

Theory, Applications, and Cases

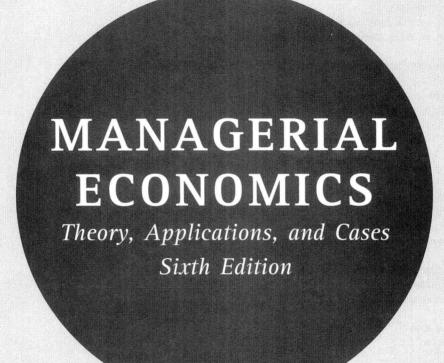
SIXTH EDITION

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EDWIN MANSFIELD





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Dedication:

To Edwin Mansfield, a pioneer of managerial economics

MANAGERIAL ECONOMICS

Theory, Applications, and Cases, Sixth Edition Edwin Mansfield, W. Bruce Allen, Neil A. Doherty, and Keith Weigelt

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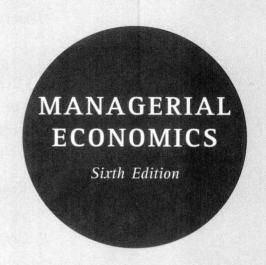
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character made famous by Lewis Carroll is used by biologists to show why progress is a relative measure. Alice encountered the Red Queen in *Through the Looking Glass*. Though the Queen is a model of perpetual motion, she travels hardly any distance because her world travels with her. This idea of relative change is hardly confined to the fantasies of Carroll or the world of biology. In 1903, traffic traveled through central London at an average of 12 mph. The leisurely pace was largely determined by the physical limits of horses. Over the succeeding 100 years, man developed the internal combustion engine to overcome the physical limits of horses. However, traffic in central London in 2003 only averaged 9 mph. The increased speed of transportation was offset by the increase in traffic congestion. Progress is indeed relative.

The relativity of progress also exists between textbooks and the subjects they cover. For, unless a textbook stays ahead of the changes in a complex world, a revision doesn't necessarily equal progress. We believe that this sixth edition of *Managerial Economics* represents progress. By taking into account the latest changes in the business world, this edition will better prepare our readers for their future managerial tasks. As stated in the fifth edition, our goal in making changes is to better integrate the Mansfield tradition within the changing business world. We see five mainstays of this tradition:

- 1. To tightly couple practice to theory.
- 2. To use formal analysis.
- 3. To use mathematics as a tool, not an end.
- To update materials to remain current with the changing business landscape.
- 5. To listen and learn from the experiences of readers and instructors.

The three of us teach the Managerial Economics course at The Wharton School. It is required for most MBA students, taken in their first-semester. Our charge is to develop a class to help students transfer economic principles to the business world. We find to do so requires us to accomplish several goals. It is these goals that have guided our revisions for this sixth edition. The first goal is to establish economics as a decision-making framework. We need to get students to see past the equations and graphs and understand why, as managers, they want to follow its general precepts. For example, the precepts of marginal analysis or backward induction. Secondly, we want to establish the integrative nature of economics. Economic models permeate all business disciplines. Thirdly, we want to accomplish the above without sacrificing the formal analysis that underlies rational choice. For without it, knowledge is speculative. The objectivity of mathematics brings focus to a business discussion. After all, most managers realize that demand should increase if prices drop, but fewer are able to quantify the sales increase. We want to produce managers who could do the latter. Our final goal is to acknowledge that at times managers can be boundedly rational. We wanted to show students how boundedly rational managers might act, and help them to understand how behavior is affected.

As they did in the fifth edition, these four goals guided our revisions in this edition. It is not so much that economic principles change, rather change is manifested in how managers apply the principles. As the business world becomes more global, complex, and competitive, managers need to use more sophisticated decision-making models. Providing managers with these models, and the ability to apply them to the real world, was a primary goal in our revision efforts.

As we explain below, most of the changes in the sixth edition reflect our desire to give readers the ability to make better decisions in today's complex business world. The book reflects this desire in both content and organization. New content has been added to better reflect developments in the business world. For instance, the game theory chapter is entirely new and illustrates important strategic principles managers need to follow. Also, our treatment of pricing has been expanded and re-organized. The following are the major additions and changes made to the sixth edition:

1. New Content-In the fifth edition we added two new chapters to reflect our shift to treating economics as a model of managerial decision-making. The

two chapters were on auctions and moral hazard, especially as applied to principal-agent issues. We continue that path in this sixth edition with six chapters of essentially new material.

