Framework 2: Managing via 3 Lenses

In hard problems, Formal is Flawed, Relational is Required, Build an Equilibrium

Managing via Three Lenses (1.0)

Formal
machine planning

Political
contest power

Cultural
institution habit

Need all three!

Three Lenses on Org. Processes

Design
Organizations are machines
An organization is a mechanical system crafted to achieve a defined goal. Parts must fit well together and match the demands of the environment.
Action comes through planning.

Political
Organizations are contests
An organization is a social system encompassing diverse, and sometimes contradictory, interests and goals. Competition for resources is expected.
Action comes through power.

Cultural
Organizations are institutions
An organization is a symbolic system of meanings, artifacts, values, and routines. Informal norms and traditions exert a strong influence on behavior.
Action comes through habit.

Need all three!

- Can’t have two views of a formula
- Might have two views of a promise
- Then need “cultural” work towards shared understanding

One economist’s view of part of grey!

R. Gibbons, Feb. 2021
Managing via Three Lenses (1.1)

Managing via Three Lenses (1.2)

Managing via Three Lenses (1.3)

Managing via Three Lenses (1.4)

Managing via Three Lenses (2.0)

Managing via Three Lenses (2.1)

Managing via Three Lenses (3.0)
Managing via Three Lenses (3.1)

Formal machine planning

FORMULA

no implementation challenges

Cultural institution habit

STORY

Political contest power

PROMISE, RELATIONAL CONTRACT

If contracts were perfect, would we tolerate discretion?

Need all three!

Managing via Three Lenses (3.2)

Formal machine planning

FORMULA

no implementation challenges

Cultural institution habit

STORY

Political contest power

PROMISE, RELATIONAL CONTRACT

If contracts were perfect, would we tolerate discretion?

If promises were clear, why not use contracts?

Managing via Three Lenses (4.0)

Formal machine planning

FORMULA

no implementation challenges

Building relational contracts involves cultural work.

Cultural institution habit

STORY

Political contest power

PROMISE, RELATIONAL CONTRACT

If contracts were perfect, would we tolerate discretion?

If promises were clear, why not use contracts?

Framework 2: Managing via 3 Lenses

If contracts were perfect, would we tolerate discretion?

Allocation of control=exercise of control

If promises were clear, why not use contracts?

Building relational contracts involves cultural work.
Summary of Formal + Relational

a) Problems where formal instruments (alone) do poorly are hard.

b) Discretion differs from a formula in two important respects:
   (i) under discretion, someone has a choice, whereas under a formula, nobody has a choice; and
   (ii) under a formula, there is a shared understanding of how things will proceed, whereas under discretion, there may not be a shared understanding of how things should proceed.

c) In theory, discretion can help solve the problems that rules alone create—for example, by increasing a bonus when low output was not the worker’s fault, or decreasing the bonus when high output was due to luck.

Summary of Formal + Relational

d) In practice, there are long-standing relational contracts that have been key sources of competitive advantage (such as decentralization at J&J).
   - A relational contract is a shared understanding of the appropriate exercise of discretion (or, in different words, of the parties’ roles in and rewards from collaborating together).
   - The “shared understanding” of J&J’s relational contract about decentralization probably could not have been enforced by a court.

e) In practice, there can be substantial hiccups (or worse) in building or updating relational contracts—recall Lincoln going overseas or CSFB or Oitcon. In this sense, building relational contracts that support appropriate exercise of discretion is a key managerial challenge.

Alternative Summary

1) We are studying the economics of goods and services actions that cannot be cleanly transacted via pricing. Such transactions can arise both within organizations and in other organized settings.

2) Formal interventions—such as formal incentive plans, or formal allocations of control via org charts or contracts or ownership—may be useful but in hard problems are unable on their own to induce consummate performance. (Indeed, this inability might be the definition of a “hard” problem.)

3) Discretion (i.e., power or control over something) is almost everywhere: bosses have discretion over many things, but subordinates do, too; likewise for headquarters and divisions, and for the firms in supply chains or alliances or joint ventures.

4) Numerous high-performing organizations seem to owe much of their success to abiding by promises about the appropriate exercise of discretion—consider the bonus at Lincoln (before going overseas), empowerment at J&J, the “ProPub” system at Merck, and the relationship between Crown Equipment and Richardson Smith, as just four examples.

5) Among experienced members of these organizations, these promises seem to have passed both the credibility test (“Should I believe the promise I understand you to have made?”) and the clarity test (“Do we have a reasonably shared understanding of the promise you just made?”)

6) If these promises were simple to state, they could have (and should have?) been contracts. Thus, we should expect it to be very difficult to pass the clarity test—probably involving ongoing rather than one-shot managerial attention (in part because new members will join the organization, but also because the environment will change and the old understanding, if taken literally, may now be inappropriate).