Framework 1: “Market” “Failures”

Besides Markets: Governance of Value Creation

Coase, 1991
Ostrom & Williamson, 2009
Hart & Holmstrom, 2016

Nobel ≠ Managerial Relevance

Organize the Right Problems

Different transactions require different safeguards — under different governance structures.

Gibbons, 2000

Different transactions require different safeguards.

Gibbons, 2000
Lessons

1. If the organizations you observe seem less efficient than the markets you observe, consider that they may be handling different problems.

2. If a contract will handle your problem well, why use a boss?

3. If a contract would do poorly, you face a hard problem, so a boss might do better but still not be perfect.

“Sometimes fiat is more efficient than haggling.”
Williamson, 1971
Many Formal Governance Structures

<table>
<thead>
<tr>
<th>Multiple Orgzns</th>
<th>One Orgzn</th>
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<tr>
<td>&quot;spot market&quot;</td>
<td>Functional</td>
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<tr>
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Alternative allocations of control / decision rights?

Visible Hands:

Governance of Value Creation

in Firms

and Beyond

Invisible Hand?

As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value, every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was not part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.

Economics beyond the invisible hand?
Which Interactions Are Governed?

Transaction difficulty

Effectiveness

100%

Integrated

(ILLUSTRATION)

Non-Integrated

interactions are priced

Invisible Hand

Visible Hands

Transaction difficulty

(illustration)
Which Interactions Are Governed?

Effectiveness

100%

Integrated

(ILLUSTRATION)

Non-Integrated

interactions are priced

interactions are “governed”? Transaction difficulty

“substantially the same factors that are ultimately responsible for ‘market’ failures’ also explain failures of internal organization.” (Williamson, 1973)

Value creation in markets vs. in firms

Governance of non-integration

Governance vs. pricing

Do not “bring the market inside the firm (or even the alliance)”

Many Formal Governance Structures

Multiple Orgzns

“spot market”
Alliance
Joint Venture
Consortium
...

Alternative allocations of control / decision rights?

One Orgzn

Functional
Divisional
Matrix
“Networked”
...

Not providing recipe for Make vs. Buy

Am proposing “habits of mind”

What collaboration are we trying to implement?

What are the alternative formal governance structures?

What do they achieve?