

Remarks on the Economics of Organizational Design

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“Organization Design: Current Debates and
Future Opportunities”

Harvard Business School

Economist Designers

- Pigou -- Tax and Subsidy Schemes
- Lange, Lerner -- Planning Mechanisms
- Hurwicz -- Mechanism Design, Matching
- Vickery -- Auctions, Market Design

- Mostly about markets
- What about managed organizations, firms?

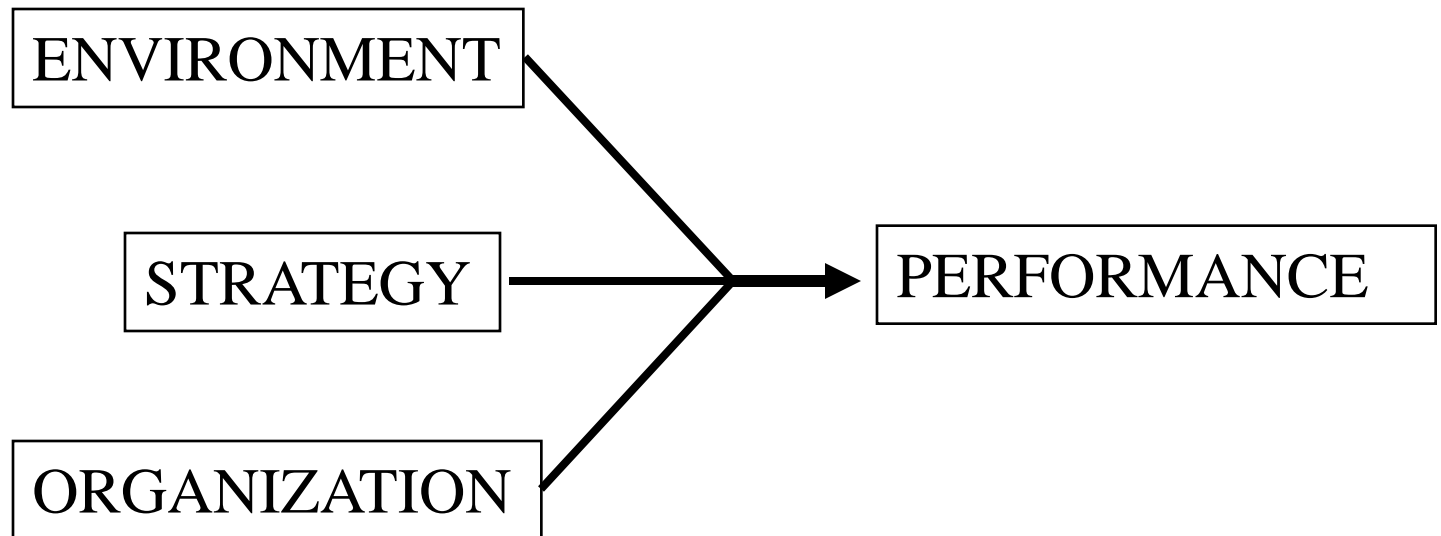
Economics of Organization in Economics Departments

- Rare, not a recognized, established field – the firm as a black box is believed to suffice for most questions
- Focused on Coasian question: Why are there firms and what determines what is handled inside them?
- Largely positive

