

Management Practices in Europe, the US and Emerging Markets

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Lecture 4: Power & Decentralization in Firms



- **What is decentralization?**

- Alibaba Case
- Decentralization & learning
- Measuring real authority
- Factors affecting decentralization



What is decentralization?

- One aspect of firm organization - how power and decision making are distributed
- Unlike basic management practices no typical “good” and “bad” – just different styles which tend to vary by country
- Why should you care:
 - Key in designing your business or advising others
 - Changing over time, generating broader economic effects, like increased inequality and worker empowerment

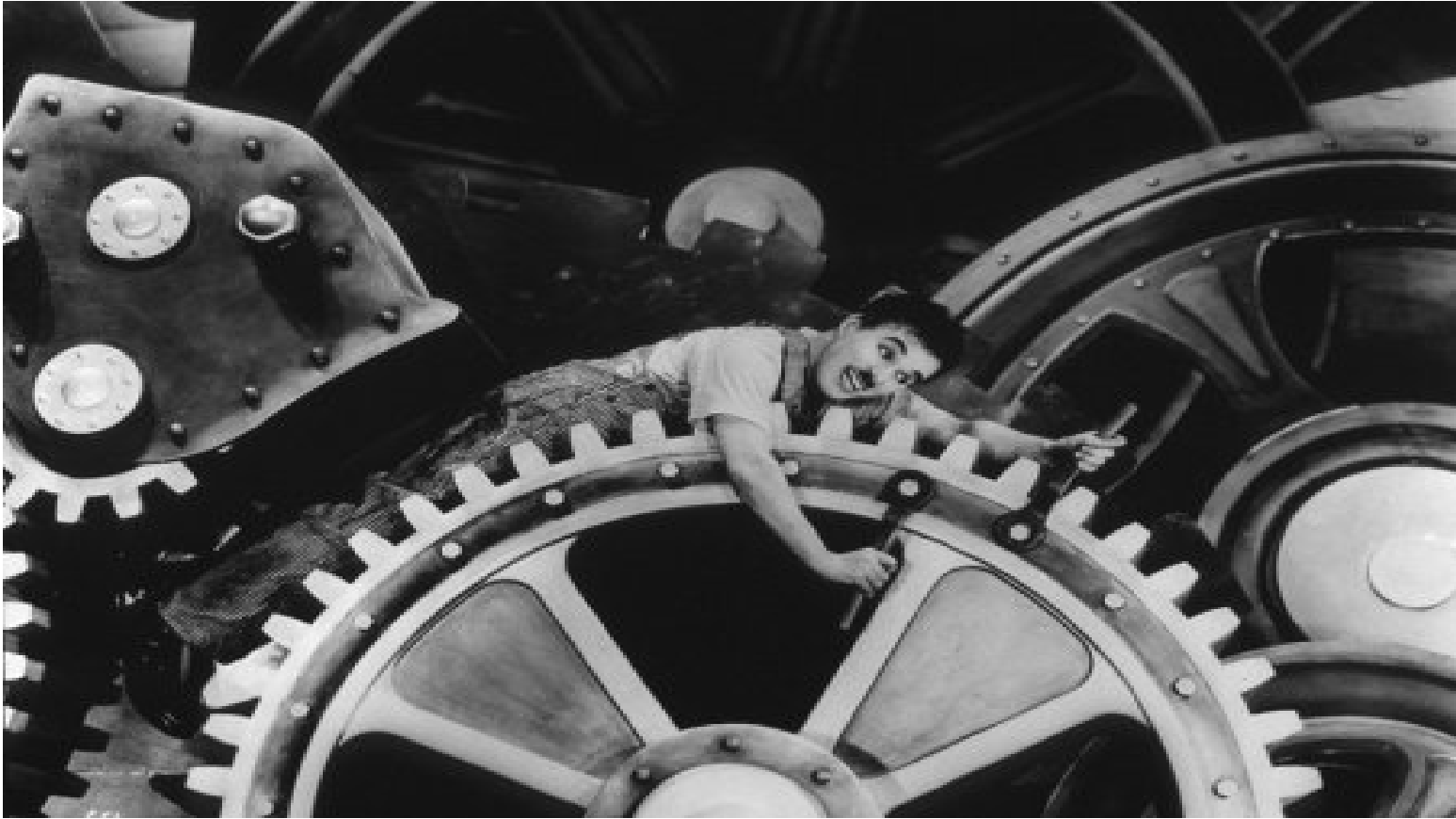


Formal vs. Real Authority

- Formal authority in the organization chart (“organogram”)
 - E.g. Profit centers vs. cost/sales centers
- Real authority
 - How things actually get done. Power
 - <http://www.youtube.com/watch?v=5FRVvjGL2C0>
- Can be different across different types of decisions
 - e.g. Investment, pricing, products

