

EC 906: Economics of Organisations

MA Final Year

Delhi School of Economics

2023

I would mainly use journal articles for this course. Here is a tentative wish list of topics and some related references. The course would have organizational economics as its central focus. This course requires a very good understanding of the **Introductory Game Theory**. All economic transactions are performed under the aegis of some organizational setting. The course, *Economics of Organisations*, attempts to study the nature, design and performance of organizations in different economic environments. Most of the literature keeps the firm as a classic example of organisations.

This field is growing and not organized yet in the form of a textbook for this course. Many of the topics we will cover are active research areas. The course will raise many questions and provide a few incomplete answers at best. Thus, the purpose of the course is to motivate some of you to pursue the issues and problems in future research or to understand the core issues and trade-offs when you apply them in real life situations.

Grading

There will be 70% weight on the final examination and 30% weight on internal assessment. Depending on the class size we will decide on a mid-term examination or a term paper presentation. In case of presentation you may choose from a list of papers or you can propose any other paper that you are interested to present subject to my approval.

Important References:

- R. Gibbons and J. Roberts (eds.), (2013). *The Handbook of Organizational Economics*. Princeton, NJ: Princeton University Press. Various articles.
- Bolton, Patrick and Mathias Dewatripont. (2005). *Contract Theory*. Cambridge, MA: MIT Press. Chapters 4, 8, and 10.
- (Read Introductions of Tirole and Oz Shy)
- Tirole, J. (1987). *The Theory of Industrial Organization*, Cambridge, MA: MIT Press.
- Shy, O. (1995). *Industrial Organization: Theory and Applications*, Cambridge, MA MIT Press.
- Barron, D., & Powell, M. (2018). Lectures in organizational economics. *Draft manuscript, Mimeo*.

1. Introduction to Economics of Organization

- What is economics of organisations?
- Basic structures and relevant questions in Organisational Economics.

2. Managerial Delegation and Competition

- Tirole, J. (1987). *The Theory of Industrial Organization*, MIT Press. pp. 34-55.
- *Fershtman C. and Judd, K. (1987). Equilibrium Incentives in Oligopoly, *American Economic Review*, 77, 927-940.
- *Basu, K. (1995). Stackelberg Equilibrium in Oligopoly: An Explanation based on Managerial Incentives, *Economics Letters*, 49, 459 – 464.
- *Kopel, M. and Pezzino, M. (2018) Strategic Delegation in Oligopoly, In: Corchon, L. C. and Marini, M. A. (Eds) *Handbook of Game Theory and Industrial Organization, volume II: Applications (Vol.2)*, Chapter 10, Edward Elgar.

3. Outsourcing and vertical contracts

- Double Marginalisation (Tirole, 1987), page 174-175)
 - Strategic outsourcing of inputs in oligopoly
 - Vertical contracts with input suppliers and competition
-
- Shy, O. and R. Stenbacka. (2003). “Strategic Outsourcing.” *Journal of Economic Behavior and Organization* 50: 203-224.
 - Buehler, S. and J. Haucap. (2006). “Strategic Outsourcing Revisited.” *Journal of Economic Behavior and Organization* 61: 325-338.
 - *Sinha, U. B. (2016). Economies of Scale and (Non)Existence of Strategic Outsourcing in Cournot Duopoly, *Economics Bulletin*, 36(3), 1260-66.
 - *Arya, A., Mittendorf, B., and Sappington, D. (2008a). The make-or-buy decision in the presence of a rival: strategic outsourcing to a common supplier. *Management Science* 54, 1747–1758.
 - Arya, A., B. Mittendorf, and Sappington, D. (2008b). “Outsourcing, Vertical Integration, and Price vs. Quantity Competition.” *International Journal of Industrial Organization*, 26, 1-16.
 - Chen, Yutian, Dubey, P., Sen, D. (2011). Outsourcing induced by strategic competition, *International Journal of Industrial Organization*, 29, 484-92.
 - *Kabiraj, T., and Sinha, U. B. (2014). Strategic Outsourcing with Technology Transfer under Cournot Competition, *Economics Bulletin*, 34 (2), 1133-1140.
 - Milliou, C., (2019), Outsourcing without cost advantage, *mimeo*.
 - Kabiraj, T. and Sinha, U.B. (2017). Outsourcing under incomplete information, *Indian Growth and Development Review*, 10(1), 3-15.

- *Kopel, M. and Pezzino, M. (2018) Strategic Delegation in Oligopoly, In: Corchon, L. C. and Marini, M. A. (Eds) *Handbook of Game Theory and Industrial Organization, volume II: Applications (Vol.2)*, Chapter 10, Edward Elgar.

4. Firm as an organisation: Introduction

➤ *Overviews*

➤ **Various theories of firm and its boundaries**

- *Gibbons, R. (2005). Four Formal(izable) Theories of the Firm? *Journal of Economic Behavior and Organization*, 58, 202-247 (Sections 1-3).
- Coase, R. (1937). The nature of the firm. *Economica* 4, 386–405.
- Williamson, O. E. (1981). The modern corporation: origins, evolution, attributes. *Journal of economic literature*, 19(4), 1537-1568.
- Hart, O. (1995). Corporate Governance: some theory and implications, *Economic Journal*, 678-689.
- Bolton, P. and Dewatripont, M. (2005). *Contract Theory*. Cambridge, MA, MIT Press, Chapters 11 and 12.
- Paul Walker (2014). Contracts entrepreneurs, market creation and judgement: The contemporary mainstream theory of the firm in perspective, *Journal of Economic Surveys*, 1 – 22.
- Pol Antras, Lecture note on the theory of the firm, Chapter 10 and 11 (Introductions), MIT Press.
- Tadelis, S. and Williamson, O. (2010). Transaction Cost Economics. in R. Gibbons and J. Roberts (eds.), *The Handbook of Organizational Economics*. Princeton, NJ: Princeton University Press.
- Holmström, B. and Tirole, J. (1987). The Theory of the Firm" in *Handbook of Industrial Organization*, ed. By Schmalensee, R. and Willig, R. Amsterdam, North-Holland

