

KEELE UNIVERSITY
ECONOMIC AND MANAGEMENT STUDIES
ECO-20015
Managerial Economics II

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1 Module Details:

Module type: Principal Management Science, Business Economics, Finance & Economics

Session: 2007/08

Semester: First

Level: II

CATS Credits: 15

Compulsory for: Management Science, Economics & Finance

Pre-requisites:

Co-requisites: None

Available to Socrates/Erasmus, exchange and visiting students: Yes

Teaching and learning methods: Lectures/Classes (2 hours lectures per week and one hour class per fortnight)

Assessment method: Mixed (exam 70% and mid-term 30%)

Hand-in Date: N/A

Study time: 150 hours (of which approximately 20 hours lectures, 5 hours tutorials, 25 hours class preparation, 100 hours independent study)

Module times: Thursday 11.00-13.00 in CBA.1.098

Tutorial times: Thursday 14.00, Thursday 15.00 all in CBA.1.078/9 (weeks 4,6,8,10,12).

Module coordinator: Prof. Tim Worrall

Teaching staff: Nicholas Vasilakos and Tim Worrall

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Tim Worrall: Room CBA 2.021, E-Mail: t.s.worrall@econ.keele.ac.uk.

Consultation times: Thursday 16.00-18.00.

2 Aims and Objectives:

Aim of Module: The aim of the module is to consider the classical theory of the firm and industry. It examines important aspects of information and organization theory as these impact on firm behaviour and strategy.

Objectives of Module: The objective of the module is to understand management problems of organizations accounting for the basic two objectives, viz., co-ordination and the motivation of strategically interacting persons, with particular emphasis on the tools to solve the managerial decision making problems.

Intended Learning Outcomes: By the end of this module you should be able to understand the pricing decisions and competitive behaviour of firms, the role of incentives in the firm, signalling and reputation and the transactions costs approach to organisation. You will learn about the five (or is it six) competitive forces which determine the profitability within an industry. In particular the module will provide you with the opportunity to acquire the following skills:

Knowledge and Understanding

- understand the fundamental problems of economic organisation, coordinating and motivating the members of an organisation to achieve the common interests
- understand the importance of strategic decisions making of the managers of organisations
- understand the role of price mechanism to deal with co-ordination and motivation problems
- understand potential problems in contractual relationship
- understand the tools to deal with uncertain situations faced by the managers in decision making process
- understand the importance of the marginal concept in optimization, both at the discrete and continuous margin and gain an understanding of constrained optimization in simple settings
- understand the problem of multi-marginalisation and how a fixed fee and other strategies can be used to overcome such problems
- know the different types of price discrimination and the types of strategies firms can adopt to extract consumer surplus
- know Porter's five forces and the sixth force of complementarity and understand the factors that determine industry profitability
- know the role played by hidden information and adverse selection and understand their importance in determining firm strategy and market equilibrium
- understand the trade-off between risk-sharing and motivation in firms and the reasons why certain incentive schemes are used within organisations
- understand the role for co-operation within business and the need for credibility of actions
- understand the role that transactions costs play in determining organisation structure

Practical, Professional and Subject-specific Skills

- recognise the various problems firms face
- motivate people in organisations to achieve efficiency and other objectives
- apply the theory of contact to various organisational situations

Cognitive and Intellectual Skills

In this module you can considerably enhance your numeracy skills by gaining an understanding of simple stochastic processes such as the binomial model. You will be able to advance your problem solving skills through a series of assigned exercises and to test your communications skills by explaining the pricing and strategic behaviour of firms cogently and concisely and by being able to explain how simple examples can illustrate general principles.

Transferable and Key Skills and Attributes

You will also have the opportunity to work with others in self-study groups to use web and other resources.

If you should wish to know more about key skills or personal development portfolios please visit the website at <http://www.keele.ac.uk/depts/aa/class/pdp/index.html>.

3 Syllabus

This is a course on managerial economics. It thus focuses on that part of microeconomics that deals with the theory of the firm and the theory of industry. We'll put particular emphasis on strategy and strategic decision making. We'll focus not only competitive markets and price-mediated transactions but also on complexities of moral hazard and hidden information, on repeated interactions and the organizational complexities of the firm.

From the course textbook, we will concentrate on only a sub-set of chapters but you should aim to read all the chapters from the book and some chapters from the supplementary reading too.

Topics to be covered:

- **Marginal this and that**

In managerial economics we often want to maximize something or other (profits, for example). At a maximum it is impossible to make a small or marginal change that can improve one's position (profits, say). We look at continuous, discrete margins and constrained optimization and the importance of considering marginal and not average changes in all three cases. Read K Ch 3.

- **Double marginalization**

Many businesses have a multi-step distribution system. We consider the impact of double marginalization and how it can be remedied by vertical integration, fixed fees, franchising etc. Read K Ch 6.

