Instructor: Aaron Meininger
  - Email: ameining@ucsc.edu
  - Office hour: 2:30–4:45 pm Wednesday in E2 405G

TA: Aadil Nakhoda
  - Email: anakhoda@ucsc.edu
  - Office hour: Wednesday 3ish-5
  - Sections: TBA (soon, for next week!)

Class website: TBA
Managerial Economics and Business Strategy by Michael R. Baye

- 6/e is the main text
- 5/e is also acceptable but the difference in end-of-chapter exercises should be noted
Syllabus— Course Requirement

- Case studies/Participation— 20%

- Preliminary discussions on Mondays
- Case discussion on Wednesdays
- Cold calling first and floor discussion later
- Practice at the end of this lecture
- Quizzes— 30%
  - On the last day of every week
  - One hour long
  - Only the three highest scores counted
  - Similar to sample questions posted on class website on Wednesday
- TA sections will devote to the discussion of samples
Syllabus— Course Requirement

▶ Case studies/Participation— 20%
   ▶ Preliminary discussions on Mondays
   ▶ Case discussion on Wednesdays
   ▶ Cold calling first and floor discussion later
   ▶ Practice at the end of this lecture

▶ Quizzes— 30%

On the last day of every week
One hour long
Only the three highest scores counted
Similar to sample questions posted on class website on Wednesday
TA sections will devote to the discussion of samples
Syllabus— Course Requirement

- **Case studies/Participation**— 20%
  - Preliminary discussions on Mondays
  - Case discussion on Wednesdays
  - Cold calling first and floor discussion later
  - Practice at the end of this lecture

- **Quizzes**— 30%
  - On the last day of every week
  - One hour long
  - Only the three highest scores counted
  - Similar to sample questions posted on class website on Wednesday
  - TA sections will devote to the discussion of samples
Final exam— 30%

Comprehensive

Similar to quizzes

Business Analysis Project (BAP)— 20%

Use economics tools to analyze real-world business situations

3–5 people per group

Submit project proposal on July 6 (Monday)

Present on July 20 (Monday)

Wild card

Anonymous vote after presentation

Winners' grades automatically get raised by one letter grade
Syllabus— Course Requirement Cont’d

- Final exam— 30%
  - On the last day of instruction (July 22, Wednesday)
  - Comprehensive
  - Similar to quizzes

- Business Analysis Project (BAP)— 20%
  - Use economics tools to analyze real-world business situations
  - 3–5 people per group
  - Submit project proposal on July 6 (Monday)
  - Present on July 20 (Monday)

- Wild card
  - Anonymous vote after presentation
  - Winners’ grades automatically get raised by one letter grade
Final exam— 30%
  - On the last day of instruction (July 22, Wednesday)
  - Comprehensive
  - Similar to quizzes

Business Analysis Project (BAP)— 20%
  - Use economics tools to analyze real-world business situations
  - 3–5 people per group
  - Submit project proposal on July 6 (Monday)
  - Present on July 20 (Monday)
  - Wild card
Final exam— 30%
  ▶ On the last day of instruction (July 22, Wednesday)
  ▶ Comprehensive
  ▶ Similar to quizzes

Business Analysis Project (BAP)— 20%
  ▶ Use economics tools to analyze real-world business situations
  ▶ 3–5 people per group
  ▶ Submit project proposal on July 6 (Monday)
  ▶ Present on July 20 (Monday)
  ▶ Wild card
    ▶ Anonymous vote after presentation
    ▶ Winners’ grades automatically get raised by one letter grade
My Short Bio

- 2005 BA in Economics, Sonoma State University
- 2007 MA in International Economics, University of California, Santa Cruz
- 2005–2011 Ph.D. in International Economics, University of California, Santa Cruz
Class Participation Exercise— Sunk Cost I

- Sunk cost— A cost that is forever lost after it has been paid. It should not be considered when making a decision.
Class Participation Exercise— Sunk Cost I

