Unit Outline*

ECON2245
Business Economics

Semester 2, 2011
Campus: Crawley

Unit Coordinator
Professor Michael McLure

Business School
www.business.uwa.edu.au

* This Unit Outline should be read in conjunction with the Business School Unit Outline Supplement available on the Current Students web site http://www.business.uwa.edu.au/students
UNIT DESCRIPTION

Introduction
The purpose of this unit is to help students to see how a confident understanding of a number of fundamental economic concepts provides insight into the business world. It is intended to help you become a more informed consumer, in the short term, and help you develop into a more effective employee or manager in the future.

This course will seek to demonstrate both the power and generality of certain key microeconomic concepts. This will be achieved by focusing on the practical usefulness of these concepts to the customer and to business decision-maker. The unit will draw on real world examples to further this goal. The motivating principle behind the course is that each decision made will be a better decision if the economic dimension to the problem is laid bare, and the lessons of microeconomic theory consistently applied to it.

Learning outcomes
Upon completion of this unit you will have been provided with the opportunity to:

1. Illustrate why the ‘economic way of thinking’ and ‘consumer sovereignty’ are conceptually important for business managers
2. Understand how to calculate measures of elasticity of demand
3. Understand how to calculate an ‘optimal price’
4. Use the ‘Lancaster model’ to analyse consumer choice
5. Comprehend the concept of opportunity costs and explain the relationship between costs, value added, profits and shareholder value.
6. Learn about the economics of advertising and market structure
7. Discover the economics behind the ‘make or buy’ decision
8. Understand why managers of firms ‘think strategically’ and solve some ‘games’
9. Learn the economic perspective on corporate governance
10. Understand the basic economics behind the role of Government in business, and privatisation
11. Explain why economic sectors are comprised of individual firms and learn about some performance indicators for firms
12. Illustrate the preceding outcomes with reference to examples from modern firms or from ‘business history’. 
TEACHING AND LEARNING RESPONSIBILITIES

Teaching and learning strategies

In addition to normal lecture and question-based teaching methods, this unit incorporates a number of other techniques to facilitate learning. There is a group essay, and prior to that credit can be earned for attending group meetings in some tutorials. A group presentation based upon aspects of the group essay is also included in tutorials. Tutorials may also include other group-based problem-solving. Lectures may include some clips from DVDs.

Teaching and learning evaluation

You may be asked to complete two evaluations during this unit. The Student Perception of Teaching (SPOT) and the Students’ Unit Reflective Feedback (SURF). The SPOT is optional and is an evaluation of the lecturer and the unit. The SURF is completed online and is a university wide survey and deals only with the unit. You will receive an email from the SURF office inviting you to complete the SURF when it is activated. We encourage you to complete the forms as your feedback is extremely important and can be used to make changes to the unit or lecturing style when appropriate.

Attendance

Participation in class, whether it be listening to a lecture or getting involved in other activities, is an important part of the learning process. It is therefore important that you attend classes (and be on time). More formally, the University regulations state that ‘to complete a course or unit students shall attend prescribed classes, lectures, seminars and tutorials’. Simply watching Lectopia with liberal use of the ‘fast forward’ is unlikely to help you achieve the goals of the unit.

TEXTBOOK(S) & RESOURCES

Unit Website

http://www.webct.uwa.edu.au

Recommended/required text(s)

The textbook for the class is:


Course materials on line

The library now makes readings available for this unit on its CMO website,

http://www.library.uwa.edu.au/students/undergraduates/course-materials
**CONTACT DETAILS**

We strongly advise students to regularly access their student email accounts. Important information regarding the unit may be communicated to you at your student email address.

| **Unit coordinator/lecturer**  
| for topics 1 to 7 and 12 |  |
| **Name:** | Professor Michael McLure |
| **Email:** | michael.mclure@uwa.edu.au |
| **Phone:** | 6488 2921 |
| **Consultation hours:** | Thursday 3:00pm to 6:00pm |
| **Lecture times & venue:** | Wednesday 12:00noon and 1:00pm,  
|  | John Bloomfield Lecture Theatre  
|  | ‘Sports Science, Exercise & Health’ Building |
| **Tutorial times & venue:** | Please check details olcr.uwa.edu.au |

| **Unit coordinator/lecturer**  
| for topics 8 to 11 inclusive |  |
| **Name:** | Assistant Professor Li Bei |
| **Email:** | li.bei@uwa.edu.au |
| **Phone and Consultation hours:** | TBA |
| **Tutorial times:** | Tutors |
| **Monday 9:00am &10:00am** | Mr Phillip Christopher 20247815@student.uwa.edu.au |
| **Wednesday 11:00am & 4:00pm** | Ms Karen Knight knighk01@student.uwa.edu.au |
| **Monday 3:00pm & 4:00pm**  
| **Thursday: 11:00am** | Ms Caroline Moser 20364076@student.uwa.edu.au |
| **Tuesday 2:00, 3:00 & 4:00pm &  
| **Thursday 9:00am & 10:00am** | Ms Parinaz Ezzati 20911639@student.uwa.edu.au |
| **Thursday 11:00am** | Michael McLure michael.mclure@uwa.edu.au |
## UNIT SCHEDULE

