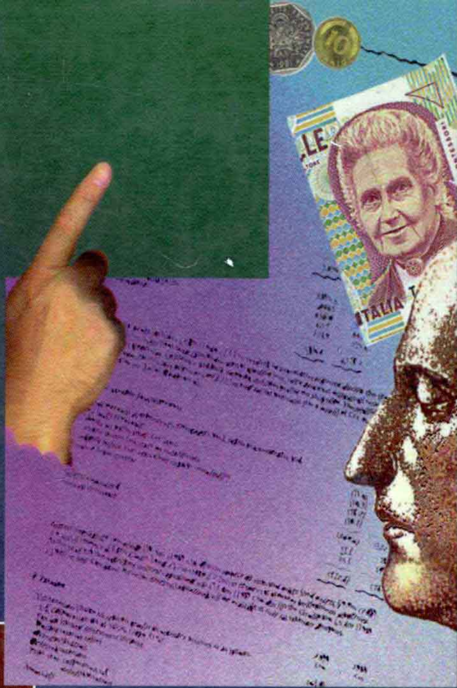
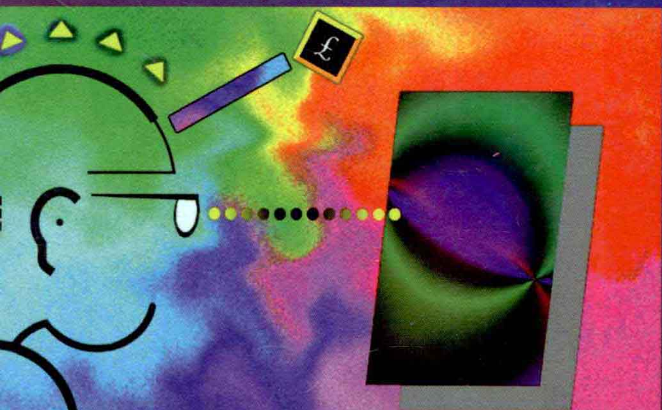
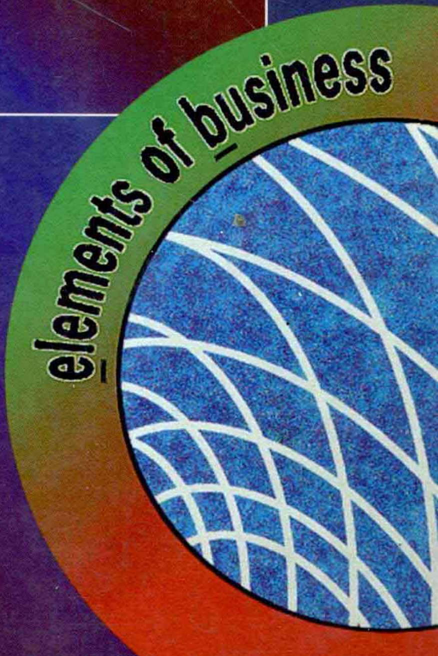
BUSINESS ECONOMICS

concepts and cases

M.S. Greenwood
and M.J. Carter







INTERNATIONAL
THOMSON
BUSINESS PRESS

Business Economics Concepts and Cases

M. S. Greenwood and M. J. Carter

INTERNATIONAL THOMSON BUSINESS PRESS
I(T)P® An International Thomson Publishing Company

London • Bonn • Boston • Johannesburg • Madrid • Melbourne • Mexico City • New York • Paris
Singapore • Tokyo • Toronto • Albany, NY • Belmont, CA • Cincinnati, OH • Detroit, MI

Business Economics: Concepts and Cases

First published by International Thomson Business Press

I(T)P® A division of International Thomson Publishing Inc.
The ITP logo is a trademark under licence

British Library Cataloguing-in-Publication Data
A catalogue record for this book is available from the British Library

---

First edition 1997

Typeset by LaserScript, Mitcham, Surrey

Printed in the UK by T.J. International, Padstow, Cornwall

ISBN 1-86152-048-4

International Thomson Business Press
Berkshire House
168–173 High Holborn
London WC1V 7AA
UK

International Thomson Business Press
20 Park Plaza
13th Floor
Boston MA 02116
USA

http://www.itbp.com

Introduction
Routes through this book

'It was nothing to me but a lot of unintelligible graphs, which I didn't understand then and I still don't understand'. This was the comment of a young relative, a practising surveyor, who had been educated at one of England's leading polytechnics. Economics was no more than a difficult hurdle to be crossed before she could go on to the really interesting stuff. Perhaps she might have found her present task, with her husband, of building a private practice in times which are extremely difficult for the construction industry, a little easier if her economics course had been more meaningfully presented.

