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Markets, Bureaucracies, and Clans

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Evaluating organizations according to an efficiency criterion would make it possible to predict the form organizations will take under certain conditions. Organization theory has not developed such a criterion because it has lacked a conceptual scheme capable of describing organizational efficiency in sufficiently microsopic terms. The transactions cost approach provides such a framework because it allows us to identify the conditions which give rise to the costs of mediating exchanges between individuals: goal incongruence and performance ambiguity. Different combinations of these causes distinguish three basic mechanisms of mediation or control: markets, which are efficient when performance ambiguity is low and goal incongruence is high; bureaucracies, which are efficient when both goal incongruence and performance ambiguity are moderately high; and clans, which are efficient when goal incongruence is low and performance ambiguity is high.[1]

The Nature of Organizations

What is an organization, and why do organizations exist? Many of us would answer this question by referring to Barnard's (1968) technological imperative, which argues that a formal organization will arise when technological conditions demand physical power, speed, endurance, mechanical adaptation, or continuity beyond the capacity of a single individual (1968: 27–28). Yet when the stone is too large or the production facility too complex for a single person, what is called for is cooperation, and cooperation need not take the form of a formal organization. Indeed, grain farmers who need a large grain elevator do not form corporations which take over the farms and make the farmers into employees; instead, they form a cooperative to own and operate the elevator.

Others would refer to March and Simon's (1958) argument that an organization will exist so long as it can offer its members inducements which exceed the contributions it asks of them. While this position explains the conditions under which an organization may continue to exist, it does not explain how an organization can create a whole which is so much greater than the sum of its parts that it can give them more than they contribute.

Most of us, however, would refer to Blau and Scott's (1962) definition of a formal organization as a purposive aggregation of individuals who exert concerted effort toward a common and explicitly

recognized goal. Yet we can hardly accept this definition whole, suspecting as Simon (1945: 257–278) has that individuals within organizations rarely have a common understanding of goals.

Another point of view on the question of why organizations exist began with an inquiry by Coase (1937) and has recently been developed by Williamson (1975). In this view, an organization such as a corporation exists because it can mediate economic transactions between its members at lower costs than a market mechanism can. Under certain conditions, markets are more efficient because they can mediate without paying the costs of managers, accountants, or personnel departments. Under other conditions, however, a market mechanism becomes so cumbersome that it is less efficient than a bureaucracy. This transactions cost approach explicitly regards efficiency as the fundamental element in determining the nature of organizations.

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Transactions costs are a solution to the problem of cooperation in the realm of economic activity. From the perspective of Mayo (1945) and Barnard (1968), the fundamental problem of cooperation stems from the fact that individuals have only partially overlapping goals. Left to their own devices, they pursue incongruent objectives and their efforts are uncoordinated. Any collectivity which has an economic goal must then find a means to control diverse individuals efficiently.

Many helpful ideas have flowed from this definition of the problem of cooperation. Some (e.g., Etzioni, 1965; Weick, 1969) have emphasized the tension between individual autonomy and collective interests which must attend cooperative action, while others (e.g., Simon, 1945) have emphasized the impossibility of achieving a completely cooperative effort. Our interest is in the efficiency with which transactions are carried out between individuals who are engaged in cooperative action.

Cooperative action necessarily involves interdependence between individuals. This interdependence calls for a transaction or exchange in which each individual gives something of value (for example, labor) and receives something of value (for example, money) in return. In a market relationship, the transaction takes place between the two parties and is mediated by a price mechanism in which the existence of a competitive market reassures both parties that the terms of exchange are equitable. In a bureaucratic relationship, each party contributes labor to a corporate body which mediates the relationship by placing a value on each contribution and then compensating it fairly. The perception of equity in this case depends upon a social agreement that the bureaucratic hierarchy has the legitimate authority to provide this mediation. In either case, individuals must regard the transaction as equitable: it must meet the standards of reciprocity which Gouldner (1961) has described as a universal requirement for collective life.

It is this demand for equity which brings on transactions costs. A transactions cost is any activity which is engaged in to satisfy each party to an exchange that the value given and received is in accord with his or her expectations.