<table>
<thead>
<tr>
<th>Week #</th>
<th>Date of Lecture Wednesday</th>
<th>Lecture Topic</th>
<th>Tutorial Topic</th>
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<tbody>
<tr>
<td>1</td>
<td>3 August</td>
<td>Topic 1: Business, Management and Economics</td>
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<td>2</td>
<td>10 August</td>
<td>Topic 2: Markets and Consumer Theory</td>
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<td>3</td>
<td>17 August</td>
<td>Topic 3: Business Performance and Economic Costs</td>
<td>Tutorial 1</td>
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<tr>
<td>4</td>
<td>24 August</td>
<td>Topic 4: The Competitive Environment</td>
<td>Tutorial 2</td>
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<tr>
<td>5</td>
<td>31 August</td>
<td>Topic 5: Barriers to Entry and Pricing Strategies</td>
<td>Tutorial 3</td>
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<tr>
<td>6</td>
<td>7 September</td>
<td>Topic 6: Firms: Technology, Innovation and Organisation</td>
<td>Tutorial 4</td>
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<td>7</td>
<td>14 September</td>
<td>Topic 7: Risk, Uncertainty and Business History</td>
<td>Tutorial 5</td>
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<tr>
<td>8</td>
<td>21 September</td>
<td><strong>Mid Semester Exam</strong></td>
<td>Tutorial 6</td>
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<td></td>
<td>28 September</td>
<td><strong>Study Break</strong></td>
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<tr>
<td>9</td>
<td>5 October</td>
<td>Topic 8: The Principle-Agent Problem and Corporate Governance</td>
<td>Tutorial 7</td>
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<td>10</td>
<td>12 October</td>
<td>Topic 9: Game Theory</td>
<td>Tutorial 8</td>
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<td>11</td>
<td>19 October</td>
<td>Topic 10: Business and Globalisation <strong>Assignment Due on Monday 17 October</strong></td>
<td>Tutorial 9</td>
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<tr>
<td>12</td>
<td>26 October</td>
<td>Topic 11: Business and the Public Sector</td>
<td>Assignment Presentation</td>
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<tr>
<td>13</td>
<td>2 November</td>
<td>Topic 12: Revision and Putting it All Together</td>
<td>Assignment Presentation</td>
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<td>Topic</td>
<td>Business, Management and Economics</td>
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<tr>
<td></td>
<td>Introduction to business economics; discussion of the uses and limitations of the ‘economic way of thinking’ in a management context</td>
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<table>
<thead>
<tr>
<th>Text</th>
<th>W. Boyes, Chapter 1.</th>
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<tbody>
<tr>
<td></td>
<td>“MoD invents suit that is forever clean”, <em>The Sunday Times</em>, October 11th 1998.</td>
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</table>

**Topic 2**  Markets and Consumer Theory  
Market allocations, demand and optimal pricing; introduction to Lancaster’s alternative theory of consumer behaviour; relevance of consumer theory for management when considering product development and differentiation.

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<tr>
<th>Text</th>
<th>W. Boyes, Chapters 2 and 4.</th>
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**Topic 3**  Business Performance and Economic Costs  
The relationship between value, economic profit and shareholder value; different concepts of costs; the uses of marginal analysis; fixed costs in decision making; economies and diseconomies of scale.

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<thead>
<tr>
<th>Text</th>
<th>W. Boyes, Chapters 3 and 5.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reading</td>
<td>“A Book-Keeping Error”, <em>The Economist</em>, September 1st 2007, p.64.</td>
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</tbody>
</table>

**Topic 4**  The Competitive Environment  
How the structure of the industry affects a firm’s decisions; review of alternative market structures; Profits maximisation in the ‘real world’ over time; the nature and purposes of advertising. Brief introduction to strategy & games.

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<thead>
<tr>
<th>Text</th>
<th>W. Boyes, Chapter 6.</th>
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<tbody>
<tr>
<td>Reading</td>
<td>“And Only a Smile Remained”, 1981 by Lipsey and Steiner.</td>
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</table>

**Topic 5**  Barriers to Entry and Pricing Strategies  
Product differentiation; strategies to defer entry; the nature of price; price discrimination; mark-up pricing; ‘complexities’ in pricing.

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<th>Text</th>
<th>W. Boyes, Chapters 7 and 8.</th>
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**Topic 6**  Firms: Technology, Innovation and Organisation  
Economic reasons why firms exist; technology and the supply chain; Organisational change, vertical v horizontal boundaries, Internal structure.

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<thead>
<tr>
<th>Text</th>
<th>W. Boyes, Chapters 9 and 10</th>
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</thead>
<tbody>
<tr>
<td>Reading</td>
<td>“Business: Take two; Face value” <em>The Economist</em>, May 3, 2008 , p.84</td>
</tr>
<tr>
<td>Topic 7</td>
<td>Risk, Uncertainty and Business History</td>
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<tr>
<td>Relevance of the distinction between risk and uncertainty for business; business history to highlight issues that businesses confront; review economic role of the entrepreneur.</td>
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<tr>
<td>Text</td>
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<td>Reading</td>
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<table>
<thead>
<tr>
<th>Topic 8</th>
<th>The Principle-Agent Problem and Corporate Governance</th>
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<tbody>
<tr>
<td>Relevance of the principal-agent structure; balancing the interests of the different stakeholders, particularly when ownership is divorced from control.</td>
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<tr>
<td>Text</td>
<td>W. Boyes, Chapter 11</td>
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<tr>
<td>Reading</td>
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<tr>
<td>“So Many Options”, <em>The Economist</em>, November 9th 2002, p.82.</td>
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</tbody>
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<thead>
<tr>
<th>Topic 9</th>
<th>Game Theory</th>
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<tr>
<td>A non-technical look at strategic thinking and some applications of game theory in real business decisions, the value-net, and the importance of changing the game.</td>
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<tr>
<td>Text</td>
<td>W. Boyes, Chapter 13.</td>
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<tr>
<td>Reading</td>
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<table>
<thead>
<tr>
<th>Topic 10</th>
<th>Business and Globalisation</th>
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<tbody>
<tr>
<td>Alternatives to the neo-classical model, including behavioural and managerial theories. Suggestions for improving governance structures.</td>
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<tr>
<td>Text</td>
<td>W. Boyes, Chapter 14</td>
</tr>
<tr>
<td>Reading</td>
<td>-</td>
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<tr>
<td>“Benvenuto, up to a point; Globalisation and immigration”, <em>The Economist</em>, June 11 2011, p.1</td>
<td></td>
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<tr>
<td>“International: The centenarians square up; IBM v Carnegie Corporation”, <em>The Economist</em>, June 11 2011, p.64</td>
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<table>
<thead>
<tr>
<th>Topic 11</th>
<th>Business and the Public Sector</th>
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<tbody>
<tr>
<td>Why Government is involved in business; the debate over microeconomic reform; the choice between alternative methods of decreasing state involvement.</td>
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<tr>
<td>Text</td>
<td>W. Boyes, Chapter 15.</td>
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<tr>
<td>Reading</td>
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<tr>
<td><strong>Topic 12</strong></td>
<td><strong>Revision and Putting it All Together</strong></td>
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<td>Methods for assessing firms’ performance; problems of some performance indicators and incentive schemes, including the recent explosion in executive pay.</td>
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<td><strong>Text</strong></td>
<td>▪ W. Boyes, Chapter 16.</td>
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Tutorial questions

