EXAM   THE ECONOMICS OF STRATEGY

17 June 2013   Mikko Mustonen / Rune Stenbacka

Time limitation: 4 h   Help aid: Calculator

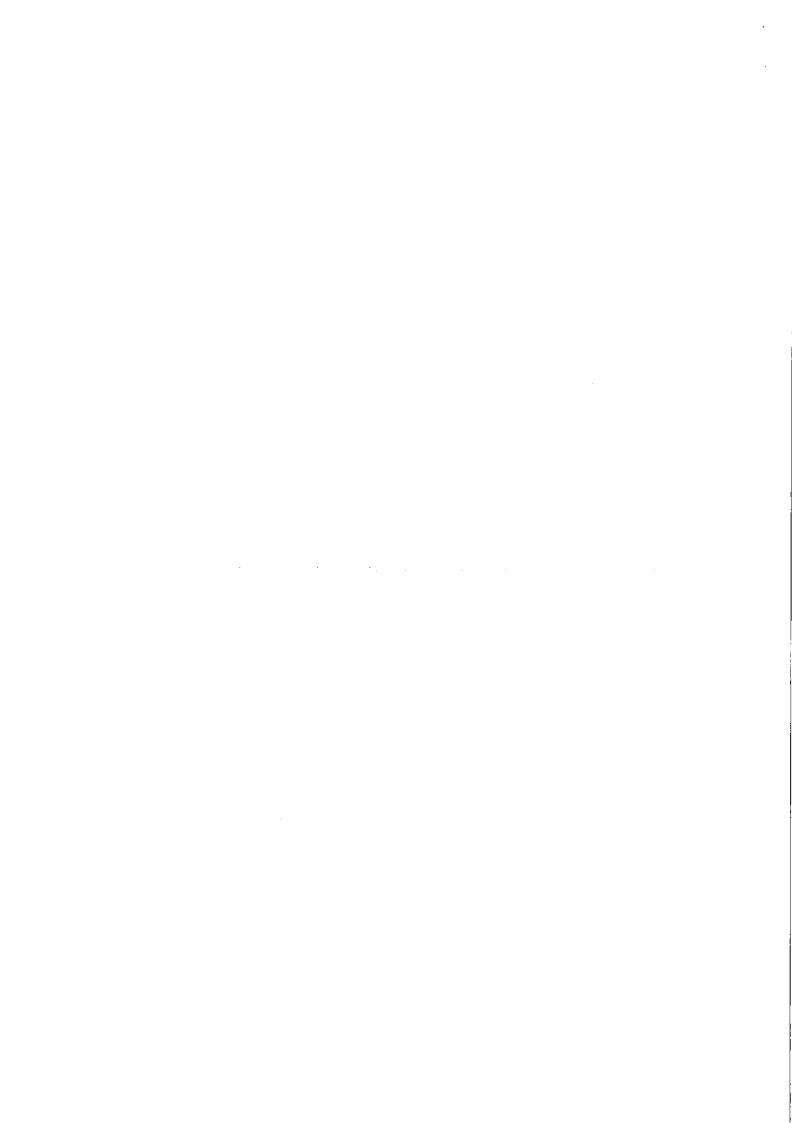Answer (in English or Swedish) all the four questions below! Please, answer question number four on a separate sheet of paper!

Observe that the questions do not have equal weight!

1a. Give a short description of how the Finnish Competition and Consumer Authority reviews mergers and acquisitions. (max 1 page)

1b. Supply and Demand Estimation of Homogenous Products: Assume you want to estimate the price elasticity of the demand for ready-mix concrete in Finland. Ready-mix concrete is concrete that is manufactured in a factory and then delivered to work sites using trucks. It is heavy and is therefore generally not transported over long distances. You observe price-quantity data for the year 2012 from local markets all over Europe. Describe your estimation strategy for linear supply and demand models. Is the data sufficient to identify the price elasticities? If not, what else do you need? (max 1 page)

1c. Define briefly the following concepts: (1) Lerner-index, (2) bundling, (3) strategic commitment, (4) tacit collusion. (Problem 1: 15/70p)

2. Durable goods. Explain the monopolist's problem when it is producing durable goods. What pricing strategy would solve the problem and why? (20/70p)

3. Two firms (called A and B) compete on a standard Hotelling line of length one. There is a unit mass of consumers, distributed uniformly along the line, and these consumers face linear transportation costs. Like in the standard Hotelling model, each consumer buys one unit of the good. Firms are located at the ends of the line, firm A at point 0 and firm B at point 1. Firms have marginal costs c_i, i=A,B. Firms choose prices.

a. Show how the location of the consumer who is just indifferent between the two firms' offers is defined.

b. Derive equilibrium prices for the firms.

c. Derive equilibrium profits for the firms. (Problem 3: 20/70p)

4. Assume that two competing firms (A and B) sell differentiated goods. Assume that these firms face the following demand functions:

$$q_A = 15 - p_A + \frac{1}{2}p_B$$

and

$$q_B = 15 - p_B + \frac{1}{2}p_A,$$

where p_A and p_B denote the prices charged by A and B, respectively. The duopolists face firm-specific marginal costs c_A and c_B, respectively. For simplicity, we neglect fixed costs.

(a) Calculate the Bertrand equilibrium in this market.

(b) Does Bertrand competition generate prices equal to marginal costs in this market? Why or why not? Explain in detail.

(c) Consider a situation where firm A is more efficient than firm B. Assume, for simplicity, that $c_A = 0$, whereas $c_B = c > 0$. How does this efficiency advantage translate into a profit advantage for firm A? In other words, compare the equilibrium profits for A and B in order to draw a conclusion about how the profit difference depends on the difference in marginal costs. (Problem 4: 15/70p)

Good luck!