

Economics of Strategic Behavior

B8216 Fall Term 2022

PROFESSOR JACOPO PEREGO

A. ADMINISTRATIVE INFORMATION

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Required Materials

Bruce Greenwald and Judd Kahn (2005): *Competition Demystified* (CD)

Case studies, readings, and class handouts posted on Canvas.

B. COURSE DESCRIPTION

This course examines the underlying economics of successful business strategies, including:

- 1) The sources of long-run competitive advantage.
- 2) The dynamics of competition and competitive advantage.
- 3) Strategic interactions (competitive and/or cooperative) among firms.

Three characteristics distinguish our approach. First, we focus on fundamental strategic decisions that firms face rather than more detailed operation/managerial issues. Second, we seek broad principles that can be applied across many firms and markets, rather than anecdotal success stories or institutional details that apply only in limited cases or as a result of idiosyncratic factors. Finally, we develop these broad principles from the framework of microeconomic theory. As such, potential answers will be subjected to the rigor of economic analysis to test their validity and applicability.

The approach toward teaching and learning is primarily inductive. That is, you will learn the concepts and principles outlined above largely through examples – this is the essence of the case study method. The goal is to carefully study specific business situations and decisions with the goal of extracting broader principles about business strategy, which will then be available to you in a wide variety of managerial contexts. Class time will be split roughly 65/35 between case discussions and lectures.

Good cases are necessarily complex and ambiguous. In preparing for case discussions, you may find sorting through this complexity and ambiguity to be frustrating. The problems presented in the case discussion may not have one correct answer. However, there will generally be a set of insights and solutions that are better than others. And it is in working through the messy details to find these insights and solutions – both in your own preparation and in-class discussion – that the concepts and principles introduced in the readings and lectures will come alive and be enriched for you.

C. PREREQUISITES AND CONNECTION TO THE CORE

The learning in this course will utilize, build on, and extend concepts covered in the following core courses:

Core Course	Connection
Managerial Economics	<ol style="list-style-type: none">1. Understanding market competition and equilibrium thinking (in the short-run)2. Market equilibrium thinking (in the long-run) and barriers to entry3. Strategic Interaction among firms and Nash Equilibrium4. Pricing with market power
Strategy Formulation	<ol style="list-style-type: none">1. Creation of value vs. value capture2. Competing firms

Students will be expected to have mastered these concepts and be able to apply them in the course.

D. COURSE SCHEDULE

Part I

Date	Topics Covered	Readings
Session 1	Introduction, Competitive Advantage, Industry Analysis	CD Ch 1 to 3, Enterprise
Session 2	Competitive Advantage, Learning Curve	The Economist, Capital One
Session 3	Overcoming BTE	Aldi, Tesla
Session 4	Competitive Advantage in a digital world, Platform Markets	Etsy

Part II

Date	Topics Covered	Readings
Session 5	Price Wars, Strategic Interactions	Albert Heijn
Session 6	Competition vs Cooperation,	Philip Morris, Shrimp Game Handout
Session 7	Antitrust I, Guest Lecture I	IP handout
Session 8	Price Wars, Guest Lecture II	General Mills, Pratt & Whitney

Part III

Date	Topics Covered	Readings
Session 9	Strategic Entry, Antitrust II	Microsoft
Session 10	Strategic Entry, Bargaining Power	Red Bull, Spotify
Session 11	Bargaining Power, Wrap Up	Nintendo
Session 12	Final Exam	Take home

E. COURSE REQUIREMENTS AND GRADING

The final grade will be based on:

Class Participation (35% - Individual/Type B)

Class participation is essential in order for you to get the maximum benefit from the course. To create proper incentives, your final grade depends on your class participation. Your class participation grade will be based on two metrics: (1) engagement and (2) contributions.

- (1) *Engagement*. During class and in-between classes, you will be asked to complete small tasks. The fraction of tasks that you complete determine your engagement grade. These tasks include:

Online Quizzes. For most sessions, there will be an online quiz posted on Canvas, to be completed *before* the beginning of the session. Questions are multiple-choice and/or require you to write a paragraph justifying your answer. Grading is based on the thoughtful completion of each of the quizzes. Your answers may be used in class and you may be called to discuss them.

PollEverywhere. During most sessions, students will be asked to answer questions via PollEverywhere. Your answers will be used in class and you may be called to discuss them. Your PollEverywhere answers are also used implicitly, to track attendance.

- (2) *Contributions*. Your in-class contributions are expected to be: *Relevant*: Are your comments related to the case and to the comments of others? Do they move the discussion forward? Do they bring clarity to the general discussion? *Fact-Based*: Have you used specific data from the case, from readings, or from personal experience to support the assertions that you are making?

Cold Calling. In addition to your voluntary participation, I regularly select a few students at random to open and/or lead the case discussion.

I ask that you deal with the cases as you find them; do not seek outside or post-case data on the firm or industry. Of course, if you already know things

about the case, from previous experience, this can be very useful in case discussions. Please let me know about it in advance, and I will make a point to call on you at the appropriate time.

Case discussion constitutes more than half the class time, so there will be ample opportunity for each of you to participate. If you feel that you are preparing well but that I am not calling on you enough, please let me know so that I can address the problem.

Case Writeups (30% – Group/Type A)

Each student has to submit **six** case writeups. For each case, Section F lists the questions that the student has to answer. Writeups are graded on a scale from 1 to 5 and contribute to 30% of the final grade. Students can work on their writeups in groups of at most **four** people of the same session (strict limit). For each submission, groups can send a single copy of their work listing the names of participating students.

