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Faculty of Economics & Management
INTERNATIONAL MANAGEMENT
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5015 Introduction to Management II (ST 2006) – Final Exam

Examiner: Prof. Dr. Wolff

You will be able to make a maximum of 60 points. There are a few pieces of advice we can offer at this stage:

1. Use the theoretical tools and terminology you have learned in class and from the textbook.
2. Make sure there is a clear structure in your argument. (Use some time to sort your ideas before you start writing the version you want to submit.)
3. Use the time you have! If you are ready much earlier than we planned you should wonder if you forgot something.
4. Remember: people have to be able to decipher what you write.
5. Leave a margin for our comments, so we can give you a more detailed feedback than just the number of points.

Here is the set of problems:

Please solve four (4) of the following six (6) problems (maximum of 15 points per problem):

(You are welcome to use a non-programmable calculator.)

1. Multiple Choice

Write the answers to each question on the answer sheet. For each incorrect answer, half of the possible points will be deducted for that particular question. If no solution is marked, you will neither gain nor loose a point.

1. In market economies, individuals:
   a) bear the wealth effects of their decisions.
   b) require guidance from a central planner.
   c) have no incentive to choose efficient actions.
   d) trade decision rights to those without specific knowledge.

2. Competitive pressures:
   a) drive prices up to ensure profits.
   b) create inefficient organizational architectures.
   c) force inefficient firms to shut down.
   d) all of the above.
   e) none of the above.

[redacted]

3. Decision rights are more likely to be decentralized:
   a) in rapidly changing environments.
   b) if the firm is less diversified.
   c) if the firm is smaller.
   d) when the coordination of activities is less important.

4. The degree of rivalry is generally higher when there is:
   a) no excess capacity.
   b) low fixed costs.
   c) significant product differentiation.
   d) slow growth.

5. Lowering production costs causes:
   a) demand to shift to the right.
   b) demand to shift to the left.
   c) supply to shift to the right.
   d) supply to shift to the left.

6. Implicit contracts:
   a) are backed up by legal documents.
   b) are easy to enforce in court.
   c) consist of promises and understandings.
   d) are not important in resolving conflicts of interest.

7. Corporate Culture:
   a) consist only of explicit contracts.
   b) is easy to change.
   c) does not depend on organizational architecture.
   d) includes many aspects of organizational architecture.

8. When the objective for a cost center is to __________, then the managers have incentive to__________:
   a) minimize cost for a given output; choose output to minimize cost.
   b) maximize output for a given budget; increase quality to reduce costs.
   c) minimize average cost; push to increase output when there are economies of scale.
   d) minimize average cost; push to decrease output when there are economies of scale.

9. The optimal transfer price for a product or service is always its:
   a) opportunity cost.
   b) marginal production cost.
   c) marginal revenue.
   d) all of the above.
   e) non of the above.

10. Spot market transactions are characterized by:
   a) many sellers and no long-term contracts.
   b) many sellers and long-term contracts.
   c) many different prices for a given product or service.
   d) few sellers and short-term contracts.

2. Agency Theory

a) Name and describe two information problems. What are possible solutions for those problems?

b) In what way can the ethical issues of the Lopez case be interpreted using agency theory? Outline briefly the ethical issues addressed in the case study and discuss the results of the VW-GM battle critically.

3. Outsourcing and Vertical Integration

a) Only Radios (OR) makes nothing but radios. They distribute the radios through independent retailers carefully selected by location (so as to prevent free-rider problems). Suppose the demand for the radios faced by each retailer is P=$100-2Q. The marginal cost of production to OR is $20. The retailer sells so many other goods that the effective marginal cost to retailers is only the wholesale price they pay for the radios. What is the profit earned by the retailer and OR? Show that both the retailer and OR can increase profits if the retailer agrees to pay a $500 fee for the privilege of selling the radios and OR agrees to charge $20. Show that this would be equivalent to an agreement specifying that the retailer purchase 20 units at a price of $45 from OR.

b) The usage of consultancy services as offered by e.g. McKinsey & Company is one example for Outsourcing. What are the different roles consultants take in such business relationships? Name and explain them as outlined by McKinsey.

4. Individual Performance Evaluation

Two personal-injury lawyers are considering a partnership to share risk. They would split the combined income equally. In any year each has a 40 percent chance of earning $200,000 or a 60 percent chance of earning only $50,000 (these probabilities are independent). Each can earn a salary of $100,000 in their next-best alternative – with no risk.

a) Currently, each is indifferent between the current expected income and the next-best alternative. Are the lawyers risk-averse? Explain. If so, what is the risk premium?

b) Should they form the partnership to share the risk? Explain.

c) Consider incentive compensation in general, what should an effective incentive contract include? When are strong incentives desirable?

5. Creating and Capturing Value

a) Name and explain superior factors of production. Illustrate these with your own examples.

b) Producer surplus can be captured by superior assets. Discuss this statement critically. Use graphical tools with respect to the firm's and market's situation.

c) Pepsi produces Fritos and Lays potato chips in addition to its basic soft-drink products. Discuss potential ways that this business combination might increase value.

6. Market and Nonmarket Transactions.

a) What are firm specific assets? Name and explain the different forms of specificity. Illustrate these with your own examples.

b) BioChem has a patent on a chemical product that is used as a key input in producing farm and home agricultural fertilizer. Currently, BioChem produces the product and sells it to companies who manufacture the final products for the farm and home users. BioChem faces the following demand curves from the farm and home market segments:

Farm: P = 300 – 10 Q.
Home: P = 100 – 5 Q.

BioChem can produce the product at a constant marginal cost of $1. Calculate the optimal prices that BioChem would like to charge in each market segment to maximize profits. Discuss how vertical integration might be used to accomplish this pricing policy. Be sure to indicate which market BioChem should vertically integrate (assume they can only integrate in one). Explain why you chose this market.

Good Luck!