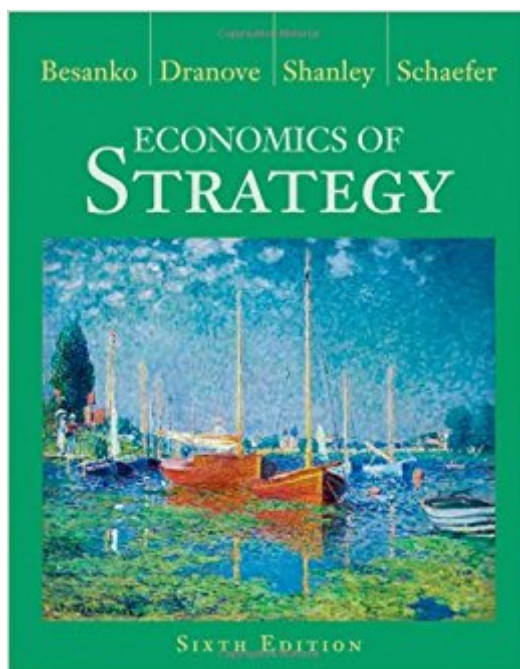


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# Economics Of Strategy



## Synopsis

Economics of Strategy offers a comprehensive text that provides a link between economic theory and business applications that is at once technical in its approach and accessible due to its numerous examples and clear writing style. The sixth edition of Besanko's Economics of Strategy uses economic theory to bring new insights to popular topics in modern strategy. By presenting basic concepts of economic theory with ideas in modern strategy literature, this book provides readers with a logical framework for understanding the strategic activities within a firm.

## Book Information

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## Customer Reviews

I had this book for a micro class that was focused on strategy in my MBA program. It was a rich source of information. The only real big issue I had with it was that it assumed so much previous micro knowledge, that you really need to have taken a micro class at some level for it to make sense. There is a chapter that introduces most of the stuff you would cover in a micro class, but it is just one chapter and not an in-depth look at all you should know. The other issue was more based on the structure of my class, but is based partly on the book. The first eighty percent of the book is based on external strategy, but I know that firm structure is important, especially in terms of labor versus capital. In the sections that we covered, that there seemed to be an acceptance of some sort of monolithic firm that makes decisions in the markets. The only labor issue was in the history, section in one of the first chapters where the authors hit on Taylorism very briefly. Other than that, the internal structure of the firm was left until the last unit, and I would bet that my professor was not

the first to elide that section. I would want to see firm structure more interspersed with how the firms compete in the market. Other than those two issues, I was impressed with the book, and would have kept it for a reference if it did not have a nice cash value. The below is a summation I wrote for the class, inspired by this book:

There was a story tossed around at some point about Henry Ford's crowning jewel, the River Rouge manufacturing plant. It was said that Ford, who owned the mines for the coal and iron ore and the plantations of rubber trees for the rubber, would have the ships unload their cargo on one end and the other end would spit out fully formed Ford automobiles. This is an example of perfect vertical integration from tree to tearing up the country roads. It is also, what may look to be the best way to realize profit in a market system is vertical integration. A firm will not have to be at the mercy of suppliers, and they can capture whatever profit the supplier firm might have, thus creating more profit within the firm. It is simplistic and wrong. One of the key insights of microeconomics is that there is a whole constellation of factors to take into consideration when looking at integration, either vertical or horizontal. These are termed *make-or-buy* decisions (Besanko et al. p. 99) and they determine if a firm should obtain an input from a supplier on the market or bring it in-house. The ultimate takeaway is that the profit the supplier firms create is hard to capture because the supplier firms have their own learning curve and their own economies of scale. It may make no sense for an automobile manufacturer to make their own airbags when every manufacture needs airbags, and a supplier can specialize and sell airbags to several companies. This allows the supplier to have lower costs because they are operating at scale where a singular manufacture of automobiles would have higher costs because they are manufacturing for only themselves. The potential exist for the manufacture to be a supplier for other manufacturers, but that is rare because other manufactures do not want to be reliant on competitors for suppliers. This is why Delphi and Mopar were spun off the larger parent companies, and they have gone through further specialization themselves. A further incentive to buy in the market is that by having multiple suppliers a firm can buy an input at the market price and be shielded from any supply chain disruption. Competitive firms do realize a profit, but bringing production of an input in house is no guarantee of capturing that profit both because the supplier is working at scale and there is a potential for the supplier to get lost in the bureaucracy of the firm and the potential profits instead become costs to overhead. Ultimately, it can be the firm that does the least that is the most efficient because it can then utilize the learning curve and the economies of scale for that one thing that they do. There are other important takeaways of strategic microeconomics. An important thing to take into

