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EQUILIBRIUM INCENTIVES IN OLIGOPOLY[†]

by

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Abstract

This paper examines what incentives owners give their managers and how these may be manipulated for strategic purposes. We examine this problem in two oligopoly models. In a market with Cournot quantity competition owners will give their managers positive incentives for sales, and sometimes may even **punish** them for profits at the margin. The equilibrium outcome will have a lower price and achieve greater efficiency than the standard Cournot equilibrium. Deviations from profit maximization will be less as owners' and managers' ex ante uncertainty about costs is greater and as the ex ante correlation between the firms' costs is less. As the number of firms increases to infinity, managers' incentives will converge to profit maximization. In contrast, when we examine a market with price competition among differentiated products, we find that managers will be punished for sales at the margin and prices will be greater compared to simple price competition.