Tutorial 1

1. Do you think the ‘economic way of thinking’ and utility maximisation provides a useful perspective for describing how people make choices?
   i) If we have been maximising our total utility for years, shouldn’t we all be deliriously happy by now?
   ii) When we need to choose between very similar products, why doesn’t it take us ages to examine all the pros and cons to find out which item has slightly more utility for the last dollar spent?

2. Critics of the ‘consumer sovereignty’ hypothesis claim that businesses sometimes deliberately produce goods that wear out, even though longer lasting versions would be easy to make. They argue that a firm would not willingly slash the replacement market for the goods it sells. This argument is known as ‘planned obsolescence’ and implies ‘producer sovereignty’. Assess the strengths and weaknesses of these two rival claims with reference to the following examples:
   i) In the article ‘MoD invents suit that is forever clean’ the textile producers seem happy with the new invention. Does that surprise you? Why or why not? Would the arguments of the ‘planned obsolescence’ perspective be enough to stop this technology from being introduced?
   ii) Now suppose you are the boss of a light-bulb manufacturer with a monopoly granted by patent. Your research department informs you that they have discovered how to produce a light-bulb that lasts twice as long for the same production cost. Assume each light-bulb initially costs $1 to produce, and lasts for 100 hours of use. Assume also you are charging $2/light-bulb and currently sell 1000/week. Explain whether profits would rise or fall if you were to introduce the new light-bulb. What then should you do, and does your answer support consumer sovereignty or producer sovereignty?

3. For Sophie the major relevant characteristics of both beef and chicken are protein and vitamins. Suppose each 1kg of beef contains 100g of protein and 150mg vitamins, and each 1kg of chicken contains 50g protein and 250mg vitamins.
   i) If chicken costs $2/kg and beef costs $3/kg, and Sophie’s income is $12, illustrate her budget constraint using the Lancaster diagram.
   ii) Impose a suitable convex indifference curve to identify the optimal combination of characteristics on the feasibility frontier. Show diagrammatically the quantities of beef and chicken she will buy to achieve this optimum.

4. If time permits: extension exercises from the text book
   i) Chapter 2, pp. 36-37 Questions: 1, 2, & 9.
   ii) Chapter 4, P. 79 Questions: 3, 6 & 8.
MoD invents suit that is forever clean.

By Chris Dignan and Zoe Brennan.

11 October 1998

PORTON DOWN, the former biological and chemical weapons research station, has discovered the ultimate in designer fashion: clothes that never need cleaning.

The Ministry of Defence (MoD) facility in Wiltshire, once notorious for testing radiation on humans and blowing up live pigs for military research, has been developing futuristic uniforms for the battlefield. But the MoD’s men in white coats have discovered a process far more useful in the high street: a way of making any fabric almost impervious to stains.

Forget splashing red wine down your white cocktail dress or spilling carrot soup on silk ties - with Porton Down’s revolutionary “plasma processing” your clothes will survive. The dry-cleaning industry, however, may not.

The Defence Evaluation and Research Agency (Dera), which now runs Porton Down, says the process has the “potential for use in a wide variety of civilian applications”.

Even delicate silks and the finest chiffons, say Dera scientists, can be made more durable and resistant to dirt. On heavier fabrics the technique works even better. It may come too late for President Clinton, but the sort of dress that Monica Lewinsky wore during one of her White House encounters with him might have been made stain-proof.

The discovery echoes the 1950’s film, The Man in the White Suit, a comedy in which Alec Guinness plays a shy chemist who accidentally produces a fabric that never gets dirty or wears out. In the film textile producers reacted initially with excitement, then with anger as they digested the implications of clothing that might never need replacing.

Last week, however, fashion designers and clothing retailers welcomed the idea of Dera’s stain-free clothing. “This sounds wonderful, a fantastic invention,” said Marks & Spencer. “We are always investigating new fabrics and technological advances.”

Jemima Khan, who has launched a range of dresses hand-embroidered in Pakistan, said: “It sounds like a miracle. I will have to wait until I drop curry on something in Pakistan to test it. My dresses are all made from silk georgette, and we have terrible problems keeping the fabric clean because the clothes are embroidered in mud huts by women living in remote villages. They come back covered in curry stains and children’s sticky finger marks.” Khan, whose dresses retail for up to £800 each, hopes to launch a new range in February.

Other designers were excited but cautious. “It’s a brilliant idea,” said Paul Smith. “My only concern would be that it might alter the quality of the cloth and affect the drape of the material.”

