VALVE'S WAY

WAYWARD, VISIONARY, OR VOGUISH?

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Puranam and Håkonsson (2015) challenge us to ponder what we as organization design theorists make of Valve's way (see also Jeppesen, 2008). We believe that Valve, in spite of its radical vision, does not represent a challenge to fundamental organization design theory and that it is questionable to what extent it represents a new blueprint for organization design, despite it being consistent with an "egalitarian Zeitgeist" (Puranam, 2014). In fact, managerial authority may be of increasing importance rather than the opposite (Guadalupe, Li, & Wulf, 2015). Thus, Valve is, and will remain, an outlier, albeit a voguish one.

HOW UNUSUAL IS VALVE'S WAY, REALLY?

Valve is just one example, albeit a radical one, of a spate of companies that have adopted flat hierarchies with widely distributed decision authority, project organization, high-powered incentives, and/or employee ownership of assets. Already in the 1980s, Wisconsin's Johnsonville Sausage slashed managerial oversight and put quality control, personnel management, customer relations, and even business expansion in the hands of worker-managed teams. As CEO Ralph Stayer (1990) declared, "My job was to put myself out of a job." The so-called "spaghetti organization" in the Danish hearing-aid producer, Oticon, which was adopted in 1991 (and partially abandoned in 1996) is an early example with many features similar to Valve (even down to the mobile trolleys). Foss and Klein (2014) refer to such examples as "wikified companies", using the wiki-prefix to denote the loosely structured, bottom-up, egalitarian structure popularized by the Wikipedia encyclopedia and touted by management thinkers and consultants.

In fact, over the last two to three decades the popular management literature has been replete with proclamations of the impending death of managerial authority (e.g., Hamel, 2014; Kastelle, 2013; Peters, 1994; Semler, 1989). We remain skeptical of such arguments. One reason is that the exemplary companies are often special and therefore unrepresentative cases. Consider Valve. This is a company that by virtue of the nature of the products it develops, produces, and selects is able to locate many interdependencies within organizational units of the company, namely, the individual project. (Of course, reputational interdependencies remain, and all projects draw on corporate resources.) This means that the externalities associated with task and outcome interdependencies are, to a large extent, internalized within projects (games), and such a "modular" design means less demand for managerial intervention. Valve is an example of an organization where a modular design of its product is reflected in a modular design of the organization (Sanchez & Mahoney, 1996). Employees are likely to be similar in terms of backgrounds, education, lifestyle choices, and so on. As a result, fault lines (van Knippenberg et al., 2011) in project teams are less likely to arise, and peer effects (Kandel & Lazear, 1992) presumably do a good job of addressing problems of moral hazard within projects. High-powered incentives also help. Because there are no fixed hierarchical positions and change is constant, there are no endowment and loss effects that may introduce organizational inertia (Kahneman, Knetsch, & Thaler, 1990).

From an organization design perspective, the particular organizational form used by Valve is hardly surprising. This is the kind of company where such a design would be viable (and by implication, less viable in more traditional companies) (Foss, 2003).

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LATENT DESIGN CHALLENGES

While so far Valve appears to have been a success, we do not think the Valve design is without latent problems. An immediate observation is that there is no functional specialization. For example, the absence of a marketing department may have negative consequences for the development of competencies in support functions such as marketing or sales (this is relevant to the scalability problem mentioned by Puranam and Håkonsson, 2015).

However, perhaps a more serious problem has to do with project selection. The modular organizational design of Valve removed managerial oversight not only from coordination within projects but also coordination and resource allocation across projects. Selection of projects with high potential, and termination of unsuccessful projects, are key strategic decisions made in firms. Typically, firms develop well-defined sets of decision criteria and processes to discriminate among promising and excessively risky projects. They also develop organizational structures such as committees or hierarchies to govern those decisions. In Valve, such decisions are delegated to the employees and rest upon several mechanisms.[1]

In a flat, project-based organization with self-selection into projects, these mechanisms include popularity of a project among employees, likeability and reputation of colleagues already involved in a project, interpersonal climate and conflicts among employees, and the visibility of a project. The personal characteristics of individuals, or the extent to which certain people like each other, may overshadow the true potential of a project or may even compromise its success. Thus, the process of signaling project value gets noisy, and the application of unbiased criteria potentially gets compromised – and arguably more so than in a traditional hierarchical structure.

