

## ECONOMICS OF STRATEGIC BEHAVIOR

Block week class – Summer (May) 2023

PROFESSOR WOUTER DESSEIN

### A. ADMINISTRATIVE INFORMATION

#### Contact Information

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#### Required Materials

- Cases, additional readings and hand-outs posted on CANVAS.
- Bruce Greenwald and Judd Kahn (2005): Competition Demystified (CD).

### B. COURSE DESCRIPTION

This course examines the underlying economics of successful business strategy, including

- (i) The sources of long-run competitive advantage.
- (ii) The *dynamics* of competition and competitive advantage.
- (iii) *Strategic interactions* (competitive and/or cooperative) between pairs of firms.

Three characteristics distinguish our approach. First, we focus on the large strategic decisions which 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 quite 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. Course 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. REQUIRED 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 with Core
Managerial Economics	<ol style="list-style-type: none"><li>1. Understanding market competition and equilibrium thinking (in the short-run).</li><li>2. Market equilibrium thinking (in the long-run) and barriers to entry.</li><li>3. Strategic Interaction among firms and Nash Equilibrium.</li><li>4. Pricing with market power.</li></ol>
Strategy Formulation	<ol style="list-style-type: none"><li>1. Creation of value vs. value capture</li><li>2. Competing firms.</li></ol>

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

### **D. CLASS SCHEDULE**

#### **I. Sources and Dynamics of Competitive Advantage .**

The first part of the course is focused on understanding the sources and dynamics of competitive advantages. It presents a simplified approach to business strategy, based on the notion that any *long-run competitive advantage* must rely on “barriers to entry”. Firms without competitive advantages should concentrate all their efforts on being efficient. Firms that do have competitive advantages need to design strategy with their competitors in mind.

## II. Shared Competitive Advantages: Managing Strategic Interactions.

After having developed the basic tools for the analysis of competitive advantage, we will use game theory as a framework for analyzing “shared competitive advantages”. The basic issue is simply this – when competitive advantage is shared with other firms, any action I take will elicit a reaction by my competitors. How can I incorporate those reactions in forming strategies so that I am not blindsided, and if possible, can even use them to my advantage? Can I find a way to move away from mutually destructive price competition, toward win-win games? How do I enter an industry, or avoid entry by new competitors? How do I structure and manage my relationship with suppliers and complementors?

Session		Topics Covered	Required Pre-readings <i>(optional if not in bold)</i>
<b>Day 1 Monday May 16</b>	Session A	Introduction,	<b>Enterprise Rent-A-Car*</b>   <b>Aldi: The Dark Horse Retailer*</b>  <b>The Economist*</b>  <i>Competition Demystified (CD) Chapters 1-4</i>
	Session B	Competitive Advantage & Industry Analysis	
	Session C	Competitive Advantage	
	Session D	--- --- --- --- ---	
<b>Day 2 Tuesday May 17</b>	Session A	Dynamics of Competitive Advantage	<b>Netflix: Competitive Dynamics in the Consumer Video Market*</b>      ETSY vs Amazon  <b>Tesla*</b>  <i>Competition Demystified (CD) Chapters 5-7</i>
	Session B	Competitive Advantage in a digital world.	
	Working lunch	Reading of Case: <b>ETSY vs Amazon</b>	
	Session C	Competitive Advantage in online marketplaces	
	Session D	Entry & Dynamics of Competitive Advantage	

\* Cases: Require advance reading and completion of an online case quiz prior to class.

Case preparation questions can be found at the end of the syllabus.

	<b>Topic</b>	<b>Topics Covered</b>	<b>Required Pre-readings</b> <i>(optional if not in bold)</i>
<b>Day 3 Wednesday May 18</b>	Session A	Strategic Interactions & Game Theory	<b>Shrimp Game</b>
	Session B	--- --- --- --- ---	"Game Theory: How to make it pay"
	Session C	Price Wars	<b>Philip Morris: Marlboro Friday*</b>
	Session D	Competition vs Cooperation	Albert Heijn <i>(Case distributed in class)</i>  <i>Competition Demystified (CD) Chapters 8-10</i>
<b>Day 4 Thursday May 19</b>	Session A	Price Wars & Entry-deterrence strategies	<b>Ready-to-Eat Breakfast Cereal*</b>
	Session B	Guest Speaker: <b>TBD</b>	
	<i>Working lunch</i>	Reading of case: <b>Dogfight over Europe: Ryanair (A)</b>	
	Session C	Entry Strategies	Dogfight over Europe: Ryanair
<b>Day 5 Friday May 20</b>	Session D	--- --- --- --- ---	<b>Red Bull*</b>  <i>CD Chapters 11-12</i>
	Session A	Suppliers, Distributors, Complementors: Friends or Foes?	<b>Spotify I: Music Streaming*</b>
	Session B		<b>Spotify II: Leading the podcasting market.</b> <i>(case distributed in class)</i>
	Session C	--- --- --- --- ---	<b>Power Play (A): Nintendo; *</b>
	Session D	Wrap-up	<i>CD Chapters 14-15</i>

**E. COURSE REQUIREMENTS AND GRADING** *(PRELIMINARY AND SUBJECT TO CHANGE)*

Grading will be based on (1) On-line case quizzes, (2) Class Participation and (3) a take-home case-based exam.

