MECN 441:
Competitive Strategy and Industrial Structure
Summer Quarter 2020 Syllabus

Professor Brett Saraniti
(cell) 808-258-7701
e-mail: b-saraniti@kellogg.northwestern.edu

Office Hours: One hour before class
What is this Course About?

Warren Buffet once said: “When an industry with a reputation for difficult economics meets a manager with a reputation for excellence, it is usually the industry that keeps its reputation intact.” Though some business executives share Buffet’s realistic appreciation of the power and relentlessness of competitive forces, many often under-appreciate the numerous ways in which competition can destroy profitability. Consider a sample of common competitive dynamics:

In commodity industries such as copper or bulk shipping services, torrents of new capacity flow in during boom times but once in place, the capacity remains stuck in the industry during bad times, and indeed the fact that firms refuse to withdraw capacity during the bad times makes the bad times even longer and more dismal.

In tight oligopolies such as the global commercial airframe business (Boeing versus Airbus) or the electric turbine business (GE versus Siemens), firms leave enormous amounts of money on the table through brutal competition on price and delivery terms.

In consumer packaged goods markets, such as ready-to-eat breakfast cereals, firms that otherwise seem to do a good job of avoiding head-to-head price competition, squander profits through the mass issuance of coupons. Similarly, some pharmaceuticals compete through aggressive sampling.

Even large, successful incumbent firms with seemingly secure, invulnerable competitive positions --- e.g. P&G (Gillette) in the shaving business --- find their positions and long-run profitability nibbled away as a result of incursions by smaller, seemingly more nimble, competitors.

In competition for the strategic assets that might serve as the source of future competitive advantages or market dominance --- e.g., competition by European telecom firms to acquire 3G licenses in government-sponsored spectrum auction or competition for “clicks” and “eyeballs” by Internet retailers --- firms end up paying prices for these assets that just offset -- or maybe even more than offset --- the extra value conferred upon the firm by virtue of owning the asset.

The goal of MECN 441 is to teach you how to use structured thinking based on microeconomic theory to enable your intuition about market competition so that you increase the odds of making better and more focused strategic decisions. More specifically, by the time you are done with this course, you will come away with four valuable skills. You will be able to:
1. Apply microeconomic reasoning to complex environments and anticipate when profit-destroying competitive dynamics might arise.

2. Construct and analyze simple, logically consistent, microeconomic models that capture the essence of a competitive situation and drive you toward a deeper understanding of the key economic forces in that situation.

3. Incorporate uncertainty, strategic behavior, and equilibrium analysis into financial analyses of strategic decisions.

4. Combine your deepened intuition with your new-found analytical skills to identify economically grounded and strategically creative options for overcoming profit-destroying competitive dynamics.

In particular, the course studies competition from three different angles:

- First, we study competition in oligopoly markets. In this setting we explore the factors that drive the intensity of short-run price competition among firms in an industry and the steps that firms can take to blunt the profit-dissipating effects of that competition. In addition, we explore long-run strategic moves that firms can take to shape the nature of competition within an oligopolistic industry to its advantage.

- Next, we study competition between firms to acquire valuable strategic assets, assets that give the firm an opportunity to develop and sustain a competitive advantage in the future. Sometimes such competition takes place in the form of an auction. Other times, it takes the form of a race to dominate a market or develop a new technology. This part of the course explores the extent to which competition to acquire valuable strategic assets is likely to dissipate the rents that the firm would otherwise earn from ownership of the asset.

- Finally, we study competition in free-entry markets --- markets with minimal barriers to entry, where the reality of entry acts as a key force in driving rents toward zero. We'll move beyond the simple model of perfect competition that you learned in your MECN 430 class by exploring how uncertainty about demand, coupled with the so-called “option value of delay”
can lead to extraordinarily volatile industry environments, and how potential difference in information about fundamental market conditions can exacerbate this volatility.

**Teaching Approach**

The course relies on lectures, problem solving, and case discussions. Each week, I will distribute an assignment sheet that includes questions on the assigned readings and cases and homework problems.

**Grading**

Grades in the course will be based on three components: (1) a team term paper, which counts 40 percent in the determination of your final grade; (2) a midterm exam [actually a ¾ term exam] which counts for 40 percent of your grade; (3) group homework problems which count 20 percent in the determination of your final grade. Lastly, in extreme circumstances I reserve the right to adjust your raw grade score by up to 10% based on peer reviews and class participation.

**Course Materials**

The course will use a case packet that can be purchased through Study.net. Articles from popular sources (The Economist, WSJ, Chicago Tribune, etc…) will be made available on Canvas.