- Sunk cost— A cost that is forever lost after it has been paid. It should not be considered when making a decision.
- Example 1— Driving from Santa Cruz to San Francisco

101/sunk.jpg
Class Participation Exercise— Sunk Cost II

- 11/19/2007 *New York Times*— United Rentals sued Cerberus Capital Management on Monday over the private equity firm’s cancellation of a $4 billion buyout of the company. The lawsuit, filed in Delaware’s Court of Chancery, seeks to force Cerberus to complete the deal and could test the use of breakup fees as a way to cancel merger agreements......
Class Participation Exercise— Sunk Cost II

- 11/19/2007 New York Times— United Rentals sued Cerberus Capital Management on Monday over the private equity firm’s cancellation of a $4 billion buyout of the company. The lawsuit, filed in Delaware’s Court of Chancery, seeks to force Cerberus to complete the deal and could test the use of breakup fees as a way to cancel merger agreements......
Class Participation Exercise— Sunk Cost II

11/19/2007 New York Times— United Rentals sued Cerberus Capital Management on Monday over the private equity firm’s cancellation of a $4 billion buyout of the company. The lawsuit, filed in Delaware’s Court of Chancery, seeks to force Cerberus to complete the deal and could test the use of breakup fees as a way to cancel merger agreements...... Last week, Cerberus declared that it would walk away from the deal it struck in July. Oddly enough, it said it was not declaring a material adverse change in the rental equipment provider, a magic legal phrase that would let it end the deal without penalty. Instead, Cerberus said it would pay the $100 million breakup fee.
New York Times— United Rentals sued Cerberus Capital Management on Monday over the private equity firm’s cancellation of a $4 billion buyout of the company. The lawsuit, filed in Delaware’s Court of Chancery, seeks to force Cerberus to complete the deal and could test the use of breakup fees as a way to cancel merger agreements. Last week, Cerberus declared that it would walk away from the deal it struck in July. Oddly enough, it said it was not declaring a material adverse change in the rental equipment provider, a magic legal phrase that would let it end the deal without penalty. Instead, Cerberus said it would pay the $100 million breakup fee.

The Wall Street Journal— Cerberus’ victory in its court battle with United Rentals Inc. today means the buyout firm gets to walk away from a deal that could have cost it as much as $1.5 billion — on paper anyway. That is the difference between what Cerberus agreed to pay for United Rentals and what the value of the equipment-rental firm fell to after news spread that a judge will not force Cerberus to complete the deal.
Class Participation Exercise— Sunk Cost III

Should the U.S. withdraw troops from the Middle East?
Definition of Managerial Economics

The study of how the manager directs scarce resources in the way that most efficiently achieves a managerial goal.

- The manager
- Scarce resources
- A managerial goal
Effective Management

- Identify goals and constraints
Effective Management

- Identify goals and constraints
- Recognize the nature and importance of profits
Effective Management

- Identify goals and constraints
- Recognize the nature and importance of profits
- Understand incentives
Effective Management

- Identify goals and constraints
- Recognize the nature and importance of profits
- Understand incentives
- Understand markets
Effective Management

- Identify goals and constraints
- Recognize the nature and importance of profits
- Understand incentives
- Understand markets
- Recognize the time value of money
Effective Management

- Identify goals and constraints
- Recognize the nature and importance of profits
- Understand incentives
- Understand markets
- Recognize the time value of money
- Use marginal analysis
Identify Goals and Constraints

- Different goals entail different decisions
- What is the goal of a for-profit firm?
  - Is money everything?
  - Social responsibilities?
    - Milton Friedman and CALPERS
    - Adam Smith said, "It is not out of the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest."
- Constraints prevent the manager from reaching their goal
Recognize the Nature and Importance of Profits

