

MODULE 13 (PROFIT AND PRICING)

- Accounting Profit:

$$\text{Total Revenue} - \text{Explicit Costs}$$

- Economic Profit

$$\text{Total Revenue} - \text{Explicit Cost} - \text{Implicit Cost}$$

Q1

$$\text{ECONOMIC PROFIT} = \text{TOTAL REVENUE} \\ - \text{EXPLICIT COSTS} - \text{IMPLICIT COSTS}$$

$$200 - 600 = -400$$

Cost is the same of buying a NOA franchise

Short Run

- Total Cost: Variable Cost + Fixed Cost
- Average Cost:

$$\frac{\text{Total Cost}}{\text{Quantity}} = \frac{VC}{Q} + \frac{FC}{Q}$$

Short term

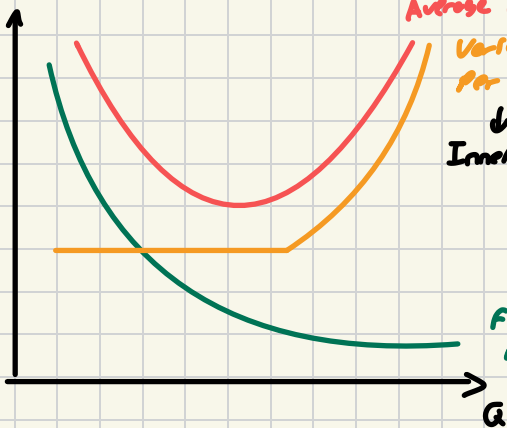
Cost per unit

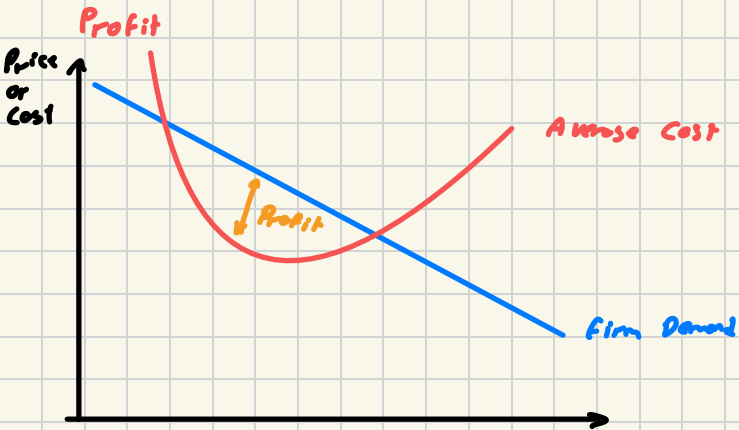
Average cost

Variable cost per unit

↓
Inefficiencies

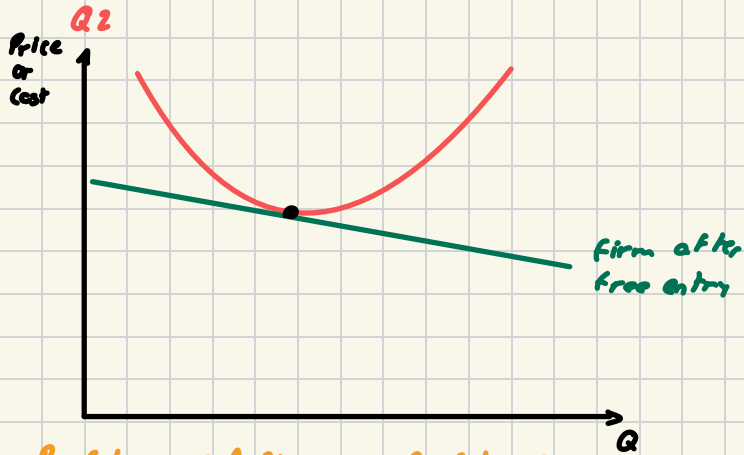
Fixed cost per unit





• Long term

- Rivals can increase their capacity and new rivals may enter the market
- Profit $> 0 \Rightarrow \uparrow$ firms \Rightarrow Profit $= 0$
- Price = Average Cost

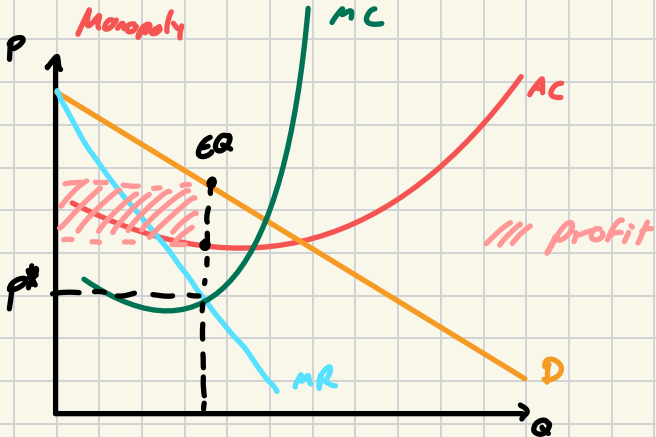


Profit $> 0 \Rightarrow \uparrow$ firms \Rightarrow Profit $= 0$



Q3

Monopoly



• Price Discrimination

- Selling the same good for different prices
- **Perfect:** Charge consumers their reservation

price

- **Group:** Charge different prices for different groups

- **Hurdle:** Offering lower prices only to buyers who are willing to overcome some obstacles

Q6

↑ inelastic \Rightarrow more firms can price discriminate

GAME THEORY

Q2

pl 2

		L	R
pl 1	T	<u>300</u> , 200	100, <u>300</u>
	B	200, 100	<u>200</u> , <u>200</u>

		pl 2		
Q1		straight		Turn
pl 1	straight	Crash, Crash		<u>1 win</u> , <u>2 loses</u>
	Turn	<u>1 loses</u> , <u>2 wins</u>		tie, tie

b) Anti-coordination game

c) Turn Turn

IF pl 2 choose straight the best is crash - Turn is better

IF pl 2 choose turn the best is turn - better

Q3

		Firm 2	
		High	Low
Firm 1	High	<u>2</u> , <u>2</u>	<u>5</u> , 1
	Low	1, <u>5</u>	4, 4

(Low Quality, Low Quality)

Maximizes the joint payoff