Amanda Wakeley, whose elegant creations captivated audiences at the London Fashion Week last month, said: “It is quite exciting to think that a pale-coloured suede might soon be as dirt-resistant as black tweed is now. But I would find it psychologically difficult not to wash my clothes. It would
bother me to wear something in a smoke-filled room and not clean it, even if it were impenetrable to dirt.”

What bothers the dry-cleaning industry is that people might do just that. “If they are saying you can have a shirt or jacket that never needs cleaning, then we are out of business,” said Mike Clark, technical director at Sketchley dry cleaners.

Professor Stephen Gray, head of the Computer Clothing Research Centre at Nottingham Trent University which researches new fabrics, agreed. “If it is developed fully and there is no need to wash fabric,” he said, “people in the textile industry could be looking for another job.”

Conventional protective methods are based on applying liquids; they can adversely affect the feel and drape of a fabric, as well as lose some of their effectiveness under dry-cleaning. Dera’s system uses gas. Though Dera is coy about exactly how the technique works, it is known to be based on existing “plasma”, or gas, processing delivered in a new way.

“Plasma processing works on the same principle as electroplating on cars when they have paint put or them through electromagnetism in a tank of paint,” said George Roberts, professor of textile science at Nottingham Trent University.

In the same way, a chamber containing fabric can be filled with gas through which an electric charge is passed. This causes the gas to bond to the fabric which, if done in the right way, can produce a breathable but non-stick molecular structure on the surface.

Not all are convinced. Martin Bell, the MP and former war correspondent, said he will continue to wear his trademark white suits in conventional fabric despite the expense.

“This could clearly save me an awful lot of money’ he said. “I would not wear the new fabric, however because I wouldn’t want to put my dry-cleaners out of business”.

Tutorial 2

1. In 1999 producers of palm oil in Malaysia were severely criticised by the Malaysian Government for raising the price charged for domestic sales of palm oil. The world market price of palm oil had increased, and the producers were already receiving the higher prices for their exports of palm oil. However the local production costs were unchanged and the price increase to domestic consumers was viewed as exploitation. If you were a palm oil producer, how would you defend your action to the Government?

2. Travellers between Sydney and Brisbane can choose between taking a two-hour journey by plane, and an eight-hour journey by coach. The plane ride costs $200, while the coach journey costs $50. The pool of potential travellers has the following hourly wage distribution:

<table>
<thead>
<tr>
<th>Number of People</th>
<th>Hourly Wage</th>
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<tbody>
<tr>
<td>1000</td>
<td>$0-15</td>
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<tr>
<td>2000</td>
<td>$16-25</td>
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<tr>
<td>2000</td>
<td>$26-35</td>
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<tr>
<td>500</td>
<td>$36-100</td>
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</table>

How many people will choose to fly rather than take the coach?
(a) 500 (b) 1000 (c) 2000 (d) 2500 (e) 3000 (f) 4500

3. The management department at the ‘London School of Business’ employs its own full-time computer consultant, whose duties are to assist staff with their computing problems. The consultant is generally kept fully occupied in carrying out these tasks. Using your understanding of implicit and explicit costs, explain the following with the aid of diagrams:

i) Why does the consultant usually have a backlog of work unfinished?
ii) How can the department discover the correct quantity of consultancy time to purchase, such as hiring more consultants or reducing the working hours of the current consultant?
iii) Does adopting this point of view help you to suggest changes to the manner in which computing advice is purchased?

4. If time permits: extension exercises from the text book

Chapter 3, p. 57 Questions: 2 & 7; & Chapter 5, pp. 118-119 Questions: 5 & 12.

5. Group meeting 1:

The remainder of the tutorial will be dedicated to organising groups for the group assignment and presentation. Once groups are formed, students need to swap contact details and give their tutor details on the members of each group. Presentation times will be allocated. In this meeting, students should establish a regular meeting time outside of the tutorials; discuss potential markets to study and allocate sections of the assignment to each student.
Tutorial 3  
Exercise 1  

In this tutorial, students will divide into groups to play the shrimp game. The core instructions are given below, however some tutorial groups will have a different number of players than the three listed below.

Andrew, Brooke, and Christopher own the only three shrimp boats on the island of Augustine. Each incurs a cost of $5.00 per kilo of shrimp (this includes the opportunity cost of time) and each person can catch at most 75 kilos per day.

At the end of each day, they bring their catch to market where price is determined by market demand and the supply of fish. Let QA, QB, and QC denote Andrew’s, Brooke’s and Christopher’s catch, respectively. Once each has decided when to stop fishing and has brought his or her shrimp to market, the price is determined by the following equation:

\[ P(QA, QB, QC) = 45 - 0.2(QA + QB + QC). \]

Each shrimper agrees that the above equation correctly predicts the market price of shrimp, and each tries to catch enough shrimp so as to maximize his or her dollar profits. All shrimps goes bad after one day, so a shrimper cannot keep shrimp off the market and sell them the next day. The profits for each shrimper equal the number of kilos caught multiplied by its profit margin, that is

\[ \Pi_A(Q_A, Q_B, Q_C) = Q_A[P(Q_A, Q_B, Q_C) - 5]. \]

Imagine you are Andrew, Brooke, or Christopher. Each day you will be asked to set that day’s level of production. Note that you are not able to catch more than 75 kilos of shrimp per day. The amount of money you earn at the end of the day will equal the value described above. Remember your goal is to maximize your own profits; you do not care at all about the profits of the other shrimpers.

All shrimp is traded at the Fish Market. When trade takes place each shrimper reveals its level of production for that day, so this information becomes public knowledge.

The three shrimpers have a history of family feuds and no personal contact. Each will have to set its shrimp production for the day without knowing what levels the other two shrimpers set. However, as described above, at the end of each day the production levels that were set by each shrimper will become public knowledge. We will play several rounds of this game using a couple of different scenarios. You will need to divide yourselves up into groups of three (or another number told to you by your tutor). After the game has ended, we will go through the ‘optimal’ solution.