Transactions costs arise principally when it is difficult to determine the value of the goods or service. Such difficulties can arise from the underlying nature of the goods or service or from a lack of trust between the parties. When a company is being sold by one corporation to another corporation, for example, it may not be unambiguously clear what the true value of that company is. If firms similar to the company are frequently bought and sold, and if those transactions occur under competitive conditions, then the market process will be accepted as a legitimate estimator of the true value. But if the company is unique, and there is only one potential buyer, then market forces are absent. How will the buyer and seller determine a fair price? They may call upon a third party to estimate the value of the company. Each party may in addition call upon other experts who will assist them in evaluating both the value of the company and the adequacy of the judgment of the third party. Each side may also require an extensive and complete contract which will describe exactly what is being bought and sold. Each of these activities is costly, and all of them are regarded here as transactions costs: they are necessary to create a perception of equity among all parties to the transaction.

This same argument applies to transactions in which a service, such as the labor of an individual, is the object of exchange. If one individual sells his or her services to another, it may be difficult to assess the true value of that labor. In particular, if the labor is to be used in an interdependent technology, one which requires teamwork, it may be difficult to assess the value contributed by one worker as opposed to another, since their joint efforts yield a single outcome in this case, or in a case where it is likely that task requirements will change, then the auditing and complex contracting required to create the perception of equity can become unbearably costly.

We have identified two principal mechanisms for mediating these transactions: a market and a bureaucracy. These alternatives have received the greatest attention from organization theorists (e.g., Barnard, 1968; Weber, 1968) and economists (e.g., Coase, 1937; Arrow, 1974). However, the paradigm also suggests a third mechanism: If the objectives of individuals are congruent (not mutually exclusive), then the conditions of reciprocity and equity can be met quite differently.

Both Barnard and Mayo pointed out that organizations are difficult to operate because their members do not share a selfless devotion to the same objectives. Mayo (1945) argued that organizations operated more efficiently in preindustrial times, when members typically served an apprenticeship during which they were socialized into accepting the objectives of the craft or organization. Barnard (1968: 42–43) posed the problem thus:

> A formal system of cooperation requires an objective, a purpose, an aim. . . . It is important to note the complete distinction between the aim of a cooperative effort and that of an individual. Even in the case where a man enlists the aid of other men to do something which he cannot do alone, such as moving a stone, the objective ceases to be personal.

While Barnard, like Arrow, views markets and bureaucracies as the basic mechanisms for achieving the continued cooperation of these individuals, he also allowed (1968: 141) for the possibility of reducing the incongruence of goals in a manner consistent with Mayo's view of the preindustrial organization:

> An organization can secure the efforts necessary to its existence, then, either by the objective inducement it provides or by changing states of mind. It seems to me improbable that any organization can exist as a practical matter which does not employ both methods in combination.

If the socialization of individuals into an organization is complete, then the basis of reciprocity can be changed. For example, Japanese firms rely to a great extent upon hiring inexperienced workers, socializing them to accept the company's goals as their own, and compensating them according to length of service, number of dependents, and other nonperformance criteria (see Abegglen, 1958; Dore, 1973; Nakane, 1973). It is not necessary for these organizations to measure performance to control or direct their employees, since the employees' natural (socialized) inclination is to do what is best for the firm. It is also unnecessary to derive explicit, verifiable measures of value added, since rewards are distributed according to nonperformance-related criteria which are relatively inexpensive to determine (length of service and number of dependents can be ascertained at relatively low costs). Thus, industrial organizations can, in some instances, rely to a great extent on socialization as the principal mechanism of mediation or control, and this "clan" form ("clan" conforms to Durkheim's meaning of an organic association which resembles a kin network but may not include blood relations, 1933: 175) can be very efficient in mediating transactions between interdependent individuals.

Markets, bureaucracies, and clans are therefore three distinct mechanisms which may be present in differing degrees, in any real organization.[2] Our next objective is to specify the conditions under which the requirements of each form are most efficiently satisfied.

The Market Failures Framework

We can approach this question most effectively by examining the markets and hierarchies approach provided by Williamson (1975), which builds upon earlier statements of the problem by Coase (1937) and others (for a more detailed description of the functioning of each mechanism, see Ouchi, 1979).

