

Economics of Strategic Behavior

B8216 Fall 2020

PROFESSOR JACOPO PEREGO

(This syllabus is provisional and subject to change)

A. ADMINISTRATIVE INFORMATION

Contact Information

Office: Uris 616

Phone: (212) 851 - 5864

Email: jacopo.perego@gsb.columbia.edu

Office hours: TBD

Required Materials

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

Case studies, readings, hand-outs posted on Canvas.

B. COURSE DESCRIPTION

This course examines the underlying economics of a successful business strategy, 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. 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">1. Understanding market competition and equilibrium thinking (in the short-run).2. Market equilibrium thinking (in the long-run) and barriers to entry.3. Strategic Interaction among firms and Nash Equilibrium.4. Pricing with market power.
Strategy Formulation	<ol style="list-style-type: none">1. Creation of value vs. value capture.

2. Competing firms.

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

D. CLASS SCHEDULE

Part 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.

Each segment is about 1 hour and 30 minutes of class-time

Segment	Topics	Readings
Segment 1	Introduction	Enterprise
Segment 2	Industry Analysis	CD Chapters 1 to 3
Segment 3	Competitive Advantage	<u>Aldi</u>
Segment 4	Competitive Advantage	<u>The Economist</u> , CD Chapters 5 and 6
Segment 5	Competitive Advantage	<u>Capital One</u>
Segment 6	Network Effects and Economics of Platforms	<u>LinkedIn</u>
Segment 7	Mergers and Market Power	AT&T and Time Warner

Part II 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 predict and incorporate those reactions in forming strategies so that I am not blindsided, and if possible, can even use them to my advantage? We will focus attention on two distinct strategic problems: Price Cooperation (Part II.A) and Strategic Entry (Part II.B). More concretely, 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?

Part IIA: Price Cooperation

Segment	Topics	Readings
Segment 8	Introduction to Strategic Interactions	Game Theory: How to make it Pay CD Chapter 8
Segment 9	Competition and Cooperation	Shrimp Game CD Chapter 13 to 15
Segment 10	Price Wars	<u>Philip Morris</u>
Segment 11	Price Wars	<u>Albert Heijn</u>
Segment 12	Price Competition and Differentiation	<u>General Mills</u>
Segment 13	Antitrust	Handout
Segment 14	Guest Lecture	International Paper
Segment 15	Guest Lecture	<u>Pratt & Whitney</u>

Part II.B: Strategic Entry

Segment	Topics	Readings
---------	--------	----------

Segment 16	Strategic Entry	<u>Microsoft</u> CD Chapter 11-12
Segment 17	Platforms and Antitrust	Handout
Segment 18	Strategic Entry	<u>CarMax</u>
Segment 19	Guest Lecture – Strategic Entry	<u>Ryanair</u>
Segment 20	Guest Lecture – Strategic Entry	<u>Red Bull</u>
Segment 21	Strategic Entry	<u>S Group</u>
Segment 22	Strategic Entry	<u>Tesla</u>
Segment 23	Wrap Up	
Segment 24	Exam	

E. COURSE REQUIREMENTS AND GRADING

The final grade will be based on:

- **Class Participation and on-line Quizzes (35% - Individual/Type B)**

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.

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. Students who miss 33% or more of classes due to unexcused absences will receive a maximum grade of LP. 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?

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.

- **Case Write-ups (30% – Group/Type A)**

During the semester, you have to submit **six** case writeups. If by mistake you submit more than 6 writeups, only the first 6 will be graded. At the beginning of the course, you are expected to form groups of **up to four** students (strict limit). Each group has to submit two writeups per each part of the course, for a total of six submissions:

Part I: Aldi, The Economist, Capital One, LinkedIn

Part II.A: Albert Heijn, Philip Morris, General Mills, Pratt and Whitney

Part II.B: Microsoft, CarMax, S Group, Ryanair, Red Bull, Tesla

Due date. The day before the case is discussed in class submitted online on Canvas.

Format. The write-ups should be no longer than one page (strict limit, excluding tables and figures, if at all necessary). Writeups must focus on the underlined questions that you can find in Section F of this file and on Canvas as well. Please, structure your answers as follows. One paragraph summary that states your basic position. This paragraph should be as concise as possible. Shorter is better. This is an exercise in synthesis. The rest of your answer essentially argues why, through the lens of economic reasoning, you think that your position is correct. To conclude, you should list concisely potential problems with your position.

Use. I may occasionally call upon someone or a group to discuss his or her ideas. I will not write comments on the case write-ups but will grade them from 1 to 5.

3) Remote, open-book, case-based exam (35% – Individual/Type B)

Remote, open-book, case-based exam during last class session. A case will be distributed one week prior to the date of the exam. Questions will be published on exam day. Students will be able to submit via Canvas.

F. PREPARATION QUESTIONS

When reading the cases, please be prepared to discuss these questions in class. Case write-ups answer only underlined questions.

Enterprise

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

Aldi

- 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?
- 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?
- What opportunities can the Economist take advantage of, and what threats should they be sensitive to?
- Is Mass Intelligence a real business opportunity?

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?

LinkedIn

- Consider the market in which LinkedIn operates. Who are the company's customers? What affects their willingness-to-pay (WTP)? How does this market differ from a "standard" market? Explain.
- Briefly describe LinkedIn's pricing strategy and its rationale? How does the company's pricing strategy compare with the pricing strategy of The Economist, that we studied in class?
- Consider the industry of professional network services/platforms. Five years from today, do you expect competition to mature into a "cozy oligopoly," where a few rivals split the market equally and cooperate to maintain profitability high, or into a monopoly, where the winner takes all. Explain.

Microsoft

- What, if any, competitive advantages does Google enjoy in search? Are these competitive advantages sustainable?
- Does Microsoft have a competitive advantage in search? What market share do they need to be profitable? Do you think they will be successful?
- How should Google respond to Microsoft?

Car Max

- Why is car retailing a low-profit business?
- Discuss the main elements of CarMax's strategy. How does it affect consumers' willingness-to-pay? How does it influence costs?
- Does CarMax have a sustainable competitive advantage in the used-car market? How much room does CarMax have to grow?

Philip Morris

- How would you describe Marlboro's competitive position in early 1993?
- What is Marlboro's marketing strategy at that time?
- How does this compare to RJ Reynolds'?
- What accounts for Philip Morris' dramatic shift in strategy in April 1993? What are its goals?
- How should RJ Reynolds respond?
- What kind of industry future does Philip Morris anticipate?

Albert Heijn

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

Pratt and Whitney

- Should Pratt & Whitney go ahead with the GTF? Or, was the decision made by previous management to pull back from new engine programs the right one? (Assume UTC's cost of capital is 8%)
- Assume PW has decided to go ahead with the GTF technology, how should it proceed?

General Mills

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

S-Group

- In your opinion, does S-Group have a position-based CA, capability-based CA, or a combination of both?
- How concerned should S Group be about Amazon's expansion in Europe?

Ryanair

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

Red Bull

- 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?
- Is there anything that Coke or Red Bull should have done differently?
- 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?

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?