

**Faculty of Commerce and Administration**

VICTORIA UNIVERSITY OF WELLINGTON

*Te Whare Wānanga o te Ūpoko o te Ika a Māui*

**International MBA Programme**



**VICTORIA  
MANAGEMENT SCHOOL**

*Te Kura Whakahaere*

**2006**

## **IMBA 503**

### **Economics, Global Organisations and International Markets**

#### **COURSE OUTLINE**

- Start Date:** 4<sup>th</sup> November 2006
- Format:** 12 - two-hour sessions over two weekends.
- Lecture Times:** 4 November: 2:00 – 6:00 pm & 7:00 – 9:00 pm  
5 November: 11:00 – 3:00 pm & 4:00 – 6:00 pm  
2 December: 2:00 – 6:00 pm & 7:00 – 9:00 pm  
3 December: 11:00 – 3:00 pm & 4:00 – 6:00 pm
- Location:** William M W Mong Engineering Building (ERB) Rm 803
- Teaching Staff:** Neil Quigley, BA, MA *Canterbury* Ph.D. *Toronto*,  
Professor of Economics and Deputy Vice Chancellor  
  
Office: HU302, PO Box 600, Wellington, New Zealand  
Email: neil.quigley@vuw.ac.nz  
Telephone: 644-463-5083 Fax: 644-463-6798
- Textbook:\*** Paul Milgrom and John Roberts *Economics, Organisation and Management (Prentice Hall)*.

\* - In addition to the textbook, this course will rely on materials from a variety of sources, including practitioner and academic journals.

## Course Objectives

The International Master of Business Administration Programme serves to produce professional managers capable of fulfilling strategic roles within corporate and government enterprises. Integral to this capability is an understanding of the fundamentals of microeconomics and its applications to business decision-making.

This course aims to provide you with an understanding of the basic theory of microeconomics, but it treats theoretical issues at a conceptual level and avoids the formal mathematical presentation of ideas commonly used in courses on economic theory. Where assigned readings include formal mathematical models, an understanding of the mathematics is not required. We use this theoretical base to consider applications in four areas: the structure, ownership and governance of the firm; agency problems and decision-making under imperfect information; pricing, competitive strategies and regulation; and labour markets. By the end of this course, you should:

1. Understand the major theories and concepts associated with the field of microeconomics.
2. Understand how these theories may be applied to business decision-making.
3. Have the ability to analyse, from an economic perspective, decision-making problems in relating to pricing and other aspects of strategy, the writing of contracts, the governance of firms and the analysis of market structures.

## Assessment

Individual Assignment	20 %	due 18 November returned 2 December
Group Project Assignment	30%	due 2 December
Final Examination	50 %	17 December

**Individual Assignment (20%)** – The individual hand-in assignment will be discussed during the initial sessions, at which time detailed terms of reference will be distributed. Written assignment reports will be due at lecture hall by 2:00 pm on Saturday, 18 November.

**Group Project (30%)** – The group project will be discussed during the first visit, at which time detailed terms of reference will be distributed. Written Group Reports will be due on Saturday 2 December at 2:00 pm (at the lecture).

Important Note – Inclusion of others' work and research completed is welcome. However, such material (even if it is a single sentence) must be explicitly recognised with quotation marks in the project report, citing its origin in a footnote.

**Final Examination (50%)** - A final three-hour closed-book examination will be held on Saturday, 18 December, (location and details to be advised by APIB) during which students will be expected to answer 3 essay-style questions that will test their ability to explain the theoretical concepts covered in the course and apply them to specific problems in business decision-making or the structure of markets and organisations. In accordance with University policy, students must obtain a minimum of forty percent of the marks available on the final examination in order to pass the course.

## **Course Terms of Reference**

### **Late Assignments**

Given the modular nature of the course delivery and relatively short time for marking and return, it is imperative that assignments are handed in on time. Late assignments will incur a 50% penalty on the assigned mark. Assignments more than two weeks late will not be accepted. In addition, late assignments will not be available by the agreed-to return date.

### **Obtaining Terms**

To obtain terms to sit the final examination in this course, students are required to participate in both weekend modules and submit both written assignment reports.

### **Passing the Course**

In order to pass this course, students are required to obtain at least forty percent of the final examination marks available, and obtain at least fifty percent of the overall course marks available.

## **Victoria IMBA Grading Standards**

### **Excellent Category**

A- (75 – 79%) to A (80 – 85%) to A+ (above 85%): The learning is demonstrated to a very high level of proficiency, i.e. it is at a standard that makes it exceptional at Master's level.

### **Very Good Category**

B+ (70 – 74%): The learning is demonstrated at a high standard. Students have reached a level that clearly exceeds “competency”.

### **Good Category**

B (65 – 69%): The learning is clearly demonstrated without being exceptional in any way. Students can be thought of as fully competent.

