Microeconomic Analysis
2000

An Introduction
What is economics?

Analysis of ...
- choices
- exchange
- prices
- competition
- strategic interaction
Why study economics?

- **Descriptive:** allows you to understand the forces at work in business
  - predict price movements
  - impacts on investment decisions
- **Prescriptive:** gives you a framework for better decision-making
  - whose decisions?
Skills for the subject

- Logical/intuitive thinking
- Interpretation of graphs
- Mathematics
Strategic Thinking

- Strategic thinking involves recognising the interests of those playing against you.
- This is the difference between simple financial decision-making and strategy.
- Lesson: Put yourself in the shoes of others.
Housekeeping

- Textbook
- Readings
- Lecture Notes
- Cases and Problem Sets
- Assessment
- Web Page
- E-mail
Course Objectives

Key understanding of:

- Price formation: what factors determine how much you pay or are paid?
- Acting to change price: what actions can you take that alter pricing outcomes?
Theories of Price Formation
Price formation

- Price is an outcome of economic interaction.
- No agent (even a monopolist) can dictate pricing.
- There are two theories of price formation:
  - Posted pricing - that is, textbook economics
  - Negotiations and bargaining
Posted pricing

- A mass market phenomenon: set a price and see what you can sell
- Helps understanding:
  - relationship between price and cost: determination of mark-ups
  - pricing strategies
Negotiations and bargaining

- In both games, a price emerged. The result of free-form bargaining.
- Sometimes different prices for like transactions: depends upon sophistication in negotiations.
- What theory explains this type of pricing?
  - Answer: added value ...
Added Value

YOUR ADDED VALUE =

The size of the pie when you are in the game

minus

The size of the pie when you are out of the game
What you get?

- It is hard to get more than your added value.
- You should try not to accept less than your added value.
- Zero added value means you get zero

What happened in the two card games?
Ego. Vs Allo

What happens when you participate in a game?
- Ego view: What’s in it for you?
- Allo view: How does your play change the game for others?

Counterfactual thinking: “It’s a Wonderful Life”
Added Value - The Movie

When Macaulay Culkin was picked for *Home Alone*, he took the role for little more than $100,000. Twentieth Century-Fox released the film in 1990. It grossed $286 million in the home market alone and went on to become the sixth highest grossing movie ever.
The story of the sequel, *Home Alone 2: Lost in New York*, was very different. This time, Macaulay got paid around $5 million, plus five percent of the domestic gross. The sequel rapidly grossed $174 million, and that added another $8.7 million to Macaulay’s paycheck, helping him become the youngest of Hollywood’s top-40 grossing artists.
The Business of Business

- Business involves:
  - the creation of a pie
  - the division of the pie

- These two aspects of business are intertwined:
  - people create pie with an eye to what share they can claim
  - the shares people can claim reflect what they contribute to the pie