- Economic versus accounting profits
  - Accounting profits— revenue minus dollar cost
  - Economic profits— revenue minus dollar and/or opportunity cost
    - Nimble Silicon Valley startups vs. Japanese *Shosha*
- Profits signal to resource holders where resources are most highly valued by society
- Michael Porter’s Five Forces
Michael Porter’s Five Forces

- Entry Costs
- Speed of Adjustment
- Sunk Costs
- Economies of Scale
- Network Effects
- Reputation
- Switching Costs
- Government Restraints

Power of Input Suppliers
- Supplier Concentration
- Price/Productivity of Alternative Inputs
- Relationship-Specific Investments
- Supplier Switching Costs
- Government Restraints

Power of Buyers
- Buyer Concentration
- Price/Value of Substitute Products or Services
- Relationship-Specific Investments
- Customer Switching Costs
- Government Restraints

Industry Rivalry
- Concentration
- Price, Quantity, Quality, or Service Competition
- Degree of Differentiation
- Switching Costs
- Timing of Decisions
- Information
- Government Restraints

Substitutes & Complements
- Price/Value of Surrogate Products or Services
- Price/Value of Complementary Products or Services
- Network Effects
- Government Restraints

Sustainable Industry Profits
Understanding Incentives

- People react to incentives
- Principal-agent problem
Understanding Incentives

101/principal-agent problem.jpg

Asymmetric information

P

A

hires

performs

self

interest

self

interest
Understanding Incentives

- Improving Productivity with Light Controls.-Dr. Ian Rowbottom
Understand Markets

- Consumer-producer rivalry
- Consumer-consumer rivalry
- Producer-producer rivalry
- Government and the market
Recognize the Time Value of Money

Present value analysis—
A dollar today is not a dollar tomorrow: \( 1 \times (1 + 5\%) = 1.05 \)

One period: \( FV = PV(1 + i) \)
n periods: \( FV = PV(1 + i)^n \)

Therefore, present value is calculated as \( PV = \frac{FV}{(1+i)^n} \)

General form of present value:
\[
PV = \frac{FV_1}{(1+i)^1} + \frac{FV_2}{(1+i)^2} + \frac{FV_3}{(1+i)^3} + \ldots + \frac{FV_n}{(1+i)^n}
\]

Net present value:
\[
NPV = -C_0 + \frac{FV_1}{(1+i)^1} + \frac{FV_2}{(1+i)^2} + \frac{FV_3}{(1+i)^3} + \ldots + \frac{FV_n}{(1+i)^n}
\]

An example:
Recognize the Time Value of Money

Applications of present value analysis—

- **Perpetuity**: 
  \[ PV = \frac{CF}{(1+i)} + \frac{CF}{(1+i)^2} + \frac{CF}{(1+i)^3} + \ldots = \frac{CF}{i}. \]
  - Real-world perpetuity

- **Firm valuation**: 
  \[ PV_{firm} = \pi_0 + \frac{\pi_1}{(1+i)} + \frac{\pi_2}{(1+i)^2} + \ldots \]
  - with constant profit growth:
    \[ PV_{firm} = \pi_0 + \frac{\pi_0(1+g)}{(1+i)} + \frac{\pi_0(1+g)^2}{(1+i)^2} + \ldots = \pi_0 \frac{1+i}{i-g} \]
  - An example:
Use Marginal Analysis

No. 1 rule in Managerial Economics (maybe in life as well)—marginal benefits = marginal costs
Homework Assignment 1

- Conceptual and Computational Questions
Homework Assignment 1

- Conceptual and Computational Questions
  - 2, 3, 5, 6, 8

Problems and Applications
- 10, 12, 15, 17, 20
Homework Assignment 1

- Conceptual and Computational Questions
  - 2, 3, 5, 6, 8
- Problems and Applications
Homework Assignment 1

- Conceptual and Computational Questions
  - 2, 3, 5, 6, 8
- Problems and Applications
  - 10, 12, 15, 17, 20
THATS IT!!!

Have a great day!