Chapter 14-Game Theory This chapter has been re-written and updated. Game theory is explained more in terms of behavioral principles. For example, dominant strategy and backward induction. We show how issues like reputation-building, credible signals, and repeated games can change managerial behavior. As we explain the various concepts, all our game examples follow the interaction between two rivals-Allied and Barkley. We show how game models can reflect the added complexity of the real world. Chapter 18-Adverse selection This chapter is entirely new material and should be thought of as a companion to our chapter on moral hazard. Adverse selection and moral hazard are two sides of the same coin. Adverse selection is more focused on "hidden" information, while moral hazard is focused on "hidden" actions. But, they share behavioral principles that lead to similar actions. For example, they both recommend that incentive schemes can alter managerial behavior.

The remaining four chapters examine managerial pricing under different market structures. All chapters give a more comprehensive treatment of the optimal pricing options, conditional on market structure. We also changed the logical flow of introducing options to better reflect our understanding of economic models and behavior. We feel these changes will make it easier for students to understand how market structure changes impact managerial decisions.

Chapter 10-Pure Competition This chapter looks at managerial actions in a perfectly competitive market. It covers such topics as pricing where marginal cost is equal to price, average and marginal cost curves, producer surplus, the market's social welfare and long run market equilibrium.

Chapter 11-Monopoly and Monopolistic Competition This chapter examines managerial decisions in markets characterized by either a monopoly or monopolistic competition. It covers such topics as pricing and output decisions in a monopoly, the use of cost plus pricing, the output of multiproduct firms, the pricing of joint products, the use of advertising, and pricing and output decisions in a monopolistic competitive market.

Chapter 12-Sophisticated Pricing This chapter examines the managerial use of sophisticated pricing schemes. It covers three pricing schemesbundling, two-part tariffs, and price discrimination. Each of these schemes is being seen with greater frequency in many different markets. We show how and why these pricing schemes work. We also look at pricing within the firm by examining transfer pricing options.

Chapter 13-Oligopoly Pricing This chapter looks at managerial decisions in oligopolistic markets. It covers such topics as Cournot and Stackelberg pricing, and dominant price leaders.

- 2. New Cases and Applications This textbook has long been viewed as the best expression of Edwin Mansfield's special talents as an economist and business consultant. As one who spent a great deal of time applying microeconomics in the business world, Professor Mansfield believed deeply in the power of example. For the Fifth Edition we introduced ten new cases. In the Sixth Edition we introduce over two dozen additional cases. The cases are consistently interwoven into the main body of the text, and they also appear in a variety of boxed inserts. Every step of the way, students are presented with economic ideas and their applications, and real instances when the ideas at hand have been critical to solving managerial problems. More than one hundred cases and applications appear in the book (see the endpapers). New or significantly revised cases in this edition include:
 - The Yankees Buy A-Rod's Contract
 - Paying for Early SAT Scores
 - · Textbook Prices: At home and Overseas
 - · Variable Pricing for Baseball Tickets
 - Therma-Stent and Cost-Plus Pricing
 - · Printers and Product Tying
 - Personal Seat Licenses and Sports Teams
 - · New Yorker Magazine and Bundling
 - · AT&T and Bundling
 - · Wal-Mart and Home Depot
 - Seagoing Chemical Haulers
 - Drug Sales
 - Disposable Syringes
 - Genetic Testing
 - Shell Oil
 - Information Technology and Productivity
 - Airbus
- 3. The E-Media Package which addresses the desire of the business student and the need of the business instructor to integrate electronic media into the curriculum. The Sixth Edition comes complete with a powerful group of electronic ancillaries, including the student website and PowerPoint slides, all of which are detailed below.
 - Spreadsheet Exercises Over 40 spreadsheet exercises, several new to this
 edition, have been written by Stephen Erfle of Dickinson College. Some
 of the exercises are tutorial in nature, designed to help the student work
 through various principles and models. Others are designed as labs, suitable for use as homework problems.
 - Economics News Service Every week an article from a major newspaper is posted on the site, along with annotation and questions connect-

ing the article back to specific chapters in the book. This helps the student see that the principles they learn in *Managerial Economics*, 6th Edition are manifested in the news stories they encounter every day.

- Review Quizzes Multiple-choice questions for every chapter offer the student a chance to check their understanding of the chapter they just read. The results of these quizzes can be emailed to the instructor, enabling the instructor to assign them as a homework assignment.
- PowerPoint Slides All figures in the textbook will be reproduced for PowerPoint and available for download from the book's Internet site.

ANCILLARIES

Study Guide and Casebook This popular supplement includes eight full-length case studies in which students become the managers, tackling practical problems with real data and economic analysis.

Instructor's Manual and Test-Item File This IM-TIF includes suggestions for lectures and discussion topics as well as exam questions. It is available in print and digital form, and the test bank is also available as a CTIF. Revised by Kathryn Nantz of Fairfield University.



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