



**KELLOGG**

DEPARTMENT OF MANAGERIAL ECONOMICS AND DECISION SCIENCES  
J.L. KELLOGG GRADUATE SCHOOL OF MANAGEMENT, NORTHWESTERN UNIVERSITY

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## COURSE SYLLABUS

# Strategic Issues in Commodity Industries

*Executive Masters Program*

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## What is this course about?

This course will introduce basic concepts and tool for the analysis of commodity industries. In particular, we will study:

- ***The determination of prices in competitive markets through supply and demand.*** In this part of the course, we will learn how to construct industry supply curves from actual data on costs and capacity and how to use these supply curves, in conjunction with information about demand, to develop educated conjectures about the path of market prices in an industry. This will enable us to develop intuition about the factors that permit a firm to attain above-average returns in what are often harsh and volatile industry environments.
- ***Evaluation of consolidation strategies.*** We will examine the sources of competitive advantage that result from consolidation strategies and, in particular, whether they are associated with improved efficiency or with the imposition of greater competitive discipline.
- ***Imperfect information and market volatility.*** We study two key concepts. First, we examine the causes and consequences of herd behavior in exaggerating volatility in commodity markets. Second, and more briefly, we shall study the role of real options in postponing capacity additions and withdrawals and its consequences on pricing dynamics.
- ***Government intervention and its effect on prices in competitive markets.*** We illustrate critical issues concerning the role of government with two cases. First, we examine the controversies surrounding subsidies in the global market for cotton. Second, in a “capstone” case, we examine the deregulation of the electric power market in California and the causes and consequences of the crisis in that market in 2000 and 2001.
- ***Collusion, market manipulation and market power.*** We examine collusion and market power in the context of the alleged conspiracy to raise fees in the NASDAQ in the mid 1990’s, and the California energy case where a allegations of market manipulations are central in the ongoing legal cases against energy companies.

## Course requirements

### *Homeworks:*

- Homework due dates appear in the course calendar.
- *All homeworks are to be done individually.*

### *Exercises:*

- Exercises will underlie case discussions and they are thus integral to understanding the course.
- However, unlike homeworks, *exercises will not be collected or graded.*

### *Term paper:*

- Due date is the beginning of the final class.
- The paper is to be done in teams.
- Term paper guidelines and topic selection will be discussed in class.
- All teams will be required to make a presentation of their paper in the final class.

### *Grading:*

- *Team Term Paper, 60%.*
- *Individual Homeworks, 40%* (distributed equally across homeworks).

### *Participation:*

The final grade computed above may be adjusted up or down by a maximum of 10% to reflect class participation and, by an additional maximum of 10% to reflect participation in team efforts.

# Course Outline

## **WEEK 1:**

### **SESSION 1:**

**Course introduction; in-class experiment on the operation of competitive markets**

#### *Readings:*

- “Preparing for the Aplia Exercise.”

#### *In-Class Exercise:*

- Aplia Market Exercise.

## WEEK 2:

### SESSIONS 2 & 3: *The Aluminum Smelting Industry*

#### *Readings:*

- “Does Paying \$500 to see Titanic Seem Fair?” *Wall Street Journal* (April 1, 1998).
- Seligman, D., “Of Mice and Economics,” *Forbes* (August 24, 1998), p. 24.
- D. Besanko, “Executive Summary of Cost Concepts,” Kellogg School of Management.
- D. Besanko, “Executive Summary of Perfect Competition,” Kellogg School of Management.

#### *Exercise:*

- “Constructing the Supply Curve for Primary Aluminum in 1994.” Kellogg School of Management.

*This homework requires a spreadsheet of data to be e-mailed to you separately.*

#### *Cases:*

- “The Aluminum Industry in 1994” (HBS 9-799-129).
- “Aluminum Smelting in South Africa: Alusaf’s Hillside Project” (HBS 9-799-130).

## WEEK 3

### *Individual Homework Problem 1 due:*

- Al-Najjar, N., “Competitive Analysis of the Copper Market,” Kellogg School of Management.

*This homework requires a spreadsheet of data to be e-mailed to you separately.*

### *Individual Homework Problem 2 due:*

- Al-Najjar, N. and D. Besanko, “Pricing Dynamics in the Cargo Shipping Business,” Kellogg School of Management.

## SESSION 4: *Consolidation*

### *Cases:*

- “The Newsprint Industry” (HBS N9-703-404).

## SESSION 5: *Herd behavior and Competitive Strategy*

- All reading will be supplied in class.

## **WEEK 4**

### **SESSION 6: *Government Policy Issues in Commodity Markets: Collusion***

#### *Readings:*

- Chapters 8 and 9 in Eichenwald, K., *The Informant* (New York: Broadway Books), 2000.

#### *Case:*

- Price-Fixing Vignettes (HBS 9-902-068)

### **SESSION 7: *Government Policy Issues in Commodity Markets: subsidies***

#### *Readings:*

- “Hanging by a Thread: In U.S. Cotton Farmers Thrive; In Africa they Fight to Survive --- America’s Subsidies Depress World Prices, Undermining its Foreign Policy Goals,” *Wall Street Journal*, (June 26, 2002).
- “A Knotty Problem: The WTO Looks Set to Declare America’s Cotton Subsidies Illegal,” *The Economist*, (April 29, 2004).
- Watkins, K., “Cultivating Poverty: The Impact of U.S. Cotton Subsidies on Africa,” *Oxfam Briefing Paper 30*, (September 27, 2002).

## WEEK 5

### *Individual Homework Problem 3 due:*

- Al-Najjar, N. and D. Besanko, “Competitive Dynamics with uncertain cost,” Kellogg School of Management. *To be passed out in class in Week 4.*

### *Individual Homework Problem 4 due:*

- Al-Najjar, N. and D. Besanko, “Competitive Dynamics with exit cost,” Kellogg School of Management. *To be passed out in class in Week 4.*

## SESSIONS 8 & 9:

## CAPSTONE CASE: The Market for Power in California

### *Readings*

- Thurm, S., “As California Starved for Energy, U.S. Businesses Had a Feast,” *Wall Street Journal* (September 16, 2002), p. A1, A8.
- Birnbaum, L., J-M. del Aguila, G. Dominguez Orive, & P. Lekander, “Why Electricity Markets Go Haywire,” *McKinsey Quarterly* (2002, 1), pp. 64-73.

### *Case:*

- Al-Najjar, N, & D. Besanko, “The California Power Crisis” (KSM 5-403-759).

## WEEK 6

## SESSION 10:

## Course wrap-up and term paper presentation