

MANAGERIAL ECONOMICS ECONOMICS 2129B-001

Department of Economics
University of Western Ontario

Al Slivinski

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Office: 4089 SSC

Phone: (519) 661-2111 ext. 85294

E-mail: aslivins@uwo.ca

Office Hours: Monday, 12:30 - 1:30, and Wednesday, 2:30-3:30 or by appointment

Class Times: M 9:30 - 11:20, W 10:30 – 11:20, KB106

Undergraduate inquiries: 519-661-3507, SSC Room 4075, or econugrd@uwo.ca

Registration

You are responsible for ensuring you are registered in the correct courses. If you are not registered in this course, the Department will not release any of your marks until your registration is corrected. You may check your timetable by using the Login on the Student Services website at <https://student.uwo.ca>. If you notice a problem, please contact your home Faculty Academic Counsellor immediately.

Prerequisite Note

The prerequisites for this course are **Economics1021A/B** and **Economics 1022A/B**, or **Economics 2001A/B**.

Course Description: This course will help you to better understand the decisions made within firms, by uncovering and analyzing the motivations and constraints that underlie those decisions. The course differs from a course in Management in that the goal of the course is not to help you to be a better manager, but rather to help you to understand managerial decisions from the outside in one's role as a customer, employee and citizen. Among the decisions to be studied are: setting employee compensation and incentive schemes, deciding whether to purchase or manufacture product components (vertical integration), the use of sophisticated pricing systems, and reacting to changes in taxes and government regulations.

Learning Outcomes: Students who successfully complete this course will:

- at least three times during the term say to themselves 'I hadn't thought of that'.
- be able to explain the forces that determine whether any activity important to a firm is done within the firm or outside of it.
- be able to explain the conditions required for a variety of sophisticated pricing strategies used by firms to be profitable.

- be able to explain the way in which a variety of employee compensation schemes alter employee incentives, and also explain the defects in those schemes.

- understand the legal, organizational and behavioral differences that distinguish the different types of organizations encountered in everyday life.

Textbooks:

1. *Managerial Economics and Strategy*, 1st Edition, Perloff and Brander, Pearson, 2014.

There is a 2nd edition of this text out, published this year, but I am not using it. I used the same text last year, so you can purchase a used copy of the hardbound text if you wish.

However, I have also arranged with Pearson Academic to provide two alternative ways for you to access this text.

i) The Bookstore has copies of a ‘custom-built’ paper version of this text which includes all the chapters from Perloff and Brander’s 1st edition that will be used in Econ 2129 this year.

ii) You can purchase an (even cheaper) e-copy of the entire 1st edition of the text from Pearson online by following the directions posted on the website under **Resources/E-book purchase instructions**. According to Pearson, this will give you online access to the e-text for 180 days, and allow you to download an e-copy to **one** computer, and print **one** copy.

2. *The Org: The underlying logic of the office*, Fisman and Sullivan, Princeton University Press, 2013.

This is not a textbook, but an interesting book by two economists that discusses economic research on organizations in a way that illuminates everyday interactions with organizations as customers, employees and spectators. It is available at the Bookstore (as well as from Amazon) and we will also be reading and analyzing a number of chapters from this book during the term.

Evaluation: There will be three 50-minute in-class quizzes, each worth 30 marks, which will together count for 60% of your term mark, as I will drop the lowest of your three quiz marks.

Since I am dropping your lowest quiz mark, there will be **no make-up quizzes**. If you miss one, I will drop the zero. If you miss two, you should drop the course, as you will get zero for the second one missed. The Quizzes will occur *in-class* on:

Wednesday, January 25th

Wednesday, February 15th

Wednesday, March 15th

A two-hour Final Exam to be scheduled by the Office of the Registrar will make up the other 40% of your mark.

Note: The quizzes and Final Exam will include *no multiple choice questions*. They will consist entirely of short-answer questions, along with (perhaps) a few fill-in-the-blank definitional questions.

Course Outline

Note 1: All references to P&BC:x.y below refer to chapter x section y of the Perloff and Brander *Custom text*.

All references to P&BE:x.y below refer to chapter x section y of the Perloff and Brander *E-text*.

