

Probability of failure (risk), f

A's best-response function (ICC), $f = \frac{1}{2} + \frac{\delta}{2q}$
Slope = $\frac{1}{2q}$

$$f^N = \frac{3}{4}$$

n

P's iso-expected
profit curve, $\hat{\pi} = \hat{\pi}^N$

$$\text{Slope} = \frac{1-f}{\delta}$$

Better for lender

$$\hat{\pi}^N = \hat{\pi}_1$$

$$\hat{\pi}_2$$

$$\delta^N = \frac{q}{2}$$

Interest factor, δ