Over 100 universities in the UK are in most cases offering courses in management, either at undergraduate level, MBA level, or both. In most cases they include a compulsory core course in economics. I suspect that many of these courses are seen by the students in much the same light as my young relative describes. The sad thing is that this need not be so.

Economics for management courses have traditionally been one full year in duration and little different from any other first year economics course in other social science degree frameworks. They are usually delivered through lectures supported by one of a handful of very successful textbooks which have been in use for many years both in university and for A level economics courses for at least the brighter candidates. The course usually also requires attendance at tutorial classes, which tend to be didactic and unfocused, degenerating into an interpretation of the week's lecture through what amounts to another mini-lecture. The role of the student tends to be passive. Assessment is usually by sudden death examination using conventional essay questions, possibly supplemented by multiple choice tests, or possibly data response questions.

The content of such courses tends to centre on a corpus of theoretical propositions and models, which purport to explain events in the real world of microeconomy and macroeconomy. Little attempt is made to provide any historical underpinning, or any account of the realities of economic behaviour – unless the course requires a second programme of 'applied' economics to be studied.

A further structural change in universities is gaining momentum. This is the switch to a combination of semesters and modular courses. Two semesters replace the traditional three terms, and courses are structured in half-year 'modules' rather than full-year courses. In many cases this may mean that an economics course originally scheduled for a full year of thirty weeks, is now to be delivered within twelve weeks, and examined after fourteen weeks, along with a couple more foundation modules. This is rather hard on young students, who are still adjusting to all the problems of finding and settling into student accommodation, making friends and undergoing all the tribulations of establishing themselves as independent young adults.

Last year I took over responsibility for the economics foundation course for 250 undergraduates, most of whom were on business and management programmes, together with sixty or so who were studying computers and management, pharmacy and management or maths and management. Less than half had an A level in economics. The course was already published, and could not be changed. It took the form of twelve weeks, covering the essentials of both microeconomic and macroeconomic theory, using a well-known standard introductory text (of 500 pages plus). Despite our best efforts, fear and confusion were the order of the day, and I swore that I would not deliver such an unwieldy and indigestible course again.

When the ordeal was over, my colleague, Martin Carter and I decided to sit down and reinvent the course from the ground up. We asked ourselves two questions: what economics does a management student need to know in order to be able to function well as a manager? How should we deliver such a course in a way which will foster genuine understanding, develop useful skills, and above all be an enjoyable experience? This book has developed out of our efforts to answer these questions. We hope that it will help hard-pressed teachers of business and management students in university, school, and further education college, to reinvent their own courses, with our customers, the students, firmly in mind.

It may be helpful at this point to explain something of the logic behind the book and its relationship to course development. The first, and most difficult decision we had to make was (given the constraint of a twelve-week course), should we concentrate on microeconomics or macroeconomics, or even attempt to do both as in the old course? There is in our view a case for either micro or macro, but not both. We decided that the students would eventually have to operate in a market-based economy, and that they would above all need to understand the behaviour of economic agents in the market-place, both individual consumers and firms. In our university it is possible for the student to go on to elective courses in the second year in either industrial economics, or macroeconomics policy. Our decision, therefore, was to focus on the microeconomics of business but to put in two lectures, and one tutorial as a 'taster', on the basic background of the UK economy over the last twenty years.

