

2022 IESE-ECGI Corporate
Governance Conference

Corporate Governance, Corporate Culture and the Board's Culture

Visible Hands Building Equilibrium

Naming (and Framing?)

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MIT and NBER



Outline

- 1) Visible Hands exist w/in orgs & btw orgs
- 2) Promises are made (by VH) w/in orgs & btw orgs
- 3) “Rel Con” offer one way to analyze some promises
- 4) Horseshoe? (vs. mgr’l task & empirical expectation)
- 5) w/in or btw, Rel Con can have credibility & clarity pbms
- 6) next steps: Naming (and Framing?)

Background:

My obsession:

What can an economist do to help a fixed set of parties collaborate better?

Possible answer:

- Describe concept & role of equilibrium
- Facilitate parties in building one
- [• Intra- or inter-organizational]

		Investment Characteristics				
		Nonspecific	Mixed	Idiosyncratic		
Frequency	Occasional	Market Governance (Classical Contracting)			Trilateral Governance (Neoclassical Contracting)	
	Recurrent				Bilateral Governance (Relational Contracting)	

FIGURE II
MATCHING GOVERNANCE STRUCTURES WITH COMMERCIAL TRANSACTIONS

“I submit ... that substantially the same factors that are ultimately responsible for market failures also explain failures of internal organization.

If this contention is correct, the study of alternative modes of economic organization can proceed in a symmetrical fashion. Rather than having to devise a separate apparatus for each organizing mode, a common language and conceptual apparatus can be brought systematically to bear across modes.” (p. 316)

Williamson 73

Stinchcombe 85

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Not Anonymous Pricing (Mechanism)

A. Within one organization (beside firm)

- Hospitals, schools, agencies
- Legislatures

(Weingast-Marshall 88)

B. Not within one organization

- Contract, alliance, ... (Richardson 72; Williamson 79; Stinchcombe 85)
- Communities (Landa, 81; Greif 89; Ellickson 91; Bernstein 92)
- Polycentric governance (Ostrom 90)
- Other “strange animals” (Thorelli 86; Powell 90, Ménard 96)

- *Non-integration is often not “the market”*

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VH Do What Contracts Cannot?

- Coase 37
 - if markets were perfect, would we need firms?
 - **if contracts were perfect, would we need bosses?**
- Barnard 38
 - “... no principle of executive conduct better established in good orgzns than that orders will not be issued that ... will not be obeyed.” (p. 167)
- March 62/63
 - “The Business Firm as a Political Coalition” (1962)
 - “Just as [the manager] needs to predict and attempt to manipulate the ‘external’ environment, he must predict and attempt to manipulate his own firm.” (Cyert-March 63: 206)
- Mintzberg 04
 - Analysis vs. Administration

Q: analogs *not* w/in 1 org?

Build an (Imperfect) Equilibrium?

- Nelson & Winter 82 (Ch. 5, on Routines as Truce)

path-
dependence



“the terms of a truce can never be fully explicit [They become] defined by a shared tradition arising out of the specific contingencies confronted and the responses of the parties to those contingencies. ...

[A] contemplated action otherwise sensible both for the organization and for the member taking it may have to be rejected if it is likely to be interpreted as ... signaling a lessened commitment to the preservation of the truce

inefficiency

Adaptations that appear ‘obvious’ and ‘easy’ to an external observer may be foreclosed because they involve a perceived threat to internal political equilibrium.” (p. 111)

(Some) Modern Evidence

- Ethnography: when should (& do) surgery residents go home?





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- Ethnography: delegation of voice (but not decisions) → how to demonstrate listening?






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Do what contracts cannot?

Build an equilibrium?

