

# **Syllabus: MGMT 900 Economic Foundations of Management**

Fall 2013

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## **Overview**

This course examines some of the central questions in management with economic approaches as a starting point, but with an eye to links to behavioral perspectives on these same questions. It is not a substitute for a traditional microeconomics course. Economics concerns itself with goal directed behavior of individuals interacting in a competitive context. We adopt that general orientation but recognize that goal directed action need not take the form of maximizing behavior and that competitive processes do not typically equilibrate instantaneously. The substantive focus is on the firm as a productive entity. Among the sorts of questions we explore are the following: What underlies a firm's capabilities? How does individual knowledge aggregate to form collective capabilities? What do these perspectives on firms say about the scope of a firm's activities, both horizontally (diversification) and vertically (buy-supply relationships)? We also explore what our understanding of firms says about market dynamics and industry evolution, particularly in the context of technological change.

A central property of firms, as with any organization, is the interdependent nature of activity within them. Thus, understanding firms as "systems" is quite important. Among the issues we explore in this regard are the following. Organizational "systems" have internal structure, in particular elements of hierarchy and modularity. Even putting aside the question of individual goals and objectives and how they may aggregate, the question of organizational goal is non-trivial. To say that a firm's objective is to maximize profits is not terribly operational. How does such an overarching objective get decomposed to link to the actual operating activities of individual subunits, including individuals themselves. This issue of goals has links to some interesting recent work that links the valuation process of financial markets to firm behavior. Financial markets are not only a reflection of firm value, but may guide firms' initiatives in systematic ways.

## **Assignments**

For each class session, each student is to prepare a brief (roughly three pages) Puzzle & Gaps (P&G) note. This note conveys some provocative reflections on the part of the student on the readings. These reflections may take many forms. They may be organized around a student's puzzlement at the argument that the author(s) are making. They may reflect on contrasts in the arguments of the various authors. It might identify gaps in the existing literature and, in turn, research opportunities. Alternatively, the note

could focus on application and examine ways in which the conceptual material may provide insight into some important business phenomena; or, alternatively, how an important business phenomena points to gaps and weaknesses in the theoretical ideas. These notes should not merely, or primarily, restate the arguments of the various authors. In writing these notes, you should assume that your audience (me and your fellow students) have read the articles associated with that class with some care and would not be interested in regurgitation of these ideas but would be stimulated by a fresh and provocative take on them. Furthermore, your note may draw from a subset of the readings; however, it should be anchored in at least one of the articles.

While the baseline requirement is that students submit one of these notes for every class session, you are entitled to two get out of Puzzlement & Gap notes “cards”. That is, you can select two class sessions for which you do not have to submit a note, possibly based on other demands on your time at that point, possibly based on fear or aversion to that particular material (however, fear and aversion may make a promising basis for a P&G note with emphasis on the “P”). One can submit more than 11 notes (13 class sessions minus two) and the 11 highest notes will count towards your course grade.

These reaction papers are due by **8am the day of class**. Place an electronic copy on the course web café. **No reaction papers will be accepted subsequent to the associated class session.**

The course grade will be based on a 50% weight on your P&G papers and 50% class discussion.

## **Materials**

The readings for the course are available on the course Canvas site: <https://wharton.instructure.com/courses/1128268>. The readings for each class session have an internal logical flow and are best read in the sequence suggested in the syllabus.

### 1. Theories of Choice (9/4)

D. Kreps (1988). *Notes on the Theory of Choice*. Boulder, CO: Westview publishing. Pp 43-46.

H. Simon (1955). "A behavioral model of rational choice". *Quarterly Journal of Economics*, 69: 99-118.

D. Kahneman and A. Tversky (1979). "An analysis of decision under risk". *Econometrica*, 47: 263-291.

D. Levinthal (2011). "What is not a behavioral strategy --- What's the alternative?" *Strategic Management Journal*, 32: 1517-1523.

### 2. Views of Production (9/11)

S. Winter (2006 [1968]). "Towards a neo-Schumpeterian theory of the firm". *Industrial and Corporate Change*, 15: 125-141.

E. Penrose (1959). Chapter II "The firm in theory" in *The Theory of the Growth of the Firm*. White Plains, NY: M. E. Sharpe.