The second important decision we took was that the course should be proactive, engaging the students in an active attempt to understand and apply economic concepts, models and theories to real world situations. This resulted in a change in emphasis. The lecture became a means of introducing key concepts and, hopefully, inspiring interest. Tutorials were to be the focal point of the course. We set out to ensure that each week the students were engaged in some activity relating to case material provided by us a week in advance. This helped us to overcome the serious limitations of good teaching practice imposed by the growth of numbers to twenty plus in each class. For at least part of every tutorial the students worked in small syndicates of four or five students. The tutor was thus able to circulate, enabling him to identify students who were in difficulty, and give them help then, or arrange to do so privately later. As an overarching exercise to develop personal skills (of research, teamwork, presentational skills) the syndicates were given a major case study after five weeks or so, on which they were to make a brief presentation in the last tutorial.

The next question was what areas of economics were essential if the students were to develop an ability to think logically as an economist would about matters of business strategy in the modern economy? We decided that these could be reduced to an amount which would be digestible in such a short course in the following areas:

- The basic economic problem of scarcity, choice and allocation.
- The alternatives of market and planned allocation.
- The price mechanism as the basis of a free market system.
- The spectrum of models of the firm in perfect competition, oligopoly and monopoly.
- The Porter schema of structure, conduct and performance as a method of analysing business situations.
- A brief overview of the macroeconomy and its key variables over the last twenty years.

We were determined that our students should understand this limited range of economic theory and be able to apply it to strategic business analysis, rather than simply learn undigested theory by rote as most of their predecessors had done. We hoped by devising suitable tasks to turn the models into something more than 'unintelligible graphs'. Beyond that we also wanted them to lose their distaste for, and fear of, numbers. A Cambridge don was once asked by one of my students what he should be able to *do* when he had finished the Economics Tripos. The don replied by taking down from the shelf a copy of the *Annual Abstract of Statistics*, opening it at random, and remarking that he would expect the student to be able to tell the story in words from a glance at the numbers. In a more limited way this is what we hoped to do. We wanted the student to be able to take a set of unfamiliar data, and at least come up with the right questions which needed investigating, and perhaps one or two hypotheses to test by further enquiry. We wanted the students to develop a set of tools, and skills, which would enable them to approach their later studies, in marketing, financial analysis, production management and business strategy, in a more confident and logical way.

In our view a foundation course is as much about developing a particular mindset, and set of skills as about acquiring quantities of knowledge. If the reader feels some empathy with our objectives, then this book may be a useful starting-point in the process of developing a course suited to the particular needs of groups of student, be they at A level, undergraduate level or MBA level.

If the focus of the course was to be on a sequence of proactive tutorials, then suitable materials were needed on which to hang the activities. The course covered what we felt was feasible in a series of twelve tutorials. In the book we have added cases on areas which we would have liked to cover had more time been available. If the reader is fortunate enough to have a full year of, say, twenty-four tutorials to work in, the full set of seventeen cases should be enough to work with. Within our twelve tutorials we had to restrict ourselves to the following plan.

Week 1 is inevitably a 'get to know you' session, but there is time to have at least a brief discussion of the fundamental problem of economics, the allocating of scarce resources, and the advantages and limitations of the approach of the academic economist in developing theoretical models which may have the power to explain and predict in the uncertain and changing world of economic activity. Tutorial 2 (Week 2) happens before they have really got very far on the theory front, and is used as an opportunity to present them with some simple data, from which they are invited to infer the appropriate questions which need further enquiry. We chose to use data relating to the small firm sector since many of the students will in the future work in this sector. It is also an area where rather wild claims are made by politicians on flimsy statistical evidence which is often misused. By Week 3 they have been exposed to some of the theory relating to individual behaviour in markets, and are beginning to be bombarded with seemingly unintelligible graphs. For this reason we developed an exercise which enabled us to reinvent the demand curve, using data which the students themselves generated. In Week 4 we followed a similar line using simple stylized data to develop the basic cost curves which underpin the conventional static theory of the firm. By Week 5 they have been exposed to the full price mechanism model, and are ready to test its predictive power, and weaknesses, by manipulating the model in response to examples of government interference in the operation of markets. By Week 6 the models of oligopoly and monopoly have been demonstrated, and the tutorial is used to examine, on the basis of some given questions, the case of the coffee industry.

