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Administration of an organization undergoing change: Some limitations of the transaction cost economics approach

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Abstract

Purpose – This paper aims to develop conceptual arguments questioning the efficacy of administration by the transaction cost economics (TCE) approach in an organization undergoing a major change.

Design/methodology/approach – The focus is on three distinct dimensions of organizational life where, as per prior research, TCE is likely to be inadequate: interdependence across transactions, high reliance on managerial foresight and inseparability of administrative decisions made at different points in time.

Findings – The climate of coercion and surveillance engendered by administration based on TCE approaches – that punishes deviation from goals, even when they are framed on inadequate knowledge – forestalls creative problem-solving that is necessary to address unforeseen developments that arise during change implementation. Fiat accomplishes within-group compliance in the change project sub-teams, but between-group interdependencies tend to be neglected, hampering organizational effectiveness. Moreover, attempts to create independent spheres of accountability for concurrent fiats regarding pre-existing and new commitments breed inefficiency and wastage.

Research limitations/implications – The malevolent aspects of TCE-based administration contribute to organizational dysfunctions like escalation of commitment and developing of silos in organizations.

Practical implications – To succeed in effecting a major organizational change, meaningful relaxation of demands for delivering on prior goals is required, along with forbearance of errors made during trial-and-error learning.

Originality/value – TCE-based administration is deleterious to an organization attempting a major change. Supremacy accorded to resolution of conflicts in distinct hierarchical relationships by the mechanism of fiat fails to address the needs of an organizational reality where multiple groups are engaged in a set of interdependent activities and where multiple, interdependent organizational imperatives need to be concurrently served.

Keywords Creativity, Surveillance, Organizational change, Transaction cost economics, Administration, Coercion, Incomplete contracts, Interdependence, Escalation of commitment, Coordination failure, Silo, Fiat

Paper type Conceptual paper

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Introduction

How does administration based on principles of *Transaction Cost Economics* (TCE) (Williamson, 1975, 1979, 1991a, 2007) impact an organization undergoing a major change? To motivate an answer, we consider the interplay of TCE's limitations – with respect to spatial and temporal interdependence of transactions[1], and substantial reliance on managerial foresight – with other key tenets of TCE, and conditions arising from a major change project being underway.

In a series of influential treatises, Williamson proposed that business firms exist to minimize transaction costs that would otherwise be accrued, if transactions were organized through the market, instead of being housed inside a business organization. Transaction costs arise from the potential of harm caused by opportunistic behaviour by any given party in a transaction, particularly upon materialization of circumstances unforeseen in the contract. Transaction costs exist because contracts are inherently incomplete in nature, i.e. it is not possible to write a contract that anticipates all possible situations for all times.

Williamson asserts that organizational members seek self-interest with guile. This makes it difficult to attain an appropriate degree of alignment of organizational member goals with the goals of the organization. To address the issue, Williamson recommends using fiat, augmented by arrangements for surveillance and credible punishment upon detection of failure to deliver on commitments. This makes organizing transactions inside a business firm superior to organizing transactions in the market. In the latter, conflicts arising from incomplete contracting require time-consuming arbitration in courts, thwarting coordination. A business firm, on the other hand, functions as "its own court of ultimate appeal" (Williamson, 1991b, quoted in Williamson, 2007, p. 13). Thus, according to Williamson, within the four walls of a business organization, a regime of fiat – backed by surveillance and credible punishment of failure – is effective in handling issues arising from incompleteness of the employment contract. This is the principal claim in the TCE literature that we inspect.

TCE's treatment of organizational reality does not appear to do justice to some important nuances in organizational functioning. First, truly significant unforeseen circumstances materialize in an organization when it attempts to institute a change having firm-wide implications – say, in response to developments in the organization's environment. In such a case, past knowledge – that is deployed to issue commands under the fiat mechanism – is inappropriate for guiding actions of organizational members. In a climate of continuous change, goals to control employee behaviour expire before they are fulfilled, rendering superfluous TCE's claim to effectiveness in controlling employee behaviour.

Second, following the TCE logic, when a conflict arises on account of unforeseen circumstances, the conflict gets resolved in favour of the more powerful party – the hierarchical superior – by resetting of expectations, re-planning of actions and so forth. This arrangement may be satisfactory when just one group – comprising a few members – carries out a specific task. However, in modern business firms, company-wide change initiatives are carried out by organizing as a *change project team*, comprising a large number of company personnel as well as some consultants from the industry. The personnel of the change project team are deployed as separate work-units or project *sub-teams*. Each work-unit is given a mandate to carry out a distinctive part of the complex change task. To administer the mechanism of fiat, tenets of TCE require persistence of such hierarchical structures – i.e. project sub-team work-units – throughout the duration of the change project. As the change project progresses, unforeseen tasks arise, primarily on account of the organization's lack of prior experience with the new scheme of things. However, control enforced by TCE at the level of work-unit transactions engenders a situation where only tasks within the jurisdiction of a given work-unit get attention. Novel tasks that do not follow the logic of creation of the work-units obtain orphan status. This hurts organizational effectiveness.

