

Economics 380: Homework 1

28 September, 2006

1. Complete the “five” forces analysis of Haagen Dazs in the slides for week 1.
2. You are in charge of pricing the “Pirates of the Caribbean” DVD. How should the market be defined? Suggest four possible definitions.
3. What is the difference between horizontal and vertical differentiation? Classify the following examples with a brief explanation.
 - (a) Conventional CRT monitor vs. Flat panel monitor.
 - (b) Playstation vs. XBox.
 - (c) Cheap inkjet printer vs. Expensive laserjet printer.
4. North American car makers often lose money on their smallest cars. Why do they offer them?
5. Suppose Ford bargains with Hunts, a supplier of crankshafts. Hunts has cost \$100 per crankshaft; Ford has value \$200 per crankshaft and requires 100 crankshafts.
 - (a) The Ford–Hunts relationship is worth \$100 per crankshaft. Suppose the firms split this surplus 50:50. What price will Ford pay? What are the profits of Ford and Hunts? (Think of Ford’s profits as their value minus the price they pay).
 - (b) Suppose Hunts can invest in a Wundermaschine which costs \$3000 and lowers the cost per crankshaft to \$50. If Hunts buys the Wundermaschine and subsequently bargains with Ford (again splitting the surplus 50:50), what price will Ford pay? What are the profits of Ford and Hunts? Should Hunts buy the Wundermaschine?
 - (c) Suppose Ford and Hunts bargain *before* Hunts buys the Wundermaschine. The two firms agree that Hunts will pay for the Wundermaschine and then split the remaining surplus 50:50. What price would we expect Ford to pay? What are the profits of Ford and Hunts?
6. You are the CEO of Zara. Your manager makes a number of suggestions. How do they fit in with the overall strategy?
 - (a) Subcontracting the manufacture of a new line of trousers to a specialist firm in Morocco.
 - (b) Hiring a star designer to make a new line of suits that will be the corner piece of your stores.
 - (c) Launching a childrens section.
7. Consider the hotelling model where two firms, A and B, are located along a line $[0, 1]$ and

choose prices simultaneously.

(a) Suppose A moves towards the centre (i.e. towards B). What effect does this have on prices? What effect does this have on B's profits? What effects does this have on A's profits? In equilibrium, where do you think the firms will locate?

(b) Suppose prices are exogenously fixed by a regulator. What happens to A's profits as they move towards the centre? In equilibrium, where do you think the firms will locate?

8. Holdup is due to lack of commitment. Holdup is due to incomplete contracts. Holdup is due to asset specificity. Which view is correct?