The lectures in weeks 7, 8 and 9 set out the Porter schema of structure conduct and performance. This is really the core of our course, relating as it does very strongly to both industrial economic and business policy electives. We used the case of the recent newspaper price wars as an example of an oligopolist apparently breaking ranks and acting irrationally. The plaster-board industry offered an example of the breakdown of an apparently secure monopoly. Price discrimination in the railway industry offered another interesting example of common business strategy which is best explained through economic analysis. Week 10 gave us one opportunity to have an open discussion on the possible importance for the professional manager of macroeconomics. Week 11 was reserved for the syndicates to finish preparation of their presentation cases for delivery in Week 12. This exercise in self-help team skills, presentational skills and independent application of economic theory and concepts, was based on two of the five cases: ICI/Kermara, Reckitt & Colman/Sara Lee, the ice cream industry, the recorded music industry and the photocopier industry. These cases were all based on Monopolies and Mergers Commission (MMC) reports published in recent years, of which only the Introduction/Summary and Conclusion of the two cases are printed here. The full report is usually available in a university library. The coffee and plasterboard cases were based on summaries of MMC material developed by Chris Pass for use in *Business and Microeconomics* (Pass and Lowes, 1994). The other cases included here were written by Martin Carter and myself.

It is our view that the greatest weakness of our course, due to the time constraints, is the failure to develop more thoroughly modern industrial economics theory. In particular we would have liked to introduce game theory, and the economics of total quality management which are generally ignored by foundation level texts, but which in our view are increasingly important. We have therefore included here discussion of these topics in the theory section, and some cases which we have written but not yet had chance to trial with students. We have also included extra cases which we would have liked to include in the more conventional sections. The Lanzaroti restaurants case is one used by the author over many years to attempt to illustrate the operation of that rare beast, a perfect competition market, or at least one as near to it as we are likely to find. It illustrates how such a market would move down the road of greater concentration, despite efforts by the authorities to keep it in its pristine state. For the price discrimination case we are greatly indebted to Dr Robin Sissions, of Bradford Grammar School, who is a member of the NE Region Rail Users' Consultative Council, and knows more about railways than the previous government ever knew.

Just a word about the practicalities of delivery and assessment. Most introductory texts in economics are designed to be used on a full-year course, and are aimed at students who are either at the start of a full economics degree course, or are taking one or two papers in economics within a more widely based social science course. Such texts are not really suitable for our purposes. The course we have set out here is designed to be used with the companion text *Business and Microeconomics* (see above) by Chris Pass and Bryan Lowes, also of Bradford Management Centre. A slightly simpler text for less confident students is *The Microeconomics of Business* by Nellis and Parker. This however does not include the structure conduct performance schema, which we have used as the core of the course. For further reading students should refer to Griffiths and Wall, *Applied Economics* (1997).

Our practice in tutorials is as follows. Case material is issued to students at least one week prior to use. The one-hour tutorial is divided into a maximum of ten minutes introduction, thirty minutes of syndicate activity, usually centred around issued questions or tasks, and twenty minutes minimum of plenary discussion guided by the tutor. Each student syndicate should be asked to start discussion by responding to one of the questions with a very brief statement. Feedback is provided at the end of each chapter to Activities and Case Study Activities in some but not all cases.

Assessment on our course is by a sudden death two-hour examination. Students are required to respond to a compulsory question on the presentation case, plus two from a selection of two data response and six essay questions. Two pieces of non-assessed coursework are set, for diagnostic purposes only. One is an essay question, and the other a data response. The supermarket case was used for the latter this year. We felt that the problems of equity were too great to permit the formal assessment of the presentation case work, which we specifically wanted to provide an endpiece to the term which would be relaxed and fun.

The authors hope that the lecturers will find ways of using this book to improve the quality of their course in economics for business students' at whatever level. If economics is not enjoyable, and useful, we should not be teaching it. We have suggested below some possible routes through this book which might be used for different types of course.

SUGGESTED ROUTES THROUGH THE BOOK

One-semester foundation course

Student cohort: mostly beginners.
Course structure: 10–12 lectures and 10–12 tutorials.

