Syllabus: MGMT 900 Economic Foundations of Management

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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 make 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, you 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 three 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 10 notes (13 class sessions minus three) and the 10 highest notes will count towards your course grade.

These reaction papers are due by **7am 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.**

In addition to the reaction papers, for **each** class session each student must identify an individual paper for which they will serve as a key resource and will help kick off the discussion in class of that paper. The student should be prepared to summarize the key points of the article, suggest why the work might be viewed as important, and indicate e possible issues or limitations with the work. A signup sheet is posted on the course website. Note that no more than two students can sign up for a single paper so as to ensure some diversity of coverage. No written, submitted material is required for this assignment.

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

Materials

The readings for the course are available on the course Canvas site: https://canvas.upenn.edu/courses/1242947 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** (8/27)

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

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

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

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

Gigerenzer, G. and P. Todd (1999). "Fast and frugal heuristics: The adaptive toolbox". In *Simple Heuristics that Make Us Smart.* New York, NY: Oxford University Press.

2. **Views of Production** (9/3)

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

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

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

Syverson, C. (2011). "What determines productivity?" *Journal of Economic Literature,* 49(2): 326-365.

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

3. **Resources and Rents** (9/10)

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

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

Peteraf, M. (1993). “The cornerstones of competitive advantage: A resource-based view”. *Strategic Management Journal,* 14: 179-191.

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

Lippman, S. and R. Rumelt (2003). “A bargaining perspective on resource advantage”. *Strategic Management Review,* 24: 1069-1086.

4. **Aggregation of Knowledge** (9/17)

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

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

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

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

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

5. **Firms as Interdependent Systems** (9/24)

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

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

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

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

Puranam, P., M. Raveendran, and T. Knudsen (2012). "Organization design: The epistemic interdependence perspective". *Academy of Management Review*, 37(3): 419-440.

6. **Organizations as Evolvable Systems** (10/1)

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

Burgelman, R. (1994). "Fading memories: A process theory of strategic business exit in dynamic environments". Administrative Science Quarterly, 39: 24-56.

Adner, R. and D. Levinthal (2008). "Doing versus seeing: Acts of exploitation and perceptions of exploration". *Strategic Entrepreneurship Journal,* 2: 43-52.

Adner, R. 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.

Manso, G. (2011). "Motivating innovation". *Journal of Finance,* 66(5): 1823-1860.

7. **Economics of the Diversified Firm** (10/8)

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

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

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

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

Levinthal, D. 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** (10/15)

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

Williamson, O. (1985). Chp 2 “Contractual man” and Chp 3 “The governance of contractual relations”. *The Economic Institutions of Capitalism.* New York: Free Press.

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

Langlois, R. (1992). “Transaction cost economics in real time.” *Industrial and Corporate Change*, 1: 99-127.

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

9. **Neither Markets nor Hierarchy** (10/22)

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

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

Srikanth, K. and P. Puranam (2014). “Firm as a coordination system: Evidence from software services off-shore”. *Organization Science,* 25(4): 1253-1271.

Baker, G., R. Gibbons, and K. Murphy (2002). “Relational contracts and the theory of the firm”. *Quarterly Journal of Economics,* 117(1): 39-84.

Puranam, P., O. Alexy, and M. Reitzig (2014). “What’s ‘new’ about new forms of organizing?” *Academy of Management Review,* 39: 162-180.

10. **Linking Firm and Industry Dynamics** (10/29)

Porter, M. (1981). “The contributions of Industrial Organization to Strategic Management”. *Academy of Management Review*, 6(4): 609-620.

Klepper, S. and E. Grady (1990). “The evolution of new industries and the determinants of market structure”. *Rand Journal of Economics*, 21: 27-44.

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

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

Klepper, S. and S. Slepper (2005). "Entry by spinouts". *Management Science,* 58(8): 1291-1306.

11. **Technological Change** (11/5)

Henderson, R. (1993). "Underinvestment and incompetence as responses to radical innovation: Evidence from the Photolithographic Alignment industry". *Rand Journal of Economics*, 24(2): 248-270.

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

Klette, J. andS. Kortum (2004). "Innovating firms and aggregate innovation". *Journal of Political Economy,* 112(5): 986-1018.

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

Lipsey, R., K. Carlaw, and C. Bekar (2005). Chapter 4 "Technology and technological change" in *Economic Transformations: General Purpose Technologies and Long-Term Economic Growth.* Oxford University Press.

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

Cyert, R. and J. March (1963). Chapter 3, "Organizational goals". *A Behavioral Theory of the Firm*. Prentice-Hall, Englewood New Jersey

Zbaracki, M. and Bergen (2010). "When truces collapse: A longitudinal study of price-adjustment routines". *Organization Science,* 21(5): 955-972

Gibbons, R. (1998). "Incentives in organizations". *Journal of Economic Perspectives,* 12(4): 115-132.

Milgrom, P. and J. Roberts (1988). "An economic approach to influence activities in organizations". *American Journal of Sociology,* Vol. 94: S154-S179.

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

13. **Financial Markets and Firm Strategy** (12/3)

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.

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

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