I. REVIEW: STRATEGIC ISSUES INSIDE THE FIRM

A. PRINCIPAL/AGENT PROBLEMS

1. SUPPLIERS/INPUTS HAVE PRIVATE INFORMATION
   a. ADVERSE SELECTION—CHIP SUPPLIERS
   b. MORAL HAZARD—LEGAL SERVICES

2. EXAMPLE:
   TOTAL BENEFIT OF LEGAL SERVICES: \( TB = 600L - L^2 \)
   AVERAGE BENEFIT OF LEGAL SERVICES: \( AB = 600 - L \)
   MARGINAL BENEFIT OF LEGAL SERVICES: \( MB = 600 - 2L \)
   LAW FIRM: FEE OF $200 PER HOUR, GOAL IS TO MAXIMIZE BILLABLE HOURS

   IF CHOICE OF QUANTITY OF LEGAL SERVICES IS LEFT TO LAW FIRM: MAXIMIZE BILLABLE HOURS SUBJECT TO CONSTRAINT THAT TOTAL BENEFITS \( \geq \) TOTAL COST
   \[ 600L - L^2 = 200L \Rightarrow 400 = L \]
   FIRM MAXIMIZATION OF NET BENEFITS: \( MB = MC = 200 \)
   \[ \Rightarrow 600 - 2L = 200 \Rightarrow L = 200 \]

LAW GROUP’S EXPLOITATION OF ASYMMETRIC INFORMATION CAN HURT THE FIRM
B. COORDINATION PROBLEMS
   1. COMPLEMENTARY INPUTS OR TEAMS
   2. MULTIPLE NASH EQUILIBRIA
C. TIME-CONSISTENCY AND FIRM SPECIFIC INVESTMENTS
D. ALL OF THE ABOVE ARE ISSUES OF CONTRACT DESIGN—CONTRACTS MUST SOLVE
   1. INCENTIVE ISSUES
   2. PARTICIPATION CONSTRAINT

II. WHO’S IN CHARGE? GROUP DECISION MAKING AND ECONOMIC OUTCOMES

A. FREER TRADE IN FREDONIA
B. INDIVIDUAL RATIONALITY VERSUS COLLECTIVE IRRATIONALITY
C. STRATEGIC VOTING AND VOTE TRADING