

SELECTION EFFECTS WITH HETEROGENEOUS FIRMS

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Abstract

We characterize how firms select between alternative ways of serving a market. “First-order” selection effects, whether firms enter or not, are extremely robust. “Second-order” ones, how firms serve a market conditional on entry, are much less so: more efficient firms select the entry mode with lower market-access costs if firms’ maximum profits are supermodular in production and market-access costs, but not necessarily otherwise. We derive microfoundations for supermodularity in a range of canonical models. Notable exceptions include horizontal and vertical FDI with “sub-convex” demands (i.e., less convex than CES), fixed costs that increase with productivity, and R&D with threshold effects. (JEL: F23, F15, F12)

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