

Syllabus

MECS 570-1

Organizational Economics I: Organizations and Markets

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Course Description and Objectives

Most activity in the modern economy takes place within, or is facilitated by, organizations. This is the first course in a two-course sequence in Organizational Economics that focuses on developing and deepening our understanding of firms and other organizations. Our central premise is that organizations are messes but not mysteries: many firm practices can be understood as the result of strategic interactions among individuals who are faced with internal and external constraints.

This course focuses on theories of incentives, adaptation, and firm boundaries, with the ultimate aim of understanding how firm practices affect and are affected by the broader economy. In addition to covering more recent papers, we will also discuss several classic papers. One goal of the course is that by the end of the quarter, when faced with an empirical phenomenon, you should be able to quickly write down a model to explain it.

To reach this goal, the lectures will focus more on models' key assumptions than on their mechanics. To get more out of the class, you should always have in mind the following questions when we discuss a model. What are the key assumptions of the model that drive its main results? How reasonable are these assumptions? What would happen to the model if these assumptions are modified?

Requirements

There are three deliverables for credit in the course: two model-development essays and the choice between one in-class presentation of a paper from the syllabus or a short write-up of the results in that paper. Your grade will be based in equal measure on the model-development essays and your class participation.

The model-development essays should select one aspect from one case and do three things: first, briefly describe the chosen aspect of the case; second, assess the extent to which existing theory is or is not consistent with this chosen aspect; and, third, briefly sketch the beginnings of a model that would be consistent with this chosen aspect. These model-development essays should be just short sketches—three to five pages.

Timing

The class will meet on Tuesdays and Thursdays from 9:00am to 10:30am. The class is currently scheduled to meet in Jacobs 619 (the Strategy conference room), though the meeting location will change when we move to the new building. **Note that the first meeting will be on Thursday, January 5th.**

Course Overview

The course is organized around 5 topics. I might still make changes to the topics and readings but the next few pages should give you a pretty good idea of what we will cover in class. The topics are:

Topic 1: Incentives and Communication in Organizations (3 weeks)

Topic 2: Decision Making in Organizations (2 weeks)

Topic 3: Boundaries of the Firm (2-3 weeks)

Topic 4: Organizational Structures and Processes (1-2 weeks)

Topic 5: Competition and Organization (1 week)

Topic 1: Incentives and Communication in Organizations

(3 weeks)

Overview

*Gibbons, R. and Roberts, J. (2013), “Economic Theories of Incentives in Organizations,” in *The Handbook of Organizational Economics*, R. Gibbons and J. Roberts (eds.), Princeton, NJ: Princeton University Press.

Formal Incentive Contracts

Risk-Incentives Trade-off

Holmstrom, Bengt. 1979. Moral Hazard and Observability. *The Bell Journal of Economics*, 1(1): 74-91.

Limited Liability

Jewitt, Ian, Ohad Kadan, and Jeroen Swinkels. 2008. Moral Hazard with Bounded Payments. *Journal of Economic Theory*, 143(1): 59-82.

Multiple Tasks and Misaligned Performance Measures

Holmstrom, Bengt and Paul Milgrom. 1991. Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design. *The Journal of Law, Economics, and Organization*, 7(Special Issue): 24-52.

Baker, George. 2002. Distortion and Risk in Optimal Incentive Contracts. *The Journal of Human Resources*, 37(4): 728-751.

Contracts with Externalities

Segal, Ilya. 1999. Contracting with Externalities. *The Quarterly Journal of Economics*, 114(2): 337-388.

No Contracts

Career Concerns

Holmstrom, Bengt. 1999. Managerial Incentive Problems—A Dynamic Perspective. *Review of Economic Studies*, 66(1); 169-182.

Relational Incentive Contracts

*Malcomson, James. 2013. Relational Incentive Contracts. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Topic 2: Decision Making in Organizations (2 weeks)

Overview

*Gibbons, Robert, Niko Matouschek, and John Roberts. 2013. Decisions in Organizations. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Topics

Authority

Aghion, Philippe and Jean Tirole. 1997. Formal and Real Authority in Organizations. *The Journal of Political Economy*, 105(1): 1-29.

Dessein, Wouter. 2002. Authority and Communication in Organizations. *The Review of Economic Studies*, 69(4): 811-838.

Delegation

Alonso, Ricardo and Niko Matouschek. 2008. Optimal Delegation. *The Review of Economic Studies*, 75(1): 259-293.

Li, Jin, Niko Matouschek, and Michael Powell. Forthcoming. Power Dynamics in Organizations. *American Economic Journal: Microeconomics*.

Hierarchies

Garicano, Luis. 2000. Hierarchies and the Organization of Knowledge in Production. *The Journal of Political Economy*, 108(5): 874-904.

Topic 3: Boundaries of the Firm (2-3 weeks)

Overview

*Gibbons, Robert. 2005. Four Formal(izable) Theories of the Firm? *Journal of Economic Behavior and Organization*, 58(2): 200-245.

Papers

Transaction Cost Economics

Tadelis, Steven and Oliver Williamson. 2013. Transaction Cost Economics. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Property Rights

Hart, Oliver. 1995. *Firms, Contracts, and Financial Structure*. New York: Oxford University Press (Chapter 2).

Incentive Systems

Holmstrom, Bengt and Paul Milgrom. 1994. The Firm as an Incentive System. *The American Economic Review*, 84(4): 972-991.

Influence Activities

Powell, Michael. 2015. An Influence-Cost Model of Organizational Practices and Firm Boundaries. *The Journal of Law, Economics, and Organization*, 31(suppl 1): i104-i142.

