

The Wharton School  
*UNIVERSITY OF PENNSYLVANIA*  
Department of Operations and Information Management  
Syllabus for OIDD 613

**Information and Information-Based Strategy:  
Learning from History, Experience, and Economics**

Professor Eric K. Clemons

[clemons@wharton.upenn.edu](mailto:clemons@wharton.upenn.edu)

<https://oid.wharton.upenn.edu/profile/26/>

JMHH 572 // Ext. 8-7747

Fall 2016 // Q 1

Class Sessions: M, W 10:30-12:00 and 3:00-4:30

Office Hours: M, T, W 2:00-2:45 and by appointment

Course Administrators Cindy Li and Ajay Jagannath

[lixiangm@wharton.upenn.edu](mailto:lixiangm@wharton.upenn.edu) and [ajayj@wharton.upenn.edu](mailto:ajayj@wharton.upenn.edu)

This course starts from six basic assumptions:

- Information technology has enabled a wide range of new business opportunities by reducing or eliminating barriers to entry, by changing the value of physical resources, and by creating virtual substitutes for those resources.
- And yet, there is very little that is entirely new in business. Basic objectives, such as differentiation, long-term competitive advantage, customer relationship management, and intelligent pricing strategies, are still essential. Even the apparently novel business model of Google is the model that was used by American and United Airlines to control search for and distribution of seats in the airline industry. Patterns repeat themselves.
- The set of relevant patterns has been changed by recent developments in the application of information and communications technologies, and by recent software strategies such as those followed by Capital One Bank, Facebook and MySpace, Google, and a range of companies that most of us have never followed.
- Strategic business problems often do not come nicely delineated, or clearly marked as problems in multi-echelon inventory management, or in pricing of a portfolio of product, or in pricing service offerings to multiple market segments, or clearly labeled as requiring algorithmic problems in any single discipline.
- The skills needed to recognize business problems can be developed, based on a changing set of frequently occurring patterns. This course seeks to teach students how to recognize patterns, act as talented diagnosticians of business strategy, and think about business strategy in ways appropriate to today's technology-enabled environment.
- It is possible to teach a course about information and strategy without teaching

about technology. *This course is not about technology.* It is about information and information-based strategy; it will use patterns, history, and information economics to teach you how to think about new competitive environments.

We focus on problem identification and on the development of sound strategic responses. More precisely, we focus on problems caused by rapidly changing conditions in the competitive environment, most frequently caused by changes in information technologies, and on the rapid development of competitive strategies to respond to those changes. We will develop in some detail how to respond, how the organization may need to change structurally, and how systems may need to change to reflect changes in organizational structure.

The course is intended to provide students with a set of skills that will be useful in careers in consulting and in strategic management. It can be seen as an introduction to the strategic use of information technology, with a focus on changes, threats, and opportunities resulting from changes in information availability. It draws on the professor's professional experience in diverse settings, in industries ranging from securities trading to the retailing of fast moving consumer goods. It is based in part on solving problems for and with clients, in settings ranging from start-ups to senior officers at the Pentagon, and locations ranging from London to Beijing. The course attempts to integrate this experience and the experience of students with relevant theory; experience and theory can be combined to develop an approach to information-based strategies that is more general than that which can be derived from any location or any competitive setting. The course provides a focused and modern complement to the strategy courses normally taken in the management department.

All aspects of the firm – production, service, sales, marketing, and strategy – will be affected by changes in information cost and information availability. Clearly, some firms will win and others will lose; nearly all will have to change. And yet, fundamental laws of economics have not been repealed. This course uses economic theory and previous experience with rapid technological change, to provide insights for the development of strategy in an increasingly digital age.

### **Course Objectives**

Students completing the course will have a sound theoretic framework for pursuing further studies in the area of information-based strategies, including eCommerce. They will understand how information technology affects the basic strategic options available, and will understand how firms and industries are likely to be affected. They will understand the often poorly structured process of evaluating potential systems innovations. They will be able to participate in strategic planning and systems planning because they will understand the relationships among them. The course is particularly recommended for students in strategic management and marketing, and for those interested in careers in consulting or who expect to manage portfolios of new technology companies. No background in technology or in technology management is required. Students completing this course will have mastered an understanding of the

competitive implications of information technology and the fundamentals of the use of information in business.

### Required Text

The text for the course is *Oh, Yeah, Now I Get It: Information and the Digital Transformation of Everything*. The published text has not yet been released, so students will have access (without charge) to pre-publication material posted online.

### Assignments and Grading

There will be several in-class discussions of cases or of problem sets during the semester. Please note that all written assignments are shown in **RED** in the electronic version of the course syllabus. Dates when written assignments of any kind are due are noted in **RED**, both in the session-by-session course outline and at the top of each day's page in the syllabus. Classes that require additional preparation for discussion but do not have written assignments due are highlighted in **BLUE**, both in the session-by-session course outline and at the top of each day's page in the syllabus. Written assignments should all be done in *groups of two or three* students. These same groups may wish to prepare together for discussion sessions as well.

Written assignments must be submitted electronically to the course website at the start of the class sessions in which they are due; since assignments will usually be discussed in class on the date that they are due, it will not be possible to accept late assignments unless prior arrangements have been made. Please note that students will only have to submit **TWO** of the **THREE** assignments. *If students do submit more than two assignments, only the highest assignments will be counted towards their grades; thus the later assignment can be considered a make-up assignment for an assignment missed for any reason or for an assignment where students felt they did poorly.*

Consistent with requests made by the class over the past two years, the structure of the course has been significantly altered. The number of written assignments has been dramatically reduced. As a result, the written assignments will now determine only 30% of your final grade. Lectures have been reduced and there is much more time for discussion. As a result, class participation will now determine 35% of your course grade, and the remaining 35% will be determined by a final exam during the normal exam period. The exam for the course will be held at noon on 9 May. Class participation grades will be based on the frequency and the quality of students' interactions in the classroom. Not surprisingly, a high grade in class participation will require class attendance. More importantly, a high grade in participation will require active engagement in classroom discussions, high quality responses to cold calls, and high quality interactions when the student volunteers rather than waiting to be called.

Since class participation is so essential in this course it will be assessed three ways. (1) Students will be cold called during class. (2) Students with insights and strategic epiphanies can volunteer information. (3) For classes with discussion, highlighted in

**BLUE** in the syllabus, groups will be asked in advance to prepare to lead the class discussion.

### Color Coding in the Syllabus

A **bold red session heading** indicates that something is due at the beginning of the day's class. A **bold blue session heading** indicates that this is a discussion session, although there will not be a written assignment due.

### Final Notes on Grading

As we did last semester, we will have a vote before the first written assignment is due. If 60% of the class votes in favor of an alternative grading scheme, there will be **no required assignments**. The weights on class participation and on the final exam would then be increased to 50%. Assignments would then be optional, and could be submitted before class to improve class participation grades.

### Student Bios

Please send a word file containing a short biographical sketch, not a full resume, via email, to [clemons@wharton.upenn.edu](mailto:clemons@wharton.upenn.edu). This will be very helpful to me in guiding class discussions. Please title your attached file **613S16\_I\_NAME.doc**, where **I** is your first initial, and **NAME** is your last name. Please provide the following information:

- Your expected major at Wharton
- Your experiences relevant to the topics of this course
- Your reasons for taking this course and what you hope to get out of it