If time permits: extension exercises from the text book

Text Book Exercise: Chapter 6, p.143, Question 7.


**Tutorial 4**

1. Like many other firms, Bunnings sometimes advertises that if you buy a product from them and subsequently find it cheaper elsewhere in Perth, they will refund the difference plus an additional 10%. What do you think will be the effect of this kind of guarantee on prices in that industry? Are these kinds of guarantees good for consumers?

2. Why are petrol caps on the driver’s side of some cars but on the passenger’s side of others?

3. Exercises from the text book

   Chapter 6, p.143, Questions 4, 5, 10, & 12.

5. **Group meeting 2**

   The remainder of the tutorial will be a group meeting. Students will need to meet in their groups for the group assignment and presentation. In this meeting the groups should have established the market which they are going to study. They should discuss the potential literature on the market as well as progress on the assignment.
Tutorial 5

1. Referring to the article 'And only a smile remained', answer the following questions:
   a) What happened to the price of ball-point pens during the first few years of production? Why?
   b) What can you infer about changes to the price elasticity of demand for ball-point pens over this period? What data allowed you to draw this inference?
   c) How would you characterise the extent of barriers to entry into this industry? Do you think the picture described is consistent with the predictions of economic theory? Why?

2. The following are approximate market shares of different brands of soft drinks during the 1980's:

   - Coca Cola: 40%
   - Pepsi: 30%
   - Seven-Up: 10%
   - Dr Pepper: 10%
   - All other brands: 10%

   a) Assuming no other brand has >1%, calculate the Herfindahl index and the CR4 for the soft drink market.
   b) Suppose Pepsi bought up Seven-Up. Calculate the likely post-merger Herfindahl index and CR4. How many equally-sized firms are implied by the Herfindahl index?
   c) The ACCC might be concerned by the increase in the Herfindahl. How might Pepsi respond to their concerns about monopoly power?

3. The well-known economist, J.K. Galbraith, claimed in his book 'The Affluent Society' that as people get richer, the intensity of their wants diminishes, so that our preferences for many goods are held lightly. Consequently, firms can manipulate our preferences through advertising, allowing them to create demand for their products. This leads to a 'shop till you drop' mentality and debasement of the noble human spirit. More recent best-sellers, such as 'No Logo', make related arguments.

   a) Do you think this argument is correct? Why?
   b) Some people with strong brand preferences are unable to distinguish their favourites from other brands in blindfold tests. What then do you think is the source of their preference?

4. A profit-maximizing, monopolistically competitive firm has optimally chosen its advertising/sales ratio. Research has shown that the price elasticity of demand for its product is -3.4, and that its advertising elasticity is +0.068. The firm will spend which of the following proportions of total revenue on advertising?

   (a) 50% or (b) 2% or (c) 23.12% or (d) 5% or (e) Insufficient information to say.

5. If time permits: extension exercises from the text book

Reading for Tutorial 5

AND ONLY A SMILE REMAINED

[The Cheshire Cat] vanished quite slowly, beginning with the end of the tail, and ending with the grin, which remained some time after the rest of it had gone.- - LEWIS CARROLL

Laszlo Jozsef Biro took out a patent on a ball-point pen in Paris in 1939. During World War II, he moved to Argentina where his company, Eterpen S.A., started producing and selling the pens in 1943. Unlike a conventional fountain pen, it had a miniature socket, that held a ball bearing, it used a special ink that dried almost instantly, and it held enough of this unconventional ink to work for months without refilling.

Unlike fountain pens, this pen could work at high altitudes without the risk of leakage. As a result, the U.S. Air Force was interested. It sent pens to various American manufacturers, saying it might be interested in buying ten thousand or so of them. The big three pen manufacturers – Parker, Sheaffer and Eversharp – looked into the patent rights and discovered that Eberhard Faber, a pencil manufacturer, had obtained them but had run into difficulties producing them. Eversharp obtained the rights in 1945.

Eversharp redesigned the pen for mass production and instituted an advertising campaign to prepare the public for this new ‘miracle pen.’ This advertising greatly benefited Milton Reynolds, who beat Eversharp to the market.

Reynolds had seen the pen in South America. When he found he was too late to buy the rights from Biro, he developed ways around Biro’s patent. What was unique about the Biro pen was its pressure-feed system that regulated the ink supply. Reynolds developed a different system that used gravity.

The Reynolds International Pen Company started production on October 6, 1945. A major New York department store, Gimbel’s advertised extensively that the pen was guaranteed to write for two years without refilling, to write under water and at stratospheric altitudes, and to make a clear impression on six to eight carbons. These claims made Gimbel’s price of $12.50 (the maximum price allowed by the wartime Office of Price Administration) seem, if not a bargain, at least not the most staggering extravagance of all times.

Because the initial cost of production was around 80c per pen, healthy profits were realised when Gimbel’s sold 10,000 pens (worth about a third of the store’s average totally daily sales volume) on the first day of sale, October 29, 1945. This success encouraged Reynolds to expand production; by early 1946, his 800 employees were producing 30,000 pens per day.

Production could not keep up with orders, and gift certificates were printed. By March 1946, Reynolds had banked $3 million. During one 10-day period, he deposited $1.5 million from orders of pens yet to be made. By February 1946, Reynolds had an after-tax profit of $1,558,607.81.

These enormous profits encouraged entry. Gimbel’s rival department store, Macy’s sold the biro pen for $19.98. It too did well, encouraging still more entry. Late in April, Eversharp finally entered the market with a $15 pen. The July 1946 Fortune magazine reported that Sheaffer was going to sell a pen at $15. Eversharp then announced plans to sell a retractable pen at $25.

