Chapter 12: Firms as Organizations

I. Firms as Organizations rather than Production Functions

The models of the firm used to this point are the most common in micro-economic textbooks. In effect, firms are production and profit functions, or more generously, proprietorships that single mindedly produce goods or services in order to profit from them. The models of chapters 3-5 all used this highly simplified model as a "first approximation," a characterization that would capture much about an efficient economic organization's decisions. If an economic organization exists just to make profits, and there were no internal disagreements about how to do so, firms would make the production, output, and pricing decisions implied by those models implied—even if the internal decision making process of the firm was more complex than the model suggests.

Even in such cases, the manner in which firms are generally organized would be of interest if one was interested in how such organization make decisions and also how they incentivize their workforce to produce their products efficiently. However, the best way to determine how his id done is to begin by assuming that commercial organizations are not inherently efficient profit maximizing machines, but rather have to overcome a variety of problems associated with the task of "organizing" production and also the manner in which various modes of ownership may affect both the array of problems that need to be confronted and the types of decisions that we would expect from less than perfectly efficient profit maximizing organizations.

After all, variation in the organizational efficiency is one of the possible sources of differences in the cost functions of Ricardian producers. In this chapter, we'll begin by analyzing organizational problems faced by proprietorships (one-owner firms) and then explore those confronted by partnership and corporations with many shareholders.

II. A Proprietor's "Agency" Problems