

**Brown University
Department of Economics**

Prof. Dennis Wright Michaud

**Fall 2006
Economics 178
Competitive Strategy**

This course teaches analysis of strategic decisions facing an organization. The primary emphasis is on decisions at the line of business (rather than corporate) level, and the primary source of analytical method is economics. We cover traditional strategy topics such as capabilities and sustainability as well as modern game theory models of competition. A central integrating idea is anticipating the response of other actors in the economy and recognizing that often an organization's profits depend on the actions of other firms. We study nonprofits as well as for-profits. Class sessions are a mixture of applications (cases and other examples) and lectures.

Course Prerequisites

In order to assimilate fully the information presented in this class students must have completed previously the following courses: Economics 111, Economics 177, and Economics 71. It is recommended that students complete Economics 146 (Industrial Organization) prior to or during the same academic year when taking the Economics of Competitive Strategy.

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I will be happy to discuss the course, your progress, or any other issues of concern to you, individually, or in groups. Also, please contact me if you feel you are having problems participating in class for any reason.

Class participation/Attendance:

Class participation counts for a significant fraction of your grade. One or the other of us will mark down a “zero” or “one” each class for each person called on; those not called on should anticipate that, to accommodate “one” in a large class may require one to volunteer.

Case Discussion:

An integral part of this course will require you to be familiar with the assigned theoretical material and be prepared to apply it to the assigned cases. Questions for each case will be handed out in advance of class. Responses will be prepared prior to the class when the assigned case is scheduled for discussion. Late response papers will not be accepted.

Midterm Examination

A take home midterm examination will be administered at the course midpoint. Students will obtain this exam from the Brown Economics Department Office and place it in the designated box in the economics department by 9:00 AM the following day.

Final Project:

You will be assigned into teams of four. You will evaluate a strategic problem facing a real company. You will analyze the firm, its options, and develop a recommended strategy. You will turn in a written report. You will then make a brief presentation to the firm’s senior management on December 7, 2006

Final Examination:

The Final Examination will require you to focus on a dynamic case study that illuminates many of the strategic choices facing contemporary firms. The case will require you to assume the role of consultants, evaluate possible strategic choices, make recommendations to the firm’s board of directors, and defend these recommendations based on theoretic models discussed in the course.

Grading:

Class Participation/Response papers	25%
Midterm Exam	25%
Final Project	25%
Final Examination	25%

Reading List

The following required texts are available at the Brown University Book Store:

- Grant, Robert M. (2005) *Contemporary Strategy Analysis*, Fifth Edition, Oxford: Blackwell
 Grant, Robert M. (2005) *Cases to Accompany Contemporary Strategy Analysis*: Fifth Edition, Oxford: Blackwell.
 Hax, Arnaldo C. and Dean L. Wildell (2001) *The Delta Project: Discovering New Sources of Profitability in a Networked Economy*.
 Porter, Michael E. (1980) *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, New York: Basic Books (on course reserve)

The following texts are recommended and are available at the Brown University Book Store:

- Barney, Jay B. (2001) *Gaining and Sustaining Competitive Advantage: Theory and Practice* 2nd Edition, New York: Pearson (on course reserve)
 Macafee, Preston R. (2002) *Competitive Solutions: The Strategist's Toolkit*: Princeton: Princeton University Press (on course reserve)

The following texts are recommended for those wishing to strengthen their business economics background. They are available on line at Barnes and Noble.com or through special order by the Brown University Bookstore.

- Carlton, D.W. and J.M. Perloff. (2004) *Modern Industrial Organization*. 4th edition, New York: Addison Wesley (on course reserve)
 Copeland, T.E., J.F. Weston and Kuldeep Shastri. (2004) *Financial Theory and Corporate Policy*, New York: Pearson (on course reserve)
 Nelson, R. and S. Winter (1994) *An Evolutionary Theory of Economic Change*, Cambridge: Harvard University Press (on course reserve)

In addition it will be necessary for students to purchase a course packet at the Allegra Copy Center. There will be a second case packet (Part II) that will also be available at Allegra. Please note that these packets are made to order and require 24-hour advance purchase.

Schedule

Before each class you should read the assigned material and answer the associated preparation questions. Preparation questions will be distributed a' priori one class prior to the due date. Readings asterisked will be discussed in class are included in the course packet. We are including additional readings to in course packet and in some books on course reserve to provide students additional depth of the economics of strategy. It is highly recommended that you attempt to read these articles. Students who allocate the additional time necessary to grasp the course material will find it highly rewarding. In taking the aforesaid approach you will gain a mastery of the concepts of strategy.

Sept 5

Introduction: to the Competitive Strategy

Why do we study strategy?

The link between strategy and corporate governance

Ad hoc versus scientific management

September 7

What is strategy?

Definitions of strategy

Hierarchical Definitions of Strategy and Management

Eclectic Definitions of Strategy and Strategic Management

Matching Definitions of Strategy and Strategic Management

Readings:

Coase R. H. 1937. "The Nature of the Firm." *Economica*, 4, pp.386-405 (in course packet) *

Nelson and Winter. 1994. op.cit. Chapter 1 "The Need for an Evolutionary Theory"

Porter. 1980. op.cit, Chapter 1 "Structural Analysis of Industries" *

Barney, op.cit Chapter 1 *

Grant, op.cit Chapter 1 *

Case Discussion: *Madonna* (in Grant case book)

Sept 12

What is Performance?

