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
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.
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
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.
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