## Course Outline and Readings

- Session 1 W 31-Aug **Introduction and Course Overview**  
*Introduction to the changing role of information in business. Changing information endowment changes everything, from human behavior to corporate strategy. Discussion of grading and course mechanics.*  
Read: *Now I Get It*, (Preface)  
Read: *Now I Get It*, (Prolog) (Optional)
- M 5-Sep **No Class – Labor Day**
- Session 2 W 7-Sep **Learning from the Experience of Others – The Power of Pattern Recognition**  
*Review of the science of business and the science of strategy formulation in the presence of discontinuous change, based on patterns observed over the past twenty years.*  
Read: *Now I Get It*, (Unit 1: Introduction and Chapters 1-4)
- Session 3 M 12-Sep **Versioning and the Market for Information Goods**  
*Introduction to types and willingness to pay. Introduction to information asymmetry. Introduction to versioning contracts to maximize producer surplus.*  
Read: *Now I Get It*, (Unit 2: Introduction, all Chapters, and Appendix)
- Session 4 W 14-Sep **Dealing with Information Asymmetry – Screening Mechanisms in Newly Vulnerable Markets**  
*Gaining competitive advantage through systems for market micro-segmentation and differential pricing; attempting to sustain advantage. The launch of Capital One, and extensions into other industries.*  
Read: Review *Now I Get It*, (Unit 1: Chapter 5, Review Unit 2 Chapter 3)  
**Discussion: Screening and Competitive Advantage**
- Session 5 M 19-Sep **The Power of Framing and Reframing**  
*Problems can be made much easier by proper reframing. Conversely, problems can be made much more difficult, or even impossible to solve, by an incorrect framing.*  
Read: *Now I Get It*, (Unit 3: Introduction, Chapters 1 through 8 and 10)
- Session 6 W 21-Sep **The Power of Certainty – Resonance Marketing**  
*The role of increased information in the changing balance between cost-based strategies and value-based strategies, the changing advantage of incumbents, and the changing nature of competition.*  
Read: *Now I Get It*, (Unit 7: Introduction and all Chapters; Unit 8 Chapters 1 – 3, Appendix A.1)  
**Discussion: The Logic of Resonance Marketing**

- Session 7 M 26-Sep **Hustle at a Discontinuity and Platform Envelopment**  
*What do we know about platform extensions and resource-based competitive advantage? What does this tell us about Microsoft? What does this tell us about Google? What does this tell us about Amazon? What does it tell us about the competitive advantage of existing companies in a net-based economy?*  
Read: *Now I Get It*, (Unit 5: Introduction, and all Chapters)  
**Discussion: Platform envelopment**
- Session 8 W 28-Sep **Quantitative Analysis of Resonance Marketing Examples**  
*The ideas of resonance marketing can be used to quantify the impact of online content and community-generated reviews on new product launches.*  
Read: *Now I Get It*, (Unit 8: all Chapters plus Appendix 8.A2)  
**HW1: Written Analysis – Quantitative Analysis of Resonance Strategies**
- Session 9 M 3-Oct **Information Goods as a Strategy – Monetizing the Net beyond Advertising**  
*Current acquisitions of social network websites and user content websites have generated considerable interest and huge bids from media companies. Is this the big play in the next round of internet-based companies or simply the next round of dotcom silliness? How can the net be used to generate revenues and profits? Surely there must be something other than advertising!*  
Read: *Now I Get It*, (Read Unit 12)  
**Discussion: Business models, and discussion of why the net must be “free” and funded by advertising, privacy intrusions, and control of search**
- Session 10 W 5-Oct **Making the Technology Investment Decision**  
*In some ways information technology investments are similar to other large capital investments with long lead times and resulting uncertainty; in other ways they have unique problems all their own.*  
Read: *Now I Get It*, (Read Unit 11: Chapters 1 and 2. Read Chapters 4 through 6 if you are not familiar with statistical decision making and decision trees. Read Chapters 7 and 9.)  
**HW2: Computational exercise on business valuation**
- Session 11 M 10-Oct **Learning To See Alternative Worlds – The Power of Scenario Analysis When Dealing with Strategic Uncertainty**  
*Planning under uncertainty and the use of scenario analysis; discarding your old mental models in preparation for developing a new world view. What is the future of Chinese consumer goods? What companies are positioned to succeed and which companies are not? Where are the opportunities for Western companies?*  
Read: *Now I Get It*, (Read Unit 8)  
**Analysis and Discussion – Using Scenarios**

Session 12 W 12-Oct **Third Party Payer Business Models, Online Gateways, and the Future of Competition**

*Third Party Payer business models appear to be a special case of what are now commonly called two sided markets. Online gateways are emerging as one of the most powerful business models on the net. What is the source of their power? When are they dangerous to competition and to consumers? When might third party payer business models require new forms of regulation and why?*

Read: *Now I Get It*, (Unit 6: Introduction and Chapters 1 through 5, 7, 10, 11)

**HW3: Written Analysis – Computational Analysis of the Power of Search**

## **OIDD 613 – Information: Strategy and Economics**

### **Suggestions for Preparing Written Case Analyses**

The following simple guidelines will help you in your written case assignments for this course:

- You are, of course, not only permitted but **actively encouraged to meet to discuss your case assignments** before class. All written exercises still must be done individually or in your work groups of two or three.
- The most important thing to remember about each exercise is that it is necessary for you to **answer the assigned questions**. In this course we are not asking you to perform a general competitive analysis, tell a captivating story, summarize the case reading, or describe the company. We are asking you to perform specific analyses, based on specific principles from economics and competitive strategy. Please be certain that your answers are responsive to the assigned questions. Likewise, please separate and number your answers to ensure that you answer each part of each question, and to help your graders when reviewing your work. Please number and place your name(s) on each page. If what you are writing does not respond directly to a specific question, it probably does not need to be written, however extra credit can be earned for especially insightful and especially terse answers.
- Next, it is critical to understand that the graders are not looking for specific key words, but they are looking for **careful strategic analyses and for specific supporting details**. On many questions, it is possible to reach dramatically different but equally valid conclusions about the case, depending on the assumptions you make or the data you use. Please be specific about your assumptions and your supporting data and clear about your analyses.
- **There is no maximum length acceptable and no minimum length required. Most cases can be answered in three or four pages, double-spaced.** However, longer answers are not generally better or more complete. It is preferable to have a well-articulated response that presents a single well-considered viewpoint, well defended by specific examples. This is always preferable to a lengthy unstructured summary of various points, no matter how interesting each point may be separately. Longer papers frequently mean that you have not yet decided upon your answers and have instead “written around the question” and provided multiple and contradictory responses rather than articulating a single argument.
- Please turn cases in at the start of the class in which they are due. Since cases will be discussed in class, written assignments done after class would enjoy a considerable advantage over those done before class discussion. Consequently,



written analyses cannot be accepted late unless prior arrangements have been made.

It will be beneficial for groups to meet to discuss questions before class, even on days when no written assignment is due.

**OID 613 – Information:  
Strategy and Economics**

**The Changing Role of Information in Business and Strategy**

**Session 1 – 31 August 2016**

**Questions for Class Discussion**  
**Not for Written Analysis**

1. Why do we have an MBA course on *information*? Why is this course about information and *not* information technology? Why is this course about *information-based strategy* rather than about information technology?
2. What is the role of uncertainty in creating a strategy? What is the role of hostile intent when creating a strategy? Do you actually *need* a strategy if neither uncertainty nor hostile intent is present?
3. Do big data and the emergence of real-time advanced analytics eliminate the need for strategy? Can you use machine learning, rapid adaption, and controlled testing to eliminate the need for advanced strategic planning?

**OIDD 613 – Information:  
Strategy and Economics**

**Learning from the Experience of Others – The Power of Pattern  
Recognition**

**Session 2 – 7 September 2016**

**Questions for Class Discussion  
Not for Written Analysis**

1. Why do we have an MBA course on information? Why is this course about information and not information technology? Why is this course about *information-based strategy* rather than about information technology?
2. What makes a theory useful? Descriptive power? Predictive power? Falsifiability? What do we think about the theory that human behavior is leading to climate change?
3. How would we judge a theory that says Amazon did well because it branched out boldly, and J&J failed because it tried to sell what it had always sold but in a new online channel? What does this theory tell us to expect from very safe and traditional online grocery sales at Tesco or bold and innovative online sporting goods sales at Buy.com?
4. What are the principal differences between strategic *uncertainty* or *ambiguity* and *strategic risk*? Think of a situation in which you faced uncertainty and be prepared to discuss how you analyzed it and resolved it. Why are the mechanisms for managing risk better understood than the mechanisms for managing uncertainty and ambiguity?
5. Do you believe that standard paradigms like conservation of energy in physical systems or finite element analysis in structural engineering have counterparts in management?
6. Can managers be taught a set of paradigms to permit rapid diagnosis of problems and rapid recognition of solutions? Are new paradigms really needed for management education?
7. What is the importance of speed in diagnosis and recognition? Is diagnosis really a critical skill for managers?