The lack of a hierarchical structure in Valve does not mean that performance of employees is not being assessed; hierarchical monitoring is substituted with monitoring by peers. Performance bonuses are based on reviews by peers, while in traditional organizations performance is assessed more or less objectively by a boss, sometimes supplemented by 360 degree feedback. Being assessed by peers gives strong incentives not only to deliver high performance to a project but also to comply with social norms in the firm. Assessment by peers may be an effective tool to keep shirking at bay, as reputation among peers becomes important (Kandel & Lazear, 1992). Valve has apparently developed strong social norms for cooperation and for providing strong individual contributions.

While peer assessment may often be more accurate than supervisory assessment because of its superior access to person-specific information, it has its drawbacks. First, social skills, interpersonal relationships, and reputation become more important than in traditional organizations. To some extent, these assets arise as side effects of interaction in and across projects. However, investing in those assets is also a choice, and employees will undertake such investments (which may be seen as a special case of rent-seeking, involving peers rather than superiors). Second, these processes introduce feelings of loyalty and other emotions that may distort the assessment of projects. Because people are prone to a bias of overestimating the quality of ideas of outspoken, extroverted team members while underestimating the thoughts of more introverted colleagues, productive but introverted employees may not realize their full potential. Third, the lack of a formal hierarchy provides plenty of room for the formation of an informal hierarchy. As a former Valve employee confided, Valve "felt a lot like high school" (Warr, 2013):

> *It is a pseudo-flat structure where, at least in small groups, you're all peers and make decisions together. But the one thing I found out the hard way is that there is actually a hidden layer of powerful management structure in the company and it felt a lot like high school. There are popular kids that have acquired power in the company, then there's the trouble makers, and everyone in between.*

While formal hierarchy inside Valve is absent, formal authority held by the owner, Gabe Newell, is highly visible in the firm. Newell signals his authority, organizational values,

1 The precise allocation of the many decision rights that attach to projects (i.e., initiating, executing, monitoring, and terminating) is not entirely clear from the case description, and this may be critical.

and the culture of appreciating high performers through high wages, a strict and elaborate recruitment process, and also dismissing redundant employees.[2]

BEYOND VALVE

Valve can do without much formal authority, we submit, because of the particular nature of its processes and products. In general, when activities are highly time-dependent, key knowledge is concentrated within the management team, and there is a need for internal coordination because of interdependencies, the case for managerial authority is strong (Foss & Klein, 2014). While timing the launch of games seems to be important, these conditions do not seem to describe Valve well. This raises the issue of the generalizability of Valve's organizational design to other companies and industries. Valve is and will remain an outlier.

And yet, Valve is a stark illustration of the fact that while managerial authority is here to stay, the nature of managerial authority may be changing. For many everyday business activities, employees no longer need a boss to direct them to tasks or to monitor their progress. In fact, such involvement can be demotivating (Robinson & Rousseau, 1994). In a company characterized by dispersed knowledge residing inside the heads of highly qualified specialists, leaders need to let go of the notion that things should be managed from the top (Dobrajska, Billinger, & Karim, forthcoming). Managers need to move away from specifying methods and processes in favor of defining the principles they want people to apply or the goals they want people to meet. In other words, they can design the rules of the game without specifying the actions of the players. Besides establishing the organization's guidelines for rewards, instruction, rules, and communication, managers need to convey a general understanding of "how things are done here" to help employees react effectively to changes and unexpected occurrences. Effective leaders are good at defining such frameworks. Letting organizational culture emerge and percolate on its own, without deliberate structure and design, can lead to a number of problems not the least of which is a rough-and-tumble culture that favors certain employees at the expense of others, which Valve seems to exemplify (Miller, 2014).

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2 http://www.forbes.com/sites/danielnyegriffiths/2013/02/13/layoffs-at-valve-senior-staff-among-rumoredreported-departures/

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