Product Markets and Corporate Finance

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Abstract

The literature on corporate finance and the literature on oligopoly have placed relatively little emphasis on the strategic relationships between financial decisions and output market decisions. The purpose of this paper is to analyze the important relationship between these two decisions. In the first part of this paper, we argue that the choice of financial structures can affect product market strategies. In a Cournot (quantity) oligopoly structure, competing firms are induced to rely on heavy debts to commit to an aggressive output stance. But in contrast, Bertrand (price) competing firms may choose not to use any strategic debt. In the second part of this paper, we discuss the real options approach to analyzing investments under uncertainty. While the real options approach is proven to be useful in providing an analytical framework for analyzing the timing of investment decisions, the notable failure of this approach is the lack of strategic considerations. In order to highlight the importance of incorporating strategic considerations into real options models, we try to combine the real options approach with game theory. In our model, oligopolistic competitors decide their own optimal investment strategies considering the potential impacts of other firms' strategies.