**1) On-line Quizzes (15% - Individual/Type B)**

For each starred case, there will be an **online quiz**, to be taken prior to 9am the day of class.

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. Be also prepared to discuss your answers in class.

**2) Class Participation (30% - Individual/Type B)**

Class participation is essential in order for you to get the maximum benefit from the course.

Your grade will be based on attendance, effort and the content of your contributions to the class discussions. The evaluation of content will be based on the following:

- **Relevance:** Are your comments clearly related to the case and to the comments of others? Do they move the discussion forward?

- **Fact-Based:** Have you used specific data from the case, from readings, or from personal experience to support the assertions that you are making?

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. In addition to voluntary participation, *I often randomly select a few students to open and/or lead the case discussion.*

Importantly, 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.

**3) Take-home case-based exam (55% - Individual)**

Information about this case-based final will be provided in class.

*Preparation Questions (be prepared to discuss these questions in class)*

**Enterprise Rent-a-Car**

1. How attractive is the car rental industry in terms of long-term profitability?
2. Analyze Enterprise's strategy and competitive position. Why has Enterprise been so successful?
3. Should Hertz or Avis launch a frontal assault on Enterprise?

**Aldi: The Dark Horse Discounter**

Aldi, the German-based hard discounter, has ambitious growth plans for the US market.

1. Discuss the main elements/choices of Aldi's strategy. Does this strategy result in a cost advantage in the discount grocery segment relative to Walmart?
2. Does Aldi have a (sustainable) competitive advantage in the US? Yes or no?
3. 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**

1. What explains the success of The Economist thus far? Why has it managed to succeed while so many other magazines are struggling?
2. Can the Economist survive and thrive in the digital age? What should its digital strategy be? (in terms of pricing, branding, format, ...)

**Netflix: Competitive Dynamics in the Consumer Video Market**

1. What was Netflix's original Competitive Advantage in DVD Rentals? How did it change over time?
2. Why was it so hard for Blockbuster to react to Netflix's entry?
3. Which of Netflix's Positional Advantages or Capabilities of Netflix helped the move to VOD?
4. Netflix decided to enter content production. Is this the right way forward for it? What are its advantages and disadvantages in this field?

**ETSY vs Amazon** *(Case distributed in class)*

1. Evaluate Amazon's initial response to Etsy's entry. Did they blow it?
2. Does ETSY have a sustainable competitive advantage? Can Amazon "out-ETSY" ETSY?

**Tesla Motors.** Tesla Motors attempts to become the first US firm since WWII to successfully enter the car industry with a mass-produced car.

1. 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?
2. 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?
3. How do you expect the industry to evolve?

**Philip Morris: Marlboro Friday**

1. How would you describe Marlboro's competitive position in early 1993?
2. What accounts for Philip Morris' dramatic shift in strategy in April 1993? What are its goals?
3. How should RJ Reynolds respond?
4. What kind of industry future does Philip Morris anticipate?

**Albert Heijn: Price Wars Among Retailers** *(Case distributed in class)*

1. How would you describe Albert Heijn's competitive position in 2003?
2. What are the goals of Albert Heijn's dramatic shift in strategy in October 2003?
3. Will Albert Heijn be successful in achieving its goals? Is the new price strategy a smart move?

**Ready-to-Eat Breakfast Cereal Industry**

1. Why has RTE cereal been such a profitable business?
2. How have the incumbent brands managed rivalry?
3. And how has entry been avoided for such a long time?
4. How should RTE cereal producers react to non-branded entry?

**Dogfight over Europe: Ryanair (A)** *(Case distributed in class)*

1. Describe Ryan Air's entry strategy.
2. Evaluate Ryan Air's entry strategy. Will it succeed?
3. Place yourself in the shoes of BA or AL. How would you respond to Ryan Air's entry?

**Red Bull**

1. At the time Red Bull entered the US market, would Coke have been at a competitive advantage if it had attacked Red Bull? If so, what were its sources of advantage? Why didn't it attack aggressively?
2. Is there anything that Coke or Red Bull should have done differently?
3. How was Monster Drinks able to catch up with Red Bull? Why didn't Red Bull react more aggressively? Should Red Bull or Monster have done things differently?

**Spotify: Music streaming.**

1. Why has Spotify been so successful?
2. Does Spotify have a competitive advantage? Can they maintain their leading market position?
3. Spotify has accumulated losses. Should we be worried? Can this become a profitable industry in the medium to long-run?

**Nintendo**

1. Nintendo successfully recreated the home video game business following the Atari-era boom and bust. How did it do so?
2. How did Nintendo capture value from the home video game business? How did it avoid that “content” developers (such as Electronic Arts), or distribution channels (such as Wal-Mart, ToysRUs) captured all the rents?