Markets and Hierarchies: Analysis and Antitrust Implications: A Study in the Economics of Internal Organization

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Abstract
This study analyzes organization of economic activity within and between markets and hierarchies. It considers the transaction to be the ultimate unit of microeconomic analysis, and defines hierarchical transactions as ones for which a single administrative entity spans both sides of the transaction, some form of subordination prevails and, typically, consolidated ownership obtains. Discusses the advantages of the transactional approach by examining three issues: price discrimination, insurance, and vertical integration. Develops the concept of the organizational failure framework, and demonstrates why it is always the combination of human with environmental factors, not either taken by itself, that causes transactional problems. The study also describes each of the transactional relations of interest, and presents the advantages of internal organization with respect to the transactional condition. The analysis explains why primary work groups of the peer group and simple hierarchy types arise. The same transactional factor which impede autonomous contracting between individuals also impede market exchange between technologically separable work groups. Peer groups can be understood as an internal organizational response to the frictions of intermediate product markets, while conglomerate organization can be seen as a response to failures in the capital market. In both contexts, the same human factors, such as bounded rationality and opportunism, occur. Examines the reasons for and properties of the employment relation, which is commonly associated with voluntary subordination. The analysis attempts better to assess the employment relation in circumstances where workers acquire, during the course of the employment, significant job-specific skills and knowledge. The study compares alternative labor-contracting modes and demonstrates that collective organization is helpful in enhancing the acquisition of idiosyncratic knowledge and skills by the work force. The study then examines more complex structures -- the movement from simple hierarchies to the vertical integration of firms, then multidivisional structures, conglomerates, monopolies and oligopolies. Discusses the market structure in relation to technical and organizational innovation. The study proposes a systems approach to the
innovation process. Its purpose is to permit the realization of the distinctive advantages of both small and large firms which apply at different stages of the innovation process. The analysis also examines the relation of organizational innovation to technological innovation. (AT)

Introduction

May you live in interesting times. –Ancient Chinese proverb Post the 2008 financial crisis, the Chinese proverb quoted in the epigraph received much attention because the only thing that is interesting is —uncertainty. The definition of uncertainty has evolved and become more complicated over the years due to development and increasing integration among various financial market segments, domestically and internationally—a result of globalisation and economic liberalisation. The development of an economy is largely influenced by financial markets—they competitively allocate financial resources that are mobilised from savers and investors among users in the economy. India’s central bank, the Reserve Bank of India (RBI), has proactively shaped the development of financial markets in India through its series of economic policy reforms—market-determined interest and exchange rates, current account convertibility, monetary policy dealing with price-based instruments, auction-based allocation in the government securities market (GSM), and phased capital account. Such a closely monitored development of the financial market is essential in an emerging and developing economy such as India to avoid financial instability, which is likely to occur otherwise (Gopinath, 2008).

Literature Review

Conceptual framework:

The various stages and the steps involved for the development of financial markets of a country are broadly outlined in this section. ii. Behavioural relationship between macroeconomic and financial environment: This section discusses how developments on the macro-economic front in India impact its financial markets, depicted through changes in key macro-economic and financial variables during 2003–2013. iii. Stylised facts on financial markets developments: This section outlines the phased development (since 1990) and the current defining statistics of the four financial markets that are the focus of this study. iv. Financial market integration in an economy: This section discusses the importance, the associated benefits and risks, and the measures for the integration of financial markets.

Empirical Analysis

Behavioural relationship between macroeconomic and financial environment: The relationship between macro-economic fundamentals and financial market variables is evaluated in this section. ii. Liquidity, volatility, and efficiency of four financial markets: The depth, stability, and efficiency of the financial markets that are the focus of this study are assessed using corresponding indicators and statistical variables.

Cross-correlation analysis to evaluate level of market integration: The co-movement of various indicators is analysed to understand the level of integration and impulse transmission from one financial market to another. This assessment is done for a decade (2003–2013) and on a temporal basis (pre-crisis, crisis, and post-crisis). The analysis also includes a
comparative assessment of cross-correlation studies conducted at different timeframes to understand the evolution of market integration.

