Problem Set 8

1. Consider the classical entry game. The entrant (Firm 1) may be Strong or Weak with probabilities (p=0.5) each. If F1 decides not to enter, the Entrant and Incumbent (Firm 2) get (0,2) as payoffs. If Firm 1 decides to enter, then Firm 2 can Fight or Acquiesce. If F2 decides to fight, and F1 is Strong, then the payoffs are (-1,-1), while if F2 decides to acquiesce they get (1,1). On the other hand, if F1 is weak, then fighting gives payoffs (-2,0) and acquiescing leads to (-1,1).

Find the PBE.

2. Check if separating strategies [(L, R), (R, L)] and pooling strategies [(L, L), (R, R)] lead to PBE in the following game, and describe the equilibria.