Third, in the elementary case where one department or organizational grouping is the site for more than one organizational imperative – for example keeping the business running and implementing a company-wide change initiative to improve organizational responsiveness – operation of TCE's tenets of control by means of coercion and surveillance breeds inefficiency. Inefficiency emerges on account of coming into being of separate organizational arrangements to serve each instance of fiat independent of the others. The TCE-inspired imperative of dispensing rewards and retribution to metered organizational outcomes gets accomplished when independent organizational arrangements pin-point responsibility for serving distinctive mandates. In sum, Williamson's recommendation to resolve organizational issues by operating the mechanism of fiat appears to be inappropriate for situations involving firm-wide change, belying the promise of effectiveness upon materialization of unforeseen circumstances.

Prior critiques of the TCE literature have focused on TCE's neglect of the negative effects of surveillance and fiat on attitudes of individuals being controlled (Ghoshal and Moran, 1996). Negative effects arise because surveillance and control threatens the personal autonomy of individuals and lowers intrinsic motivation (Enzle and Anderson, 1993; Ghoshal and Moran, 1996; Ghoshal, 2005). When attitudes of individuals being controlled are impacted negatively, the result is damage to self-perception and deterioration of employee behaviours (Ghoshal and Moran, 1996; Lepper and Greene, 1975), particularly in the non-measurable or non-metered forms of behaviours (Ghoshal and Moran, 1996). As a consequence, management perceives a need for higher surveillance and control (Ghoshal, 2005; Ghoshal and Moran, 1996; Kipnis, 1972; Kruglanski, 1970). The situation represents a classic instance of "pathological spiralling relationship" (Enzle and Anderson, 1993, p. 263 quoted in Ghoshal and Moran, 1996, p. 25). Moran and Ghoshal (1996) argue that TCE is wrong in making the control of pathological behaviour as its focus.

Alternately, even when threat of opportunism is non-existent, incorporating a set of transactions within the four walls of a company can accomplish lower transaction costs compared to organizing transactions in the market (Holmstrom and Milgrom, 1991; Masten *et al.*, 1991; Moran and Ghoshal, 1996). Therefore, instead of focusing on curbing opportunism, organizations should strive to create and sustain a context in which collaboration can prosper (Moran and Ghoshal, 1996).

However, business firms continue to get shaped by an ideology – christened as *liberalism* by Milton Friedman (Friedman and Friedman, 2002):

> [. . .] grounded in a set of pessimistic assumptions [. . .] that views the primary purpose of social theory as one of solving the "negative problem" of restricting the social costs arising from human imperfections. (Ghoshal, 2005, p. 77, double quotation marks in the original).

TCE is cited as an empirical success story (Williamson, 2000, p. 605; Ketokivi and Mahoney, 2016, p. 131). That, organizational ineffectiveness may materialize from reasons other than wilful shirking by managers and employees (Ethiraj and Levinthal, 2009; Hodgson, 2004), seems to have attracted lukewarm attention from scholars. TCE research continues to claim efficacy of coercion and surveillance mechanisms when task execution is successful. Otherwise, the necessity for more draconian measures of domination and control is inferred. This state of affairs falls short of doing justice to actual experiences in organizational life.

In this paper, we frame a set of propositions that speak of the inadequacy of TCE tenets in an organization undergoing change. We identify the operation of specific TCE principles, and the impact of such principles on organizational functioning. Thereby we highlight important boundary conditions of the validity of the TCE approach in managing organizations.

Theoretical foundations

Transaction cost economics and the logic of power

Williamson's characterization of the efficacy of hierarchical organizational processes draws from the concept of power (Emerson, 1962). If **A** has power over **B**, **A** can make **B** do things that **B** may otherwise not be willing to do – because the action or task is not in his/her (**B**'s) own interest. Williamson's idealization of an employee is that of the *contracting man* (Williamson, 1996a). Similar to the *economic man*, the contracting man pursues self-interest, all the time. In addition, the contracting man is opportunistic and deploys guileful behaviour to fulfil self-interest and displays bounded rationality (Williamson, 1996a)[2]. If all organizational participants – shareholders, executives, managers and employees – acted in the model of the economic man and were on equal footing (i.e. had equal power), each entity would pursue only his/her own interest, often at the expense of the interest of the organization as a whole. This would lead to chaos and make coordination within a business firm impossible, calling into question the very existence of the business firm as an entity.

Williamson proposes a Hobbesian solution (Hobbes, 1651; Holt, 2004) to this problem[3]. Williamson elevates the interests of the shareholders or their agents – for example investors, or *temporary owners* who hold the shares of a company for a brief period (Chen and Miller, 2015) – above the interests of all other organizational participants, namely, company executives, managers and employees[4]. Thereby, investors may compel company executives to act according to their wishes and objectives (George and Lorsch, 2014; Ignatius, 2015; Mayer, 2013). Company executives, in turn, are to lay down objectives for managers, deriving such objectives from the ones *they* are held accountable for. Finally, managers require employees to obey commands.

Credible deterrence exists at each level. Unhappy investors may champion actions to dismiss company executives (George and Lorsch, 2014; Goldman, 2015), or have a company dismembered and sold (Araskog, 1999; Bruck, 1988; Hack, 1996; Sayer, 2014; Selznick, 1996). Company executives may fire managers who, in their eyes, failed to act according to instructions. Finally, managers may fire employees on like grounds. Thus, the threat of loss of livelihood is what persuades the organizational members to deviate from the model of the *economic man*, and eschew self-interest in favour of working according to commands of the hierarchical superior.

