

ECON 364 Industrial Organization

Assistant Professor Nicola Lacetera

Email: nicola.lacetera@case.edu

Office Phone: 216-368-2197

Office PLB280

Office hours

Mondays-Tuesdays, 2:30-4:30pm

Course schedule

MW, 12:30-1.45pm

Room PBL 501

Introduction

Most of the industries and companies that spring to mind when we think of business do not fit into the model of perfect competition used in introductory courses in microeconomics, where companies' profits are driven to zero. Many industries, such as automobiles, oil production, computers' operating systems, pharmaceuticals, and soft drinks are not characterized by a large number of small firms that take market variables (prices, quantities) as given and do not affect them. McDonalds, Microsoft, Pepsi, the oil companies and the like do make profits, control prices, decide to advertise, and so on. Even markets that, at a first glance, might seem perfectly competitive, such as fish markets or the markets for medical residents, are only imperfectly competitive, and/or are regulated and centralized. This course studies these sorts of real companies and real markets. Students will learn about the rationale behind such business strategies as pricing and price discrimination, price wars, product differentiation, advertising, R&D strategies, bundling and tie-ins, building entry barriers, mergers and acquisitions, collusion and cartels, and the dynamics of network industries (e.g. information and communication technologies).

The course will take two complementary approaches to the studies of industries. First, we will consider the point of view of companies, and ask how different business strategies can affect competitive success. Second, we will consider the perspective of consumers and policy makers: we will ask whether different firm strategies enhance or reduce social welfare, and will explore different policy options to increase welfare. These options include antitrust policies and patent systems.

The **textbook** for this course is “**Industrial Organization: contemporary theory and practice**” by Lynne Pepall, Dan Richards, and George Norman (I will indicate the book at PRN hereinafter). Either the third or the fourth edition (3E and 4E hereinafter) is fine. 3E has been around longer and you can find good deals in the used book market. 3E is very similar to 4E in the content, but, at the end of most chapters, references and description of empirical studies have been added. We will refer to some of these studies throughout the course. In fact, the textbook will be more of a general reference than something we will tightly follow. In addition to the textbook, students will also be assigned short cases (mostly newspaper articles) for each class. Students will also be required to perform some bibliographic research (in teams) for their final project.

The typical class is made up of an initial discussion of the assigned newspaper article(s) or case(s), followed by the introduction of some economic tools for the analysis of a given business strategy and its consequences on companies' profits, industry structure, and social welfare.

Over the term, the students will form teams and play the Competitive Strategy Game. Details are below.

There will also a guest lecture, given by Jack Kleinhenz, an economic consultant, on how analysts and business people define and analyze markets.

Audience

This course should be valuable for anyone interested in:

- 1) Managerial positions in companies (especially in strategy and marketing), business consulting, or investment banking (especially the mergers and acquisitions side).
- 2) Careers at the intersection of law and economics, including law school and careers in regulation or consumer protection.
- 3) Economic research, including graduate school or a career in policymaking.

Prerequisites

Knowledge of microeconomic principles at the level of ECON 102 and of basic calculus and statistics (at the level of STAT 207) is required.

Requirements and grading

The final grade will be based on the performance on a series of requirements.

Attendance and participation

I expect you to come to class (and to tell me in advance if you have to miss one), and to actively participate in the discussion. The initial part each class will be spent discussing the required cases and articles. Please come prepared by reading the assigned material in advance.

Problem sets and article collection

There will be six problem sets throughout the course, to be handed in at dates specified in the detailed schedule below. Doing the problems sets is of key importance in order to do well in the midterm exam (see below). In addition, the problem sets are designed in order to clarify the concepts learned in class, apply them to real cases, and also to introduce topics that we do not have time to treat in class. While this is an individual task, you should feel free to interact with your fellow students in try to answer the questions in the problem sets.

At each due date for problem set 2, 3, 4 and 5, each student should also find an article from the popular press on a topic related to those treated in class in the previous couple of classes. Each student should post the article on [Blackboard](#), accompanied by a brief comment (5-10 lines) on its relevance.

Midterm exam

A midterm exam will be given on Monday November 2 during class time.

Jack Kleinhenz guest lectures

Each student will write a one-page report on the lecture given by Jack Kleinhenz, stressing the main messages and takeaways from the talk.

Industry studies

You are asked to form teams of three and, as a final project for the class, elaborate a ten-page (double spaced, 12pt font size) study of an industry of your choice. While there is no unique format for the study, I would like to learn about the following issues:

- The degree of concentration in the industry
- Other structural characteristics such as the technologies, the presence of network externalities, and the like
- The identity of the industry leaders (if any) over time
- The type of competition companies seemed to have played (e.g. price competition or price war, horizontal or vertical differentiation and niche strategies, brand identification and brand proliferation, research and development, advertising, etc.).
- Whether public authorities (FDA, FTC, Antitrust Commission) have intervened in the industry and why.
- The profit opportunities of new firms considering entering the industry.

