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Lecture One - Introduction

1. **What is a manager (in terms of this subject)?**
   Someone who makes decisions for the firm

2. **What are the three views of what a firm is?**
   1. The neoclassical view of the firm is that it is a black box that efficiently transforms inputs into outputs.
      - In this view managerial labor is just one input like any other.
   2. In 1937 Ronald Coase suggested that a firm can be understood as a bundle of transactions that would have higher *transaction costs* if they were mediated by markets.
      - Imagine an assembly line worker who buys each input from her predecessor and sells each output to her successor.
   3. A more recent view is that a firm is a bundle of assets that are efficiently jointly owned

3. **What are four aspects of the transactions cost theory?**
   - A firm must manage its boundaries
     - Make or buy
     - Factor's that determine a product line
     - Strategic orientation - surviving indefinitely, folding at a certain date, flirting with bankruptcy by taking big risks
   - Firms interact with each other
     - Cooperative
     - Adversarial
     - Game Theory is an analytical tool for grasping insights to navigate interactions
   - A firm has some (limited) ability to commit to future behaviour

- The stakeholders (shareholders, employees, managers, customers) of the firm have divergent interests, and interact strategically

What are the key ideas of managerial economics?

- Incentives matter (most of the time)
- Decision makers are (mostly) rational: stable and well-defined preferences and/or goals
- Prices provide correct signals of relative scarcities
- Optimal decisions take into account the environment: customers, suppliers, competitors and complementors
- Information and beliefs are relevant

What are the key tools of managerial economics?

- "Mathematical" models of consumer and firm behaviour
- Competition models: perfect competition, oligopolistic competition, monopoly
- Game theory: strategic interaction among players (consumers, firms, regulators, providers)
- Models of decision theory under uncertainty or incomplete information

Individual decision-making

What are the fundamentals of decision-making?

- Rational decision-makers: optimising agents with stable, well-defined preferences and goals
- Constraints: environment determines what is or isn't feasible (affordability/feasibility)
- Information: decisions under complete or incomplete information (expected profit)
- Time: static or dynamic decision
- Strategic interaction: among different players (other firms, government policies)

What is the decision-tree?

- Tool used to frame the decision process as an optimization problem
- Nodes for new available information
    - Decision node
    - Chance node
- Branches represent available alternatives
- Final nodes describe payoffs

How do decision trees help?

Decision trees provide a systematic way of organizing an expected profit calculation.

- This is convenient and thus helpful, but purely as a method of calculation, rather trivial.

In any actual business situation, reality will be more complex than the decision tree.

- Expressing the problem as a decision tree forces us to write down a precise model of our thinking.
- In this way underlying assumptions become explicit, and thus open to criticism and improvement.
- This sort of analysis identifies which factors deserve more research, and which can be ignored.

How does using decision trees simplify analysis?

By allowing us to focus on the factors that are truly important.

- If it is apparent that one action would lead to a lower expected payoff than another *no matter what*, then it is not necessary to analyse that part of the tree in detail