FINAL EXAMINATION QUESTIONS

Your final examination will be drawn from these questions. Please prepare answers to all of these in preparation for the final.

Questions

1. Why do we call computer software, movies, books, and patented formulas public goods while apples, cars, and homes are called private goods? What is the difference in the market demand for these two different types of goods?

2. There is a strong public opposition to gun control in the U.S. What is the best explanation for this?

3. Public policy has been strongly opposed to monopoly for over a century. However, many economists are generally unconcerned about monopoly. Is monopolization likely to be a serious economic problem? If so, explain when, why, and how government intervention is likely to be helpful. If not, what is likely to be the effect of government intervention?

4. Why is the concept of U-shaped average cost a good characterization of the nature of production within a firm? Why is it empirically relevant?

5. Very few industries (maybe none) exhibit the theoretical conditions of perfect competition. Even so, competition from the fringe seems to be common in most markets. Discuss the competitiveness of the fast-food industry in this light.

6. The terms separation of ownership and control and agency cost are applied to the modern publicly-traded corporation. What are the benefits of the common stock corporation? What are the costs? What are features of the corporate organization that help increase the benefits and reduce the costs? Give as much detail as possible.

7. One of the fundamental theorems of finance is that firms are risk neutral. What is the basis of this argument? What does it imply about the organizational structure of the firm?

8. Under what circumstances does a company go into bankruptcy? Under what circumstances does a firm dissolve and cease doing business? Is it normal for a bankrupt firm to shut down?

9. Non-profit firms such as Harvard University dominate some industries. This is true in education (especially higher education), the arts, hospitals, social groups, and charities. On the other hand, most industries are made up of publicly traded corporations like the Fluor Corporation, Ford Motor Company, and DuPont. What are the characteristics of the non-profit industries that make them different from construction, cars, and chemicals and make the non-profit form of organization efficient? (Who are the "shareholders" in the non-profit firm?)

10. What are the issues involved in the structure of managerial compensation? Are the top managers of large corporations paid too much? How should this be measured? Is their pay efficiently linked to the performance of the firm? How can you tell?
11. Describe the market for corporate control. How do proxy contests work? How do tender offers work? What causes firms to be the object of a takeover?

12. Over the next few years the educational system in the United States will be going through a transformation with the introduction of school vouchers. The voucher system will allow parents to send their children to a school of their choice compared to current system where parents send their children to schools within their school district. This choice by parents will change the educational system. Describe the changes that will take place within the educational system from educational standards, school districts, and individual schools. Specifically, describe the educational industry structure or organizational issues from school administrators at the school district level to school principles at individual schools. Also, discuss the compensation structure of administrators, principals, and teachers. Focus on the economic issues at hand, and be specific in your analysis.

13. Majority rule is one of the fundamental principles of democratic government. In practice, however, narrow special interest groups tend to dominate the political process. Why is this so? Can you suggest and justify any changes in the constitutional rule of the game that would limit the ability of private interests to benefit themselves at the expense of an unwilling majority?

14. In 1987, Sony Corp, a leader in consumer electronics (television, compact disk and audio cassette player, home video recording and playback machines), purchased the CBS Record Company. In 1989, Sony purchased Columbia Pictures Entertainment, on the giants of the movie and TV production industry. In 1990, Matsuushita, the world leader in consumer electronics with its Panasonic, National, and Quasar brands, purchased MCA Corporation, which makes movies, television shows, and music recordings. Why would these companies want to expand into these particular industries? Focus on organizational issues and discuss various managerial issues. Be specific in your analysis.

15. Many franchisors like McDonald’s, Wendy’s, and Burger King own and operate a substantial fraction of their franchise outlets. Explain why the company-owned outlets tend to be larger (measured in terms of gross sales) and to be located closer to the franchisor’s national headquarters than independent franchisees. Also, explain why there is a tendency for the proportion of company-owned retail outlets to decline as the franchisor expands. Finally, why do established firms in recent years seem to be buying back their franchises and reintegrating into a single firm? Be specific in your analysis.

16. Explain why so-called outlet malls are usually located away from major population centers; why the shops in these malls, which sell name-brand merchandise at prices below those charged by department and specialty stores located in more populous areas, are typically owned by the merchandise’s manufacturer; and, most importantly, why the lower price charged by the discount outlets have nothing whatsoever to do with lower costs. Focus on organizational structure and managerial issues, and be specific in your analysis.
17. In an employee-owned firm, the company’s assets are owned jointly by the workers. In a capitalist firm, the company’s assets are owned by the stockholders. The number of owners is usually smaller in the former case than in the latter case, yet the employee-owned firms typically have higher operating costs and lower profits margins than their capitalist counterpart. Explain the difference in the organizational structure between the two enterprises, and be specific in your analysis.

18. In New York City, taxicab operators are required to purchase (at market determined price) and affix prominently to their vehicles a medallion that authorizes them to carry passengers for hire. The number of medallions in circulation is far less than the number of taxis that would operate if no such licensing requirements were in effect. Answer the following questions and be specific in your analysis.
   a. What determines the market price of a taxicab medallion?
   b. What is the effect of the restriction on the number of licenses on the price of taxi service in New York City?
   c. In what sense is it efficient to restrict the number of taxis in New York?