**OIDD 613 – Information:  
Strategy and Economics**

**Versioning and the Power of Information**

**Session 3 – 12 September 2016**

**Questions for Class Discussion**  
**Not for Written Analysis**

1. Why is it necessary to enjoy a monopoly position before a firm can attempt to set a single, profit-maximizing price?
2. Why does a single profit-maximizing price result in a large consumer surplus and a large deadweight loss? That is, why are multiple prices better, both for higher producer profits and lower deadweight loss?
3. With perfect information, consumers would always choose the lower price if the same item was made available at different prices. How does this explain the existence of *versioning*, selling very similar items at different prices? Why is *versioning*, to set very different prices on very closely related items after damaging the highest quality ones to create variation, more common with information goods than with purely physical goods?
4. If a firm knew each customer's *type* (good or bad risk, expensive or inexpensive to serve, etc.) how could it use this information?
5. Why does a signal have to be expensive or difficult to send? What if consumers got a 20% reduction in their insurance for taking a 2-hour *attitude training and anger management* class? What if they got the same 20% reduction only after perfect attendance at a 12-month class with an exam after each session? What if you got a 20% reduction in health insurance costs for joining a health club for \$100? What if you got the same reduction only for having played a varsity sport and continuing to play in an amateur club league?
6. What is the principal difference between a *signal* and a *screen*? Why is the use of screening mechanisms and screening contracts in business so much more common than the use of signals?
7. Why are there complex social issues associated with information asymmetry? Why are these issues becoming more complex? Why are regulators becoming suddenly more interested in corporate use of screening contracts and data mining?

8. Why are these issues complex enough that regulators often get their analyses wrong in subtle ways that have huge implications for the markets?

**OIDD 613 – Information:  
Strategy and Economics**

**Dealing with Information Asymmetry –  
Screening Mechanisms in Newly Vulnerable Markets  
(Discussion of Newly Vulnerable Markets<sup>1</sup>)**

**Session 4 – 14 September 2016**

**Questions for Case Discussion  
Not for Written Analysis**

1. What is the *customer profitability gradient* and why is it so important to modern profitability-based strategies?
2. It seems pretty clear that the *defender* should *always* enjoy an information advantage, relative to a competitor attempting to capture its most profitable customers. That is, the *attacker* is *making educated guesses* about who might be profitable and who might not be; the *defender should always have more accurate information* on who has been profitable and who has not been. Why do some attackers encounter situations where defenders appear unable to duplicate the attackers' strategies and thus unable to defend themselves effectively?
3. What are the three characteristics of a Newly Vulnerable Market and why are each important?
4. Why did Capital One face a Newly Vulnerable Market? Describe each of the three elements that enabled Capital One to treat credit cards as a newly vulnerable market?
5. Capital One had higher costs than other credit card issuers because it did not have access to deposits or other cheap sources of funding for its credit card portfolio, it did not have operational scale, and it was attempting to implement more complex marketing strategies than its competitors. And yet it charged lower prices than its competitors, as reflected in its lower APR. How can any organization have higher costs and lower prices than competitors and still be more profitable?
6. Customer profitability gradients are not unique to banking or even to sophisticated services. The US Postal Service has been in trouble for years, since long before the widespread adoption of services like email. At one end of the market it lost market share among customers who wanted mass mailings to city residents. At the other

---

<sup>1</sup> There are no power points posted in the course website for class discussion sessions.

end it lost market share among customers who were willing to pay for special delivery services, who switched to Federal Express. (i) The USPS is required by law to charge all customers the same amount for each class of service, regardless of location of sender and addressee. How does this contribute to the existence of a CPG? (ii) Why are local delivery customers and customers who most want immediate delivery extremely desirable? (iii) How does the loss of these two segments create problems for the USPS?

7. The idea of customer profitability gradients and information asymmetry should be readily extensible to other industries. (i) Is there a strong customer profitability gradient in private medical coverage, such as operating an HMO or PPO? If so, what would constitute a profitable customer? (ii) How might an unscrupulous HMO or PPO operator earn extraordinary profits through a Capital One strategy? (That is, what would a screening mechanism look like?) (iii) In the era of traditional landlines and regulated telephone service, was there a strong customer profitability gradient? If so, what constituted an extraordinarily profitable customer? (iv) How might an unregulated new entrant have attracted profitable customers? (That is, what would a screening mechanism look like?)
8. How easy was it for Capital One to extend its strategy to other industries? That is, (i) How well did they succeed with their attempts to create a retail online flower business or an online retail gift retailer selling valentine chocolates and other holiday favorites? Are they competing effectively with Amazon, Teleflora, and other online retailers? (ii) How large is the customer profitability gradient in those industries? (iii) How easy is it to construct a screening mechanism for these other industries? [Check Capital One's annual report for contributions from online sales of flowers and gifts to assess their success in these industries.]
9. Uber has certainly been in the news lately, and much of the news has not been good. Traditional taxicab companies and their drivers hate Uber. Uber targets the most profitable customers, those who need cabs when cabs are difficult to get, and charges them much higher prices. Uber confirms timing and pricing, and lets you use your smart phone to pay for your taxi and to monitor the location of your car as it approaches. Let's analyze this as if it were a newly vulnerable market (i) Is the market for online delivery of taxi reservations newly easy to enter? (ii) Is it attractive for Uber to attack? (iii) Is it difficult for traditional taxi companies to defend themselves from Uber, and if so, why?

## **OIDD 613 – Information: Strategy and Economics**

### **The Power of Framing and Reframing**

**Session 5 – 19 September 2016**

#### **Questions for Class Discussion**

1. Why do we spend an entire class on framing, reframing, and asking the right question? Doesn't your manager, or your client, always know how to ask the right question? Don't you always know what question you are trying to answer and what problem you are trying to solve?
2. OK, so Lewis Carroll came up with some cute problems. How can you solve his "clock" problem by brute force arithmetic? How can we solve this problem more easily, simply by reframing the question? Be prepared to think about some additional cute Lewis Carol problems in class. Alternatively, be prepared to bring your own problems to the class, and be able to discuss and present them clearly.
3. The Board at Merrill Lynch was considering a serious decision regarding restricting Mike Bloomberg or allowing him to sell his system whenever and wherever he wished. Why was the problem important? Why was it difficult to solve in its original form? How and why did changing the question make it easier to solve? Why didn't members of Merrill Lynch's management team make this transformation sooner?
4. Unilever and British Airways both started thinking about online sales because supermarket markups and travel agent commissions at least potentially represented great new profit sources without requiring any increases in sales. Why did Lever conclude that the supermarket distribution channel was neither easy to enter nor attractive for a new entrant to attack? Why did BA conclude that travel agent distribution was both newly easy to enter and attractive to attack? Why was the supermarket easy for large retailers to defend against attack by manufacturers of fast moving consumer goods? Why was the market for online travel difficult for agencies to defend against attack by airlines?
5. And then there is that Monty Hall problem again. Explain it to me. Explain it to your classmates. What is the general principal at work here that makes this problem interesting?



**OID 613 – Information:  
Strategy and Economics**

**The Power of Certainty – Resonance Marketing<sup>2</sup>**

**Session 6 – 21 September 2016**

**Questions for Class Discussion  
Not for Written Analysis**

1. What are the factors leading to hyperdifferentiation? What is the relationship between hyperdifferentiation and resonance marketing?
2. (i) Why does a consumer's willingness to pay for a product depend both upon the product's location in the "product attribute space" and the consumer's own location in that space? (ii) Why does a reduction in the consumer's uncertainty about a new product's location in product attribute space increase the customer's willingness to pay for those new products that are most suitable for him or her? [In other words, why is there a curved portion in the center of the curve when uncertainty is introduced?] (iii) Why does reduction in uncertainty have little or no effect on consumers' willingness to pay for products that do not represent a good fit with their preferences? [In other words, why does the curved portion usually not affect the outer edges of the triangular willingness to pay curve?]
3. In resonance marketing it does not matter how many customers like you or how many hate you; it only matters how many customers love you. Why?
4. (i) Why are resonance products more likely to be snacks, soft drinks, beer, blue jeans, or other small-ticket consumable items? (ii) The Boeing 787 was intended to be a resonance aircraft. The Toyota Prius was intended to be a resonance automobile. Are they? (iii) Why are there so few big-ticket resonance products?
5. (i) Can resonance products be either manufactured goods or services? Can they be either niche or mass market? (ii) Almost all of Amazon's sales are in the fat part of the distribution and *not* in the long tails. If that is true, how does having long tail offerings help Amazon compete?
6. Comment on the importance of resonance marketing to *real* companies. (i) Does the presence of resonance products affect grocery stores and department stores? (ii) Does the presence of resonance products affect the strategies of established companies? Are there categories where growth and profitability of the fat spots is threatened by the accumulation of competitors' sweet spot offerings? (iii) How should P&G, Lever, or Pepsi respond to the growth of sweet spot offerings?
7. What if this resonance marketing theory is all wrong? What if consumers can still be manipulated by ads and company-sponsored messages, as long as these

---

<sup>2</sup> There are no powerpoints posted in the course website for most discussion sessions.

messages successfully present themselves as community-generated content? (i) How would successful astroturfing affect Budweiser, Miller, and Coors as they attempt to enter the high-margin craft brewing marketplace? (ii) How would successful astroturfing affect small craft brewers like Victory, Dogfish Head, Ommegang, Stone, and others that have never invested in advertising?

