

Relative Profit Maximization in Duopoly: Difference or Ratio

Atsuhiko Satoh

Faculty of Economics, Doshisha University, Japan

Yasuhito Tanaka*

Faculty of Economics, Doshisha University, Japan

Abstract

We compare two formulations of relative profit maximization in duopoly with differentiated goods: (1) (difference case) maximization of the difference between the profit of one firm and that of the other firm and (2) (ratio case) maximization of the ratio of the profit of one firm to the total profit. We show that in asymmetric duopoly the equilibrium output of the more efficient (lower cost) firm in the ratio case is larger than that in the difference case and the price of the good of the more efficient firm in the ratio case is lower than that in the difference case. For the less efficient (higher cost) firm we obtain the converse results.

Key words: duopoly; relative profit maximization; difference; ratio

JEL classification: D43; L13; L21

1. Introduction

In recent years, maximizing relative profit instead of absolute profit has aroused the interest of economists. For analyses of relative profit maximization see Schaffer (1989), Vega-Redondo (1997), Matsumura et al. (2013), Gibbons and Murphy (1990), Lu (2011), Satoh and Tanaka (2013, 2014a, 2014b), and Tanaka (2013a, 2013b).

In Vega-Redondo (1997) it was shown that the equilibrium in oligopoly with a homogeneous good under relative profit maximization is equivalent to the competitive equilibrium. With differentiated goods, however, the equilibrium in duopoly under relative profit maximization is not equivalent to the competitive equilibrium.

In Tanaka (2013a) it was shown that, under the assumption of linear demand and cost functions when firms in duopoly with differentiated goods maximize their relative profits, the Cournot equilibrium and the Bertrand equilibrium are equivalent. Satoh and Tanaka (2014a) extended this result to asymmetric duopoly in which

*Correspondence to: Faculty of Economics, Doshisha University, Kamigyo-ku, Kyoto, 602-8580, Japan. E-mail: yasuhito@mail.doshisha.ac.jp. The authors thank anonymous referees for providing helpful comments to improve the manuscript.

firms have different cost functions. Satoh and Tanaka (2013) showed that, in a Bertrand duopoly with a homogeneous good under relative profit maximization and quadratic cost functions, there exists a range of the equilibrium price, and this range is narrower and lower than the range of the equilibrium price in duopolistic equilibria under absolute profit maximization shown by Dastidar (1995). Tanaka (2013b) showed that, under relative profit maximization, the choice of strategic variables, price or quantity, is irrelevant to the equilibrium of duopoly with differentiated goods. In Satoh and Tanaka (2014b), we analyze a free entry oligopoly with differentiated goods, or monopolistic competition, under relative profit maximization.

In these papers, the relative profit of a firm in duopoly is defined as the difference between its profit and the profit of the rival firm. But we can alternatively define the relative profit as the ratio of the profit of one firm to the total profit of two firms. In this paper we compare two formulations of relative profit maximization in duopoly: (1) (difference case) maximization of the difference between the profit of one firm and that of the other firm and (2) (ratio case) maximization of the ratio of the profit of one firm to the total profit of two firms, under linear demand and cost functions.

We think that seeking relative profit or utility is based on the nature of man. Even if a person earns big money, if his brother/sister or close friend earns more money, he is not sufficiently happy and may be disappointed. On the other hand, even if he is very poor, if his neighbor is poorer, he may be consoled by that fact. Similarly, firms in an industry not only seek to improve their own performances but also want to outperform the rival firms. The TV audience-rating race and market-share competition by breweries, automobile manufacturers, convenience store chains and mobile-phone carriers, especially in Japan, are examples of such behavior of firms. Market-share competition of firms in many industries indicates that the definition of relative profit based on the ratio may be more appropriate.

