VALVE CORPORATION

STRATEGY TIPPING POINTS AND THRESHOLDS

TEPPO FELIN

Valve Corporation represents an intriguing case study of flat structure and self-organization (Puranam & Håkonsson, 2015). The structures and practices of Valve, of course, are not new. But the company provides an interesting experiment and illustration that powerfully highlights how organization design can impact individual and collective behavior, strategy, and performance.

For the past two years, I have used Valve's *Handbook for New Employees* (Valve Corporation, 2012) as a case study with MBA students and executives. The Valve case illustrates many important concepts related to organization design and strategy. For example, Valve is a nice example of infusing the market mechanism into hierarchy (Foss, 2003; Zenger & Hesterly, 1997). The company utilizes high-powered incentives and peer mechanisms to reward, lure, and retain top talent. The company can also be seen as a form of polyarchy (Knudsen & Levinthal, 2007; Sah & Stiglitz, 1986), where individuals can pursue initiatives at their own discretion without fear of managerial intervention. Puranam and Håkonsson (2015) also touch on a number of other principles illustrated by Valve.

What is new about the structures and practices of Valve? Last year I interviewed a key informant (the primary author of Valve's *Handbook*) to learn more about the company (Felin & Powell, 2014). The interview provided rich details about Valve's structures and practices, including some novel aspects that are worth further consideration. What intrigued me most about Valve was its use of the "rule of three." This rule requires that at least three individuals within the organization agree that a particular initiative, product idea, or project is worth pursuing before it is launched. Not only should three individuals agree about the value of the project, but they also need to be willing to join and work on the project. Thus, unlike polyarchies (in their pure form), Valve has instituted a practice where individuals cannot pursue projects on their own. Every initiative and project requires a threshold level of social support – in effect, creating a tipping point (of three individuals) for action.

Valve's rule of three for initiating a project is interesting in a number of ways. The need to recruit or incorporate at least three people to start a project creates a kind of initial social proof about both the possibility and feasibility of a potential project (Felin & Powell, 2014). If three people think an idea is worthwhile – and are willing to "vote with their feet" to join and work on the project – this creates a signal about the potential value of the project. In fact, individuals within the company are encouraged to constantly be thinking about and scanning for those projects that might create the most value for themselves and the organization.

The rule of three also creates a mechanism whereby an individual's initial ideas are likely to morph and improve through social interaction. The need for social interaction can lead to improvements and changes in the nature of the initial idea and project itself as well as the consideration of adjacent opportunities beyond the purview of any one individual. The rule of three demands social interaction, which in turn unleashes a valuable set of processes: brainstorming, pitching and recruiting, consensus building, discussion, negotiation, and learning. Thus, a form of collective wisdom accrues as individuals interact with others, and the project idea evolves toward the threshold of three.

The rule of three, and the associated need to recruit and interact with others, also ensures that ideas are vetted more carefully. The rule can be seen as providing a much-needed check on cognitive biases that might hamper individuals. Individuals suffer from a host of biases

Journal of Organization Design
JOD, 3(2): 10-11 (2014)
DOI: 10.7146/jod.20157

that may lead to poor project selection and decision-making, including confirmation bias, attentional biases, blind spots, and overconfidence. The recruitment of others onto a project can dampen the effect of these individual biases, as project or product ideas are vetted and scrutinized by others.

Adding the social factor to decision-making and project selection does not ensure that biases disappear completely. Beyond individual biases, a host of social biases can also detrimentally impact decision-making and project evaluation and selection. For example, individuals – even within small social circles – might suffer from an in-group or shared information bias. Furthermore, social interaction and peer recruitment onto projects might happen based on homophily. That is, there is a natural tendency for human interaction to occur on the basis of similarity on demographic or value-related factors, which can hamper the extent to which sufficiently diverse ideas are introduced and considered.

I directly asked Valve respondents about any concerns that they might have about these types of social biases. They argued that because they hire the very top talent in their industry – and aggressively pay and incentivize them – that these individuals might be less susceptible to such biases. Perhaps so – research has shown that there are individual differences in biases, where some are less prone to certain types of biases than others (Stanovich, 2011). Mistakes are inevitable (and even encouraged) as Valve, after all, operates in a dynamic and uncertain technology environment where experimentation and trial-and-error are part of the process of innovation.

In conclusion, Valve has created a seemingly dynamic, self-organizing ecosystem where strategies and opportunities emerge endogenously as individuals imagine, interact, and self-select to create projects and joint value. I find the more general principle of strategy tipping points and thresholds – as Thorbjørn Knudsen and I tried to model in the context of entrepreneurship and strategy (Felin & Knudsen, 2012) – to be interesting and worth careful consideration. How individuals "vote with their feet," both within and across organizational settings, is important from a strategic perspective. Tipping points and thresholds associated with self-selection and the mobility of human capital, I believe, can serve a number of functions: a signal of value, a decision heuristic, a source of managerial insight, and even a way of validating and implementing strategies. Thus, I think Valve's rule of three, and the more general idea of strategy tipping points and thresholds, provides an intriguing opportunity for future work at the nexus of organization design and strategy.

REFERENCES

Felin T, Knudsen T. 2012. A theory of nascent entrepreneurship and organization. *Managerial and Decision Economics* 33: 409-426.

Felin T, Powell T. 2014. Organization design and capabilities. Working Paper, Oxford University, UK.

Foss NJ. 2003. Selective intervention and internal hybrids: Interpreting and learning from the rise and decline of the Oticon spaghetti organization. *Organization Science* 14: 331-349.

Knudsen T, Levinthal D. 2007. Two faces of search: Alternative generation and alternative evaluation. *Organization Science* 18: 39-54.

Puranam P, Håkonsson DD. 2015. Valve's way. *Journal of Organization Design* 4(2): 2-4.

Sah RK, Stiglitz JE. 1986. The architecture of economic systems: Hierarchy and polyarchy. *American Economic Review* 76: 716-727.

Stanovich KE. 2011. *Rationality and the Reflective Mind*. Oxford University Press, Oxford, UK.

Valve Corporation. 2012. *Handbook for New Employees*.

Zenger TR, Hesterly WS. 1997. The disaggregation of corporations: Selective intervention, high-powered incentives, and molecular units. *Organization Science* 8: 209-222.

TEPPO FELIN

Professor
University of Oxford
E-mail: teppo.felin@sbs.ox.ac.uk