**OID 613 – Information:  
Strategy and Economics**

**Hustle at a Discontinuity, followed by Platform  
Envelopment: Platform Envelopment and Resource-Based  
Sustainable Competitive Advantage  
(Discussion of Channel Conflict<sup>3</sup>)**

**Session 7 – 26 September 2016**

**Questions for Case Discussion  
Not Written Analysis**

1. Rosenbluth appears to have benefitted from opportunities in travel as travel became in some sense a newly vulnerable market. (i) Why was there a customer profitability gradient in air travel reservations after deregulation of air travel? (ii) Why were there now opportunities to add value for corporate customers? (iii) Why were airlines not able to counter Rosenbluth's moves into corporate-focused travel services? That is, why were they not able to protect themselves from Rosenbluth's attack on their ability to serve their most profitable customers?
2. Rosenbluth seems to have enjoyed competitive advantage for many years. (i) Why didn't American Express or some other dominant player launch a corporate-focused strategy before Rosenbluth? (ii) Why didn't every other small agency replicate this strategy once its value to Rosenbluth became clear? (iii) [Platform envelopment strategies occur when new applications make old applications more valuable, and make existing infrastructure more valuable. This increases the value of incumbents' assets, making it harder for new entrants to compete.] In what ways did Rosenbluth clearly follow a platform envelopment strategy, with new applications interacting with older applications to create value for customers?
3. Rosenbluth has exited the industry, and under terms much less attractive than they would have gotten in 2000. (i) Why did airlines want to recapture control over their ticket sales? (ii) Why were airlines able to recapture the booking of air travel; that is, what made the market for selling airline tickets newly easy for airlines to re-enter using a channel encroachment strategy?
4. When valuing Google, we are tempted to claim their business model is unique. Almost nothing in business is unique. (i) Could we use the CRS business as a "like" when using mark to like to value Google? What are the similarities? Who uses the CRS and who uses Google? Who pays in each case? (ii) What other differences are relevant? Why couldn't airlines escape from the travel agent CRSs in the 1980s?

---

<sup>3</sup> There are no posted class notes for case discussion sessions.

Are there firms that can escape from the power of third party payer search? Are there firms that probably cannot? (iii) Does Google appear to be following a platform envelopment strategy, with new applications intended to build on and increase the value of existing applications? (iv) What risks does this create for other businesses or for society, if any?

5. Did Microsoft follow a platform envelopment strategy? That is (i) did it have at least one application with nearly universal adoption? (ii) did it find a way to combine that application with other applications, to produce a sustainable revenue source that competitors could not match?
6. Is Facebook following a platform envelopment strategy? That is (i) Does it have at least one application with nearly universal adoption? (ii) Has it found a way to combine that application with other applications, to produce a sustainable revenue source that competitors cannot match?
7. Think of other companies that are trying to follow a platform envelopment strategy and be prepared to present your analysis in class. What is their foundation app or service? What are they trying to build on top of their foundation? Why do you believe that it will work, or that it will not work?

**OID 613 – Information:  
Strategy and Economics**

**Quantitative Analysis of Resonance Marketing**

**Session 8 – 28 September 2016**

**Questions for Written Analysis  
(Questions Span Several Pages)**

**<<This assignment will be updated as the election campaigns unfold>>**

Information indeed changes everything. In past elections, many voters were influenced by, well, influential people, like their clergymen, or their mayors, or the local schoolmasters. Now we can learn whatever we want, immediately, on the net. And as the party elders on both the left and the right are rapidly learning, this makes voters unpredictable and primaries impossible to control. So not only is the market for beer, power bars and denim jeans changing; even the market for presidential candidates appears to be changing as well.

American political commentators have been writing about and worrying about the demise of the Moderate Republican for several years. See, for example,

[https://www.foreignaffairs.com/reviews/review-essay/missing-middle-american-politics?cid=nlc-bnr-20160205&sp\\_mid=50636907&sp\\_rid=Y2xlbW9uc0B3aGFydG9uLnVwZW5uLmVkdQS2&spMailingID=50636907&spUserID=NTA0ODYwNTg0MjAS1&spJobID=860631241&spReportId=ODYwNjMxMjQxSQ](https://www.foreignaffairs.com/reviews/review-essay/missing-middle-american-politics?cid=nlc-bnr-20160205&sp_mid=50636907&sp_rid=Y2xlbW9uc0B3aGFydG9uLnVwZW5uLmVkdQS2&spMailingID=50636907&spUserID=NTA0ODYwNTg0MjAS1&spJobID=860631241&spReportId=ODYwNjMxMjQxSQ)

Could this be an unanticipated result of resonance marketing? Could this be a result of the interactions between resonance marketing and the strange anomalies associated with selecting one candidate out of a group of candidates? You might take comfort in Ken Arrow's Impossibility Theorem, also known as Arrow's Paradox, which demonstrates that there is no best way of selecting one candidate from two or more alternatives.

*In social choice theory, Arrow's impossibility theorem, the General Possibility Theorem or Arrow's Paradox states that, when voters have three or more distinct alternatives (options), no rank order voting system can convert the ranked preferences of individuals into a community-wide (complete and transitive) ranking while also meeting a pre-specified set of criteria. These pre-specified criteria are called unrestricted domain, non-dictatorship, Pareto efficiency, and independence of irrelevant alternatives. The theorem is often cited in discussions of election theory as it is further interpreted by the Gibbard-Satterthwaite theorem.*

No, I don't expect you to use either Arrow's Theorem or the Gibbard-Satterthwaite theorem! Just take comfort in the fact that designing elections is an extremely difficult problem. Many nations have found various ways of getting election design wrong, but

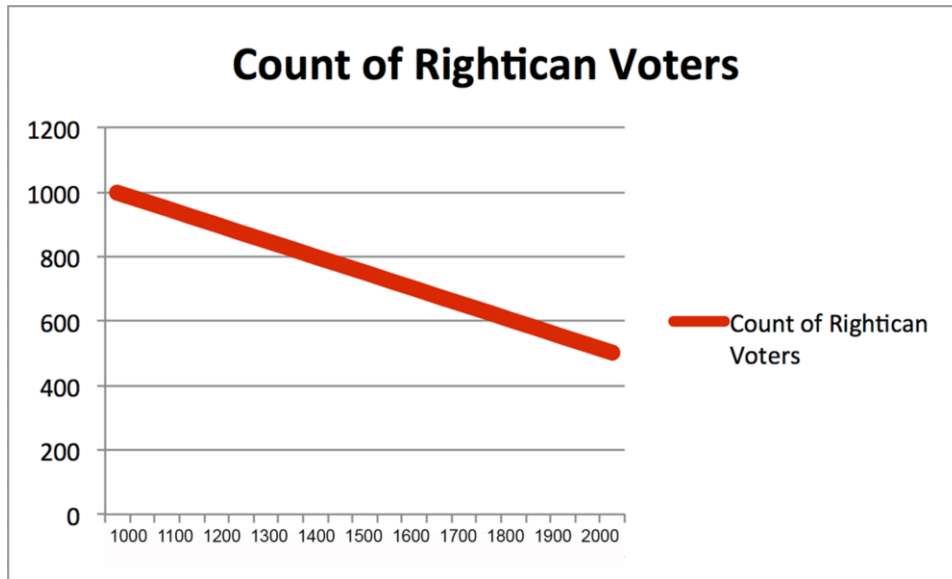
it is reassuring to know that with more than two candidates there is no way of getting the design right.