We show that in a symmetric duopoly these definitions of relative profit are completely equivalent, but in asymmetric duopoly the equilibrium output of the more efficient (lower cost) firm in the ratio case is larger than that in the difference case, the equilibrium price of its good in the ratio case is lower than that in the difference case, the equilibrium output of the less efficient (higher cost) firm in the ratio case is smaller than that in the difference case, and the equilibrium price of its good in the ratio case is higher than that in the difference case. Also we show that the equivalence of Cournot and Bertrand equilibria holds in both cases and that the total output in the ratio case is larger than that in the difference case.

In the next section we present the model of this paper, in Section 3 we analyze the difference case, in Section 4 we consider the ratio case, and in Section 5 we discuss the results. A game of relative profit maximization in a duopoly in the difference case is a zero-sum game. The game in the ratio case is a constant-sum game. It is equivalent to a zero-sum game. We present an interpretation of our result and, in particular, the equivalence of Cournot and Bertrand equilibria from the point of view of zero-sum game theory.

2. The Model

There are two firms, A and B. They produce differentiated substitutable goods. The outputs of firms A and B are denoted x_A and x_B . The prices of the goods of firms A and B are denoted p_A and p_B . The inverse demand functions of the goods produced by the firms are:

$$p_A = a - x_A - bx_B,$$

and

$$p_B = a - x_B - bx_A,$$

where $0 < b < 1$. Here x_A represents the demand for the good produced by firm A, and x_B represents the demand for the good produced by firm B. The prices of the goods are determined so that the demand by consumers for each firm's good and the supply of each firm are equilibrated.

The ordinary demand functions are obtained from these inverse demand functions as follows:

$$x_A = \frac{1}{1-b^2}[(1-b)a - p_A + bp_B],$$

and

$$x_B = \frac{1}{1-b^2}[(1-b)a - p_B + bp_A].$$

The demand and inverse demand functions are symmetric for the firms.

The marginal costs of firms A and B are denoted c_A and c_B . In symmetric duopoly, the firms have the same marginal cost, that is, $c_A = c_B$; in asymmetric duopoly, $c_A \neq c_B$. Without loss of generality we assume $c_A < c_B$ in the asymmetric duopoly, that is, firm A is more efficient than firm B. There is no fixed cost. c_A and c_B are positive, and $a > \max\{c_A, c_B\}$.

In the Cournot model the absolute profits of firms A and B are written as:

$$\pi_A = (a - x_A - bx_B)x_A - c_A x_A,$$

and

$$\pi_B = (a - x_B - bx_A)x_B - c_B x_B.$$

Denote the relative profits of firm A and B, when the relative profit of each firm is defined as the difference between its profit and the profit of the rival firm, by Π_A and Π_B . Then, we have:

$$\Pi_A = \pi_A - \pi_B = (a - x_A - bx_B)x_A - c_A x_A - (a - x_B - bx_A)x_B + c_B x_B,$$

and

$$\Pi_B = \pi_B - \pi_A = (a - x_B - bx_A)x_B - c_Bx_B - (a - x_A - bx_B)x_A + c_Ax_A.$$

Denote the relative profits of firm A and B, when the relative profit of each firm is defined as the ratio of its profit to the total profit, by Φ_A and Φ_B . Then, we have:

$$\Phi_A = \frac{\pi_A}{\pi_A + \pi_B} = \frac{(a - x_A - bx_B)x_A - c_Ax_A}{(a - x_A - bx_B)x_A - c_Ax_A + (a - x_B - bx_A)x_B - c_Bx_B},$$

and

$$\Phi_B = \frac{\pi_B}{\pi_A + \pi_B} = \frac{(a - x_B - bx_A)x_B - c_Bx_B}{(a - x_A - bx_B)x_A - c_Ax_A + (a - x_B - bx_A)x_B - c_Bx_B}.$$

We call the former the *difference case* and the latter the *ratio case*.