Administrative process under transaction cost economics: coercion and surveillance

In Williamson's scheme, a subordinate obeys the command from a hierarchical superior and eschews working as per his/her self-interest because he/she has accepted a position that pays wages. The hierarchical superior, in turn, refrains from issuing commands driven by his/her self-interest because of a similar arrangement with the next level superiors. To make the arrangements credible, business organizations are required to put in place pervasive measures of surveillance, such that any deviation from the laid-down script can be detected quickly and sanctioned. CEOs need to get on a conference call with *Wall Street* analysts every quarter, to explain deviations from financial commitments made in the prior quarter's call, and to explain the effect of every planned initiative in terms of its impact on the next quarter's earnings (Barton and Wiseman, 2014; Chanda and Ray, 2015). Inside the company, every employee needs to commit to goals set by a hierarchical superior ahead of time. Performance appraisals are held periodically, to check progress on such goals. The appraisal process, in turn, generates information that determines rewards and sanctions to organizational members.

Williamson asserts that the mere possibility that even a small section of organizational members may pursue self-seeking behaviour is adequate reason for requiring pervasive surveillance systems in managing organizations. Such is the case because *a priori* it is difficult to know which organizational member will pursue self-interest with guile (Williamson and Ouchi, 1981). Ketokivi and Mahoney (2016) draw a parallel between airport security searches and surveillance under TCE. They suggest that honest organizational members have no ground for being uncomfortable with surveillance stemming from TCE-based administration, just as airport travellers ought to be comfortable with security-related searches, given that the searches aim to deter the dishonest. However, unlike passengers at airport gates, employees of a company are not strangers to the organization. Further, it is an open question whether the psychological effects of searches during one-off instances of air travel is the same when intense surveillance is applied to the workplace, every day.

Transaction cost economics and organizational change

Moran and Ghoshal (1996, p. 65) observe that TCE's preoccupation with mitigation of hazards of opportunism tends to "eliminate the opportunity for discovery and learning among transaction partners [. . .] and for them to benefit from their evolving [. . .] knowledge". TCE-based administration "[. . .] locks organizations into predetermined paths and, thereby, sacrifices the flexibility of responding to unfolding uncertainty and of using evolving knowledge" (Moran and Ghoshal, 1996, p. 65). The shortcomings are acutely felt at the time of organizational change. In the paragraphs later in the text, we elaborate on this theme.

Organizations host distinct departments within their boundaries to have them carry out specialized functions. At a certain point in time after founding, an organization attains the status of a *going* concern[5] and settles down to functioning in a certain way. Organizational members form a clear idea regarding roles and responsibilities of departments and their contribution to the work of the department. Further, there is also clarity on how the departments interact with each other. If the organization structure stays the same over time, as do the patterns of internal transactions between departments, there is room for instituting systems for controlling employee behaviour to a set pattern. A TCE approach to administration will make deviation from the set pattern costly for employees. It rewards employees having better compliance profiles, particularly when outcomes for the organization – for example market performance – are good.

On the other hand, if the design of the organization has to change, or if an organization chooses to change the pattern of transactions between departments, emphasis on TCE tenets will end up undermining the change effort. As organizational members attempt to discover routines and operating procedures to adapt to the changed circumstances, the TCE-based monitoring systems flag non-compliances, triggering retribution where none is warranted. TCE's inability to distinguish between honest mistakes – as is inevitable in trial and error learning – and shirking or incompetence (Ghoshal and Moran, 1996; Shimizu, 2012) has a negative impact on employee morale. Risky actions that are necessary but deviate from the laid-down script are not attempted. This is because even inadvertent failure attracts sanctions, under administration based on TCE principles.

When organizations countenance novel situations, coercion and surveillance of the type advocated by TCE theory serve to make a difficult situation worse – by creating an air of mistrust – effectively blocking creative problem-solving. Moreover, supremacy accorded to the resolution of conflicts in distinct hierarchical relationships by the mechanism of fiat fails to address the needs of an organizational reality where multiple groups are engaged in a set of interdependent activities and where multiple, interdependent organizational imperatives need to be concurrently served. Yet we find that TCE is being widely used to analyse organizational phenomenon and to prescribe managerial action (Williamson, 1996b; Earl and Potts, 2011; Ketokivi and Mahoney, 2016). To stem the tide, it is necessary that research is carried out to trace the dysfunctions caused by operation of TCE principles in the context of important organizational imperatives. It is the responsibility of scholarship to highlight findings from such inquiry to management practice. Otherwise, organizations are harmed through mindless application of TCE-inspired prescriptions, further compromising the tenuous standing of scholarship in organization and management research (Bennis and O'Toole, 2005; Hambrick, 1994; Huehn, 2008; Mintzberg, 2004; Pfeffer and Fong, 2002). Therefore, we suggest a set of propositions tracing some of the mechanisms by which TCE-based administration undermines organizations' efforts to implement change.