For this assignment we will examine the presidential elections in Illyria. Illyrian elections are characterized by the following:

- Like our own, they generally involve only two parties. In Illyria the parties are the *Leftocrats* and the *Righticans*.
- Like our own elections they start with a primary as each party selects its candidate, and the two candidates then face each other in a general election. For simplicity assume that everyone is registered in either one party or the other.
- You can assume that voters can vote in either primary, but that they do not engage in *spite* voting. That is, voters vote for the candidate that they most like to see represent them in the general election, and not to influence the other party's selection of a candidate.
- Like our own elections, they usually involve competition among several candidates in the primaries and competition between two candidates in the general election.
- They are held on the Twelfth Night after the current president declares an election. The general elections are held twelve nights later. As a result they are shorter and less chaotic in many ways than our own. Candidates know the voters preferences on issues; they know where the voters are located in their own liberal to conservative voter attribute space. Candidates do not fight for the same voters in the primaries; that is, once a candidate has staked out a position, no other candidate in the same party would take a position so close to his or hers that they fight directly for the same voters. They locate themselves as rationally as companies locate themselves in any other resonance marketing competition.

As with our own elections, more voters in both parties are Centrist than extreme left or extreme right. And as with our own elections, although there are fewer voters in the extreme left or extreme right, they are far more passionate about their positions.

Let's start with an analysis of the *Rightican* primaries. For concreteness, assume that the *Rightican* voters are located between 1,000 and 2,000 in Voter Attribute Space (VAS), where 1,000 is the center of the political spectrum and 2,000 is the far right. Assume that there are more Centrists than extremists, so that there are 1,000 voters per click in VAS at the center dropping at a consistent rate to 500 voters per click at 2,000 in VAS. It's clear that the number of potential *Rightican* voters decreases by 50 for every 100 clicks, or by 5 for every 10 clicks, in VAS.



Now assume that the *Rightican* voters at the extreme right are far more likely to vote in the primaries than voters in the center of VAS, which is the left end of the *Rightican* Party. To calculate the likelihood of voters showing up for the primaries you need to know that there is a relatively high cost to them of doing so. There is little else of importance on the primary ballot, and there is little social pressure from most of their neighbors to be good citizens and vote in the primaries. Assume that there is a cost  $C$  of voting in the primaries. And assume, as in all resonance examples, that voters maximize their expected surplus after voting, by voting for the candidate whose value to them is based on the candidate's position and their own position in VAS and their perceived cost of voting.

- **Centrists:** Assume that the voters between 1,000 and 1,250 are low  $V$  low  $t$ , with  $V = C$  and  $t = 0.25 * C$  per 100 clicks in VAS.
- **Moderates:** Assume that the voters between 1,250 and 1,750 are Moderate  $V$  and Moderate  $t$ , with  $V = 1.5 C$  and  $t = 1 * C$  per 100 clicks in VAS.
- **Conservatives:** Assume that voters between 1,750 and 2,000 are extreme single-issue voters who want a clarity of conservative vision. They are high  $V$  high  $t$ , with  $V = 11 C$  and  $t = 8 C$  per 100 clicks.

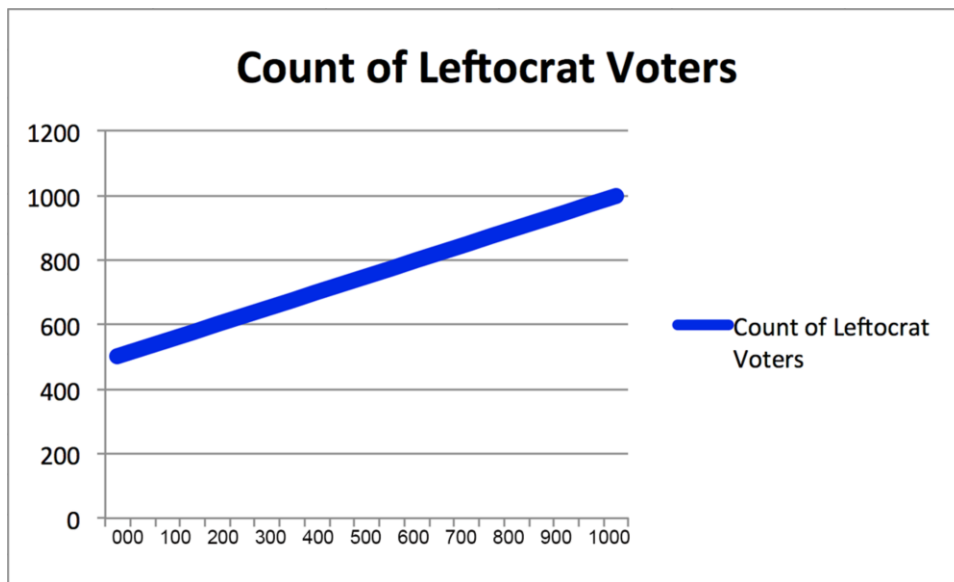
Use the information provided above to answer the following questions. Assume that candidates can locate themselves wherever they wish for the primaries. Assume that candidates cannot credibly change their locations after the primaries.

1. What is the ideal location of a Conservative *Rightican* Party primary candidate locate in VAS to maximize the number of votes he gets in the primary?
2. What is the ideal location for a Moderate *Rightican* candidate to locate in VAS in order to maximize his or her "market share"?
3. What is the ideal location for the second Moderate *Rightican* candidate to locate, given where the first Moderate candidate has located? That is, where should the

second Moderate candidate locate in order to avoid overlapping in VAS when competing for primary voters?

4. What would happen to a *Rightican* primary candidate who attempted to compete for voters in the Centrist *Rightican* Party?
5. Who will win the *Rightican* primaries, if the candidates avoid locating in positions where they fight for the same voters by letting their zones of voters overlap in voter attribute space?
6. How does that affect the general satisfaction of the more Centrist voters at the left end of the *Rightican* Party?

Now assume that the *Leftocrat* Party has a similar distribution of voters, as shown below. Assume also, for whatever reason, that their high  $V$  high  $t$  voters and low  $V$  low  $t$  voters have slightly different values for  $V$  and  $t$ .



- **Centrists:** Assume that the voters between 1,000 and 750 are again low  $V$  low  $t$ , with  $V = C$  and  $t = 0.25 C$  per 100 clicks in VAS as was true for the *Righticans*.
- **Moderates:** Assume that the voters between 750 and 250 are Moderate  $V$  and Moderate  $t$ , with  $V = 1.5 C$  and  $t = 0.5 C$  per 125 clicks in VAS. They are less sure of themselves, or less committed, or even in some sense less pure than the Moderate Illyrian *Righticans*. Thus they have lower fit cost than their *Rightican* equivalents
- **Liberals:** Assume that voters between 250 and 0 are single-issue voters who want a clarity of radical liberal vision. They are high  $V$  high  $t$ , with  $V = 11 C$  and  $t = 8 C$  per 100 clicks.