In the Bertrand model, the absolute profits of firms A and B are written as:

$$\pi_A = \frac{1}{1-b^2}[(1-b)a - p_A + bp_B](p_A - c_A),$$

and

$$\pi_B = \frac{1}{1-b^2}[(1-b)a - p_B + bp_A](p_B - c_B).$$

The relative profits of the firms in the difference case are:

$$\begin{aligned} \Pi_A &= \pi_A - \pi_B, \\ &= \frac{1}{1-b^2}\{[(1-b)a - p_A + bp_B](p_A - c_A) - [(1-b)a - p_B + bp_A](p_B - c_B)\}, \end{aligned}$$

and

$$\begin{aligned} \Pi_B &= \pi_B - \pi_A, \\ &= \frac{1}{1-b^2}\{[(1-b)a - p_B + bp_A](p_B - c_B) - [(1-b)a - p_A + bp_B](p_A - c_A)\}. \end{aligned}$$

The relative profits of the firms in the ratio case are:

$$\begin{aligned} \Phi_A &= \frac{\pi_A}{\pi_A + \pi_B}, \\ &= \frac{[(1-b)a - p_A + bp_B](p_A - c_A)}{[(1-b)a - p_A + bp_B](p_A - c_A) + [(1-b)a - p_B + bp_A](p_B - c_B)}, \end{aligned}$$

and

$$\begin{aligned}\Phi_B &= \frac{\pi_B}{\pi_A + \pi_B} \\ &= \frac{[(1-b)a - p_B + bp_A](p_B - c_B)}{[(1-b)a - p_A + bp_B](p_A - c_A) + [(1-b)a - p_B + bp_A](p_B - c_B)}.\end{aligned}$$

3. Difference Case

We consider the difference case of asymmetric duopoly.¹ In the Cournot duopoly the first-order conditions for maximization of relative profits of the firms are:

$$\begin{aligned}\frac{\partial \Pi_A}{\partial x_A} &= \frac{\partial \pi_A}{\partial x_A} - \frac{\partial \pi_B}{\partial x_A} = a - 2x_A - bx_B - c_A + bx_B \\ &= a - 2x_A - c_A = 0,\end{aligned}\tag{1}$$

and

$$\begin{aligned}\frac{\partial \Pi_B}{\partial x_B} &= \frac{\partial \pi_B}{\partial x_B} - \frac{\partial \pi_A}{\partial x_B} = a - 2x_B - bx_A - c_B + bx_A \\ &= a - 2x_B - c_B = 0.\end{aligned}\tag{2}$$

The second-order conditions:

$$\frac{\partial^2 \Pi_A}{\partial x_A^2} = -2 < 0 \quad \text{and} \quad \frac{\partial^2 \Pi_B}{\partial x_B^2} = -2 < 0$$

are satisfied.

The equilibrium outputs of firm A and B are obtained as:

$$\tilde{x}_A^{d,C} = \frac{a - c_A}{2},$$

and

$$\tilde{x}_B^{d,C} = \frac{a - c_B}{2}.$$

The superscript *d* denotes *difference* and *C* denotes *Cournot*. The equilibrium prices of the goods of firms A and B are obtained as follows:

$$\tilde{p}_A^{d,C} = \frac{(1-b)a + c_A + bc_B}{2},$$

and

$$\tilde{p}_B^{d,C} = \frac{(1-b)a + c_B + bc_A}{2}.$$

In the Bertrand duopoly the first-order conditions for maximization of the relative profits of the firms are:

$$\begin{aligned} \frac{\partial \Pi_A}{\partial p_A} = \frac{\partial \pi_A}{\partial p_A} - \frac{\partial \pi_B}{\partial p_A} &= \frac{1}{1-b^2} [(1-b)a - 2p_A + bp_B + c_A - bp_B + bc_B] \\ &= \frac{1}{1-b^2} [(1-b)a - 2p_A + c_A + bc_B] = 0, \end{aligned} \quad (3)$$

and

$$\begin{aligned} \frac{\partial \Pi_B}{\partial p_B} = \frac{\partial \pi_B}{\partial p_B} - \frac{\partial \pi_A}{\partial p_B} &= \frac{1}{1-b^2} [(1-b)a - 2p_B + bp_A + c_B - bp_A + bc_A] \\ &= \frac{1}{1-b^2} [(1-b)a - 2p_B + c_B + bc_A] = 0. \end{aligned} \quad (4)$$

