

Competitive Strategy and Industrial Structure

Syllabus for Winter 2014

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Office Hours: Fridays, 1:30pm-3:00pm

What this Course is About

This course is about the economics of competition. We use the tools of economics to study how market structure shapes competition, how to evaluate and respond to competitors' strategic moves, and how to formulate competitive strategies that take into account objective structural issues as well as competitors' responses and biases in decision making.

Major themes, supported by cases and exercises, include:

- 1. Product positioning.** We will use *the location model of product differentiation* to examine competitive strategy issues centered around product positioning decisions. We will also use the location model to examine strategies like proliferation, fighting brands, competitive convergence, and price protection policies, among others.
- 2. Short-term price competition.** The leading cases are American Airlines Value Pricing and GE vs. Westinghouse. The latter documents 10+ years of destructive price dynamics in an industry where just two firms have a virtually complete lock on a highly lucrative market. We will develop sets of tools, including the reaction functions framework, to examine short- vs. long-term incentives, destructive short-term price competition and price wars.
- 3. The durability of competitive advantage.** Competitive advantage is often the result of acquiring valuable strategic assets: unique, non-replicable assets that convey a long term cost and/or demand advantage. This part of the course explores how ownership of such assets impacts the ability of a firm to innovate and to compete, and how a small entrant can successfully penetrate a market controlled by large and powerful incumbents. We will use the frameworks of judo economics and credible strategic preemption to better understand strategic interactions in such environments.

4. **Managerial practices and competitive strategy.** We will study how marketing strategies, and in particular couponing and loyalty programs, affect competition. We will also use the location model of product differentiation to examine the effect on competition of managerial incentives and bonus plans to managers.
5. **Behavioral biases and irrationality.** Throughout the course we will emphasize how biases in managerial and consumer decision making affect competition.

Course Material

The course case packet will be available online at <https://www.study.net/kellogg>. Additional readings, assignments, solutions and other material will be periodically posted on the course Blackboard site at <https://courses.northwestern.edu/>.

Class Preparation

Class preparation is classified into 5 categories. Each category requires a different type of preparation, as follows:

Required readings. Class discussion will draw heavily on such readings and so you should study these readings carefully before coming to class.

Cases. You are required to prepare all cases covered in the course. In preparing a case for class discussion, read through the case thoroughly. Some cases are preceded with a set of discussion questions that should guide you in your preparation.

Homework assignments. These will play a central role in class preparation and discussion, and will also be used to reinforce conclusions that we reached in class.

There are 6 homework assignments, 3 to be done individually and 3 to be done in teams. Homework assignments will usually be posted on blackboard a week before the due date. They are due in the beginning of class.

For a team homework, each team should hand in a single write-up of the solution.

Exercises. Class discussion will draw heavily on these, so you are required to thoroughly familiarize yourself with the exercises *before* coming to class. Each team should go over the exercise and prepare either a written sketch of a solution or a written account of the difficulties that prevented you from reaching such solution. Answers to exercises will not be collected or graded.

Optional readings. These are readings we might refer to in class (usually depending on the time available). Although they provide useful supporting material, they are not essential for the main points made in class.

Class Sessions

Class attendance, preparation, and participation are expected and represent an essential component of the learning experience in this course. Learning opportunities are maximized when a student is actively engaged in class discussion. Active engagement means that you are listening carefully to the comments of other students and seeking opportunities to make relevant comments. I evaluate class participation based on:

Relevance: Are your comments clearly related to the case and to the comments of others? Does your comment stick to a subject or does it wander?

Advancement: Does your comment move class discussion forward? Does it take the discussion farther or deeper than previous comments?

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

Logical: Is your reasoning consistent and logical? Do you use concepts from the readings or lectures correctly?

Originality: Do your comments go beyond the mundane and commonplace and bring fresh analytic perspectives to bear on the problems under consideration?

On the whole, what matters is the quality of class participation, not the quantity.

To increase opportunities for effective participation, I will ask a student to open the class discussion. I will also cold call students during the course of a discussion. If you feel that you are preparing well but that I am not calling on you often enough, please let me know.

Please bring your nameplates to class and display them throughout the quarter.