Meanwhile, Reynolds introduced a new model with a retractable point protector that cost 60c per pen to produce but sold at the original price of $12.50. By late in the summer of 1946, his pens were being sold in 37 countries (with prices in Hong Kong reaching $75). As profits remained high, still others entered.
The Ball Point Pen Company of Hollywood ignored a patent infringement suit and sold a $9.95 version. Another manufacturer, David Kahn, announced plans to sell a pen for less than $3. In October, Reynolds introduced a new pen that cost 30c to produce and sold for $3.85.

Approximately 100 manufacturers were producing pens by Christmas 1946, some selling for a little as $2.98. Reynolds again introduced a new model priced at $1.69, but Gimbel’s sold for 88c in a price war with Macy’s. At one point, Gimbel’s changed prices five times during shopping hours. Again Reynolds introduced a new, two-colour model priced at 98c that was still highly profitable.

By mid-1948, some ball-point pens were selling for 39c and cost between 8c and 10c to produce. The price of some pens fell to 25c by 1951, and soon after pens were available at 19c. By this time, the large number of firms in the industry had driven the price down to the point where no unusual economic profits were being earned. Reynolds’ market share went to zero and the firm stopped producing new pens in the United States.

This example shows that if a firm has no cost or other advantage, it cannot maintain a large share of the market in the long run. Nonetheless, even a short-lived period of dominance can be highly lucrative. It is estimated that in a single month Reynolds earned profits as high as $500,000, which was about 20 times his original investment of $26,000.

Tutorial 6

1. In Australia until recently, university academics have been paid using the same pay scales. That is, a Professor of ancient history at the University of Central Queensland would receive the same salary as a Professor of finance at the University of New South Wales. But in the USA an academic’s salary varies across universities and across disciplines.

   a) What are the strengths and weaknesses of each policy?
   b) Which do you prefer?

2. A producer of widgets sets a price for widgets using a mark-up on fully allocated costs (i.e. average total costs). She faces a constant marginal cost of $3/unit. Total fixed costs for a year’s production are estimated at $10,400. She chooses a mark-up of 20%, believing that such a figure is ‘fair’. She manages to sell 100 widgets each week.

   a) Calculate the price charged for widgets.
   b) Given that the demand for these widgets can be written as: Q = 1000 - 150P. Draw a suitable diagram and calculate the profit-maximising price and quantity. What profits are earned? How do they compare to profits in part a)?
   c) What would your advice to the manager be, based on these answers?
   d) What is the elasticity of demand at the optimal price?

3. Why does Apple sell its black laptop computers for more than otherwise identically configured white ones?

4. Why do female models earn so much more than male models?

5. A key purpose of many pricing strategies is to gain extra sales by lowering the price to customers that will only buy at a lower price, but avoid lowering the price to those customers who are prepared to pay more. In this light, try to explain the growing trend to use ‘mail-in rebates’ on some items, rather than just charging the lower price at the point of sale.

6. If time permits: extension exercises from the text book

   Chapter 9, p. 206, Questions 4 & 7.

7. Group meeting 3

   The remainder of the tutorial will be a group meeting. Students will need to meet in their groups for the group assignment and presentation. In this meeting the groups should be discussing their progress on the assignment. By this stage, students should have clear idea of their sections to the assignment as well as draft versions of their sections of the assignment.
Tutorial 7

1. In their classic article, ‘The Core Competence of the Corporation’, Prahalad & Hamel argue that “Outsourcing can provide a shortcut to a more competitive product, but it typically contributes little to building the people-embodied skills that are needed to sustain product-leadership”. Do you agree? Why?

2. Construction companies frequently bid for contracts. It is very common for these companies to utilise sub-contractors in the actual construction work. In fact, some of the companies contract out all of the actual construction work to sub-contractors. What can you say about the core competence of these companies? Are they victims of ‘corporate anorexia’?

3. Opponents of out-sourcing (such as unions) point to the potential for disruption to production if input suppliers are unable to meet their obligations, perhaps as a result of strike action. Do you think this represents a powerful enough argument for choosing vertical integration?

4. In the 1920’s Ford Motor Company used to be highly vertically integrated, to the extent of owning its own rubber plantations in South America. Today it is much less integrated. How does the development of the economy affect where a company should set its boundaries; that is, which tasks are to be kept in-house and which should be conducted using market relationships?

5. If time permits: extension exercises from the text book

Chapter 10, p. 227, Questions 2, 5 and 8.
Tutorial 8

1. Answer the following questions:

   a) What is a Principal-Agent relationship?
   b) Explain how the Principal-Agent relationships influence the way a business is structured and run.

   The next part of this tutorial will be devoted to playing the “Principal–Agent” Game. The instructions for this game will be given to students during the tutorial.

2. Distinguish between ‘risk’ and ‘uncertainty’ in the sense adopted by Frank Knight. (Consult “Theorising Risk and Uncertainty in Social Enquiry: Exploring the contributions of Frank Knight” by Darryl Jarvis when preparing your answer).

   a) What is the relationship between subjective and objective probability?
   b) Outline the relevance of the subjective and objective probability distinction for businesses when trying to manage issues related to risk and uncertainty.

3. Explain how ‘business history’ helps illustrate important issues in management economics. Before class, find an article from the Journal “Business History” (which is available electronically from the UWA Library – look up the catalogue and do a “title” search for ‘Business History’) that makes important points for business economists.

4. Group meeting 4

    Following the Principal-Agent game, the remainder of the tutorial will be a group meeting. Students will need to meet in their groups for the group assignment and presentation. In this meeting the groups should be discussing their progress on the assignment. By this stage, students should be discussing the final version of their assignment. They should allocating group members to proof read the assignment and submit the assignment.
**Tutorial 9**

1. H. Demsetz (1983) claims that:

   “The allegation of effective separation between ownership and control, if true, would pose a genuine puzzle. The alleged vacuum of control surely should not exist, for the self-interest of owner’s calls for avoiding the surrender of the control of valuable assets except to others who have similar interests. Not every owner of shares can or wishes to control management, but those who purchase shares do presume that in the typical case there will be some owners with enough at stake to oversee management.”

