

ECON 5103 Unit 6 Video 1

The Organization of the Firm

Two major issues tackled in chapter 6:

1. How should a firm obtain the inputs that it requires to produce and sell its product?
2. How should a firm compensate its managers to achieve the best performance from them?

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Redbox blames studios, stores for DVD shortage

A lawsuit says studios are leaning on retailers to curtail bulk sales of DVDs to the rental kiosk firm.

December 04, 2009 | By Ben Fritz

Redbox is having trouble stocking DVDs from the three studios it is battling in court -- 20th Century Fox, Universal and Warner Bros. -- and is blaming **retailers** for the problem.

However, two of the three major chains that the fast-growing \$1-per-night DVD kiosk company named, Best Buy Co. and Wal-Mart Stores Inc., denied the charge.

Redbox made the allegation in amended versions of its lawsuits filed this week against Fox and Warner. The Fox complaint accuses the studio of "unfair competition" in forcing **retailers**, in an effort aimed at Redbox, to restrict the number of DVDs that any individual can purchase. Though Redbox did not name retailers in the amended suit, it identified Best Buy, Wal-Mart and Target in a Securities and Exchange Commission filing Thursday.

A Redbox spokesman said it was unclear exactly how the studios were influencing the retailers. "We do know that certain Wal-Mart, Best Buy and Target stores have informed field representatives of Redbox that such stores were limiting sales of new-release DVDs to as few as three copies," he said.

The company has had employees buy Fox, Warner and Universal movies from retail stores ever since those studios over the last year have instructed their distributors not to provide DVDs to discount kiosk renters until about one month after they go on sale. Redbox responded by suing.

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How can a seller obtain inputs necessary to produce and sell its product? Three different ways:

1. Spot exchange
2. Contract
3. Vertical integration (make it yourself)

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1. Spot exchange: The producer buys the input from a readily available source, in a one-time fashion with no contract required.

Example: A firm runs out of copy paper so a dude goes to Office Depot and buys some more.

Example: RedBox sends employees to WalMart to buy DVDs to stock its machines.



Chili's Kids Pizza = Frozen Kroger Pizza?

2. Contract: A seller negotiates a contract with a supplier to provide an input at a specified price under specified conditions over a specified period.

Example: An electricity utility contracts with an energy provider to provide natural gas over the next year to its power plant.

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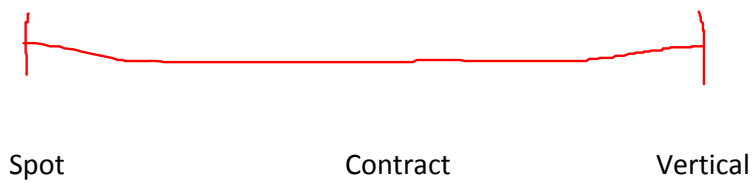


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3. Vertical Integration: The firm produces the inputs itself

Example: ExxonMobil extracts crude oil itself to make into gasoline

Example: Ford produces its own windshields for its autos





TOM'S HARDWARE GUIDE > News > Special > Events > Apple Launches Its Own CPU, the 1GHz A4

Apple Launches Its Own CPU, the 1GHz A4

Next news

2:31 PM - January 27, 2010 by Tuan Nguyen

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More than meets the eye.

Today's unveiling of what seemed to be a dull product, also introduced something else even more significant from Apple--its first real CPU, the 1GHz Apple A4 processor.



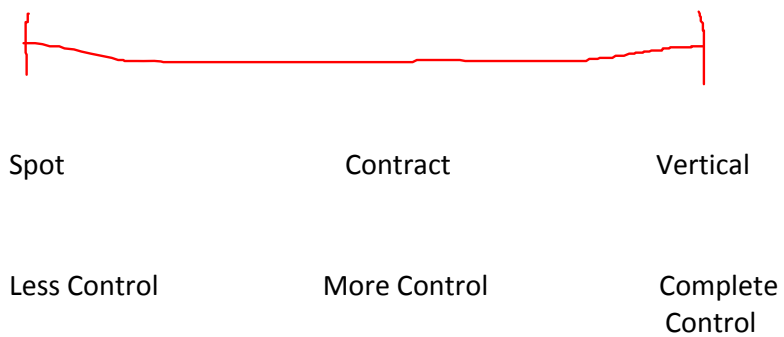
Zoom

Apple's purchase of PA Semiconductor not too long ago, yielded its first product today, but it's not the fact that it was used in the iPad that makes it special. What's special is that Apple now has a real processor on its hands. And in case you're wondering whether or not Apple's own CPU can compete with the likes of ARM's Cortex or Qualcomm's Snapdragon CPUs, the A4 has potential to kick the living shnizzles out of those CPUs.

