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Economic Man Versus Organization Man

Markets and Hierarchies: Analysis and Anti-trust Implications: A Study of the Economics of Internal Organization, by OLIVER E. WILLIAMSON. New York: Free Press, 1975. 286 pp. $14.95 cloth.

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Attempts to develop an interface between sociology and economics have been numerous. For example, the evolution of "pure" sociological thought to the contemporary developments involving social exchange (e.g., side payments, distributive justice, social commodities, etc.) reflects increasing stress on the rational foundations of social structure and change concepts such as power, conflict, disintegration, and deviance. It is not clear to what degree economists are aware of these sociological developments, but I have a strong suspicion that their awareness is not great. Likewise, we can ask to what degree sociologists are aware of the work on the other side of the fence. "Institutional economics," which has adopted a broader view of the nature and scope of economics by treating the economic process as part of a complex social system, is a case in point. But even orthodox economics has moved away from the limited focus on utility and self-interest—movement exemplified by the work in information economics which deals with the incomplete availability of relevant information and the asymmetry or inequality of information among exchange partners. This information imperfection can account for market inefficiencies when the price can no longer be construed as a pure "condensation" of objective information. Such lines of thinking have induced many economists to consider regulating the market to neutralize the inequities or to speculate about alternate mechanisms for establishing more efficient allocation of resources. In brief, economists have moved into areas that many sociologists would claim as theirs.

Williamson's *Markets and Hierarchies* clearly represents an interface treatise by an economist who writes about sociology. Since he presents a concise, coherent, and powerful framework that will greatly enhance our thinking about complex organization, corporate conspiracy, public and business policy, and regulation, his book should find its way onto the shelves of any sociologist who is involved in these areas. Williamson's framework—called the "organization failures framework"—deals with a disaggregated microeconomic analysis of the transactional processes characterizing the distribution of activity within and between complex organizations. The framework explores the substitutability of organizations for markets whenever transactional factors favor the former over the latter. The author presents an argument parallel to social exchange theory (although Williamson may not be aware of its existence). Like exchange theorists, he emphasizes the delicate equilibrium between trust and market, integration and conflict, and involvement and opportunism that characterizes human interaction systems. But unlike exchange theorists, he does not limit himself to the social psychological level of human interactions but throws his net widely, ranging from employee-employer to inter-firm relationships. Indeed, the book displays such an extraordinarily high density of ideas that it is difficult to provide a superficial but fair and veridical overview. Basically, the choice between markets and organizations is predicated upon the information imperfections that are associated with exchange relationships. In an efficient market with many participants, the price (or any other exchange parameter) conveys all the necessary information. If the market becomes inefficient, that is due to the emergence of incomplete, biased, and inconsistent information. The reasons for such imperfection are numerous. A frequent reason is "small numbers" (e.g., oligopoly). Small numbers invite opportunistic behavior such as bluffing and making of false threats and promises. If information were fully available, small numbers would not induce opportunism, but markets often become tainted by "first mover" events that eventually create a lack of information parity. (For example, Miller was the initiator of "light" beer, Texas Instruments of electronic calculators, and New York's New School for Social Research of university departments with European-style intellectuals.) The information inequality is due to the lagged differences in learning curves. Individuals or firms in small numbers markets who take the first action obtain an immediate strategic advantage over the other parties; they begin to learn at an earlier point in time and therefore possess comparatively more information. The subsequent information asymmetry constitutes a second reason for market failures. The informationally deprived parties may have to incur prohibitive cost for restoring knowledge parity. Examples of this "information impactedness" can range from episodes in the armaments race between the U.S. and U.S.S.R. to differences in organizational innovation. Williamson refers to the so-called "moral hazard" phenomenon, illustrated by the person who buys fire insurance and then becomes negligent about fire safety. When small numbers with inadequate knowledge prevail, there is an incentive for opportunism and contract breaching. If intelligence is expensive or difficult, there is little chance to determine the extent of contract breaching.

Finally all these conditions aggravate the uncertainty and complexity of the market. The uncertainty may often exceed the information processing capabilities of the parties. Whenever these market failures surpass some threshold, Williamson suggests that there is movement from markets to "hierarchy," i.e., formal organizations.

Formal organizations alleviate the failures inherent in markets. Compared with markets, they can effectively monitor the behavior of the membership, and they possess quasi-judicial mechanisms for resolving conflict. Since they have elaborate information and control systems, they have created conditions of near perfect information, and even if the participants are few in number, there is therefore little incentive for strategic behavior. Also, compared with the limits of the human mind, organizations are far superior in their information processing capabilities, because they have the resources to process complex information sequentially. Organizations are also based on trust and cooperation and are a preferable remedy for inefficient exchange relationships.

