



STANFORD UNIVERSITY

The Modern Firm in Theory and Practice (Econ 149) **Winter Quarter 2021, Professor Nick Bloom**

This course aims to integrate economic analysis with closely related studies of business practices. Compared to most economics courses, it makes unusually high use of cases to develop ideas and illustrate applications. Compared to most business school courses, it makes unusually rigorous use of economics research, particularly careful empirical studies.

COURSE REQUIREMENTS

The basis for grading will be 67% on class participation and 33% on a final exam. The class will be run in an MBA style, with extensive class participation. To help with this you will be expected to complete all the assigned readings. During the class we will ask you to make substantial contributions to the analysis. Students will be both invited to participate and also cold-called, so will need to cover all readings before the class. Most classes will require reading a short text. I will guide the class discussion, provide a framework and ask probing questions, but it is your job to contribute constructively to the discussion with the purpose of drawing useful lessons from each session. This course involves a joint process of discovery between you and your fellow students. For it to be successful, you must be prepared by having done the reading and considered the questions posed in the assignment. The instructor will encourage you to contribute regularly and succinctly to the discussion (as noted including cold calling students on the readings). You will be encouraged to disagree constructively with your fellow students and the instructor, and to master the course framework.

The final exam will be from 9:00am to 11:30am on Tuesday 16th March (to be confirmed). It will cover all the readings in this reading list plus the discussion in class. So, I would advise reading all the readings on the list and following along in class. On the reading list the main readings are highlighted as these will also be covered in class, while the other readings will not. Hence, it is essential to read the main readings before class and advised to read all of the readings before class (in order to avoid having to read too many new papers in the revision for the exam). These readings are included to extend the coverage of the course, so will be related to but not overlapping with the class. There is a reasonable amount of reading but several breaks in the class, so I strongly advise you to use class breaks to keep up with reading, so before the exam it is not a huge stress.

Because your contribution to the class is essential, your attendance at every class is expected. As an MBA style course this is focused on class time (rather than lots of outside class work). So, if attending class is difficult then this course is not a good fit. We realize that personal issues necessitating an absence can occasionally intervene, so if you find it unavoidable to miss a class, please notify us ahead of time. If you miss a class due to illness or some emergency, and cannot give notice beforehand, please let us know as soon as possible. Unexplained and unexcused absences will negatively affect your grade. Whether an absence is excused is solely at our

discretion. If you are absent under any circumstances it is your responsibility to obtain whatever materials were handed out at the session. We will take class participation to use as part of the course grading.

Any lecture slides will be shared after class, so you only need to take (at most) brief notes in class.

Common syllabus. Like all undergraduate courses in economics, this course is subject to the common syllabus: <https://economics.stanford.edu/undergraduatemajor/economics-common-syllabus>.

Required Readings. All required readings will be put into a course folder.

Class Times: Monday-Wednesday is 11:30-12:50 and Tuesday-Thursday is 10:30-11:50.

Class Textbook: There is no textbook.

CLASS TEACHING ASSISTANT:

The class TA will be Mike Shi, who can be emailed at mikeshi@stanford.edu. Mike is a PhD candidate in Economics whose primary line of research investigates behavioral responses to debt. A large part of this work focuses on how the presence of debt can lead to suboptimal financial decision making, driven by a desire to repay debt faster, in an experimental lab setting.

ORGANIZATION OF THE COURSE

The course will focus on productivity and management practices as a framework for understanding the modern firm. To do this, it will review the results from a large management practices project (www.worldmanagementsurvey.com) involving Accenture, Harvard Business School, the London School of Economics and McKinsey. McKinsey have developed a basic management practice evaluation tool – detailing about 20 key practices – which has been used to evaluate about 20,000 organizations in manufacturing, retail, healthcare and education across the US, Europe, Asia, Africa, Australasia and South America. These results provide a global insight into the basic management practices around monitoring, targets and talent management that firms adopt around the world, their link to performance, and the reasons for differences in these across countries. This will be supplemented with the results from recent research with Accenture and the World Bank in India on change management interventions in a developing country context.

