ECO 411: Study questions for Midterm Exam

Go over the list of examples of complex business transactions in the preface of Rubin.

According to Oster, what forces influence and shape the optimal business strategy for a firm?

“If everyone can do it, you can’t make money at it.” Use the concept of entry barriers to explain.

What is the neoclassical theory of the firm?

Is the neoclassical theory of the firm appropriate to use if we are trying to understand what soybean prices will be in three years? If we are trying to understand whether soybean farming will be dominated by family-owned farms or national conglomerates?

Give an example of how we use the “black box” notion of the firm in production theory, in cost theory, in perfect competition, and in monopoly.

Use the notion of transactions costs to explain when firms should produce internally and when firms should buy in the external market.

When will it be cheaper to use the market?

What is vertical integration?

Why might firms decide to vertically integrate?

Toyota makes its own engines and body parts. It buys radios and tires. Are these decisions random or is there some sound business principle that Toyota is applying in each instance?

What is asset specificity? What are sunk costs? What are quasi-rents? Write an essay that ties these three things together.

What is opportunistic behavior (or hold-up) and why is it a problem when asset specificity and quasi-rents are present?

In what specific situations does asset specificity arise?

When assets are specific but transactions are infrequent, which is preferred, a contractual solution or vertical integration?

Give an example of an information asymmetry, and explain how vertical integration can solve problems created by information asymmetries.

Why is it usually cheaper to use the market to acquire inputs rather than rely on internal production?

What is meant by the term “efficient contract”?

Why is it often undesirable to rely on a legal remedy when two parties to a business transaction disagree?

What is meant by the term “self-enforcing agreement”? In what sense is Toyota’s arrangement with Johnson Controls to produce seats for Camrys a self-enforcing agreement?

What is a hostage and how are they used in business transactions?

How can a sunk investment be used to make a business agreement self-enforcing?

What are principal-agent relationships? Give an example and explain what problems arise in principle-agent situations.

What is shirking? How do frequent-flier programs induce shirking among business travelers?

Why do piece-rates solve the shirking problem?

What is general human capital? Specific human capital? Give examples.

In what sense do efficiency wages constitute a bond for workers not to shirk?

Why do contests not work well if there are production synergies among the contestants?

What is the difference between a proprietorship and a corporation? Do principal-agent problems arise in proprietorships?

What is meant by "separation of ownership from control"?

Explain why agency costs arise when outside equity is used to finance an expansion.

Explain why agency costs arise when debt is used to finance an expansion.

What determines the market value of a firm? Explain how outsiders can make a profit by taking over a poorly run firm.

Briefly describe the different types of takeovers.

What is an anti-takeover measure? Give examples. Should stockholders be in favor of the adoption of anti-takeover measures by their firm?

What are different ways that an upstream manufacturer can exert vertical control over a downstream distributor? In what types of markets do we see vertical controls used?

What are three possible problems that may arise in these types of markets? Give an example of a vertical control instrument that can alleviate each of these problems.

Franchising is an example of an agent-agent relationship. Explain the nature of the principal-agent relationship that runs from the franchisor to the franchisee, and then explain the nature of the principal-agent relationship that runs from the franchisee to the franchisor.

Why might a MacDonald's restaurant located at an interchange of I-75 be more likely to be company-owned than a MacDonald's restaurant located in town?

How can franchisors deter chiseling on quality by franchisees? Use the notions of irreversible investments and quasi-rents in your answer.

How can a franchise system be set up so that the franchisor has an incentive to continue to monitor quality across outlets and maintain the value of the brand name?