Market transactions, or exchanges, consist of contractual relationships. Each exchange is governed by one of three types of contractual relations, all of which can be specified completely. That is, because each party is bound only to deliver that which is specified, the contract must specify who must deliver what under every possible state of nature. The simplest form of contract is the "spot" or "sales" contract. This is what occurs when you walk up to a candy counter, ask for a candy bar, and pay the amount the salesperson asks. In such a transaction, all obligations are fulfilled on the spot. However, the spot market contract is, by definition, incapable of dealing with future transactions, and most exchange relationships involve long-term obligations.

A common device for dealing with the future is the "contingent claims contract," a document that specifies all the obligations of each party to an exchange, contingent upon all possible future states of nature. However, given a future that is either complex or uncertain, the bounded rationality of individuals makes it impossible to specify such a contract completely. Leaving such a contract incompletely specified is an alternative, but one that will succeed only if each party can trust the other to interpret the uncertain future in a manner that is acceptable to him. Thus, given uncertainty, bounded rationality, and opportunism, contingent claims contracting will fail.

Instead of trying to anticipate the future in a giant, once-and-for-all contract, why not employ a series of contracts, each one written for a short period within which future events can confidently be foreseen? The problem with such "sequential spot contracting" is that in many exchange relationships, the goods or services exchanged are unique, and the supplier requires specialized knowledge of how to supply the customer best and most efficiently. The supplier acquires this knowledge over time and in doing so gains a "first mover advantage," which enables him to bid more effectively on subsequent contracts than any potential competitor can. Knowing this, potential competitors will not waste their time bidding, thus producing a situation of "small numbers bargaining" or bilateral monopoly, in which there is only one buyer and seller. Under this condition, competitive pressures are absent, and each party will opportunistically claim higher costs or poor quality, whichever is in his or her interest. In order to maintain such an exchange, each party will have to go to considerable expense to audit the costs or performance of the other. If these transactions costs are too high, the market relationship will fail due to the confluence of opportunism with small numbers bargaining, even though the limitations of uncertainty and bounded rationality have been overcome.

Thus, under some conditions no completely contractual market relationship is feasible. Table 3.1 summarizes the conditions which lead to market failure. According to the paradigm, no one of the four conditions can produce market failure, but almost any pairing of them will do so.

The idea of market failure is an analytical device. Economists do not agree on a specific set of conditions that constitute the failure of a market; indeed one point of view argues that even monopolistic conditions may be competitive. However, the idea of market failure as expressed by Williamson (1975) is useful as a conceptual framework within which to compare the strengths of markets as opposed to bureaucracies. The technique is to contend that all transactions can be mediated entirely by market relations, and then ask what conditions will cause some of these market mechanisms to fail and be replaced by bureaucratic mechanisms. In this sense, every bureaucratic organization constitutes an example of market failure.

The bureaucratic organization has two principal advantages over the market relationship. First, it uses the employment relation, which is an incomplete contract. In accepting an employment relation, a worker agrees to receive wages in exchange for submitting to the legitimate right of the organization to appoint superior officers who can (1) direct the work activities of the employee from day to day (within some domain or zone of indifference), thus overcoming the problem of dealing with the future all at once and (2) closely monitor the employee's performance, thus minimizing the problem of opportunism.

Table 3.1 The Market Failures Framework*

Human factors	Environmental factors
Bounded rationality	Uncertainty/Complexity
Opportunism	Small numbers

*Adapted from Williamson (1975: 40).

Second, the bureaucratic organization can create an atmosphere of trust between employees much more readily than a market can between the parties to an exchange. Because members of an organization assume some commonality of purpose, because they learn that long-term relationships will reward good performance and punish poor performance, they develop some goal congruence. This reduces their opportunistic tendencies and thus the need to monitor their performance.

Bureaucracies are also characterized by an emphasis on technical expertise which provides some skill training and some socialization into craft or professional standards. Professionals within a bureaucratic setting thus combine a primary affiliation to a professional body with a career orientation, which increases the sense of affiliation or solidarity with the employer and further reduces goal incongruence.[3]

In summary, the market failures framework argues that markets fail when the costs of completing transactions become unbearable. At that point, the inefficiencies of bureaucratic organization will be preferred to the relatively greater costs of market organization, and exchange relationships move from one domain into the other.

