

Inefficiency in the Organizational Decisions of the Firm

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I. THE ISSUES

Over the past several years there has been an awareness that markets, contractual arrangements, and hierarchical organizations can be utilized as alternative modes of coordinating resource allocation in the context of the firm. In most practical situations non-market coordination mechanisms are being utilized even in predominantly market oriented economies. Mixed forms of organizations are very often the preferred pattern [1]

However, an analytical structure to examine the welfare effects of mixed organizational forms is not adequately developed as yet. The only consensus is that the ultimate effect on the performance of the firm, of any specific organizational pattern, has to be through the cost curve and/or the demand curve. [2] In general, both non-price strategies of the firm and organizational decisions can affect social welfare by altering the cost curve as well as the demand curves. [3] The sources and the extent of change in the cost and demand relationships are as yet not clearly defined.

The neoclassical welfare paradigm resulted in two distinct concepts of efficiency: technical, related to the choice of inputs; and economic, related to both the choice of inputs and the extent to which a given market structure takes consumer preferences into account. [4] Under the mixed organizational modes the primary change, if any, will be in the former concept. This aspect requires a more careful analysis than has been possible so far. [5]

One of the basic changes in the analytical arguments has been the recognition that managerial preferences, in the presence of mixed organizational modes, need not correspond to cost minimization. The notion of technical inefficiency has been re-examined in this context. The resulting concepts of managerial and X-inefficiency have been controversial partly because they have not been properly correlated with the neoclassical concepts of welfare economics.