Non-Integration, Integration, and the Decentralized Firm: Management of “Externalities vs. Private Benefits”

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Abstract

We present a comparative theory of “Non-Integrated”, “Integrated”, and “Decentralized” firms, and study the optimal scope of a firm and the assignment of different types of managers to different types of firms, in an IO setting with R&D and production activities. “Non-integrated firms” fail to take into account the externalities that managers’ decisions have on other firms. While an “integrated firm” internalizes these externalities, it does not take into consideration the “private benefits” of managers. The “Decentralized Firm” works as a hybrid of these two structures. We also interpret our model from the viewpoint of the allocation of formal authority, and uncover some interesting economic implications.

Key words Non-Integration, Integration, Decentralized Firm, Private Benefit, Internalization of Externalities.

JEL classification D23, L22

Running heads Decentralized Firm

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