

ECO 610: Managerial Economics

October 2006 Course for UK/TEI Piraeus Program

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Course Description:

In this course we will apply economic theory to managerial decision making. We will employ many of the traditional tools of microeconomics and see how they can be used to analyze practical business problems. We will pay particular attention to the strategy of firms in the marketplace. ECO 610 is a core course in the MBA program and is intended to complement the other core courses. Prerequisites for this course are principles of micro and macroeconomics, basic probability theory and statistics, and introductory calculus.

Textbook

Assigned readings will come from:

Besanko, Dranove, Shanley, and Schaefer, *Economics of Strategy* (3rd edition), John Wiley & Sons, Inc., 2004.

There will also be assigned readings for each class taken from business periodicals such as the *Wall Street Journal*. **The entire set of readings, including the assigned chapters from the textbook, can be purchased in electronic form in course packets available from XanEdu-ProQuest Learning.** So you do not need to purchase a hard copy of the entire textbook. Instructions on how to purchase the readings are attached.

Grading

Your grade in the course will be based on your performance on (1) in-class quizzes, (2) a short research memorandum, and (3) an in-class final exam. We will have a short quiz toward the end of each evening's class. There will be eight quizzes in all, and I will drop your lowest and count your top seven scores. I will ask you to write a 6-8 page (12 point font, double-spaced) memorandum, in which you analyze a particular industry of your choosing using the "five-forces" approach as outlined in Chapter 10 of the textbook. This memorandum will be due two weeks after our last class meeting. Finally, we will have a comprehensive final exam, for which you will be able to use your textbook and notes. The quizzes will count 30% in total, the research memorandum will count 30%, and the final exam will count 40% towards the determination of your letter grade in the course.

Class Structure

Since this course is so compact and concentrated, we have to be very efficient in our use of class time. Also, I recognize that many students will have already put in a full day at work before coming to class. We will typically break each evening into three sessions. In the first session, from 6:00 p.m. until 7:15, I will introduce the evening's topic and provide some examples to motivate interest. After a fifteen-minute break, I will provide further theoretical discussion of the topic. The second session will typically last from 7:30 until 8:45. After another fifteen-minute break, we will finish off the evening with an hour-long discussion of cases and applications, ending class at 10:00 p.m. Each evening's short quiz will typically come at the end of the second session.

Course Schedule and Reading Assignments:

Monday, October 2: Introduction to the course—examples of managerial decision-making, economic costs and profitability.

- BDSS: pp. 7-8, 19-23.

Tuesday, October 3: Economic concepts—costs, demand, market structure.

- BDSS “Primer: Economic Concepts for Strategy,” pp. 9-35.
- “Greece offers new wave of wines,” *WSJ*, 8/4/03.
- “Spanish put new accent on olive oil,” *WSJ*, 11/17/03.

Wednesday, October 4: Horizontal boundaries of the firm—economies of scale and scope, diseconomies of size, the learning curve.

- BDSS ch. 2: “Horizontal Boundaries of the Firm,” pp. 72-96, 100.
- “Power pork: corporations begin to turn hog business into an assembly line,” *WSJ*, 3/28/94.
- “Extinction of the predator—the global car industry,” *The Economist*, 9/10/05.

Thursday, October 5: Vertical boundaries of the firm—make or buy, transactions costs, asset specificity, hold-up, vertical control devices.

- BDSS ch. 3: “Vertical Boundaries of the Firm,” pp. 105-116, 122-137.
- “Made to measure: invisible supplier has Penney's shirts all buttoned up,” *WSJ*, 9/11/03.
- “Growing pains: to bag China's snack market, Pepsi takes up potato farming,” *WSJ*, 2/19/05.
- “Bike maker faces a tactical shift,” *WSJ*, 10/12/98.

Friday, October 6: Principal-agent relationships—principal-agent problems, costs of tying pay to performance, implicit incentive contracts, incentives in teams.

- BDSS ch. 14: “Agency and Performance Measurement,” pp. 476-480, 484-490.
- BDSS ch. 15: “Incentives in Firms,” pp. 510-525.