### **Satisfactory Category**

B- (60 – 64%): The learning is demonstrated without being exceptional in any way. Students can be thought of as competent.

### **Marginal Category**

C (50 – 54%) to C+ (55 – 59%): The learning is demonstrated to a minimally acceptable level. There may be flaws but these are not serious enough to “fail” the student.

### **Unsatisfactory / Failure Category**

E (0 – 39%) to D (40 – 49%): The learning is absent or performed to a very low level, or the performance is seriously flawed.

## **Individual Work**

While the Victoria IMBA programme has a tradition of study group collaboration, there are important elements in the assessment process that are strictly individual. Collaboration on individual assignments is not allowed. Please do not work together to formulate a response and do not loan out your completed assignments.

## **Plagiarism**

The Victoria IMBA programme views plagiarism as a serious offence. Students who plagiarise put themselves at risk of expulsion from the programme. Plagiarism is defined as representing someone else's work as your own. It includes, cutting and pasting material from websites, typing in sentences and paragraphs from books and journals, copying from other assignments and materials, and taking quotes that others have used without recognising the originator. It also includes writing verbatim from a textbook in an open-book examination situation without recognising the source of your material. If you use other peoples' materials, then you must give them credit and recognise the source. This includes making the material explicit by putting it in quotations and placing a footnote at the bottom of the page or back of your document to indicate complete details of the author and source.

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**GENERAL UNIVERSITY POLICIES AND STATUTES**

Students should familiarise themselves with the University's policies and statutes, particularly those regarding assessment and course of study requirements, and formal academic grievance procedures contained in the statutes in the VUW website.

**The University Statute on Student Conduct and Policy on Staff Conduct**

The Statute on Student Conduct together with the Policy on Staff Conduct ensure that members of the University community are able to work, learn, study and participate in the academic and social aspects of the University's life in an atmosphere of safety and respect. The Statute on Student Conduct contains information on what conduct is prohibited and what steps can be taken if there is a complaint. For queries about complaint procedures under the Statute on Student Conduct, contact the Facilitator and Disputes Advisor. This Statute is available in the APiB Administration Office or on the website at:

[www.vuw.ac.nz/policy/StudentConduct](http://www.vuw.ac.nz/policy/StudentConduct)

The policy on Staff Conduct can be found on the VUW website at:

[www.vuw.ac.nz/policy/StaffConduct](http://www.vuw.ac.nz/policy/StaffConduct)

**Academic Grievances**

If you have any academic problems with your paper you should talk to the tutor or lecturer concerned or, if you are not satisfied with the result of that meeting, see the IMBA Director. Class representatives are available to assist you with this process. If, after trying the above channels, you are still unsatisfied, formal grievance procedures can be invoked. These are set out in the Academic Grievances Statute which is published on the VUW website: [www.vuw.ac.nz/policy/AcademicGrievances](http://www.vuw.ac.nz/policy/AcademicGrievances)

**Plagiarism**

Victoria University defines plagiarism as the copying of ideas, organisation, wording or anything else from another source without appropriate reference or acknowledgement so that it appears to be one's own work. This includes published and unpublished work, the Internet and the work of other students and staff. Plagiarism is an example of misconduct in the Statute of Student Conduct. Students who have plagiarised are subject to a range of penalties under the Statute. See the website: [www.vuw.ac.nz/policy/StudentConduct](http://www.vuw.ac.nz/policy/StudentConduct)

**Reasonable Accommodation Policy**

The University has a policy of reasonable accommodation of the needs of students with disabilities. The policy aims to give students with disabilities an equal opportunity with all other students to demonstrate their abilities. If you have a disability, impairment or chronic medical condition (temporary, permanent or recurring) that may impact on your ability to participate, learn and/or achieve in lectures and tutorials or in meeting the course requirements, then please contact the Course Coordinator as early in the course as possible.

[disability@vuw.ac.nz](mailto:disability@vuw.ac.nz)

The name of the Disability Liaison Person can be obtained from the IMBA Programme Director.

### **Appeals / Concerns / Statute on Conduct**

If you have any concerns with your course you should first raise those concerns with Professor Quigley. If you are not satisfied with the result of that meeting, you may contact the Director of the IMBA, Dr Paul McDonald. The University has developed independent procedures for dealing with academic grievances and complaints. These procedures are set out in the Statute on Academic Grievances in the University *Calendar*.