The framework does not only apply to the individual but also to the inter-firm level, particularly when specialized firms can no longer cope with the flawed markets in which they operate. When firms experience market failures (either on the supply side or the selling side), they should consider vertical integration. Vertical integration represents mergers between buyers and sellers to realize larger aggregate or joint profits. Through vertical integration, the resulting larger firm can create an all-encompassing information system and bring the previously adversary parties together into a hierarchical system based on trust and cooperation. In Williamson's framework, vertical integration is the response of specialized firms which are technologically separable but transactionally interdependent.

This book is likely to be very influential for future developments in the field of occupations and organizations. Like any other novel, provocative, and penetrating attempt to reconceptualize human behavior, it has some strengths and weaknesses. One of its major strengths is the merger of economic and sociological literature while invoking the information paradigm, so that the book emits a unified social science. The paradigmatic foundation of this analysis is noticeable in every paragraph and allows the reader to connect a diversity of apparently unrelated or dissimilar phenomena. Yet, by the same token, the strong reliance on a single paradigm gives an impression of one-sidedness. The book exaggerates the benefits of organizational information systems and tends to ignore or superficially deal with the limits and unanticipated consequences of such systems. It tends also to be superficial in the treatment of conflict, deviance, and distortion of information inside the organization. It is also uneven in quality depending on whether the author deals with interpersonal, intergroup, organizational, or inter-organizational relationships.

The book is very strong when the author deals with higher levels of aggregation, but the analysis of lower levels (e.g., peer groups and smaller, specialized one-product firms) is rather one-sided and reveals a shallow and mechanical description of the social reality in groups and organizations. Williamson views formal organizations as "internal labor markets," in which it is inefficient to bargain individually. Organizations would suffer if their memberships were to bargain about any rule or procedure, hierarchical commands, or the legitimacy of sanctions. As a system, they enjoy efficiency gains when the participants arrive at a social contract—a collective agreement—and each one of them complies with the agreement. To achieve the subordinates' compliance to rules and hierarchical orders, organizations must establish mechanisms for monitoring their behavior. Naturally, as Williamson asserts, they are comparatively well equipped to process information and to develop a language to disseminate information. The abundance of information also alleviates inequality in information holding among the membership. Furthermore, the collective agreements in organizations have built-in adjustment clauses such as grievance procedures, which permit adaptation to unanticipated consequences too unpredictable or too complex to be dealt with at the time of bargaining. Finally, internal reward systems—including upward mobility inside the organization, in conjunction with the acquisition of firm specific, nontransferable skills ("task idiosyncracies")—induce the participants to exceed minimum or "perfunctory" performance levels, thereby reinforcing attachment to the internal labor market. All this is very rational and does not require any reference to authority, legitimate power, and other Weberian concepts.

This analysis contrasts nicely with Stinchcombe's comparison of craft and bureaucratic organizations and the whole literature on the professional-bureaucratic conflict. Stinchcombe concluded that craft organizations (e.g., construction companies) have relatively little hierarchy, as measured by the percentage of clerical workers, because craftsmen and professionals have undergone extensive training and professionalization. The internationalization of work values and norms promotes self-direction and decreases the need for formal coordination and control. Stinchcombe argued that because relevant skills and abilities are craft or profession specific, the participants derive their rewards from their status in the craft or profession and not from administrative/hierarchical rule. Williamson's employer relationship analysis stresses the above mentioned "task idiosyncracies," which tend to make the participants in the organization local rather than cosmopolitan. Being local makes them rather immune to the exchange inefficiencies of the external labor market and thereby benefits the organization.

Unfortunately, it is not always clear what Williamson means by "the" organization; it is a system characterized by rationality, efficiency, and effective information/control mechanisms. It comprises various parties which are held together by joint commitments to pursue the organizational goal. He is rather coy in elaborating on how an organization defines its goal and how it solves the problems of assessment and evaluation. In his organizations, there is surprisingly little concern with interhierarchical and interdepartmental conflict, power differences, coalition formation, and differences in values, goals, and preferences among all the interest groups. It is also ironic that someone who is so concerned about information is oblivious of its equivocality in organizations. Indeed, Williamson is a far cry from recent information-based conceptualizations (e.g., Weick, March, and Olsen) which treat randomness, equivocality, ambiguity, and hypocrisy as central aspects of formal organizations. He begs the issue of selective evaluation and the frictions in the exchange relationship between evaluator and evaluatee. It is not difficult to recognize that organizations are a political stage where participants make all kinds of social exchanges and acquire organizational "gamesmanship" skills. In Williamson's organizations, we do not encounter such a stage, perhaps because such an approach would have required him to incorporate market-like relationships *within* the organizational context, even if such relationships are blurred by opportunism, information withholding, ambiguity, and uncertainty. Recent work by economists, accountants, and organizational consultants has recognized such quasi-market behavior and has legitimized its organizational existence. Examples of this are goal-setting procedures, cost and profit centers, and transfer pricing systems.

