

Syllabus

MECS 475: The Economics of Organizations

Spring 2015

Michael Powell

mike-powell@kellogg.northwestern.edu

Course Description and Objectives

This course provides an introduction to Organizational Economics. 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 weekly on Wednesdays from 9:00am to 12:00pm. The class is currently scheduled to meet in Jacobs 619 (the Strategy conference room).

Course Overview

The course is organized around 7 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 in Organizations (2 weeks)

Topic 2: Boundaries of the Firm (2 weeks)

Topic 3: Careers in Organizations (1 week)

Topic 4: Persistent Performance Differences (1 week)

Topic 5: Competition and Organization (1 week)

Topic 6: Relational Incentive Contracts (1 week)

Topic 7: Decision Making in Organizations (2 weeks)

Topic 1: Incentives in Organizations

(2 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: Boundaries of the Firm (2 weeks)

Overview

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

*Coase, Ronald. 1937. The Nature of the Firm. *Economica*, 4(16): 386-405.

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. Forthcoming. An Influence-Cost Model of Organizational Practices and Firm Boundaries. *The Journal of Law, Economics, and Organization*

Empirical Papers

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.

Forbes, Silke and Mara Lederman. 2010. Does Vertical Integration Affect Firm Performance? *The RAND Journal of Economics*, 41(4): 765-790.

Whinston, Michael. 2003. On the Transaction Cost Determinants of Vertical Integration. *The Journal of Law, Economics, and Organization*, 19(1): 1-23.

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. 2015. Behavioral Limitations of Subgame-Perfect Implementation. *Working Paper*.

Topic 3: Careers in Organizations (1 week)

Overview

*Waldman, Michael. 2013. Theory and Evidence in Internal Labor Markets. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Papers

Internal Labor Markets

Waldman, Michael. 1984. Job Assignments, Signalling, and Efficiency. *The RAND Journal of Economics*, 15(2): 255-267.

Baker, George, Michael Gibbs, and Bengt Holmstrom. 1994. The Internal Economics of the Firm: Evidence from Personnel Data. *The Quarterly Journal of Economics*, 109(4): 881-919.

Gibbons, Robert and Michael Waldman. 1999. A Theory of Wage and Promotion Dynamics Inside Firms. *The Quarterly Journal of Economics*, 114(4): 1321-1358.

Personnel Policies

Lazear, Edward. 1979. Why is there Mandatory Retirement? *The Journal of Political Economy*, 87(6): 1261-1284.

Ke, Rongzhu, Jin Li, and Michael Powell. 2015. Managing Careers in Organizations. *Working Paper*.

Topic 4: Persistent Performance Differences (1 week)

Overview

*Syverson, Chad. 2011. What Determines Productivity? *Journal of Economic Literature*, 49(2): 326-365.

Henderson, Rebecca and Robert Gibbons. 2013. What Do Managers Do? In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Implications, Management Practices, and Theories

Misallocation

Hsieh, Chang-Tai. and Peter Klenow. 2009. Misallocation and Manufacturing TFP in China and India. *The Quarterly Journal of Economics*, 124(4): 1403-1448.

Management Practices

Bloom, Nicholas and John Van Reenen. 2007. Measuring and Explaining Management Practices Across Firms and Countries. *The Quarterly Journal of Economics*, 122(4): 1351-1408.

Bloom, Nicholas, Benn Eifert, Aprajit Mahajan, David McKenzie, and John Roberts. 2013. Does Management Matter? Evidence from India. *The Quarterly Journal of Economics*, 128(1): 1-51.

Theories

Chassang, Sylvain. 2010. Building Routines: Learning, Cooperation, and the Dynamics of Incomplete Relational Contracts. *The American Economic Review*, 100(1): 448-465.

Ellison, Glenn and Richard Holden. 2014. A Theory of Rule Development. *The Journal of Law, Economics, and Organization*, 30(4): 649-682.

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. 2015. Productivity and Credibility in Industry Equilibrium. *Working Paper*.

Topic 6: Relational Contracts (1 week)

Overview

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

Relational Incentive Contracts

Imperfect Public Monitoring

*Levin, Jonathan. 2003. Relational Incentive Contracts. *The American Economic Review*, 93(3): 835-857.

Limited Transfers

Fong, Yuk-Fai. and Jin Li. 2015. Relational Contracts, Efficiency Wages, and Employment Dynamics. *Working Paper*.

Li, Jin and Niko Matouschek. 2013. Managing Conflicts in Relational Contracts. *The American Economic Review*, 103(6): 2328-2351.

Subjective Performance Measures

Fuchs, William. 2007. Contracting with Repeated Moral Hazard and Private Evaluations. *The American Economic Review*, 97(4): 1432-1448.

Persistent Private Information

Halac, Marina. 2012. Relational Contracts and the Value of Relationships. *The American Economic Review*, 102(2): 750-759.

Imperfect Private Monitoring and Multiple Agents

Andrews, Isaiah and Daniel Barron. 2015. The Allocation of Future Business. *Working Paper*.

Barron, Daniel and Michael Powell. 2015. Policy Commitments in Relational Contracts. *Working Paper*.

Topic 7: 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. 2015. Power Dynamics in Organizations. *Working Paper*.

Potential Papers for In-Class Presentations

More will be added

(Incentives in Organizations) Bonatti, Alessandro and Johannes Horner. 2015. Career Concerns with Exponential Learning. *Working Paper*.

(Incentives in Organizations) Cisternas, Gonzalo. 2014. Two-Sided Learning and Moral Hazard. *Working Paper*.

(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. Forthcoming. The Empirical Content of Pay-for-Performance. *Journal of Law, Economics, and Organization*.

(Incentives in Organizations) Holden, Richard. 2008. Comparative Statics in Principal-Agent Problems. *Working Paper*.

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

(Boundaries of the Firm) Baliga, Sandeep and Tomas Sjöström. 2013. Coordination, Rent-Seeking, and Control. *Working Paper*.

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

(Careers in Organizations) Alonso, Ricardo. 2014. Recruitment and Selection in Organizations. *Working Paper*.

(Persistent Performance Differences) Halac, Marina and Andrea Prat. 2014. Managerial Attention and Worker Engagement. *Working Paper*.

(Competition and Organization) Board, Simon and Moritz Meyer-ter-Vehn. Forthcoming. Relational Contracts in Competitive Labor Markets. *Review of Economic Studies*.

(Relational Contract) Rayo, Luis. 2007. Relational Incentives and Moral Hazard in Teams. *The Review of Economic Studies*, 74(3): 937-963.

(Relational Contracts) Bowen, Renee, David Kreps, and Andy Skrzypacz. 2013. Rules with Discretion and Local Information. *Quarterly Journal of Economics*, 128(3): 1273-1320.

(Relational Contracts) Garicano, Luis and Luis Rayo. 2013. Relational Knowledge Transfers. *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. 2014. Rational Inattention and Organizational Focus. *Working Paper*.

(Decision Making in Organizations) Bonatti, Alessandro and Heikki Rantakari. 2015. The Politics of Compromise. *Working Paper*.

(Decision Making in Organizations) Che, Jiahua, Kim-Sau Chung, and Yang Lu. 2015. Decentralization and Political Career Concerns. *Working Paper*.

(Decision Making in Organizations) Akerlof, Robert and Richard Holden. 2015. Movers and Shakers. *Working Paper*.