

Detailed Table of Contents

Preface *xiii*

Acknowledgements *xxi*

Guided Tour *xxii*

Technology to enhance learning and teaching *xxiv*

1 Introduction 1

1.1 Introduction 2

1.2 The economic problem 2

1.3 An example of the 'economic way of thinking' 4

1.4 Problems of information and knowledge faced by decision makers 7

1.4.1 Varieties of problems of information and knowledge 8

1.4.2 Factors that generate problems of information and knowledge 14

1.5 Summary 15

1.6 Some questions to consider 16

1.7 Recommended additional reading sources 16

2 Markets and models 19

2.1 Introduction 20

2.2 Specialization 22

2.3 Scope for failures in economic co-ordination 24

2.4 Market-based co-ordination via the price mechanism 26

2.4.1 The mainstream view of 'a market' 27

2.4.2 How markets work 27

2.5 A mainstream model of the hot dog market 30

2.6 Further discussion of the hot dog model 32

2.7 The art of applying a model 39

2.8 The mainstream view of economic systems 43

2.9 The heterodox view of economic systems and co-ordination 47

2.10 Markets as institutional structures 52

2.11 The firm as an answer to market failure 54

2.12 Summary 57

2.13 Some questions to consider 58

2.14 Recommended additional reading sources 59

3 What do entrepreneurs do? 61

3.1 Introduction 62

3.2 An entrepreneur's story: the early years of Sir Richard Branson 62

3.3 Six perspectives on the economics of the entrepreneur 67

3.3.1 The mainstream perspective on the entrepreneur 68

3.3.2 The entrepreneur and the inefficient firm 69

3.3.3	The Austrian perspective on the entrepreneur	70
3.3.4	Schumpeter on the entrepreneur as innovator	72
3.3.5	The entrepreneur as a specialist in co-ordination	74
3.3.6	Empirical analysis of the entrepreneur	80
3.3.7	A new departure – the entrepreneur as a constructor of connections	82
3.4	Summary	85
3.5	Some questions to consider	87
3.6	Recommended additional reading sources	88
4	Who wants the product and in what quantity?	91
4.1	Introduction	92
4.2	Mainstream consumer theory	95
4.2.1	Indifference analysis	96
4.2.2	Marginal utility theory	99
4.2.3	Demand for product characteristics	103
4.3	Contexts of choice	104
4.4	Behavioural/evolutionary consumer theory	112
4.4.1	The struggle against increasing entropy	112
4.4.2	Consumer preferences exist at several levels	113
4.4.3	Rules for closing open minds	116
4.4.4	We're all hunter-gatherers, really	120
4.5	Fads, fashions and product lifecycles	121
4.6	Products in the context of lifestyles	125
4.7	Purchasing decisions of businesses	127
4.8	Brand loyalty and brand equity	130
4.9	Summary	132
4.10	Some questions to consider	134
4.11	Recommended additional reading sources	135
5	How shall the firm produce the product?	139
5.1	Introduction	140
5.2	The story of Dyson vacuum cleaners	140
5.3	The mainstream theory of production	147
5.3.1	Overview	147
5.3.2	The basic elements of the mainstream story	148
5.3.3	The short-run theory of production	150
5.3.4	The long-run theory of production	155
5.4	The heterodox approach to production	164
5.4.1	Overview	164
5.4.2	Knowledge	164
5.4.3	Returns to scale	168
5.5	Summary	176
5.6	Some questions to consider	179
5.7	Recommended additional reading sources	180

