

Organizational Theory and Decision Making

Part I: Foundations and Boundaries of Organizations

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Part I.B: The Property Rights Approach

Video 1:
A Short Introduction to the topic

Property Rights Approach (PRA)

- In the following we will concentrate on another approach which is closely related to TCE
- **The Property Rights Approach**

Oliver Hart (S. Grossman / J. Moore)

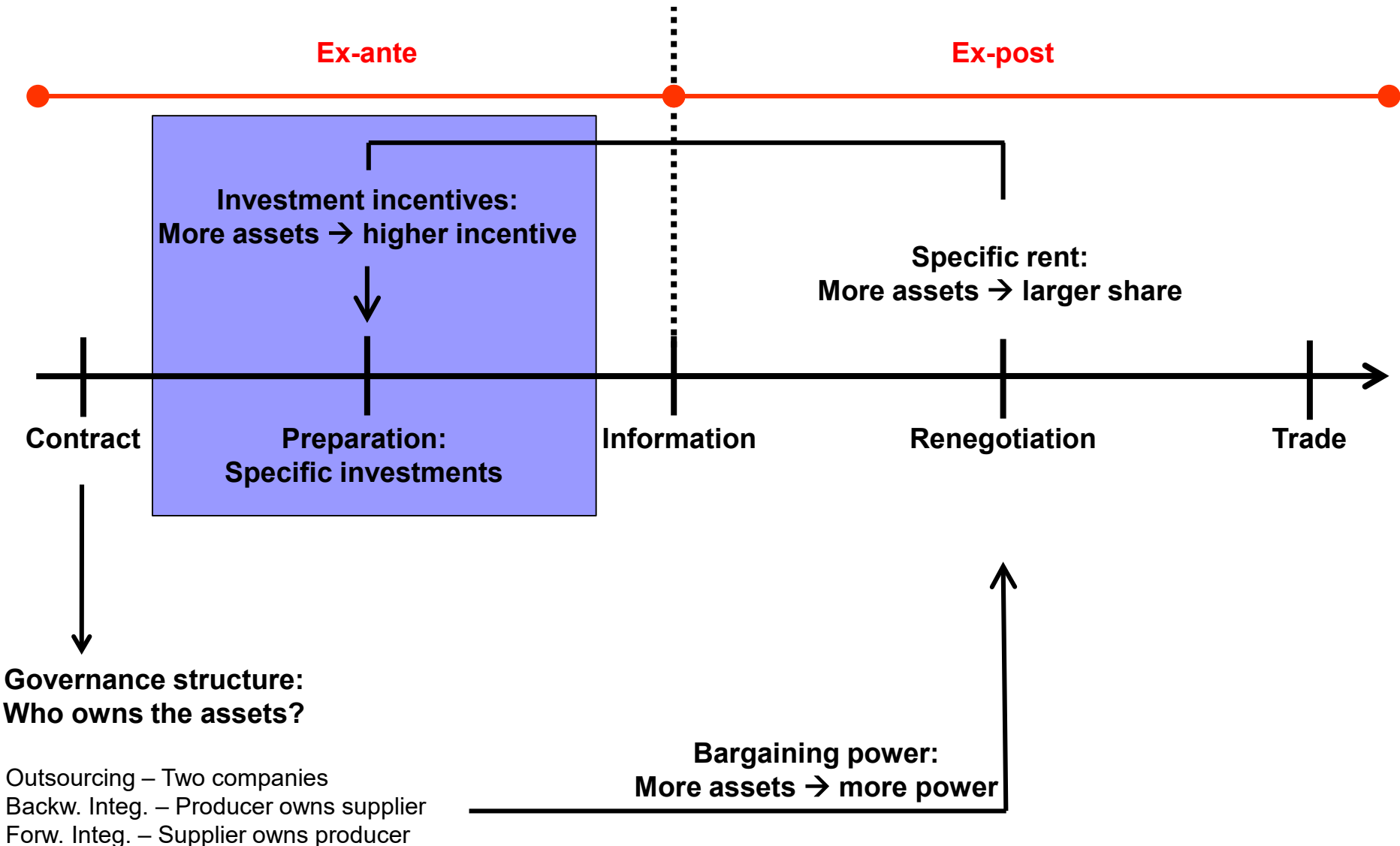
- Same basic setup as TCE
- But while TCE focuses on the ex-post problem (bargaining costs), PRA emphasizes the ex-ante problem (distorted investments)



Difference between PRA and TCE

- The PRA assumes that rational parties avoid bargaining problems (see the discussion in Coase 1960):
 - No haggling costs / Coasian bargaining
→ Ex-post efficiency
 - Concentrates on distortions in ex-ante investments
 - Focus on insights about the role of optimal asset ownership and the allocation of formal control rights
- Contrary to TCE the PRA takes a fully formal approach
 - This is very useful, because it allows to get a much more precise picture of how the assumptions drive the results