Examples of industry studies are posted on Blackboard

Competitive strategy game (CSG)

Over the semester, the same team formed to undertake the industry study will play an internet-based strategy game. This multi-period game replicates, in stylized form, the operating of four markets, and such decisions as whether to enter a market, what capacity to invest in, what price to charge, and what additional information and communication to share with competitors, will be made by each team. Additional details about the Game will be described in class and posted on Blackboard. Deadlines to submit each period's strategies will be reported in the detailed program below.

Composition of the final grade

Attendance and participation: 12%

Homework: 16%

(For homework 2-to-5, the problem set will count for 90%, and the collected article for the remaining 10%)

Midterm exam: 30%

Jack Kleinhenz report: 7%

Industry study: 20%

CSG: 15%

Course material

The PRN textbook can be found at the CWRU bookstore and on Amazon ([here](#)). Most of the cases and articles are freely available online through major databases the university subscribes to. I added links to these readings in the detailed syllabus below. Finally, I have put some readings on [Blackboard](#).

Academic Integrity

University policy on plagiarism and academic integrity will be rigorously enforced. The University does not tolerate cheating or plagiarism in any form. Cheating or plagiarism will result in a failing grade. Ignorance is not considered an excuse. If you are not sure whether or not something you plan to submit would be considered either cheating or plagiarism, please do not hesitate to ask me, or your other faculty.

Students with Disabilities

I will be happy to meet with students with disabilities and who may need individual arrangements. **Please inform me of any of these issues at the beginning of the course.** The Coordinator of Disability Services can be contacted at 216-368-5230.

Detailed schedule

Date	Topic	Readings	Assignments handed/due
Aug. 24	Introduction: The theory of Business Strategy and its welfare implications	PRN (E3, E4), Ch. 2 Graddy, K., 2006: "The Fulton Fish Market", <i>Journal of Economic Perspectives</i> . [Blackboard]	Problem set 1 distributed
Aug. 26	Introduction: Market definition. Market Power and its determinants	PRN (E3, E4), Ch. 3-4 Humblen, M., 2009: " AT&T may have to pay dearly to retain iPhone exclusively "	
Aug. 31	Monopoly pricing: group pricing, market segmentation	PRN (E3, E4), Ch. 5 (skip 5.4) "Merck, AIDS, and Africa", NYU Stern Case [Blackboard] Lee, N., 2009: " Virgin Mobile offers new plan to ease your wallet " The Daily Record, 2009. " Marks & Spencer Drop Surcharge on Larger Bras "	

Sept. 2	Monopoly pricing: non-linear and two-part pricing	PRN (E3, E4), Ch. 6: Intro, 6.1. Hamilton, D., 2001: “The Price Isn't Right: Internet pricing has turned out to be a lot trickier than retailers expected”, <i>The Wall Street Journal</i> [Blackboard] Yinger, G., 1998: “Evidence on Discrimination in Consumer Markets”, <i>Journal of Economic Perspectives</i> , 12, 2, 23-40 [Jstor]	Problem set 1 due in class Problem set 2 distributed
Sept. 7	No class – Labor Day		
Sept. 9	Monopoly pricing: asymmetric information, screening, quantity discounts, menu pricing	PRN (E3, E4), Ch5: 5.4. Ch. 6: 6.2, 6.3 F.T.C. v. MORTON SALT CO [Blackboard] Bart Atwell, 2009. “ Small Business Loses in Health Care Status Quo ”	
Sept. 14	Introduction to CSG and industry studies. Team formation		
Sept. 16	Bundling and tie-ins	PRN (E3, E4), Ch. 8: Intro, 8.1 “A la carte cable TV” 1 Bruni, F., 2009: “ Our Nightly Bread ”	Problem set 2 due in class Problem set 3 distributed
Sept. 21	Strategic interactions: static games and Nash Equilibrium	PRN (E3, E4), Ch. 9: Intro, 9.1-9.3. Alan Dershowitz, 2002. “ Terror Training ”, Guardian	
Sept. 23	Strategic interactions: dynamic games. Commitment and credibility. Repeated games and cooperation	PRN (E3, E4), Ch. 11: Intro, 11.3-11.4 Ferriere, R., 1998: “Help and you shall be helped”, <i>Nature</i> [Blackboard] Tommy Sarda, 2009. “ Big Brother 11: Ronnie ”	Problem set 3 due in class Problem set 4 distributed
Sept. 28	Oligopolistic competition: the Bertrand Paradox and how to escape it.	PRN (E3, E4), Ch. 10: Intro, 10.1-10.2 “Britannica and Encarta”, NYU Stern case [Blackboard] Stross, R., 2009: “ Encyclopedic Knowledge, Then vs. Now ” Acohido, B., 2009: “ Reboot? Wal-Mart hopes deals make it a 'laptop destination' ”	CSG Round 1 submission due by 8pm
Sept. 30	Oligopolistic competition: the Cournot Model. Product vs. price competition, strategic complements and substitutes	PRN (E3, E4), Ch. 9: 9.4-9.6. Ch. 10: 10.4. Kassam, N. et al, 2009: “ Developing a Sustainable Dubai ”	CSG Round 2 submission due by 8pm