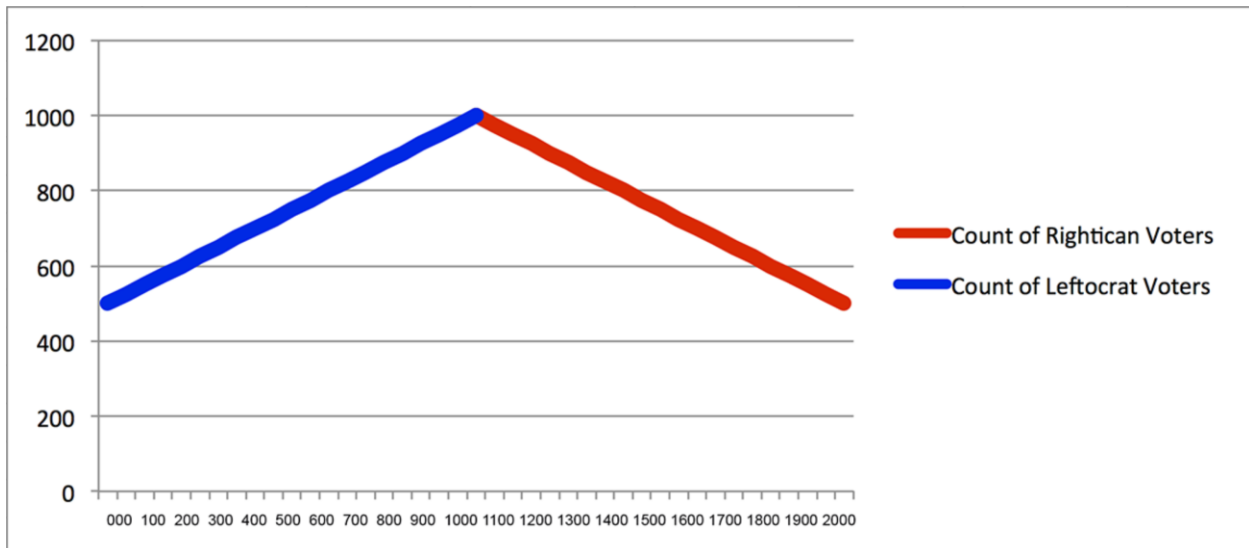
Now analyze the predicted behavior of *Leftocrat* Party primary candidates.

7. What is the single best location for the *Leftocrat* Party primary candidate to locate in VAS?



8. Why is your answer different for the answer for *Righticans*? What difference between the voters in the two parties drives this answer?

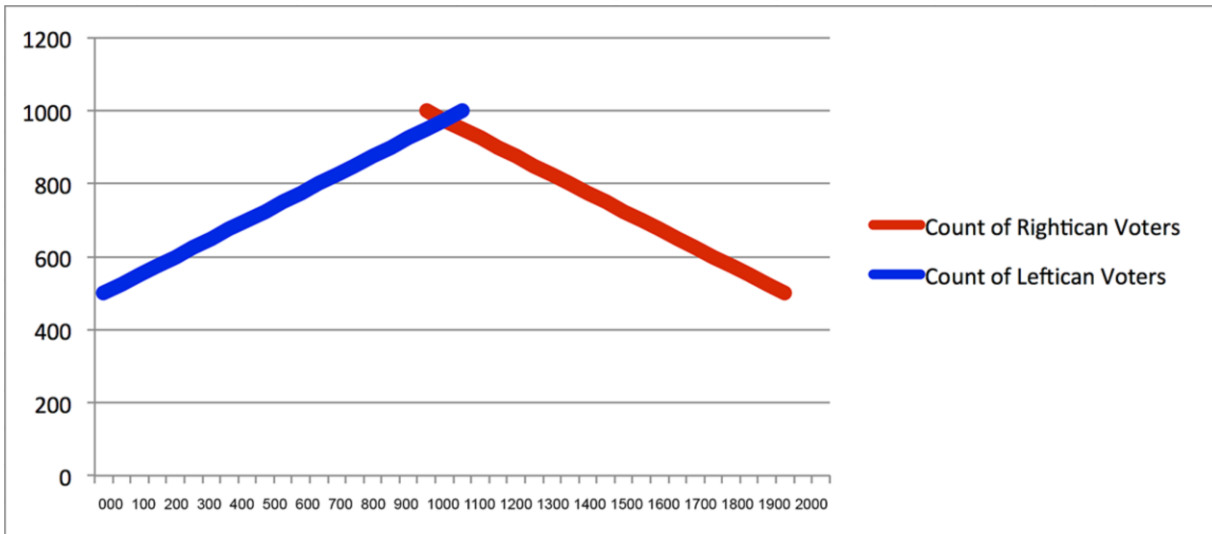
Now assume that in the general elections the voters' perceived cost of voting drops to  $0.25 C$ . However,  $V$  and  $t$  do not change for any voter; it is merely the cost of voting that has changed. To understand the outcome of the general elections it's necessary to understand how the two parties line up in VAS and how their voters behave. The ranges of the two parties just touch at 1,000 in VAS. Illyrian voters are highly rational and they select their candidates without preference for party affiliation. All voters vote as if they were selecting a beer or a power bar, maximizing their "voter surplus" for the candidates that give them the best value for  $V - t * x$ , where  $x$  is the distance between the candidate and the voter in VAS. Just as a consumer won't buy a beer or a power bar if  $V - t * x$  is negative for that product, a voter won't vote for a candidate when  $V - t * x$  is negative for that candidate.



9. Who will win the general election, the *Leftocrat* or the *Rightican* candidate? Assume that neither  $V$  nor  $C$  will change for any voter, but that party affiliation does not matter when casting votes. Assume that each party's nominee is the winner of the primary that you identified before. Voters will select that candidate with the highest value for their  $V$ , minus their fit cost.
10. Why will the *Righticans* continue to make the same mistake, and continue to lose the general election, year after year unless they can figure out how to modify their nominating process?

Now assume that the parties are not quite that different, and that the registered *Leftocrats* and the registered *Righticans* actually overlap in VAS, as shown below. That is, assume that *Righticans* are located between 900 and 1,900 in VAS rather than between 1,000 and 2,000. There are registered *Leftocrats* to the right of some and *Righticans* and registered *Righticans* who are to the left of some *Leftocrats*. Obviously, this shifts the

locations of the high  $V$  high  $t$  *Righticans*, the Moderate  $V$  Moderate  $t$  *Righticans*, and the low  $V$  low  $t$  *Righticans*.



11. Assume even with the overlap that only registered *Leftocrats* can vote in the *Leftocrat* primary and that only registered *Righticans* can vote in the *Rightican* primary. Does this change any of your answers above in any of the questions?
12. Assume that the *Leftocrat* candidate for the general election is the one at the location you identified in question 7 above. What is the best location for a *Rightican* candidate? An approximate answer will be sufficient, but explain your answer.
13. Could this candidate actually win the General Election, if he or she could be nominated?
14. Note that the Moderate *Righticans* have stronger beliefs than the *Leftocrats* as represented by their higher fit cost. Why doesn't this help? Can they ever "take back Illyria" by continuing to "take back control of their party?"
15. Does this say anything about the prospects for a *brokered convention* for the *Righticans*? Does it say anything about the prospects for a well-funded independent who could locate anywhere he wished? [There was a rumor that the former mayor of the largest Illyrian city, Flowering Mountain, might indeed choose to enter as an independent.]

**OID 613 – Information:  
Strategy and Economics**

**Information Goods as a Strategy – Monetizing the Net  
Beyond Advertising<sup>4</sup>**

**Session 9 – 3 October 2016**

**Questions for Class Discussion**  
**Not for Written Analysis**

1. Is the problem with advertising in traditional mass media the fact that no one watches television or reads magazines? That is, is the problem caused by no one viewing the *media*, or by no one viewing the *ads*? If the problem really is with the message, what happens when you try to advertise on the internet? When will the commercial messages have more success? When will they be no more effective than traditional ads?
2. What alternative mechanisms are available for monetizing the internet and operating online businesses? Is the future of everything really advertising? If online advertising should prove to be ineffective, would that really *Break the Internet*?
3. How does advertising create brand awareness and a perception of quality? Is Google's array of paid search mechanisms a form of advertising, no different from charging a premium price for billboard in a prime high traffic location? Or might paid search be seen as something somehow different from advertising?
4. What is the future of online social networks? Are they a form of interpersonal communication? A form of entertainment? A form of boredom relief, like CB-radios, which were obliterated by better in-car entertainment systems or a fundamental change in human interaction, like the telephone?
5. What is the future of advertising and the undisguised use of commercial messages in social networks? When did "popping the question" come to mean offering to sell your beloved a new cell phone or other electronic device?
6. When can mobile promotional messages be really useful to the recipient? What are attributes of a perfect mobile ad?
7. Why might mobile promotional campaigns become even more expensive for merchants, and even more dangerous for them?
8. Why might all of the data collection used for targeted ads sometimes be worse

---

<sup>4</sup> There are no power points posted in the course website for most discussion sessions.

than an annoyance to the recipient? Isn't it always better for the recipient to have only perfectly targeted ads? How might perfectly targeted ads be dangerous to the recipient?