Chapters 1–3	Lecture 1	Tutorial 1 (Case 1)
Chapters 4–5	Lecture 2	Tutorial 2 (Case 2)
Chapter 6	Lecture 3	Tutorial 3 (Case 3 or 4)
Chapter 7	Lecture 4	Tutorial 4 (Case 5)
Chapter 8	Lecture 5	Tutorial 5 (Case 6)
Chapter 9	Lecture 6	Tutorial 6 (Case 7)
Chapter 10	Lecture 7 (Structure)	Tutorial 7 (Case 9)
	Lecture 8 (Conduct)	Tutorial 8 (Case 8)
	Lecture 9 (Performance)	Tutorial 9 (Presentation Case 4)
Chapter 16	Lecture 10 (Review so far)	Tutorial 10 (Review *or* Presentation)
	Lecture 11 (Introduction to Macroeconomics)	Tutorial 11 (Presentation *or* Macro)
	Lecture 12 (Review revision)	Tutorial 12 (Revision workshop)

One-year foundation course

Student cohort: mostly beginners.
Course structure: 20 lectures and 10 tutorials.

Chapter 1	Lecture 1 (Introduce course)	Tutorial 1 (Introduce presentation case Chapter 1)
Chapter 2	Lecture 2 (How to tackle case studies)	
Chapter 3	Lecture 3 (What economists do)	Tutorial 2 (Case 1)
Chapter 4	Lecture 4 (Basic problem)	
Chapter 5	Lecture 5 (The market)	Tutorial 3 (Cases 2 and 3)
Chapter 6	Lecture 6 (Market failure)	
Chapter 7	Lecture 7 (Modelling firms)	Tutorial 4 (Cases 5 and 6)
Chapter 8	Lecture 8 (Market structures)	
Chapter 9	Lecture 9 (Oligopoly)	Tutorial 5 (Cases 7 or 8)
Chapter 10	Lecture 10 (Structure)	
Chapter 10	Lecture 11 (Conduct)	Tutorial 6 (Cases 7 or 8)
Chapter 10	Lecture 12 (Performance)	
Chapter 11	Lecture 13 (Beyond theory of the firm)	Tutorial 7 (Cases 10 and 11)
Chapter 12	Lecture 14 (Growth of firms)	
Chapter 13	Lecture 15 (Game theory)	Tutorial 8 (Cases 12 and 13)
Chapter 13	Lecture 16 (Game theory)	
Chapter 14	Lecture 17 (Economics of TQM)	Tutorial 9 (Cases 14 and 15)
Chapter 15	Lecture 18 (Regulation of market power)	
	Lecture 19 (Review Chaps 1–9)	Tutorial 10 (Presentation Case)
	Lecture 20 (Review Chaps 10–15)	

One-semester. Year 2 Economics of Industry

Student cohort: post-foundation course.
Course structure: 10 lectures and 10 tutorials.

Chapters 4–6	Lecture 1 (Review)	Tutorial 1 (Case 4)
Chapters 5–9	Lecture 2 (Review)	Tutorial 2 (Case 7)
Chapter 10	Lecture 3 (Review)	Tutorial 3 (Cases 8 and 9)
Chapter 11	Lecture 4 (Beyond theory of the firm)	Tutorial 4 (Case 10)
Chapter 12	Lecture 5 (Growth of firms)	Tutorial 5 (Case 11)
Chapter 13	Lecture 6 (Game theory)	Tutorial 6 (Case 12)
Chapter 13	Lecture 7 (Game theory 2)	Tutorial 7 (Case 13)
Chapter 14	Lecture 8 (Economics of TQM)	Tutorial 8 (Case 14)
Chapter 15	Lecture 9 (Regulation of market power)	Tutorial 9 (Case 15)
	Lecture 10 (Review Chaps 11–15)	Tutorial 10 (Presentation Case)

How to tackle case studies

What is a case study?

A case study could be defined in this context as being: *A set of information relating to a business situation, economic context or both, presented in verbal or numerical format, or both, and intended for the use of students to develop or demonstrate analytical, evaluation, decision-making and presentation skills.*

Case material is increasingly used in the assessment and examination process in courses at A level, GNVQ, first degree and MBA levels. In this context it offers an alternative to standard essay-type questions, which test only a limited (if important) range of skills. Case material can be used to test a variety of skills, comprehension, knowledge and understanding of key concepts, analysis through the application of theory, and evaluation of competing perspectives and opinions. It may also be used to test the student's capabilities in oral and written presentation in the report format which is commonly used in business contexts. This contrasts with and complements the essay question which tests the ability to construct a logical and coherent response in continuous prose to a problem put in the form of a question.