Empirical Evidence

Monteverde, Kirk and David Teece. 1982. Supplier Switching Costs and Vertical Integration in the Automobile Industry. *The Bell Journal of Economics*, 13(1): 206-213.

Forbes, Silke and Mara Lederman. 2009. Adaptation and Vertical Integration in the Airline Industry. *The American Economic Review*, 99(5): 1831-1849.

Baker, George and Thomas Hubbard. 2003. Make versus Buy in Trucking: Asset Ownership, Job Design, and Information. *The American Economic Review*, 93(3): 551-572.

Foundations

Maskin, Eric and Jean Tirole. 1999. Unforeseen Contingencies and Incomplete Contracts. *The Review of Economic Studies*, 66(1): 83-114.

Aghion, Philippe, Drew Fudenberg, Richard Holden, Takashi Kunimoto, and Olivier Tercieux. 2012. Subgame Perfect Implementation Under Information Perturbations. *The Quarterly Journal of Economics*, 127(4): 1843-1884.

Fehr, Ernst, Michael Powell, and Tom Wilkening. 2016. Behavioral Limitations of Subgame-Perfect Implementation. *Working Paper*.

Topic 4: Organizational Structures and Processes (1-2 weeks)

Overview

Garicano, Luis and Timothy Van Zandt. 2013. Hierarchies and the Division of Labor. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Structures

Dessein, Wouter and Tano Santos. 2006. Adaptive Organizations. *Journal of Political Economy*, 114(5): 956-995.

Alonso, Ricardo, Wouter Dessein, and Niko Matouschek. 2008. When Does Coordination Require Centralization? *American Economic Review*, 98(1): 145-179.

Rantakari, Heikki. 2008. Governing Adaptation. *Review of Economic Studies*, 75: 1257-1285.

Hierarchies

Garicano, Luis. 2000. Hierarchies and the Organization of Knowledge in Production. *Journal of Political Economy*, 108(5): 874-904.

Hart, Oliver and John Moore. 2005. On the Design of Hierarchies: Coordination versus Specialization. *Journal of Political Economy*, 113(4): 675-702.

Topic 5: Competition and Organization (1 week)

Overview

Leibenstein, Harvey. 1966. Allocative Efficiency vs. 'X-Efficiency'. *The American Economic Review*, 56(3): 392-415.

Theories

Competition and Incentives

Raith, Michael. 2003. Competition, Risk, and Managerial Incentives. *The American Economic Review*, 93(4): 1425-1436.

Information and Firm Organization

Gibbons, Robert, Richard Holden, and Michael Powell. 2012. Organization and Information: Firms' Governance Choices in Rational-Expectations Equilibrium. *The Quarterly Journal of Economics*, 127(4): 1813-1841.

Price Levels and Firm Organization

Legros, Patrick and Andrew Newman. 2013. A Price Theory of Vertical and Lateral Integration. *The Quarterly Journal of Economics*, 128(2): 725-770.

Competitive Rents and Firm Productivity

Powell, Michael. 2016. Productivity and Credibility in Industry Equilibrium. *Working Paper*.

Potential Papers for In-Class Presentations

More will be added

(Incentives in Organizations) Bonatti, Alessandro and Gonzalo Cisternas. 2016. Career Concerns and the Nature of Skills. *Working Paper*.

(Incentives in Organizations) Cisternas, Gonzalo. Forthcoming. Two-Sided Learning and Moral Hazard. *Review of Economic Studies*.

(Incentives in Organization) Carroll, Gabriel. 2015. Robustness and Linear Contracts. *American Economic Review*, 105(2): 536-563.

(Incentives in Organizations) Prendergast, Canice. 1993. A Theory of “Yes Men”. *American Economic Review*, 83(4): 757-770.

(Incentives in Organizations) Prendergast, Canice. 2015. The Empirical Content of Pay-for-Performance. *Journal of Law, Economics, and Organization*, 31(2): 242-261

(Incentives in Organizations) Ederer, Florian, Richard Holden, and Margaret Meyer. 2014. Gaming and Strategic Opacity in Incentive Provision. *Working Paper*.

(Decision Making in Organizations) Frankel, Alexander. 2014. Aligned Delegation. *The American Economic Review*, 104(1): 66-83.

(Decision Making in Organizations) Dessein, Wouter, Andrea Galeotti, and Tano Santos. 2016. Rational Inattention and Organizational Focus. *American Economic Review*.

(Decision Making in Organizations) Bonatti, Alessandro and Heikki Rantakari. 2016. The Politics of Compromise. *American Economic Review*, 106(2): 225-259.

(Decision Making in Organizations) Akerlof, Robert and Richard Holden. 2016. Movers and Shakers. *Quarterly Journal of Economics*.

(Boundaries of the Firm) Braguinsky, Serguey, Atsushi Ohyama, Tetsuji Okazaki, and Chad Syverson. 2015. Acquisitions, Productivity, and Profitability: Evidence from the Japanese Cotton Spinning Industry. *American Economic Review*, 105(7): 2086-2119.

(Boundaries of the Firm) Baliga, Sandeep and Tomas Sjostrom. 2016. A Theory of the Firm based on Hagglng, Coordination, and Rent-Seeking. *Working Paper*.

(Competition and Organization) Backus, Matt. 2014. Why is Productivity Correlated with Competition? *Working Paper*.

(Competition and Organization) Ishiguro, Shingo. Forthcoming. Relationships and Growth: On the Dynamic Interplay between Relational Contracts and Competitive Markets in Economic Development. *Review of Economic Studies*.

(Competition and Organization) Board, Simon, Moritz Meyer-ter-Vehn, and Tomasz Sadzik. 2016. Recruiting Talent. *Working Paper*.