LECTURE 6.0

WHAT IS A FIRM?

THE FIRM

The price mechanism is effective in market transactions:

- It uses information efficiently
- It provides strong incentives

A firm uses administrative fiat rather than the price mechanism to allocate resources. Why?

- Exchange or transactions in markets incur contracting costs: search and information costs, bargaining and decision costs, drafting and enforcement costs.

Why do we have firms?

- Why do some transactions take place in markets, and others within firms?

THE FIRM

Our model of firms to this point is clearly oversimplified. We had a single actor making profit maximizing decisions.

The remainder of this week’s content will examine different ways we can view the firm.

OUTLINE

READING

Hart (1989) "An Economist's Perspective on the Theory of the Firm", Columbia Law Review, 89(7), 1757-74

Chapter 10, “Incentive Conflicts and Contracts” in Brickley, Smith and Zimmerman (2016) Managerial Economics and Organizational Architecture (6th ed)

Lecture Note 2: Relational Contracts (Links to an external site.) in Robert Gibbons, MBA Course (15.903: Organizational Economics and Corporate Strategy)

Links to readings or downloads are available in Canvas.