In all fairness, it should be stated that the author is sensitive to organizational imperfections. Perhaps the impression given by this book is due to his simple but sharp dichotomy of markets versus organizations with little ground in between. It may be analogous to those glib debates in social exchange literature on the subject of marriage. Some have stressed its peer/organizational nature (marriage is an enduring bond based on love, trust, shared values, role complementarity, etc.) while others have stressed its market-like nature (the only difference between marriage and prostitution is the duration of the contract and the amount of money involved). It is more likely that marriage has aspects of both. But rather than synthesizing market and organization perspectives, Williamson tends to discount marketlike aberrations in formal organizations. This shortcoming is clearly illustrated by his treatment of the "distortion" (p. 125) which occurs whenever an organization's compliance machinery fails adequately to evaluate performance. In Williamson's framework, "distortion" conveys the meaning of aberration or marginal flaw and never gets drawn into the core of his organizational analysis. He refers to organizational size as the culprit for such distortions, which can be conveniently alleviated by creating a divisionalized structure. Such structures are a remedy for increased complexity (due to size), which sets limits on the administrative component to approximate a "distortion-free internal exchange." In Williamson's view, multidivisional firms enjoy the control benefits of small functionally-organized firms while at the same time allowing the firm to grow beyond a size-imposed ceiling.

In the middle section of the book, Williamson deals with inter-firm structures and seems at his best. This is the area in which he is best known among economists. He compares multidivisional firms (e.g., General Motors) with conglomerates (e.g., ITT). This comparison yields numerous interesting hypotheses. For instance he considers whether these forms of inter-firm organizations have different implications for competition, social welfare, and public policy. The rise of horizontal and vertical mergers and the emergence of conglomerates has drastically altered our socio-economic environment. The cure for market failures by organizational men may be worse than the disease, especially from a social point of view.

Williamson is rather bold and sweeping when he deals with the complicated issues of competition, collusion, and regulation. Like the previous chapters, the latter part of the book is so innovative, provocative, and stimulatina that it requires us to reconsider many assumptions, beliefs, and findings. For example, unlike dominant monopolies whose divestiture he favors, he is rather critical of the so-called *shared* monopoly assumption in oligopolies, since oligopolistic firms do not have the advantages of (monopoly) organizations. Their collusive behavior has all the transactional difficulties that one can imagine. They do not have the undisputed legitimacy to enforce collusive agreements nor the intelligence apparatus to monitor conformity. The implication is that many forms of "invisible" inter-firm organization such as cartels, interlocking directorates, the military-industrial complex, and "spheres of influence" are very deficient in regulating inter-firm transactions. Therefore there is little reason for anti-trust agencies to undo these "invisible" forms of organizations. Thus it is somewhat striking that Williamson tends to exaggerate the amount of organization inside the organization and to de-emphasize the amount of organization in oligopolies or the corporate world in general.

Some of the interesting statements at the end do not seem to follow logically from the organizational failures framework. One wonders whether agencies mandated to engage in trust-busting do not themselves suffer from deprivation of information and are incompletely informed about a dominant firm's market power. Even at this level, Williamson tends to shy away from political issues by focusing exclusively on rational efficiency considerations. The regulatory bureaucracy would appear to be a primary arena for interest groups to make their presence known, but Williamson again conveys the image of a Big Brother who makes rational judgments about allocative inefficiencies due to trust-like behavior. Nevertheless, his analysis invites many new hypotheses. One area of investigation might be the significance of "invisible" inter-firm organizations as a remedy for exchange deficiencies between the self-interest-seeking firms as well as their significance from a public interest point of view. Another topic might be the role and effectiveness of anti-trust agencies—the intelligence problems which their personnel encounter; the stage that they provide for all the interest groups involved; the intelligence function that they perform for the courts, the press, sociological researchers, and last but not least, for the very firms that are subject to possible trust-busting.

Many more novel themes can be spelled out, and perhaps that is the single most important function of the book. It is sometimes tedious and difficult to read, but it is highly rewarding. Like James Thompson's *Organizations in Action*, it will be rewarding even after a second or third reading; the digesting of such a voluminous set of ideas becomes subject to our own information processing limits!