   Do you find this claim persuasive? Explain.

2. In ‘Interference not welcome’ we can read the following: “Corporate governance models and other forms of interference have become too onerous, bog down management, restrict entrepreneurial spirit and ultimately create inefficiencies. …Management of public companies is not in any way the role of shareholders. This interference is against the corporate stewardship principle, is not conducive to good business practices and ultimately maximising shareholder returns”.

   a) Do you find this claim persuasive? Explain.
   b) Can you reconcile this claim with the earlier one? How does evidence of poor control of managers in some companies such as Enron and One-Tel affect your opinions?

3. A union leader referred to remuneration committees by saying:

   “They scratch each other’s backs and put up each other’s pay. Company performance is not being reflected in these salaries. More employees should be given places on the pay-setting committees”.

   a) Do you agree that there is a problem in controlling executive pay? Or is the rapid growth in pay for CEO’s just the free-market at work? Explain.
   b) How might a problem arise, when economic theory normally assumes profit-maximising behaviour?
   c) Look up the Productivity Commission’s report into this issue, released in September 2009. What suggestions might you then make to reduce or prevent such a problem?

**Tutorials 10 and 11**

These tutorials will be devoted to student presentations of the group assignments. If time permits, tutorial 11 will also cover revision for the exam.
ASSESSMENT MECHANISM

The purpose of assessment

There are a number of reasons for having assessable tasks as part of an academic program. The assessable tasks are designed to encourage you to explore and understand the subject more fully. The fact that we grade your work provides you an indication of how much you have achieved. Providing feedback on your work also serves as part of the learning process.

Assessment mechanism summary

<table>
<thead>
<tr>
<th>Item</th>
<th>Weight</th>
<th>Due date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tutorial &amp; Group Work</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Tutorial attendance and preparation</td>
<td>5%</td>
<td>Determined at tutorials 1 – 9</td>
</tr>
<tr>
<td>(ii) Attendance at group work meetings</td>
<td>4%</td>
<td>Determined at four tutorials (Tutorials: 2, 4, 6 and 8)</td>
</tr>
<tr>
<td>(iii) Written group assignment</td>
<td>10%</td>
<td>Monday 17 October by 12 noon</td>
</tr>
<tr>
<td>(iv) Presentation of group assignment</td>
<td>6%</td>
<td>Held in tutorials in Weeks 12 &amp; 13</td>
</tr>
<tr>
<td>Mid-Semester Exam</td>
<td>25%</td>
<td>Wednesday 21 September</td>
</tr>
<tr>
<td>Final Exam</td>
<td>50%</td>
<td>Held in the final exam period</td>
</tr>
<tr>
<td></td>
<td></td>
<td>12 November to 25 November</td>
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Note 1: Results may be subject to scaling and standardisation under faculty policy and are not necessarily the sum of the component parts.

Note 2: Your assessed work may also be used for quality assurance purposes, such as to assess the level of achievement of learning outcomes as required for accreditation and audit purposes. The findings may be used to inform changes aimed at improving the quality of Business School programs. All material used for such processes will be treated as confidential, and the outcome will not affect your grade for the unit.
Tutorial attendance and preparation

The weekly tutorials cover supplementary material to that covered in the lecture. The tutorial questions are found in this outline. Students are expected to attempt all the topic questions prior to each tutorial and bring their answers to class. The questions and answers will then be discussed in class.

Tutorial answers will not be placed on WebCT. Students are required to attend all tutorials to benefit discussion of the answers.

Group assignment – submission details

The group assignment has a word limit of 2,000 words and is due on Monday 17th October by 12 noon. Students are required to submit their assignment to Reception on the ground floor of the Business School building. The group assignment topics, and related details, are shown later in this outline. Students are required to complete the assignment in groups of three people, from the same tutorial class. As there will also be a presentation, it is not possible for students from different tutorials to collaborate.

The default position is that each group member will receive the same score for the assignment and the group assignment presentation. But in cases where effort has not been equal, group members are encouraged reach an agreement amongst themselves over the allocation of marks (e.g. teh group may wish to allocate 40% of the marks to the student who did most of the work, with 30% being allocated to each of the remaining two students in the group). Although this must have the agreement of each group member, common decency suggests you should contemplate a non-standard allocation of marks when you know you have done less work that the others in your group. Your tutor will be happy to adjust the scores in accordance with the unanimous wishes of group members.

Attendance at group meetings

During four of the tutorials, time has been allocated for students to discuss their assignment and presentation within their groups. These small group meetings will be held in Tutorial 2 (week commencing Monday 22 August), Tutorial 4 (week commencing Monday 5 September), Tutorial 6 (week commencing Monday 19 September) and Tutorial 8 (week commencing Monday 10 October). Students will be given about 10 minutes in each of these tutorials to discuss their assignment and presentation. Students will be rewarded with their attendance at the group meeting with one mark for each meeting they attend.

Please note: The purpose of these Group Meetings in the tutorial is to allow students to arrange times to hold group meetings outside of the tutorial and to discuss progress on the assignment. In these meetings, there is not sufficient time for students to discuss all aspects of the assignment. As such, students should still hold regularly group meetings outside of the tutorials.
Presentation of group assignment

Students are required to give a small (around ten minutes) presentation of their group assignment. The group tutorial presentations will take place within the tutorials of Week 12 and Week 13. Students can either assign the presentation to one group member, perhaps in exchange for less work on the project, or each group member can say something. Students should investigate the strengths and weaknesses of their team members before deciding the best strategy for their group. Each student will receive the same score on the presentation. If a group member does not attend class the day of the presentation (even if they were not presenting the assignment), the person will receive a score of zero, rather than the score their team members earn.