R. Nelson and S. Winter (1982). "Organizational capabilities and behavior". *An Evolutionary Theory of Economic Change*. Cambridge, MA: Harvard University Press.

J. Van Reenen and N. Bloom (2010). Why Do Management Practices Differ across Firms and Countries? *Journal of Economic Perspectives*, Vol. 24, No. 1: 203-224

R. Gibbons and R. Henderson (2012). "Relational contracts and organizational capabilities". *Organization Science*: 1350-1364.

### 3. Resources and Rents (9/18)

J. Barney (1991). "Firm resources and sustained competitive advantage". *Journal of Management*, 17: 99-120.

I. Diericks and K. Cool (1989). "Asset stock accumulation and sustainability of competitive advantage". *Management Science*, 35: 1504-1511.

J. Denrell, C. Fang, and S. Winter (2003). "The economics of strategic opportunity". *Strategic Management Journal*, 24: 977-990.

A. Brandenburger, and H.W. Stuart (1996). Value-based business strategy. *Journal of Economics & Management Strategy* 5(1) 5–24.

R. Adner and P. Zemsky (2006). A demand-based perspective on sustainable competitive advantage. *Strategic Management Journal*: 215-239.

#### **4. Aggregation of Knowledge (9/25)**

F. A. Hayek (1945). “The use of knowledge in society”. *American Economic Review*, 35: 519-530.

R. Grant. (1996). “Toward a knowledge-based theory of the firm”. *Strategic Management Journal*, 17: 109-122.

L. Garicano and Y. Wu (2012). Knowledge, communication, and organizational capabilities. *Organization Science*, 23: 1382-1397.

W. Cohen and D. Levinthal (1990). “Absorptive capacity: A new perspective on learning and innovation”. *Administrative Science Quarterly*, 35: 128-152.

O. Sorenson, J. Rivkin, and L. Fleming (2006). “Complexity, networks, and knowledge flow”. *Research Policy*, 35: 994-1017.

#### **5. Firms as Interdependent Systems (10/2)**

H. Simon (1962). “The architecture of complexity”. *Proceedings of the American Philosophical Society*, 106: 467-482.

P. Milgrom and J. Roberts (1995). “Complementarities and fit: Strategy, structure, and organizational change”. *Journal of Accounting and Economics*, 19: 179-208.

M. Porter (1996). “What is strategy?”. *Harvard Business Review*, Nov.-Dec. 3-20.

D. Levinthal (1997). “Adaptation on rugged landscapes”. *Management Science*, 43: 934-950.

R. Henderson and K. Clark (1990). “Architectural innovation: The reconfiguration of existing product technologies and the failure of established firms”. *Administrative Science Quarterly*, 35: 9-30.

## **6. Organizations as Evolvable Systems (10/9)**

J. March (1991). "Exploration and exploitation in organizational learning". *Organization Science*, 2: 71-87.

J. Rivkin and N. Siggelkow (2003). "Balancing search and stability: Interdependencies among elements of organizational design". *Management Science*, 49: 290-311.

R. Burgelman (1991). "Intraorganizational Ecology of Strategy Making and Organizational Adaptation: Theory and Field Research". *Organization Science*, Vol. 2: 239-262

R. Adner and D. Levinthal (2004). "What is *not* a real option: Considering boundaries for the application of real options to business strategy". *Academy of Management Review*, 29: 74-85.

D. Teece (2007). "Explicating dynamic capabilities: The nature and microfoundations of (sustainable) enterprise performance". *Strategic Management Journal*, 28: 1319-1350

## **7. Economics of the Diversified Firm (10/16)**

J. Martin and A. Sayrak (2003). "Corporate diversification and shareholder value: A survey of recent literature". *Journal of Corporate Finance*, 9: 37-57.

E. Penrose (1959). Chapter VII "The economics of diversification" in *The Theory of the Growth of the Firm*. White Plains, NY: M. E. Sharpe.

C. Montgomery and B. Wernerfelt (1988). "Diversification, ricardian rents and Tobin's q". *Rand Journal of Economics*, 19: 623-632.

J. Gomes and D. Livdan (2004). "Optimal diversification: Theory and evidence". *Journal of Finance*, 59(2): 507-535.

D. Levinthal and B. Wu (2010). "Opportunity costs and non-scale free capabilities: Profit maximization, corporate scope, and profit margins". *Strategic Management Journal*, 31: 780-801.