The Property Rights Approach: Summary



Predictions

■ Essential mechanisms:

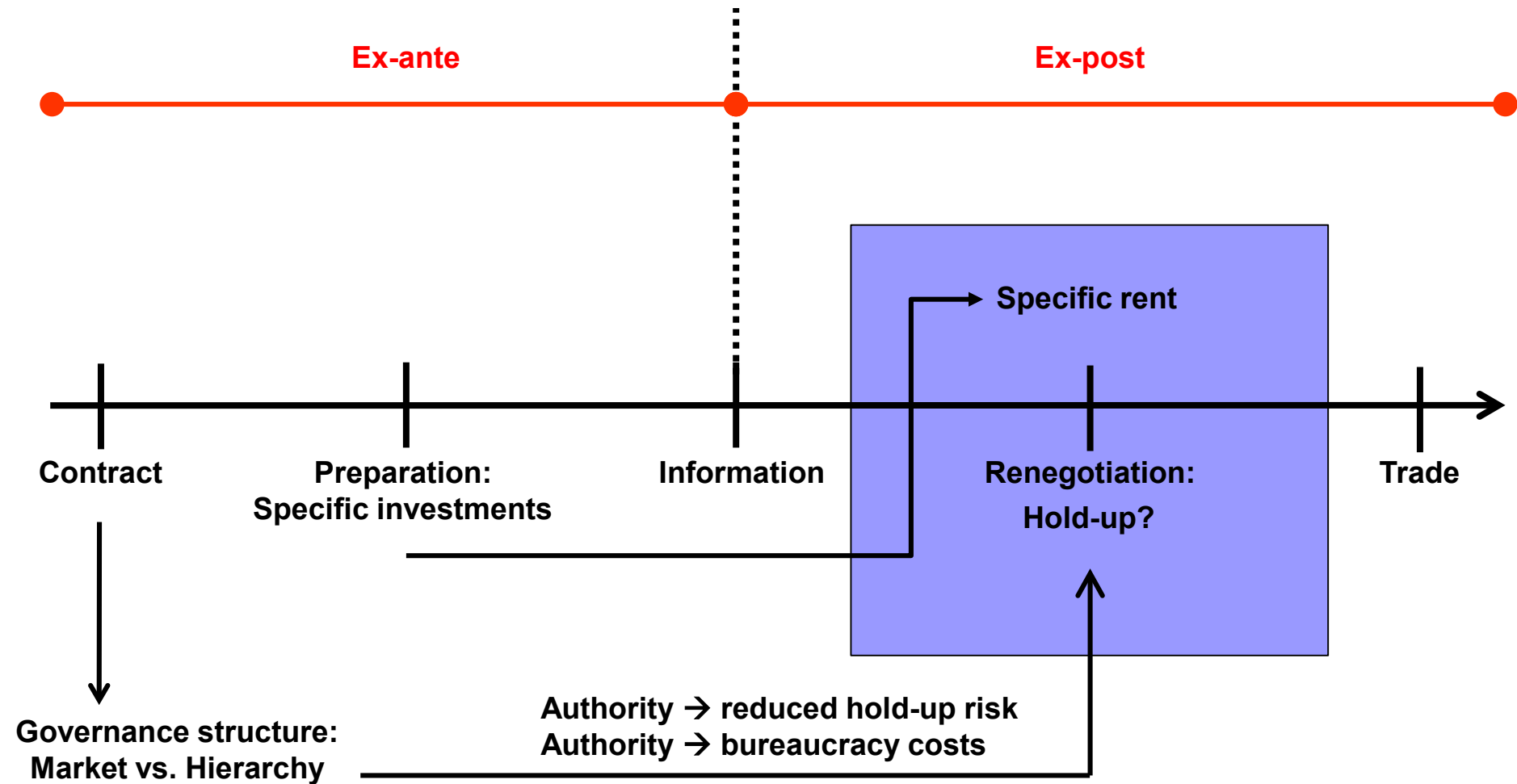
- Asset ownership determines bargaining power
- Bargaining power determines investment incentives

■ Who should own the assets?

- If the specific investments of one party are more important than those of the other party, the party with the important investments should own all the assets
- Producer's investments are more important → Backward integration
- Supplier's investments are more important → Forward integration
- No important investments / important invest. on both sides → Outsourcing

■ The direction of integration matters!!

Comparison to TCE



Comparison to TCE

- Determinants of vertical integration:
 - TCE: The overall importance of specific investments matters
 - PRA: The question is whose specific investments are more important
- Efficiency problem:
 - TCE: Inefficiencies occur in the ex-post phase
 - Hold-up: haggling costs / Bureaucracy costs
 - PRA: Inefficiencies occur in the ex-ante phase
 - If assets are not properly assigned, there is underinvestment
- These differences can change predictions
 - Sometimes the predictions of TCE and PRA are aligned
 - In other cases the predictions are different