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POINT OF VIEW

Why managers matter: the paradox of organizing

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Abstract
Building on Nicolai Foss and Peter Klein's recent book, *Why Managers Matter: The Perils of the Bossless Company*, and on its central argument that solving the problems of organizing (i.e., the division of labor and the integration of efforts) requires some form of hierarchy, I offer some observations on the relationship between organizations' pursuit of social goals and the potential emergence of non-traditional hierarchical structures. I also provide a purposefully simple theory explaining why social organizations may incur over-governance and unnecessary internal transaction costs due to their preoccupation with minimizing the negative externalities of cooperation and coordination failures. Hence, I illustrate the importance of embracing a paradoxical approach to organizational design to solve this tension and its link with the advent of new hierarchical forms.

Keywords Authority · Hierarchy · Transaction costs · Social goals · Paradox

Bosslessness is a trendy concept that captures how a number of scholars and thinkers contend organizations will look and be (un)organized in the future. According to the bossless company narrative, hierarchical structures will be displaced by flat organizations (or flatlands), peer-to-peer networks, and self-organizing teams, and management will disappear in favor of distributed leadership and worker democracy.

As Nicolai Foss and Peter Klein describe in their recent book *Why Managers Matter: The Perils of the Bossless Company* (2022), the supporters of bosslessness assume it to be the direct consequence of three ongoing transformations: (1) technology, representing a more efficient and less faulty means to manage transactions among and provide information to organizational agents; (2) unprecedented levels of environmental uncertainty and dynamism, which make the problem of organizing—i.e., the division of labor among and the integration of organizational agents' efforts—intractable; (3) an increasing human desire for dignity, autonomy, and democracy.

In light of these contingencies, are traditionally structured hierarchical businesses really predestined to become relics of an earlier era? Throughout their book, Foss and Klein persuasively explain why this is likely not the case. They present an unobjectionable argument against the bossless company narrative. Although radically decentralized organizations do exist—for instance, the authors discuss in detail the cases of W. L. Gore, the Mondragón Corporation, Morning Star, Oticon, Semco, and Valve—and, in some cases, thrive, there is no systematic evidence to allow us to reliably conclude that these structures are superior to traditional hierarchical ones. In contrast, the authors argue that, in the current knowledge-based, networked, and dynamic world, hierarchy and authority are becoming more important, not less.

While the book's presentation style, which involves the inclusion of numerous real-world examples and illustrations, is conceived for a general audience, Foss and Klein incorporate a wide range of research drawn from business history (Alfred Chandler), economics (Ronald Coase, Oliver Williamson), organization theory (Herbert Simon, James March, Richard Cyert, Chester Barnard), and sociology (Max Weber)—making it interesting for practitioners and academics alike. From a scholarly perspective, one of the many merits of the book rests on its ability to offer a comprehensive examination of the nature and purpose of managerial hierarchy that integrates both micro- and macro-structural perspectives.

Foss and Klein build on the basic premise that, unlike markets—which do not have a single ultimate purpose and in which prices alone direct production and exchange (i.e.,

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no one is relied upon for direction)—the quintessential characteristic of all organizations is that they are goal-directed. Organizations are multi-agent systems with system-level goals toward which their constituent agents—despite their often differing preferences, interests, information, and knowledge—are expected to contribute via joint production (see also March and Simon 1958; Puranam et al. 2014).

Hence, building on Williamson's (1991, 1996) conception of firms as governance hierarchies whose main purpose is transaction cost economizing, Foss and Klein describe why and how hierarchy and its corresponding coordination mechanism—namely, managerial authority—are the most effective ways to handle micro-level issues pertaining to agent collaboration and coordination in organizations the goals of which are dominated by the pursuit of profit. In doing so, they facilitate the joint survival of such organizations and their members.

The central argument is that, in the absence of managers invested with the authority (or positional power) to define an organization's goals, break them down into smaller ones, and allocate roles and responsibilities, swift and smooth coordination of people and tasks becomes problematic. Without managers defining formal rules and procedures, decision-making becomes politicized and prone to conflict, and opportunities for self-interested pursuits and moral hazards arise. The absence of managers is a prelude to chaos.

Here, one might argue that goals can emerge 'spontaneously' and that a strong trust-based culture and cooperative norms may serve as substitutes for managerial authority and formal rules. But Foss and Klein remind us of the intertwined nature of culture—in terms of shared meanings—and structure, with any decrease in meaning often calling for and producing more structure, which, in turn, counters any such decrease (Poppo and Zenger 2002; Weick 1993). Furthermore, managers—with their personalities, leadership styles, and behaviors—strongly influence the shaping and transmitting of organizational culture (Jaques 1951, 1970; Miller and Friesen 1984).

Embracing a macro-structural perspective, Foss and Klein also illustrate why and how hierarchy and authority may be useful, if not necessary, for organizations to confront the conditions that are the hallmarks of our modern economy. Among such conditions, the authors emphasize rapid technological change, value creation based on knowledge—rather than on physical resources—and increased competition based on innovation. According to the authors, the demands of an increasingly knowledge-based and interconnected economy require the presence of someone with the decision rights and specialized knowledge needed to make rapid decisions under conditions of high uncertainty and complexity. In turn, this makes managerial authority even more essential and further widens the top management team's span of control. At the same time, Foss and Klein argue that, with a more educated and highly specialized workforce asking for empowerment and autonomy, the meaning of authority will have to change. Managers will have to shift from specifying methods, processes, and actions to defining the goals they want organizational members to meet and the principles they want them to embrace.

The prescriptive aspect of the book involves the issuing of a warning of the perils linked to uncritically embracing the bossless company model. In particular, Foss and Klein alert their readers to the dangers of considering the bossless model as a one-size-fits-all solution. The authors surmise that near-bosslessness may potentially work in organizations that deal with simple technologies, operate in stable environments, and rely on simple production processes or on ones that can be broken down into self-contained modules. More in general, Foss and Klein encourage the adoption of a contingency-theory approach to organizational design: in devising solutions to the problem of organizing (i.e., the division of labor and the integration of efforts), the upper echelons need to take into account both the external features of the market and environment and the internal organizational features and their complementarities. When faced with the question "How does this organization work?", the key to successful leadership lies in identifying and acting upon trade-offs between external and internal demands.

New forms of organizing and the role of management: is hierarchy necessary or inevitable?

Overall, Foss and Klein come to the nigh inescapable conclusion that hierarchies and managers will continue to matter in the years to come. This raises the fundamental question of whether other forms of organizing will ever emerge. Allow me to offer a preliminary and quite speculative answer.

I share Simon's view—which Foss and Klein present in Chapter 10 of their book—that almost any system involving some level of complexity is, in fact, a hierarchy—at least if we intend it as a "system that is composed of inter-related subsystems, each of the latter being, in turn, hierarchic in structure until we reach some lowest level of elementary sub-system" (Simon 1962: 468). The basic idea here is that, in hierarchical structures, similar patterns of relationships recur multiple times at various levels of aggregation (Puranam 2018; Simon 1962). Therefore, unless the goals of individual organizational agents are perfectly aligned and/or their tasks are completely independent of each other, solving the problems of organizing (i.e., the division of labor and the integration of efforts) will require some form of hierarchy (Knudsen and Srikanth 2014; Puranam and Swamy 2016).

What we may observe in the future, however, is an increased variety of hierarchical forms.[1] The explanation underpinning this statement is fairly simple: in recent years, an increasing number of organizations have been pursuing goals that are non-economic in nature; this, in turn, may affect how the problem of organizing is approached. In particular, while Foss and Klein illustrate why, by enabling efficient revenue production, traditional (predominantly M-form) hierarchies represent 'satisficing' solutions to the problem of organizing in economic organizations, the maximization of efficiency and shareholder wealth may not be the priority of social organizations and of their participating agents (Adler 2001; Miller 1992).

Consider the case of the online non-profit encyclopedia Wikipedia, which Foss and Klein extensively discuss in the book. Wikipedia is probably the most illustrative example of a loose network of people who spontaneously contribute to the realization of a shared superordinate goal: to create and distribute the highest-possible-quality global human knowledge, so that it may be freely accessed and used by every single person on the planet. At Wikipedia, the problem of effort integration is solved through the digital infrastructure that co-founder Jimmy Wales set up for content creation, integration, and editing. While having the centralized coordinating properties of a hierarchy, Wikipedia is surely not a traditional pyramidal structure.

Compared to their counterparts in economic organizations, the members of social organizations—especially not-for-profit organizations based on voluntary agent contributions—are less inclined to engage in opportunistic behaviors (Glaeser and Shleifer 2001; Kaul and Luo 2018; Luo and Kaul 2019). This may be especially the case in the absence of extrinsic incentives and of virtually any separation between being part of the system and contributing joint efforts toward a system-level goal.[2] Put differently, those individuals who decide to enter and contribute via joint efforts are those that strongly identify with an organization's purpose (Akerlof and Kranton 2005; Besley and Ghatak 2003). Quoting Jimmy Wales:

> *"Those kinds of big-picture ideals make people very passionate about what we're doing. And it makes it possible for people to set aside a lot of personal differences and disputes of the kind that I talked about above, and just compromise to keep getting the work done."*

Under similar circumstances, a large proportion of the problem of organizing could simply be solved via the self-selection of members into tasks and their grouping into interconnected networks the ties of which are constituted by trust, transparency, and openness (He et al. 2020; Klapper and Reitzig 2018; Piskorski and Gorbatai 2017; Puranam et al. 2014)—commonly referred to as community form (Adler 2001) or self-governing collective (Luo and Kaul 2019; Ostrom 1990). This is how Wales described it during an interview in 2004 (SlashdotMedia, July 28, 2004):

> "[Interviewer]: *Right now, we are seeing several instances where crawlers are disrupting wikis, spammers are embedding wiki links to their sites to boost their Google rankings, and advertisers are placing ads in wikis until someone goes through and nukes them. Do you have any thoughts as to how wikis can be modified to prevent things like this in the future?*
>
> "[Wales]: ... *Basically what I think works in a wiki is to trust people to do the right thing, and trust them as much as you can possibly stand it, until it hurts your head and makes you scared for what they're going to break. Because that is what works. People are not fundamentally bad. It only takes the smallest of correctives to take care of that tiny minority that wants to disrupt the community."*

While a coalition or, simply, a constitution, may be needed to define the purpose of an organization and to map it into the sub-goals and tasks into which contributors may select themselves (Mills and Ungson 2003; Ostrom 1990), the introduction, in social organizations, of hierarchy and the active exercise of administrative authority aimed at solving problems of task allocation and reward provision would imply unnecessary transaction costs (cf. Macher and Richman 2008; Weber et al. 2022). This resonates with the findings recently obtained by Billinger et al. (2022) from a laboratory experiment involving agents dealing with complex dyadic tasks. They found that human subjects are capable of endogenously developing coordinated repeated actions by relying on lateral communication, without any need for managerial authority and aligned incentives, provided that goals and tasks are statically assigned.

This, however, raises a second important consideration: even though cooperation and coordination failures may be less likely in social organizations—thereby making hierarchy unnecessary—the social costs of these events in terms of negative externalities may be substantial. I find the following excerpt from the interview quoted above to be illustrative:

[1] Existing research characterizes organizations' forms and coordination mechanisms along a continuum between market/price, hierarchy/authority, and community/trust, identifying a number of hybrid forms (Adler 2001; Williamson 1991). These hybrid forms are what I refer to here as variations of hierarchical forms.

[2] A potential form of opportunism emerging in these circumstances may be status-related—with some contributors taking more credit than warranted for a successful project in order to increase their visibility and standing (Weber et al. 2022).

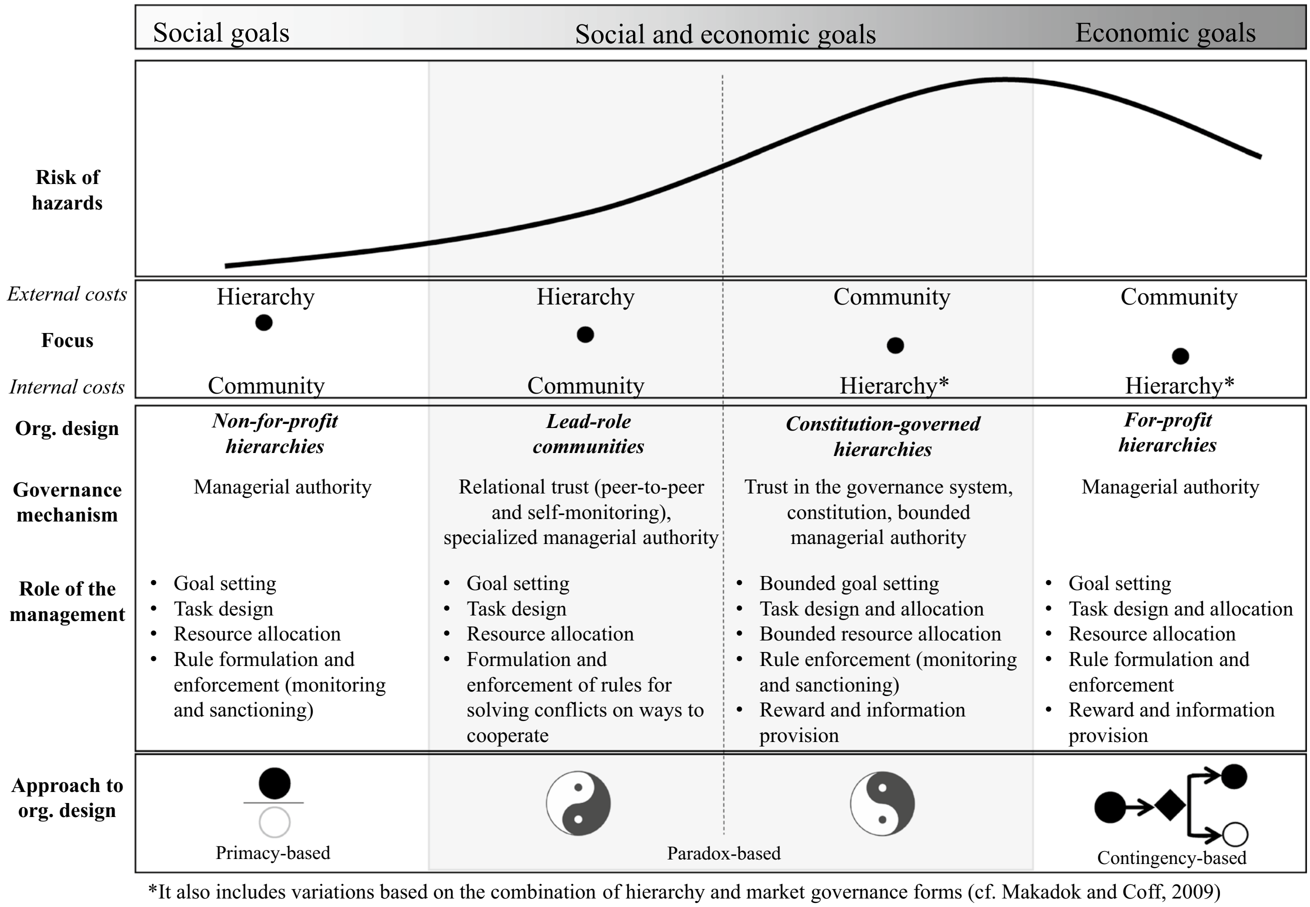

Fig. 1 Paradoxical organizational design in organizations pursuing economic and social goals

> *"I frequently counsel people who are getting frustrated about an edit war to think about someone who lives without clean drinking water, without any proper means of education, and how our work might someday help that person. It puts flamewars into some perspective, I think."*

In their efforts to avoid external costs, social organizations may systematically end up with more hierarchy and governance than would be ideal, at least from an internal cost perspective. The need to absorb these extra costs may, in turn, threaten social organizations' long-term sustainability and survival, and lead to the progressive withdrawal of organizational members. This makes the choice of organizational design in social organizations dilemmatic, involving either: (1) minimal internal transaction costs and a better probability of survival, but some risk of incurring internal cooperation and coordination failures, which would produce significant external costs; or (2) high internal transaction costs and a greater risk of failure, but a minimal probability of producing any external transaction costs (Margolis and Walsh 2003; Sundaramurthy and Lewis 2003).

As Fig. 1 illustrates, while, on the basis of a logic of goal primacy or subordination, purely not-for-profit organizations may opt for governance by administrative fiat through hierarchy, the reconciliation of this tension in organizations that pursue both economic and social goals may call for a paradoxical approach—rather than a contingency one—to dealing with the problem of organizing (Cameron 1986; Lewis 2000; Murnighan and Conlon 1991; Smith and Berg 1987).

A contingency approach implies managers agreeing upon and developing some mutual control systems for the temporal and/or spatial separation of social and economic goals—via goal prioritization or the creation of separate subunits in the organization (compartmentalization)—and thus allocating tasks and providing rewards in order to achieve the goal at hand (Cyert and March 1963; Pratt and Foreman 2000). However, social and economic goals are often difficult to rank and reconcile (Margolis and Walsh 2003). Attention to stakeholder interests and the minimization of external costs may yield results that hinder the efficiency-maximizing ambitions of shareholders (Williamson 1985, 1996), making spatial and temporal separation impractical and causing managers to be confronted with the dilemma of how to arrive at some workable balance (Gioia 1999). More importantly, as illustrated in Fig. 1, there might be an inflection point wherein the use of hierarchy and authority may encourage, rather than curtail, the risk of opportunistic behaviors. Managers might be tempted to take advantage of the tension between social and economic goals to divert resources from their rightful claimants in order to advance their own interests (misappropriation) or interests for which those resources are poorly suited (misallocation) (Eldar 2020; Lazzarini 2020; Luo and Kaul 2019; Margolis and Walsh 2003). Embracing a paradoxical approach through a synthesis of different organizational structures and governance mechanisms may represent a way for organizations to relieve the antinomy between social and economic goals (cf. Battilana and Lee 2014; Jay 2013; Smith and Lewis 2011). I would expect this approach to lead to new (hierarchical) forms and increased variety overall.

For instance, to keep both internal and external costs under control, lead-role community governance might be the preferred arrangement for organizations characterized by a predominance of social goals (cf. Bridoux and Stoelhorst 2022). Under this arrangement, organizational agents would have the possibility to self-select into tasks and coordinate their tasks endogenously without direct managerial supervision. Because of their supposedly aligned individual interests and the low incentives to free-ride, organizational agents would be provided with a space for discourse, deliberation, and negotiation. As far as the direct observation of one another's actions is possible, peer-to-peer monitoring and direct negotiation would serve as the primary control mechanisms. At the same time, despite being motivated to cooperate, the contributing agents may fear free-riding and thus still face bargaining problems in identifying mutually acceptable cooperative solutions (Luo and Kaul 2019). To reduce both the internal and external costs arising from potential coordination failures, a central coalition of managers would be mandated to act as an arbiter in face of the organizational agents' failure to agree upon a cooperative solution (Ostrom 1990).

With any intensification of the rivalry between economic and social demands, however, lead-role community governance may not succeed in settling the tension between social and economic goals and in preventing opportunistic behaviors. Settling this tension may require stakeholder participation in the formulation of an organizational constitution; i.e., of "a set of agreements and understandings that define the limits and goals of the group (collectivity) as well as the responsibilities and rights of participants standing in different relations to it" (Zald 1970: 225). As such, an organizational constitution embeds what is generally referred to as meta-rules—i.e., rules on how to make rules and under what special circumstances exceptions to rules may be made (Brady 1987). In specifying what is obligatory, permissible, and prohibited, meta-rules should define the boundaries of economic logic, including, for instance, the criteria under which the derivation of benefits for the firm also meets standards of fairness (i.e., when such derivation results in some compensatory exchange), and the criteria under which the evaluation of options according to a logic of consequences—based on weighting the economic costs and benefits—also meets conditions of appropriateness—i.e., aligns with the organization's ideology (cf. Margolis and Walsh 2003). Under a similar arrangement, system trust would be the fundamental control mechanism. While being delegated a large part of the traditional governance-related issues—including defining and allocating tasks, monitoring and sanctioning non-compliance to rules, and measuring and rewarding performance outcomes—managers would remain directly accountable to the stakeholders. In particular, in order to avoid any resource misappropriation and misallocation, their freedom to set goals and make decisions related to resource allocation and the division of value among stakeholders would be limited.

Lead-role communities and constitution-governed hierarchies are examples of hybrid governance arrangements that may help organizations meet competing demands and govern different sources of friction simultaneously. In that regard, embracing a paradoxical approach to organizational design may bring about numerous opportunities to devise novel, efficient, and meaningful modes of organizing.

Conclusion

Even those scholars who are already familiar with the work of Nicolai Foss and Peter Klein will find *Why Managers Matter: The Perils of the Bossless Company* provocative, informative, and very much worth reading. The book makes a strong case for the importance of managers in solving the problem of organizing. In this respect, the paradoxical tensions involved in the process of organizational design are likely to be substantial and worthy of careful further study. My hope is that the book will inspire others to follow in Foss and Klein's footsteps.

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