All references to FS: refer to chapters in *The Org*, by Fisman and Sullivan.

Note 2: All other readings listed below from other sources are available to be downloaded (dl) from the course website. Yes, they are part of the assigned reading for the course. If other articles, etc. come to my attention during the course that I want you to read, these will be announced in class and on the website, and made available for you to read, either as a web address or a download from the course website.

Note 3: I do not post (or lend out) my slides or my lecture notes. Ever. The only way to find out what is in them is to come to class and take notes, or rely on a classmate who does.

I. The Basics of Organizational Structure: Ownership, Control and Boundaries

A. What are the types of organizations, and what key attributes distinguish them from one another?

P&BC: 2.1 or P&BE: 7.1

FS: Introduction: 'A Machine for Getting Things Done'

'SOE performance' *The Economist* (dl)

'Staffing levels in long-term care' *CMAJ* (dl)

B. What is the distinction between ownership and control of a commercial firm, and to what issues does this separation give rise?

P&BC: 2.3 or P&BE: 7.2

FS: Chapter 6

'Schumpeter: Replacing the Board' *The Economist* (dl)

Letter to the Editor on 'Replacing the Board' (dl)

C. What determines the boundaries of the firm: which activities happen within the firm and which occur outside of it?

P&BC: 2.4 or P&BE: 7.4

FS: Chapter 1

'Delta Airlines Buys a Refinery' Gulliver Blog, *economist.com*

'Delta Refinery Sacrifices Profit' *Reuters*

II. The Decision to Use Complex Pricing Strategies

The pricing methods used by firms vary widely: what factors induce the use of such different pricing methods?

0. Consumer choice theory: The Economics of purchasing

P&BC: 3.0 – 3.4 or P&BE: 4.0 – 4.4

Slivinski, A., ‘Notes on Consumer Choice Theory’ (dl)

A. The basic conditions needed for sophisticated pricing

P&BC: 4.0 - 4.2 or P&BE: 10.0 – 10.2

B. Group pricing

P&BC: 4.3 or P&BE: 10.3

‘Loyalty to Your Car Insurer May Cost You’, *Wall Street Journal* (dl)

Price Optimization Notice – State of California (dl)

C. Block pricing and quantity discounts

P&BC: 4.4 or P&BE: 10.4

‘Discriminating prices for the discriminating consumer’ *Kellogg Insight* (dl)

D. Two-part pricing

P&BC: 4.5 or P&BE: 10.5

E. Bundling

P&BC: 4.6 or P&BE: 10.6

‘American Television: Switching Channels’ *The Economist* (dl)

F. Peak-load pricing

P&BC: 4.7 or P&BE: 10.7

‘Pricing the Surge in Taxi Demand’ *The Economist* (dl)

G. Self-selection in pricing

Slivinski, A. ‘Notes on menu pricing’ (dl)

III. The Principal-Agent Problem, Employee Incentives and Job Design

Incentivizing employees is one of the most important contributors to a firm’s success: what do we know about the effectiveness of different incentive devices?

A. Adverse Selection and Moral Hazard

P&BC: 8.0-8.3 or P&BE: 15.0-15.3

B. Solution 1: Compensation mechanisms

P&BC: 8.4 or P&BE: 15.4

‘Teacher incentive pay’ *The Economist:Free Exchange* (dl)

‘Do incentives motivate?’ *Forbes.com* (dl)

C. Solution 2: Monitoring
P&BC: 8.5 or P&BE: 15.5

D. Solution 3: Job Design and Advantageous Selection
FS: Chapter 2

IV. Game Theory and Firm Interactions

Managers must react to the actions of their competitors, and understand that their competitors will in turn react to their own decisions: what do we know about how these highly strategic interactions work?

A. Static games and one-time decisions
P&BC: 6.0 - 6.3 or P&BE: 12.0–12.3

B. Decisions over time and sequential games
P&BC: 7.0 or P&BE: 13.0

- i) Building cooperation through repeated interaction
P&BC: 7.1 or P&BE: 13.1
- ii) Applications of sequential games
P&BC: 7.2 – 7.4 or P&BE: 13.2-13.4

Course Log

The course website has a folder labelled Course Log. After each lecture (or soon thereafter) I will update that log with a *brief* summary of what was covered that day, along with any announcements of what will be covered in coming lectures.

