

WHAT DO MANAGERS DO (TO BUILD COMPETITIVE ADVANTAGE)?

**THE DEVELOPMENT OF RELATIONAL CONTRACTS
& THE ORIGINS OF ORGANIZATIONAL CAPABILITY**

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A progress report on joint work with
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Draft Only:

And I really mean it! This paper is still very much in a preliminary state – more the sketch of a paper than the finished thing. In particular, I am acutely aware that I have attempted to summarize – or at least draw from – several large and disparate literatures. In the process there is a very real risk that I have neglected important papers and/or mischaracterized existing research. If you find this to be the case, **please let me know**. I welcome your comments.

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Abstract

While there is widespread agreement in the strategy literature that organizational competencies are a potentially potent source of sustainable competitive advantage, our understanding of how they are developed and why they are difficult to imitate remains incomplete. This paper develops the hypothesis that many (most?) strategically important organizational competencies are the fruit of “relational contracts” – implicit agreements both within and across firm boundaries that serve to support “the way we behave around here” -- that have been developed through an evolutionary process that has taken both time and sustained managerial attention.

We argue that the construction of a relational contract requires all parties to understand “the terms of the deal” – the mutual expectations inherent in the contract-- and to believe that the contract will be “enforced”. Learning about the terms of the contract – and about whether it will be enforced – occurs in a context in which there are usually many relational contracts in play simultaneously – between senior and middle management, between management and employees, and between the firm and its suppliers, for example – and that is often changing in significant ways. Most well established relational contracts therefore reflect a complex process of path dependent learning that makes them very difficult to imitate.

We close by suggesting that this hypothesis not only offers a powerful explanation for the difficulty many firms experience in attempting to imitate important organizational competencies but that it also represents a potentially fruitful way of thinking about what it is that managers *do*. Much of the existing strategy literature implicitly that managers create competitive advantage through their analytical skills and decision making capabilities. In contrast, a focus on relational contracts suggests that managers may also create advantage through their ability to frame, build and maintain relational contracts. It is also intriguingly consistent with a persistent thread in the literature that identifies “trust” and “integrity” as critically important managerial qualities while offering insight into why simply announcing a policy of high trust behavior or embracing the use of commitment is unlikely to lead to superior performance, and why the empirical work in the area has obtained such inconclusive results.