19. Many colleges and universities produce some output and activities using full-time employees while some output and activities are contracted out to private firms. Explain the difference in the organizational structure between the “make” and “buy” activities, and be specific in your analysis.

20. Airline companies often try to allow for passengers who fail to show up for flights by a practice called overbooking, that is, they sell more seats than are actually available on the flight. When all passengers with reservation do show up, it becomes necessary to “bump” some passengers to a later flight. Airline companies commonly offer bonuses to passengers who will volunteer to be bumped. Analyze from an organizational perspective the efficiency of overbooking and offering bonuses to passengers. Why are both the airline and the passengers better off when passengers are compensated for delaying their travel rather than simply bumping the passengers who arrive last? Be specific in your analysis.

21. Recently, in order to better align interest of paving contractors and the motoring public, states and municipalities have begun to allow road construction contracts that contain incentive for early completion and penalties for delays. Should Clemson University implement similar strategy (for instance in the Sirrine Hall project)? How would the contract structure between the parties change if completion targets are included.

22. Explain the effects of manufacturers’ recalling of their products from the market. Specifically, during post-recall, how do consumers, competitors, and the market react to the recalling of the products. Does the issue of fault or no-fault affect the manufacturer? Finally, what actions are undertaken by the manufacturer to restore confidence in the product’s reputation?
23. The buying and selling of babies is illegal. However, couples (either married or unmarried) or eligible singles wishing to have children can adopt. The market for adoption is characterized by the presence of public and state-licensed private agencies that manage the process by with babies and older children are first given up for adoption and then allocated by means of some agency-determined ordering to persons who have paid to the agency a fixed or income-adjusted fee. First, comment on the role of government in regulating in the market for adoption. Second, using theory of contracts, explain some of the potential problems that may arise during pre- and post-contracting period. Also, what remedies or provisions are available that may eliminate or minimize the nature of the problem.

24. Video Only publicly advertises that consumers should shop around and then come to Video Only to buy at the lowest price. How do regular stores with show rooms and displays compete with discount stores that sell the same product for less? What are the contracting issues at hand? Are there any remedies?

25. Commonly, a manufacturer distributes output before knowing demand and thus risks making more than its independent retailers can sell. That is, despite its best forecasting effort, a manufacturer may produce and sell to its independent retailers more output that they can subsequently resell. If retailers anticipate this possibility ex-ante, they reduce the wholesale price they will pay the manufacturer to reflect the decrease in profitability due to surplus merchandise. First, describe the contract structure between the manufacturer and the retailers. Second, what options, if any, does the manufacturer have that minimizes the cost of unsold inventory.

26. Insurance firms, when offering policies to prospective customers, fact two problems. First, the purchase of insurance decreases the incentive of the insured party to engage in activities that reduce the likelihood that a loss occurs. Second, the probability that a loss will occur differs across individuals. These are traditional problems of moral hazard and adverse selection. Discuss the ways in which contract structure can resolve or solve these problems.

27. On the Sixty Minutes TV show of April 8, '01, the columnist, Andy Rooney, argued for a type of "most favored nation" treatment among airline passengers. Specifically, he claimed that all airline passengers should only be charged the price of the lowest paying customer. Contracts similar to this are found in some industries, but not in transportation, communications, or hotels. What would be the effect of forcing airlines to charge the same price to all customers?

28. The claim is that Holstein steers are the only breed sold at auction for veal. (Veal is cow meat that is light in color and especially tender.) Presumably this is because their stomachs bloat immediately when they first eat grass, and grass turns cow meat from veal to red meat. Assume that this is true. How can we know that the Holstein steers bought at auction are slaughtered for veal?
29. Many department stores have a higher number of salespersons available for service in the cosmetics department compared to the clothing or other departments. Why do department stores adopt this strategy? How do you imagine that cosmetic salespeople are paid? Do you think that it is different from salespeople in the other departments?

30. The current electricity crisis in California can be explained using contract theory. Specifically, during the period of government regulation, the electricity utility enjoyed certain privileges set forth in contract between the state government and the utility companies. In 1996, the electricity industry transformed from regulation to competition, and the utility companies entered into contract with the state government under this new environment. Though long-term contracts specify the obligations of the parties for the duration of the agreement, contracts do not attempt to specify all the contingencies and provide provisions to accommodate future uncertainty by stipulating terms for contract renegotiation. First, describe the specifics of the contract terms between the utilities and the state government under competition. Second, what changes took place that caused utilities to not comply with the provisions of the contract. Third, explain how these changes affect the way the utility companies conduct their business or changed their business practices. Fourth, explain how the government has intervened to help resolve the current situation. Focus on the economic issues at hand, and be specific in your analysis.

31. Bundling is a common phenomenon in retailing. In automobile sales, it is often the case that cars without elaborate option packages are simply not available. Options are not an option but a mandatory component of the sale. Another example is season ticket sales for sporting events and theatrical performances. It is most often the case that these examples of bundling occur in the hottest products rather than the goods with lagging consumer interest. Answer the following questions. Be specific and use examples in your analysis. (a) What is the theory explaining the use of bundling by sellers? For instance, next year Clemson plays Cent. Florida, Wofford, Duke, UVa, UNC, and FSU at home. Which of these games are most responsible for the sale of season tickets and why? (b) Why is it that sellers are more likely to adopt bundling in the face of strong rather than weak demand for their product?