6	Where do costs come from and how do they behave?	181
6.1	Introduction	182
6.2	The mainstream approach to the behaviour of costs	182
6.2.1	The short-run theory of costs	182
6.2.2	The long-run theory of costs	189
6.2.3	Economies of scale – further discussion	196
6.2.4	Diseconomies of scale – further discussion	199
6.2.5	Economies of scope	201
6.3	The heterodox approach to the behaviour of costs	203
6.3.1	Time and costs	203
6.3.2	The learning curve	208
6.3.3	X-inefficiency and costs	211
6.4	Summary	214
6.5	Some questions to consider	216
6.6	Recommended additional reading sources	218
7	How can the firm set the 'right' price?	219
7.1	Introduction	220
7.2	A general framework for thinking about pricing decisions	220
7.2.1	Underlying influences on the behaviour of the firm's own costs	221
7.2.2	Underlying influences on the behaviour of competitors	221
7.2.3	Underlying influences on the behaviour of potential buyers	222
7.2.4	Underlying influences on the likelihood of new competitors emerging	223
7.2.5	Underlying influences on the behaviour of regulatory authorities	224
7.3	How to define an industry for pricing purposes	225
7.4	The basic elements of the mainstream analysis of the firm's pricing decision	226
7.4.1	Perfect competition	226
7.4.2	Pure monopoly	236
7.4.3	Imperfect competition	239
7.4.4	Price discrimination	241
7.4.5	Pricing under strategic interdependence	245
7.5	Summary of the mainstream approach to pricing	256
7.6	The heterodox theory of pricing behaviour	256
7.7	Summary	261
7.8	Some questions to consider	262
7.9	Recommended additional reading sources	263
8	How can the firm earn persistent above-normal profits?	265
8.1	Introduction	266
8.2	The heterodox theory of the profit-seeking firm	267
8.3	The evolution of industry structure	279
8.4	Summary	287
8.5	Some questions to consider	288
8.6	Recommended additional reading sources	289

9 A business enterprise is born 291

- 9.1 Introduction 292
- 9.2 Capitalism and risk 294
- 9.3 Financing the enterprise 296
 - 9.3.1 Alternative financing strategies 296
 - 9.3.2 Making a case to suppliers of finance 298
 - 9.3.3 The Richardson Problem 303
- 9.4 To make or to buy? 306
 - 9.4.1 Alternative ways of organizing value chains 307
 - 9.4.2 The case against vertical integration 310
 - 9.4.3 The transaction cost analysis of vertical integration/internalization 312
 - 9.4.4 Critique of the transaction cost perspective 316
- 9.5 Recruiting and retaining staff 321
 - 9.5.1 Why do firms often make it quite difficult to apply for the jobs they offer? 321
 - 9.5.2 Why don't job contracts spell out more precisely the tasks they entail 323
 - 9.5.3 Why do 'leading-edge' employers sometimes pay less than their rivals? 325
 - 9.5.4 Why do some 'talking heads' and bosses earn so much? 326
- 9.6 The vulnerability of the new business and the importance of goodwill 329
- 9.7 Summary 335
- 9.8 Some questions to consider 335
- 9.9 Recommended additional reading sources 338

10 How can the firm grow? 341

- 10.1 Introduction 342
- 10.2 How rapidly will a firm grow? 343
 - 10.2.1 The motivation to grow 343
 - 10.2.2 The relationship between growth and profitability 344
- 10.3 Growth via contractual linkages 348
- 10.4 Growth via vertical linkages 351
- 10.5 Growth via diversification 353
 - 10.5.1 An example and a tool for mapping the strategy of a diversified firm 353
 - 10.5.2 Diversification and economies of scope 356
 - 10.5.3 Synergy and hedging 363
 - 10.5.4 Synergy links are subjective and in need of management 367
 - 10.5.5 Can we make sense of conglomerate firms? 369
- 10.6 Growth via mergers and takeovers 371
- 10.7 Inter-firm linkages 374
- 10.8 Intra-firm linkages: economics of organizational structure 377
 - 10.8.1 The organization problem 377
 - 10.8.2 The U-form structure and its problems 379
 - 10.8.3 The M-form structure 380
- 10.9 Summary 383
- 10.10 Some questions to consider 384
- 10.11 Recommended additional reading sources 386