The second-order conditions:

$$\frac{\partial^2 \Pi_A}{\partial p_A^2} = -\frac{2}{1-b^2} < 0 \quad \text{and} \quad \frac{\partial^2 \Pi_B}{\partial p_B^2} = -\frac{2}{1-b^2} < 0$$

are satisfied.

The equilibrium prices of the goods of firm A and B are obtained as follows:

$$\tilde{p}_A^{d,B} = \frac{(1-b)a + c_A + bc_B}{2},$$

and

$$\tilde{p}_B^{d,B} = \frac{(1-b)a + c_B + bc_A}{2}.$$

The superscript *B* denotes *Bertrand*. The equilibrium outputs of firms A and B are:

$$\tilde{x}_A^{d,B} = \frac{a - c_A}{2},$$

and

$$\tilde{x}_A^{d,B} = \frac{a - c_B}{2}.$$

We have $\tilde{x}_A^{d,C} = \tilde{x}_A^{d,B}$, $\tilde{x}_B^{d,C} = \tilde{x}_B^{d,B}$, $\tilde{p}_A^{d,C} = \tilde{p}_A^{d,B}$, and $\tilde{p}_B^{d,C} = \tilde{p}_B^{d,B}$. Thus, we have shown the following proposition.

Proposition 1. In the difference case, the Cournot equilibrium and the Bertrand equilibrium are equivalent.

The equilibrium absolute profits of the firms are:

$$\pi_A = \frac{(a - c_A)^2}{4} - \frac{b(a - c_A)(a - c_B)}{4},$$

and

$$\pi_B = \frac{(a - c_B)^2}{4} - \frac{b(a - c_A)(a - c_B)}{4}.$$

Comparing them yields:

$$\pi_A - \pi_B = \frac{(2a - c_A - c_B)(c_B - c_A)}{4} > 0.$$

Denote $\tilde{x}_A^{d,C}$ and $\tilde{x}_A^{d,B}$ by \tilde{x}_A^d , $\tilde{x}_B^{d,C}$ and $\tilde{x}_B^{d,B}$ by \tilde{x}_B^d , $\tilde{p}_A^{d,C}$ and $\tilde{p}_A^{d,B}$ by \tilde{p}_A^d , and $\tilde{p}_B^{d,C}$ and $\tilde{p}_B^{d,B}$ by \tilde{p}_B^d .

4. Ratio Case

Next we consider the ratio case of asymmetric duopoly. The relative profits of firms A and B in the ratio case are denoted Φ_A and Φ_B . Generally they are written as:

$$\Phi_A = \frac{\pi_A}{\pi_A + \pi_B},$$

and

$$\Phi_B = \frac{\pi_B}{\pi_A + \pi_B}.$$

In the Cournot duopoly, the condition for maximization of Φ_A is as follows:

$$\frac{\frac{\partial \pi_A}{\partial x_A} (\pi_A + \pi_B) - \pi_A \left(\frac{\partial \pi_A}{\partial x_A} + \frac{\partial \pi_B}{\partial x_A} \right)}{(\pi_A + \pi_B)^2} = 0.$$

Simplifying this equation under the assumption that $\pi_A > 0$ and $\pi_B > 0$, we have:

$$\frac{\partial \pi_A}{\partial x_A} \pi_B - \frac{\partial \pi_B}{\partial x_A} \pi_A = 0.$$

Similarly the condition for maximization of Φ_B is as follows:

$$\frac{\partial \pi_B}{\partial x_B} \pi_A - \frac{\partial \pi_A}{\partial x_B} \pi_B = 0.$$

