

ECO 610: Managerial Economics
October-November 2009 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 horizontal and vertical dimensions of the firm and to market structure and 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. Students will find it very helpful to have taken courses in principles of micro and macroeconomics, basic probability theory and statistics, and introductory calculus.

Textbook

Assigned readings will come from two different managerial economics textbooks:

Brickley, Smith, and Zimmerman (BSZ), *Managerial Economics and Organizational Architecture* (4th edition), McGraw-Hill Irwin, 2007, and

Besanko, Dranove, Shanley, and Schaefer (BDSS), *Economics of Strategy* (4th edition), John Wiley & Sons, Inc., 2007.

There will also be assigned readings for each class taken from business periodicals such as the *Wall Street Journal*.

Grading

Your grade in the course will be based on your performance on (1) in-class quizzes, (2) a research memorandum, and (3) an in-class final exam. We will have a short quiz based on the assigned outside readings 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 7-9 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 *BDSS* textbook. This memorandum must be mailed to me by Monday, November 30, 2009. 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 26: Introduction to the course, basics of market systems, demand and supply analysis.

Text:

BSZ, ch. 3, "Markets, Organizations, and the Role of Knowledge."

Outside readings:

"China's Winter of Discontent," *WSJ*, 3/14/06.

"Indonesia Has Lots of Coal—And Blackouts in Capital," *WSJ*, 7/29/08.

"Corn's Rally Sends Ripples," *WSJ*, 1/18/07.

Tuesday, October 27: Production, economic costs, economic profit.

Text:

BSZ, ch. 5: "Production and cost."

Outside readings:

"Frito-Lay Aims to Cut Gas Bill's Bite," *WSJ*, 6/5/06.

"Small Talk," *WSJ* 5/30/06.

Individual assignment: take online virtual plant tours of Toyota's Georgetown manufacturing facility (<http://www.toyotageorgetown.com/vtour/vtour.asp>) and Purity Dairy's dairy processing facility (<http://www.puritydairies.com/tour/index.html>).

Thursday, October 29: Horizontal boundaries of the firm—economies of scale and scope, diseconomies of size, the learning curve.

Text:

BDSS, ch. 2: "The Horizontal Boundaries of the Firm: Economies of Scale and Scope."

Outside readings:

"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.

Friday, October 30: Vertical boundaries of the firm—make or buy, transactions costs, asset specificity, hold-up, vertical control devices.

Text:

BDSS, ch. 3: “The Vertical Boundaries of the Firm.”

Outside readings:

“Made to Measure: Invisible Supplier Has Penney’s Shirts All Buttoned Up,” *WSJ*, 9/11/03.

“Boeing Scrambles to Fix Problems with New 787,” *WSJ*, 12/7/07.

(See also “Boeing Tightens Its Grip on Dreamliner Production,” *WSJ*, 7/2/09.)

Saturday, October 31 and Sunday, November 1: catch up on reading, work on industry study.

Monday, November 2: Competitors and competition—defining a market, elements of market structure, types of market structure, perfectly competitive markets.

Text:

BDSS, ch. 6, “Competitors and Competition.”

Outside readings:

“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; Choosing Mario over Movies,” *WSJ*, 5/18/05.

“Alligator Farming Shows There’s a Lot to be Said for Cows,” *WSJ*, 8/2/89.

(See also “Economic Woes Take a Bite out of Alligator Ranching,” *WSJ*, 11/12/97, and “A Run on Alligators Sends Designers Scrambling,” *WSJ*, 3/18/06.)

Tuesday, November 3: Monopoly, monopolistic competition, pricing with market power.

Text:

BSZ, ch. 6, “Market Structure.”

BSZ, ch. 7, “Pricing with Market Power.”

Outside readings:

“Seeking Fame in Apple’s Sea of Apps,” *WSJ*, 7/15/09.

“Seeking Perfect Prices, CEO Tears Up the Rules,” *WSJ*, 3/27/07.

Individual assignment: go to <http://disneyworld.disney.go.com/wdw/index> and check out Disney World’s pricing strategy for its theme parks, resort hotels, special events, etc.

Also visit your favorite airline’s web site, e.g. <http://www.delta.com/home/index.jsp>, and analyze pricing for air travel and vacation packages. Finally, visit your local cable monopoly and check out its bundling strategy: <http://insightlexington.cable-offers.com/>.

Wednesday, November 4 and Thursday, November 5: Oligopoly, rivalry, strategic behavior, game theory.

Text:

BSZ, ch. 6, “Market Structure.”

BSZ, ch. 9, “Economics of Strategy: Game Theory.”

Outside readings:

“Haven’t Shareholders Had Enough Chicken?” *WSJ*, 4/4/01.

“Cruise Lines Slash Their Prices as War Fears Rattle Travelers,” *WSJ*, 1/29/03.

“Upstart’s Tactics Allow it to Fly in Friendly Skies of a Big Rival,” *WSJ*, 6/23/99.

“Techdom’s Two Cold Wars,” *WSJ*, 7/22/09.

Friday, November 6: Industry analysis—Porter’s five forces, in-class application of five-force analysis to selected Greek industries.

Text:

BDSS ch. 10: “Industry Analysis,” pp. 312-320, 337-339.

Outside Readings:

“Greek Vintners Pour Energy into Selling New Wave of Wines,” *WSJ*, 8/4/03.

“Growing Pains: To Bag China’s Snack Market, Pepsi Takes Up Potato Farming,” *WSJ*, 12/19/05.

Thursday, November 12: Final Exam. Details to be provided later.

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 seven-to-nine 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.

It is very important that you 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 Monday, November 30, 2009. That means that you should mail it on or before that date to:

Professor Frank Scott
Department of Economics
University of Kentucky
Lexington, KY 40506-0034
USA

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