## **8. Questions of Markets and Hierarchies (10/23)**

R. Coase. (1937). "The nature of the firm". *Economica*, 4(16): 386-405.

O. Williamson (1985). "Contractual man" and "The governance of contractual relations". *The Economic Institutions of Capitalism*. New York: Free Press.

Hart (1989). "An economist's perspective on the theory of the firm". *Columbia Law Review*, 89: 1757-74.

B. Holmstrom (1999). "The firm as a sub-economy". *Journal of Law, Economics, and Organization*, 15: 74-102

## **9. Neither Markets nor Hierarchy (10/30)**

C. Baldwin (2007). "Where do transactions come from? Modularity, transactions, and the boundaries of firms". *Industrial and Corporate Change*, 17: 155-195.

K. Mayer and N. Argyres (2004). "Learning to contract: Evidence from the Personal Computer Industry". *Organization Science*, 15: 394-410.

J. Bradach and R. Eccles (1989). "Price, authority, and trust: From ideal types to practical forms". *Annual Review of Sociology*, 15: 97-118.

C. Menard (2013) "Hybrid modes of organization". In R. Gibbons and J. Roberts *Handbook of Organizational Economics*. Princeton University Press.

## **10. Linking Firm and Industry Dynamics (11/6)**

P. Ghemawat (2002). "Competition and business strategy in historical perspective". *Business History Review*, 76: 37-74.

S. Klepper and K. Simmons (2000). "The making of an oligopoly: Firm survival and technological change in the evolution of the U.S. Tire Industry". *Journal of Political Economy*, 108: 728-760.

J. Sutton (1991). Chapter 1 "An introductory overview" *Sunk Costs and Market Structure*. Cambridge, MA: MIT Press.

M. Jacobides, S. Winter and S. Kassberger (2012). "The dynamics of wealth, profit, and sustainable advantage". *Strategic Management Journal*, 33(10).

## **11. Technological Change (11/13)**

D. Teece (1986). "Profiting from technological innovation: Implications for integration, collaboration, licensing, and public policy". *Research Policy*, 15: 285-306.

A. Arora and A. Gambardella (1990). "Complementarity and external linkages: The strategies of large firms in biotechnology". *Journal of Industrial Economics*, 38: 361-379.

T. Bresnahan and M. Trajtenberg (1995). "General purpose technologies as 'engines of growth'?" *Journal of Econometrics*, 65: 83-108.

C. Christensen and J. Bower (1996). "Customer power, strategic investment, and the failure of leading firms". *Strategic Management Journal*, 17: 197-218.

Tripsas, M., G. Gavetti. 2000. Capabilities, cognition, and inertia: Evidence from digital imaging. *Strategic Management Journal*, 21(10/11) 1147–1161.

## **12. Problem of Goals (11/20)**

J. March (1962). "The firm as a political coalition". *Journal of Politics*, 24: 662-678.

R. Gibbons and J. Roberts (2013). "Economic theories of incentives in organizations". In R. Gibbons and J. Roberts *Handbook of Organizational Economics*. Princeton University Press.

P. Bolton and M. Dewatripont (2013). "Authority in organizations". In R. Gibbons and J. Roberts *Handbook of Organizational Economics*. Princeton University Press.

R. Axelrod and M. Cohen (1999). Chapter 4 "Selection". Pp 117-145. *Harnessing Complexity*. New York, NY: Free Press.

**11/20 Thanksgiving: No Class**

## **13. Financial Markets and Firm Strategy (12/4)**

Jensen, M. (1986). Agency costs of free cash flow, corporate finance, and takeovers. *American Economic Review*, 76 (2): 323-329.

Aghion, P. and J. Stein. "Growth versus margins: Destabilizing consequences of giving the stock market what it wants". *Journal of Finance*, 63 (3): 1025.

Aghion, P., J. Van Reenen, and L. Zingales (2013): Innovation and institutional ownership. *American Economic Review*, 103: 277-304.

E. Zajac and J. Westphal (2004). The social construction of market value: Institutionalization and learning perspectives on stock market reactions. *American Sociological Review*, 69: 433-458.

E. Zuckerman (1999). The categorical imperative: Securities analysts and the illegitimacy discount. *American Journal of Sociology*, 104: 1398-1438.