Consider one example. The 10,000 individuals who comprise the workforce of a steel mill could be individual entrepreneurs whose interpersonal transactions are mediated entirely through a network of market or contractual relationships. Each of them could also have a market relation with yet another combine which owned the capital equipment and facilities necessary to produce steel. Yet steel mills are typically bureaucratic in form and each worker is in an employment, not market, relation with the corporation. Market forces have failed because the determination of value contributed by one worker is highly ambiguous in the integrated steelmaking process, which makes the transactions cost attendant upon maintaining a market too high.

Extending the Market Failures Framework: Clans

Bureaucracies can fail when the ambiguity of performance evaluation becomes significantly greater than that which brings about market failure. A bureaucratic organization operates fundamentally according to a system of hierarchical surveillance, evaluation, and direction. In such a system, each superior must have a set of standards to which he can compare behavior or output in order to provide control. These standards only indicate the value of an output approximately, and are subject to idiosyncratic interpretation. People perceive them as equitable only as long as they believe that they contain a reasonable amount of performance information. When tasks become highly unique, completely integrated, or ambiguous for other reasons, then even bureaucratic mechanisms fail. Under these conditions, it becomes impossible to evaluate externally the value added by any individual. Any standard which is applied will be by definition arbitrary and therefore inequitable.

If we adopt the view that transactions costs arise from equity considerations, then we can interpret Table 3.1 in a different light. Simon's work on the employment relation (1957: 183–195) shows that Table 3.1 contains some redundancy. He emphasized that under an employment contract, the employer pays a worker a premium over the "spot" price for any piece of work. From the point of view of the worker, this "risk premium" compensates him for the likelihood that he will be asked to perform duties which are significantly more distasteful to him than those which are implied in the employment contract. The uncertainty surrounding the likelihood of such tasks and the expectation that the employer will or will not ask them determines the size of the risk premium. If the employee agreed with all the employer's objectives, which is equivalent to completely trusting the employer never to request a distasteful task, then the risk premium would be zero.

The employment relation is relatively efficient when the measurement of performance is ambiguous but the employer's goals are not. In an employment relation, each employee depends on the employer to distribute rewards equitably; if employees do not trust the employer to do so, they will demand

contractual protections such as union representation and the transactions cost will rise.

Thus, the critical element in the efficiency of market versus employment relations has to do with (1) the ambiguity of the measurement of individual performance, and (2) the congruence of the employees' and employer's goals. We can now reformulate the transactions cost problem as follows: in order to mediate transactions efficiently, any organizational form must reduce either the ambiguity of performance evaluation or the goal incongruence between parties. Put this way, market relations are efficient when there is little ambiguity over performance, so the parties can tolerate relatively high levels of opportunism or goal incongruence. And bureaucratic relations are efficient when both performance ambiguity and goal incongruence are moderately high.

What form of mediation succeeds by minimizing goal incongruence and tolerating high levels of ambiguity in performance evaluation? Clearly, it is one which embodies a strong form of the employment relation as defined by Simon (1945), which is a relationship in which the risk premium is minimized. The answer is what we have referred to as the clan, which is the obverse of the market relation since it achieves efficiency under the opposite conditions: high performance ambiguity and low opportunism.

Perhaps the clearest exposition of the clan form appears in what Durkheim (1933: 365) refers to as the case of organic solidarity and its contrast with contractual relations:

> For organic solidarity to exist, it is not enough that there be a system of organs necessary to one another, which in a general way feel solidarity, but it is also necessary that the way in which they should come together, if not in every kind of meeting, at least in circumstances which most frequently occur, be predetermined. . . . Otherwise, at every moment new conflicts would have to be equilibrated. . . . It will be said that there are contracts. But, first of all, social relations are not capable of assuming this juridical form. . . . A contract is not self-sufficient, but supposes a regulation which is as extensive and complicated as contractual life itself. . . . A contract is only a truce, and very precarious, it suspends hostilities only for a time.

