

**The Peter F. Drucker and Masatoshi Ito Graduate School of Management  
Claremont Graduate University**

**MGT 383**

**Economics of Strategy**

**Summer 2008  
Monday & Wednesday 7 – 10:00 PM**

**Professor Jay Prag**

**Contact Information:**

My office is Burkle 218, my phone number is (909) 607-2576, and my e-mail address is [jay.prag@cgu.edu](mailto:jay.prag@cgu.edu).

I will be in my office an hour before this class (Monday & Wednesday, 6:00 - 7:00 pm).

Faculty Support:

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MBA programs traditionally offered a class called Managerial Economics. It was usually a class in basic microeconomics that tried to use business applications for its examples and assignments. The curriculum (and typical examples) for that class hasn't changed much over the last thirty years and many programs, including ours, stopped teaching it.

The loss of this economics class creates an intellectual void in our business education, however, because the approach of economics to business decisions is unique and extremely valuable. The Economics of Strategy uses the business-related tenets of economics (old and new) to generate a modern, consistent, formal framework for strategic decision-making. Using economic intuition we will be able to address issues ranging from outsourcing to new product lines. We will be able to explain why some firms actively compete through price changes and while others in apparently similar competitive industries do not.

Economic theories seem very abstract to many students because these theories usually assume many unrealistic things about people and society. Students must be mindful of the fact that these assumptions are what allow economists to answer many otherwise intractable questions. The results that we attain usually hold even without these simplifying assumptions. This class will show how some of these economic models can provide a powerful, formal framework for answering managerial questions ranging from dealing with competition to setting proper incentives for managers.

Economics is a mathematical discipline with a strong intuitive component. This class uses a range of math skills from simple graphs to calculus. I will endeavor to refresh students whose math skills have atrophied over the years and I will always show the intuition behind the math.

The textbook for this course is: Economics of Strategy by Besanko, Dranove and Shanley, fourth edition. This book, and to some extent this class, has been called Porter's Competitive Strategy with all the graphs put in. Indeed, this class will teach you the economic underpinnings of many things you will see in strategic management classes. Suggested readings are provided below that will reinforce and expand your knowledge of the topics which we discuss in class.

Although much of the material that I discuss is covered in the text, you are ultimately responsible for the material that we cover during class time. If you miss any classes, be sure to get notes from another student.

I will hand out other reading, often newspaper and magazine articles, which are interesting and appropriate to a particular topic. Feel free to call any articles that you find to my attention.

## COURSE OUTLINE AND SUGGESTED READINGS

		<u>Chapters:</u>
Topic 1:	<b>Review of Microeconomics</b> Why do gasoline prices always rise in the summer?  The Market Model in the short and long run Consumer Theory Theory of the Firm: Marginal and Average Costs Economies of Scale (SR and LR) Perfect Competition and Monopolies	Primer
Topic 2:	<b>Vertical Boundaries: The Make vs. Buy Decision</b> Why does a law firm hire janitors but not computer people?  Principal-Agent Problems. Transactions Costs: Law and Economics Overview, Relationship Specific Assets	3 - 4, 15
Topic 3:	<b>Horizontal Boundaries: Economies of Scale and Scope</b> Why didn't Phillip Morris invent DVD players?  Umbrella Brands, Learning and Experience, Distribution Channels	2, 5
Topic 4:	<b>Market and Competitive Analysis</b> Why don't Dairy Queen and Haagen Daaz charge the same price for a sundae?  Measuring Competition: Concentration Ratios, Herfindahl Indexes Oligopoly Models: Cournot, static Bertrand and Stacklberg competition Strategic Commitment Dynamic Bertrand: Price Cooperation Game Theory Entry: Barriers to Entry, Post-Entry Competition	6 - 9
Topic 5:	<b>Strategic Position and Dynamics</b>	10 - 14

Why do Toyota, Walmart and Dell usually make higher profits than their competitors?

Competitive Advantages: Resources and Capabilities  
Benefit and Cost Drivers  
Sustaining Competitive Advantages: Resource Mobility,  
Isolating Mechanism, Early Mover Advantages

Topic 6: **Economics of Strategy in Action**  
Why is Amazon.com still around but Homegrocer.com bankrupt?

The Internet: The Rise and Fall of (several) Dot-Coms

Topic 7: **International Economic Strategy**  
Why do firms relocate their factories to foreign countries?

Gains from Trade  
International Factor Costs  
Outsourcing jobs around the world

**Grades:**

There will be occasional homework assignments based on the material we cover in class, a midterm and a final exam. Your final grade will be determined as follows:

Homework	20%
Midterm	35%
Final Exam	45%