Theory development

Approach

To select prior literature to review, we initially proceeded with an assumption that any critique of TCE after the *AMR* issue in 1996 featuring Ghoshal and Moran (1996), the response by Williamson (1996b) and the rejoinder by Moran and Ghoshal (1996) is quite likely to reference one or both of Ghoshal and Moran (1996) and Ghoshal (2005). However, we find that it is not possible to identify a tractable number of works to review. The *Web of Science* shows 1,167 citations to Ghoshal (2005). For Ghoshal and Moran (1996), there are 865 citations (as on 4 October 2017). At this point, we conceded that it is beyond our capacity to parse and present the whole gamut of critiques of TCE – and rebuttals and rejoinders thereof – presented in these articles. Instead, we decided to look for an overview of the critique of TCE in recent publications in reputed journals, to identify research opportunities.

A search in Google Scholar with the string Ghoshal, 2005 *"Bad management theories are destroying good management practices"* and filtered by "*Since 2016*" appeared more promising, reducing the number of hits from 3,050 to 441. Upon going through text of the first ten publications listed, we found our anchor paper. A recent publication, Ketokivi and Mahoney (2016, pp. 131-132) provides representative references for essence of distinctive critiques. We further narrow our focus on those studies that Ketokivi and Mahoney (2016) cite as *endogenous critique*, where TCE arguments are evaluated without rejecting the basic premises.

Ketokivi and Mahoney (2016, p. 131) highlight four strands of endogenous critique. One strand of deficiency in TCE-based administration comes from Williamson himself. Williamson (1985, p. 393) notes that although "[. . .] transaction cost economics [. . .] normally examines each trading nexus separately [. . .] interdependencies among a series of related contracts may be missed or undervalued as a consequence". In the context of an organization-wide change project, a complex change task is broken up into parcels of manageable tractability and given to project sub-teams. Certain interdependencies emerge over time, between tasks of work-units, on account of inadequate appreciation of the overall change task at the time of sub-team formation at the inception of the project. When each sub-team is held accountable to its own set of goals, the ownership and accountability of interdependent tasks get clouded.

Second, agency theorists aver that TCE puts too much emphasis on bounded rationality. They contend that much of the relevant action to dodge harmful effects of opportunism can be taken ex ante, i.e. before a contract is signed (Jensen and Meckling, 1976). The third strand, originating in Mayer and Argyres (2004), is somewhat a contradiction of the position of agency theorists: "TCE puts too much emphasis on foresight and contracting in its entirety". (Ketokivi and Mahoney, 2016, p. 131). Given that our context is one of implementing organization-wide change – where there are quite a few unknowns – we consider this latter strand as relevant, and not the critique of agency theorists. Indeed, when an organization-wide change project is under implementation, TCE's predilection to deploy fiat to settle any disagreement in favour of the option preferred by the hierarchical superior comes in the way of leveraging expertise of lower-level employees closer to developments on the ground.

The fourth strand of endogenous critique submits that: "Governance decisions are inseparable; therefore, using a single transaction as the unit of analysis is problematic". (Ketokivi and Mahoney, 2016, p. 131). Argyres and Liebeskind (1999, p. 49) elaborate:

> [...] the governance of any new transaction in which a firm may seek to engage may become linked inseparably with the governance of other transactions in which the firm is already engaged.

Further:

> [...] firms are subject to a condition [...] in which a firm's past governance choices significantly influence the range and types of governance mechanisms that it can adopt in future periods.

In the context of an organization-wide change project, this assumes salience when individual departments, already contractually bound by promises regarding delivering to periodic financial targets, get additional demands to support the change project, disrupting the planned schedule of activities.

Propositions

In explicating TCE, Williamson invokes *ceteris paribus* conditions (Holt, 2004) to denote that all organizational contextual variables, barring the constructs used in the theory, remain invariant. Therefore, when we inquire into limitations of TCE-based administration for organizations undergoing change, the null condition is that TCE continues to be effective in administering organizations under a particular manifestation of a given dimension related to organizational change.

When an organization undertakes a major change initiative, several work-units or sub-teams get formed – under the umbrella of the change project team – to implement the change. Each work-unit is given a charter and a set of goals to accomplish. The charter is drawn up based on knowledge regarding the scope and nature of the work and *a priori* understanding regarding what is needed to implement the desired functionality. Goals of members of a work-unit are derived from the goals set for the work-unit. Administration based on tenets of TCE requires that such goals be agreed upon, upfront. Later – at the time of performance appraisal of an individual employee or the leader of a work-unit – the extent of fulfilment of these goals is used to determine rewards and retribution.

New information comes to light as a change project progresses – information that was not considered at the time of setting the charter and goals of work-units. In some situations, personnel of the change team work-units need to learn by trial-and-error as to what configuration of actions will be appropriate in their organization's particular context. Such situations frequently require changes in the goals of members of sub-teams. The mechanism of fiat comes handy; members of work-units are asked to take actions that comprehend the new information. However, the *actions actually taken up* are limited to the jurisdictions assigned to sub-teams. The jurisdictions assigned to the sub-teams must remain the same to preserve the hierarchical arrangements to control organizational member behaviour, as advocated by TCE – by virtue of its focus on a transaction as a unit of analysis (Williamson, 1985). In the process though, interdependence between actions of work-units or groups of work-units get neglected. Any given work-unit chooses to resolve issues myopically, limiting the scope of action to work-dimensions within its direct control, ignoring interdependencies with other work-units. Lack of timely attention to issues falling between the responsibilities of individual work-units forestalls further discovery of novel tasks that ought to be attended to, to succeed with the change project. Accumulation of such incompletions hurts organizational effectiveness. Organizational effectiveness is a function of "[. . .] the willingness and ability of individuals to take personal initiatives, and [. . .] the structure, processes and norms organizations need to facilitate such initiatives [. . .]" (Ghoshal and Bartlett, 1994, p. 109). Thus, we have the proposition:

P1. Administration based on tenets of TCE undermines organizational effectiveness in situations where unanticipated interdependencies between work-units emerge over time.

