



B432A/B Organizational Economics

Syllabus

Instructor: Prof. Dr. Patrick Kampkötter

Content

This module introduces the economic analysis of organizations. Starting from the question of how firms create value, it examines how organizations can be designed so that self-interested individuals make decisions that increase firm value. The course is structured around the three components of organizational architecture - the assignment of decision rights, the performance evaluation system, and the reward system - and covers incentive conflicts and contracts, incentive compensation, dynamic and relational incentives, intrinsic motivation, team incentives and peer effects, social preferences, as well as the allocation of authority and the design of organizational structures. Formal models from contract theory and game theory are combined with empirical evidence from field studies, personnel records, and laboratory experiments, and are applied to real-world cases.

Learning target

In this module, students learn to analyze incentive problems in organizations with the tools of modern organizational economics. Students develop the ability to set up and solve principal-agent models, to derive optimal incentive contracts, and to explain how risk, imperfect performance measurement, multitasking, repeated interaction, and career concerns shape the design of compensation systems. They understand how insights from behavioral economics such as intrinsic motivation, fairness, reciprocity, and reference points, qualify the predictions of standard models, and they learn to critically assess empirical studies on incentives, peer effects, and corporate culture, including their identification strategies. Finally, students are able to evaluate how decision rights, performance evaluation, and rewards should be coordinated and to derive recommendations for the design of organizations in practice. Students taking B432B additionally practice presenting and critically discussing recently published research papers.

Topics

1. Introduction
 - a. The conceptual framework: decision rights, rewards, and performance evaluation
 - b. Challenges of organizational design and individual opportunism
2. Economics of strategy and value creation
 - a. The economic value of a firm and Economic Value Added (EVA)
 - b. Value creation in competitive markets
 - c. Competitive position, resources, and capabilities
3. Incentive conflicts and contracts
 - a. The separation of ownership and control
 - b. Controlling incentive problems through contracts: moral hazard and adverse selection



4. Incentive compensation
 - a. The basic incentive problem and effective incentive contracts
 - b. A principal-agent (LEN) model
 - c. The selection effect of incentive contracts
 - d. "Sell-the-shop" contracts
 - e. Joy of working
 - f. Incentives for multiple tasks
5. Dynamic incentive problems
 - a. Relational contracts
 - b. Career concerns and image concerns
6. Intrinsic motivation and crowding out
 - a. Theories of motivation crowding-out
 - b. Crowding-out of image motivation
7. Group incentive pay
 - a. Forms and rationales of group incentive plans
 - b. Team incentives and the free-rider problem
8. Groups and peers
 - a. A simple model of peer effects
 - b. Empirical and experimental evidence on peer effects and free-riding in teams
 - c. How to overcome free-riding in teams
9. Neo-classical vs. behavioral economics
 - a. Social comparison and equity concerns
 - b. Reciprocity and intentions
 - c. Reference points
 - d. Do incentive contracts work?
10. Decision rights and authority in organizations
 - a. Decision rights and the role of corporate culture
 - b. The allocation of decision rights: centralization vs. decentralization, formal and real authority
 - c. Bundling tasks into jobs and subunits: functional, divisional, and matrix organizations

Structure

Lectures

- Slides, assignments, and papers are provided on Ilias
- Dates and rooms are announced in alma
- No registration required

Tutorials

- Two parallel tutorial groups with identical content
- Dates and rooms are announced in alma
- No registration required
- Discussion of assignments (mostly previous exam assignments and sample exam questions) and of research papers. It is important to prepare for the tutorials in advance!



Colloquium (B432B version only)

- (Group) presentations of recently published research papers on topics related to the course
- Kick-off meeting with assignment of topics at the beginning of the semester
- Presentation day(s) typically in June or July
- Participation in all meetings and presentations is mandatory. In case of overlaps with other mandatory courses, please contact the instructor as early as possible.

Enrollment information

- Lecture and tutorials: no registration required.
- Colloquium (B432B): registration via ILIAS (online registration form and upload of your transcript of records). All details will be provided in the first lecture
- Successful participation in the colloquium is stored, i.e., students who have already passed the colloquium do not need to repeat it in a later semester.

Coursework

- Variant A (B432A): 6 ECTS-Credits (lecture + tutorial).
- Variant B (B432B): 9 ECTS-Credits (lecture + tutorial + colloquium).
- Written exam (90 minutes), registration is required.
- B432B: successful participation in the colloquium (Studienleistung) is a prerequisite for admission to the exam.

Teaching methods

Online lectures (video), independent study, interactive tutorials (assignments, case studies, and discussion of research papers), student presentations (B432B), oral participation

Course language

English

Prerequisites

The course is open to students of the M.Sc. Management & Economics and of other Master's programs. A working knowledge of microeconomics (optimization, basic game theory) and basic econometrics is helpful.

Literature

Textbooks

- Besanko, D., Dranove, D., Shanley, M., & Schaefer, S. (2007). *Economics of Strategy*. 4th Ed. John Wiley & Sons.
- Brickley, J. A., Smith, C. W., & Zimmerman, J. L. (2016). *Managerial Economics and Organizational Architecture*. 6th Ed. McGraw-Hill.
- Gibbons, R., & Roberts, J. (Eds.) (2013). *The Handbook of Organizational Economics*. Princeton University Press.
- Milgrom, P., & Roberts, J. (1992). *Economics, Organization and Management*. Prentice-Hall.



Core articles

- Aghion, P., & Tirole, J. (1997). Formal and real authority in organizations. *Journal of Political Economy*, 105(1), 1-29.
- Bénabou, R., & Tirole, J. (2006). Incentives and prosocial behavior. *American Economic Review*, 96(5), 1652-1678.
- Fehr, E., & Schmidt, K. M. (1999). A theory of fairness, competition, and cooperation. *Quarterly Journal of Economics*, 114(3), 817-868.
- Guiso, L., Sapienza, P., & Zingales, L. (2015). The value of corporate culture. *Journal of Financial Economics*, 117(1), 60-76.
- Holmström, B. (1999). Managerial incentive problems: A dynamic perspective. *Review of Economic Studies*, 66(1), 169-182.
- Holmström, B., & Milgrom, P. (1991). Multitask principal-agent analyses: Incentive contracts, asset ownership, and job design. *Journal of Law, Economics, & Organization*, 7(Special Issue), 24-52.
- Ichino, A., & Maggi, G. (2000). Work environment and individual background: Explaining regional shirking differentials in a large Italian firm. *Quarterly Journal of Economics*, 115(3), 1057-1090.
- Knez, M., & Simester, D. (2001). Firm-wide incentives and mutual monitoring at Continental Airlines. *Journal of Labor Economics*, 19(4), 743-772.
- Lazear, E. P. (2000). Performance pay and productivity. *American Economic Review*, 90(5), 1346-1361.
- Mas, A., & Moretti, E. (2009). Peers at work. *American Economic Review*, 99(1), 112-145.
- Ockenfels, A., Sliwka, D., & Werner, P. (2015). Bonus payments and reference point violations. *Management Science*, 61(7), 1496-1513.

Further readings are cited on the slides.