Economics 380: Suggested Solutions to Midterm 1

7 March, 2005

1. The problem is that Glaxo is a natural winner due to the synergies and the common value nature of the auction. In response Wellcome could have tried the following:
(a) Hold a first price auction.
(b) Subsidise entry or provide bidder credits to Zeneca, or handicap Glaxo.
(c) Set a high reserve price. In order to commit to this higher reserve price they may need to implement a poison pill.

2. (a) A meet–the–competition clause increases the likelihood of competition after entry. That is, it makes the incumbant tough via the strategic effect. This should help to deter entry.

(b) Holland should have entered small, going after the small drinks companies. By not signing meet–the–competition clauses with these companies NutraSweet was signalling to Holland that it was fine to go after the small companies, but not Coke and Pepsi.

3. Incompatibility aids third degree price discrimination. The compatibility decision depends upon the similarity of demands between the two countries: if demand is very similar there is no need to price discriminate. The decision will also depend how many people travel between the countries, since incompatibility reduces the incentive to buy DVDs for those moving between countries.

4. The firms problem is to maximise profit $250[p(q)q] - c(x)$ subject to $q \leq x$. Since demand is the same every day, x will be chosen such that $q = x$. Substituting, the firm maximises

$$250[500 - 10q]q - 5000q$$

Differentiating yields $q^* = 24$.