

A Formal Theory of *Ex Post* Adaptation:
A Trade-Off between Rent Seeking and Bargaining Losses*

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Abstract

This paper develops a theory of firm boundaries in the spirit of Williamson's transaction cost analysis, in which parties engage in *ex post* adaptation with rent-seeking activities and opportunistic information disclosure. We show that the presence of *ex post* inefficient bargaining creates a trade-off between rent-seeking costs and bargaining losses: while non-integration incurs fewer rent-seeking costs than integration, it suffers from bargaining delay and breakdown, which never occur under integration. This result explains why rent-seeking activities within firms are more likely to be costly than those between firms, and offers a formal justification for the "costs of bureaucracy" in Williamson (1985).

Keywords: Transaction costs; *ex post* adaptation; integration; rent-seeking; influence activity; bargaining losses

JEL Classification: D23; L22

References

Williamson, Oliver E. 1985. *The Economic Institutions of Capitalism*. New York: The Free Press.

*Available at SSRN: <http://ssrn.com/abstract=1975624>