These conditions can be rewritten as:

$$\frac{\partial \pi_A}{\partial x_A} - \frac{\partial \pi_B}{\partial x_A} \frac{\pi_A}{\pi_B} = 0, \quad (5)$$

and

$$\frac{\partial \pi_B}{\partial x_B} - \frac{\partial \pi_A}{\partial x_B} \frac{\pi_B}{\pi_A} = 0. \quad (6)$$

From the first-order conditions in the Cournot duopoly of the difference case, when $x_A = \tilde{x}_A^d$ and $x_B = \tilde{x}_B^d$, we have:

$$\frac{\partial \pi_A}{\partial x_A} = \frac{\partial \pi_B}{\partial x_A} = -bx_B < 0,$$

and

$$\frac{\partial \pi_B}{\partial x_B} = \frac{\partial \pi_A}{\partial x_B} = -bx_A < 0.$$

Since $\pi_A > \pi_B$ at the equilibrium in the difference case, the left hand sides of (5) and (6) are reduced to:

$$\frac{\partial \pi_A}{\partial x_A} \left(1 - \frac{\pi_A}{\pi_B} \right) \Big|_{x_A = \tilde{x}_A^d, x_B = \tilde{x}_B^d} > 0,$$

and

$$\left. \frac{\partial \pi_B}{\partial x_B} \left(1 - \frac{\pi_B}{\pi_A} \right) \right|_{x_A = \tilde{x}_A^d, x_B = \tilde{x}_B^d} < 0.$$

Thus, we obtain the following result.

Proposition 2. In asymmetric duopoly, the equilibrium output at the Cournot equilibrium of the more efficient (lower cost) firm in the ratio case is larger than that in the difference case, and the equilibrium output at the Cournot equilibrium of the less efficient (higher cost) firm in the ratio case is smaller than that in the difference case.

In the Bertrand duopoly, the conditions for maximization of Φ_A and Φ_B under the assumption that $\pi_A > 0$ and $\pi_B > 0$ are written as follows:

$$\frac{\partial \pi_A}{\partial p_A} \pi_B - \frac{\partial \pi_B}{\partial p_A} \pi_A = 0,$$

and

$$\frac{\partial \pi_B}{\partial p_B} \pi_A - \frac{\partial \pi_A}{\partial p_B} \pi_B = 0.$$

These can be rewritten as:

$$\frac{\partial \pi_A}{\partial p_A} - \frac{\partial \pi_B}{\partial p_A} \frac{\pi_A}{\pi_B} = 0, \tag{7}$$

and

$$\frac{\partial \pi_B}{\partial p_B} - \frac{\partial \pi_A}{\partial p_B} \frac{\pi_B}{\pi_A} = 0. \tag{8}$$

From the first-order conditions in the Bertrand duopoly of the difference case, when $p_A = \tilde{p}_A^d$ and $p_B = \tilde{p}_B^d$, we have:

$$\frac{\partial \pi_A}{\partial p_A} = \frac{\partial \pi_B}{\partial p_A} = \frac{b}{1-b^2} (p_B - c_B) > 0,$$

and

$$\frac{\partial \pi_B}{\partial p_B} = \frac{\partial \pi_A}{\partial p_B} = \frac{b}{1-b^2} (p_A - c_A) > 0.$$

Since $\pi_A > \pi_B$ at the equilibrium in the difference case, the left hand sides of

(7) and (8) are reduced to:

$$\left. \frac{\partial \pi_A}{\partial p_A} \left(1 - \frac{\pi_A}{\pi_B} \right) \right|_{p_A = \tilde{p}_A^d, p_B = \tilde{p}_B^d} < 0,$$

and

$$\left. \frac{\partial \pi_B}{\partial p_B} \left(1 - \frac{\pi_B}{\pi_A} \right) \right|_{p_A = \tilde{p}_A^d, p_B = \tilde{p}_B^d} > 0.$$

Thus, we obtain the following result.