Performance in the Definition of Strategy

A Conceptual Approach to Defining Performance

Measuring Firm Performance

Review of Cost of Capital Analysis and Firm Hurdle Rates

Readings:

McAfee. 2002. op.cit. Chapter 1, "Introduction"

Copeland et. al. 2004. op.cit. Chapter 2 "Investment Decisions: The Certainty Case" Chapter 7

"Market Equilibrium: CAPM and APT

Barney, op.cit Chapter 2 "What is performance"

Grant, op.cit Chapter 2*

Case Discussion:

Laura Ashley Holdings, plc. (in Grant case book)

Sept 14, 19**The Agent-Principal Relationship:**

Pareto Optimality for Stakeholder
 Market Based Performance Metrics
 Agency Theory

Readings:

Comment R. And G. Jarrell. 1995. "Corporate Focus and Stock Returns," *Journal of Financial Economics*, 37, pp. 67-87. (in course packet) *

Jensen, M.C. and W.H. Meckling. 1976. "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure." *Journal of Financial Economics*, 3, pp. 305-360. (In course packet)*

Jensen, Michael. 1998. op.cit. Chapter 2 "Self-Interest, Altruism and Agency Theory" * (in course packet)

Williamson. 1975. op.cit. Chapter 2 "The Organizational Failures Framework"

McAfee, op cit. Chapter 8* (in course packet)

Sept 21**Industry Analysis: The Strategic Environment**

The Attractiveness of an Industry
 From Industry Analysis to Environmental Analysis
 The Five Forces of Environmental Threats

Readings:

Porter, op.cit. Chapter 2 "Generic Competitive Strategies" *

Carlton and Perloff. 1999. op.cit. Chapter 2 "The Firm and Costs"

Barney, op.cit, Chapter 3 "Evaluating Environmental Threats" *

Grant, op cit. Chapter 3 "Industry Analysis: The Fundamentals

Case Discussion:

The US Airline Industry in 2004 (in Grant case book)

Sept 26**Industry and Competitive Analysis**

Generic Strategies
 Cost-Leadership Competitive Strategies
 Segmentation Strategies

Examining the Five Forces

Readings:

Porter.1980. op.cit Chapter 3 “Framework for Competitor Analysis” *

P. Areeda and D.F. Turner, “Predatory Pricing and Related Practices Under Section 2 of the Sherman Act,” 88 Harvard Law Review 697 (1974).

McAfee. 2002. op.cit, Chapter 2 “Industry Analysis

Grant, op cit. Chapter 4

Sept 28

Analyzing Resources and Capabilities

The role of resources and capabilities in strategy formation

Firm resources

Organizational resource

What are core competencies?

How to Develop Core Products

From Core to End Products

The Allocation and Management of Core Competencies

Readings:

Carlton and Perloff 1999. op.cit. Chapter 2 “The Firm and Costs”, Chapter 3 “Competition”

McAfee op.cit. Chapter 3 “Firm Strategies”

Grant, op cit. Chapter 5 *

Handout, Core Competencies (to be distributed prior to class)

Case Discussion

Wal-Mart Stores Inc., March 2004 (in Grant case book)

October 3

Competitive Strategies: Tacit Collusion

Tacit Collusion and Competitive Advantage

Rareness of Tacit Collusion

Tacit Collusion and Organization

Readings:

MacAfee, op cit. Chapter 6, “Cooperation”

Barney, op cit. Chapter 10, “Tacit Collusion”

Porter, op.cit Chapter 4, “Market Signals” Chapter 5, “Competitive Moves

Areeda, Phillip and Donald Turner, (1980) “An Analysis of Anti-Trust Principles and Their Application,” in *Anti-Trust Law*, Boston: Little Brown

Van Kalinowski: (1982) “Anti-Trust Law and Trade Regulation
 Areeda, Phillip and Donald Turner (1975) “Predatory Pricing and Related Practices Under
 Section 2 of the Sherman Act,” *Harvard Law Review*

October 5

Organization Structure and Management Systems

Evolution of the Corporation
 Principles of Organizational Design
 Management Systems for Coordination and Control

Grant, op cit. Chapter 6

Case Discussion:

Organizational Restructuring within the Royal Dutch/Shell Group (in Grant case book)

October 10

The Nature and Sources of Competitive Advantage

The Emergence of Competitive Advantage
 Sustaining Competitive Advantage
 Competitive Advantage in Different Market Settings

Readings:

Grant, op cit. Chapter 7

Barney, op cit. Chapter 5 “Evaluating Firm Strengths and Weaknesses”

October 12

Cost Advantage

Economies of Experience
 Sources of Cost Advantage
 The Value Chain as a Means to Analyze Costs
 Managing Cost Reduction

Readings:

