

Pothole Construction Exercise

Pothole Construction Inc. buys so little diesel fuel each month that only two wholesale oil companies are interested in bidding for Pothole's business. The wholesalers, Tiger Oil and Olympus Fuel, do not reveal their monthly bids to each other and antitrust laws prevent them from conspiring to set prices.

Each month Pothole buys from the wholesaler with the lowest price. When the prices of Tiger and Olympus are equal, Pothole buys half its supply from each firm, to maintain both companies as resources for future business.

Pothole's financial conditions allow them to comfortably pay in the 1 to 5 cent range. In the five years that Tiger and Olympus have bid on Pothole's business, no other competitor has bid on this small account.

You represent one of the wholesalers and must decide your monthly bid. Because of competition, your markup above your cost cannot exceed 5 cents per gallon of diesel. Since Pothole is a small customer, you cannot put your competitor out of business by underbidding.

Last month was January and the lowest bid contained a 3 cent markup. To help you decide February's markup, an aide has prepared this table:

Profit for the Low Bidder

Bid	If One Firm Chooses Low Markup	If Both Firms Choose Low Markup
1 cent	\$300	\$150
2 cents	\$600	\$300
3 cents	\$900	\$450
4 cents	\$1200	\$600
5 cents	**	\$750

**Since 5 cents is the highest possible markup, 5 cents cannot be the lowest markup unless both companies choose it.

Pothole Construction: Monthly Bid Sheet

Month: _____

Company Name: Tiger _____ Olympus _____

Please Circle Your Company's Markup:

1 cent

2 cents

3 cents

4 cents

5 cents