

**GPEM—Business Economics—Final Exam—Winter 2002**

**Name** \_\_\_\_\_

**Notes**

Date: 22/03/02

Time: 10.00 to 12.00 (+ 1/2 h. more for the last optional question, relevant for deciding the top grades)

Place: 20.051

Important:

- Do not use reverse pages
- Think hard and write as little as possible. Wrong answers may be graded with negative points.

**1. Concepts**

Explain clearly the following concepts and provide an example for each one of them.

1. TAKEOVER MARKET = MARKET FOR CORPORATE CONTROL

Concept

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Example

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2. SPECIFIC ASSET

Concept

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Example

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3. LIMITED LIABILITY

Concept

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Example

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4. "OPEN" CORPORATION

Concept

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Example

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2. Theory. Write an outline of the topic “Advantages and disadvantages of vertical integration”.

### 3. Ethical interest rate

Show analytically how a change in the discount rate modifies the incentives for the fulfillment of contractual obligations.

### 4. Your money back

Analyse the following news item

A magistrates' court in Malaga has ordered El Corte Inglés to return the price paid for a garment purchased by a customer holding that the department store had not fulfilled its trading motto, "Your money back if you are not satisfied".

This non-fulfilment took place when the claimant bought a woollen jumper for which she paid 10,950 pesetas (65.81 euros) in December 2000. The garment was worn by the claimant's husband on 'three or four occasions' according to the sentence but immediately 'small balls of wool' were formed. The purchaser decided to ask for her money back in accordance with the commercial motto but, after making her claim in El Corte Inglés on 20 January 2001, the return of her money was refused.

According to the sentence, the 'abnormal' deterioration of the garment 'justifies the purchaser's lack of satisfaction' and bases the return on the fulfilment of a commercial motto<sup>1</sup>.

1. Classify the various types of opportunism that this guarantee may give rise to.

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<sup>1</sup> "Condenan a unos grandes almacenes por incumplir su lema comercial", *El Mundo*, 21 January 2002.

2. Describe how this guarantee can function under two systems of *completion* and *enforcement*: relational contracting and contracting with judicial support.

3. What does conservation of a woollen garment depend on? Which of the parties—the seller or the purchaser—is in the best position to guarantee conservation?

4. Consider the viability of this type of guarantee when enforcement is carried out by the parties or by the judicial system.

5. In the case of a more valuable product for which a more complex guarantee system would be of interest, how should the guarantee conditions be stipulated?

## 5. Andersen Partners' Accounts

Analyse the following news item

“Arthur Andersen’s partners also have significant sums socked away in accounts that they are required to keep invested in the firm until they retire. Partners must keep a portion of their salaries, which can top \$1 million a year for the highest executives, in these accounts. After retirement, they typically withdraw it over 10 years .... Partners can change their annual withdrawal schedules once a year, around the end of the company’s fiscal year in August and there are rules to prevent all the retired partners from trying to grab all their capital at once”.<sup>2</sup>

Explain the advantages and disadvantages of these arrangements:

1. Partners are required to keep significant sums invested in the firm until they retire.

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<sup>2</sup> KRANHOLD, K., J. R. WILKE, and J. WEIL, “Andersen Seeks a Deal to Avoid Indictment: Criminal Charges Could Be a Fatal Blow to Firm,” *The Wall Street Journal Europe*, March 11, 2002, p. A6.

2. After retirement, partners typically withdraw these sums over 10 years.

3. Rules that prevent all the retired partners from grabbing all their capital at once.

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**6. Insuring Taxicabs—A difficult question, good for deciding top grades. If you opt to answer it, total or partially, your grade will be based on the 6 questions, with this 6<sup>th</sup> question weighting 25% . You will also have 30 more minutes for writing the exam.**

Analyse the initiative taken by Barcelona taxi-drivers that was described in the press as follows:

Taxi-drivers want, once and for all, to resolve the difficulties they face when insuring their vehicles. The Spanish Taxi Confederation (Confederación del Taxi de España—CTE) has called on its members to create a mutual insurance company in order to get round the strategies adopted by insurance companies which in recent years have pushed up premiums and avoided insuring taxis.