Grant, op cit. Chapter 8

Barney, op cit. Chapter 7, “Cost Leadership”

Case Discussion:

Southwest Airlines-1993 (A) Harvard Business School Case No. 9-694-023, 1997 (in course pack)

October 17

Competitive Strategies: Product Differentiation

Product Differentiation Strategies

The Value of Product Differentiation-influences prices, influences costs

Analyzing Product Differentiation From the Supply Side

Analyzing Product Differentiation From the Demand Side

Using the Value Chain in Differentiation Analysis

Case Discussion:

Harley-Davidson, Inc. February 2004 (in Grant case book)

Readings:

Carlton and Perloff 1999.op.cit. Chapter 7 “Product Differentiation and Monopolistic Competition” *

Caves, R.E. and P. Williamson. 1985. “What is Product Differentiation, Really?” *Journal of Industrial Economics*, 34, pp. 113-132. (in course packet) *

McAfee. 2002. Chapter 4 “Differentiation” *

Barney, op.cit. Chapter 8 “Product Differentiation” *

Grant, op cit. Chapter 9 “Differentiation Advantage

October 19

Industry Evolution

The Industry Life Cycle

Structure, Competition, and Success Factors Over the Life Cycle

Organizational Adaptation and Change

Readings :

Portor, 1980. op.cit. Chapter 8. ‘ Industry Evolution.’

Grant, op cit. Chapter 10

MacAfee, op cit. Chapter 5, ‘Product Life Cycle’

Case Study :

Intel Corporation, The Hood River Project (A) Stanford Business School Cases (in course packet)

October 24

Management of Technology

Competitive Advantage in Technology-Intensive Industries
 Strategies to Exploit Technological Innovation
 Implementing Technology Strategies

Readings:

Grant, op cit. Chapter 11
 Porter, op cit. Chapter 10, “Competitive Strategy in Emerging Industries”

Case Discussion:

Rivalry in Video Games (in Grant case book)

October 26

Midterm Examination

(take-home exam) to be picked up at 9AM at the Economics Department Office at Robinson Hall and returned by 9AM October 27.

October 31

Competitive Advantage in Mature Industries

Strategies for Firms in Mature Industries
 Strategies for Firms in Declining Industries
 Implementation of Strategies in These Industries: structure, systems, and style

Readings:

Grant, op cit. Chapter 12
 Porter, op cit. Chapter 14, “The Strategic Analysis of Vertical Integration”

Case Discussion:

Capital One Financial Corporation, Harvard Business School Case, No 9-700-124 (in course packet).

November 2

Vertical Integration and Scope of the Firm

Transaction Costs and Scope
 Costs and Benefits of Vertical Integration
 Designing Vertical Relationships

Readings:

Grant, op cit. Chapter 13

Case Discussion:

Birds Eye and the UK Frozen Foods Industry (in Grant Case book)

November 7**The Multinational Firm: Global Strategies**

Competitive Advantage in the Global Context
 Framework of International Location of Production
 Globalization versus National Differentiation
 Foreign Entry Strategies

Readings:

Grant, op cit. Chapter 14

Dicken, Peter, 2005 *Global Shift: Reshaping the Global Economic Map in the 21st Century*, New York: Guilford Press. Chapter 7, 8 (in course pack)

Case Discussion:

Euro Disney: From Dream to Nightmare 1987-1994 (in Grant case book)

November 9**Diversification and Strategy**

Trends in Diversification
 Motivations for Diversification
 Competitive Advantage from Diversification
 Diversification and Performance
 Implications for Corporate Governance

Readings:

Grant, op cit. Chapter 15

Porter, op cit. Chapter 16, "Entry into New Businesses

MacAfee, op cit. Chapter 7, "Organizational Scope"

Case Discussion:

Richard Branson and the Virgin Group of Companies in 2004 (in Grant case book)

November 14-16**Managing the Multi-business Corporation**

Structures of Multi-business Firms
 Managing Corporate Portfolio
 Managing Internal Linkages

Readings:

Grant, op cit. Chapter 16

Porter, op cit. Chapter 15, "Capacity Expansion"

Barney, op cit. Chapter 13, "Organizing to Implement Corporate Diversification"

Case Discussion:

General Electric: Life After Jack (in Grant case book)

November 21

Current Trends in Strategic Management

External Environment

New Directions in Strategic Thinking

Models of Leadership

Redesigning the Organization

Introduction: Real Options Pricing

Readings:

Grant, op cit. Chapter 17

Real Options Pricing (handout packet distributed prior to class)

Case Discussion

AES Corporation: Rewriting the Rules of Management (in Grant case book)

November 28

The Delta Model: Another Approach

Introduction to the Model

Bonding with the Customer

The Triangle Strategy Based Upon Bonding

Winning Through Costs and Features

Readings:

Hax and Wildell, op cit. Chapters 1-3

November 30

The Delta Model: Locking In Relationships

Winning Through Customer Relationships

Winning Through Complementors

Aligning Execution with Strategy

Aligning Strategy Processes and Metrics

Readings:

Hax and Wildell, op cit. Chapter 4,5, 7, 9

December 5-7

Presentation of Group Projects