Part I: Aldi, Capital One, Tesla, The Economist, Etsy

Part II: Albert Heijn, Philip Morris, General Mills, Pratt & Whitney

Part III: Red Bull, Microsoft, Spotify, Nintendo

If a group or a student submits more than 6 writeups, only the first 6 will count for the final grade. Note, if two cases are discussed in the same session, you can only submit the writeup for one, not both.

Due date. Writeups are due the day before the case is discussed in class. Submit online via Canvas.

Format. Write-ups should be no longer than one page. This is an exercise in synthesis. Length does not translate in a higher grade. In answering the question, it is essential that you use concepts developed in class.

Use. I may occasionally call upon someone or a group to discuss his/her/their ideas. Write-ups are graded on scale from 1 to 5.

Final exam (35% – Individual/Type B)

Take-home, open-book exam. Date: **TBD**. The exam must be submitted on Canvas **by TBD**. After our final session, on TBD, you will receive a case study. You will have one week to read it and review the class material. On TBD at 2pm, you will receive the exam questions, which you will have to answer before TBD, 12pm.

F. PREPARATION QUESTIONS

You can use these questions to prepare for class discussions.

Enterprise

- Analyze Enterprise's strategy and competitive position. Why has Enterprise been so successful?
- How attractive is the car-rental industry in terms of long-term profitability?

Aldi

- Discuss the main elements of Aldi's strategy. Does this strategy result in a cost advantage in the discount grocery segment relative to Walmart?
- Does Aldi have a (sustainable) competitive advantage in the US? Yes or no?
- How should Walmart react to Aldi's expansion? Should they imitate some of the key choices of Aldi's? Should they go to a price war to stop Aldi's expansion?

The Economist

- What explains the success of The Economist thus far? Why has it managed to succeed while so many other magazines are struggling?
- How was The Economist able to increase prices and circulation at the same time?
- What are the main industry threats that The Economist should be sensitive to? What are the main opportunities that it could take advantage of?

Capital One

- What, if any, competitive advantages does Capital One have?
- Are these advantages sustainable into the future?
- As head of Capital One, what would be your strategic priorities?

Tesla

- Should BMW expect Tesla to grow into a strong direct competitor like Audi (versus Tesla being either limited to a niche or a flash in the pan)? Is Tesla at a competitive advantage or disadvantage? How will that evolve?
- What do you think of Tesla's entry strategy? What barriers did it have to overcome? How did it manage to do so? Will other firms follow in Tesla's footsteps?
- How do you expect the industry to evolve?

Etsy

- Evaluate Amazon's initial response to Etsy's entry. Did they blow it? Motivate your answer.
- Does ETSY have a sustainable competitive advantage? Can Amazon replicate Etsy's strategy?

Microsoft

- What, if any, competitive advantages does Google enjoy in search? Are these competitive advantages sustainable?
- What, if any, are the strategic reasons for Microsoft to challenge Google in search?
- Does Microsoft have a competitive advantage in search? What market share do they need to be profitable? Do you think they will be successful?

Philip Morris

- Using data from the case, provide a comprehensive industry analysis of the tobacco industry during the 80s.
- Now compare this industry with the segment of the car rental industry in which Enterprise operated in the 80s. From a competitive perspective, how is PM's

position different from Enterprise's? What is the first-order difference between these two industries?

- What accounts for Philip Morris' dramatic shift in strategy in April 1993? What are its goals?

Albert Heijn

- Using data from the case, provide a comprehensive industry analysis of the food retail industry in the Netherlands at the beginning of the 2000s.
- What kind of competitive advantage did Albert Heijn have at the beginning of the 2000s?
- In your opinion, what is the strategic goal (if any) in Albert Heijn's dramatic price cut in October 2003?

General Mills

- Provide an estimate of the cost of entry, namely initial investment in fixed costs to reach MES, for the RTE Cereal industry in the 80s.
- Using the framework developed in class, explain why the RTE Cereal industry has been profitable. Why has RTE cereal been such a profitable business in the 80s?
- Describe the role of the price leader in this industry. More generally, what industry problem does a price leader solve?

Pratt and Whitney

- Qualitatively describe the cash flow that is generated by a new engine program for a company like P&W. How come that competition drives engine producers to sell their products at a loss?
- How feasible do you think it is for P&W and GE to coordinate on a better industry equilibrium. Is cooperation so hard in this industry? Explain why.

- Assuming PW has decided to go ahead with the GTF technology, how should it proceed?

Red Bull

- Describe Red Bull entry in the US market. What kind of strategy did the company adopt to successfully enter the market?
- Was it a strategic mistake for Coke to let Red Bull freely enter the US market? Did Coke have any competitive advantage to fight off the new entrant? If so, what were the sources of such an advantage?
- How was Monster able to catch up with Red Bull? Why didn't Red Bull react more aggressively to Monster's entry?

Spotify

- Who are the major players in the music industry? Which players in the value chain have the strongest position? Explain.
- How attractive is the music streaming market in the medium to long-run? Identify main threats and opportunities for Spotify.

Nintendo

- Nintendo successfully rebuilt the home videogame business following the Atari-era boom and bust. How did it do so?
- How did Nintendo capture value from the home video game business? How did it avoid that "content" developers (such as Electronic Arts), or distributors (such as Walmart, ToysRUs) captured all the rents?