➤ **Incomplete contracts and theory of the firm**

➤ **Agency problem and pay for performance**

➤ **Incentive system theory of the firm**

➤ **Hold up problem and Contractual Incompleteness**

(Example from Tadelis, S. and Segal, I. (2005): Lectures in Contract Theory, page 159-165)

➤ **Property rights theory of the firm**

- *Gibbons, R. (2005). Incentives Between Firms (and Within), *Management Science*, 51(1), 2-17.
- *Grossman, Sanford J. and Oliver D. Hart. (1986). The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration, *Journal of Political Economy*, 94, 691-719. (**Do it from IO book** : Industrial Organisation: A Strategic Approach, by Jeffrey Church and Roger Ware, Chapter 3, Pages 86 - 94).
- Aghion, P., Dewatripont, M., Legros, P., and Zingales, L. (Eds.). (2014). *The impact of incomplete contracts on economics*. Oxford University Press.
- Segal, I. and Whinston, M. (2010), "Property Rights." in R. Gibbons and J. Roberts (eds.), *The Handbook of Organizational Economics*. Princeton, NJ: Princeton University Press, 2013.

5. Incentive Contracts and Organisations

- Agency problem - Formal and Informal incentives: Relational incentive contract, career concern and skill acquisition.

Gibbons (1998), JEP; Gibbons (2005) MS; (2018 Book chapter 1.3 pp 90) (2018 Book Lecture Barron & Powell – Chapter 1, Powell Book 2016, Chapter 1).

- Decision making in Organisation

Delegation: Loss of information vs loss of control vs loss of initiative

(2018 Book Lecture Barron & Powell – Chapter 2.1.2 and 3, pp 118 - 128. 2019 Powell Lecture note MECS 570 Lecture 6)

- Formal and Informal Authority in Organisations (Aghion and Tirole, 1997)
- Power and politics (Rotemberg, 1994)

(Gibbons 2003, Team theory Garbage can...Section 4, pp. 770)

- *Gibbons, R. (2005). Incentives Between Firms (and Within), *Management Science*, 51(1), 2-17.
- *Gibbons, R. (1998). Incentives in organization, *Journal of Economic Perspective*, 12(4), 115 – 132.
- *Gibbons, R. (2003). Team theory, garbage cans and real organizations: some history, prospects and economic research on decision making in organizations, *Industrial and Corporate Change*, 12(4), 753 – 787.
- Baker, G. P., Gibbons, R., and Murphy, K. J. (1999). Informal authority in organizations, *Journal of Law, Economics, and Organization* 15: 56-73.
- Aghion, P., and Tirole, J. (1997). Formal and Real Authority in Organizations, *Journal of Political Economy*, 105 (1): 1–29.

- Rotemberg, J. (1994). Power in profit maximising organisation, *Journal of Economics and Management Strategy*, 2, 165 – 198.
- Gibbons, R., and Roberts, J. (2013). Economic theories of incentives in organizations, in R. Gibbons and J. Roberts (eds.), *The Handbook of Organizational Economics*. Princeton, NJ: Princeton University Press.

6. Organisations and Financial Market

- **Credit Rationing under moral hazard and adverse selection.**
- **collateral as a screening device: Bester model**
- **Implications of these financial frictions for organizational performance.**
(2018 Book Lecture Barron & Powell: Chapter 6)
- *Tirole J. (2001). Corporate Governance, *Econometrica*, 69(1), 1-35.
- *Tirole, J. (2006). The Theory of Corporate Finance, Princeton University Press. (Chapter 3 and Chapter 6 pp 240 – 244)
- *Bester H. (1985). Screening vs rationing in credit markets with imperfect information, *American Economic Review*, 850-855. (do it from Freixas, X. and Rochet, J. –C, (2008), *Microeconomics of Banking*, Cambridge, MA: MIT Press, Chapter 5)

7. Merger, Acquisition and Takeover

- **Mergers**
- **Entry through acquisition – asymmetric information models**
- **Takeover and free rider problems**
- **Role of large shareholder**
- Shy, O. (1995). *Industrial Organization: Theory and Applications*, Cambridge, MA: MIT Press. Chapter 8, pages 169-182.
- *Salant, S.W., Switzer, S., Reynolds, R.J. (1983). The losses of horizontal merger: the effects of an exogenous change in industry structure on Cournot–Nash equilibrium, *Quarterly Journal of Economics*, 98, 185–199.
- *Sinha, U. B. (2001). International Joint Venture, Licensing and Buy-out under Asymmetric Information, *Journal of Development Economics*, 66(1), 127-151.
- *Sinha, U. B. (2008). International Joint Venture: Buy-out and Subsidiary, *Journal of Economic Behavior and Organization*, 65(3-4), 734-756.
- *Grossman, S. and Hart, O. (1980). Takeover bids, the free-rider Problem, and the theory of the corporation, *Bell Journal of Economics* 11 42-64.
- *Shleifer, A. and Vishny, R.W. 1986. Large shareholders and corporate control, *Journal of Political Economy* 94(3), 461-489.
- *Hirshleifer, D., and Titman, S. (1990). Share tendering strategies and the success of hostile takeover bids, *Journal of Political Economy* 98, 295-324.