Stanford Strategy and competition

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1. Competition is for loosers

- When you start a company you want a monopoly.
- A business creates X dollars of value and captures Y % of X. X and Y are independent variables.
- Air travel vs. Google. Are airlines more important than google? Intuition says yes. This explains X and Y as independent variables.
- Perfect competition:

Pros	Cons
Easy to model	Psycologically unhealthy
eficient in static word	irrelevant in a dynamic world
politically salable	preempts question of value

- Monopoly:

Pros	Cons
incentive to innovate	lower output, higher prices
Stable, long term planning	Price discrimination
Deeper project financing	Stifie innovation
Symptomatic creation	Tying

- Bussiness idea: Bussinesses are either monopolies or perfectly competitive.
- Diferences are quite small, anyone that has a monopoly will pretend they don't, if the market you are in is perfectly competitive you will tend to say that it is a monopoly, it's always the oposite what you say.
- non-monopolies: "we're a narrow market" $A \cap B \cap C$
- monopolies: "we're a huge market" $A \cup B \cup C$
- Powerfull incentives to disort the nature of these markets.

2. Maximizing profits under a monopoly

- Example: AIDS drugs are expensive because of monopolies.
- Market Power: The power to raise price above marginal cost without fear that other firms will enter the market.
- In a competitive market price will fall to marginal cost, indian aids pill is 50 cents.

2.1. Sources to market power

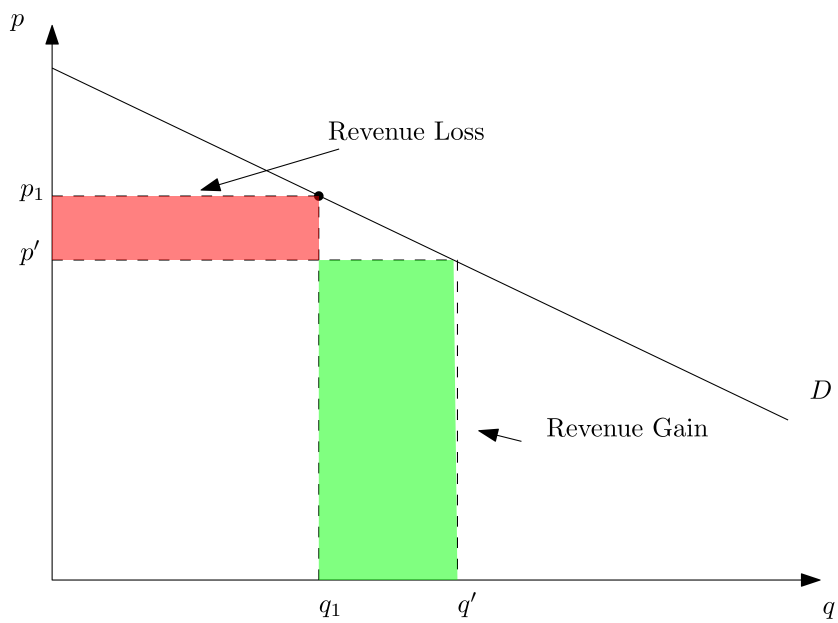
Selling a uniqyue good with barriers to entry such as:

- Patents.
- Government regulations other than patents.
- Economies of scale.
- Exclusive access to an important input good.
- Tecnological innovation.

2.1.1. Profit maximizing price

When Marginal Revenue is the same as price, remember that MR is not P, therefore this is not the same idea of the perfectly competitive market. The monopolist faces the entire downward sloping market demand curve, as a result profits are maximized when:

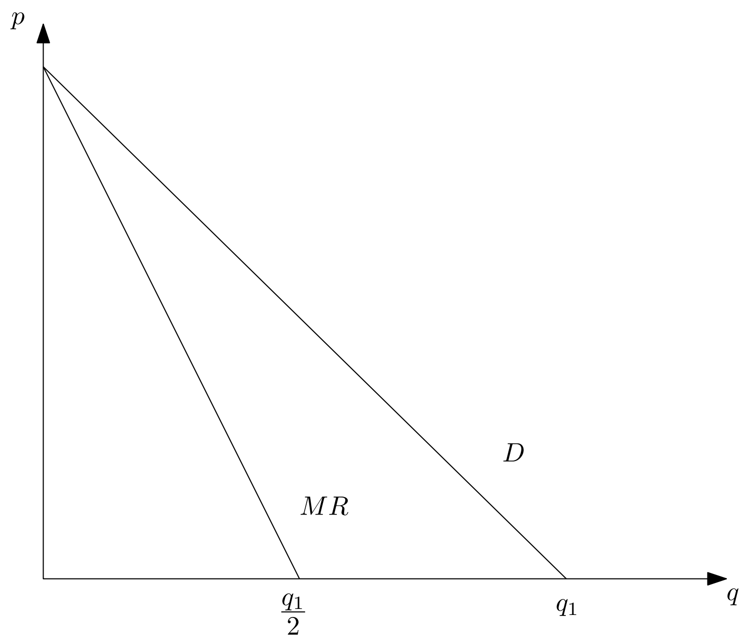
$$\text{MR} < \text{P}$$

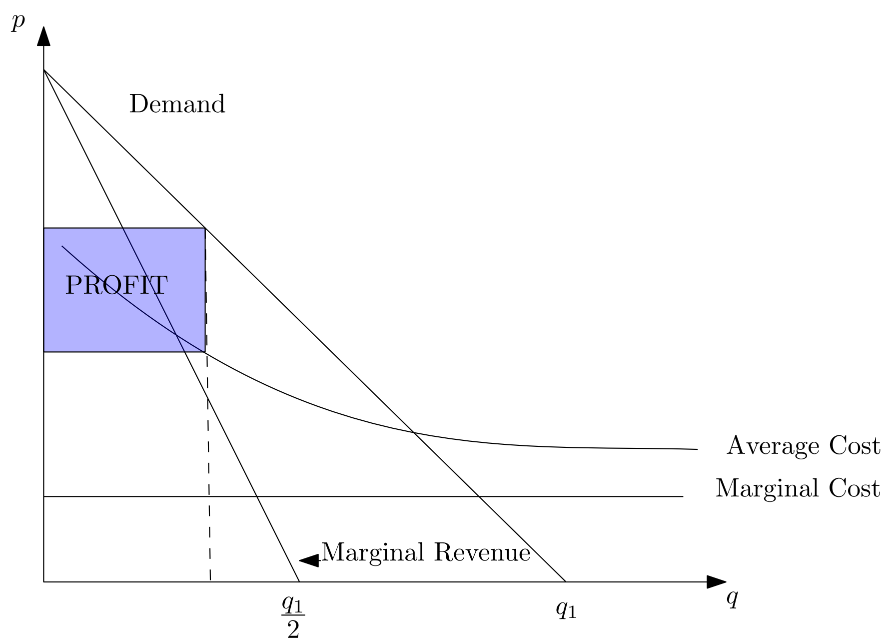


2.2. Shortcut for calculating the monopolie's maximizing profits

- MR begins at the same point on the vertical axis.
- MR has twice theslope.

$$MR = \frac{D}{2}$$





2.3. Profit

3. The monopoly markup

- Two effects increse the monopoly markup:
  1. The "'you can't take it with you" effect.
  2. The "other people's money" effect.
- The less sensative quantity demanded is to price the higher the markup, i.e. the more elastic demand the higher the monopoly markup.

3.1. Markup

- The more inelastic demand, the bigger the markup.