1. Why are the concepts of own and cross-price elasticities of demand essential to competitor identification and market definition?

3. How would you characterize the nature of competition in the restaurant industry? Are there submarkets with distinct competitive pressures? Are there important substitutes that constrain pricing? Given these competitive issues, how can a restaurant be profitable?

4. How does industry-level price elasticity of demand shape the opportunities for making profit in an industry? How does the firm-level price elasticity of demand shape the opportunities for making profit in an industry?

7. Numerous studies have shown that there is usually a systematic relationship between concentration and price. What is this relationship? Offer two brief explanations for this relationship.
9. The following are the approximate U.S. market shares of different brands of soft drinks: Coke-42 percent; Pepsi-30 percent; Dr Pepper/7-Up-18 percent; total for all other brands, 10 percent.

(a) Compute the Herfindahl for the soft drink market. Suppose that Pepsi acquired Dr pepper/7-Up. Compute the post-merger Herfindahl. What assumptions did you make?

(b) Federal antitrust agencies would be concerned to see a Herfindahl increase of the magnitude you computed in (a), and might challenge the merger. Pepsi could respond by defining the market as something other than soft drinks. What market definition might they propose? Why would this change the Herfindahl?

12. Why does Sutton draw a distinction between endogenous sunk costs, such as advertising, and other sunk costs, such as capital investments?

13. Why does Sutton’s model apply so well to consumer goods markets? Does Sutton’s model describe the structure of other markets?
Homework for Chapter 9

1. What about burning all but one of his ships made that a useful, powerful strategic commitment for Cortes in Mexico?

2. Explain the direct effect and the strategic effect of HP’s decision last week to hire Meg Whitman as CEO.

3. In economics, we say that firms should not use sunk costs when making decisions, only opportunity costs. Knowing that, how are sunk costs valuable to a firm already in a market as other firms consider entering?

4. Using the matrix of the Fudenberg & Tirole taxonomy, explain how/why you would describe Wal-Mart’s commitment to a Super Wal-Mart at Parkdale Plaza.

5. Use Pankaj Ghemawat’s framework for analyzing commitments to analyze Wal-Mart’s commitment to a Super Wal-Mart at Parkdale Plaza.