Competitive Strategy and Industrial Structure
Syllabus for Winter 2017 (Section 61)

Note: Final Winter 2018 Syllabus may differ

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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 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.

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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](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/](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 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 several homework assignments, some to be done individually and some to be done in teams.** Homework assignments will be posted and submitted on Canvas.

**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 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.*

**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 and in-class presentation 40%
2. Optional in-class midterm exam 15%
3. Final examination 35%
4. Homework assignments 10%

The result is your *course score before adjustments*.

**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.

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 Canvas.

**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 50% 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:

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


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.
Competitive Strategy and Industrial Structure
Class Schedule for Winter 2017 (Section 61)

Week 1A (January 5). Course Introduction & 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). The Competitive Strategy of Product Positioning: The Gillette Sensor

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

Week 2A (January 11). Competing in Markets with Strong Taste for Variety: The Ready to Eat Cereal Industry


Uncollected Exercise: Besanko, D., “Exercise on Product Proliferation and Preemption,” Kellogg School of Management. (Canvas)

Week 2B (January 12). Competing in Markets with Strong Taste for Variety: Auto Retailing

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


Note: Team registration due January 13 at 10pm.
Week 3A (January 18). Strategic Management of Price Competition: *American Airlines’ Value Pricing Initiative*

*Case:* “American Airlines’ Value Pricing (A)” HBS 9-594-001. (CP)

*Optional Readings:*


Week 3B (January 19). Strategic Management of Price Competition: *The Credit Card Industry*


*Case:* Al-Najjar, N., and R. Malik, “The U.S. Credit Card Industry,” Kellogg School of Management, Case KEL152. (CP)

Week 4A (January 23). Strategic Management of Price Competition: *GE vs. Westinghouse*

*Case:* “GE Versus Westinghouse in Large Turbine Generators (A)” HBS 9-380-128. (CP)

*Optional Readings:*


Week 4B (January 26). Strategic Management of Price Competition: *GE vs. Westinghouse II*

*Case:* “GE Versus Westinghouse in Large Turbine Generators (A)” HBS 9-380-128. (CP)
Week 5A (January 30). Optional In-Class Midterm Exam

Week 5B (February 2). Strategic Management of Price Competition: Class Experiment

Week 6A (February 6). Competitive Analysis of Marketing Strategies: Coupons

  **Mini-Case:** Salant, Y., “Hyundai Assurance.” *(To be distributed in class)*

  **Uncollected Exercise:** Besanko, D., “Price Discrimination in an Oligopoly Market.” *(Canvas)*

Week 6B (February 9). Competitive Analysis of Marketing Strategies: Share vs. Loyalty Building Strategies

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

  **Case:** Baliga, S. and P. Klibanoff, “Loyalty Incentives: General Motors’ GM Card,” Kellogg School of Management. *(CP)*

**Note:** Term paper proposals due February 10 at 10pm.

Week 7A (February 13). Competitive Analysis of Managerial Incentives

  **Team Homework Due:** Besanko, D., “Price Competition in the Canadian Stick Margarine Market,” Kellogg School of Management. *(Canvas)*

Week 7B (February 16). Guest Talk: Topics in Antitrust and Competition

  **Required Reading:** US Department of Justice, “Antitrust Enforcement and the Consumer.” *(Canvas)*
Week 8A (February 20). Entry and Judo Economics I

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

**Uncollected Exercise:**  Baliga, S. and P. Klibanoff, “Judo Entry,” Kellogg School of Management. *(Canvas)*


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Week 8B (February 23). Entry and Judo Economics II

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

**Optional Readings:**

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Week 9A (February 27). Competing in Long-Tail Markets: *Pandora*

**Case:**  Shih, W. and H. Tecco, “Pandora Radio: Fire Unprofitable Customers?” HBS 9-610-077. *(CP)*

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Week 9B (March 2). Course Summary and Review

**Case:**  Salant, Y., “The Burger Wars.” *(Canvas)*

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**Note:** Term papers and presentation slides due March 6 at noon.

Week 10A (March 6). Term Paper Presentations I

Week 10B (March 9). Term Paper Presentations II