

Managing a Firm



Lectures in Microeconomics-Charles W. Upton

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Starting a New Business

- A New Dry Cleaner
 - Pricing
 - Services
 - How Hard to Work

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Doing the Work

- You tend the counter and deal with the customers, but hire people to do the actual cleaning.
- Conditions of work?
 - Don't treat them like Scrooge treated Bob Cratchett
 - But test isn't one of good will, but one of economics.

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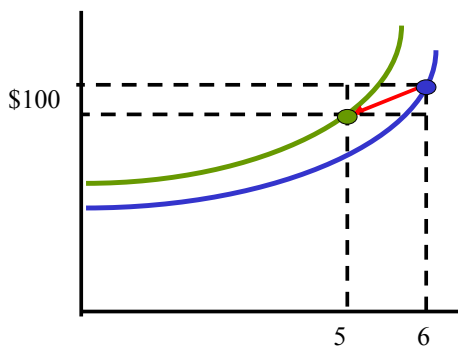
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The Business Takes Off

- Tired of working Saturdays, you decide to hire someone to mind the store on Saturday.
 - You don't do cleaning on Saturday, just handle customers
- Profits will go down, by (say) \$100 a week

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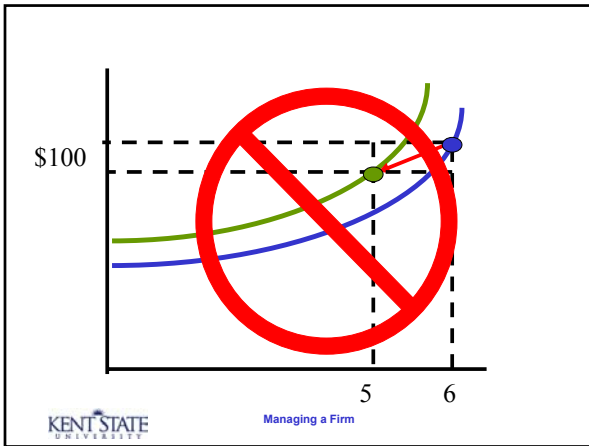
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The Business Takes Off II

- You decide to hire a friend to work with you on Fridays.
 - There are a lot of customers on Friday and it reduces the stress
 - Besides, you like to chat with your friend and it will make work more pleasant
- Profits will go down, by (say) \$100 a week

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The Basic Equation

- You get utility from lower stress, equal to \$X a week
- You get utility from chatting with your friend, equal to \$Y a week

$$\$X + \$Y > \$100?$$

The Point

- You have hired two additional workers and lost money in the process.
- Does this make sense?

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- You have hired two additional workers and lost money in the process.
- Does this make sense?
- Given the facts here, yes

Back to Saturday

- You now have Saturdays off.
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 - Watching TV
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 - Studying Economics
- But how is the store going?
 - Is your new employee a goof-off?

What you want

- The new employee attending to the store with the same diligence you would.

What you want and what you get

- The new employee attending to the store with the same diligence you would.
- The new employee looking as Saturday as a paid free day.
 - Watching TV
 - Having friends in for Lunch
 - Studying Economics

Congratulations!

- You have just discovered the principal-agent problem.
- You are the principal. The store is run for your benefit.
- The employee is your agent, and you want diligent work, but you may not get that.

Motivating the employee

- The Stick
 - Monitoring sales
 - Using a Cash Register
 - Mystery Shoppers
 - Random Visits

Motivating the employee

- The Stick
- The Carrot
 - Profit Sharing
 - Basing compensation on sales.
 - Not just Saturday Receipts

End

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