Oct. 5	Guest speaker – Jack Kleinhenz: Defining and Analyzing Markets (6:30-8pm, room PBL 258) –Note the change of time and location for this class		
Oct. 7	Oligopolistic competition: price competition with differentiated products. Non price competition through “positioning”. Market creation and market stealing	PRN (E3, E4), Ch 10: 10.3. Hays, C., 2000: “Tea by Two”, <i>The New York Times</i> [Blackboard] Gladwell, M., 2004: “ The Ketchup Conundrum ”	Problem set 4 due in class Problem set 5 distributed CSG Round 3 submission due by 8pm
Oct. 12	Oligopolistic competition: Quality differentiation	Kaplan, D., 2009: “ Restaurant's approach is good to the Earth ” Kevin Krolicki, 2009. “ GM Plans Significant in Ad Spending ” The Economist, 2009. “ Branding ” [Blackboard]	
Oct. 14	Dynamic competition: the Stackelberg model, the power of commitment, and credibility	PRN (E3, E4), Ch 11: Intro, 11.1-11.2 Weisman, K., 2008: “ The bigger, the better when it comes to luxury stores ”, New York Times Daniel Indiviglio, 2009. “ Banks' Talent: Being Big ”	CSG Round 4 submission due by 8pm
Oct. 19	No class – Fall Break		
Oct. 21	Dynamic competition and entry deterrence: Limit pricing, excess capacity, product proliferation	PRN, Ch. 12 Culpan, T., 2007: “Intel Tells Customers It Will Slash Chip Prices 50%”, <i>Bloomberg</i> [Blackboard] Rao, A. et al., 2001: “How to Fight a Price War”, <i>Harvard Business Review</i> [Blackboard] The Economist, 2008. “Friends for Life” [Blackboard]	Problem set 5 due in class CSG Round 5 submission due by 8pm
Oct. 26	Class Canceled		CSG Round 6 submission due by 8pm
Oct. 28	R&D and IP strategies. Patent policy and innovation prizes CSG Interim Report	PRN, Ch. 22-23 (E3, E4) Articles from <i>The Economist</i> (all on Blackboard) “A Gathering Storm” (2007); “Patently Obvious” (2007); “The Lesson of Blackberry” (2005) Tom Bradley, 2009. “ 5 Reasons Word Will Weather the Patent Challenge ”	Reports of Jack Kleinhenz’s talk due CSG Round 7 submission due by 8pm

Nov. 2	Midterm exam		
Nov. 4	Mergers and acquisitions. Vertical mergers and firm boundaries.	PRN, Ch. 17.1,2,3, 5 (E3, E4) Arthur Zaczekiewicz and Vicki M. Young “Merger Mania Continues” [Blackboard] “Arcelor Mittal Acquires Mexican Steel Producer” [Blackboard] “ArcelorMittal takes 49 per cent in Brazilian miner” [Blackboard]	Problem set 6 distributed CSG Round 8 submission due by 8pm
Nov. 9	Mergers and acquisitions. Horizontal mergers, diversification, and conglomerates. Alliances and networks.	PRN (E3, E4), Ch. 16, 17.4 <i>The Economist</i> , 2007: “Meandering Giants” [Blackboard] “Scale and Scope at Citigroup”, NYU Stern case [Blackboard] <i>The Economist</i> , “Flying in formation” [Blackboard] Benjamin Gomes-Casseres, 2006: “How Alliances Reshape Competition”, <i>Handbook of Strategic Alliances</i> [Blackboard]	CSG Round 9 submission due by 8pm
Nov. 11	Collusion and cartels	PRN (E3, E4), Ch. 14 PRN (E3, E4), Ch. 15 Salpukas, A., 1999: “An Oil Outsider Revives a Cartel” <i>The New York Times</i> [Blackboard] <i>The Economist</i> , 2007: “Silent Orchestration” [Blackboard] Paul Thurrott, 2009. “Apple/Google Collusion Might Be Worse than Originally Reported”	CSG Round 10 submission due by 8pm
Nov. 16	Competition Policy and Antitrust	PRN (E3, E4), Ch. 1: 1.3, Appendix <i>The Economist</i> , 2002: “Setting the Trap” [Blackboard] US vs. AMR Corp [Blackboard] “EU charges Intel with monopoly abuse”, Business Week, July 27 2007 [Blackboard] . <i>The Economist</i> , 2007: “Flying in formation” [Blackboard] <i>The Economist</i> , 2009: “The Unkindest Cuts” [Blackboard]	CSG Round 11 submission due by 8pm

Nov. 18	Market Design	Roth, Al, 2008: “What Have We Learned from Market Design?”	CSG Round 12 submission due by 8pm
Nov. 23	Network externalities and the Microsoft antitrust case	PRN, Ch. 8: 8.4. Ch. 24 Gilbert, R. and Katz, M., 2001: “An Economist’s Guide to <i>US vs. Microsoft</i> ” [Blackboard]	Problem set 6 due in class CSG Round 13 submission due by 8pm
Nov. 25	Class canceled		
Nov. 30	Wrap up		
Dec. 2	CSG Discussion (Team Presentations)		
Dec. 4	Team industry studies due by midnight (upload on Blackboard)		