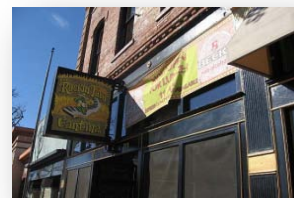


Homework 8 Questions Managerial Economics BA 445

Noise and Other Externalities,
from Lesson 11.6

Question: Consider a downtown Fullerton street on which 8 bars are run, and which suffers from a serious drunkenness problem that detracts customers because of the violence and smell. It costs \$200 daily in foregone profit for each bar to enforce moderation stop serving customers before they become drunk. If a bar owner decides to enforce moderation, all bars on the street will have improved sales and profits. Suppose every bar on the street will have a \$20 increase in daily profit for each bar that decides to enforce moderation. Should anyone enforce moderation? Are there mutual gains from cooperation? If so, can any bar trust other bars to cooperate?



Answer to Question:

Homework 8 Questions Managerial Economics BA 445

Buying Online,
from Lesson 11.7



Question: E-commerce product sales totaled \$146.4 billion in the United States in 2006, representing about 6% of retail product sales in the country. The \$18.3 billion worth of clothes sold online represented about 10% of the domestic market.

Suppose Charlie values 6 shirts at \$30 each, suppose it costs Lands' End \$10 to provide each shirt through an online purchase, and suppose Lands' End sells shirts for \$20 each online. Should Lands' End send the first shirt to Charlie?

- If the first shirt is sent, Charlie faces a decision: steal the shirt and terminate the relationship; or, send \$20 for the first shirt.
- If the first \$20 is sent, Lands' End faces a decision: take the \$20 and terminate the relationship; or, send the second shirt to Charlie.
- If the second shirt is sent, Charlie faces a decision: steal the shirt and terminate the relationship; or, send \$20 for the second shirt.
- If the second \$20 is sent, Lands' End faces a decision: take the \$20 and terminate the relationship; or, send the third shirt to Charlie.
- And so on.
- If the sixth shirt is sent, Charlie faces a decision: steal the shirt and terminate the relationship; or, send \$20 for the sixth shirt.

Are there mutual gains from cooperation? Can Lands' End trust Charlie to cooperate?

Answer to Question:

Homework 8 Questions Managerial Economics BA 445

Repeating Dilemmas,
from Lesson 11.7



Question: Wii video game consoles are made by Nintendo, and some games are produced by third parties, including Sega. The unit cost of a console to Nintendo is \$40, and of a game to Sega is \$5.

Suppose, each month, Nintendo considers prices \$250 and \$350 for consoles, and Sega considers \$40 and \$50 for games. If they choose prices \$250 and \$40 for consoles and games, then demands are 2 and 4 (in millions); if \$250 and \$50, then 1.5 and 3 (in millions); if \$350 and \$40, then 1.5 and 3 (in millions); and if \$350 and \$50, then 1 and 2 (in millions).

How are the two goods related?

What price should Nintendo choose in this pricing game if Nintendo and Sega can set different prices in January and in February and in March? Are there mutual gains from cooperation? If so, can Nintendo trust Sega to cooperate? and can Sega trust Nintendo to cooperate?

Answer to Question: