



VALVE CORPORATION

COMPOSING INTERNAL MARKETS

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Discussions of the Valve Corporation are always enlightening. The skeptic wonders how much is rhetoric and recruiting ploy and how much is real. Is there clear evidence that this organizational design actually works – that it is efficient in this setting? While revenues per employee are quite remarkable, cause and effect are unclear. Is “boss-less-ness” the cause of high sales per employee or simply the result of high sales per employee, fueled from earlier success? The same question could be asked of Google’s unusual organizational approach. Is Google’s success the result of its extensive autonomy granted to employees, or is its past success the enabling cause of such autonomy? Such questions, of course, are empirically unanswerable here. I therefore set them aside and assume this organizational specimen is efficient – well-suited to its environment – and proceed with further commentary.

It is tempting to observe Valve and ask the question: how do they operate so well without bosses – with so little hierarchy? However, for me the key question is: why do they operate with any hierarchy whatsoever? What advantage is gained from this limited form of integration? Why employ game developers rather than contract for their output or services as is common in book, film, and music production? Given the efforts to replicate the look and feel of a market with high-powered incentives and the free-flowing match of individuals to projects, why does Valve bother with integrating this activity at all?

There is no shortage of gamers willing to participate in development and no shortage of opportunities to outsource. Valve’s recent willingness to undertake layoffs despite their success suggests they are also not promoting an environment of job security or guaranteed employment.¹ Instead, Valve seems intent on replicating the market internally as best it can. But, again, why not just crowdsource or contract for the work? The answer seems non-obvious, and I can offer only speculation as to what Gabe Newell perceives as the advantage. I suspect it is quicker access to talent, a more streamlined approach to matching talent to projects, and greater capacity to facilitate the cooperation and coordination across projects and developers required to build Steam as a robust game portal. I am not convinced any of these advantages are enormously compelling, which explains Valve’s efforts to primarily replicate markets within its organizational walls.

Their apparent success in doing so takes us then to the next and to my taste the most interesting question. How does Valve get away with adding so little hierarchy and instead composing within the firm so many of the central features of markets? How does the firm so closely link pay to performance, thereby providing wide, market-like pay variance? How does the firm avoid meddling bosses? How does the firm generate this fluid matching of people to projects? These are outcomes not easily achieved inside most organizations. For instance, wide pay variance linked to subjectively assessed performance yields rampant social comparison costs in most organizations (Nickerson and Zenger, 2008). Individuals, in response to what they perceive as unfair pay, lobby managers, diminish their effort, cease their employment, or sabotage the efforts of others. Moreover, within firm boundaries managers meddle and employees aggressively politick to alter pay or change work assignments (Milgrom and Roberts, 1988). How does Valve avoid these standard impediments to the selective infusion of market-like incentives?

In my mind, the answer partly reflects the nature of the work. Game development is a rather modular, decomposable activity (Baldwin, 2008; Simon, 1962; Nickerson and Zenger,

¹ <http://www.forbes.com/sites/danielnyeegriffiths/2013/02/13/layoffs-at-valve-senior-staff-among-rumored-reported-departures/>

2004). Project groups are small; individual efforts and performance are relatively observable; and projects are rather independent of one another. But, arguably even more important, Valve succeeds because it adopts a bundle of complementary design elements, aided by rather measurable individual performance, that enable the infusion of market elements (see Zenger, 2002; Zenger and Hesterly, 1997). The absence of bosses, aggressive market-like pay, self selection to projects, and peer evaluation all function as design complements. The absence of a boss assigning pay or allocating projects curbs costly politicking over variance in rewards. There is simply no one to lobby, thereby removing an important cost associated with pay variance. The absence of bosses also ensures that there is also no one to blame for low performance, as each individual chooses both her projects and her effort. Peer assessments of performance and the resulting assignment of pay also remove targets for costly lobbying and politics. All of the above are complemented by the modular nature of work and the relative observability of performance. It is difficult to conceive of this model being successful in work setting where all projects, problems, and efforts are highly interdependent and require extensive coordination.

All of the comments above point to the origins of this design's rarity. First, for much of what Valve does, the design seems to hold only a marginal advantage over simply using the market. Second, the feasibility of the design and its potential advantage is likely limited to settings where work is highly decomposable, and individual performance rather observable. Third, replicating Valve is not an a la carte design endeavor. It instead requires the skillful adoption of a host of complementary design choices. While such work conditions are not necessarily rare, and others may learn from Valve's skillful implementation, this trio of demands likely dooms the design to "rare breed" status in the "organizational zoo."

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