## Session Schedule - IMBA 503 - 2004

Session	Date	Topic	Basic Reading
			Milgrom and Roberts = MR
1	4 <sup>th</sup> November 2:00 – 4:00pm	- Theory of the Firm	MR Ch2, 9, 16 Demsetz (1998) Li (1996) Aoki (1990)
2	4 <sup>th</sup> November 4:00 – 6:00pm	- Cost Concepts for the Firm	Carlton and Perloff pp28-49
3 117	4 <sup>th</sup> November 7:00 - 9:00pm	- Pricing under Competition and Monopoly	Carlton and Perloff pp56-
4	5 <sup>th</sup> November 11:00 – 1:00pm	- Pricing and Welfare under Regulation	Png pp 299 - 329 MR pp 78 - 81
5	5 <sup>th</sup> November 1:00 – 3:00pm	- Bounded Rationality	MR Ch 5 Mi and Wang
6	5 <sup>th</sup> November 4:00 – 6:00pm	- Moral Hazard, Adverse Selection	MR Ch 6 Evans and Quigley
7	2 <sup>nd</sup> December 2:00 – 4:00pm	- Review of first 6 lectures - Economics of Strategy	Dixit pp 43–58; 79-93 MR 106–116; 129-149
8	2 <sup>nd</sup> December 4:00 – 6:00pm	- Extensions on strategy	MR 106-116; 129-149 Dixit pp 43–58; 79-93
9	2 <sup>nd</sup> December 7:00 – 9:00pm	- Competition Policy	Carlton Perloff pp610-641
10	3 <sup>rd</sup> December 11:00 – 1 :00pm	- Regulation	Png Ch 14
11	3 <sup>rd</sup> December 1:00- 3:00pm	- Governance and Financial Structure	Allaire and Firsirotu; Faccio etal MR Ch 15
12	3 <sup>rd</sup> December 4:00 – 6:00pm	- Internal Labour Markets	MR Ch 12; 13

# IMBA 503 Teaching Objectives

## **Session 1: Theory of the Firm**

### Objectives

We will begin by briefly reviewing the objectives and course outline and discussing the assignments. We will then define transactions costs and distinguish between firms and markets. We will discuss property rights and the concept of ownership, as well as considering two key features of the modern corporation: limited liability and separation of ownership and control.

### Reading

I have assigned a lot of reading for this session. It is important that you at least read the chapters from Milgrom and Roberts before the class. The supplementary articles by Demsetz, Li and Aoki provide applications useful in analysing firm and ownership structures, as well as for material in subsequent sessions.

### Outcomes

At the end of this session you should understand the concept of transactions costs, and its application in explaining the existence and structure of firms. You should be able to explain the implications of the separation of ownership from the firm itself (through the concept of limited liability) as well as the separation of ownership and management. You should be able to explain the importance of property rights for investment and economic management, and distinguish a property right from the concept of ownership.

## **Session 2: Cost Concepts for the Firm**

### Objectives

Explain the fundamental economic concepts applied to the analysis of efficiency and profitability, including establishing precise definitions for terms such as economies of scale, economies of scope and sunk costs. Explain how these concepts may be used to analyse problems relating to the structure and boundaries of the firm.

### Reading

The section from Carlton and Perloff provides all of the information necessary for this session.

### Outcomes

At the end of this session you should have a firm grasp of all basic economic cost concepts, and be able to use these independently to identify and analysis the efficiency of the firm and the extent to which opportunities to expand the scale or scope of the business offer opportunities to increase efficiency.

## **Session 3: Competition and Monopoly**

### Objectives

Develop an understanding of the assumptions and predictions of economic models of perfect competition and monopoly, as well as an appreciation of the fact that almost all markets and firms operate under conditions that combine elements of both models.

### Reading

The section from Carlton and Perloff provides all of the information necessary for this session.

### Outcomes

At the end of this session you should be able to explain both the conditions under which perfectly competitive firms and monopolies operate, and the choices about output and pricing that they will make. You should be able to use this knowledge to analyse simple problems in the analysis of competitive and monopolistic markets.

## **Session 4: Pricing Decisions**

### Objectives

In real world markets, most firms have some market power (for example, deriving from brand recognition and loyalty, or locational advantages), sell more than one product, and are not constrained to adopt a single price point in respect of all customers. In this session we develop an understanding of the most common pricing practices that result from the assumptions of perfect competition, including bundling and price discrimination, and explore more complex cost concepts associated with these.

### Reading

The chapter from Png provides the core information for this session. The section from Milgrom and Roberts provides an interesting extension relating to pricing within firms.

### Outcomes

At the end of this session you should understand the rationale for bundling, price discrimination and multipart tariffs. You should be able apply this knowledge to the analysis of pricing strategies commonly observed in real world markets (pricing of airline seats, pricing where more than one product is purchased from the firm, pricing of entry to a facility separate from consumption while inside the facility).

## **Session 5: Bounded Rationality**

### Objectives

This session is the first of three in which we examine the economic analysis of decision-making related especially to contracts and strategy. We consider the limits to human rationality, the problem of imperfect information, and the potential for opportunism created by imperfect information. We examine market responses to imperfect information using as examples the market for used cars and the market for insurance.

### Reading

The chapter from Milgrom and Roberts provides all of the necessary information for this session.

