



IN THE SHADOW OF THE CROWD

A COMMENT ON VALVE'S WAY

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There are many ways to exercise authority. Perrow (1986), in his review of March and Simon's *Organizations* (1958), offers a threefold classification of the ways authority can be exercised in organizations: (1) direct, "fully obtrusive" controls such as giving orders and direct monitoring; (2) bureaucratic controls such as defined specializations, roles, and hierarchy; and (3) "control of the cognitive premises underlying action." Valve ostentatiously makes little use of direct authority. It downplays bureaucracy, although in fact many bureaucratic controls are in place. Instead, the legal authority vested in the owners of the company (especially the majority shareholder, Gabe Newell) is used quite extensively to set the premises of action and thus unobtrusively channel employees' efforts and communication patterns into a highly productive configuration. The sustained high profits of the company, and its ability to attract and retain talented software developers, are testimony to the success of this organizational model. At the same time, contextual variables – in particular Valve's identity as a video game creator and the fact of a single majority shareholder – are also critical factors contributing to its success. As a result, even within the software industry, the range of companies for which this organizational model is appropriate is quite limited.

Puranam and Håkonsson (2105) have provided a succinct overview of Valve's public face as presented in corporate publications such as the *Handbook for New Employees* (Valve Corporation, 2012) and employee blogs. The most obvious anomaly at Valve is the absence of direct, obtrusive authority over the effort of employees. The authority to direct the work of employees is the legal right of any employer (ALI, 2007). It is also the foundation of two influential theories of the firm (Simon, 1951; Williamson, 1975). Yet Valve publicly and emphatically disavows this right.

VALVE IS DIFFERENT

I would like to look more closely at Valve's special position in the software world. Valve makes and distributes video games. Games are a leisure time activity, an entertainment, a form of art, and for some people, an addiction. Large numbers of people "pay to play", and Valve is in direct contact with many of them. (Valve claims the ability to reach 25 million gamers through the Steam distribution platform.) Video games have considerable intrinsic value to gamers, and the subset of the gaming population that is capable of creating or modifying games obtains both use value and prestige from their creations. Although I am not aware of any formal study, it is rumored that, just as scientists accept lower pay to work at universities (Stern, 2004), many software developers will accept lower pay to work at game studios. For a significant subset of people with coding skills, it is more interesting and personally satisfying to be able to say "Yeah, I programmed the explosions for Real Action Game X," than "Yeah, I programmed the payments system for Bank Y."

What this means is that the human capital available to Valve outside the employment relationship is much larger than that of a typical company, including most software companies. Great numbers of people are willing and able to work on Valve's projects without contract, for free. In this respect, Valve resembles an open source software community – with the

key difference that, at its core, it is a profit-making enterprise. This shadow workforce also constitutes a fairly overt threat to Valve's employees and layoffs have occurred.¹

Valve's employees, at least those who code for a living, must provably do something the crowd cannot do. Shirking, if it compromises one's productivity, is not an option. Solving mundane problems does not warrant continued employment. Trying but failing to solve difficult problems is probably not a good idea either, unless your work is considered strategic and you are sure of the backing of your peers.

Thus, as a company, Valve enjoys an unusually favorable position in its labor market. It can crowdsource many features of a game for free from avid customers. It can pick and choose its employees from a deep pool of talented people who see intrinsic value and artistic merit in games and/or derive pleasure from solving problems posed by game construction. In these circumstances, there is simply no need to use direct authority for coercive purposes. Direct authority – giving orders and checking up on effort – is a blunt motivator that often backfires by alienating workers, making them sullen and resistant.

Whether it is in software or some other line of business, a company that can access large amounts of skilled effort for free for transient or mundane jobs and pick and choose its permanent employees on the basis of their intrinsic motivation, talent, and "fit" with the organization does not need to use direct authority as a motivator. Indeed, Valve is not alone in this respect: Freeland and Zuckerman (2014) argue that, to elicit identification, high-performing enterprises in the modern economy generally must make visible commitments to limit their use of hierarchical authority, especially direct supervision and close surveillance. Thus, the challenge for Valve's senior managers, particularly Newell, is to get the balance of "unobtrusive controls" just right, so as to elicit "consummate performance" from its employees (Freeland & Zuckerman, 2014; March & Simon, 1958; Perrow, 1986).

In summary, a parsimonious explanation of Valve's employment practices is as follows: (a) Valve has access to low-cost (free) human resources for much of its work and therefore can afford to be choosy in selecting its permanent workforce; (b) within its boundaries, Valve aspires to be a high-performance enterprise able to elicit identification and "consummate performance" from employees; and (c) high-performing enterprises generally commit to limit their use of direct authority and close surveillance because these practices alienate employees, undercutting their performance. Therefore, as a high-performing enterprise, Valve does not use direct authority or close surveillance as management tools but relies instead on selective recruitment and various other unobtrusive controls to direct the work of its employees. This argument can explain Valve's peculiar and happy circumstances, but it does not speak to the general question of organization design for software firms. In particular, what advice can we give software companies that are not surrounded by a large crowd of people eager to work for free? What about companies that do not aspire to "consummate performance" but perhaps only to "competent performance" or "competitive performance?" Does direct authority work in these cases? We must look beyond Valve and its very special circumstances for answers to these questions.

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¹ <http://www.forbes.com/sites/danielnyegriffiths/2013/02/13/layoffs-at-valve-senior-staff-among-rumored-reported-departures/>

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