Managerial Economics (2038B-0809)

Course Manual

January 2009

1 Introduction

Managerial economics applies microeconomic principles to managerial issues. Executives, consultants, investment bankers and many other practitioners make daily economic decisions that explicitly or implicitly follow economic laws. Understanding these laws is important for making good decisions concerning diverse managerial problems: devising an effective internal promotion and incentive schemes; making risky investments at a good moment in time; planning and executing take-overs; fighting speculative attacks; pricing products and many more. This course provides the analytical skills and economic insights to analyze such managerial problems without being trapped in everyday biases and truisms. The course will provide skills to analyze consumer behavior and make good product placement and pricing decisions. It will also provide the abilities to examine production technologies and firm cost structure and show how a manager should deal with market inefficiencies and government interventions like taxes, subsidies and regulation. The problems regarding trading on the securities or insurance markets as well as sharing of risk with employees will be discussed. The last but not lease, the course will demonstrate how to make strategic decisions in the uncertain world of management.

2 Position in the Curriculum

This course starts from the fundamentals of microeconomics that you should have learned earlier in your studies; that is, it presumes a working knowledge of microeconomic theory. Some additional knowledge on game theory might be very helpful.

3 Literature

The textbook for this course is *"Microeconomics for Managers"* by David M. Kreps, published by W. W. Norton & Company in 2004. This is a textbook designed for MBA programs that contains a great deal of examples to illustrate the economic concepts we will talk about. Reading and understanding the material in the textbook is absolutely necessary to pass this course. You can also use *"Student's Companion to Microeconomics for Managers"* which contains solutions to some problems from the text book and additional exercises. The Excel spreadsheets from the book can be found at `http://www.wwnorton.com/college/econ/kreps/`. I will use both books as

the source of problems and tasks for this course. Supplementary materials like lecture slides, problems and solutions will be provided online in EleUM.

4   Session Structure

Each meeting will have the following structure:

- Briefly summarize the content of the discussion topic

- Make a list of keywords and key concepts with their meaning

- Relate those key concepts with each other

- Discuss the literature in detail (for instance page by page), and answer each other's questions on the literature

- Do the exercises

- Discuss the tasks.

A few remarks about this list. Making and using a list of key concepts and their relations, should help to identify quickly the main aspects of the theories covered. Make certain that you understand what has been covered. If not, don't hesitate to ask questions. As the book contains some difficult material, you should not hesitate to pay explicit attention to questions about the literature. You are encouraged to prepare questions related to the literature so that you are able to formulate them clearly in class.

It is a well known fact that it is impossible to learn economics without working some problems. Therefore, a number of exercises and tasks are included in the course. They form an indispensable part of an adequate training in microeconomics. Each group member should prepare the solutions to these exercises and tasks at home, although you may find it useful to prepare and discuss them in small groups before the tutorial. The solutions will be discussed in class. On the basis of suggestions of the students, the tutor can help you to structure the problem and to find the correct solution (probably in the next meeting). Most exercises and tasks will be taken from the textbook. *"Student's Companion to Microeconomics for Managers"* contains solutions to many problems alike those in class. You might find it useful to take a look at that book.

Don't expect the tutor to elaborate her/his own solution on the whiteboard. Individual students may be asked to present their answers. The setup that includes the discussion of the literature and solution of the exercises and tasks is designed to give you a feel for solving real life problems with analytical tools that economics provides. Believe it or not, many arguments become much simpler with a little mathematics. The lectures are meant to provide an overview, explanation or deepening of the main themes and theories. Moreover, the lectures will relate the different topics discussed and provide possible applications. As a result, the logic behind the chosen structure of the course will become clear from the lectures.

