Production in general equilibrium with incomplete markets by Pascal Christian Stiefenhofer: A comment

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Main Intuition

- Financing production capacity is tighly connected to short run production efficiency;
- Firms have to raise money to finance capital expenditures;
- They endogenously create a stock market to generate the necessary cash flow;
- The objective of the firm, profit maximization, links production efficiency with financial market.

Interpretation of the Results

Results:

- Incomplete markets is a consequence of technological uncertainty;
- Ownership structure is independent from production control.

Why?

- Once we fix the objective of the firm to profit maximization, we imply the independence of the ownership structure from production.
- Technological uncertainty is somehow compensated by the endogeneity of the financial market, so the usual argument of the difference in the valuation of production by owners (Grossman and Hart, 1979; Allen and Gale, 1988) does not fully apply.
- Firms issue stocks up to the point where ownership is independent from production, but not enough to insure all the uncertainty out. They maximize profits, independently of consumers' insurance.

Implications

The very origin of the results is then the assumption of profit maximization.
What if the objective of the firms was different?

- Separation of ownership and control (Berle and Means, 1932)
- Agency problems: imperfect control of shareholders on manager's decisions.
- Solution: corporate governance and financial contracts.
- Nevertheless, corporate control frictions, i.e., inefficiency. Examples:
    - costly external finance (Kiyotaki and Moore, 1997);
    - free cash flow: total return net of contractual payments to investors (Jensen, 1986).

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