**OID 613 – Information:  
Strategy and Economics**

**Making the Technology Investment Decision**

**Session 10 – 5 October 2016**

**Questions for Class Discussion  
Not for Written Analysis**

1. What is the role of subjective and qualitative analysis in making the decision to implement strategic information systems projects? Why can't all strategic systems investments be justified through use of precise and accurate verifiable data?
2. What problems might be encountered trying to justify systems investments without such hard data? How can this best be managed?
3. What is the role of *strategic necessity* in justifying systems investments? Can systems create value for your customers and still not lead to additional profits or even to additional revenues? What are the limitations of attempting to justify investments by appealing to "strategic necessity" for the firm?
4. In class we will discuss *Strategic Chunkification*, the division of a large investment in information technology into two phases, where the first phase investment will be made early and unconditionally, and the second phase investment will be made later, and only if the conditions that emerge over time have justified continuation. (1) Relate the concept of the phase 1 investment to a strategic option. Why might the phase 1 investment be made, even if the firm knows there is a chance that it will never be completed or used? (2) If the firm later does decide to go forward with the phase 2 investment, what is the value to the firm of having made the phase 1 investment earlier? (3) Describe situations in which this two-phase strategy might make sense. That is, what are the factors, such as expense, duration, or others, that might characterize the two phases in order to make this sort of investment strategy valuable to the firm?

**Questions for Written Analysis**

You and your OIDD 613 homework team have decided that if it is good to tweet, and that tweeting is a multi-billion dollar business, it would be even better to bleat. Bird songs can be long, and high school students do not have sufficient attention for long messages. Bleating will be limited to 30 character messages and all bleats will be required to have at least one abbreviation, like OMG or LOL, and at least one Emoticon, like ☺.

You have learned from Twitter's experience that it is very important to be ready for the market when the market is ready for you. And you have learned from Zynga's experience that unneeded infrastructure can be very expensive, especially when the

market turns against you. You and your partners have laid out three development strategies.

- (i) **All or nothing:** You can build the entire system at once, whether there is a market for your product or not. That will cost you Z30 all at once (30 Zyngas). This will make you an early mover.
- (ii) **Phased:** You can make an initial investment of Z15, and then invest another Z27 if and when you determine that you should proceed, that is, if and when you determine that there actually is a market for your product. This will also make you an early mover.
- (iii) **Deferred:** You can spend nothing now, and then make a single investment of Z30 later, if and when you determine that there is a market for your product. This will make you a late mover.

Suppose the payoff for being an early mover is Z120 and the payoff for being a late mover is Z54. The payoff for launching Bleater is however Z0 if the market does not develop. Suppose further that you estimate that there is a probability of 33% that there will be a market for Bleating.

- (1) **[18 points] It's good to have choices!** What is the value of each of the three development strategies?
- (2) **[5 points] Flexibility has value:** We say that the phased strategy has an embedded option. (i) What is the option? (ii) What did it cost you? (iii) What value does it offer you?
- (3) **[10 points] More on options:** We say that options are investments that provide flexibility. (i) What would an option in flexibility be worth if we knew with certainty that there would be no market for Bleating? (ii) What would an option in flexibility be worth if we knew with certainty that there would be a Z120 market for bleating? What would your optimal strategy be? (iii) Would deferred implementation become more valuable as the payoffs for early and late movers became more similar? What would you do if the payoffs were both Z120?
- (4) **[10 points] It's hard to compete against a hungry giant. OOPS.** If the market for bleating actually turns out to be real, your phased strategy would allow Twitter to notice what you were doing. There is a chance that they would ignore you anyway. But there is a 10% chance that they would make a very ungenerous acquisition offer, which they would back up with a very credible threat to destroy you if you refused their bid. Even worse, there is a 35% chance that Twitter would choose to destroy you without bothering to make you an offer. Assume that their takeover offer is not very generous, only Z60, which is pretty nasty since they offer it only after the full market of Z120 is known to exist. Assume that if they attack and destroy you, you get no payoff at all from your development and launch of Bleater. To add insult to injury,

they only announce their intentions *after* you have made your second investment. (i) What is the value of the deferred strategy now? (ii) Now which is your best entry strategy?

- (5) **[10 points] It's good to have a partner!:** Suppose you could make an initial technology investment of Z19, rather than Z15, at the beginning of a Phased development strategy. That is, you would pay an additional Z4. This would prepare you to move quickly if the market developed, AND would enable you to move forward quickly with a single predetermined cloud-sourcing vendor as a possible alternative to making the second investment yourself. Suppose that this vendor could deliver cloud services for an additional investment of Z18, substantially less than the Z27 that represents your current best alternative for the cost of the second investment. Suppose also that this rapid response with a cloud vendor would eliminate any possible engagement with Twitter, positive or negative. What is the value of this development strategy?
- (6) **[10 points] Post-contractual small numbers bargaining in the presence of relationship specific investments, anyone?:** Would your cloud vendor actually deliver cloud services to you for the agreed upon price, once the market for Bleating was clear, if he knew that you had no other choice of cloud-sourcing vendor? (i) How badly could he hurt you if he knew your own development costs? (ii) How badly could he hurt you if he also knew what Twitter could also do to you? (iii) Is this ever your best development strategy?
- (7) **[7 points] Reducing Opportunistic Renegotiation:** Suppose you could make an initial technology investment of Z23, rather than Z15 or Z19, at the beginning. This would prepare you to move quickly if the market developed, AND would enable you to move forward quickly with any outsourcing vendor as a possible alternative to making the second investment yourself. Suppose that the competitive price for cloud services would be Z18, substantially less than the Z27 that represents your best alternative if you have to do the work yourself. (i) What is this choice worth to you? (ii) Is this choice better than any of the choices in (1) above?

**OID 613 – Information:  
Strategy and Economics**

**Case Study on Disruptive Technologies – The  
Future of Consumption in China<sup>5</sup>**

**Session 11 – 10 October 2016**

**Questions for Class Discussion  
Not for Written Analysis**

1. Scenario planning does not use historical data. Why might it ever be helpful to start without data? Why might it sometimes be dangerous to start with data?
2. Scenario planning starts with uncertainties. Are all uncertainties equally important? How do you determine which uncertainties to use when constructing your alternative worlds?
3. Statistical analyses can be compared to using data to determine “what game God is playing with the Universe.” Scenario analysis can be compared to using historical patterns to list “all the games God might start playing with the Universe soon.” What does that mean and why might it be useful?
4. Assume for the moment that Chinese consumption patterns begin to look more like those in the West, in which consumption is as much for personal delight as it is for public signals of status, but that foreign brands remain more enjoyable and more trusted. (i) What could cause this scenario to emerge? (ii) How would you know that this scenario had started to emerge? What are your early indicators of this scenario? (iii) How would this affect the strategies of retailers? How would this affect the strategies of restaurants? (iv) How would this affect foreign manufacturers who imported their products into China? Who would be best positioned? (v) How would this affect foreign manufacturers who actually manufactured their products in China? (vi) How would this affect domestic manufacturers? What sorts of firms would be best positioned?
5. Assume for the moment that Chinese consumption patterns begin to look more like those in the West, in which consumption is as much for personal delight as it is for public signals of status, but that domestic Chinese brands are now seen as more enjoyable and more trusted. (i) What could cause this scenario to emerge? (ii) How would you know that this scenario had started to emerge? What are your early indicators of this scenario? (iii) How would this affect the strategies of retailers? How would this affect the strategies of restaurants? (iv) How would this affect foreign manufacturers who imported their products into China? Who would be best positioned? (v) How would this affect foreign manufacturers who actually

---

<sup>5</sup> There are no power points posted in the course website for most discussion sessions.

manufactured their products in China? (vi) How would this affect domestic manufacturers? What sorts of firms would be best positioned?