TCE prescribes both the *means* as well as the *ends* for organizational functioning. The principal end it seeks to accomplish concerns thwarting self-seeking behaviour by organizational members. The most potent means advocated by TCE concerns use of the mechanism of fiat by hierarchical superiors to set direction as well as to resolve conflicts. TCE requires that organizational personnel tasked to issue commands possess a very high degree of foresight (Mayer and Argyres, 2004). Hierarchical superiors must know with absolute certainty what needs to be asked for, and when, from subordinates. If such foresight is not possible in a given situation, hierarchical superiors will issue commands based on irrelevant past knowledge, adversely impacting organizational effectiveness. TCE's negative impact on organizational effectiveness will be acute in an organization undergoing change, where feasible action paths emerge based on organizational members' attempts at sense-making (Weick, 1995) about the unfolding reality. This suggests the following proposition:

P2. Administration based on tenets of TCE undermines organizational effectiveness in situations where developments cannot be anticipated by managerial foresight alone.

Argyres and Liebeskind (1999) suggest that using a single transaction as a unit of analysis is problematic, as administrative governance decisions do not readily lend to separation. This assumes salience when an organizational unit is required to cater to parallel mandates from the top – to keep the business running as per financial commitments agreed upon at the beginning of the year and/or quarter, and to make changes to a department's processes to support an organization-wide change initiative. Parallel mandates of this nature usually originate at different points in time. TCE insists on fulfilment of each mandate as per *a priori* agreement. For each, a few distinct outcomes of the organizational unit are metered, to gauge fulfilment. It is essential to pin-point responsibility and accountability for the metered outcomes. This necessitates independent arrangements to serve distinct mandates. The resultant redundancy leads to inefficiency and waste. This suggests the following proposition:

P3. Administration based on tenets of TCE undermines organizational effectiveness in situations requiring fulfilment of concurrent objectives originating at different points in time.

Genesis of limitations of administration based on transaction cost economics in an organization undergoing change

In Table I, we present the mechanisms for the genesis of limitations of administration based on TCE in an organization undergoing change. An organization espousing administration based on TCE approach signs up for the following tenets:

(1) TCE-based administration works by monitoring fulfilment of goals set for a chosen persistent organizational entity – an individual or a work-unit – approving compliance and sanctioning failure.

(2) Goals must be agreed upon upfront, even with grossly imperfect knowledge of the future.

(3) Progress on pre-agreed goals is monitored through pervasive surveillance measures.

(4) Any failure is attributed to shirking or incompetence, and promptly sanctioned.

(5) Fiat is used to settle any disagreement in favour of the view of the hierarchical superior.

In Table I, we refer to the tenets identified by numerals above, to pin-point their operation in TCE-based administration's shortcomings in organizations undergoing change.

Broadly, we discern three loci of organizational contestation. The first that we call *spatial interdependence* arises from TCE's proclivity to consider each dyadic governance relationship as independent from all others (Williamson, 1985). The logic by which sub-teams are allocated distinct spheres of responsibility at the inception of the change project

Locus of organizational contestation	Challenge in an organization-wide change project	Culpability of TCE-based administration
Spatial interdependence A complex change project is divided into separate parcels of work, which are allocated to individual sub-teams	The logic of allocation of responsibilities to sub-teams is derived from limited appreciation of the change task, prevailing at the start of the project. The logic weakens upon discovery of new complications as the project progresses	Persistence of sub-team configurations[1] leads to certain emergent tasks falling in no-man's land, where sub-teams hesitate to accept responsibility[4]. Lack of timely attention to emergent tasks lowers organizational effectiveness
Hierarchy vs Expertise Managerial foresight is taken recourse to in setting targets for the change project sub-teams and individuals	The very nature of the change project may privilege competent lower-level employees – who are closer to the developments on ground – with better understanding regarding appropriate courses of action, albeit to no avail	The use of fiat to settle any disagreement in favour of the view of the hierarchical superior[5] stymies use of expertise of lower-level employees
Temporal interdependence Parallel mandates regarding stability and change are assigned to the same organizational unit	Targets regarding financial outcomes from day-to-day work of departments and targets concerning supporting the change project arrive at different points in time, and are not independent. Fulfilment on either needs to be metered independently	Silos develop to enable metering of fulfilment of targets arriving at different points in time [2, 3 and 4]. Independent arrangements to serve day-to-day requirements and requirements from the change project breed inefficiency, sacrificing coordination benefits

Table I. Genesis of limitations of administration based on transaction cost economics principles in an organization undergoing change turns out to be inadequate, as complications are discovered. As a result, certain emergent tasks fail to attain appropriate ownership and timely attention, adversely affecting organizational effectiveness.