Proposition 3. In asymmetric duopoly, the equilibrium price at the Bertrand equilibrium of the more efficient (lower cost) firm in the ratio case is lower than that in the difference case, and the equilibrium price at the Bertrand equilibrium of the less efficient (higher cost) firm in the ratio case is higher than that in the difference case.

Also in the ratio case we can show the following result.

Proposition 4. In the ratio case, the Cournot equilibrium and the Bertrand equilibrium are equivalent.

Proof. See Appendix A. [Available upon request]

We denote the equilibrium outputs of firms A and B in the ratio case both at the Cournot equilibrium and the Bertrand equilibrium by \tilde{x}_A^r and \tilde{x}_B^r and denote the equilibrium prices of the goods of firm A and B by \tilde{p}_A^r and \tilde{p}_B^r . The superscript *r* denotes *ratio*.

4.1 Explicit Calculations

Explicitly calculating the equilibrium outputs and prices, we obtain:

$$\begin{aligned} \tilde{x}_A^r &= \frac{(a - c_A)(a - c_B)[(a - c_A) - b(a - c_B)]}{2(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]}, \\ \tilde{x}_B^r &= \frac{(a - c_A)(a - c_B)[(a - c_B) - b(a - c_A)]}{2(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]}, \\ \tilde{p}_A^r &= \frac{(a - c_A)\{(1 + b^2)(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]\}}{2(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]}, \end{aligned}$$

and

$$\tilde{p}_B^r = \frac{(a - c_B) \{ (1 + b^2)(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2] \}}{2(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]}.$$

From these expressions the relations:

$$\tilde{x}_A^r > \tilde{x}_A^d \quad \text{and} \quad \tilde{x}_B^r < \tilde{x}_B^d,$$

and

$$\tilde{p}_A^r < \tilde{p}_A^d \quad \text{and} \quad \tilde{p}_B^r > \tilde{p}_B^d$$

are derived. For additional details see Appendix B, available upon request.

Comparing the total output in the ratio case and that in the difference case yields:

$$\begin{aligned} \tilde{x}_A^r + \tilde{x}_B^r - \tilde{x}_A^d - \tilde{x}_B^d &= \frac{b(a - c_A)[(a - c_A) + (a - c_B)](c_B - c_A)}{2\{2(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]\}} \\ &\quad + \frac{b(a - c_B)[(a - c_A) + (a - c_B)](c_A - c_B)}{2\{2(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]\}} \\ &= \frac{[(a - c_A) + (a - c_B)](c_B - c_A)^2}{2\{2(a - c_A)(a - c_B) - b[(a - c_A)^2 + (a - c_B)^2]\}} > 0. \end{aligned}$$

Thus, the total output in the ratio case is larger than that in the difference case.

4.2 A Note on the Symmetric Duopoly

If the duopoly is symmetric (i.e., $c_A = c_B$) in the difference case and the ratio case, the equilibrium outputs of firms A and B satisfy:

$$\tilde{x}_A^d = \tilde{x}_A^r = \tilde{x}_B^d = \tilde{x}_B^r = \frac{a - c}{2},$$

where $c = c_A = c_B$. The equilibrium prices of the goods of firms A and B satisfy:

$$\tilde{p}_A^d = \tilde{p}_A^r = \tilde{p}_B^d = \tilde{p}_B^r = \frac{(1 - b)a + (1 + b)c}{2}.$$

Therefore, in symmetric duopoly, maximization of relative profits in the difference case and maximization of relative profits in the ratio case are completely equivalent.