The mark that students’ receive for their tutorial presentation will be determined by the tutor as well as their peers in the tutorial. Students’ peers in the tutorial will be asked to give the tutor anonymous written feedback and a score on each group’s performance.

Some tips for the presentation are:

- Try to think of an original angle for your presentation to maintain your class’s interest. Remember, your class has probably studied similar material to your group. They will be giving your tutor anonymous feedback and a score on your group’s performance.
- Put some effort into the preparation of a powerpoint presentation, overheads and/or handouts for other class members. Focus on the essence of your argument.
- Do not simply read your assignment; that is usually very boring and will guarantee a poor reaction from your classmates and tutor alike.
- Practice your presentation before coming to class; other group members can give advice on how to present better. This is also important for time management reasons, as there will likely be multiple presentations in class and there must be time for all. Your tutor will penalise a failure to observe time limits.

Topics for group assignment (and related details)

The purpose of this essay is to demonstrate both a theoretical and practical understanding of a contemporary business issue that draws upon several of the topics covered in this unit. You should do your own research to discover relevant academic articles to help inform your arguments. Based on your arguments, your group must be prepared to defend its position taken on the issues discussed in during the tutorial class.

Select one of the following two topics for the group assignment / group tutorial presentation

a) What are the arguments for and against extended weekday trading and Sunday trading in WA? What are the relevant lessons for this debate from the various topics in ECON2245? Given your arguments, what is your policy recommendation? How would you seek to persuade a majority of voters that your recommendations are desirable?

Some contextual background: In recent years there has been much public debate over Western Australia’s shop trading regulations. In 2005 the state Labor Government under Geoff Gallop was in favour of deregulation and Colin Barnett’s Liberal opposition was opposed. A subsequent referendum saw two proposals to allow shops to stay open until 9pm on weekdays and to open on Sundays both defeated at the polls. In 2009 the situation was reversed when Colin Barnett’s Liberal Government wanted deregulation but the Labor opposition was opposed. More recently there has been an expansion of tourism precincts in Perth which allow longer trading hours in some parts of the city but not others. In 2010 both major parties struck an agreement to allow increased trading in defined ‘tourist’ precincts and to allow small firms outside the tourist precinct to trade on Sunday’s if that employ 13 or fewer staff. In June 2011, the Barnett Government proposed that firms outside the defined tourist precincts could still trade on Sundays if they employ 18 or less staff, but this proposal
was immediately rejected by Eric Ripper, the Leader of the Opposition (Labor), who preferred the extension to Sunday trading to cover all ‘white good and household furnishing’ stores.

or

b) What are the main lessons for managers from the economics of the firm and the economics of corporate ‘governance’ and give:

- practical illustrations of these lessons, with reference to articles from the business media (e.g. from The Economist, The Australian, the Australian Financial Review etc.) and
- scholarly illustrations of these lessons, with reference to at least one article from the journal Business History.

Submission of assignments

Due date Monday 17 October by 12 noon
Assignments must be submitted to Reception, located on the ground floor of the UWA Business School building.

Word limit
Strictly 2,000 words. Penalties may occur for assignments that exceed the word limit.

Format
Assignments should be typed using 12 font size and 1.5 spacing. All references throughout the assignment should be presented in Harvard Style Referencing. Each assignment should include a standard UWA Business School coversheet. Students must ensure that the names of all students doing the group assignment are on the cover sheet. Students should keep a back-up copy of their assignment.

Tips*

- You should aim to think critically and write originally.
- You are required to research this topic. The use of Econlit for journal article searches and Factiva for newspaper article searches will assist you with the assignment.
- A key component of the assessment of the assignment will be based on your ability to explain your answers using the economic concepts and theory discussed in this course. You will be rewarded for linking the theory with a real life example.
- If any academic article contains mathematics, notation or statistical analysis clearly above 2nd-year level, you don’t need to be able to follow it. Just focus on the parts that you can or should be able to understand.
- Be sure to re-read your assignment before submitting it; poor presentation, spelling and grammar will be penalised.

Submit your assignment in hard copy to the Student Centre. Please remember to attach an Assignment Cover sheet to the front of your assignment. You can download the relevant Assignment Cover sheet from the Business School Current Students web page [http://www.business.uwa.edu.au/students/assessments](http://www.business.uwa.edu.au/students/assessments).
Extensions

Students are required to submit the group assignment on or before the due date. Where students do not adhere to set deadlines the following policy will apply:

a) Extensions will only be considered (although not necessarily approved) if supported in writing (if on medical grounds a medical certificate should be presented).

b) Extensions must be requested at least three University working days before the due date unless unavoidable reasons apply.

c) Unless an extension has been approved, work submitted after the due date will attract a penalty of 10% of the awarded mark per calendar day late.

Mid semester exam

The mid-semester exam will be held on Wednesday 21 September. The duration of the exam has not yet been decided, but will not exceed 1 hour. The exam will be held during the lecture in the John Bloomfield Lecture Theatre (SSEH: 1.02). Information on the structure of the exam as well as areas to study for the exam will be discussed in lectures.

Final exam

The final exam will be held in the exam period of 12th November to 25th November. It is students’ responsibility to check the exam time and exam venue via StudentConnect. Details of the exam, including length, structure and material covered will be discussed in lectures.

Student Guild

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Charter of Student Rights and Responsibilities


Appeals against academic assessment

The University provides the opportunity for students to lodge an appeal against assessment results and/or progress status (refer http://www.secretariat.uwa.edu.au/home/policies/appeals).