- “Big Mac’s makeover,” *The Economist*, 10/16/04.
- “Levi’s factory workers are assigned to teams and morale takes a hit,” *WSJ*, 5/20/98.

Saturday, October 7 and Sunday, October 8: catch up on reading, work on industry study.

Monday, October 9: Competitors and competition—defining a market, elements of market structure, types of market structure.

- BDSS ch. 6: “Competitors and Competition,” pp. 199-222 (also go back and read ch. 1, pp. 35-39).
- “Alligator farming shows there’s a lot to be said for cows,” *WSJ*, 8/2/89.
- “Greece is the word,” *WSJ*, 7/30/04.
- “A buyer’s guide to the new gameboxes; Xbox will come out first, but Sony touts its graphics,” *WSJ*, 5/18/05.

Tuesday, October 10: Strategic commitment—irreversibility and credibility, strategic complements/substitutes, taxonomy of business strategies.

- BDSS ch. 7: “Strategic Commitment,” pp. 232-250 (skim pp. 242-245).
- “Haven’t shareholders had enough chicken?” *WSJ*, 4/4/01.
- “Cruise lines slash their prices as war fears scare travelers,” *WSJ*, 1/29/03.
- “Upstart’s tactics allow it to fly in friendly skies of a big rival,” *WSJ*, 6/23/99.

Wednesday, October 11: Pricing rivalry—prisoner’s dilemma, repeated games and tit-for-tat behavior, market structure and cooperative behavior, price discrimination.

- BDSS ch. 8: “Dynamics of Pricing Rivalry,” pp. 259-286.
- “Dell price cuts put squeeze on rival H-P,” *WSJ*, 8/21/03.
- “Ticket shock: U.S. business fares soar, while coach gets even cheaper,” *WSJ*, 11/4/97.

Thursday, October 12: Entry and exit—barriers to entry and exit, entry deterring strategies.

- BDSS ch. 9: “Entry and Exit,” pp. 297-321.
- “Café Ole? Madrid gets its first Starbucks,” *WSJ*, 4/11/02.
- “Airports crack down on gamesmanship over gates,” *WSJ*, 6/7/05.
- “The tri-county pizza war,” *Lexington Herald-Leader*, 11/10/05.

Friday, October 13: Industry analysis—Porter’s five forces, in-class application of five-force analysis to selected Greek industries.

- BDSS ch. 10: “Industry Analysis,” pp. 327-335, 349-351.
- “Oh, sweet revenge,” *Newsweek*, 9/29/03.

Instructions for Industry Analysis Assignment

A major (30%) portion of your grade in this course will come from your analysis of a particular industry of your choosing. Your assignment is to choose an industry that you have some interest in, and to research that industry so that you become something of an expert. Sources that you might use for your research include library and internet resources, as well as discussions with persons knowledgeable about the industry.

Your research should follow the outline of an industry study discussed in Chapter 10 of *Economics of Strategy* by Besanko, Dranove, Shanley, and Schaefer. In other words, you should do a five-forces analysis of your industry. The types of questions you should consider in analyzing your industry are outlined in Appendix 10.1 of the BDSS textbook. Your challenge is to figure out which questions are most relevant to your chosen industry and hence deserving of your attention, and which ones are not particularly important.

You should convey your research findings in a business-style memorandum. Imagine that you have been given the assignment to research a particular industry because a large corporation (your client or employer) is thinking about investing in this industry. You should write a six-to-eight page memorandum (12 pt. font, double-spaced, one-inch margins) addressed to the executive committee. Make sure that you appropriately cite all of the outside references that you use, because the company will not want to make an important decision based on unreliable sources or flimsy evidence and research.

Attach as an appendix to your memorandum a copy of each of the sources that you use. If you cite a book or long article, only include the title page and the pages you refer to in your report. For short articles from periodicals, newspapers, and internet sources, include the entire piece. If you interview a person knowledgeable about the industry, explain who the person is and include a summary of your notes from the interview. Then in writing your memo you can use very brief citations to your sources, e.g. see Appendix, Reference A-1, A-2, etc.