The course will require that students become familiar with both economics and management research. Students will learn the scoring grid so that they can easily perform an initial overview of the human resource management practices of any organization they eventually work in or consult for. For example, this would be ideal for an initial evaluation of the management practices in a private equity target company or a preliminary evaluation of a potential client by a consulting firm.

Interested students can look at some of the academic, business and media focused output from the research on: <http://www.worldmanagementsurvey.com>, including over 50 articles in the New York Times, Economist, Wall Street Journal, Business Week, Newsweek, Washington Post and the Financial Times.

ZOOM CHANGES FOR 2021

I was on sabbatical for much of academic year 2020/2021, but because of the cancellation of in-person classes I thought it was important to offer some small discussion-based classes. From my advisees I hear that it is very hard having a heavy load of zoom lectures, so this class will be almost entirely discussion focused in a small class. As such there are some changes to the in-person format.

- A) This zoom-class is deliberately relaxed with a relatively low (and hopefully engaging) workload. I am aware the lockdown and pandemic have been extremely stressful for many people. So, the aim of this class is not to load you up with huge amounts of work and reading, but instead to develop some discussion and group time in class, and also to give you a taste of research and teaching on management. For this reason grading will be 2/3 on class time – for this you need to attend class and do the pre-readings so you can take part in the discussion. I will try to call on everyone in class at least once, so it is important for you to do the class reading in advance. The remaining 1/3 of grading will cover the readings in this course and the discussion in the class in a written exam. So, you should read the readings and know the broad content – so that probably means you will need to read them twice. It is an open book exam – so you do not need to memorize the content but should be familiar with what each article is about.
- B) Class participation means having your camera on unless there are extenuating circumstances you have discussed with the Professor in advance. To make this class engaging for everyone – both faculty and students - it is important when each of us is talking we are facing a screen of faces (rather than blank screens). If there are any reasons this is not possible send me an email and we can discuss this directly – I understand that some students may have extenuating circumstances that makes video tricky, but otherwise I would like all students to keep their videos on as part of their assessed engagement.
- C) The Tue/Thur class will follow the same schedule as the Mon/Wed class with a 1-day delay– this includes the holidays (so no class on Tuesday 19th January or Tuesday 16th February).
- D) The Tue/Thur class was added very late in December due to heavy extra demand for the class, so unfortunately some dates do not work as I had pre-arranged commitments (e.g. presentations at Wharton, at the Fed and World Bank). So, on those days students can either join the M/W class or watch a recording of this class at a later date.

INDIVIDUAL CLASS SCHEDULE (DRAFT):

Monday 11th January Management Practices and Productivity

Key Reading for Class Discussion:

- “Measuring and Explaining Management Practices across Firms and Countries”, Bloom, Nicholas, and John Van Reenen (2007), *Quarterly Journal of Economics*

Today we will focus more on management practices and their link to productivity. While this literature has a long history in economics, only recently has more rigorous work on management started to appear. Prepare to discuss questions including:

1. What are the strengths and weaknesses of the management scoring approach?
2. What types of management practices are omitted?
3. Is the link between management and productivity causal?
4. Think of an example where better management practices have directly improved productivity

Before doing that I will ask everyone to briefly introduce themselves in a few sentences. You could discuss any of your current situation, background, academic or business interests, activities (e.g. any journalist, sport, music, arts etc), prior work experience etc – basically nice for each student to talk for a few minutes as a first-class icebreaker.

Wednesday January 13th Incentives management practices

Main reading (to be discussed in class):

- The Lincoln Electric Company, HBS case study 9-376-028
- Management scoring grid 18 questions – use this score one firm or organization you know, and bring those scores to class read for discussion

The third section of the management scoring grid focused on incentive management practices, which is a subset of Human Resource management practices. This class will focus on this and how firms pay, promote, hire and fire their employees.

To prepare for this class take one firm you know well – a firm you had a summer job in, a firm one of your parents work in, a family firm, a firm a sibling works in etc - and score it on each of the 18 dimensions of the Bloom and Van Reenen (2007, QJE) scoring grid. We have had a huge range of people scoring firms in the past – Costco, JP Morgan, United Airlines, Fedex, Parents Dentist Practice, Family Restaurant, Dairy Queen (summer job), Toilet Paper factory, School, Dairy Farm, Health Clinic, Radio Station, Food Truck, Accounting Firm etc. If you cannot think of a firm my advice is score a parent or siblings company – interview them about the firm they work in. Bring those scores to the next three classes as we will use individuals scoring as the basis of class discussion. In the first part of this class we will discuss incentives management and the scores you gave your firms on these dimensions (the last third of the grid).

