

Microeconomic Analysis

2000



An Introduction

What is economics?



Analysis of ...

- choices
 - exchange
 - prices
 - competition
 - strategic interaction
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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?
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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
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Housekeeping



- Textbook
 - Readings
 - Lecture Notes
 - Cases and Problem Sets
 - Assessment
 - Web Page
 - E-mail
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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?
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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
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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
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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 ...
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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?
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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"
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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.
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Added Value - The Sequel



- 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
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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
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