### Outcomes

At the end of this session you should be able to explain the problems for contracting created by bounded rationality and imperfect information, as well as being able to identify and analyse real world responses to these problems.

## **Session 6: Moral Hazard and Adverse Selection**

### Objectives

This session builds on our discussion of bounded rationality by considering strategic use of private and imperfect information on the part of parties to a contract. In particular, we consider the incentive effects of the terms of contracts using the concepts of moral hazard and adverse selection as a framework for analysis.

### Reading

The chapter from Milgrom and Roberts provides the basic information, while the paper by Evans and Quigley provides an analysis of the incentives and potential for opportunism created an interconnection contract between two telecommunications companies.

### Outcomes

At the end of this session you should be able to distinguish between moral hazard and adverse selection, and to use these concepts in the analysis of the terms of contracts. You should also understand the complex incentive effects associated with the terms negotiated in contracts.

## **Session 7 and Session 8: Economics of Strategy**

### Objectives

This session builds on our discussion of bounded rationality by considering strategic use of private and imperfect information on the part of parties to a contract. In particular, we consider the incentive effects of the terms of contracts using the concepts of moral hazard and adverse selection as a framework for analysis.

### Reading

The chapter from Milgrom and Roberts provides the basic information, while the paper by Evans and Quigley provides an analysis of the incentives and potential for opportunism created an interconnection contract between two telecommunications companies. The Chapters from Dixit provide extensions on the theory of strategy and applications.

### Outcomes

At the end of this session you should be able to distinguish between moral hazard and adverse selection, and to use these concepts in the analysis of the terms of contracts. You should also understand the complex incentive effects associated with the terms negotiated in contracts.

## **Session 9: Competition Policy**

### Objectives

Hong Kong is unusual in that it is perhaps the only developed economy without a competition law. In other countries, and in relation to mergers that cross the borders of Hong Kong, business strategy is constrained by competition laws designed to limit the use of monopoly power, limit collusion that harms consumers, and limit actions designed to harm competitors. In this session we review competition laws and their implementation, focussing on those in the US which have a broad similarity with the competition policies of other countries.

### Reading

The chapter from Carlton and Perloff provides an excellent review of issues with applications to the US.

### Outcomes

At the end of this session you should be able to identify those business strategies that may be constrained by competition laws in other countries, understand the analysis that competition regulators use to assess the existence or otherwise of harm to consumers, and identify basic strategies that allow compliance with competition law.

## **Session 10: Regulation**

### Objectives

Most countries use industry-specific regulation to constrain the actions of private firms who operate in markets where they have no effective competition. Traditionally, many countries either maintained state ownership of such firms or followed the US model of imposing “rate of return” regulation on private firms who may have been granted explicit monopoly franchises. We will review this approach to regulation, and compare it with the incentive (price cap) regulation that has been implemented in many countries more recently.

### Reading

The chapter from Png provides a review of the basic issues in regulatory economics.

### Outcomes

At the end of this session you should be able to distinguish between rate of return and incentive regulation and price cap regulation, understand the implications for the managers of firms operating under these regimes, and identify simple strategies to maximise profits when subject to these regimes.

## **Session 11: Governance and Financial Structure**

### Objectives

This session develops a more general framework for the analysis of principal-agent problems between owners and managers in firms. We will discuss governance reforms in Western countries in the aftermath of the collapse of Enron, and contrast these issues with those relevant to firms in China and other parts of Asia. We will discuss capital structure to the extent that it bears on principal-agent problems.

### Reading

The paper by Allaire and Firsirotu provides a discussion and critique of current debates about governance in Western countries. Our discussion of governance issues in Asia will draw on Faccio et al, and Li (session 1). Issues on capital structure are covered in Milgrom and Roberts Chapter 15.

### Outcomes

At the end of this session you should be able to explain the contribution of economic analysis to contemporary debates about governance in the West and in Asia, and use this knowledge to explain the fundamental governance problems confronting investors in firms. You should also be able to explain how different capital structures for the firm influence the incentives of management.

## **Session 12: Internal Labour Markets**

### Objectives

This session considers the choice between hiring from inside the firm (internal labour markets) and hiring from outside the firm. It examines the structure of internal labour markets, and the position of CEO as the ultimate prize in the tournaments that comprise competition for promotion within the firm.

### Reading

The chapters from Milgrom and Roberts provide the basic information for this session.

### Outcomes

At the end of this session you should be able to explain the incentives created by different structures commonly found in the internal labour markets of firms, including management hierarchies, tournaments, and tenure rules. You should also be able to explain the incentive effects of both the structure and total value of CEO remuneration packages.

### **Final Examination:**

17<sup>th</sup> December 2006 (3:00-6:00pm)

3 hours – Closed Book

3 Essay-style answers chosen from 10 questions

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