Tutorial 1 – The Economic Approach

This tutorial is designed to introduce some of the concepts that will be developed and discussed over the course of the semester.

1. Discussion question – organizational design.

Read the article: "The holes in holacracy" from The Economist.

Now consider the following questions:

- In terms of modelling behaviour of workers in a firm (see Brickley pp. 32-35), which would work best with the principles of holacracy?
- What might be the benefits and limitations of holacracy? Why?
- What organisations might such an approach work for?

2. Discussion question – monitoring and performance evaluation.

Read the article: "Memo to Workers: The Boss Is Watching --- Advances in Tracking Technology Are Shaking Up the Workplace" from the Wall Street Journal.

Now consider the following questions:

- Why might firms wish to monitor employees?
- Will monitoring always be effective and achieve the desired outcomes? Why or why not?

3. Discussion question incentives.

Read the article: "Is it time to end tipping" from the WSJ.

Now consider the following questions:

- What might be the benefits of a policy that allows and encourages tipping?
- What might be the implications of the 'no tipping policy'?

4. Consider Joe, an analyst at a major investment bank. Assume that Joe works for 50 weeks each year. Analysts at the bank earn a base salary of $100,000 and bonuses that depend on the sales of investment products they sell to clients. For each extra $100,000 of sales, they receive a bonus of $2,000. That is, Joe receives a 2 percent commission. Joe likes his job and takes pride in exercising diligence (D) when advising clients. Diligence, however, requires time spent checking the credentials of firms and leaves less time for analysts to sell to clients.

Assume that Joe has 40 hours per week to spend on diligence or selling. Assume that if Joe spends all his time each week selling, then he expects to make sales of $200,000. If he spends all his time in undertaking diligence, Joe will make no sales.

Show Joe's budget constraint in a set of axis with monetary rewards on the vertical axis and time spent in 'diligence (D)' on the horizontal axis. What is the opportunity cost of each hour of diligence? Alternatively, what is the price of a unit of diligence?

Suppose that Joe's utility function is given by the following:

$$U(M, D) = M^{0.5} D^{0.5}$$

If the above equation does not make sense – do not worry as we will work through the problem in class.

If Joe maximises his utility, how much time will he spend on diligence each week and what will his earnings be?

Concerned that analysts are making poor decisions, suppose that the bank decides to increase the base salary to $150,000 per annum and reduce the commission so that each $100,000 in sales now generates a bonus of $1,500. How will Joe's behaviour change? Is this a good outcome for the bank? Why or why not? Which scheme does Joe prefer? Why?

Show your answer in a well-labelled diagram.

How would your answer to the questions above change if Joe was only concerned about money?

5. Answer question 2-17 on p. 46 of Brickley et al.

6. Answer question 2-23 on p. 47 of Brickley et al.

7. Answer question 2-28 on p. 47 of Brickley et al.