5. Discussion

5.1 Comparison of the Difference Case and the Ratio Case

Using a weight on the absolute profit of the rival firm, define the relative profit of each firm as follows:

$$\Psi_A = \pi_A - \alpha_A \pi_B \quad \text{and} \quad \Psi_B = \pi_B - \alpha_B \pi_A,$$

with $\alpha_A > 0$, $\alpha_B > 0$, and $\alpha_A \alpha_B = 1$. Then, the first-order conditions for maximization of Ψ_A and Ψ_B in the Cournot duopoly are:

$$\frac{\partial \pi_A}{\partial x_A} - \alpha_A \frac{\partial \pi_B}{\partial x_A} = 0,$$

and

$$\frac{\partial \pi_B}{\partial x_B} - \alpha_B \frac{\partial \pi_A}{\partial x_B} = 0.$$

Since $\partial \pi_B / \partial x_A < 0$ and $\partial \pi_A / \partial x_B < 0$, the larger the weight on the absolute profit of the rival firm, the larger the absolute value of $\partial \pi_A / \partial x_A$ or $\partial \pi_B / \partial x_B$. This means that a firm whose weight on the absolute profit of the rival firm is larger is more aggressive, that is, produces larger output.

The difference case corresponds to the case where $\alpha_A = \alpha_B = 1$. The ratio case is equivalent to the case where $\alpha_A = \pi_A / \pi_B > 1$ and $\alpha_B = \pi_B / \pi_A < 1$. Therefore, the more efficient firm (firm A) produces larger output, and the less efficient firm (firm B) produces smaller output in the ratio case than the difference case.

In the Bertrand duopoly, we can show that the more efficient firm chooses the lower price, and the less efficient firm chooses the higher price in the ratio case than the difference case because $\partial \pi_B / \partial p_A > 0$ and $\partial \pi_A / \partial p_B > 0$. This means that the more efficient firm is more aggressive in the ratio case and in the Bertrand duopoly.

5.2 Zero-Sum Game Interpretation of the Equivalence between Cournot and Bertrand Equilibria

The game of the difference case is a zero-sum game because:

$$\Pi_A + \Pi_B = \pi_A - \pi_B + \pi_B - \pi_A = 0.$$

In the game of the ratio case, we have:

$$\Phi_A + \Phi_B = \frac{\pi_A}{\pi_A + \pi_B} + \frac{\pi_B}{\pi_A + \pi_B} = 1.$$

Thus, it is a *constant-sum game*. Of course, a constant-sum game is equivalent to a zero-sum game in practice.

Consider a two-person zero-sum game with two strategic variables as follows. There are two players, A and B. They have two sets of strategic variables, (s_A, s_B) and (t_A, t_B) . The relations between them are represented by:

$$s_A = f_A(t_A, t_B) \text{ and } s_B = f_B(t_A, t_B).$$

Assume f_A and f_B are differentiable. The payoff function for player A is $u_A(s_A, s_B)$ and for player B is $u_B(s_A, s_B) = -u_A(s_A, s_B)$. These are differentiable. The condition for maximization of u_A with respect to s_A and the condition for maximization of u_B with respect to s_B are:

$$\frac{\partial u_A}{\partial s_A} = 0, \quad (9)$$

and

$$\frac{\partial u_B}{\partial s_B} = 0. \quad (10)$$

We assume the existence of maxima for u_A and u_B . Substituting f_A and f_B into u_A and u_B yields:

$$u_A = u_A(f_A(t_A, t_B), f_B(t_A, t_B)), u_B = u_B(f_A(t_A, t_B), f_B(t_A, t_B)).$$

The condition for maximization of u_A with respect to t_A and the condition for maximization of u_B with respect to t_B are:

$$\frac{\partial u_A}{\partial s_A} \frac{\partial f_A}{\partial t_A} + \frac{\partial u_A}{\partial s_B} \frac{\partial f_B}{\partial t_A} = 0, \quad (11)$$

and

$$\frac{\partial u_B}{\partial s_A} \frac{\partial f_A}{\partial t_B} + \frac{\partial u_B}{\partial s_B} \frac{\partial f_B}{\partial t_B} = 0. \quad (12)$$

Under the assumption that $[(\partial f_A / \partial t_A)(\partial f_B / \partial t_B)] - [(\partial f_A / \partial t_B)(\partial f_B / \partial t_A)] \neq 0$, (11) and (12) are equivalent to (9) and (10). Therefore, competition by (s_A, s_B) and competition by (t_A, t_B) are equivalent.