The solidarity to which Durkheim refers contemplates the union of objectives between individuals which stems from their necessary dependence upon one another. In this sense, any occupational group which has organic solidarity may be considered a clan. Thus, a profession, a labor union, or a corporation may be a clan, and the professionalized bureaucracy may be understood as a response to the joint need for efficient transactions within professions (clan) and between professions (bureaucracy). Goal congruity as a central mechanism of control in organizations also appears repeatedly in Barnard:

> The most intangible and subtle of incentives is that which I have called the condition of communion. . . . It is the feeling of personal comfort in social relations that is sometimes called solidarity, social integration. . . . The need for communion is a basis of informal organization that is essential to the operation of every formal organization (1968: 148; see also pp. 89, 152, 169, 273).

Descriptions of organizations which display a high degree of goal congruence, typically through relatively complete socialization brought about through high inclusion (Etzioni, 1965), are also found in Lipset, Trow, and Coleman (1956: 79–80), Argyris (1964: 10, 175), Selznick (1966), and Clark (1970). In each case, the authors describe the organization as one in which it is difficult to determine individual performance. However, such organizations are not "loosely coupled" nor are they "organized anarchies" simply because they lack market and bureaucratic mechanisms. A clan, as Durkheim points out, provides great regularity of relations and may in fact be more directive than the other, more explicit mechanisms. That clans display a high degree of discipline is emphasized by Kanter (1972) in her study of Utopian communities, some of which were successful businesses such as Oneida and Amana. According to Kanter, this discipline was not achieved through contractualism or surveillance but through an extreme form of the belief that individual interests are best served by a complete immersion of each individual in the interests of the whole (1972: 41).

More recently, Ouchi and Jaeger (1978) and Ouchi and Johnson (1978) have reported on modern industrial organizations which closely resemble the clan form. In these organizations, a variety of social mechanisms reduces differences between individual and organizational goals and produces a strong sense

of community (see also Van Maanen, 1975; Katz, 1978). Where individual and organizational interests overlap to this extent, opportunism is unlikely and equity in rewards can be achieved at a relatively low transactions cost. Moreover, these organizations are typically in technologically advanced or closely integrated industries, where teamwork is common, technologies change often, and therefore individual performance is highly ambiguous.

When a bureaucracy fails, then due to excessively ambiguous performance evaluation, the sole form of mediation remaining is the clan, which relies upon creating goal congruence. Although clans may employ a system of legitimate authority (often the traditional rather than the rational-legal form), they differ fundamentally from bureaucracies in that they do not require explicit auditing and evaluation. Performance evaluation takes place instead through the kind of subtle reading of signals that is possible among intimate coworkers but which cannot be translated into explicit, verifiable measures. This means that there is sufficient information in a clan to promote learning and effective production, but that information cannot withstand the scrutiny of contractual relations. Thus, any tendency toward opportunism will be destructive, because the close auditing and hard contracting necessary to combat it are not possible in a clan.

If performance evaluation is so ambiguous and goals so incongruent that a clan fails, what then? We can only speculate, but it seems that this final cell may be the case discussed by Meyer and Rowan (1977) in which control is purely ceremonial and symbolic. School systems, like other organizations, do employ a variety of mechanisms. Yet if there is no effective mechanism of mediation between individuals, the perception of equity may be purely superstitious, based on a broad, community-based acceptance of the legitimacy of the institution.

Markets, Bureaucracies, and Clans: An Overview

Having distinguished three mechanisms of intermediation, we can now summarize them and attempt to set out the general conditions under which each form will mediate transactions between individuals most efficiently. Table 3.2 discriminates markets, bureaucracies, and clans along two dimensions: their underlying normative and informational requirements.

Normative requirements refer to the basic social agreements that all members of the transactional network must share if the network is to function efficiently, without undue costs of performance auditing or monitoring. A norm of reciprocity, according to Gouldner (1961), is one of only two social agreements that have been found to be universal among societies across time and cultures (the other is the incest taboo). If no such norm were widely shared, then a potential trader would have to consume so much energy in setting the contractural terms of exchange in advance and in auditing the performance of the other party afterwards that the potential transaction would cost too much. Under such conditions, a division of labor is unthinkable and social existence impossible. Therefore, a norm of reciprocity underlies all exchange mechanisms.

