

The Organization as a Rule of Intrafirm Bargaining

Fumi Kiyotaki*
and
Toshiji Miyakawa†

May 1, 2007

Abstract

In this paper, we study the choice of organizational form under incomplete contracts. We identify an organizational form with a rule of ex post bargaining and compare four types of organization: horizontal organizations (partnerships); common agencies; pyramidal hierarchies; and vertical hierarchies. We show that if the human capital investments of all members are complementary and essential to production, the horizontal organization is chosen. If the investments of two players including the owner are essential, then the common agency may be optimal. If the pyramidal hierarchy can motivate subordinates to invest, the pyramidal hierarchy is chosen. The vertical hierarchy may be chosen if the owner can motivate a player who engages in firm-specific investment by assigning him or her to the middle rank. We also examine who should be assigned to the middle tier in the vertical hierarchy.

*School of Economics, Kinki University, 3-4-1 Kowakae, Higashiosaka, Osaka 577-8502, Japan. Tel: +81 6 6721 2332 E-mail: kiyotaki@eco.kindai.ac.jp

†Department of Economics, Osaka University of Economics, 2-2-8, Osumi, Higashi-yodogawa, Osaka 533-8533, Japan. Tel: +81 6 6328 2431. E-mail: miyakawa@osaka-ue.ac.jp