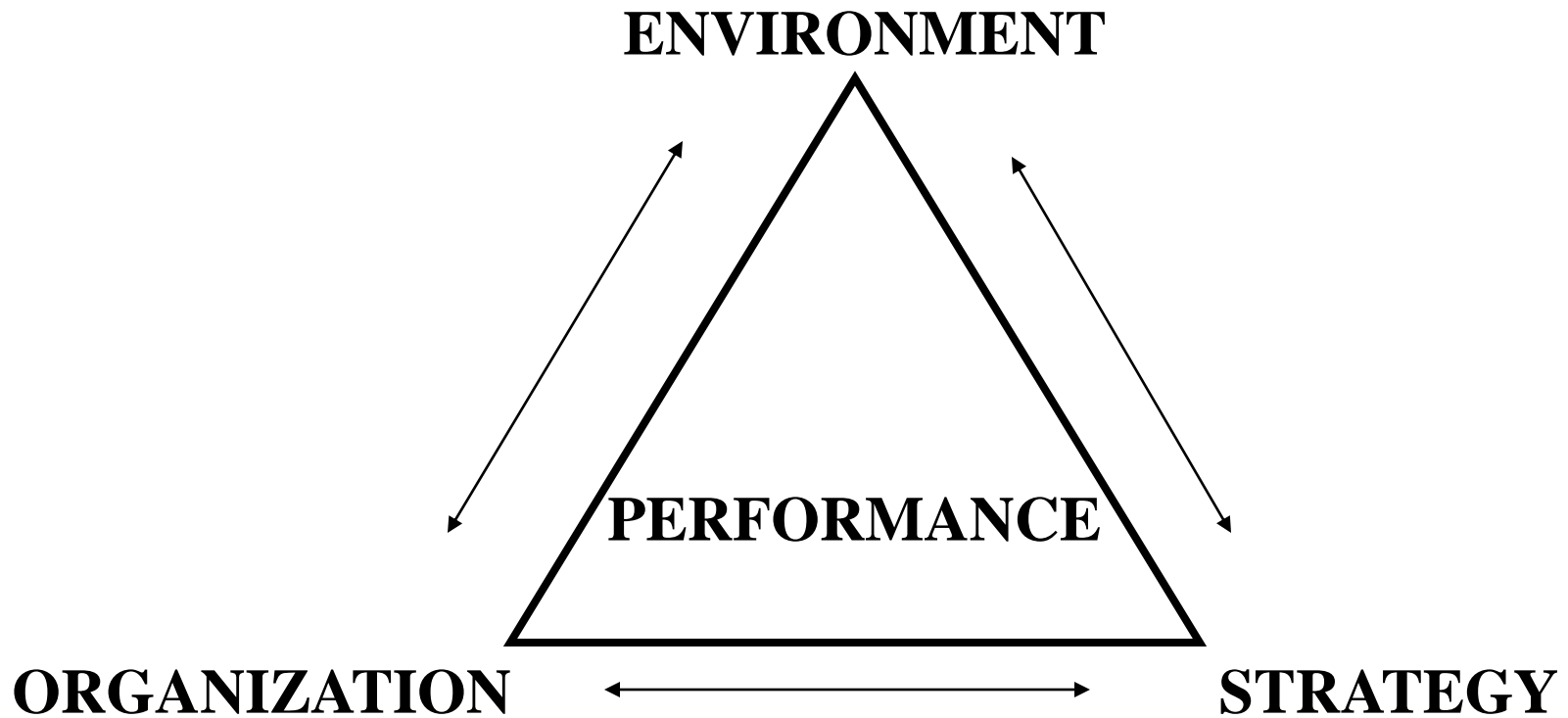
Economics of Organization in Business Schools

- Increasingly common because manifestly important
 - Economics
 - Corporate Finance
 - HRM
 - Managerial Accounting
- Broader focus
- Normative edge

My Model of Organization Design



Performance and Fit



Environment

- Customers
- Competitors (actual and potential)
- Suppliers
- Complements and substitutes
- Technology
- Social, legal, regulatory, environmental; government and NGOs

Strategy

- How will we win? How will we get control of our destiny?
- Business strategy
 - How will we create value in this business and get to keep some of it?
- Corporate strategy
 - What business portfolio? How will we create value by having these businesses under common ownership and our direction?

