

ECONOMICS OF STRATEGIC BEHAVIOR
Block week class --- FALL 2014

PROFESSOR WOUTER DESSEIN

A. ADMINISTRATIVE INFORMATION

Contact Information

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Required Materials

- Course Pack (cases and additional readings), Hand-outs 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 PREREQUISITIES 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

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:

Session	Topic	Cases <i>Other Reading Assignments</i>
Day 1 Monday August 25	Intro to Economics of Strategic Behavior Sources of Competitive Advantage.	Enterprise Rent-A-Car* Airborne Express* Capital One* <i>Competition Demystified (CD) Chapters 1-4</i> <i>“Chapter 3: Two main routes to Competitive Advantage” (Course Pack)</i>
Day 2 Tuesday August 26	Dynamics of Competitive Advantage & Two-sided markets	The Economist* E-harmony* <i>CD Chapters 5-7</i>
	Firm Scope and Competitive advantage; Resource-based Competitive Advantages	Disney and Pixar*

** 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.

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 away 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?

	Topic	Cases <i>Other Reading Assignments</i>
Day 3 Wednesday August 27	Dynamics of Competitive Advantage	Tesla Motor*
	Intro to Strategic Interactions and Game Theory	Shrimp Game; (Game instructions given in class)
	Price Wars & Dynamics of Competition	Philip Morris: Marlboro Friday;* <i>"The Dynamics of Price Competition"</i> (Course Pack)
	Guest Speaker: Michael Diamond <i>SVP at Time Warner Cable (4:15-5:15pm)</i>	
Day 4 Thursday August 28	Entry & Entry Deterrence Strategies	Ready-to-Eat Breakfast Cereal;* Microsoft in Search;* <i>CD Chapters 11-15</i>
	Guest Speakers: Warren Teichner '04; <i>Principal at McKinsey & Co (9am – 10:15am)</i> John Rose; <i>Senior Partner and Managing Director at BCG (1pm-2:15pm)</i>	
Day 5 Friday August 29	Entry Strategies;	2010 Potash Wars: BHP Billeton's bid for Potash Corporation of Saskatchewan.* Dogfight over Europe: Ryanair (Case distributed in class)
	Distributors, Suppliers and Complementors: Friends or Foes?	Power Play (A): Nintendo; * Strategy Simulation game; (Instructions distributed in class)
	Course Wrap-up	

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

E. COURSE REQUIREMENTS AND GRADING

Grading will be based on (1) class participation and on-line case quizzes; (2) a take-away, open-book case-based exam, and (3) a final group project to be handed in by the end of September.

1) Class Participation and On-line Quizzes (33% - Individual/Type B)

For each starred case, there will be an **online quizz**, 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.

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.

2) Take-away, case-based exam (34% - Individual/Type B)

This exam is open-book, case-based and to be taken at home.

3) Final Group Project (33% – Group/Type A)

Analyze a company or industry, ideally focused on a particular strategic decision (or set of strategic decisions) by that company or the players in that industry. The main goal of the exercise is to make you think carefully about applying the concepts of “The Economics of Strategic Behavior”. *You can work in groups of two to four people. **No individual papers, and no groups of 5 people will be allowed.***

You should try to pick something creative, enlightening, and somewhat complex. Industries with a small number of firms are a good place to start. Try to have at least one “insider source” (somebody who works or has worked in that industry or company). Some research on the details is essential, but the key to a successful paper is to analyze, not just describe. Finally, do not base your paper on a case you discussed in one of your classes at CBS or on a previous paper you wrote (in case of doubt, contact me first.) Suggested length is between 10 and 12 pages double-spaced (that would be between 3500 and 4000 words) . You may include as many relevant exhibits as you wish (not counted in the page total). Be sure to include references. A number of final papers of previous years will be posted online.

Due Date: September 30 (DROPBOX CANVAS).

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

Discussion groups should focus on the questions in bold

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?

Airborne Express

1. Why has the express mail industry been so difficult for smaller players?
2. This is an industry with two major players. Why is competition between FedEx and UPS so fierce?
3. **How has Airborne managed to survive, and even thrive in this tough environment?**
4. **Does Airborne have cost advantages? Quantify if possible.**
5. What must Airborne do to continue to survive and thrive?

Capital One

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

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. What should Andrew Rashbass' major priorities be going forward? What opportunities can the Economist take advantage of, and what threats should they be sensitive to?
3. Is Mass Intelligence a real business opportunity?

eHarmony

1. Why do people want to meet others on-line instead of finding them in the real world?
- 2. What are the barriers-to-entry in the online-personals market?**
- 3. Does eHarmony have competitive advantages in this market? What are they? Do they result in higher profit-margins per subscriber than Match.com and Yahoo!?**
- 4. How serious is the competitive threat from Chemistry? How should eHarmony respond?**

Disney and Pixar

- 1. Are Disney and Pixar better together?**
- 2. What are the alternatives to acquire Pixar. Is ownership really necessary? Or could another long-term contract do the trick?**
3. If you decide to acquire Pixar, how would you integrate the two companies? Where are the opportunities and the headaches, how would you handle them?"

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 is Marlboro's marketing strategy at that time?
3. How does this compare to RJ Reynolds'?
4. What accounts for Philip Morris' dramatic shift in strategy in April 1993? What are its goals?
5. How should RJ Reynolds respond?
6. What kind of industry future does Philip Morris anticipate?

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)

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

Microsoft's Search

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

2010 Potash Wars

1. Why has the price of Potash been so volatile?
2. How does the Canpotex cartel work, given that the cartel only controls a subset of the market capacity? What is the position of the Potash corporation in the cartel?
3. Describe BHP's strategic position in the potash market, before its takeover attempt. Is it weak? Strong? Why?
4. Describe how a take-over of PCS allows BHP to improve or exploit its pre-takeover strategic position. What would be other alternatives? In what ways is a takeover better or worse than these alternatives from BHP's perspective?*
5. Describe whether and how BHP's strategy will increase value creation in the potash industry. Describe whether and how it allows BHP to capture value in this industry.

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?