In the second part of the lecture we will discuss the Lincoln Electric Company. This is the bestselling business case of all time. Read the case and prepare to answer the following questions:

1. What types of performance incentives does Lincoln Electric provide, and how have these helped to drive performance?
2. Could Lincoln's system be replicated in other industries and other countries?
3. Do you think Lincoln electric's incentive systems would work outside the US? Prepare to discuss their success/failure in another country you know.
4. What are the downsides of Lincoln Electric's performance incentives? Try to relate this to experiences you have had with strong performance incentives.
5. Which of the several parts of Lincoln's structure – its ownership, management style, piece rates, bonuses, permanent employment, high levels of inventory, high rate of innovation, flexible work rules, lack of a union, and hiring only at limited "entry-level" positions – are independent, and which are better regarded as mutually supporting?

Monday January 18th MLK Holiday – no class

Wednesday January 20th Monitoring management practices

Main readings:

- Danaher Corporation, HBS case Study
- Management scoring grid 18 questions – score the one firm or organization you know.

The original McKinsey management scoring grid broke management practices down into three sections, and we will focus on the first block of monitoring management practices. This covers the way firms collect, process and act on data in their organizations. As before we will have a class discussion using the scores from the management scoring grid you prepared for the last class.

In the second part of class we will cover the Danaher Case Study. Read the case study carefully and prepare to discuss the following questions:

1. Why has Danaher been successful as a multi-business conglomerate over the past two decades? What do you see as the core attributes of its corporate strategy that have allowed it to sustain superior performance during this period?
2. Are there any salient tradeoffs that the DBS system creates for the organization?
3. How easy is it for other companies to mimic or emulate what Danaher does? Why?
4. How far can Danaher's advantage travel? What types of businesses are best suited to leveraging DBS? And what types of businesses are not well suited to this model?
5. What do you consider to be the biggest challenges that Danaher is likely to confront during the next 10-15 years? What can Larry Culp do to prepare for these challenges?

Monday January 25th Management Practices in Healthcare

Main readings:

- Virginia Mason Medical Centre, HBS Case Study 9-606-044

Other readings:

- “The Impact of Competition on Management Quality: Evidence from Public Hospitals”. Bloom, N., Propper, C., Seiler, S., and Van Reenen, J. (2015), *Review of Economic Studies*, 82(2):457-489
- “Healthy business? Managerial Education and Management in Healthcare”, Nicholas Bloom, Renata Lemos, Raffaella Sadun and John Van Reenen (2020), *Review of Economics and Statistics*.

Analogous to the previous class, in this class we will investigate management practices in healthcare. We will go over the Virginia Mason case study, discussing how management concepts applied in manufacturing can be translatable into the healthcare setting and investigating the link between management practices and patient outcomes. Prepare to discuss the following points:

1. What is Gary Kaplan trying to achieve at Virginia Mason?
2. How does the Toyota Production System fit into his strategy?
3. What is your view of the "people are not cars" debate?
4. Is Kaplan's approach transferable to other U.S. hospitals?

In the second half of class we will discuss management practices in healthcare and how they impacted the response to the pandemic. Does anyone have any examples of good or bad management healthcare practices during the pandemic? Either examples in the news or personal stories you would like to share. In discussing examples try to focus on the management scoring grid – that is raise examples of healthcare management practices that would score low or high on the grid, and the impact that had on the health of the US Population.

Wednesday January 27th Family Ownership and Management

Main readings:

- “Keeping it in the Family at Hayden Saw Company” HBS Case Study

Other readings:

- “Inherited Control and Firm Performance,” Francisco Perez-Gonzalez, (2006), *American Economic Review*, 1559–1588.
- Inside the Family Firm: The Role of Families in Succession Decisions and Performance", Bennedsen, M., Nielsen K.M., Perez-Gonzalez, F., Wolfenzon, D. (2007), *The Quarterly Journal of Economics*, 122(2): 647-691

In the first half of class we will discuss Family firms. These are the most prevalent type of firm in the world and account for a large proportion of the economic activity and employment, especially in developing countries. In this class, we discuss the relationship between family control and firm organization and performance around the world. Prepare to discuss the following points, drawing wherever you want from the Hayden’s case

1. Why should we care about how family firms are run?
2. What are the benefits of family ownership?
3. What are the drawbacks of family ownership?
4. Do you think family ownership leads to better or worse management? Why?