Strategy

- Goal
- Scope
 - What, where, how, for whom
- Competitive advantage
 - Cost and quality/differentiation
 - Position and capabilities
- Logic
 - Why it will work

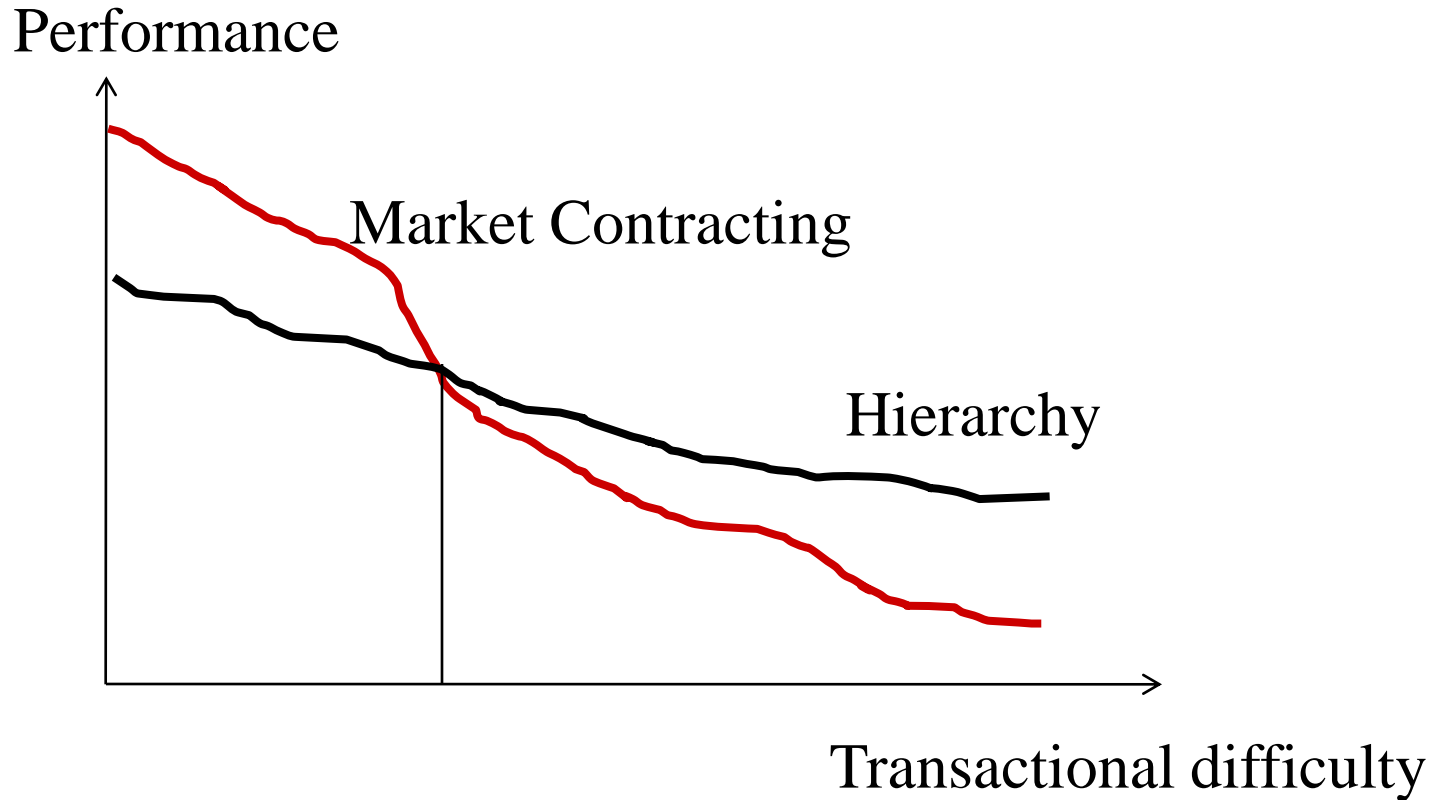
Organization

- The means through which strategy is realized and executed
 - “Structure follows strategy.”--- Alfred Chandler
- Sets the context for strategy
 - Organizational inertia means organization and administrative heritage constrain strategy choices
 - Capabilities are embedded in the organization
 - Incentive and info systems generate strategic choices
 - “Our organization is our strategy.” --- John Browne, BP

Why Managed Organizations?