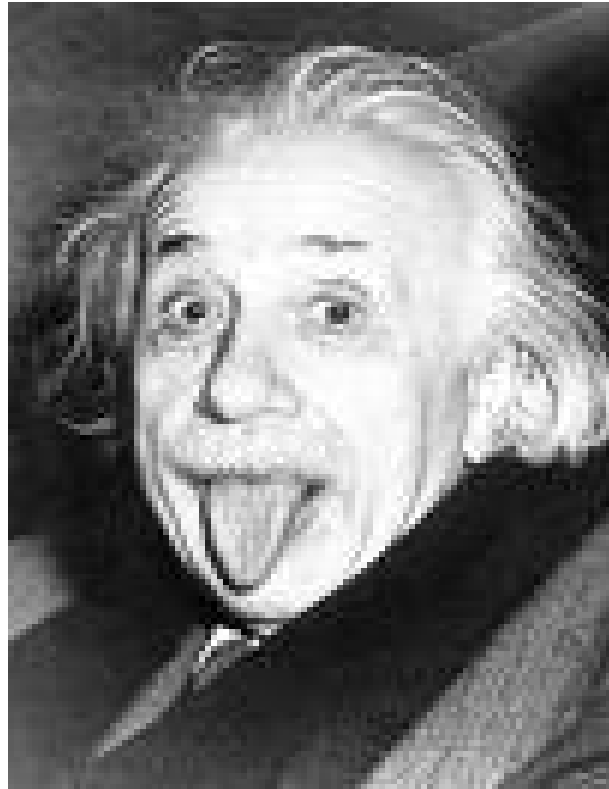


Real authority models: Centralized



http://www.youtube.com/watch?v=wBl0v_CSqyl&feature=related

Real authority models: Decentralized



e.g. Universities

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Jack Ma to step down as boss of Alibaba

One of China's best-known businessmen, Jack Ma, will step down as chief executive of Alibaba, the hugely successful e-commerce firm he founded.

In a letter to employees, Mr Ma said he would appoint a successor and act only as an executive chairman from 10 May.

The move comes just days after Alibaba said it was breaking up its business into 25 different units that will be led by different executives.

Alibaba, founded in 1999, is one of the world's biggest online companies.

"I see that Alibaba's young people have better, more brilliant, dreams than mine, and they are more capable of building a future that belongs to them," Mr Ma said in the letter, adding that the decision had been a difficult one.



Jack Ma has compared himself to Forrest Gump

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Questions on the Alibaba case

- *What does Alibaba do?*



Questions on the Alibaba case

- *Is the current degree of competition/decentralization among the business units appropriate?*



Questions on the Alibaba case

- *Do you think that Jack Ma should encourage more cooperation? If so, how?*



Questions on the Alibaba case

- *Where should the new business initiatives (mobile platforms and financing small businesses) reside organizationally? At corporate or within the individual business units?*