Basic Rules and Procedures for Ec 2129B

1. It is your responsibility to keep yourself informed about the course: in particular all required readings and the dates for all quizzes. All of this information will be presented in class and also can be found on the course website. My responsibility is to insure that information is accurate and up to date.

2. You are welcome to communicate with me via email. I will answer as promptly as possible, subject to the following constraints:

- a. If you send an email with a question whose answer is clearly provided on the website or course outline, I'll ignore the email; see Point 1 above.
- b. If you ask a question about the course material that requires a long, detailed answer, my only reply will be 'comeseeme'.
- c. The university's position on Ontario's *Freedom of Information and Privacy Protection Act* implies that I am not to respond to any email in a way that could possibly be interpreted as conveying confidential academic or personal information, **unless** it is to a *UWO* email address. Therefore, if you want to be sure to get an answer from me to any email, write to me from your *UWO* email account.

3. My lectures sometimes use slides and sometimes 'chalk and talk'. Everything in the lectures is designed to be an elaboration of the material you are expected to read for the course, therefore **I will not post slides or lecture notes on the website**. Understanding the material in this course will require you to read the text and other materials and come to the lectures to take notes and ask questions. I do post material on the website if it is not available in the readings and is highly detailed, such as charts or tables of figures.

4. The course lectures are intended to be interactive, and you are expected to arrive having read the assigned material and to participate. I expect and encourage questions and will certainly pose questions to you all and expect answers. Anything that comes up in a lecture is part of the course material, so you are absent at your peril.

Long experience in this and other courses has made the following clear: *if you do not come to class and take notes, you will not do well*. Further – taking pictures of my slides is not an effective substitute for taking notes.

5. You may use a laptop in class until the first time you are found to be doing something on it that is not class-related. I reserve the right to ban all laptops that are not required for approved reasons if they become a distraction. Cell phones and other electronic devices are not to be used in class **at all**. You may sound (not video) record lectures if you like, so long as it doesn't become a distraction.

Please Note
Department Policies for 2016 – 2017

Remember that the University expects all students to take responsibility for their own academic Programs. Also remember to check your registration to make sure you are enrolled in the correct courses.

1. Guidelines and policies for the Faculty of Social Science and the Department of Economics are posted online in the current Western Academic Calendar at <http://westerncalendar.uwo.ca>.
2. Students must familiarize themselves with the “Rules of Conduct for Examinations” <http://westerncalendar.uwo.ca/2016/pg136.html>.
3. **Cheating as an academic offence:** Students are responsible for understanding what it means to “cheat”. The Department of Economics treats cheating incidents very seriously and will investigate any suspect behavior. Students found guilty will incur penalties that could include a failing grade or being barred from future registration in other economics courses or programs. The University may impose further penalties such as a notation on your official academic transcript, suspension or expulsion.
4. **Plagiarism:** Students must write their essays and assignments in their own words. Whenever students take an idea or a passage from another author, they must acknowledge it by using quotation marks where appropriate and referencing with footnotes or citations. Plagiarism is a major academic offence (see Scholastic Offence Policy in the current UWO Academic Calendar at <http://westerncalendar.uwo.ca/2016/pg113.html>).

The University of Western Ontario uses software to check for plagiarism and students may be required to submit their written work in electronic form. Those found guilty will have penalties imposed as noted in point 3.

5. It is Department of Economics policy that **NO** assignments be dated, stamped or accepted by staff. Students are responsible for submitting assignments in class or to the instructor during office hours.
6. When appealing a mark, students should refer to the University’s Procedures in the current UWO Academic Calendar (<http://westerncalendar.uwo.ca/2016/pg112.html>). Please note the relevant deadlines.

The Department will not consider any appeal unless an attempt has been made to settle the matter first with your instructor. If after this discussion you remain dissatisfied with a grade or other decision, you may proceed with a written appeal (e-mails are not acceptable) to the Undergraduate Director in Economics, stating the reasons for your appeal. A useful form and checklist is provided at (http://economics.uwo.ca/undergraduate/program_counselling/responsibilities_policies.html#appeals).