- 11 What can an established firm do when its sales volume stagnates or declines?** 387
- 11.1 Introduction 388
 - 11.2 The role of slack in the competitive process 389
 - 11.3 Innovation and the competitive process 392
 - 11.3.1 Schumpeter and innovation 393
 - 11.3.2 Innovation, technology and organization – some stylized facts 395
 - 11.3.3 Routines and innovation 407
 - 11.4 Coping with a market in terminal decline 407
 - 11.4.1 The nature of the decision problem in a terminal market 408
 - 11.4.2 Exit barriers 412
 - 11.5 Summary 413
 - 11.6 Some questions to consider 414
 - 11.7 Recommended additional reading sources 414
- 12 Fundamentals of macroeconomics** 417
- 12.1 Introduction 418
 - 12.2 What does GDP consist of? 419
 - 12.2.1 The output measure of GDP 421
 - 12.2.2 The income measure of GDP 423
 - 12.2.3 The expenditure measure of GDP 424
 - 12.2.4 Adding government to the simple economy 426
 - 12.2.5 Adding foreign trade to the closed economy 428
 - 12.3 The behaviour of GDP over time 429
 - 12.4 The Keynesian cross model of the economy 432
 - 12.4.1 A story about consumption expenditure 433
 - 12.4.2 A story about investment expenditure 436
 - 12.4.3 A story about government expenditure 438
 - 12.4.4 A story about exports and imports 438
 - 12.4.5 Putting the stories together to obtain a model of the economy 441
 - 12.5 The Aggregate Demand – Aggregate Supply model 446
 - 12.6 The basis of government policy intervention 455
 - 12.7 Summary 457
 - 12.8 Some questions to consider 458
 - 12.9 Recommended additional reading sources 459
- 13 What are the main sources of controversy in macroeconomics?** 461
- 13.1 Introduction 462
 - 13.2 The mainstream perspective on macroeconomics 462
 - 13.2.1 Mainstream analysis of unemployment 463
 - 13.2.2 The mainstream perspective on output and inflation 465
 - 13.3 A roadmap for a journey into heterodox macroeconomics 471
 - 13.4 Flows of funds between sectors 474
 - 13.5 Saving, investment and an ageing population 476

- 13.6 Short-term fluctuations in aggregate demand 483
 - 13.6.1 Demand is likely to be function of current income 483
 - 13.6.2 The 'feel good factor' 483
 - 13.6.3 Wealth effects 485
 - 13.6.4 Crows behaviour 486
- 13.7 Effective demand, unemployment and inflation 487
 - 13.7.1 Expectations and employment 487
 - 13.7.2 The importance of a fractional marginal propensity to spend from marginal income 489
 - 13.7.3 The hetrodox perspective on unemployment 490
 - 13.7.4 Heterodox perspectives on inflation 492
- 13.8 Speculation and business cycles 494
 - 13.8.1 Classical speculation versus movement trading 496
 - 13.8.2 The propensity to speculate is not fixed, nor is the population of speculators 497
 - 13.8.3 Increased risk-taking leads to financial fragility 499
 - 13.8.4 Triggers for upswings and collapses 500
 - 13.8.5 Limits to the fallout when a speculative bubble bursts 501
- 13.9 Summary 502
- 13.10 Some questions to consider 503
- 13.10 Recommended additional reading sources 504

14 The international environment 000

- 14.1 Introduction 508
- 14.2 What do we mean by the 'balance of payments'? 509
- 14.3 What are exchange rates and how are they determined? 511
- 14.4 How can firms deal with exchange rate variability? 514
- 14.5 Why do some firms become multinational enterprises? 517
- 14.6 Why do firms charge different prices in different countries? 521
- 14.7 What should a firm do when exchange rates change? 526
- 14.8 What is the relationship between economic expansion and the structure of a country's balance of payments? 528
 - 14.8.1 Export-led growth 529
 - 14.8.2 Export-led unemployment – 'the Dutch disease' 530
 - 14.8.3 Spiralling foreign debt 530
- 14.9 Can market forces stop growing foreign indebtedness from becoming a problem? 532
- 14.10 Why do current account deficits persist even after currency depreciations? 536
- 14.11 What is the orthodox medicine for countries facing a balance of payments crisis? 539
- 14.12 Summary 544
- 14.13 Some questions to consider 546
- 14.14 Recommended additional reading sources 547