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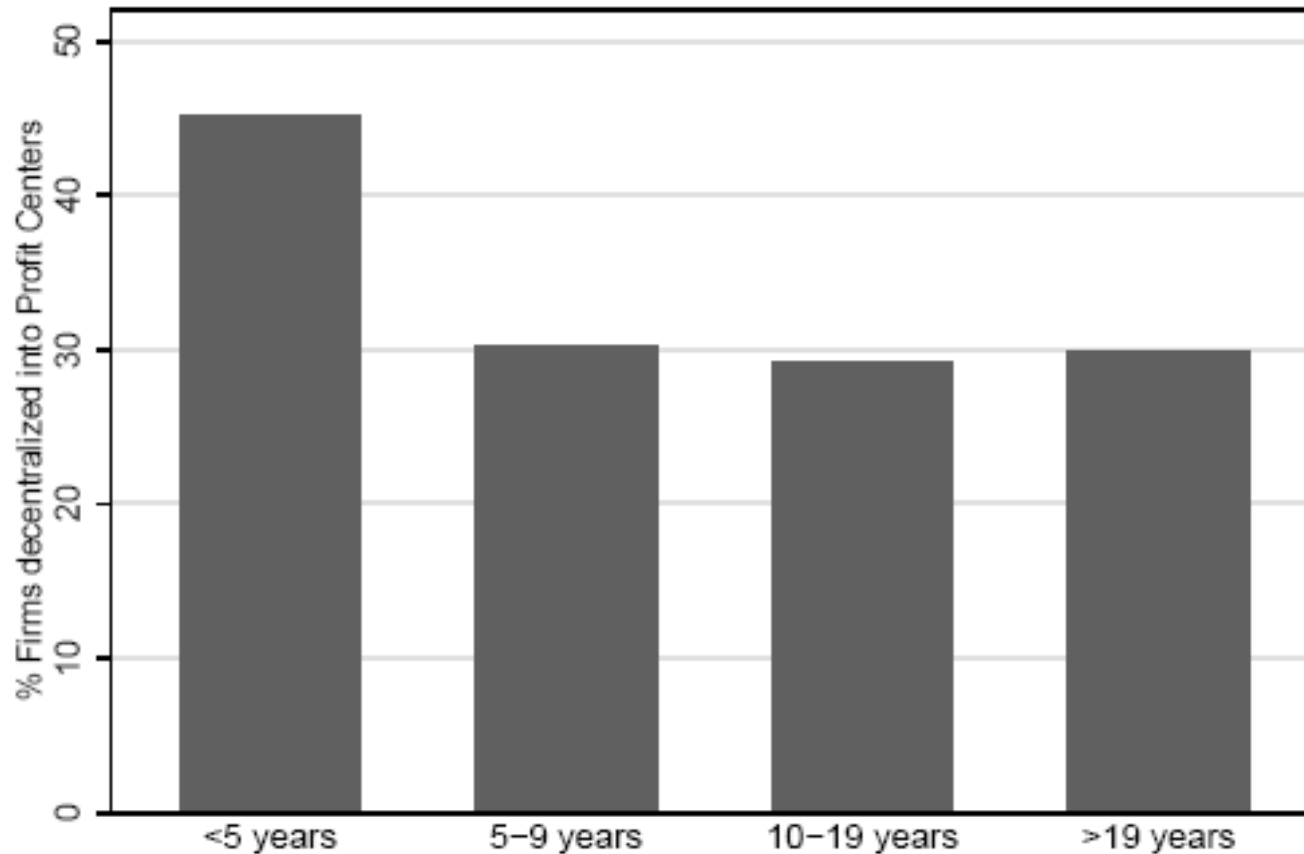
Decentralization (into profit centers like Alibaba)

- **Learning Theory:** CEO decentralizes when knowledge of local managers very important. Decentralize when:
 1. Firm is young (less experience to draw on)
 2. Firm uses more advanced technology
 3. Industries are more volatile & changing quickly (heterogeneous – harder to learn from others)
- Evidence
 - Consistent with Alibaba
 - Acemoglu, Aghion, Lelarge, Van Reenen, Zilibotti (2007) look at 1000s of French and British firms. Ran econometric models with many controls

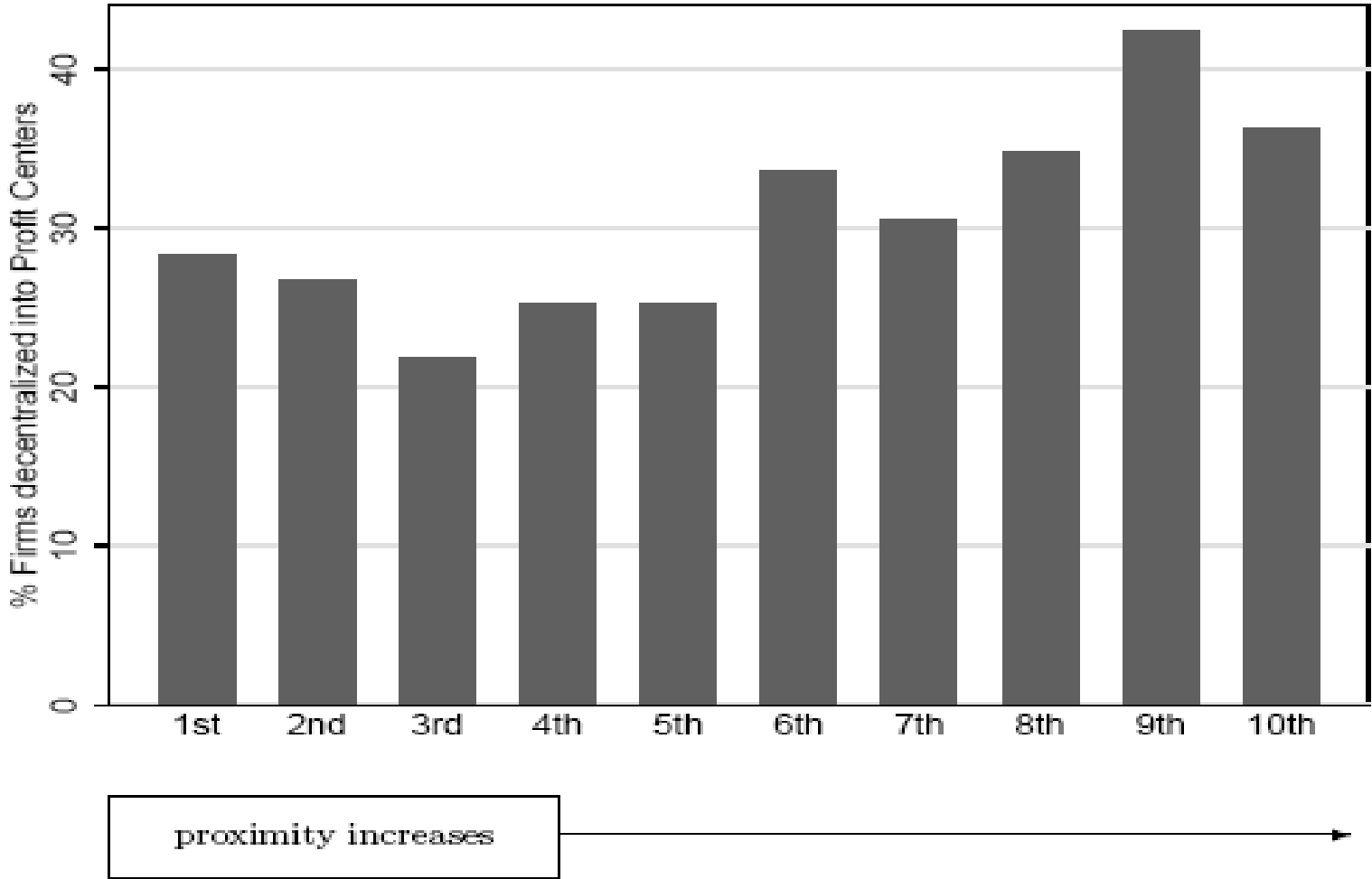


Younger firms are more decentralized

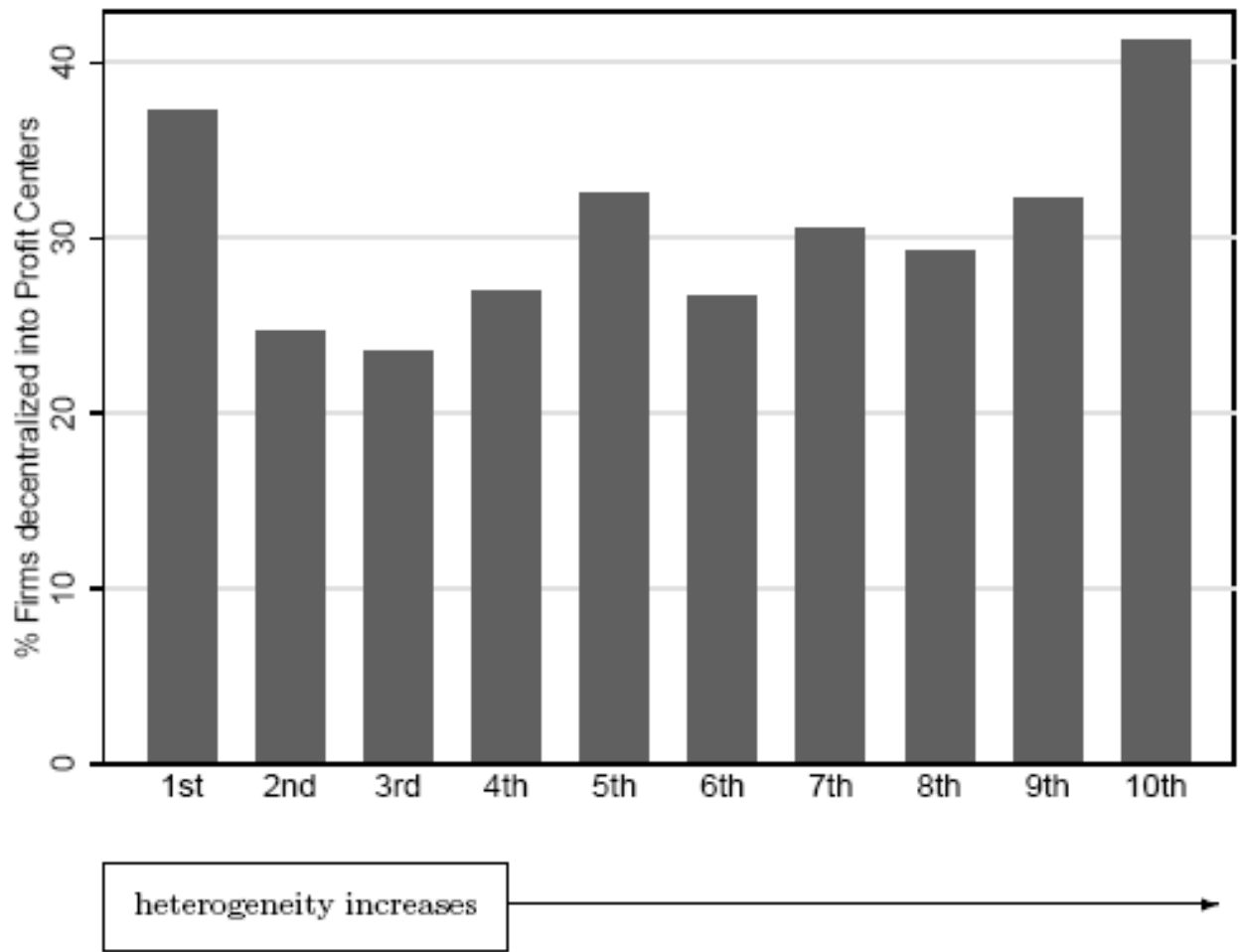
Figure 3: Age and decentralization
Decentralization to Profit Centres (COI)