The second *locus* of organizational contestation arises from infeasibility of managers having sufficient foresight (Mayer and Argyres, 2004) regarding the whole range of contingencies that may arise in a project involving organization-wide change. TCE's recourse of resolving differences of opinion by deferring to the option preferred by the hierarchical superior has a compounding effect of failing to leverage expertise residing at lower levels, close to the theatre of unfolding developments. We cite this facet of organizational contestation as one concerning deference to hierarchy vs deference to expertise.

The third *locus* of organizational contestation arises from inseparability of administrative decisions (Argyres and Liebeskind, 1999) when fiat mandates arrive at a department at different points in time. Independent arrangements come into being to cater to TCE's insistence on metering accomplishment on each mandate separately, creating inefficiencies and sacrificing coordination benefits.

Organizational implications

In this section, we highlight some macro-level dysfunctions that come to the fore when an organization under TCE-based administration undertakes a significant change project. Traditionally, these dysfunctions have been attributed to personal deficiencies of managers. We observe that administrative tenets of TCE, rather than managerial shortcomings, lie at the root of the dysfunctions.

Dysfunction one: managers assuming an aura of infallibility

TCE-based administration privileges actions based on fiat from the hierarchical superior. This arrangement resolves disagreements quickly, as the company is "its own court of ultimate appeal" (Williamson, 2007, p. 13). At the same time, overvaluation of managerial foresight places demands that managers be always right. This is infeasible when an organization embarks on a project to implement a significant change. Yet, if a manager accepts a significant course-correction suggestion from lower-level staff (who have greater exposure to the developments on ground), it may be construed as admission of a mistake. Re-setting of a prior decision, it is suspected, is done either to cover up a prior mistake or to draw advantage towards oneself, i.e. as an act promoting self-interest. Prompt sanctions materialize, in a TCE-administered world. Managers, perforce, have to project an aura of infallibility, not to be seen as weak. Thus, our research suggests that managers are sometimes observed to project a dysfunctional aura of infallibility and incorrigibility not necessarily because power gets into their heads and because they are opportunistic people in general, but for a more mundane reason – that espousing alternative behaviours threaten their careers.

Dysfunction two: escalation of commitment

Our analysis deepens the explanation of the phenomenon of escalation of commitment to a failing cause (Staw, 1976) observed in organizational life from time to time. Staw (1976) suggests that managers, under pressure to justify prior behaviour, tend to increase commitment to the status quo regarding the way a project is executed, even in the face of warning signs that forebode negative consequences. In most cases, such managerial behaviour eventually leads to organizational failure. Escalation of commitment is evidenced when the configuration of change project sub-teams persists, even when the logic of sub-team formation – derived at the inception of project with limited knowledge – has expired (owing to emergence of new information during the course of project implementation). Resolution of disagreements by deferring to fiat instead of deferring to expertise is another manifestation of escalation of commitment.

Administration based on tenets of TCE – comprising threat of sanction and retribution upon detection or admission of failure – constitutes a potent source of pressure to justify prior behaviour. Early managerial decisions acquire the character of a *mistake* only after proceeding further along the path of implementation of a change project, i.e. upon uncovering of new information. TCE however requires commitment to goals ahead in time. Owning up a mistake attracts penalty, regardless of the fact that a mistake can be sensed only when additional information is obtained at an advanced stage in the project. Thus, managers choose to stay on course even when they obtain evidence that the approach being followed is wrong. When a change project fails eventually, there is a certain degree of ambiguity as to whether the project failed because it was infeasible or on account of competency issues of its managers or *otherwise*. That, the administrative arrangements in place thwart course-corrections, has remained an under-researched aspect of organization studies.

Dysfunction three: silo-d functioning

Organizations develop silos over time. Quite a bit has been written about the need to burst, break or ventilate silos (Gleeson and Rozo, 2013; Govindarajan *et al.*, 2011; Holtz, 2014). Our analysis throws light on the origin of silos. Silos come into being to cater separately to each imperative from the top management. Distinct imperatives materialize at different points in time, but are eventually concurrently operational in one organizational site. TCE's vigil to enforce accountability to pre-agreed goals gives birth to silos.

An example will help illustrate the emergence of silo-d functioning of organizations. One company set out to implement a new, state-of-the-art supply chain management (IT) system. All managers pledged support. However, when the project team reached a departmental site and proposed making changes to existing IT systems, there was considerable resistance. The project team was told that they should build new functionality *around* existing systems: none of the existing functionality could be modified or eliminated, being crucial for market success. The project team had to concede. They made certain *ad hoc* changes to the companywide template and deployed extra resources to implement the intended functionality keeping the older functionality intact.

We advance that if organizations wish to reduce silos, the first thing to revisit would be the tenets by which the organization is administered. Otherwise, we shall continue to see silo-d functioning causing inefficiency, by sacrificing benefits of coordination.

