market with identical firms, free entry equilibrium number of type one firms is equal to free entry equilibrium number of type two firms. Moreover, it is found that social optimum number of type one firms is equal to social optimum number of type two firms. When it comes to entry biases, the entry is again found to be excessive.

When non-identical firms are introduced to non-homogeneous goods market, non-corner solutions start to appear as the degree of product differentiation increases. In other words, when the degree of product differentiation is close to zero the goods become independent goods and both type of firms can survive in the market due to the maximum degree of product differentiation.