

MFP SET

Strategic & Economic Thinking

What is economics useful for?

- Write down 3 types of problems economists deal with
- Discuss this with the person sitting to your right
- Did you agree on the types of problems?

What questions does economics deal with?

- Allocation of resources
 - What goods & services are produced
 - Who gets how much, at what price
- How is this allocation reached?
 - Through market exchange?
 - Through a command system?
 - ✦ As in a firm

Examples

- How many hotel rooms does Sydney need for the Olympics?
- Should a company perform its own IT functions or contract it out?
- Will interest rates rise again this year and by how much?
- What sort of environmental protection policies should be put in place?

Why is economics important to managers?

- Economics provides an approach to problem-solving
- It improves managers' awareness of the costs & benefits of activities
- It gives the manager an understanding of a key element of the managerial environment

Why MFP SET?

- MFP SET is designed to give you the *foundations* of economic thinking
 - Basic models of economics
 - An introduction to markets & market interactions
 - ✦ Individual markets
 - ✦ The whole economy
 - An introduction to strategic thinking by market participants

How will we proceed?

- Two segments
 - Foundations of economic thinking: Robin
 - An introduction to strategic thinking: Bob
- Class format:
 - Lectures
 - ✦ Discussion of basic concepts
 - Tutorials
 - ✦ Discussion of cases
 - ✦ Opportunity for questions

Assessment

- Case one: (group) 10%
 - In weeks 2-4
- In-class exam: (individual) 40%
 - Covers first five weeks
- Case two: (group) 10%
 - Bob will give you schedule
- Final exam: (individual) 40%
 - Covers strategic thinking

Why is everybody in?

- Because we don't want to exclude anyone!!
- Because you're here to learn from each other as much as from us
- Implications:
 - We will form groups on the basis of your backgrounds in economics
 - Look to those in your group who have done economics to help you

What is an economic model?

- A simplified picture of a part of the real world
- It has some of the real world's attributes, but not all
- It is useful *because* it simplifies the world
 - Models allow us to analyse complex problems because we look at a small section of the world in a simplified way

How do we construct a model?

- We are confronted with an interesting problem
- We observe facts about the problem
- We speculate about the processes that might have produced such observations
- We construct a description of the process that allow us to deduce:
 - results, implications, consequences, predictions

Three rules of thumb

- Think “process”
- Develop interesting implications
- Look for generality

What do models look like?

- They can be physical
 - an architect's model of a building project
- They can be verbal
 - a detective's description of how the murder was done
- They can be diagrammatic
 - the model of supply & demand we'll develop
- They can be mathematical

The importance of assumptions

- What you assume determines the results you get
- Never underestimate the power of assumptions!
- Example:
 - How much will prices rise after the introduction of the GST in July?
 - It depends...

Some basic notions

- Opportunity costs:
 - What is the value of the next best alternative?
- Example:
 - What could you be doing instead of studying for an MBA?
 - Opportunity costs include ... loss of income, loss of time spent with friends & family, loss of additional experience in the workplace

Is there a free lunch?

- Economists recognise the trade-off inherent in the resource allocation problem – if a resource is allocated to one activity, it cannot be allocated to another
- This is the basis of the notion of opportunity cost – the cost of something is the value of the next best alternative activity

Rational economic (wo)man

- What does rationality mean?
 - Your actions have a purpose
 - You realise the consequences of your actions
 - You choose only those actions which leave you better off

Transaction costs

- How much does it cost to buy a house in Sydney?
 - The cost of the house
 - Stamp duty
 - The cost of search time
 - The cost of evaluation of the property
 - Legal fees for conveyancing
 - The cost of moving

Implications of transaction costs

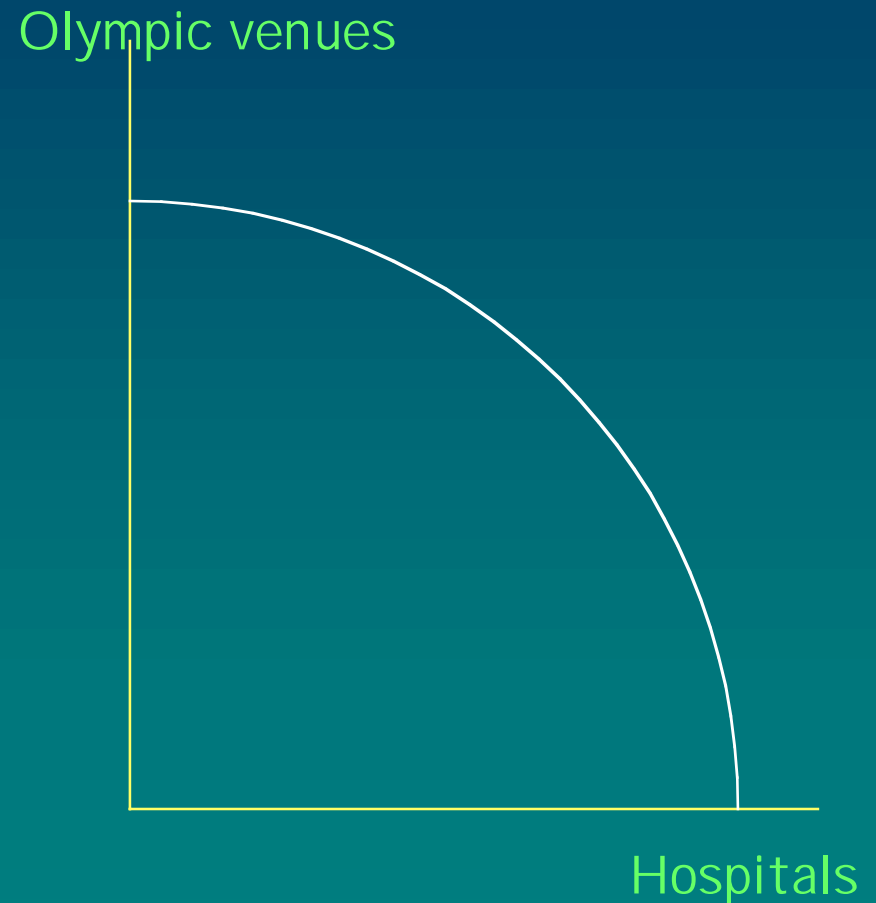
- Should a business (the AGSM) perform its own printing activities or should it outsource?
- Costs?
 - Costs of actual printing: \$0.10 per page
 - Additional costs:
 - ✦ Faculty costs:
 - Being prepared ahead of time
 - Inability to respond to student feedback
 - ✦ Coordination costs

Economic efficiency

- *Economic efficiency* is producing the most that we can given the resources & technology that we have
- What does this imply about costs?
 - That we are producing a given quality & quantity as cheaply as possible
 - If we could produce the goods or services more cheaply, then we could use the excess resources to produce more

Production possibility frontier

- A production possibility frontier shows the various combinations of output that an economy can produce, given resources & technology



Efficiency

- What does efficiency mean?
- Being *inside* the frontier represents inefficiency
- Being *on* the frontier represents efficiency