Discussion

Notwithstanding the claims that TCE is an empirical success story, there have been numerous criticisms (Ghoshal and Moran, 1996; Ghoshal, 2005; Hodgson, 2004; Holt, 2004; Huehn, 2008; Pfeffer and Fong, 2002 and so on). Other researchers suggest tenets diametrically opposite to those of TCE – such as fostering trust instead of focusing on preventing opportunism – as *necessary* for promoting cooperation (Lewicki and Bunker, 1996; Morgan and Hunt, 1994; Shapiro *et al.*, 1992). Cooperation requires trust. Trust prevails where one does not fear that one's exchange partner will act opportunistically (Gulati, 1995). We find the state of affairs problematic: absent further qualifications, it is difficult to reconcile these streams of research with the claims of TCE. We reason that unless the anomalies are addressed head-on, academia fails in its responsibility of providing useful guidance to Practice.

In our research, we focus on a set of endogenous critiques of TCE – where the TCE argument is examined without rejecting its basic premises (Ketokivi and Mahoney, 2016) – highlighted in prior research. These pertain to:

(a) interdependence across transactions (from Williamson, 1985);

(b) high degree of reliance on managerial foresight (from Mayer and Argyres, 2004); and

(c) inseparability of administrative decisions made at different points in time (from Argyres and Liebeskind, 1999).

The theory we develop shows how organizational effectiveness is impaired by the interplay of mechanisms underlying these anchor critiques with other tenets of TCE *and* conditions arising from a major change project being underway. We select the setting of an organization undergoing a major change project primarily on the basis of our field experience, and noting that limitations arising from critiques (a), (b) and (c) are less likely to be salient in organizations not undergoing change. We establish that TCE-based administration definitely hampers organizational effectiveness when deployed in an organization undergoing a major change process. Thus, we provide a partial resolution of the problem we started with: focusing on limiting opportunism is not the recipe for obtaining cooperation in all circumstances. Administration based on tenets of TCE is *sufficient* to impair organizational effectiveness when an organization-wide change effort is underway. Our study suggests the following implications for the practice of administration:

- An organization administered by the tenets of TCE is quite likely to fail in accomplishing a major change effort. Focus on individual contribution frustrates cooperation. A climate of domination and control thwarts creative problem-solving.
- Holding organizational members to goals agreed upon ahead of time – a product of the elaborate machinery of coercion and surveillance promoted by TCE approaches – is counterproductive, when an organization sets out to effect a major change. To succeed, meaningful relaxation of demands for delivering on prior goals is required.
- To cope with novelty, deference to expertise is required, rather than deference to authority. Experts will contribute if they are given a fair hearing, i.e. if suitable measures are in place to override fiat.

Implications for future research

Our theoretical propositions suggest new lines of inquiry into organizational phenomena. Take, for example, spatial interdependence of transactions. At normal times (i.e. when a major change is not underway) organizations rely on routines and standard-operating-procedures to handle interdependence between work-units. In a *temporary organization* – for instance the project team tasked to implement organizational change – there is need for different set of arrangements to accommodate interdependence between sub-teams. Project managers use a variety of tools (e.g. PERT, CPM charts[6]) to plan for and monitor the sequence of activities assigned to the various sub-teams. The problematic piece, though, is that the logic of sub-team formation gets increasingly antiquated as time passes, invalidating much of the contents of the planning artefacts (PERT/CPM charts). Much more fluidity is required in assignment of personnel's task responsibilities and in sub-unit composition. While such (fluidity) may be infeasible under TCE-based administration, other administrative forms that do better need to be identified and studied.

Second, we have noted that it is inappropriate to rely solely on managerial foresight to set goals and drive implementation through fiat, in a major change project. Competent lower-level employees – who are closer to developments on the ground – often have better understanding regarding appropriate courses of action. Providing experts a voice requires measures to override fiat. Prior research has examined this issue as one of facilitating speaking "truth to power" (for example Burgelman and Grove, 2007). Alternately, managers are encouraged to pick up more technical knowledge, and technical people are encouraged to take up management courses. We observe that the root of the problem lies in attempting the impossible: attempting to simultaneously achieve the maximum in multiple *interdependent* objectives (Ethiraj and Levinthal, 2009), namely, administrative as well as technical objectives. Organization research needs to suggest ways and means of fashioning a hierarchy of objectives for particular situations, complemented by identification of reasonable thresholds for level of attainment to aim for. Research should also suggest ways of refashioning the hierarchy upon accumulation of new insights.

Third, it is quite likely that an organization that is in a settled state (i.e. not undergoing major change) possesses well-explicated routines and procedures to handle situations where distinct mandates from the top arrive at different points in time. Further, it may very well be the case that, when requesting support from the ranks for a major change project, the top management is willing to extend a certain degree of forbearance if departments come short on their prior financial targets. However, vague utterances regarding potential forbearance is not credible. An organization-wide change project will affect day-to-day operations in unpredictable ways. Even the departmental personnel may be hard-pressed to definitively say which extant processes have significant contribution to the department's outcomes, and therefore deserve to stay unchanged. Such *causal ambiguity* – uncertainty that "stems from a basic ambiguity concerning the nature of the causal connections between actions and results" (Lippman and Rumelt, 1982, p. 418) – tends to breed silo-s, where independent mandates are provisioned and tracked separately. Thus, research needs to show the path as to how organizations can understand themselves better, moving away from less-effective means for control via the TCE-inspired imagery of an angry divinity ever-prepared to dole out punishment upon the slightest hint of misfiring (recall TCE's inability to distinguish between honest mistakes and shirking, Shimizu, 2012).