7. Systematic adjustments of a class grade distribution (either up or down) can occur in Economics courses. The fact that grades have been adjusted is **not** grounds for an appeal.
8. Note the following add and drop deadlines:

Last day to **add** a first term half course:
Friday, January 13th, 2017

Last day to **drop** first term half course without academic penalty:
Tuesday, March 7th, 2017
9. Faculty of Social Science policy states that oversleeping or misreading an exam schedule is not an excuse for a make-up. This rule applies to all mid-term tests and final exams in the Department of Economics.

Policy Regarding Makeup Tests and Final Examinations

*Academic Accommodation will **not** be granted automatically on request. You **must** demonstrate by documentation that there are **compelling** medical or compassionate grounds before academic accommodation will be considered.*

If you decide to write a test or an examination, you must be prepared to accept the mark you earn. Rewriting tests or examinations, or having the value of the test or examination reweighted on a retroactive basis, is **not** permitted. Book airline flights after you know the dates of your final examinations. Airline flights must not conflict with test or final exams.

If you are requesting a makeup test for a midterm or a final examination, unless medically incapable, notify your instructor by email or phone, preferably prior to the scheduled date of the test, but definitely within **24 hours** of the date of the test or exam. Failure to follow this procedure may result in denial of a request for academic accommodation or result in a grade of zero. Set up an appointment as soon as possible to meet personally with your instructor. If the instructor is not available, you may send an email message, copying the Undergraduate Coordinator at econugrd@uwo.ca (Social Science Room 4075). **Notifying your instructor of a missed test or exam does not automatically entitle you to a makeup test.**

Students who seek a makeup test or examination must provide medical or other relevant verification that their absence from a regularly scheduled test or examination is beyond their control. Documentation must support your reasons. Medical documentation should be given to the Academic Counselling Office of your *home* Faculty **as soon as possible (preferably within 24 hours of the test)** if you know you may not be able to write your final examination on the scheduled day and time. Failure to follow this procedure, or to provide supporting documentation, may result in denial of a request for academic accommodation or result in a grade of zero. If your documentation is not acceptable, you will be given a zero for the missed test.

For personal illness, if you consult Student Health Services regarding your illness or personal problem, you should request a Student Medical Certificate from the physician. If you were seen by an off-campus doctor, obtain a certificate from his/her office at the time of your visit. The off-campus medical certificate form must be used and can be found at: http://www.uwo.ca/univsec/pdf/academic_policies/appeals/medicalform.pdf. Notes stating "For Medical Reasons" are not considered sufficient.

For any other circumstances, if you are not sure what documentation to provide, ask your Academic Counselor. If your documentation is judged sufficient, the academic counselor will issue a Recommendation for a Special Examination (a single form for midterms or a triple color form for final examinations). Once you have this form, contact your instructor as soon as possible to make arrangements. Even if approved from your home faculty Academic Counsellor, there is no guarantee that you will be allowed to write the makeup test and exam.

For final examinations, you need permission from your *home* Faculty Counsellor, your instructor, and the Department Undergraduate Director. Failure to follow this procedure may result in an examination grade of zero. You must ensure that the Special Examination form has been signed by the instructor and Department Undergraduate Director and that the form is returned to the Academic Counseling Office for approval without delay. Make-up final examinations, if permitted, will be written within one month of the end of the exam period.

Policies Regarding Academic Accommodation

Information about the Faculty of Social Science's policies regarding academic accommodation is found on its website at <http://counselling.ssc.uwo.ca/procedures/havingproblems.asp> or in Social Science Room 2105. Your "Academic Rights and Responsibilities" are also outlined in the current UWO Calendar at <http://westerncalendar.uwo.ca/2016/pg111.html>. Claiming that "you didn't know what to do" is not an acceptable excuse for not following the stated procedures.

Policy Regarding Class Attendance

If your instructor views your class attendance as unsatisfactory, you can be prohibited from writing the final examination. If there is intent to make use of this University policy, you will be notified in writing.

Statement on Mental Health and Support Services

If you or someone you know is experiencing emotional/mental distress, there are several resources here at Western to assist you. Please visit <http://www.uwo.ca/uwocom/mentalhealth/> for more information and a complete list of resources, as well as how to obtain help.