Advantages and disadvantages of each method of obtaining inputs:

1. Quality control and innovation

Example: A Kolache maker has more control over quality and taste if she makes her own sausages to put in the Kolache

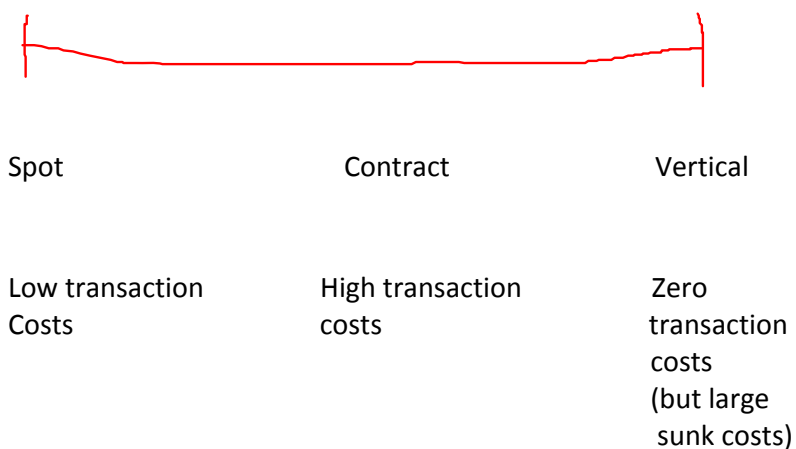


Advantages and disadvantages of each method of obtaining inputs:

2. Transaction costs: Costs of acquiring an input beyond the amount paid for the actual input.

Example: cost of testing an input obtained with a spot exchange

Example: cost of writing a contract for an input



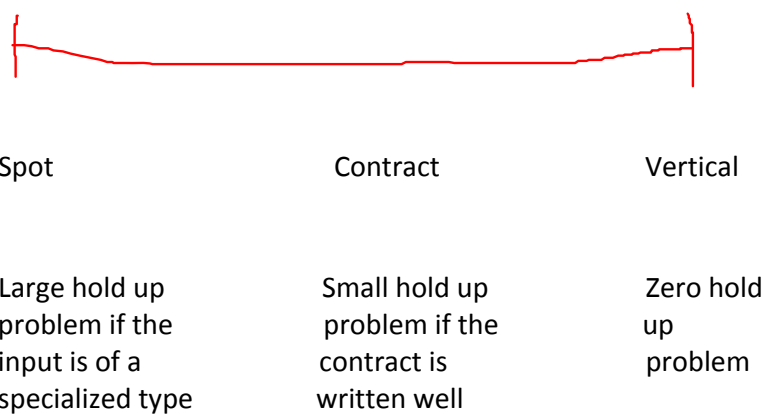
Advantages and disadvantages of each method of obtaining inputs:

3. Hold Up Problem: A supplier charges a buyer more than the cost of the input because the supplier knows that the buyer will have problems finding another supplier quickly.

Example: Intel raises the price it charges Dell for microchips (knowing that it would take a while and be costly for Dell to reengineer its PCs to use a different brand of microchip)

Example: A property owner raises the lease rate on a firm's office space (knowing that it would be a costly hassle for the firm to relocate).

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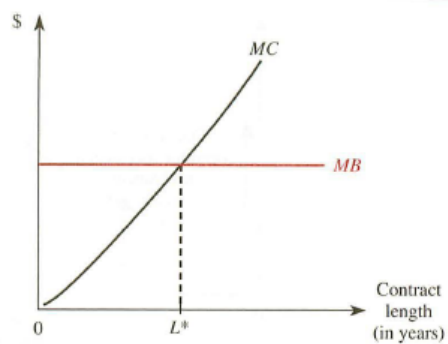
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More on contracts: What is the optimal length (time) of the contract?

Answer: compare the benefits of added length to the cost of added length. (Generally, it is more costly to write longer term contracts because more contingencies must be put into the contract)

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FIGURE 6-2 Optimal Contract Length



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Example: The marginal benefit of adding length to a contract is \$100 per year. The marginal cost of adding length to a contract is: $10 + 15L$, where "L" is number of years.

Set marginal benefit equal to marginal cost and solve for L

$$100 = 10 + 15L$$

$$90 = 15L$$

$$6 = L \quad \text{Optimal length of contract is 6 years.}$$