If we regard f_A and f_B as demand functions, s_A and s_B as outputs of firms, and t_A and t_B as prices, we obtain the equivalence of Cournot equilibrium and Bertrand equilibrium under relative profit maximization. For example, consider the ratio case of relative profit maximization in duopoly. We regard s_A and s_B as the outputs of the firms and denote them by x_A and x_B ; we also regard t_A and t_B as the prices of the goods and denote them by p_A and p_B . We have:

$$\begin{aligned}
u_A &= \frac{(p_A - c_A)x_A}{(p_A - c_A)x_A + (p_B - c_B)x_B} \\
&= \frac{(a - x_A - bx_B)x_A - c_A x_A}{(a - x_A - bx_B)x_A - c_A x_A + (a - x_B - bx_A)x_B - c_B x_B}, \\
u_B &= \frac{(p_B - c_B)x_B}{(p_A - c_A)x_A + (p_B - c_B)x_B} \\
&= \frac{(a - x_B - bx_A)x_B - c_B x_B}{(a - x_A - bx_B)x_A - c_A x_A + (a - x_B - bx_A)x_B - c_B x_B}, \\
f_A(p_A, p_B) = x_A &= \frac{1}{1-b^2}[(1-b)a - p_A + bp_B], \\
f_B(p_A, p_B) = x_B &= \frac{1}{1-b^2}[(1-b)a - p_B + bp_A], \\
\frac{\partial f_A}{\partial p_A} &= -\frac{1}{1-b^2}, \quad \frac{\partial f_B}{\partial p_A} = \frac{b}{1-b^2}, \quad \frac{\partial f_A}{\partial p_B} = -\frac{1}{1-b^2}, \quad \text{and} \quad \frac{\partial f_B}{\partial p_B} = \frac{b}{1-b^2}. \quad (13)
\end{aligned}$$

Consequently, $[(\partial f_A / \partial p_A)(\partial f_B / \partial p_B)] - [(\partial f_A / \partial p_B)(\partial f_B / \partial p_A)] \neq 0$ is satisfied. Thus (9) is reduced to:

$$\frac{\partial u_A}{\partial x_A} = \frac{(p_A - c_A - x_A)(p_B - c_B)x_B + bx_A x_B (p_A - c_A)}{(\pi_A + \pi_B)^2} = 0.$$

This is equivalent to (14) in Appendix A. Since:

$$\frac{\partial u_A}{\partial x_B} = -\frac{b(p_B - c_B)x_A x_B + (p_A - c_A)(p_B - x_B - c_B)x_A}{(\pi_A + \pi_B)^2},$$

using (13), we find that (11) means:

$$\begin{aligned}
& -[(p_A - c_A - x_A)(p_B - c_B)x_B + bx_A x_B (p_A - c_A)] \\
& -b[b(p_B - c_B)x_A x_B + (p_A - c_A)(p_B - x_B - c_B)x_A] = 0.
\end{aligned}$$

Arranging the terms we get:

$$[(1-b^2)x_A - (p_A - c_A)]x_B - bx_A(p_A - c_A) = 0.$$

This is the same as (16) in Appendix A (as said, available upon request), which is the condition for relative profit maximization in the Bertrand duopoly of the ratio case. Similarly, we can show that (10) and (12) mean (15) and (17) in Appendix A.

The results of this paper, in particular, the relation between the difference case and the ratio case, seem to extend to a case of general demand functions. This is a theme for future research.

Notes

1. The result in this section has been proved in Tanaka (2013a). But for comparison with the ratio case we recapitulate the analysis in the difference case.

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