

Ch 15: Entry, Exit, + Long Run Profitability

accounting profits := total revenue - explicit costs

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

(what we use as economists)

} economic profit
≤ 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

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

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

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

↓
fixed cost =
sink cost when
deciding how much
to produce
in short run: $\text{TR} > \text{VC}$

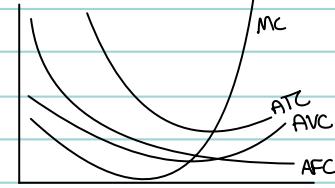
↳ fixed costs
available in long run
where rule of production
becomes $\text{TR} > \text{TC}$ entry, exit available

Trends: AFC decreases as q increases

MC decreases immediately but soon increases as q increases

As $\text{MC} < \text{ATC}$, ATC decreases but once $\text{MC} > \text{ATC}$, ATC increases } $\text{ATC} - \text{AVC} = \text{AFC}$

As $\text{MC} < \text{AVC}$, AVC decreases but once $\text{MC} > \text{AVC}$, AVC increases



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 $\frac{1}{3}$, exit increases profits so all industries move toward 0 economic profits in the long run
market power $\uparrow \rightarrow P \downarrow, q \uparrow$ market power $\uparrow \rightarrow P \uparrow, q \uparrow$ $\Pi = \text{TR} - \text{TC} = Q(P - AC) = 0$

barriers to entry := obstacles that prevent new firms from entering $\frac{1}{3}$ ∴ 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