

AUSTRALIAN GRADUATE SCHOOL of MANAGEMENT

Strategic and Economic Thinking

Term 1, 2000

Robin Stonecash
Room 222, Ext. 562
robins@agsm.edu.au

Robert Marks
Room 251, Ext. 271
bobm@agsm.edu.au

What is SET About?

MFP is the first steps of your journey with the AGSM. MFP subjects allow you to begin to get to know your fellow students and to learn areas and disciplines new to you as well as polishing things you once learned before.

Strategic and Economic Thinking is the first of many subjects offered by the Economics Group at the AGSM -- at the moment Robin and Bob, although we're hiring at least two new members as we speak. The subject is split into two five-week sections -- Economics, offered by Robin, and Strategy, offered by Bob.

Robin's section will emphasise several ideas. The first is how economists think, and this will continue through the ten weeks of the subject. Our slant is towards micro economics -- the behaviour of buyers and sellers in a market, or in related markets, rather than the economy as a whole. Robin will introduce the wider, macro, picture in Week 5, as a prelude to Macroeconomics for Managers, the Term 3 elective.

Economics is not just telling stories, or looking at once-off cases. It tries to discern the underlying patterns and forces, in order to understand the economic world, and eventually to change it. To do this, we need to understand modelling, which can be done in many ways. Robin's first lecture reveals how pervasive our models of the world are.

Supply, demand, and market equilibrium are revision for many students, but often it turns out that previous familiarity has been superficial. Learn more about Alfred Marshall's scissors in Week 2. The Gateway in Term 2 builds on these topics, leading to Economic Investment Appraisal in Term 3 and Industrial Organisation in Term 4 and Incentives, Contracts and Economics in Term 5.

We all know about profit, but it turns out that the accountant's idea of profit is not the economist's: economists are concerned about the opportunity cost, especially of capital, a forward-looking concept, which should be at every MBA's fingertips. After Week 3 it will be.

Undergraduate economics breeds the notion that economists are only interested with the two extremes of perfect competition on the one hand or monopoly on the other. (I know,

how does the old joke go? "Give me a one-handed economist ...") But strategic interdependencies are more usual, and economics has tools to understand, to predict, and to prescribe the manager's behaviour in interactive market situations. Robin introduces this, and Bob follows with much closer examination. The last five weeks are an introduction to Strategic Game Theory for Managers in Term 2.

What is the Prisoner's Dilemma? What if the interaction is repeated? How can Game Theory provide a framework for analysing and predicting interactive behaviour and outcomes? When is collusion not collusive? Bob strips some strategic interactions to their skeletons, in order to highlight their essential nature, in Weeks 6 and 7.

In Week 8, he introduces game trees, and the importance of commitment and credible threats. Just how can commitment be established when talk is cheap?

Reputation is one way, but this requires repeated interaction. Week 9 examines some implications of repetitive strategic behaviour.

The Internet provides an almost costless medium for buying and selling which is set to increase competition in many areas, not least in B2B (business-to-business) sales. The use of auctions is now transforming the relationships between buyers and sellers of many goods and services. Week 10 looks at types of auctions and issues of values.

Week	Reading:
1. Introduction to the Economic Way of Thinking	MMP chapter1 (Package), Gans, King, Mankiw chapters 1, 2 (Package)
2. Basic concepts of economics: supply, demand & market equilibrium	MMP chapter 2: pp 1-32, chapter 3: pp 1-41 (Package)
3. An economist's view of costs: opportunity cost & accounting vs economic profit	Maital, chapter 3 (Package) Young & McAuley, chapter 10 (Package)
4. Interdependence within markets: Economics & strategy	Kay, "Economics & Business" (Package) Gans, King, Mankiw, chapter 16 (on reserve)
5. Issues in Macroeconomics	Stonecash, chapter 19 (Package)

6. Strategic Decision-Making	<p>Dixit & Nalebuff, Chapters 1–3</p> <p>R. Norton, Winning the game of business, Fortune, February 6, 1995, p.36. (Package)</p> <p>F.W. Barnett, Making game theory work in practice, Wall Street Journal, February 13, 1995, p.A14. (Package)</p> <p>B. O'Neill, International escalation and the dollar auction, Journal of Conflict Resolution, 30(1): 33–50, 1986. (Package)</p> <p>R.E. Marks, Competition and common property, AGSM WP 98-003. (Package)</p>
7. Strategic Decision-Making	As above
8. Credible Commitment	Dixit & Nalebuff, Chapters 5, 6
9. Repetition and Reputation	<p>Dixit & Nalebuff, Chapter 4</p> <p>D. Besanko, D. Dranove, and M. Shanley, The dynamics of pricing rivalry, Ch. 9 of their: The Economics of Strategy, N.Y.: Wiley, 2nd edition, 2000. (Package)</p>
10. Bidding and Auctions	<p>Dixit & Nalebuff, Chapter 12, Part 3.</p> <p>R.P. McAfee and J. McMillan, Competition and game theory, J. Marketing Research, 33, 263-267, August 1996. (Package)</p> <p>S.E. Landsburg, Cursed winners and glum losers, Ch. 18 of his: The Armchair Economist: Economics and Everyday Life, N.Y.: The Free Press, 1993. (Package)</p> <p>The Economist, Revenge of the nerds, Auction fever, and Learning to play the game, 23 July 1994, 3 December 1994, 17 May 1997. (Package)</p> <p>R. Koselka, Playing poker with Craig McCaw, Forbes, 156(1): 62–64, July 3, 1995. (Package)</p> <p>J. McMillan, Bidding in Competition, Chapter 11 of his: Games, Strategies, & Managers: How managers can use game theory to make better decisions, Oxford: O.U.P., 1992. (Package)</p> <p>R. Koselka, Businessman's dilemma, and Evolutionary economics: nice guys don't finish</p> <p>S. Strudwick, Celluloid Games: the Cannes Film Festival, Student Essay, August 1994. (Package)</p>

The following schedule lists important dates for MFP SET. The tutorials will be held at two times: Thursday, 2-3:30pm and 3:30-5:00pm. Once results from both the maths test and the economics fitness test are known, we will put out a timetable for tutorials.

Important Dates:

Mon	Tues	Wed	Thu	Fri
Lecture 21 Feb	22	23	Lecture 24	25
Lecture Case handed out 28	29	1 Mar	Tutorial: Case discussed 2	3
Lecture: Case handed out 6	7	8	Tutorial: Case discussed 9	10
Lecture: Case handed out 13	14	15	Tutorial: Case discussed 16	17
Lecture 20	21	22	In-class exam 23	24
Lecture 27	28	29	Lecture 30	31
Lecture Apr 3	4	5	Tutorial 6	7
Lecture 10	11	12	Tutorial 13	14
Lecture 17	18	19	Tutorial 20	21
Easter Monday 24	25	26	Review lecture 27	28

Assessment:

Assessment for this subject will consist of two case studies and two exams. The cases will be done in groups (to be chosen by Bob & Robin). Each group will be required to hand in for assessment one of the three cases covered in weeks 2 - 4, although all groups are encouraged to do each case. Robin will give out a schedule listing which cases will be assessed for each group. The cases will form the basis for discussion in the tutorials. Tutorials will also be used to discuss any problems with material covered in lectures. Bob will hand out his schedule for assessment when he begins lecturing in week 6.

The first in-class exam will cover material from the first 5 weeks on the fundamentals of economic thinking, presented by Robin. The final exam will cover the material in the second five weeks on game theory, presented by Bob.

- Case one: 10%
- In-class exam: 40%
- Case two: 10%
- Final exam: 40%