AREC 315
Fall 2006

Exam #4
(80 Points Possible)

Please respond to the following questions in a clear and precise manner. Use equations, graphs, and numbers, where appropriate or when asked for, to support you answer. Show your calculations on problems to receive full credit for your answers. Use complete sentences in your responses. Please manage your time wisely.

(10 Points) 1. Please define, in one sentence, the following terms or principles as they were utilized in class or in your textbook. **No graphs or equations please.**

a. Expected Value

b. Monopsony

c. Direct Segment Discrimination

d. Sunk Cost

e. Economies of Scale

(15 Points) 2. Using the appropriate graphical models, discuss and illustrate the claim that a monopolist (1) prices goods higher, produces less, and makes more profit than the firm would in a perfectly competitive market and (2) would prefer complete price discrimination to uniform pricing.

(10 Points) 3. Mary and Sarah work for a firm that designs, manufactures and sells video games. They find themselves in a heated argument about the optimal level of production of games if their objective is maximized profit for the firm. Mary believes she can use the cost structure of the firm to estimate this optimal level of production. Sarah states that the cost structure of their firm promotes an emphasis on increasing market share to increase, not maximize profits. With the appropriate economic model, please illustrate both persons' argument. Then discuss who you think is correct and why.

(10 pts.) 4. Decision making under uncertainty (or risk) is why managers get paid "the big bucks" in corporate America. Good decisions produce a higher stock price for the stockholders and poor decisions reduce stock value. In reality, no manager makes good decisions all the time. In fact, a manager may find himself or herself stumbling into decision traps that keep the company from realizing its potential. Below are five types of decision traps. Please define each trap and provide a business example for each one.

a. Anchoring Trap

b. Status Quo Trap

c. Sunk Cost Trap

d. Confirming Evidence Trap

e. Framing Trap

(10 pts.) 5. Hiring the best person for the job, and then providing this person a productive work environment are critical responsibilities of any manager responsible for the human capital of an organization. Please respond to the following questions.

A. Why should a manager be concerned, from a pure economics point of view, about the productivity of an employee? Use the appropriate economic concept(s) and model(s) to answer this question.

B. How could a manager use trust to encourage the employee performance you discussed in A?

(5 Points) 6. You have a friend who has just inherited $40,000. She should receive the check next week. If your friend has a discount rate of 15%, what sum of money would she have to receive in 5 years to be indifferent between $40,000 next week and the future sum?

(5 Points) 7. Suppose you buy a new Gateway computer with a printer, scanner, and digital camera for $3,000. Gateway will finance your purchase at a 12% interest rate for one year if you agree that you will make monthly payments. What will your monthly payment be?

(15 Points) 8. Walgreen Drug Stores seems to have a store at each major intersection in Tucson. You have discovered that a typical store costs $1,500,000 to build and stock for opening day. You also have information that net benefits for the first five years of operation are:

Year	Net Benefits
1	$ 250,000
2	350,000
3	500,000
4	600,000
5	600,000

A. What is the payback period for this investment?

B. What is the net present value of this investment if Walgreen's opportunity cost of capital is 18%? Show your work above.

C. What does this NPV mean to the management of Walgreen Drug Stores?

D. What would be the impact on this NPV if Walgreen's management changed their discount rate from 18% to 22%? Why? Do not recalculate the NPV.