Mobile Devices Policy

Tablets are allowed during class only if used for class purposes and lay flat on your desk. Other mobile devices are not allowed unless otherwise noted.

Grading

Course score before adjustments:

- | | |
|-----------------------------------|-----|
| 1. Team term paper | 35% |
| 2. Optional in-class midterm exam | 20% |
| 3. In-class final examination | 35% |
| 4. Homework assignments | 10% |

The result is your course score before adjustments.

Team term paper: The team term paper is an essential part of the learning experience in this course. A good paper will sharpen your understanding of the frameworks and concepts developed in the course by applying them to important real-world situations.

The first and most critical task is to identify a context (a firm, an interaction among firms, a change in an industry's structure, etc.) with a *relevant Economics-based, strategy question*. To help you in deciding on the paper topic, I will ask that you send me a two paragraph topic proposal by the end of the 6th week of the quarter.

Detailed term paper guidelines will be posted on Blackboard.

Optional midterm: For each student I take the *highest* of two scores:

- 1-The score based on the percentages above; and
- 2-The score with the same weights for the term paper and homeworks, but where the final exam counts for 55% and the midterm exam carries no weight.

This means that if you decide not to take the midterm, or if you take it but you do better in the final exam, only the final exam grade will count. The midterm will count only if it can help you improve your overall position.

Adjustments: The score computed above is then adjusted *up or down* to reflect class participation, attendance, and participation in the collective team effort.

Class participation adjustment: your grade can move *up or down by a factor of 10%*, reflecting class participation. Please note that it is the quality of participation that counts, not its quantity.

Team participation adjustment: at the end of the quarter I will circulate an electronic form in which you evaluate the individual contribution of each member of your team to collective team effort. The grade computed according to the percentages above can *move up by at most 5%* or *move down by at most 15%* based on your contribution to your team. Most students make a fair and adequate contribution and so they get no adjustment, positive or negative, indicating adequate contribution to team effort. As a general rule, *these adjustments will be made conservatively, and only when there is a compelling reason to do so.*

In rare cases, a student does not contribute to the team effort. In such cases, the grade can be adjusted down by more than 15%.

Adjusted course score: I will take the score before adjustment and add to it any adjustments as described above to obtain the adjusted course score. Your final letter grade in the course will be based on this adjusted score.

Preparation before the course starts

Knowledge of elementary concepts of probability and finance will be assumed throughout. More critical is that you are expected to be comfortable with the basic Economics concepts covered in a standard introductory course (such as MECN 430). Homeworks and exercises are prepared based on the premise that the students can apply basic economic reasoning to the problems at hand.

Your economic background should include basic familiarity with demand and cost concepts, perfect competition, and monopoly pricing. *These concepts will not be reviewed in class.* On the other hand, you can review them using the textbook:

Besanko, D. and R. Braeutigam, "Microeconomics: An Integrated Approach," 2002. John Wiley and Sons. Chapters 2, 8, 9, 11 and 13 are the ones to focus on.

Alternatively, you may review them using the following notes (to be posted on Blackboard):

Besanko, D., "**Review Notes:** Economic Concepts of Cost and the Theory of Perfectly Competitive Markets" (Kellogg School of Management).

Besanko, D., "**Review Notes:** Marginal Revenue and the Theory of Profit-Maximizing Pricing" (Kellogg School of Management).

Kellogg Honor Code

The Kellogg Honor Code is applicable in this class. The complete text of the Honor Code is available on the Honor Code website:

http://www.kellogg.northwestern.edu/stu_aff/policies/honorcode.htm

The following discussion in this syllabus of the Honor Code does not cover all applications of the Honor Code but only highlights some very important aspects of it. If you believe something is unclear or has been omitted, please do not hesitate to speak to me.

Assignments and Exams. Write-ups must be your original work. You may not use materials containing solutions or partial solutions to the homework or papers (including solutions prepared by current or former students). If your analysis contains information from outside sources, then you must properly cite the sources. You may not discuss a team homework with any person who is not a member of your team, other than me. You may not discuss an individual homework with any person other than me. No assistance may be given or received during an exam. You may not discuss the exam with any other person before the exams are graded. Exams must be completed within the allotted time and only approved materials may be used.