**OID 613 – Information:  
Strategy and Economics**

**Third Party Payer Business Models and Online Gateway Systems  
Plus A Quick Review of Digital Transformation**

**Session 12 – 12 October 2016**

**Questions for Class Discussion  
Not for Written Analysis**

1. Third party payer business models have been around for some time. The airline reservations systems model provides a good example. Travel agencies had a choice of going directly to the airlines for reservations or staying with the CRSs that they were provided; why did they use CRSs? Once customers use agencies to book flights, and agencies use CRSs to find flights, airlines are required to participate and to pay the fees that CRSs demand. Why didn't agencies object to the fees charged to airlines? Why didn't customers object?
2. American Express can also in part be considered a third party payer business model. The customer uses AmEx to pay for travel or for expensive impulse shopping purchases, but at least in the US the customer does not pay for the use of the card. The merchant needs the traffic brought by American Express, and pays the fee charged by AmEx. What limits the fees charged by American Express? What limits the fees that acquiring banks charge these merchants when customers use MasterCard or Visa instead?
3. So competition between numerous banks servicing merchants seems to limit the fees charged by credit card companies even in a credit card third-party payer environment, but competition between search engines does not appear to limit pricing charged by Google. Why? What is different between Google and the credit card business model? What is the same?
4. What are the most important patterns for the impacts of information technology on business strategy that we have discussed in this class? How might you be able to use them as you become progressively more senior in the management of your organization?

**Questions for Written Analysis  
(Questions are continued on the next page!)**

**Is this, like, the greatest business model, ever?**

The diverter flodget on your new *Barbarian Weizenbock Kegorator und Sous Vide 6L* just broke and, fortunately, it is one of the few user-installable parts on the unit, hereafter called simply the BWK. Like all Barbarian Weizenbock parts it seemed quite expensive when you called the dealer, so you decided to check online for availability from third party vendors. Most of the URLs returned through Google were surprisingly unhelpful, either referring to the diverter flodget of BMW's 328 and 528 sedans, or to

Matthias Flodget, the bass player so often written up in European tabloids for his sex scandals, his drug scandals, and his path-breaking work in regulatory economics.

Fortunately, Google also offers *sponsored search*, those pesky items that show up above *organic search* results, and you believe that somewhere in the sponsored search area you are likely to find a supplier of the replacement diverter flodgets you need for your BWK.

And yet, the results of sponsored search are often disappointing. Let's see why. Assume the existence of two flodget sellers. Best Discount Flodget (formerly known as Billy Bob Discount Bait, Tackle, and Beverages) has an online storefront that sells flodgets. ([BestDiscountFlodget.com](#)). Best Discount Flodget (Best) buys low quality counterfeit Chinese parts for \$2 and sells them for \$14. They are very low quality, and consumers are generally forced to replace their flodget again very soon after buying from Best. Your other alternative is Munchen Import Flodget ([MunchenImportFlodget.com](#)). Munchen buys authentic German parts for \$11 and sells them for \$16. Assume for simplicity of analysis that a user searching for flodgets will click on the top spot in the sponsored search area if he does not recognize any of the names in organic search; we know that this is not entirely accurate.

- (5 pts) 1. Perhaps [BestDiscountFlodget](#) hopes that by purchasing the top spot in the sponsored search area it will acquire additional sales. What is each incremental **sale** for [BestDiscountFlodget](#) worth to Best? What is each incremental **sale** for [MunchenImportFlodget](#) worth to Munchen? Who is *willing to bid more per actual sale* for the keyword "Flodget" in order to get higher placement in the sponsored search area?
- (5 pts) 2. But Google sponsored search does not charge for sales at present. Google charges by the click. But just because a searcher clicks on a sponsored URL and generates a website hit does not mean that the click will generate a sale. Suppose that Munchen Import is well-known and well-respected and that 20% of [MunchenImportFlodget.com](#) **click-throughs** generate a sale. Assume also that Best is not nearly as well known and that only 10% of [BestOriginalFlodget.com](#) **click-throughs** generate a sale. What does each seller earn per click-through? *Which would be willing to pay more per click-through* for the keyword "Flodget"?
- (5 pts) 3. Assume that half of all BWK owners already know about Munchen Import Flodget and would go directly to their website, while none has heard of Billy Bob or of Best. Which company *needs the traffic from sponsored search more*? How might this affect the bidding?
- (5 pts) 4. So we now know who bids more. Does this tell us anything about why the sponsored search area does not always get us the company that we would expect to find first?

- (5 pts) 5. Now assume that the total market for Flodgets in any given year is made up of no more than 100,000 individual BWK owners, none of whom ever needs a second flodget in the year. Since the market has a fixed size, how might this affect the bidding for keywords?
- (5 pts) 6. Now that we know that both companies are bidding, think about how Google should rank them. Assume customers are much happier after they go to Munchen's website, but that Best is willing to pay Google more per click. To be more precise, assume that Best is willing to bid \$1.20 per click. Assume also that putting Best on top of the sponsored list results in a click only 10% of the time, and that putting Munchen on top results in a click 50% of the time. What is the minimum that Google should charge Munchen per click?
- (10 pts) 7. Charging different prices for different sellers paying for the same keyword is called "rank by quality score", rather than ranking solely by the size of the bid. Google is quite proud of this innovation, since it says it protects consumers. (i) Assuming that Munchen pays the amount you suggest Google should demand, is Google earning more or less than it was before the introduction of quality rankings? (ii) Is Munchen getting more or less exposure than it would have if Best were able to outbid it? (iii) Are consumers getting better access to higher quality sellers than they were getting before the introduction of quality rankings? (iv) Are BWK owners more likely to trust Google sponsored search results with "rank by quality score" than they would have been under the older "rank by bid" business model?
- (5 pts) 8. [So why do we care? We know that companies have always used advertising to attract customers. Google wants us to think of them as an advertising company.] Why don't we view Google's charging for prime space as advertising, simply equivalent to charging for a good billboard location along a busy highway?
- (5 pts) 9. Everyone uses Google. Therefore Google knows a lot about everyone. They know what "people like you" search for, and what "people like you" rate highest in their search results. So, yeah, Google's results are better, and they are certainly better for "people like you" most of the time. Would it make sense for people like you to switch search engines simply because Google abuses some sellers?
- (5 pts) 10. Suppose you learned that Google's business model increased the cost of everything you buy because it increases the expenses of every company you buy from. Would your switching to Bing save you any money, if no one else switched at the same time? (i) Do you have any way of knowing what the seller is being charged when I click through from Google? (ii) Is there a

line item cost for your use of Google that the seller would stop charging you or other reason to suspect that your seller would or even could give you a discount for not using Google search? (iii) If you alone switched to another search engine would this save the seller a significant amount of money?

- (5 pts) 11. Google claims that competition is “just a click away” and that they have no real power over merchants. (i) Would many users switch search engines because of the cost of Google to the merchant, given that Google really knows enough to offer them all personalized service and no other search engine does? (ii) If you wouldn’t switch, can the seller switch? Is competition really “just a click away” for the sellers?
- (5 pts) 12. Neither you nor anyone else actually knows how quality scores are computed. Google can declare Best’s quality score or Munchen’s quality score to be anything it wants. And it knows enough about Munchen’s business to implement first degree price discrimination; it’s has no need to guess Munchen’s willingness to pay. What is the most it could charge per click, irrespective of Best’s willingness to pay per click?
- (5 pts) 13. The cost of some keyword combinations has now risen to over \$500 per click-through. For some online services, the cost of key words represents over 50% of the seller’s total costs. So why do we care? Comment on the following two sentences: (i) The seller doesn’t care enough about the cost of search engines to justify a change, or it would be using Bing in its keyword campaigns now instead of Google, right? (ii) So why should we care; it doesn’t cost us anything, right?
- (5 pts) 14. Comment on the statement “Going digital is not a strategy by itself.” (i) Was there anything that Rosenbluth Travel or any of the other traditional agencies could have done to preserve their commission-based businesses after airlines created their own websites and cooperated to launch Orbitz? (ii) Have hotels been able to do anything so far to protect themselves effectively from the increased cost of dealing with Google and with hotels.com?
- (5pts) 15. Do third party payer business models represent an antitrust threat as severe and as unanticipated as natural monopolies were after the framing of the Sherman (Antitrust) Act? Natural monopolies were recognized in the late 19th century as a novel regulatory problem with railroads, and then even more obviously with telecommunications. Might third party payment mechanisms require unique regulatory treatment? If so, when?