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- Ethnography: delegation of voice (but not decisions) → how to demonstrate listening?
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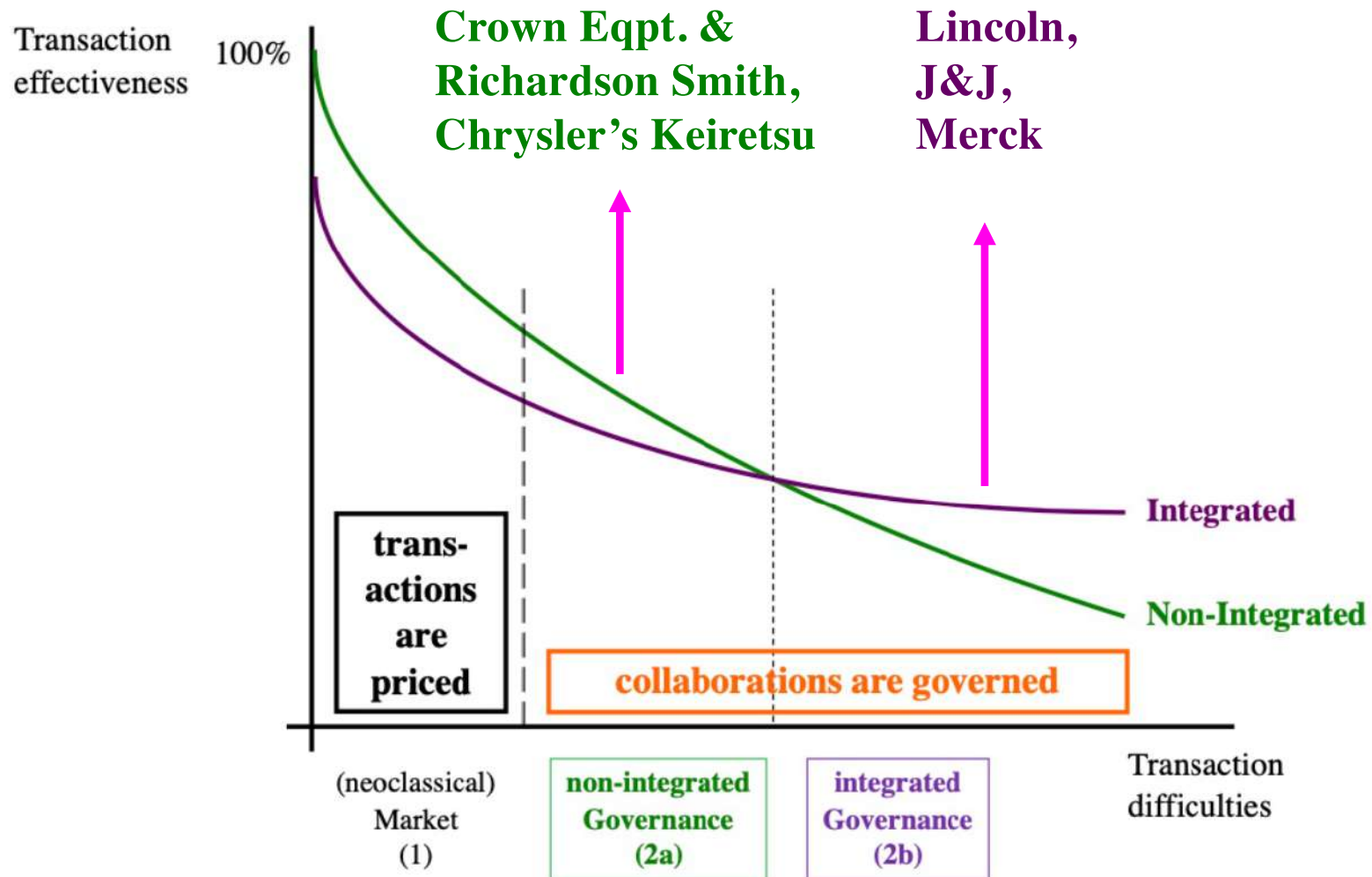
Relational Contract (n.)

- A promise you can believe in
- A shared understanding of the appropriate exercise of discretion.
- A shared understanding of parties' roles in and rewards from collaboration (so rooted in the details of the parties' relationship that it cannot be shared with a court)
- An equilibrium of a repeated game (with transfers?)

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Mgr'l Task, Empirical Expectⁿ



Surely an alliance can have a culture.

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Clarity / Naming / K-T Pbm

- Sunday night!
 - VH rel cons *can't* be clear (initially)?
 - Knowing-Telling Pbm for strategies—eg, $a_i(s)$

“Did we miscommunicate,
or am I being gamed?”