A case may fall into one of several broad categories. It may use one or two very short passages from an article or book, or one or two sets of statistical data, presented in tabular or graphical format. Such cases are commonly used in examinations especially at A level as a question to be completed in forty to forty-five minutes. They are intended to enable the student to demonstrate knowledge of a particular section of the syllabus. The questions relating to such cases may be said to elicit either *data response* or *stimulus response*. By data response I mean that they may be answered pretty directly from the material given. In other words they are testing comprehension of the passage. Stimulus response questions use the material given as a starting-point from which the student is intended to infer answers which are based on demonstration of his or her recognition of the parts of the course which bear on the topic, and his or her ability to apply such principles to the material. The questions asked on such case material usually include both types.

Another form of case commonly used in examinations is of fuller length, perhaps a full page of text, or of statistical data. Such cases are presented unseen, i.e. seen for the first time by the student in the examination. They attract the same types of question on a data or stimulus response basis, with the possible addition of a question requiring a response in essay or report format. Cases of this type may take up half of the examination, up to perhaps one and a half hours.

In business examinations, (but not often, as yet, in economics) a longer case may be used as the basis for a whole examination paper of two or three hours duration. This is preseen, i.e. it is issued to the student some time in advance of the examination. It is thus possible for the student to examine every possible application of the theory to this particular case, and to deal with any problems which are inherent in the material.

Cases such as those types described above are commonly used also as teaching vehicles on A level and GNVQ courses, but less commonly and less systematically on university courses. The latter courses are still mostly taught on a traditional pattern of a series of lectures presenting information and theory, backed up by recommended reading and supported by a series of tutorials in which key issues are (supposedly) developed via class discussion, perhaps prompted by either a series of questions posed in advance by the tutor, or on the basis of a brief paper presented by a student. This rather passive model is in our view increasingly inappropriate as a learning experience for students. This is particularly so as tutor groups have grown in size to twenty plus, especially on first year foundation courses. We believe that a strong case can be made for a more proactive approach to teaching. Our external customers, the future employers of the students, require them to have developed certain learning skills which will last a lifetime, rather than have learned specific areas of information which may have a short shelf-life in a fast changing environment.

Students should be enabled to acquire the following life learning skills:

- value curiosity
- plan and organize work/time
- observe objectively
- develop team skills
- develop interpersonal skills
- understand own strengths/weaknesses
- develop self-esteem
- develop communication/listening skills.

If we are to help students develop these skills and characteristics, we need to understand the *process* of learning.

There are basically three learning styles (see Figure P.1). University teaching is still heavily biased towards the first. Every teacher and student has a preferred style, therefore we should attempt to present what we teach in all three styles. We believe that the strongest of the three for permanent learning is the kinaesthetic approach, which we too rarely use in universities. If the student is required to be *active* in his or her learning, he/she is more likely to take *ownership* of what he has learned, grow in self-esteem, and so in confidence. This process may be summed up as in Figure P.2.

Students will hate the first role, and be delighted to move to the second where they may passively accept the tutor's lead. They may be able to move to the third role, where they feel they are working with rather than for the tutor, but will remain dependent on him or her. To move to the fourth role, where students become the instigators and movers in the process and where the tutor becomes the facilitator rather than the director, is a massive and difficult step for many. Once they have been encouraged to take it they will never want to go back.

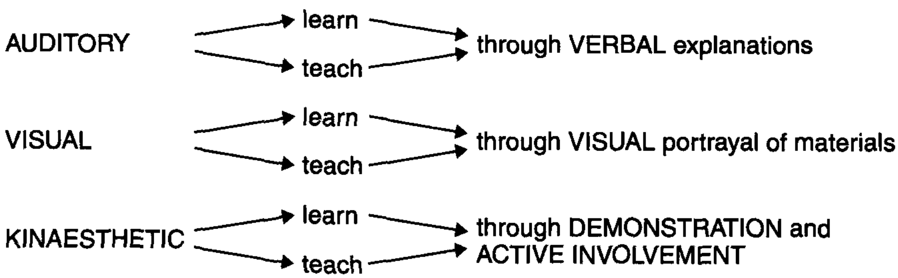


Figure P.1 The three learning styles

MOVING TO A QUALITY CLASSROOM →

Teacher style	Do to	Do for	Do with	Enable
Student role	No choice, captive, antagonistic	Captive, passive, dependent	Dependent, accept, follow	independent investigator, actively seeking knowledge
Student reaction	LET ME OUT	I'M OK	IT'S OK	JOY IN LEARNING