This assignment is due Friday, October 27. That means that you should mail it on or before that date to:

Professor Frank Scott
Department of Economics
University of Kentucky
Lexington, KY 40502-0034
USA

Make sure that your packet has a date stamped on it so that I will know that you mailed it on time.

Instructions for ordering the Coursepack

Name: Frank Scott

Address: University of Kentucky
Department of Economics
Lexington, KY 40506-0034

Phone Number: 859-257-7643

CoursePack Title: A BXS CoursePack for ECO 610--TEI Piraeus Program

CoursePack ID: 258968

Page Count: 439

CoursePack ISBN: 0470071842

Online-only Price: \$62.65

Course Info: University of Kentucky

Course Name/number: ECO 610

Term: Fall 2006

Class Begin Date: 09/25/2006

Class End Date: 12/15/2006

Expected Enrollment: 40

Delivery Format: Digital access with desktop printing

Purchase Method: eCommerce

If you have questions or need assistance, please contact your Wiley representative, e-mail WileyDE@napubco.com, or call XanEdu Customer Service at 1.800.218.5971.


To purchase and access your online CoursePack, you will need to do the following:

- 1. Go to: <http://www.xanedu.com/login.shtml?PackId=258968>**
- 2. If you have previously registered for another CoursePack, log in. If not, click the "Student Registration" button under the "New Users Register Here" banner. Complete the registration page, and click Continue.**
- 3. Confirm your CoursePack selection, and click Continue.**
- 4. Complete your billing information, confirm and click Continue.**
- 5. After completing the purchase pages, you will be taken to your CoursePack.**


Helpful hints: In step 2 above, after you click on the "register" button under the Student heading, a registration page will pop up. For your campus address just put "Department of Economics." For your city put "Lexington." For your country choose "USA." For your state or province choose "Kentucky." For your institution choose "University of Kentucky." Then put your own email and telephone numbers in the appropriate spaces. Choose a username and password that you can remember and type them in, then hit the "submit" button. That should take you to the page where you order your coursepack and provide payment information. You will be given electronic access to the reading materials. The materials that are included in the packet are listed on the following pages.

A BXS CoursePack for ECO 610--TEI Piraeus Program

Economic Concepts


 [Primer: Economic Concepts for Strategy](#). David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In *Economics of Strategy*, 3rd Edition. pp. 9-39. Published 2004, 2004. **John Wiley and Sons, Inc.** (32 pages).

Notes: file is 0.1 Mb and may take up to **41 seconds** to open using a 56k modem


 [Greece Offers New Wave of Wines; Vintners Aspire to Global Markets, But Production Costs Are High And Marketing Remains Poor:](#) Tugwell, Paul. In *The Wall Street Journal (Europe)*, Europe Edition. pp. A5. Published Aug 4, 2003, 2003. Brussels: **Dow Jones Company, Inc.** (1 pages). Sec. A. **Permission granted for online use and to provide a single printed copy per purchase.**


 [Spanish Put New Accent on Olive Oil; Producers Advertise More To Counter Italian Rivals; Banderas Adds Star Power:](#) In *Wall Street Journal*, Europe Edition. pp. A.10. Published Nov 17, 2003, Brussels: . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**

Chapter 2: The Horizontal Boundaries of the Firm: Economies of Scale and Scope

 [Chapter 2. The Horizontal Boundaries of the Firm: Economies of Scale and Scope](#). David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In *Economics of Strategy*, 3rd Edition. pp. 72-104. Published 2004, 2004. **John Wiley and Sons, Inc.** (33 pages).


Notes: file is 0.1 Mb and may take up to **43 seconds** to open using a 56k modem

 [Power Pork: Corporations Begin To Turn Hog Business Into an Assembly Line --- Lean, Uniform Pigs Pop Out And Are Robotically Cut Into Neat, Branded Chops --- Short, Fertile Life of a Sow.](#) By Scott Kilman. In *Wall Street Journal*, Eastern Edition. pp. PAGEA.1. Published Mar 28, 1994, New York, N.Y. . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**


 [Special Report: Extinction of the predator - The global car industry:](#) In *The Economist*, Vol. 376, Iss. 8443. pp. 72.