Organization Science

Vol. 23, No. 5, September–October 2012, pp. 1350–1364
ISSN 1047-7039 (print) | ISSN 1526-5455 (online)

informs

<http://dx.doi.org/10.1287/orsc.1110.0715>
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Relational Contracts and Organizational Capabilities

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A large literature identifies unique organizational capabilities as a potent source of competitive advantage, yet our knowledge of why capabilities fail to diffuse more rapidly—particularly in situations in which competitors apparently have strong incentives to adopt them and a well-developed understanding of how they work—remains incomplete. In this paper we suggest that competitively significant capabilities often rest on managerial practices that in turn rely on relational contracts (i.e., informal agreements sustained by the shadow of the future). We argue that one of the reasons these practices may be difficult to copy is that effective relational contracts must solve the **twin problems of credibility and clarity** and that although credibility might, in principle, be instantly acquired, clarity may take time to develop and may interact with credibility in complex ways so that relational contracts may often be difficult to build.

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Stories (AER P&P 2020 w/ L. Prusak)

- Organizations full of stories
- Organizational economics, not so much

Stories not only important empirically – also a clue to what orgs are and how they might be managed?

- Bruner (1986), “Two Modes of Thought”

There are two modes of cognitive functioning, two modes of thought, each providing distinctive ways of ordering experience, of constructing reality. The two (though complementary) are irreducible to one another.

...

They differ radically in their procedures for verification. ... The one verifies by eventual appeal to procedures for establishing formal and empirical proof. The other establishes not truth but verisimilitude. (p. 11)

- Bruner (1991): brain *and* domain

“... [M]ost of our knowledge about human knowledge-getting ... is drawn from studies of how people come to know the natural or physical world rather than *the human or symbolic world*.”

... [W]e do not achieve our mastery of *social reality* by growing up as ‘little scientists,’ ‘little logicians,’ or ‘little mathematicians.’

... [W]e organize our experience and our memory *of human happenings* mainly in the form of narrative (p. 4, emphasis added)

Story Naming Equilibrium?

- What *are* stories? $s \rightarrow a \rightarrow y$
 - (rare) example? fictional?
 - legs: one point defines a line? (eg, Nordstrom)
- What do stories *do* (here)?
 - which action in which states (promised, desired, ...)
- If equilibrium involves shared interpretation (of what to do now)
- And if interpretation depends on tacit knowledge
- And if a good story can leverage or transfer tacit knowledge
- Then stories may play a role in building equilibrium

Framing (→ K-T Pbm)

Framing / Categorization / Interpretation

- What situation is this? (Goffman, 1974; March & Olsen, 1983)

Culture and Framing

- Nisbet (2003)
- “the basis of all cultural knowledge is our capacity to categorize” (Patterson, 2014: 8)
- “a culturally provided set of categories” (Denzau and North, 1994: 5)
- “regulative” versus “constitutive” (DiMaggio, 1997: xx)

Organizational culture and Framing

- “system of terms, forms, categories and images [that] interprets a people’s situation to themselves” (Pettigrew, 1979: 574)
- “mindsets and frames of reference ... [that are] invisible and to a considerable degree unconscious” (Schein, 2010: 14)

Different shared frame → different K-T Pbm for given strategies?

Need Models! (& Expts, ...)

- Knowledge in economics (& frames in economists?)

- “Facts only dent a theorist’s hide.” (attributed to P. Samuelson)
- “Like it or not, ... [in economics] the influence of ideas that have not been embalmed in models soon decays.” (P. Krugman, 1995: 27)

- **Goal: “miscommunicate, or being gamed?”**

- Models of K-T Pbm (but not of stories):

- Message might not arrive (Bolton-Dewatripont 13 on Dessein-Santos 06)
- Can’t discuss (states, actions) until observed together (Crawford-Haller 90, Blume-Franco 07, Ellison-Holden 14)
- Other limits on communication (Lizzeri-Siniscalchi 08)

- Models of Narratives (but not K-T Pbm):

- Stories change utility / create incentives / change beliefs (Akerlof et al. 20, Bénabou et al 18)
- “Narratives” as causal models (Eliaz-Spiegler 20)
- Epidemic models of diffusion (Shiller 17)

- Models of something like frames:

- (Common knowledge of) Coarse info aware
- (Single agent) Rational inattention aware
- (Single agent) Learning under misspecified model unaware
- (Single agent) Categorization (Mullainathan et al 08) unaware
- Transmission of collective memory (Dessi 08)
- Competing models (Schwartzstein-Sunderam 21, Olea et al. forth; Eliaz-Spiegler 20)
- [In] Subjective eqbm (Fudenberg-Levine 93, Jehiel 05, Esponda-Pouzo 16)

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Academy of Management
“Governance of Interorganizational Relationships”
August 9, 2022