DIRECTION IF INCREASING AUTONOMY →

Figure P.2 The kinaesthetic learning process

Source: After Trybus (1992)

This book is the result of our efforts to move cohorts of undergraduate first year students, and foundation course MBA students along the spectrum of increasing autonomy. We would like now to set out briefly the learning strategy which we have sought to adopt in developing this material.

We suggest a five-stage strategy. This presupposes that the case material is being used for teaching purposes and is pre-issued to the students. In examination conditions the process would have to be truncated and actioned very rapidly.

The emphasis of the teaching process is changed. The tutorial becomes the central focus of the course rather than the lecture, which is used to establish the key principles and theoretical concepts which are being taught, in an outline form which is comprehensible to students with no prior knowledge of the subject. (Those with an A level in economics will find some but not all of the lectures merely rehearse known concepts.) These basic principles are to be followed up and consolidated by the student from an appropriate textbook. All this activity precedes a systematic study of the specific case study which is being used to demonstrate the use of the principles, and which will be dealt with in the following tutorial.

The five-stage strategy comprises:

1 Comprehension: read for understanding, using a dictionary of economics to check out any unfamiliar terms. Check out the method used to present statistical data – what are the strengths/limitations of the method used? Research further information which may throw light on the case by searching literature in the library.
2 Relation to theory: which aspects of economic theory may help in the interpretation of the material. Check understanding of these concepts in textbook/lecture notes.
3 Application of theory/analysis: use appropriate models to process data, or interpret the scenario given in the case. Develop a theoretical analysis of the case. Consider the limitations of this analysis in explaining the case.
4 Prediction: what does the theoretical analysis predict will happen next?
5 Evaluation: make judgements about possible responses; by business in decision-making or by government in policy-making. Making judgements in the light of economic theory of the possible consequences of such decisions.

The process which we have set out here is, of course, what an academic economist does for a living. Thus we are seeking to enable our students to become economists, with a serious contribution to make either to government or corporate decision-making, using the rational approach adopted by the profession. The students will find that this is both much more fun, and much more effective, than simple rote learning certain concepts for regurgitation in examinations, to be immediately forgotten when the examination is over.

Where teaching groups are large, i.e. in excess of twelve students, we find it works better if the students work within the tutorial sessions in permanent syndicates of four or five. This encourages them to operate as a self help group outside the tutorial group itself. The tutor would probably be wise to very quickly rehearse the key principles to be used perhaps for ten to fifteen minutes. The syndicates would then spend thirty minutes working on specific aspects of the case. This gives the tutor time to circulate in order to spend more time with individual students who are finding the work difficult. In the final twenty minutes, the syndicates should very briefly feedback their findings to the whole group, with the tutor drawing out general discussion from the points raised.

We also found it helpful to issue at the end of the tutorial, or the following week, some feedback of information which has stemmed out of the process, including occasional model answers to the questions.

In order to cement the syndicates as self help groups, we have also used an overarching major case study on which the syndicates work for several weeks towards a presentation of their findings in the final tutorial session.

Acknowledgements

We would like to pay tribute to the indefatigable efforts of our team of tutors who helped us to trial much of this material: Roy Rimmington, Keith Brunskill, Kalim Saddique and Kath Watson. Chris Pass and Bryan Lowes, for encouraging us to produce this book as a companion to their *Business and Macroeconomics* text. Kath West of Computerwork Unlimited and Sylvia Ashworth for secretarial help. Not least to our long-suffering students who cheerfully encouraged us in our efforts to make the 'dismal science' fun, and relevant to their needs as management students.

We also owe a debt to the economists, past and present, whose work inspired our efforts, particularly those whose books are listed in the Bibliography.