Published Sep 10, 2005, London: . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**


Chapter 3: The Vertical Boundaries of the Firm

 [Chapter 3. The Vertical Boundaries of the Firm](#). David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In ***Economics of Strategy***, 3rd Edition. pp. 105-139. Published 2004, 2004. **John Wiley and Sons, Inc.** (35 pages).


Notes: file is 0.1 Mb and may take up to **45 seconds** to open using a 56k modem

 [Made to Measure: Invisible Supplier Has Penney's Shirts All Buttoned Up; From Hong Kong, It Tracks Sales, Restocks Shelves, Ships Right to the Store; Inside a 'Radical' Power Shift](#). Gabriel Kahn. In ***Wall Street Journal***, Eastern Edition. pp. A.1. Published Sep 11, 2003, New York, N.Y. (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**

 [Growing Pains: To Bag China's Snack Market, Pepsi Takes Up Potato Farming; Locals Get Taste for Lay's Chips But Raising Enough Spuds Proves to Be a Challenge; Ms. Huang's 2 a.m. Scooter Ride](#). In ***Wall Street Journal***, Eastern edition Edition. pp. A.1. Published Dec 19, 2005, New York, N.Y. . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**

 [Bicycles: Bike Maker Faces a Tactical Shift](#): Kerber, Ross. In ***Wall Street Journal***, Eastern edition Edition. pp. B.1. Published Oct 12, 1998, 1998. New York, N.Y. **Dow Jones Company, Inc.** (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**


Chapter 6: Competitors and Competition


 [Chapter 6. Competitors and Competition](#). In Economics of Strategy, 3rd Edition, by David Besanko, David Dranove, Mark Shanley, and Scott Schaefer, 2004. 2004. **John Wiley and Sons, Inc.**

Notes: file is 0.1 Mb and may take up to **44 seconds** to open using a 56k modem


 [Alligator Farming Shows There's a Lot To Be Said for Cows --- But High Prices on Reptiles Make Risks Worthwhile For Louisiana Farmers](#). By Mark Robichaux. In ***Wall Street Journal***, Eastern edition Edition. pp. 1. Published Aug 2, 1989, New York, N.Y. . (1


pages). **Permission granted for online use and to provide a single printed copy per purchase.**


 [PERSONAL JOURNAL: Greece Is the Word; Go for the Games, or Just Go: We Break Training to Sample Luxury Yachts, Wines, Fashions and Foods Ahead of the Olympic Spectacle; Testing the Waters:](#) In *Wall Street Journal*, Europe Edition. pp. P.1. Published Jul 30, 2004, Brussels: . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**


 [A Buyer's Guide To the New Gameboxes; Xbox Will Come Out First, But Sony Touts Its Graphics; Choosing Mario Over Movies.](#) Nick Wingfield, Rob Guth and Phred Dvorak. In *Wall Street Journal*, Eastern edition Edition. pp. D.1. Published May 18, 2005, New York, N.Y. . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**

Chapter 7: Strategic Commitment


 [Chapter 7. Strategic Commitment.](#) In Economics of Strategy, 3rd Edition, by David Besanko, David Dranove, Mark Shanley, and Scott Schaefer, 2004. 2004. **John Wiley and Sons, Inc.**
Notes: file is 0.1 Mb and may take up to **36 seconds** to open using a 56k modem

 [Business World: Haven't Shareholders Had Enough Chicken?](#) By Holman W. Jenkins Jr. In *Wall Street Journal*, Eastern Edition. pp. A.21. Published Apr 4, 2001, New York, N.Y. . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**


 [Cruise Lines Slash Prices As War Fears Scare Travelers --- In Stroke of Poor Timing, Ships Head Back to Europe; Travel Insurance Now Free.](#) By Evan Perez. In *Wall Street Journal*, Eastern edition Edition. pp. D.1. Published Jan 29, 2003, New York, N.Y. . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**


 [Airlines: Upstart's Tactics Allow It to Fly In Friendly Skies Of a Big Rival:](#) In *Wall Street Journal*, Eastern edition Edition. pp. B.1. Published Jun 23, 1999, New York, N.Y. . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**

Chapter 8: The Dynamics of Pricing Rivalry


 [Chapter 8. The Dynamics of Pricing Rivalry](#). David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In *Economics of Strategy*, 3rd Edition. pp. 259-296. Published 2004, 2004. **John Wiley and Sons, Inc.** (38 pages).