**Acknowledgements**

This course has been developed over many years as a result of collaboration among a number of Kellogg faculty members. I want to especially thank Professors David Besanko, James Dana, Peter Klibanoff, Sandeep Baliga, and Nabil Al-Najjar for their insights and willingness to share their course materials with me. And I am particularly grateful to Professor Mark Satterthwaite who pioneered this course for Kellogg.
Detailed Course Outline

Detailed schedule updates and homework assignments will be posted each week on the class Canvas site. Power point slides from each lecture, Excel workbooks with case data, and additional readings will also be posted on canvas each week.

Course Introduction/Motivational Readings:

Readings:
“Game Theory in Practice” Economist (September 3, 2011).
DePillis, Lydia. “These Hyper-Secretive Economists are Transforming How Amazon Does Business” CNN (March 13, 2019).
Part I: Short-run price competition in oligopoly markets

SESSION 1: Price competition in oligopoly markets: product differentiation & other factors that soften or intensify rivalry

Readings:
Al-Najjar, N., “Notes on Strategic Interaction and Oligopoly,” (Kellogg School of Management).
Besanko, D., “Note on Product Differentiation and Price Competition in an Oligopoly,” (Kellogg School of Management).
Lahart, Justin “United Continental May Drag Industry into Price War” WSJ (January 24, 2018).

Cases:
Saraniti, B., The Hawaiian Airlines Industry 2001-2008 (Kellogg School of Management)

(Uncollected) Exercise for Class Discussion:
Saraniti, B., “Launching the Nintendo Switch,” (Kellogg School of Management).

SESSION 2: Strategically managing price competition in an oligopoly industry

Readings:
“The Experience Curve,” Economist (September 14, 2009.)
White, J. “Medicaid Best Price Approach to Drug Costs Needs and Upgrade.” STAT (Nov 10,
2017.)
Lyrchikova, A., “Russian Drive to Replace Western Technology…” Reuters (April 17, 2018).


Case:
GE Versus Westinghouse in Large Turbine Generators (A), (B), and (C). (HBS 9-380-128-130) [(B) and (C) will be passed out during class].

Team HW #1 Due

SESSION 3: Strategically managing price competition in an oligopoly industry: price discrimination, coupons, loyalty and market segmentation

Readings:
“Can GM Sell Cars with a Credit Card?” Businessweek (Sept 21, 1992)

Case:

Team HW #2 Due:

Additional (Uncollected) Exercise for Class Discussion:
SESSION 4: The US credit card industry

Readings:

Karagianis, L. “Hidden Costs,” MIT Spectrum (Spring 2009.)

“All Credit to Them” Economist (September 21, 2015.)

Video:

“Secret History of the Credit Card” PBS-Frontline

https://www.pbs.org/wgbh/frontline/film/showscredit/

Case:

Al-Najjar, N., and R. Malik: “The U.S. credit card industry,” Kellogg School of Management, Case KEL152.

TEAM Homework #3 Due:

Part II: Strategic moves that shape industry structure

SESSION 5: New product introductions, pre-emption, and entry: RTE cereals

Readings:

“Invasion of the Bottle Snatchers” Economist (July 9, 2016.)


Case:

The Ready-to-Eat Breakfast Cereal Industry in 1994 (A) (HBS 9-795-191, 192) (review)

Team Homework #4 Due:
Part III: Competing for strategic assets

SESSION 6: Competitive bidding for strategic assets and winner-take-all markets

Readings:
Cramton, P., “Money out of Thin Air: the Nationwide Narrowband PCS Auction,” pp. 267-279
“Off the block” Economist (August 29, 2015)
“What price air” Businessweek (March 14, 1994)
Metz, Cade, “Facebook Doesn’t Make as Much Money as it Could – On Purpose,” Wired (September, 2015).
“War of Attrition and Regulation for Operators in Australia’s Bike Sharing market” (Financial Review 1/24/19)
LINK to video by Hal Varian (Chief Economist, Google) explaining Google’s Adword Auctions: https://www.youtube.com/watch?v=umL3CTEbmdw&list=PL28D81F8088CD3D88
Case:
Al-Najjar, and Baliga. “War of Attrition over the Satellite Television Market in the UK”

SESSION 7: Innovation competition, networks, and licensing

Reading:

Team Homework #5 Due:
SESSION 8: ¾ term Exam

Part IV: Competitive dynamics in markets with free entry

SESSION 9: Volatility and chaos in free-entry markets: option value and herding

Readings:
“Sink or Swim” Economist (March 26, 2009.)
Al-Najjar, N. I., “Herd Behavior and Cascades” (Kellogg School of Management)

(Uncollected) Team Homework Exercise:
Besanko, D., "Scrapping an Oil Tanker."

SESSION 10: Consolidation Strategies: Used car retailing

Reading:

Case:
Al-Najjar, N. and N. Pardasani: “The U.S. Autoretailing in the mid-1990’s (A). Kellogg School of Management. The B and C cases will be passed out in class.

Group Term Paper Due