Competing for a Quiet Life: An Organizational Theory of Market Structure

(with Patrick Legros and Zsolt Udvari)

Abstract

We develop a property-rights model of endogenous market structure in which contracting imperfections, rather than scale economies or entry costs, emerge as the source of market power. Production of a homogenous good is carried out by substitutable, incentive-constrained teams that can stand alone as perfect competitors or sell their assets to profit-motivated HQs, thereby becoming subordinate members of their firms. HQs subsequently Cournot compete in the product market. Team output aggregates linearly within and across firms, there are no fixed production costs, no diseconomies of HQ ownership and HQs are abundant.

A fundamental hold-out problem places lower and upper bounds on the degree of concentration. The equilibrium market structure is typically an oligopoly, sometimes with a competitive fringe. Concentration may increase with the size of the market, unlike in the standard Cournot entry model. Entry barriers and competition policy may have distinct effects, depending on the demand regime, which has implications for differences in optimal merger policy in rich vs. developing countries.