Notes: file is 0.1 Mb and may take up to **47 seconds** to open using a 56k modem

 [Dell Price Cuts Put a Squeeze On Rival H-P](#). Gary McWilliams and Pui-Wing Tam. In *Wall Street Journal*, Eastern Edition. pp. B.1. Published Aug 21, 2003, New York, N.Y. **Permission granted for online use and to provide a single printed copy per purchase.**


 [Ticket Shock: U.S. Business Fares Soar, While Coach Gets Even Cheaper --- Computers, Obscure Science Make It Easy for Airlines To Manipulate Pricing --- European Travelers Suffer](#). In *Wall Street Journal*, Europe Edition. pp. 1. Published Nov 4, 1997, Brussels: . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**

Chapter 9: Entry and Exit


 [Chapter 9. Entry and Exit](#). David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In *Economics of Strategy*, 3rd Edition. pp. 297-326. Published 2004, 2004. **John Wiley and Sons, Inc.** (30 pages).

Notes: file is 0.1 Mb and may take up to **40 seconds** to open using a 56k modem

 [Cafe `Ole'? Madrid Gets Its First Starbucks --- Fast-Growing U.S. Chain Opens Spanish Outlets --- Will `Coffee Cultures' Clash?](#). In *Wall Street Journal*, Europe Edition. pp. A.7. Published Apr 11, 2002, Brussels: . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**


 [The Middle Seat: Airports Crack Down on Gamesmanship Over Gates; United Maintains Presence Despite Drop-Off in Traffic, Riling Budget Competitors](#). Scott McCartney. In *Wall Street Journal*, Eastern edition Edition. pp. D.4. Published Jun 7, 2005, New York, N.Y. . (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**

Chapter 10: Industry Analysis



 [Chapter 10. Industry Analysis](#). David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In *Economics of Strategy*, 3rd Edition. pp. 327-351. Published 2004, 2004. **John Wiley and**

Sons, Inc. (26 pages).



Notes: file is 0.1 Mb and may take up to **32 seconds** to open using a 56k modem

-  [Oh, sweet revenge:](#) Daniel McGinn. In *Newsweek*, Vol. 142, Iss. 13. pp. E4. Published Sep 29, 2003, New York: (1 pages).
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Chapter 14: Agency and Performance Measurement

-  [Chapter 14. Agency and Performance Measurement.](#) David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In *Economics of Strategy*, 3rd Edition. pp. 476-509. Published 2004, 2004. **John Wiley and Sons, Inc.** (34 pages).
Notes: file is 0.1 Mb and may take up to **44 seconds** to open using a 56k modem
-  [Special Report: Big Mac's makeover - McDonald's turned around:](#) In *The Economist*, Vol. 373, Iss. 8397. pp. 88. Published Oct 16, 2004, London: (1 pages). **Permission granted for online use and to provide a single printed copy per purchase.**
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Chapter 15: Incentives in Firms

-  [Chapter 15. Incentives in Firms.](#) David Besanko, David Dranove, Mark Shanley, and Scott Schaefer. In *Economics of Strategy*, 3rd Edition. pp. 510-533. Published 2004, 2004. **John Wiley and Sons, Inc.** (24 pages).
Notes: file is 0.1 Mb and may take up to **31 seconds** to open using a 56k modem
-  [Jeans Therapy: Levi's Factory Workers Are Assigned to Teams, And Morale Takes a Hit --- Infighting Rises, Productivity Falls as Employees Miss The Piecework System --- `It's Not the Same Company'.](#) By Ralph T. King Jr. In *Wall Street Journal*, Eastern edition Edition. pp. A.1. Published May 20, 1998, 1998. New York, N.Y. **Dow Jones Company, Inc.** (1 pages). Sec. A. **Permission granted for online use and to provide a single printed copy per purchase.**