Motivation for development of domestic financial market segments In response to the 1997 Asian crisis, the development of the domestic bond market became significant not only for fund channelization but also for the diversification of the external sector risk in the financial system (Reddy, 2002). In general, governments are motivated by different factors for developing the domestic bond market. For instance, the Singaporean government viewed it as a means of financial intermediation for credit allocation, while the Hungarian government was motivated to reduce monetisation of the government deficit and increase competitiveness in the banking sector (that possessed wide spreads between deposits and advances) to encourage foreign investment. Whatever be the motivation factor, the macroeconomic fundamentals of an economy do impact the performance of its domestic financial markets to a certain extent.

International financial market integration refers to an increase in capital flows and a tendency for prices and returns on internationally-traded financial assets to equalise on a common-country basis. The validity of various international parity conditions—purchasing power parity (PPP), covered interest parity (CIP), uncovered interest parity (UIP), and real interest parity (RIP)—provides a direct test to analyse the degree of international market integration. On the other hand, indirect tests include the measurement of the degree of correlation between national savings and investments (Jain and Bhanumurthy, 2005). This paper, however, deals only with the analysis of the integration levels of domestic financial markets.

Behavioural Relationship between Macroeconomic and Financial Environment

Post the 1991 balance of payments crisis, the Indian economy really opened up to the outside world. The end of the License Raj, the liberalisation of the economy in terms of bold economic reforms, and globalisation for true economic developments were the key changes of this era. India reaped the benefits of these reforms in the truest sense during the 2003–2008 global bullrun. The Indian economy was growing at a stupendous rate of 8.7% on average (Table 1), wholesale price index (WPI) and consumer price index (CPI) inflation were at normal levels, the government had negative primary deficit, the current account deficit was just 0.3% of the gross domestic product (GDP), foreign inflows—foreign direct investments (FDIs), foreign institutional investments (FIIs), and non-resident Indian (NRI) deposits—were high, the import cover was at 14 months, and there was a net increase in the foreign exchange reserves of the economy. Truly, it was the golden period of the Indian economy.

The 2008 financial crisis, whose epicentre was the U.S., had repercussions on the entire world. India’s initial reaction to the global meltdown was that since it was a closely-monitored and decently regulated economy, it should remain insulated from the crisis, unlike many other countries of the world. However, this was only the partial truth. By this time, the Indian economy had integrated well enough with the global economy to feel the effects of this slowdown. The export sector of the Indian economy was significantly impacted because both the key markets for exports—the U.S. and Europe—were reeling under the effects of the crisis. Slowly and steadily, the Indian economy also started feeling the impact of the crisis. The GDP growth rate dropped to 6.7%, WPI and CPI
levels were high, reserve money fell to 6.4%, the CAD/GDP and government deficits increased, and there was a decline in the net capital inflows, which ultimately resulted in a fall in the foreign reserves.

The true impact of these developments was felt when the financial indicators in the domestic economy started showing signs of distress. Short-term borrowing rates shot up, the turnover of the GSM dropped, and the overall liquidity of the system was impacted. In order to address these developments, the Indian authorities made adjustments in the policy rate (the repo rate decreased from 6.8% to 5.0%) to increase, or rather to sustain the money supply in the system. Circumstances improved over the next couple of years, only to deteriorate once again in 2012–2013. This time, though, the crisis was more due to domestic reasons. However, the impact of the fragile global economy cannot be neglected. What remained constant during both these difficult times was that distress in the macro-economic indicators was quickly translated to distress in the financial indicators. Thus, it would not be incorrect to comment that there is moderate correlation/co-movement between the macro-economic indicators and the financial indicators of the Indian economy. This study includes an empirical analysis to test this hypothesis.

CONCLUSIONS

The price difference in these two markets is stationary and the speed of mean reversion varies according the stock. Roughly the result conformed to the law of one price reasonably. We suppose that arbitrage opportunities appeared to exist when stock-brokering houses trade for their own accounts, obviously with no transaction costs.

References


