

# Resource Allocation and Firm Scope

Guido Friebel and Michael Raith

## Motivation

### “Fiction” of Selective Intervention

“[e]fforts to ‘hold incentives constant,’ thereby to effect incentive neutrality . . . turn out to be delusional” (Williamson 1985: 161)

## Answer

- Not assume different objective functions (private benefits, empire building,...)
- Influence Activities?
  - Optimal resource allocation (information) vs. incentives (effort)

# Model Results – Discussion

## Key parameters

- Importance of resources (scale project)
- Importance of incentives (probability good project)

## Integration versus Independence

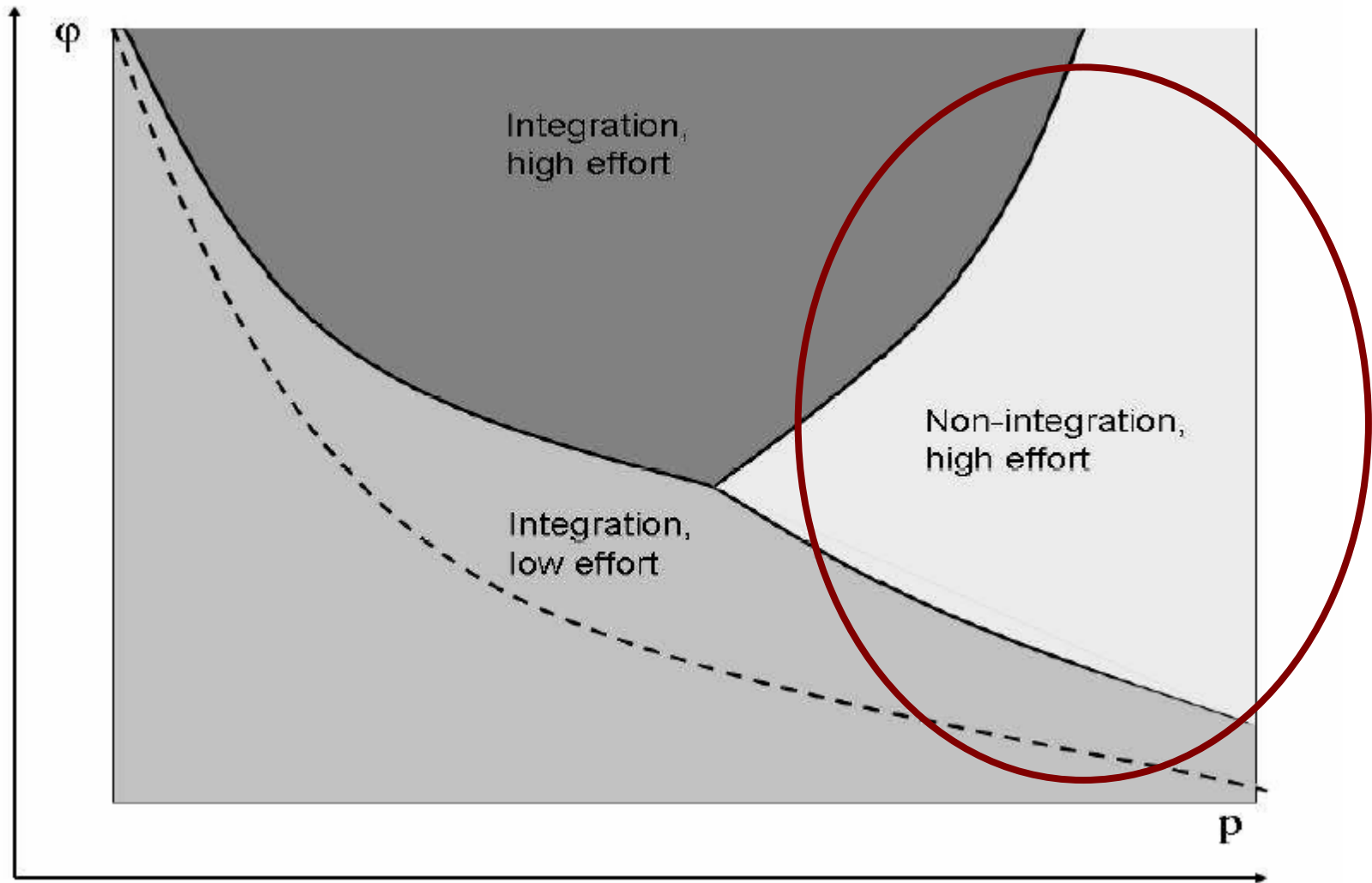
- Competition Effect: lower powered incentives
- Information Rent Effect: higher powered incentives

With complete contracts: both effects exactly cancel each other

With incomplete contracts: information rent effect dominates, i.e. integration is always weakly more costly

- Get manager to reveal bad project

# Optimal Firm Scope



# Discussion

- Capacity constraint: resource allocation important because resource is in limited supply. Why can't the firm invest in resources? Non-integration when  $\rho$  high as resources are split.
- Asymmetric information about G/B project, not  $\Phi$  or  $y_2$ . Why?
- Not really (ownership) boundaries of the firm.
  - Organizational integration: authority allocation or potential of leveraging the same resource across different projects
  - Which Resources? “strategic, organizational or procedural capabilities... embedded in the routines of the organization” (Sutton, 2004)  
Problem: hard to reallocate.
  - Non-integration with high effort: Innovation stage gate and Spin-out: not all projects internal (XTV)
  - Why within same firm? Horizontal communication (battery control chip BMW). Different projects competing for engineering resources
  - Rather than reveal information auction resources (corporate R&D)
- Integration (high effort) leads to higher wage bill: firm size and wages
- Scope and Effort: Rotemberg and Saloner (AER 1994): Narrow Business Strategies (strategy). Relax CEO IC constraint.
- Organization and Effort: Rotemberg and Saloner (MS 1993): Empathic CEO (culture)
- Scope and Selection: Diversification discount versus selection
- Relatedness (Rumelt, 1982)