

# MFP SET

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Strategic & Economic Thinking

# What is economics useful for?

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- 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?

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- 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

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- 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?

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- 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?

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- 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?

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- 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

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- 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?

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- 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?

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- 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?

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- 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

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

# What do models look like?

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- 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

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- 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

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- 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?

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- 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

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- 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

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- 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

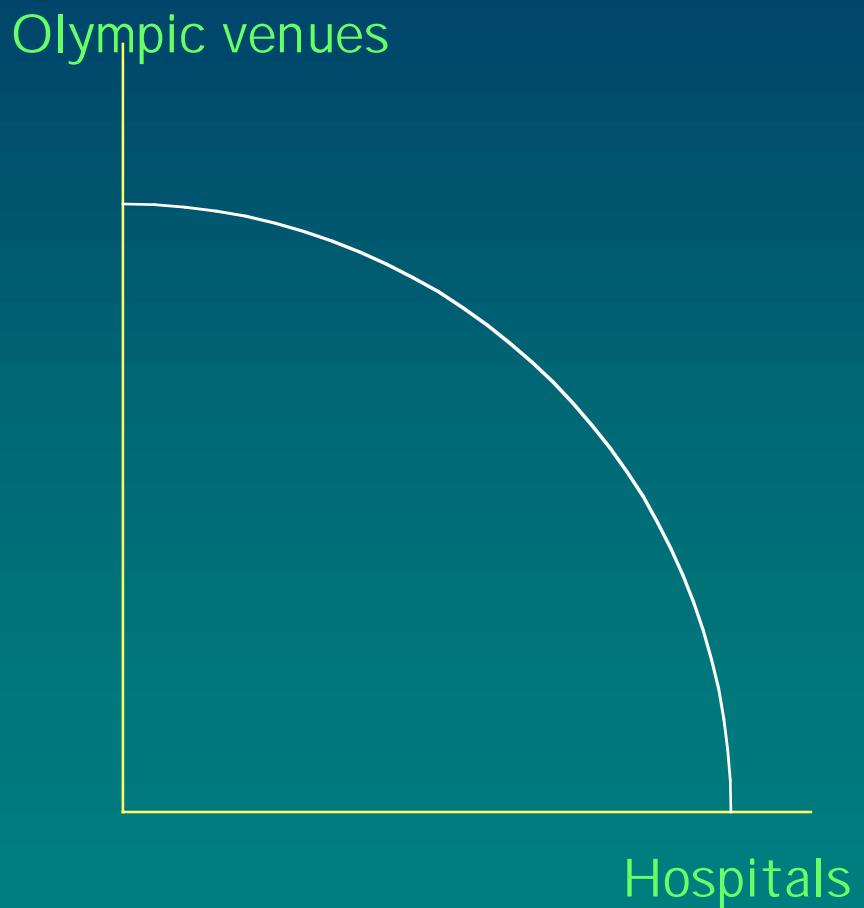
# Economic efficiency

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- *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

