

LECTURE 7.2

CENTRALISATION AND DECENTRALISATION

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Consider a firm that operates across two markets: Perth and Sydney. Suppose that there is a CEO (in Sydney) and local managers in Perth and Sydney. How might pricing decisions be allocated?

- The CEO could specify prices in both markets (centralisation).
- The decision could be decentralised to each local manager.
- The decision for both markets could be decentralised to a single local manager.
- Any decentralisation could have limits imposed on them.

What are the costs and benefits of such approaches and decentralised versus centralised decision-making more generally?

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Benefits of centralisation:

- Economies of scale or public goods: they may be ignored at 'local' level (e.g. advertising or purchasing decisions)
- Better use of 'central knowledge: can be used to provide better incentives to local decision makers
- Coordination: allows complementarities and interdependencies to be factored into the decisions

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Benefits of decentralisation :

- Save management time and resources for important (strategic) decisions: managerial skills are scarce
- Creates a more enriched job environment: opportunities for training and promotion; develop management skills; provide motivation and incentives
- Avoids need to transmit information: this may be costly in time and resources
- Exploits specific knowledge: allowing more rapid responses to changes in market conditions.