Organization and Strategy: Some Lessons on Incentives Between Firms

1. There are incentive contracts and incentive problems between firms as well as within. [Chrysler, Crown Equipment]
   a) The contracts are both formal and relational.
   b) The problems are similar to “get what you pay for” problems in pay plans for individuals.

2. The prospect of hold-up (i.e., opportunistic renegotiation after the fact) creates incentives. [Alexander at HGA]
   a) Some of these incentives are to build value (Q).
   b) Others are to improve bargaining position (P).

3. Actions that improve bargaining position may or may not build value.
   a) \( Q = a + \epsilon, \ P = a + \phi \). [Sloan, 1970]
   b) \( Q = a_1, \ P = a_2 \). [HBS, 1970]

4. The integration decision affects incentives (and control) in the supply chain. [GM-Fisher Body]
   a) Under non-integration, upstream gets \( P + \alpha(Q-P) \), where \( \alpha \) reflects upstream’s bargaining power.
   b) Under integration, upstream loses control over the decision to sell outside (and the decision to sell at all), but downstream (or HQ) therefore needs to create incentives for upstream, such as through transfer pricing, resource allocation, and performance evaluation and reward systems.

5. Models can be too simple, and can also be not useful for other reasons.
   a) A model is too simple if its lesson disappears in richer, more realistic environments.
   b) A model is not useful if it has no lesson, or if its ostensible lesson is too contingent on a specific environment (e.g., the lesson disappears in environments of interest).

6. The models in this course are intended to be juuust right: simple enough to be a useful, by identifying major factors that persist in richer and more realistic environments.