

## Ch 15: Entry, Exit, + Long Run Profitability

accounting profits := total revenue - explicit costs

economic profits := total revenue - explicit costs - implicit costs

(what we use as economists)

economic profit  $\leq$  accounting profit

↳ can be 0 or even negative

includes opportunity costs (foregone income) in order to construct a relative measure of profit, relative to other choices

average revenue :=  $\frac{\text{total revenue}}{\text{quantity}}$  = price

average cost :=  $\frac{\text{total cost}}{\text{quantity}} = \frac{\text{fixed cost}}{\text{quantity}} + \frac{\text{variable cost}}{\text{quantity}}$

$$\text{Profit} = TR - TC = (AR)(Q) - (AC)(Q) = Q(AR - AC) = Q(P - AC)$$

fixed cost = sunk cost when deciding how much to produce  
in short run:  $TR > VC$

↳ fixed costs avoidable in long run where rule of production becomes  $TR > TC$  entry & exit available

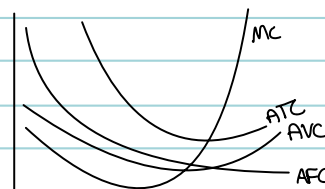
Trends: AFC decreases as  $q$  increases

MC decreases immediately but soon increases as  $q$  increases

As  $MC < ATC$ , ATC decreases but once  $MC > ATC$ , ATC increases

As  $MC < ATC$ , AVC decreases but once  $MC > ATC$ , AVC increases

$$ATC - AVC = AFC$$



Profit Margin :=  $P - AC$

$$\hookrightarrow \frac{\text{Profit}}{Q} = \frac{(P - AC)Q}{Q} = P - AC$$

Entry & Exit:

Rational Rule for Entry & Exit: Enter (exit) a market if there are positive (negative) economic profits

↳ entry lowers profits & exit increases profits so all industries move toward 0 economic profits in the long run

market price  $\downarrow \rightarrow P \downarrow, q \downarrow$

market price  $\uparrow \rightarrow P \uparrow, q \uparrow$

$$\Pi = TR - TC = Q(P - AC) = 0$$

barriers to entry := obstacles that prevent new firms from entering &  $\therefore$  allow for positive long run economic profit

↳ ex: gov franchising, licensing, regulation, patents, economies of scale, cost advantages, ownership of scarce factor of production, network effect

## Ch 16: Sophisticated Pricing Strategies

price discrimination := selling the same product at different prices to set prices as close as possible to consumers' reservation price

perfect price discrimination := price = reservation price

↳ max WTP

"first degree"

→ allows firms to make max profit on each sale AND sell more ... sell until  $P = MC$

→ removes all CS

→ results in socially optimal quantity produced

What conditions allow for Price Discrimination?

→ firm w/ mkt power, preventable resale, accurate targeting

group pricing := price discrimination by charging different prices to different groups.

the hurdle method := offer lower prices to buyers who are willing to jump over a hurdle you set high enough so that high MB consumers find it

"second degree"

too costly

· quantity discount

· bundling