INCENTIVES AND INFORMATION IN ORGANIZATIONS

Abstract

by

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This thesis aims at a formal analysis of some of the significant issues related to the choice between firms and markets. The third chapter examines the technology acquisition strategy adopted by symmetric duopolists. There exist asymmetric equilibria in which a firm chooses to make [go for inhouse research] and the other to buy technology. The analysis shows that integration may be the preferred option when firms wish to avoid delay.

The fourth chapter views discretion as the possibility of deviating from the action specified in the contract. The tradeoff between incentive effects and agency costs defines the limits of an agent's discretion. His discretion can be altered by changing either his target performance standard or his wage.

Discretionary gains are high powered incentives. They can induce agents to continually search for and introduce advanced techniques. Unless cost savings are sufficiently high, an increase in product market competition decreases a manager's discretion. When potential losses from granting agents the levels of discretion required to induce them to undertake an activity are high. a market contract that constrains agents to bear the full costs of their actions may be preferred to an employment contract.

The fifth chapter investigates task assignment in organizations. Hierarchies sort candidates into insiders & outsiders according to some criteria. Then conduct a test. Polyarchies confine themselves to just conducting the test. Tasks are assigned on the basis of the test score which is a noisy signal.

Sometimes biasing a decision may permit one to make the best use of available information. Sorting reveals additional information about candidates & causes standards faced by insiders and outsiders to differ. The conditions under which a polyarchy outperforms a hierarchy are determined. Introducing a bias is then insufficient to improve decision making. The analysis shows that when the adverse

selection problem becomes more severe the bias in favour of (against) insiders increases (decreases). This result implies that if insiders were offered employment contracts and outsiders market contracts, an increase in the severity of the adverse' selection problem would cause intrafirm transactions to be favoured over interfirm transact ions.