A norm of legitimate authority is critical for two reasons. As discussed above, it permits the assignment of organizational superiors who can, on an ad hoc basis, specify the work assignments of subordinates, thus obviating the need for a contingent claims employment contract which would be

Table 3.2 An Organizational Failures Framework

Mode of control	*Normative requirements*	*Informational requirements*
Market	Reciprocity	Prices
Bureaucracy	Reciprocity	Rules
	Legitimate authority	
Clan	Reciprocity	Traditions
	Legitimate authority	
	Common values and beliefs	

either so complex as to be infeasible or so simple as to be too confining or else incomplete. Legitimate authority also permits organizational superiors to audit the performance of subordinates more closely than is possible within a market relationship. In a bureaucracy, legitimate authority will commonly take the "rational/legal" form, whereas in a clan it may take the "traditional" form (see Blau and Scott, 1962: 27–38). Legitimate authority is not ordinarily created within the organization but is maintained by other institutions such as the church or the educational system (Weber, 1947; Blau and Scott, 1962; Barnard, 1968: 161–184). While the legitimacy of a particular organization may be greater or smaller as a result of its managerial practices, it is fundamentally maintained within a society generally.

Common values and beliefs provide the harmony of interests that erase the possibility of opportunistic behavior. If all members of the organization have been exposed to an apprenticeship or other socialization period, then they will share personal goals that are compatible with the goals of the organization. In this condition, auditing of performance is unnecessary except for educational purposes, since no member will attempt to depart from organizational goals.

A norm of reciprocity is universal, legitimate authority is accepted, though in varying degree, in most formal organizations, and common values and beliefs are relatively rare in formal organizations. Etzioni (1965) has described this last form of control as being common only to "total organizations" such as the military and mental hospitals, and Light (1972) describes its role in ethnically bound exchange relationships. However, we have also noted that a partially complete form of socialization, accompanied by market or bureaucratic mechanisms, may be effective across a wider range of organizations. Mayo (1945) contended that instability of employment, which upsets the long socialization period necessary, is the chief enemy of the development of this form of control.

The informational prerequisites of each form of control are prices, rules, and traditions. Prices are a highly sophisticated form of information for decision making. However, correct prices are difficult to arrive at, particularly when technological interdependence, novelty, or other forms of ambiguity obscure the boundary between tasks or individuals. Rules, by comparison, are relatively crude informational devices. A rule is specific to a problem, and therefore it takes a large number of rules to control organizational responses. A decision maker must know the structure of the rules in order to apply the correct one in any given situation. Moreover, an organization can never specify a set of rules that will cover all possible contingencies. Instead, it specifies a smaller set of rules which cover routine decisions, and refers exceptions up the hierarchy where policymakers can invent rules as needed. As Galbraith (1973) has pointed out, under conditions of uncertainty or complexity the number of exceptions becomes so great that the hierarchy becomes overloaded and the quality of decision making suffers.

Traditions are implicit rather than explicit rules that govern behavior. Because traditions are not specified, they are not easily accessible, and a new member will not be able to function effectively until he or she has spent a number of years learning them (Van Maanen and Schein, 1978). In terms of the precision of the performance evaluation they permit, traditions may be the crudest informational prerequisite, since they are ordinarily stated in a general way which must be interpreted in a particular situation. On the other hand, the set of traditions in a formal organization may produce a unified, although implicit philosophy or point of view, functionally equivalent to a theory about how that organization should work. A member who grasps such an essential theory can deduce from it an appropriate rule to govern any possible decision, thus producing a very elegant and complete form of control. Alternatively, a disruption of the socialization process will inhibit the passing on of traditions and bring about organizational inefficiency.