In the second half of class I want everyone to find one article about family firms in the news over the last year (including publications like the Economist magazine, New Yorker etc) and be

prepared to briefly discuss this and present it to the class. Ideally pick something relevant to business, management or finance connected to a family firm. Also send the article to the TA in advance so we can assemble these for everyone to read afterwards in case there is further interest.

Monday February 1st Scientific Management and Experiments

Main readings:

- HBS Case 5-313-018 CTrip: Scientifically managing travel services
- ID Insight HBS case study (N9-814-103)

Other readings

- “Does working from home work? Evidence from a Chinese field experiment” (2014)
Bloom, Liang, Roberts and Ying, Quarterly Journal of Economics.

The first half of class will investigate Scientific management – a name for data driven management practices – and how firms practice this with the help of experiments. We will discuss the CTrip case in class and draw from the research paper as well (which could be covered in the exam). Prepare to discuss the following questions in class:

- 1) What are the key elements of CTrip’s Scientific approach to management?
- 2) What is the role played by experimentation?
- 3) Will judgment-based management ever outperform scientific management (if ever)? In what circumstance is that more or less likely to be true?
- 4) What makes Scientific management so hard in practice?

This second half of class will discuss a case-study on running randomized control trials – experiments – and discuss the pros and cons for this as a management strategy in organizations.

Wednesday February 3rd Culture and Globalization:

Main Readings:

- Lincoln Electric Venturing Abroad case
- Cemex case: Global Competition in a Local Business (Stanford GSB Case IB-17)

This class will use two cases on globalization and culture. In the first half we will discuss the Lincoln electric case. Prepare to discuss the following issues/questions in class:

1. What made Lincoln’s system so unusual in the US context?
2. What problems did Lincoln face in trying to take its system to other countries?
3. Was Lincoln’s system a good model for other US manufacturing companies to follow?

In the second part we will discuss the Cemex case, which focuses on a classic David – vs - Goliath business case where a firm from a developing country through the sheer focus on world-class management practices came from being a local cement firm to a global superpower in the industry. Prepare to answer the following questions:

- 1) Why are global companies emerging in the cement business? What is the advantage of being global in this business?
- 2) How does the theory of the firm help us understand the Cemex case? How does this case call the theory into question?
- 3) After gaining scale in Mexico, Cemex enters Spain. Why did many doubt Cemex's ability to add value to the Spanish acquisitions? What did Cemex find out about itself in this process?
- 4) What do you make of Cemex's acquisitions?

Monday February 8th Mid-Quarter Break – Jury Service

I have been called for Jury service for the week of February 8th so there will be no class this week. However, there is a class assignment which is to watch the Movie “**The Founder**” (2016, Directed John Lee Hancock). This is about the origins of the McDonalds Hamburger chain. It is great overview of the importance of operations (e.g. Lean) in food service, but also the intangibility of intellectual property for process innovations, the importance of drive and motivation, but also an example of bad business ethics. Think about the following questions to discuss in the next class:

- 1) What were the major innovations in business practices from the movie?
- 2) Why did McDonalds expand by franchisee rather than its own stores?
- 3) What did you think of the business ethics of Ray Kroc?
- 4) Why did the original McDonalds brothers not patent their food service process?
- 5) Do you believe in the importance of persistence as highlighted in the movie?

Wednesday February 10th Mid-Quarter Break – Jury Service

Again no class today but there is a class assignment to read the Harvard Business Review case “*Pal's Sudden Service – Scaling an Organizational Model to Drive Growth*”. This case ties very closely with the movie “The Founder” and is a great example of service sector managerial excellence. Be prepared to answer the following questions:

- 1) How did Pal's compete with McDonalds and Wendy's? What was its distinct advantage?
- 2) Does Pal's focus on talent even for front-line workers seem similar or different to your understanding of talent for front-line employees in McDonalds or Burger King?
- 3) How does Pal drive store expansion and how is this different from other firms?
- 4) What parallels and differences do you see in the Pal case vs The Founder film?