consideration is that the market is not everywhere and anywhere. A lot of goods and services are available through the internet. Call up and hope you find a good price and can trust the reviews, and you can buy most anything near the market price depending on how you get it shipped to you. Other products are very tied to the location of the consumer and the supplier. If a particular sweater is only available in Mongolia, and the firm does not ship it, then the buyer has to both find the sweater and go to Mongolia to obtain it. The location of a firm has some very real drivers on how much the customer is willing to pay. The ultimate cost of a good is not just the price paid in market, but also the time it takes to find it and get to it. There is the gas paid and the depreciation of the car, and the opportunity cost involved with the travel. What does a potential customer give up in terms of going to Mongolia to get that sweater? It can be so much that the firm could give them away to American customers and they would not be able to. Instead, the market for that sweater is more realistically geographically defined. Mitigating these search costs (Besanko et al. p. 179) is why it is so common to see multiple locations of some stores. In Chicago, there are Dunkin' Donuts and Walgreens stores almost every other block. The reason is that though they sell differentiated products, the next best option is similar enough they have to put their stores everywhere or else they will lose potential sales to competitors. A third important take-away from studying the strategy of competitive markets is the importance of the demand curve. In macroeconomics, the demand curve is given and it is more conceptual, but the slope of the demand curve is important. It is also not wholly a straight line. Individual markets have their own demand curve, and they can be empirically measured to show the inverse relationship between quantity and price, so that the demand curve is a downward sloping line. This has two interesting consequences (Besanko et al. p. 20). First is that an individual firm's price flexibility is based on the demand curve. The less of a slope the demand curve has, also meaning the more elastic that demand is the less power an individual firm has to set prices. This can be seen in a perfectly competitive market. All the firms in a perfectly competitive market have to charge the one price that is also the market rate where the average total cost curve and the marginal cost curve intersect. The downward sloping demand curve has an important consequence at the other end of potential market structures, in a monopoly. In a monopoly, the seller has pricing power, but they still have to face the quantity consequences of that pricing. If they try to take the price higher, they will lose customers. There is a theoretical point of price elasticity called perfectly inelastic demand, where the demand curve is a horizontal line, but that does not reflect the real world. Even in a world where a company had a monopoly on breathable oxygen, there would be a slope to the demand curve because ultimately, the willingness

to pay would still be infinite, but the actual ability to pay would be finite. Ergo, there would be a backwards slope to the demand curve, and the monopolist is price constrained. These and other ideas in microeconomics are crucial takeaways from the science. Some things that may look to be common sense on the surface are actually more complex once the math is grafted on the too easy narrative statements. Integration is not always perfect, there is a cost to search, and the demand curve can be limiting. Any prospective manager, as well as current manager, should be cognizant of these results of microeconomics.'ReferencesBesanko, D., Dranove, D., Shanley, M., & Schaefer, S. (2013). Economics of Strategy (6th ed.). New York: Wiley.

Helped me through my MBA at Texas A&MCC!

Highly Recommended!

As far as textbooks go, this one was great! It was easy to follow and linked real life examples from companies to the concepts that they were explaining. I would highly recommend it for use in college classes.

Excellent. Came in good condition. Thanks.

This book is a good introductory book into economics. The book's focus is more on the management aspect rather than economics itself. Nevertheless, the book is a good read.

The case studies were very up-to-date and useful. It is a great book for learning about strategy and business applications.

Very good classroom material

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