Some Concluding Thoughts

Under conditions of extreme uncertainty and opportunism, transactions cost may rise. Indeed, Denison (1978) has observed that net productivity declined in the United States between 1965 and 1975 due to changes in "the industrial and human environment within which business must operate" (1978:21). According to Denison, output per unit of input has declined for two reasons: 78 percent of the decline

is due to increased costs of air, water, and safety on the job, and the remaining 22 percent is attributable to increased needs for surveillance of potentially dishonest employees, customers, contractors, and thieves. The resources put into improvements in air, water, and safety are not a net loss to society although they may reduce corporate profitability. The increased need for surveillance in business, however, may represent the fact that the cost of monitoring transactions has risen. Mayo (1945) might have predicted this change as an inevitable result of the instability which accompanies industrialization. In our framework, we could advance the following explanation: exchange relationships are generally subject to so much informational ambiguity that they can never be governed completely by markets. Consequently, they have been supplemented through cultural, clan mechanisms. As instability, heterogeneity, and mobility have intensified in the United States, however, the effectiveness of these cultural mechanisms has been vitiated and bureaucratic mechanisms of surveillance and control have increased. Although bureaucratic surveillance may be the optimal strategy under present social conditions, it is nonetheless true that the United States is devoting more of its resources to transactional matters than it did ten years ago, and that represents a net decline in its welfare.

The degree of uncertainty and opportunism that characterize American society may be such that no mechanisms of control ever function very well. We have already observed that the conditions necessary for a pure market, bureaucracy, or clan are rare. Even a combination of these control mechanisms may be insufficient in many cases, however. In organizations using new technologies or in the public sector, the rate of change, instability of employment, or ambiguity of performance evaluation may simply overwhelm all rational control attempts.

In these cases, exchange becomes institutionalized. Meyer and Rowan's (1977) central thesis is that school systems, by their nature, evade any form of rational control. They have no effective price mechanism, no effective bureaucratic control, and no internally consistent cultures (see also Meyer et al., 1978). Thus school systems (as distinguished from education, which need not be done by large organizations) continue to grow and survive because the objectives which they are believed to pursue have been accepted as necessary by society. Since rational control is not feasible within the school, no one knows whether it is actually pursuing these goals, but an institutionalized organization (the church is another example) need not give evidence of performance (see also Ouchi, 1977: 97–98).

All work organizations are institutionalized in the sense that fundamental purposes of all viable organizations must mesh at least somewhat with broad social values (Parsons and Shils, 1951). This institutionalization permits organizations to survive even under conditions that severely limit their capacity for rational control. Ultimately, organizational failure occurs only when society deems the basic objectives of the organization unworthy of continued support.

What is an organization? An organization, in our sense, is any stable pattern of transactions between individuals or aggregations of individuals. Our framework can thus be applied to the analysis of relationships between individuals or between subunits within a corporation, or to transactions between firms in an economy. Why do organizations exist? In our sense, all patterned transactions are organized, and thus all stable exchanges in a society are organized. When we ask "why do organizations exist," we usually mean to ask "why do bureaucratic organizations exist," and the answer is clear. Bureaucratic organizations exist because, under certain specifiable conditions, they are the most efficient means for an equitable mediation of transactions between parties. In a similar manner, market and clan organizations exist because each of them, under certain conditions, offers the lowest transactions cost.

Notes

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2. In the broader language necessary to encompass both economics and organization theory, an organization may be thought of as any stable pattern of transactions.

In this definition, a market is as much an organization as is a bureaucracy or a clan. The only requirement is that, for the purposes of this discussion, we maintain a clear distinction between the idea of "bureaucracy" and the idea of "organization." Bureaucracy as used here refers specifically to the Weberian model, while organization refers to any stable pattern of transactions between individuals or aggregations of individuals.

3. Despite these desirable properties, the bureaucratic type has continually been under attack and revision. As Williamson points out, the move from U-form (functional) to M-form (divisional) organization among many large firms has been motivated by a desire to simulate a capital market within a bureaucratic framework because of its superior efficiency. By regrouping the parts of the organization, it is possible to create subentities that are sufficiently autonomous to permit precise measurement and the determination of an effective price mechanism. Although each division may still operate internally as a bureaucracy, the economies which accrue from this partial market solution are often large, offsetting the diseconomies of functional redundancy which often accompany the separation of the organization into divisions.

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