Monday February 15th: Presidents Day Holiday, No Class

Wednesday February 17: Food Service Management Practices

Main Readings:

- “The Founder” movie (on Netflix <https://www.netflix.com/title/80101899>)
- HBR Case “*Pal's Sudden Service – Scaling an Organizational Model to Drive Growth*”.
- “The Operational Consequences of Private Equity Buyouts: Evidence from the Restaurant Industry”, by Shai Bernstein and Albert Sheen, (2016) Review of Financial Studies,

In this class we will start by discussing the movie “The Founder”. We will then discuss the HBR case study about Pal’s Sudden Service.

Monday February 22 Private Equity

Main readings:

- “Private Equity, Jobs and Productivity”, Steve Davis, John Haltiwanger, Kyle Handley, Ron Jarmin, Josh Lerner and Javier Miranda, *American Economic Review* (2014)
- See also http://en.wikipedia.org/wiki/Private_equity_fund
- “Firming up inequality”, Jae Song, David Price, Fatih Guvenen, Nicholas Bloom and Till von Wachter (2019), *Quarterly Journal of Economics*

In the first half we will talk about one way to improve management practices – private equity firms. Be prepared to answer the following questions:

1. *What is a private equity firm – explain the two types of partners and what they do*
2. *How might a private equity firm make money? How might a private equity firm improve management and productivity?*
3. *What types of firms should private equity firms typically target?*
4. *Who might be opposed to private equity firms?*

In the second half we will talk about inequality. I will present an overview of recent work and I have been doing on this and ask class questions to promote the discussion.

Wednesday February 24: Incentives and decentralization

Main readings:

- Alibaba Group, HBS case study 9-710-436 (in course reader)
- Performance pay at Safelite Glass Case Study A: 9-800-291

Other readings

- “The organization of firms across countries”, (2012), Nick Bloom, Raffaella Sadun and John Van Reenen, *Quarterly Journal of Economics*
- “Performance pay and productivity”, *American Economic Review*, (2000) Edward Lazear

In the first half of class we will discuss the Safelite case which focused on selection effects. Prepare to discuss the following questions:

1. *Why was the productivity of Safelite installers so low?*
2. *Does the proposed PPP plan address the problems raised in the case? Does it introduce new problems?*
3. *What are the pros and cons from going from wage rates to piece rates? In terms of impacts consider turnover, recruitment, productivity and product quality.*
4. *Are Safelite installers good candidates for piece-rate pay?*
5. *Should there be a guaranteed wage?*

In the second part of the class we will discuss the Alibaba case, which highlights the trade-offs CEOs have to make in various organizational decisions in fast growing companies. Prepare to discuss the following questions from the case-study:

1. Is the current degree of competition among the business units appropriate? Do you think that Jack Ma should encourage more cooperation? If so, how?
2. As Alibaba develops new businesses, how should the firm incorporate them into the organizational structure? What are the benefits and costs of having new businesses report directly to Jack Ma?
3. What should Jack Ma and his C-Suite be concerned about? Should Jack Ma centralize more functions at the corporate level? If so, which ones? Should Jack Ma create a Chief Operating Office position?
4. Where should the new business initiatives (mobile platforms and financing small businesses) reside organizationally? At corporate or within the individual business units?

Monday March 1: Management Practices in Education and Developing Countries

Main readings:

- The New Yorker, Steven Brill, "The Rubber Room", Aug 31, 2009
- Gokaldas Exports Stanford Business School Case Study, SM-213(A)
<http://worldmanagementsurvey.org/wp-content/images/2013/10/Stanford-Business-School-Case-Study-Gokaldas-Exports.pdf>

Other readings:

- "Injecting Charter School Best Practices into Traditional Public Schools: Evidence From Field Experiments", Fryer, R.G. (2014), *Quarterly Journal of Economics*, 129(3): 1355-1407
- "Does Management Matter in Schools?", Bloom, N., Lemos, R., Sadun, R., Van Reenen, J. (2015), *The Economic Journal*, 125(584): 647-674
- "Does management matter: evidence from India" Nicholas Bloom, Benn Eifert, Aprajit Mahajan, David McKenzie & John Roberts, (2013), *Quarterly Journal of Economics*
- "Do management interventions last? Evidence from India" Nicholas Bloom, Aprajit Mahajan, David McKenzie & John Roberts, (2020) *American Economic Journal Applied*

Basic techniques of modern management that have become standard in leading organizations in other parts of the economy are now becoming widespread in the public sector. In education, these practices include rigorous collection of data on lessons, systematic feedback and supporting staff that struggle while rewarding and promoting good teachers. In the first part of class we will focus on management practices in education. Prepare to discuss the following points:

1. How do you think management practices in New York schools will impact pupil performance?
2. How would you change the practices in the New York school district?
3. Can you provide examples from your own experiences of management practices in schools in other countries?

In the second part of class we will focus on management practices in developing countries. These appear to be typically worse than those in developed countries. We will run a class discussion around the Gokaldas case. Prepare to discuss the following questions around the case study:

1. *Do you think management practices in developing countries are usually worse than those in developed countries?*
2. *What are the challenges they face – for Gokaldas did they face any challenges unique to a developing country?*
3. *What factors may lead to differences in management practices between firms in developing and developed countries?*

Wednesday March 3rd: Working From Home

Given Zoom classes I want to talk about working (and learning) from home. This is a topic I have been researching for the last 10 years (you saw the Ctrip paper earlier) and has become very topical.

Main readings:

- TEDx https://www.youtube.com/watch?v=oiUyyZPIHyY&ab_channel=TEDxTalks
- “Why working from home will stick” Jose Barrero, Nicholas Bloom and Steve Davis, NBER Working Paper (forthcoming)
- Blog <https://siepr.stanford.edu/research/publications/how-working-home-works-out>

In the first half of class we will discuss the impact and future of working from home. Feel free to enrich the discussion with feedback from parents, siblings and others you know that work – you may want to talk to one or two of them in advance of class. It would be interesting to hear from people that can work from home and also those that cannot.

In the second half of class we will discuss teaching from home – your experience of classes and learning remotely. I know this has been hard and faced many challenges so feel free to be honest!

Prepare to discuss the following questions:

1. *What do you see as the future of working from home in the US (and globally)?*
2. *What impact will this have on society?*
3. *Why did firms not adopt more WFH before the COVID pandemic?*
4. *How have your experiences been of teaching from home (and your friends, relatives and roommates’ experiences of working from home)?*

Monday March 8th: The Efficient Market Hypothesis, Investing and Stock Markets

This class is a mix of basic finance, economics and personal investing. If you want to invest money you should understand the efficient market hypothesis – what it says, what it does not say, and the arguments for and against it. As economists we often get asked about Warren Buffet so I thought we would have a class on him and investing.

Main readings:

- “Warren Buffet 2015” Harvard Business School Case
- Skim the wiki entry on the EMH (it’s long so I’d mainly read the initial parts) https://en.wikipedia.org/wiki/Efficient-market_hypothesis

Other readings

- “What triggers stock market jumps”, Scott Baker, Nicholas Bloom, Steve Davis and Marco Sammon, NBER Working paper (forthcoming)

In the first half of class we will discuss the Warren Buffet case. Please prepare to discuss the following questions:

1. What is the efficient market hypothesis (EMH)?
2. What does Warren Buffet think of the EMH? Do you agree with him?
3. What types of firms does Warren Buffet target (look at exhibit 8 plus the text)?
4. Does Warren Buffet disprove economics in any way?

In the second half of class we will discuss the stock-market jumps papers. Please be prepared to discuss:

1. What are the primary factors leading stock markets to jump – does this surprise you?
2. Do the findings contradict the Efficient Market Hypothesis?
3. Why might the clarity of stock markets change over time (days, weeks and years)

Wednesday March 10th: Catch-Up and Revision Session

Often, we are running slightly behind schedule at this point as there is a lot of material packed into the quarter. So can use this class to catch-up. If we are on schedule we can use this discuss any questions on the material over the last quarter.