- Coordinate and motivate people in the context of interdependencies
- Why not use the market?
- Failures of market dealings and simple contracting
 - Information asymmetries
 - Bounded rationality
 - Externalities and public goods
- Managed organizations may handle interdependencies better

Coase Meets Heckman (Introduced by Gibbons)



Taxonomy of the Elements of Organization: PARC

- People
- Architecture
- Routines, Processes and Procedures
- Culture

PARC: People

- Their intelligence, skills and abilities
- Their motivations and fears
- Their attitudes to life, work and risk
- Their personal and professional interests
- Their networks and the relations they have with others

PARC: Architecture

- Formal structure --- What's on the org chart
 - Grouping of tasks into jobs, jobs into units, units into departments/divisions,...
 - Hierarchic authority/reporting structure
 - Allocation of decision rights/responsibility
- Boundaries of the firm
- Financing, ownership and governance

PARC: Routines

- Formal and informal procedures, processes, routines that determine
 - How work is done
 - How information is gathered and disseminated
 - How resources are allocated
 - How performance is measured and rewarded
 - How decisions are made

PARC: Culture

- Shared values, beliefs, mental models, language, norms
 - Why are we in business? What really matters?
 - How do we interpret observations and actions?
 - What do we mean by various words?
 - How do we act towards one another and outsiders in different situations? What can we expect from one another?

The Design Problem

- Leaders can manipulate all the elements of PARC in creating an organization
- Dimensionality and interactions
- Differences in speed, control

Speed, Control

Fast
Sure

Slow
Uncertain

Architecture

Routines

Culture

People

Where is This Going?

- *Handbook of the Economics of Organization*, Robert Gibbons and John Roberts, eds. Princeton U.P. forthcoming 2010.
- Attempt to coalesce the field, establish its legitimacy and encourage much greater interest in it among economists.

Handbook of Org Econ

Table of Contents

- Foundations
- Methods
- Within Firms: Individuals and Groups
- Within Firms: Structures and Processes
- Between Firms
- Beyond Firms

“Foundations”

- Brynjolfsson and Milgrom on Complementarities
- Gibbons and Roberts on Motivation in Organizations
- Segal and Whinston on Property Rights
- Tadelis and Williamson on Transaction Cost Economics

“Methods”

- Baker on Clinical Studies
- Camerer and Weber on Experimental Methods
- Ichniowski and Shaw on Insider Econometrics

“Individuals and Groups”

- Baron and Kreps on the Employment Relationship
- Bolton and Dewatripont on Authority
- Hermalin on Culture and Leadership
- Lazear and Oyer on Personnel Economics
- Waldman on HR Systems and Career Dynamics

“Structure and Processes”

- Azoulay and Lerner on Innovation & Org'n
- Bloom and van Reenen on Productivity, Organization and Management
- Garicano and Van Zandt on Coordination and Hierarchy
- Gibbons, Henderson, Repenning and Sterman on Capabilities and Management

“Structure and Processes” (2)

- Hansmann on Legal Forms of Organization
- Mookherjee on Incentives in Hierarchy
- Roberts and Saloner on Strategy and Organization
- Gertner and Scharfstein on Resource Allocation
- Zingales on Corporate Governance

“Between Firms”

- Bresnahan and Levin on Vertical Integration
- Johnson and Schoar on Organizations in Emerging Economies
- Kornhauser and MacLeod on Contract Law and Economics

“Between Firms” (2)

- LaFontaine and Slade on Evidence on Vertical Contracting
- Malcomson on Relational Contracts
- Menard on Hybrids

“Beyond Firms”

- Banerjee and Mullainathan on Corruption and Public Governance
- Moe on Government Agencies