"Divide and Conquer? Decentralized Firm Structure May Promote Cooperation"

I consider a model in which an entrepreneur's objective is to maximize cooperation in a multidivisional organization. In order to do so, the entrepreneur can choose the number of production units in a profit center. The profit centers may rely on their long-term relationships with one another for cooperation. I use a repeated games setting that endogenizes the cooperation decisions. I show that in certain cases, in contrast to the common wisdom, decentralization may promote cooperation. In particular, I show that the stronger the interdependencies among units are, the smaller the optimal number of units in each profit center. I further use this setting to examine efficiency gains of mergers and acquisitions. Efficiency gains of a merger are below the value of synergies between the acquiring firm and the target when the ties are not strong enough to sustain cooperation. However, the potential synergy between an acquiring firm and a target may be an underestimate of the efficiency gains of a merger when the ties are sufficiently strong to cause a firm to shift from a noncooperative to a cooperative equilibrium. I characterize these cases and draw policy implications.