

Economics of organisations

Business



Economics of Organisations - TAKE HOME EXAM Question #3 It is a well-known fact that Alchian and Demsetz attempt to counter the claim that the essence of the employment relation is authority. Coase argued differently, by saying that firms have the tendency to acquire high internal costs through continuously negotiating new contracts. In contrast, Alchian and Demsetz that firms rise because of information costs.

According to Wikisum (2009 p. 1), Firms will develop (Y) when two conditions obtain:

X1: It is possible to increase production through team effort. Think of two men loading bulky cargo onto a truck. By working together, they can load the cargo in far less time than if they worked separately; the product of their efforts exceeds the sum of their individual contributions. When there is a team effort like this, you have information problems: it is hard to tell who is shirking.

X2: It is possible to meter each input's (laborer's) marginal contribution, either by observation or specification of the inputs.

They go on further to say that the above will make a capitalist firm, having the conditions that are described in the following diagram:

Figure 1: Characteristics of a Classical Capitalist Firm

" The essence of the classical firm is identified here as a contractual structure with: 1) joint input production [team efforts]; 2) several input owners [e. g. each laborer owns himself]; 3) one party who is common to all the contracts of the joint inputs [the employer/owner]; 4) who has rights to renegotiate any input's contract independently of contracts with other input owners [e. g. can hire, fire, etc. to reward inputs that contribute more]; 5) who holds the residual claim [i. e. gets the " residual" income; see below];

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and 6) who has the right to sell his central contractual residual status [i. e. can sell the company]."

Source: Wikisum 2009, p. 1

In earlier literature regarding the theory of the firm, many argued with Alchian and Demsetz. According to Organizations and Markets. com (2009 p. 1), " The striking insight of Alchian and Demsetz (1972) and Jensen and Meckling (1976) is in viewing the firm as a set of contracts among factors of production. In effect, the firm is viewed as a team whose members act from self-interest but realize that their destinies depend to some extent on the survival of the team in its competition with other teams." Fama criticizes Alchian and Demsetz, however, for failing to eliminate the entrepreneur from the picture; their theory still includes an employer who, like an entrepreneur, polices shirking because he collects the benefits of doing so."

Alchian and Demsetz had their own unique view of the firm. It is presented in the following diagram:

Figure 2: Organizational Chart

Source: Emerald Insight (2009 p. 1)

Their arguments have their good points and their bad points. I do believe authority plays a large role in the success of organization and that too much authority and/or too little authority can certainly bring a firm down, but I also believe that information is way more than valuable to the rise of a firm, and therefore the cost of it is duly justified. I am just not sure at this point which is more important. Perhaps they are of equal importance.

One could argue that every little function within an organization could make or break that organization. These are just two points of view that we are

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presented with. Perhaps a broader spectrum of ideas would help to justify one side or the other of the argument. The ideas would come from multiple departments within the organization instead of a few elite professionals. The broader the spectrum is from which to choose, the better conclusion one can make.

References

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