Competitive Strategy and Industrial Structure
Syllabus for Winter 2019 (Sections 31, 32)

Note: Final Winter 2020 Syllabus may differ

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Office Hours: Thursdays, 9:00am–11:00am (walk in)

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. **Managing price competition.** The leading cases are American Airlines’ Value Pricing and General Electric 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-term vs. long-term incentives, destructive short-term price competition, and risk factors for 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 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

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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 posted on the course Canvas site at https://canvas.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, 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 several homework assignments, some to be done individually and some to be done in teams.* Homework assignments will be posted and submitted on Canvas. Submissions may be either typeset or legibly handwritten.

**Exercises.** Class discussion will draw heavily on these, so you are expected to thoroughly familiarize yourself with the exercises before coming to class. Each student, either individually or in teams, should go over the exercise and prepare either a written sketch of a solution or a written account of the difficulties encountered in reaching such a 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. 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 further 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 often 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.*

**Electronic Devices Policy**

Tablets are allowed during class only if used for class purposes and only if they lay flat on your desk. Laptops, cell phones, and other electronic devices are not allowed unless otherwise noted.

**Team Term Paper and In-Class Presentation**

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. Teams will also present their analysis in class, during the last week of the course.

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 are posted on Canvas.*

**Grading**

**Course score before adjustments.** Your course score *before adjustments* is determined by the following components.

1. Team term paper and in-class presentation 40%
2. *Optional* in-class midterm exam 0% – 15%
3. Final examination 35% – 50%
4. Homework assignments 10%

**Midterm and final exams.** For each student, I choose the weights placed on the midterm exam and the final exam in the above formula so as to result in the highest possible course score. In other words, if you do better on the midterm than on the final, then the midterm will count for 15% of your grade, while the final will count for 35%. On the other hand, if you do better on the final than on the midterm, or if you do not take the midterm at all, then the final will count for 50%, while
the midterm will carry no weight. The midterm is optional, and it will count only if it can help you improve your overall position. Choosing not to take it will not count against you.

**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.* The grade computed according to the percentages above can move up or down by 10% in response to class participation. Please remember that it is the quality of participation that counts, not the quantity.
- *Team participation adjustment.* At the end of the quarter I will circulate an electronic form through which you may 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. As a general rule, these adjustments will be made conservatively, and only when there is a compelling reason to do so. Most students make a fair and adequate contribution and so they get no adjustment, positive or negative, indicating adequate contribution to team effort. In rare cases in which a student completely fails to contribute to the team effort, the grade may 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, finance, and algebra 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). Homework assignments 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.* However, you can review them using the following textbook (Chapters 2, 8, 9, 11 and 13 are the ones to focus on):


Alternatively, you may review these concepts using the following notes, which are posted on Canvas:

- 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 paragraphs do not cover all applications of the Honor Code to this course, but only highlight some very important aspects of it. If you believe something is unclear or has been omitted, please do not hesitate to speak to me.

Homework assignments. 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.

Exams. 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.
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Class Schedule for Winter 2020 (Sections 31, 32)

Note: Final Winter 2020 Schedule may differ

Week 1A (January 6). Course Introduction & The Location Model of Product Differentiation

Required Reading: Besanko, D., “Note on Product Differentiation and Price Competition in an Oligopoly,” Kellogg School of Management. (Canvas)

Uncollected Exercise: Besanko, D., “Exercise in Product Differentiation,” Kellogg School of Management. (Canvas)

Week 1B (January 9). Competing in Markets with the Potential for Differentiation: Product Positioning

Individual Homework Due: Besanko, D., “Positioning of Gillette Sensor,” Kellogg School of Management. (Canvas)

Week 2A (January 13). Competing in Markets with the Potential for Differentiation: Ready-to-Eat Cereal

Individual Homework Due: Besanko, D., “Product Proliferation and Preemption,” Kellogg School of Management. (Canvas)


Optional Reading: Gryta, T., “A Spoonful of Sugar Helps the Sales Go Up: Cereal Makers Return to the Sweet Stuff,” Wall Street Journal, April 5, 2018. (Link)

Week 2B (January 16). Dynamic Price Competition: Tacit Collusion and Risk Factor Analysis

Mini-Case: Mollner, J., “Price Transparency in the Chilean Retail Gasoline Industry.” (To be distributed in class)

Uncollected Exercise: Mollner, J., “The Gas Station Game,” Kellogg School of Management. (Canvas)


Note: Team registration due January 17 at 10pm.
Week 3A (January 22). Dynamic Price Competition: American Airlines’ Value Pricing

Week 3B (January 23). Dynamic Price Competition: The Credit Card Industry
Due: Case: Al-Najjar, N., and R. Malik, “The U.S. Credit Card Industry,” Kellogg School of Management, Case KEL152. (CP)

Week 4A (January 27). Dynamic Price Competition: Burger Wars & Class Experiment
Case: Salant, Y., “The War of the Burgers,” Kellogg School of Management. (Canvas)

Week 4B (January 30). Strategic Management of Price Competition: Introduction to Strategic Commitments

Week 5A (February 3). Optional In-Class Midterm Exam
Uncollected Exercise: Mollner, J., “Exercise on Strategic Commitments,” Kellogg School of Management. (Canvas)

Week 5B (February 6). Strategic Management of Price Competition: GE vs. Westinghouse I

Week 6A (February 10). Strategic Management of Price Competition: GE vs. Westinghouse II
Uncollected Exercise: Mollner, J., “Price Competition with Price Floors,” Kellogg School of Management. (Canvas)

Week 6B (February 13). Strategic Management of Price Competition: Managerial Incentives
Team Homework Due: Besanko, D., “Price Competition in the Canadian Stick Margarine Market,” Kellogg School of Management. (Canvas)

Note: Term paper proposals due February 14 at 10pm.
Week 7A (February 17). Strategic Management of Price Competition: Coupons

Mini-Case: Salant, Y., “Hyundai Assurance,” Kellogg School of Management. (To be distributed in class)

Uncollected Exercise: Besanko, D., “Price Discrimination in an Oligopoly Market,” Kellogg School of Management. (Canvas)

Week 7B (February 20). Strategic Management of Price Competition: Share vs. Loyalty Building

Team Homework Due: Besanko, D., “A Simple Model of Pricing and Rebates in the Automobile Market,” Kellogg School of Management. (Canvas)


Week 8A (February 24). Entry and Judo Economics I

Mini-Case: Al-Najjar, N., “Delta’s Choice,” Kellogg School of Management. (To be distributed in class)

Uncollected Exercise: Mollner, J., “Responding to Entry in the Steel Industry,” Kellogg School of Management. (Canvas)


Week 8B (February 27). Entry and Judo Economics II

Team Homework Due: Besanko, D., “Revisiting Entry in the RTEC Industry,” Kellogg School of Management. (Canvas)

Mini-Case: Al-Najjar, N., “Microsoft in Thailand,” Kellogg School of Management. (To be distributed in class)

Optional Reading: “Invasion of the Bottle Snatchers,” The Economist, July 9, 2016. (Link)

Week 9A (March 2). Competing in Long-Tail Markets I


Week 9B (March 5). Competing in Long-Tail Markets II


“Craft Beer Turns Out to Be a Big Business,” Wall Street Journal, April 1, 2018. (Link)
Note: Term papers and presentation slides due March 9 at noon.

Week 10A (March 9). Term Paper Presentations I

Week 10B (March 12). Term Paper Presentations II