THEORIES OF ORGANIZATION

Core Course – PhD Program in Management

University of Lausanne – Faculty of Business and Economics

Spring 2013 – Classes from 8:15am to 11:45

(Thursdays in the morning; First class: Feb 28, 2013)

Please notice that there is NO CLASS in the first week of the semester
(February 21)

ROOM: Extranef 118

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<th>Professor Jean-Philippe Bonardi</th>
<th>Professor Christian Zehnder</th>
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<td>Faculty of Business and Economics</td>
<td>Faculty of Business and Economics</td>
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<tr>
<td>Tel: 021 692 3440</td>
<td>Tel: 021 692 3681</td>
</tr>
<tr>
<td>Email: <a href="mailto:Jean-Philippe.Bonardi@unil.ch">Jean-Philippe.Bonardi@unil.ch</a></td>
<td>Email: <a href="mailto:Christian.Zehnder@unil.ch">Christian.Zehnder@unil.ch</a></td>
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<td>Office: 604</td>
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Course website available at:

https://www.hec.unil.ch/docs/czehnder/cours/274/2013
Starting assumption: This is a course about the fundamental aspects of theories of organizations that can be (and are) applied to any sub-disciplines in management. “Specialization seminars” in Organizational behavior, Strategy, Marketing, Management science, Operations management or Information systems will follow.

A focus on economics-based theories of organizations: Many of the theories of the firm invoked in management research have been adopted from, or have been substantially influenced by, the literature in economics, psychology and sociology. The most influential of these, however, are economic-based theories. This is why we will concentrate mostly on these here, even though we will also try to contrast them with other approaches (or discuss the potential benefits of other approaches from time to time).

In this course we will therefore analyze in considerable detail the leading theories of the firm including transaction cost economics, Austrian economics, agency theory, property rights theory, relational approaches, evolutionary approaches, and behavioral approaches. By analyzing alternative theoretical perspectives and debates among them, we will develop our understanding of the strengths and shortcomings of alternative theoretical frameworks for understanding business enterprises. We will conclude by considering some of the directions in which management and economics research might go in an attempt to overcome some of the difficulties that have been encountered in theorizing about what is arguably the most critical economic institution in advanced industrial economies.

Learning objectives: This course is a doctoral level seminar on the major theoretical approaches looking at organizations. The main objective of the course is to familiarize you with the basic assumptions, concepts and theories underlying the management field. Because this field is an evolving subject area and undergoing continual change, be forewarned: the boundaries of the field are fuzzy, subjective, and open to interpretation. In addition, the topics and readings are only a subset of those with which doctoral students need to be familiar. The course is intended to provide you with an exposure to some of the major theoretical ‘lenses’ underpinning the field and some of the major issues to which they are applied. You need to explore further, beyond the topics listed here and their required readings. Our objectives for the seminar are the following:

1. Each student should develop a mental model of the literature on organizations and show an understanding of and appreciation for its key concepts and theories.
2. Each student should be able to communicate both verbally and in writing, current knowledge, critical evaluations and new ideas regarding the theories developed in this seminar.
3. Each student should develop new ideas and/or approaches that advance some portion of the theory/research on organizations.

Approach: The format of the course is that of a research seminar, meaning that you will be assigned a weekly reading list followed by intensive group discussions. Each student contributes to the success of the class. Even one student who is not actively engaged or disruptive can undermine the collective potential of the class. Therefore, each one of you has to be prepared for each class. Simply reading the material is not enough—you must also evaluate this material, criticize it, and analyze how it fits with other literatures.

Each session will be devoted to a particular topic. For each session, a discussion leader will be determined. We will assign sessions to students during our first class, if possible.
The role of the session leader will be the following:

- Introduce the class by presenting a few slides regarding the theory that will be covered during that class, and how that theory relates to the ones we saw in previous classes.
- Select the order in which the papers will be discussed.
- Prepare questions to guide the discussions of each paper (and hopefully lead to a better understanding of the papers, what they add and their limitations).

We have kept the weekly required reading list relatively light, so that we can dig deep into each of the readings. Most of the readings are drawn from major peer-reviewed journals in social sciences. There are four types of articles that you will encounter during the course: 1) ‘classics’ that provide you with an understanding of the origins of particular theories and debates as well as an understanding of the evolution of scholarly thought; 2) survey articles that review the major contributions in the field; 3) theory articles that dive deep into a specific aspect of the week’s readings; and, 4) contemporary empirical pieces that apply and test an aspect of the theory. In addition, you will also have a list of recommended readings (indicated ‘Further Readings’ in the list below) that we encourage you to at least skim before class, but we do not expect you to read these papers in detail for class.

Some of the papers that we cover in the course rely on formal models. We understand that many of you do not have extensive training in mathematical modeling. So, we expect you to concentrate on understanding the main assumptions and mechanisms of the theories instead of formally solving the details of the models. However, in most cases understanding the papers requires that you process the formal arguments up to a certain degree. Therefore, it is essential that you exert some effort and do not give up when you encounter the first mathematical difficulties.

In our class discussions, we will start broad, ensuring you understand the assumptions, predictions, and boundary conditions of the theory. Then, we’ll dive deep into further readings to help to build your critical thinking skills. This places an enormous burden on you to be able to analyze the big picture, while at the same time drilling into details.

**Course Requirements / Evaluation:** Every session, you will submit at least one piece of written work. As explained below, we will not grade these submissions, but rather the overall quality and the evolution of your analytical skills over the time of the course. The focus is on development, not on assessment. We care less about your abilities at the start of the course, and more about your ability at the end of the course, which is when the final assessment is made. During the course, we expect you to be provocative, take risks, and uncover your own style. The course is aimed at developing you, not at evaluating you. This type of environment facilitates a healthy cooperative environment. But please don’t let the quality or timeliness of your work slip below the minimum standard. We will let you know if this should be the case.

There are several components to the class, which are described below.

**Classroom Contribution (40%)**

You are expected to participate actively in every class. Comments should be inquisitive, thoughtful, and insightful. To make such comments, you will have to prepare well for class and listen carefully to
the discussion. You are encouraged to challenge ideas, not individuals. Classroom discussions should be fun, provocative and enlightening.

Each class will start with a general question of the following sort: what did you think about this session's readings? Here, we look for you to express your (dis)satisfaction with the theoretical lens being considered with supporting reasons. On the heels of this general discussion, we will move into a detailed discussion of each paper on the required reading list.

Everyone is expected to have a thoughtful opinion, and if you don’t volunteer your ideas, you will be called on to do so. Keeping silent is not an option.

As well, only emergencies should keep you away from class. If you know you cannot make one of the class dates, then let us know and we will change the date of the session. Each class covers an important theory, so missing a class really is debilitating.

As a student, you will also be asked to take the lead of the discussion in one class. How well you handle this exercise will also have a significant impact on your contribution grade.

Reflection Papers (20%)

By the end of the day prior to the class (i.e., every Wednesday evening say 7pm), you must submit to both of us by email a 1 to 2 page (max) reflection paper. The very first line of the paper should have your full name (left centered) and the Session number (right centered).

The first assignment is therefore due for Wednesday February 27 at 7pm.

This reflection paper should do two things:

1. Summarize what you see as the core content of the papers assigned for the session.
2. Express your personal opinion on the readings: what do you find interesting, what is dissatisfying or missing.

We will not grade each of these reflection papers, but rather your ‘overall production’ over the course of the term. Again, the focus here is on your development rather than on punctual evaluation.

We will also use the papers to help guide the discussion. They are useful in telling us the areas that are not fully understood and the areas that intrigue you. Please feel free, in these reflection papers, to raise issues that you would like to have discussed in class.

We know that you put in a lot of effort in preparing these reflection papers, and they may seem like a lot of work. But the analytical skills, communication skills and knowledge that you will acquire through this process will serve you well in your comprehensive exams and throughout your career. This process will also help to contribute to a more lively, thoughtful and relevant class discussion.

You can choose to opt out of this assignment two times during the course; however, we strongly encourage you to avoid doing so. It is inevitable that you will not have much confidence in the theoretical area(s) that you miss. However, each of us sometimes confront lumpy workloads, family-related issues, or personal illness or emergencies that make it difficult to write a reflection paper. If
you choose to opt out of a reflection paper, you must send us an email message before the class, so we know that you are exercising this choice. Without this email message, we will invoke the penalty for lateness.

Late or missing reflection papers will result in a penalty to your final course grade.

Final Assignment: Project presentation and Discussion (40%)

A detailed outline of a research idea based on the theories seen during the course is due at the end of the semester. The work must be original and relevant to one (or several) of the management disciplines.

We have really two ‘main options’ in mind regarding this research idea:

- It could be a project that would identify some limitations in the theories we have covered in class, and would try to make a contribution by developing these theories further (as you will see, most of the papers we will study attempt to do this, in that they build on each other and try to overcome the limitations of previous works). This type of paper would be theoretical in essence, but could also explore ways through which the new theory could be tested.

- It could be a project applying the theories of organization discussed in the course to real issues. We have no restrictions about what these issues can be, but examples could be questions such as: How does corporate branding affect vertical integration decisions? Or: How do the CSR policy and outsourcing decisions of an organization interact with each other? Or also: How do contractual reference points affect the supply chain management? (Again, these are just examples; we expect good and innovative ideas from you!).

The project might involve various stages that you will show to us, but only the final outcome will be graded. There are a number of reasons for developing the project in stages. First, the project-developing process is less intimidating and oblique when we take it in stages. Second, you are forced to think earlier about the project, which means your ideas will have matured as the deadline approaches. Third, we can discuss each stage along the way in class, so that there is much more learning.

We will discuss the expectations of each submission in class, but here is a brief description of how you could structure your thinking.

1) Research question. Expressed in a few sentences, the research question states succinctly the phenomenon you want to look at and the question that your project will attempt to answer.

2) Literature review. This should be a mix of the papers we have covered in class and other papers that you have found and which apply to your topic.

3) The project itself. This is the core of your idea. You can propose a new theoretical approach (this theory can be conceptual or you might even try to formalize it a bit if you like and feel able to do it) or you can propose an empirical study design that allows you to perform a clean test of a theoretical hypothesis in a particular context.

4) Presentation of the ideas. Every student will be asked to present the topic and main ideas behind his/her paper during the last two classes of the course (i.e., in June 2013). This will be an opportunity for everybody to not only clarify her or his own ideas, but also to get feedback (from
the class and the professors). Each student will play two roles. In one class, the role of a presenter (of its own research project) and in another the role of a discussant (of somebody else’s project).

5) **Full project outline.** The full project outline is due on June 23 (i.e., one week after the end of the course itself). You can hand in the outline in Powerpoint (or a similar) format. The outline should not exceed 15 slides.

**Details of the sessions**

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**No class on February 21**

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**Session 1: Introduction and Classics of the Theory of the Firm (February 28)**

In the first part of this session we will provide a general outline and overview of the course (methods, objectives, etc.). In the second part of the session we will discuss three classic papers on the theory of the firm. To benefit from the session it is important that you read these three papers in detail. They will provide an important basis for much of what is following in the later sessions.

You should start with the Coase paper. This article is essentially the starting point for the whole literature on the theory of the firm. Coase raises the two fundamental questions around which our course will be organized: “Why do firms exist?” and “Why is there not only one big firm?” Coase also provides first answers to these questions. Simon’s paper investigates whether there is a fundamental difference between a typical sales contract and the employment contract. Both Coase and Simon identify authority as a decisive element of the firm. Alchian and Demsetz criticize the authority based view of the firm and propose an alternative approach.

**Required readings**


Session 2: Market Process, Entrepreneurship: Early explanations for why firms exist (March 7)

In the second session, we will go back to one of the streams (generally called Austrian economics) that has done the most, historically, at comparing various institutional systems and what they bring to individuals. In particular, Austrians became quite famous at the beginning of the 20th century through their defense of market systems (versus proponents of planned systems, something that remains known as the 'socialist calculation debate'). A key question that emerges from the first paper below is 'why do market systems exist, and why/how are they often superior to planned systems?'.

Building on answers provided by Austrians to this question (which are nicely summarized in the Boettke et al. paper), the two other papers (which are much more recent) explore implications for the theory of organizations (why are certain market exchanges organized through market transactions, while others are internalized within firms?).

We will see how Austrians can be seen as precursors of some of the questions that will appear only much later in the literature, but also how Austrians can be seen as offering a view that is still distinct today, and which explains their recent revival in economics and management studies.

Required readings


Further readings


Session 3: Transaction Cost Economics (March 14)

Oliver Williamson has built the transaction cost economics approach based on Coase’s early insights. However, Williamson adds important new elements, in particular the notions of incomplete contracts and the relationship-specific investments. Adding these new feature provides important new insights and allows to give new answers to the questions raised in Coase’s 1937 paper.

The paper by Gibbons provides a summary of the achievements that transaction cost economics has delivered so far and gives an outlook on interesting future research in this area. Please focus on the second part of the paper where Gibbons mostly talks about future directions. However, it is also interesting to read the first part, because – as you will see – Gibbons offers a somewhat different perspective on this research.

Required readings


Further readings


Session 4: Property Rights Theory (March 21)

The focal reading for this session is the chapter in Oliver Hart’s book, which introduces property rights theory. You will realize that the general framework of the property rights approach is very similar to the one of transactions cost economics. However, there are important differences. In particular, although both theories emphasize the importance of relationship-specific investments, each theory identifies other determinants of vertical integration and outsourcing. Please try to identify the differences between the theories and how this affects their implications for practice.
The first part of Hart’s 1989 paper discusses established theories of the firm (neoclassical theory, agency theory, and transaction cost economics etc). This part of the paper is very interesting, because it highlights achievements and shortcomings of these different theories. The second part explains how the property rights approach makes progress in those areas in which the other theories have limitations.

Tirole (1999) identifies a specific problem in the assumption underlying the property rights model. Here it is enough if you succeed in understanding the problem in a general way. Don’t lose too much time with the theoretical details of the paper. We will do a simple example in class. Baker, Gibbons and Murphy (2002) move the property rights framework into a dynamic context. As you will see this adds a few interesting new insights. It is useful if you understand the basic idea of the paper and its implications. It is not necessary to go too much into the details, though.

**Required readings**


**Further readings**


**Session 5: Empirical Evidence on TCE and Property Rights Theory (March 28)**

Lafontaine and Slade (2007) provide a very nice review of current state of the empirical literature on transaction cost economics and property rights theory. The paper covers evidence on two central questions. The first question is “which transactions should be vertically integrated?”, the second question is “what are the economic consequences of integration?”. In this course we will focus on the first question (i.e., you need to read section 2 very carefully, but you can essentially ignore
section 3 of the paper). Acemoglu et al. (2011) and Woodruff (2002) are interesting examples of studies in which transaction cost economics and the property rights approach are directly tested against each other. Please read them carefully. Baker and Hubbard (2004) is a creative empirical application of property rights theory. Here, it is useful if you understand the basic idea of the paper. We will not have the time to discuss the details.

Required readings


Further readings


EASTER BREAK (No session on April 4)

Session 6: Contracts as Reference Points (April 11)

The most important paper for this session is Hart and Moore (2008). It is an attempt to formalize ex post costs of incomplete contracts using ideas from behavioral economics. Please read it carefully and try to understand how it contributes to our understanding of firm boundaries. Fehr et al. (2011) is an example of how experiments can be used to test the basic mechanism of the theory. We will not really go into the details, but it is useful if you study the design of the experiment carefully, so that you can decide for yourself whether you find the experimental approach helpful or not. Hart (2009) is an important extension of Hart and Moore (2009). For the theory of the firm, it is even more interesting than the first article. Please read it carefully and try to understand how the theory explains vertical integration.
**Required readings**


**Further readings**


**Session 7: Agency Theory and Explicit Incentives (April 18)**

This session will move our exploration of why firms exist in a slightly different direction: instead of focusing purely on transactions, we will start looking at the costs of firms’ internal organization and how these costs relate to the incentives which are not always convergent among different players in an organization. The focus will be put on what is now universally called ‘the principal-agent framework’.

Milgrom and Roberts (1992) is a simple textbook introduction to the principal-agent framework. If you are not yet familiar with this type of model, this is where you should start. Once you understand the “incentive intensity principle”, you know the central mechanisms of all these models. Holmstrom and Milgrom (1992) (in particular, section 3.3) and Gibbons (2005) (in particular, sections 1.3 and 2.1) are papers which show how the principal-agent model can be used to build a theory of the firm. While you should mostly focus on understanding the message of the sections specifically mentioned above, it is not possible to read these sections without also reading the sections on which they build.
Required readings


Further readings


Session 8: Evidence on Agency Theory and Explicit Incentives (April 25)

In this session we discuss different empirical applications and tests of agency theory. Lazear (2000) Lo et al, and Bitler et al. (2005) are studies using field data, Falk and Dohmen (2011) is a laboratory experiment. Please read all four papers carefully and try to identify advantages and weaknesses of each of the presented empirical methodologies.

Required readings


Further readings


Session 9: Relational Contracts (May 2)

All three papers in this session use very similar frameworks (the notation is a bit different across papers, but the general reputational forces that are at work, are always the same). Please try to understand the central mechanism and the focal message of each paper. This does not require that you go through all the formal details. However, it is much easier to understand the idea of these papers if you look at one of the formal models in a bit more detail (the Baker et al. 1994 paper is probably the best candidate for a somewhat deeper inspection).

Required readings


Further readings


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Ascension (No session on May 9)

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Session 10: Implicit Incentives and Alternative Motivators (May 16)

Falk and Fehr (2002) and Fehr et al. (2009) are survey articles. They give a good overview of the literature and you should read them carefully. The other three papers are examples of single studies in this field. All three are experimental papers (field and laboratory) which are relatively easy to read. So, please go through all of them, so that we can discuss and compare them in class.

Required readings


Further readings


Session 11: Back to Production: Firm Capabilities (May 23)

In this session, we will consider another rationale for why firms exist: the development of internal capabilities that make certain firms more efficient than others at producing goods or services. Instead of focusing purely on transactions or on internal incentives, this literature builds on ideas related to evolutionary biology and argues that organizations develop internal routines which can make them superior to markets.

This view is nowadays quite popular in management studies but perhaps less well structured or formalized than some of the literature we have looked at before. We will discuss its merits and how it might be moved forward in the future.
**Required readings**


**Further readings**


**Session 12: Empirical Evidence on Firm Capabilities: (May 30)**

This session will look at empirical papers trying to test the capabilities view of the firm.

**Required readings**


Session 13 and 14 (June, Dates to be determined): Paper Presentations and Course Wrap-up

No required readings for this class.

TBA

For these two sessions, students will either present their research project or be discussant on another student’s project.