- **Costs**

We look at the costs of the firm, average and marginal, efficient scale, cost minimization and multi-period production. We show the difference between profit maximization and efficient scale and the difference between profit maximization and the profit margin. Read K Ch 8-10.

- **Differentiation and pricing**

We consider pricing and differentiation strategies of firms: first, second and third degree price discrimination, quality complementarities, networks and exclusive dealing. Read K Ch. 7.

- **Competition**

We consider perfect and imperfectly competitive firms and the industry equilibrium. Read K Ch. 11.

- **Industry analysis**

We consider Porter's five forces that determine the profitability of firms within an industry and whether a sixth force of complementarity should be added. Read K Ch. 20.

- **Signalling**

A choice almost always reveals something about the chooser. When the chooser is aware of this such inferences should be made with care. We examine cases where there is hidden information which may be revealed through choices an in particular at adverse selection, signalling, screening, and the winner's curse in contracting. Read K Ch. 18.

- **Incentives**

We examine how agents may be motivated to achieve high performance in firms and organizations. We examine moral hazard and the trade-off between motivation and risk sharing. We examine benchmarking, tournaments and the ratchet effect. Read K Ch. 19.

- **Co-operation**

Sometimes firms will wish to co-operate or collude. We'll examine repeated interaction and the "Folk Theorem". We'll also discuss reputation and credibility. Read K Ch. 22-23.

- **Organisation**

We will examine the nature of the firm as a complex of transactions, transaction-specific assets, transfer pricing and the use of quantities and prices within organizations. Read K Ch. 24.

4 Organisation and Assessment

Organisation: The module consists of approximately 20 lectures plus 5 tutorial classes. The course outline is available in week 1. Lectures begin in week 2 with two lectures per week. Classes begin in week 4 and take place in even weeks. There will be a reading week in week 7 and a mid-term test on material from the first part of the course in week 9. In week 12, if time permits, one lecture slot will be given over to feedback, revision and exam preparation guidance. Roughly 25 hours are given over to class preparation and 100 hours to private study. Attendance at lectures and tutorials will be monitored.

Teaching and learning methods: Lectures will cover all the main material and emphasizes the topics for study. Class sessions and will go through some problem solving of examples. Exercises will be given out ahead of time and groups will be expected to have attempted these exercises in advance of the class and hand them in one written copy in advance to the tutor. There will be no formal assessment of this work but informal feedback will be given. Seminar rooms can be made available for "self-study groups" if required.

Please make use of the consultation times, study groups, and other resources that are listed below. You will find the books, articles, course materials and web-based materials extremely helpful. You should note that you will need to work steadily and continuously throughout the module.

Assessment: There will be a two-hour exam in January examination period worth 70% of total mark for the module. The exam paper from 2006/07 is available as a pdf file from the course materials page. There will be a 50-minute mid-term on Thursday 22nd November at 12.00noon. Venue CBA1.098. A mid-term from last year together with model answers will be put up later on the course materials page.

5 Resources

It is important that you read and comprehend all the relevant material from the course textbook and study the other course materials. Only by working consistently will you benefit most from the module.

Note: The Campus bookshop has been notified of the course textbook but if the books listed are not in the Campus bookshop, they can also be ordered from a variety of online bookstores.

Course Textbook: The course textbook is

David M. Kreps: Microeconomics for Managers, Norton, 2004.

ISBN 0-393-97698-5. £38.99.

HB172.K75

One copy general loan, one copy 7-day loan, 5 copies short-loan

This is an extremely good textbook at exactly the right level. It is written in a straightforward and accessible style explaining the key theoretical and practical material that the course will cover. You should make sure you obtain a copy and work through the relevant chapters.

Course Materials: Other course materials including lecture slides, assigned exercises and some lecture handouts are also available on WebCT. The relevant URL is

- <https://www.vle.keele.ac.uk/webct/logon/32614652001>

You should bookmark that page and return to it frequently as the course materials will be updated at regular intervals.

Supplementary reading: No one textbook is ever sufficient and you will gain valuable understanding by consulting other texts that may present similar material in slightly different ways. Here are a few suggestions.

R. Preston McAfee: Competitive Solutions: The Strategist's Toolkit. Princeton University Press, 2002.

Paul Milgrom and John Roberts: Economics, Organization and Management. Prentice-Hall, 1992

John McMillan: Games, Strategies and Managers. Oxford University Press, 1996.

Adam Brandenberger and Barry Nalebuff: Co-opetition. Profile Business, 1997.

Michael Porter: Competitive Advantage. Free Press, 2004.

Web Resources: There are lots of web resources for business and managers. One that you may find useful is

- <http://www.bized.co.uk/>

Let me know if you find others that you think would be helpful for your fellow students to know about.

6 Guidance and Feedback:

General Guidance: Work steadily and consistently. Ask for help when needed.