Some limitations of the study

Our study has some limitations. We illuminate dysfunctions precipitated by two basic premises of TCE – supremacy of fiat, and surveillance of personnel to swiftly detect and punish failure to perform according to pre-agreed goals – in an organization undergoing change. The broader TCE literature discusses further organizational aspects regarding *asset specificity*, *small numbers bargaining* and so forth; our study does not inform on the status of TCE's recommendations with respect to these stylized dimensions of organizational functioning.

Moreover, we have limited our inquiry to situations involving just *two* kinds of interdependencies inside organizations – those concerning interdependence between work-units formed to jointly address a complex task, and those concerning interdependencies that apply when a given organizational site (say, a department) is the theatre of action for more than one imperative mandated by the top management in a company. Further research is necessary to investigate how a company administered on the basis of tenets TCE fares with respect to other forms of interdependencies between entities and processes in an organization. Again, TCE's failure to incorporate effects of learning and experimentation – discernible in its inability to distinguish between honest mistakes and shirking – plays an important role in our findings. We speculate that what we present is merely the tip of the iceberg; it is probable that many organizational problems arise from this deficiency of TCE.

Conclusion

For TCE to continue its march as an empirical success story, it is necessary that the theory be suitably modified to credibly stave off dysfunctions in:

- situations where unanticipated interdependencies between work-units emerge over time;
- situations where developments cannot be anticipated by managerial foresight alone; and
- situations requiring concurrent fulfilment of objectives originating at different points in time.

The age of temporary advantage (D'Aveni *et al.*, 2010) repeatedly presents situations involving one or more characteristics from (a), (b) and (c). Thus, even if an organization is not attempting a major change, TCE-based administration may severely handicap an organizations' ability to be responsive to fleeting opportunities. Applying Williamson's own logic, the possibility that even a miniscule proportion of mistakes may be punished (under a regime of TCE-based administration) will make employees wary of deviating from pre-agreed patterns of behaviour. Thereby, the organization fails to respond to fleeting opportunities appropriately.

Till such time TCE overcomes the limitations noted above, it is necessary that the stranglehold of TCE-based administration be loosened when a significant organizational change is set in motion. When a company embarks on implementing a major change, CEOs may consider issuing an earnings guidance, that targets may be underachieved in future quarters. In this regard, enhanced representation of lower level staff of the company in the Board of Directors (Ketokivi and Mahoney, 2016) is also likely to inspire confidence that a radical change being contemplated is in the best interests of the company. If investors display a spirit of forbearance to the earnings guidance, all levels of the company shall get energized to cast away the mental baggage anticipating punishment at every wrong move. This will enable ringing in the supportive changes in "[. . .] structures, processes, communication, and incentive systems [. . .]" (Dutton and Duncan, 1987; Greiner and Bhambri, 1989; Huy, 2002, 2011; quoted in Herrmann and Nadkarni, 2014, p. 1320) necessary to successfully implement a major organizational change. The climate of trust-based relationships (Lewicki and Bunker, 1996; Morgan and Hunt, 1994; Shapiro *et al.*, 1992) is likely to confer positive-sum gains through collaboration (Gulati *et al.*, 1994; Koza and Dant, 2007).

Notes

1. A *transaction* is an activity that occurs between two parties, concerning exchange of some tangibles and/or intangibles (say money for material and/or services) according to a pre-agreed schedule for frequency, quantity, quality and price. The pre-agreed schedule – written or orally agreed upon (as per conventions in the ecology of the transacting parties), and including explicit or implicit termination clauses – functions as a contract between the two parties.

2. Williamson (1996a, p. 56) elaborates thus: "Specifically, economic agents are permitted to disclose information in a selective and distorted manner. Calculated efforts to mislead, disguise, obfuscate, and confuse are thus admitted. This self-interest seeking attribute is variously described as opportunism, moral hazard and agency . . ."

3. Williamson (1996a, p. 56) contests the "neo-Hobbesian" label accorded on account of the assumption that economic agents are given to opportunism in varying degrees. He states that the bilateral design of credible commitments and other forms of private ordering constitute a *non-Hobbesian* response. However, across a power-hierarchy in an organization, the credibility of threat of sanction from a superior to subordinate is always higher.
4. This is equivalent to the King or royalty having binding authority in pronouncing judgments in disputes, in Hobbes's schema. All disputes get resolved by the judgment provided by the King, bringing order into society. There is, however, no safeguard against the King (or his representatives) pursuing self-interest at the expense of the subjects. For example, the King may demand that, by taking up residence in the kingdom, people have provided implicit consent to serve in wars designed to further the King's interests, even if residents of the kingdom have no desire to go to war and engage in killing people.
5. A *going concern* is a business that functions without the threat of liquidation for the foreseeable future. (Source: *Wikipedia*. Retrieved from https://en.wikipedia.org/wiki/Going_concern. Date Accessed: 25 April, 2017).
6. **PERT** (Programme Evaluation and Review Technique) is a statistical tool that invokes a probabilistic model to analyse and represent the tasks involved in completing a given project. In contrast, **CPM** (Critical Path Method) uses a deterministic model to plan, schedule and control complex projects. (Source: *PERT/CPM for Project Scheduling & Management*. Retrieved from www.interventions.org/pertcpm/. Date Accessed: 25 October 2017).

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