5 Course Structure

Week	Day	Date	Meeting	Subject, Literature, Tasks
1	Tue	Feb 3	L-01	Introduction, *Why Do Managers Need Microeconomics?*
				Consumer Choice
	Fri	Feb 6	T-01	*GM Truck Coupons Case*, Lit.:pp.1-22, 36-40
				Four Puzzles of Thinking at a Margin, Lit.:pp.42-43; Exc.:3.2, 3.4, 3.9.
2	Tue	Feb 10	L-02	*Firms and Decisions They Make*
				Models of Technology
	Fri	Feb 13	T-02	*Making Supply Meet Demand*
				Lit.:the article, pp.84-94,102-127; Exc.: 4.2, 4.6, 4.13, 5.3, 5.7, 5.9
3	Tue	Feb 17	L-03	*Perfect Competition and Market Efficiency*
				Government Regulations and Externalities
	Wed	Feb 18	T-03	*A Porsche Story*
				Lit.: Discussion questions, Chapters 6 and 21
	Fri	Feb 20	T-04	*Sugar Industry in the US*
				Lit.: Case material, Chapter 13 and parts of Chapters 11-12 necessary to understand it; Exc.: 13.3, 13.5, 13.6, 13.7
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5	Fri	Mar 6	T-05	*Commitment and Credibility*
				Lit.: Discussion questions, Chapter 21 and section 23.1
6	Tue	Mar 10	L-04	*Repeated Games: Reciprocity, Collusion, Reputation*
				Extensive Form Games of Imperfect Information
	Tue	Mar 10	L-05	*Games of Incomplete Information*
				Moral Hazard, Adverse Selection, Signaling, Screening
	Fri	Mar 13	T-06	*Bertrand Duopoly and Repeated Games*
				Lit.: Discussion questions, Chapter 22
7	Wed	Mar 18	T-07	*Entry, Forward Induction, Bank Runs*
				Lit.: Discussion questions, Lecture notes, Chapter 21
	Fri	Mar 20	T-08	*TBA*
8	Wed	Mar 25	T-09	*TBA*
	Fri	Mar 27	T-10	*TBA*

The horizontal lines separate the meetings by weeks. There are two different kinds of meetings. The lectures are numbered by L-xx. Apart from a short explanation of the content of the chapters to be studied, the lectures will address the applications and the relation between theories within economics. In order to optimally benefit from the lectures, it is advised to read/scan through (rather than study) the literature and the lecture slides that will be provided before each lecture. There are only 5 lectures and they are spread rather unevenly throughout the course (in week 6 there are 2 lectures). That's why the material covered in lectures can go beyond current tasks discussed in the tutorials. The literature section in the table states the chapters from the textbook that correspond to each lecture. The material covered in class will not necessarily cover *everything* in the stated chapters. Certain topics might not be covered.

The rest of the meetings are regular tutorials numbered by T-xx. For each tuto-

rial the chapters from the textbook, the exercises and the tasks are given in the last column. To prepare for the tutorial you are supposed to study the chapter (which involves *understanding* of the material), solve exercises and tasks.

I have not decided on the contents of the tutorials in three weeks. This is because it is a new course and I need to see how it goes. I will announce the topics of the tutorials at least a week in advance.

6 Grading Policy

The course grade will be determined by a written exam. The exam is closed book and will consist of open (not multiple choice) questions. The exam problems will be similar to the exercises and tasks discussed during the tutorials. Consult the examinations website in EleUM for the latest news on the date, time and location of the exam.

Your results for the test will be graded on the scale from 1 to 10, and rounded to the nearest half point. To pass the exam you need to get an *unrounded* grade of at least 5.5. Students who fail the exam will be offered a reexamination during exam period 5.

7 Block Assignments and Participation

The block assignment is an essay of approximately 2000 words for each meeting. The exact topic of the essay is decided by the coordinator of the course, but will be related to the content of the meeting. Students with sufficient participation are exempted from writing block assignments. However, mere physical presence at the tutorial meetings is not enough to make a session a success. The effectiveness depends also on your efforts at home as well as during the meetings. Active participation is essential to have an exemption from the block assignment. During each meeting your tutor will evaluate the individual effort. At the first session she/he will provide you with the necessary information on the evaluation procedure and criteria. Basically, she/he will evaluate two aspects: preparation, the extent to which you demonstrate that you studied the required material; and participation, the extent to which you actively contribute during group discussions. Given the course structure, preparation shows in the questions you raise and the answers you provide, and in the preparation towards and contribution in solving the exercises and tasks. Participation reflects not only the frequency of your contributions, but also their relevance, quality and professionalism,

such as respecting other group members and their contributions, refraining from distracting conduct, punctuality, etc. If your efforts are considered insufficient on one or both accounts, the tutor can ignore your physical attendance and book you as being mentally absent (M). Physical absence is denoted by (A). Exemption for the block assignment is only granted if you have no more than 2 A's, no more than 2 M's and $A + M \leq 3$. At any time you may consult the list of your attendance or absenteeism. Students who do not meet the criteria for full exemption from the block assignment can still benefit from a leniency programme: they will be exempted for a number of essays equal to the number of meeting in which they sufficiently participated.

8 Contact Information

Alexander Vostroknutov (coordinator/tutor)
Office: A4.06
Phone: +31 (0)43 38-84606
E-mail: `a.vostroknutov@algec.unimaas.nl`

Diogo Geraldes (tutor)
Office: A4.04
Phone: +31 (0)43 38-83626
E-mail: `d.geraldes@algec.unimaas.nl`

Ayse Yüksel (tutor)
Office: A4.03
Phone: +31 (0)43 38-83626
E-mail: `a.yuksel@algec.unimaas.nl`