The CTE has set up a campaign ending at the end of March to encourage 15,000 cab-drivers to pay between them a minimum of 4.5 million euros, this being the minimum capital required by the Ministry of Finance for a mutual insurance firm to be created. If the CTE meets its targets, the National Mutual Insurance Fund for Taxi-Professionals will begin operating next year, according to its President, Miguel Tomás. Also participating in the project are Caixa de Cr dit dels Enginyers and its subsidiary, Segurengin.

This is their way of forgetting the contacts established two years ago with the Ministries of Finance and the insurance organisation, Unespa, with a view to finding a solution to the problem. “They never replied”, says Tomás. He explains that companies selling insurance to taxi-drivers only do so if the latter take out other policies as well, such as household insurance. “They claim they have to complement the coverage of a vehicle that is on the roads many hours a day”.

According to data provided by the taxi-drivers’ association, the minimum cost of third-party insurance is 1,320 €. This goes as high as 2,746 € if it is taken out through the Insurance Clearing Consortium, a governmental organization set up to cover the difference between supply and demand in the insurance market. The Taxi-Drivers’ Mutual Insurance Company will bring these prices down to between 790 € and 1,020 €.

Tom s explains that the viability of the new mutual insurance fund will be ensured by its independence, which is not the case at present. The CTE President complains that insurance companies have agreements whereby “taxi-drivers are always guilty of any accidents they are involved in”. In his opinion, “85% of accidents are caused by the other driver”.<sup>3</sup>

### Questions and Analysis

Analyse the situation according to two possible hypotheses whereby the sector is, or is not, competitive, and the practices observed are the result of considerations of efficiency or monopoly.

Keep your answers short and clear.

Answer the following questions, amongst others:

1. Does the situation described reflect a problem of adverse selection in the market for insurance for taxis?
  
  
  
  
  
  
  
  
  
  
2. Explain why insurance companies may be requiring the policy-holder to also take out household insurance in order to solve an adverse selection problem.

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<sup>3</sup> Source: Cordero, D., “Taxi-drivers want to set up a mutual insurance company to cover their risks and reduce their insurance costs”, *Expansi n*, 11 February 2002.

3. What are the advantages of a mutual insurance fund from the point of view of adverse selection?
  
4. Assess the disadvantages of a mutual insurance fund as opposed to the alternative solution of contracting the insurance policies in the market.
  
5. Propose a solution falling half way between setting up a mutual insurance fund and individual policies, and explain its comparative advantages.
  
6. What is the reason for the increased prices for taxi insurance? Assess the accusation that insurance companies agree amongst themselves to always blame the taxi-driver in accidents.
  
7. Explain how the following affects empirical assessment of both hypotheses:
  - a) There is no central register recording past data for each driver.
  
  - b) Some taxi-drivers hold a single licence and use the vehicle during a single shift, whereas others hold a number of licences and use the taxis during two shifts.
  
  - c) Licences cannot be legally transferred but figure under the names of other individuals.
  
  - d) Odometers in vehicles can be manipulated.
  
  - e) In this sector, companies have reached agreements to avoid litigation and speed up payments. They meet and pay/collect (reaching settlements in net terms and using standard prices). Blame is determined

according to simple automatic rules. This brings forward payments and, with them, speed up the provision of services to the insured parties.

f) In recent years, competition has increased with the entry of insurers who operate by phone. Costs have risen recently as a consequence of increasing indemnities to those harmed in accidents and an increasing incidence of accidents.

g) Having their cars in the garage for repair is very costly to taxi owners.

8. Advance an explanation in terms of bounded rationality why taxi-drivers may be unfairly treated by the courts in that they receive an unfairly large share of the blame.

9. Carry out an assessment of the two hypotheses taking into account all the information available.

10. If needed, use the reverse side of this page for your comments, but keep them relevant—otherwise, they will reduce your grade.