

## **Economics Seminar, Indian Statistical Institute, New Delhi.**

**SPEAKER:** Debdatta Saha, Doctoral Student, Indian Statistical Institute (Delhi)

**TITLE:** Does the Market Kill Bad Ideas? An Institutional Comparison of Committees and Markets in Networked Industries

**TIME:** 9:50-11:00 A.M.

**DAY & DATE:** Friday, 22nd August 2008

**PLACE:** Seminar Room 2

### **Abstract:**

Network externality is a dominant feature of some hi-tech industries like telecommunication and internet. Coordination is required among different market participants for standardizing different incompatible protocols for accomplishing transactions. In the absence of coordination, multiple incompatible protocols emerge reducing the utility of the end consumer. Ex-ante coordination can be achieved through de-facto standardization in markets or through formal committees. Existing literature shows that formal committees outperform the market in achieving coordination even though the committee design limits it to be a pure “cheap talk” institution designed exclusively for achieving coordination. This paper analyzes the problem of protocol coordination between two firms, where one firm has private information about its own protocol which it might or might not reveal. The model formalizes the coordination and information revelation mechanisms of the market and the committee in a two-period game. The institutional characteristics of the market and the class of strategies adopted by the firms admits multiple equilibria in the market. Of these, one particular equilibrium has an interior information revelation cutoff for the firm with private information. These equilibria demonstrate that the market might not be able to “kill bad ideas”, but it might “reward good ideas”. In contrast, the institutional design of the committee ensures that the same class of strategies gives rise to a unique equilibrium in the committee, with the informed firm revealing all private information. The committee game results generalize easily to N-periods. Overall probability of coordination is higher in the committee than in the market. Comparative statics are carried out to distinguish the role of information revelation and coordination in the committee and the market. The paper concludes with some indications about the appropriate design of the committee in the context of network externality and asymmetric information.

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