More technologically advanced firms more likely to be decentralized



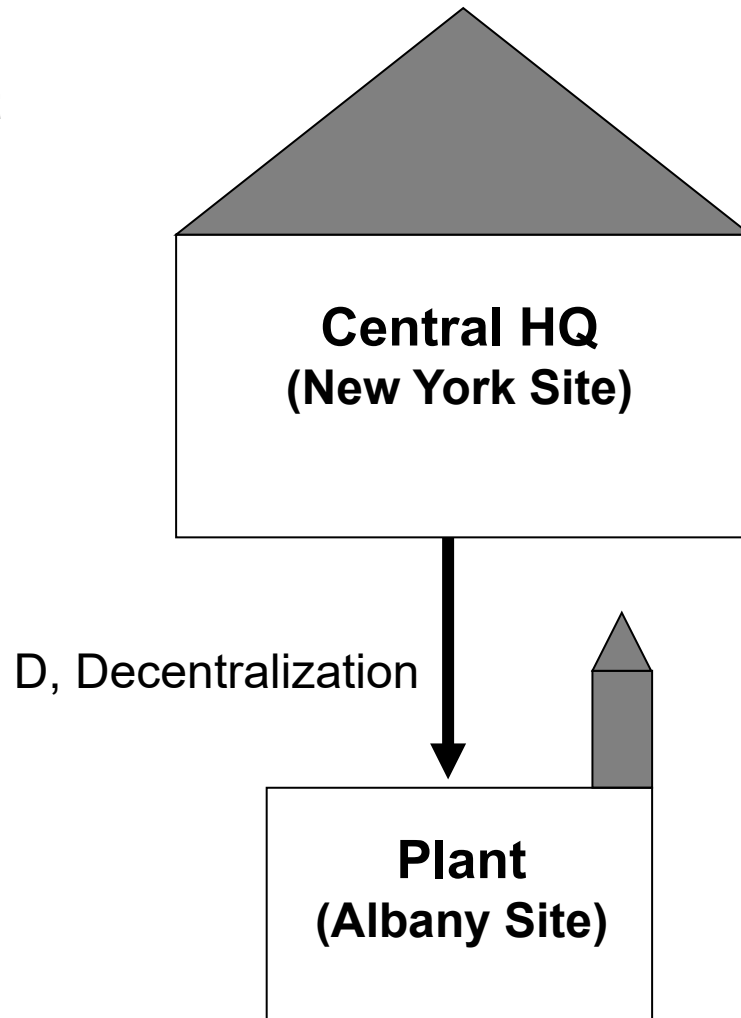
Firms in more volatile sectors (bigger variance of productivity shocks) are more likely to be decentralized



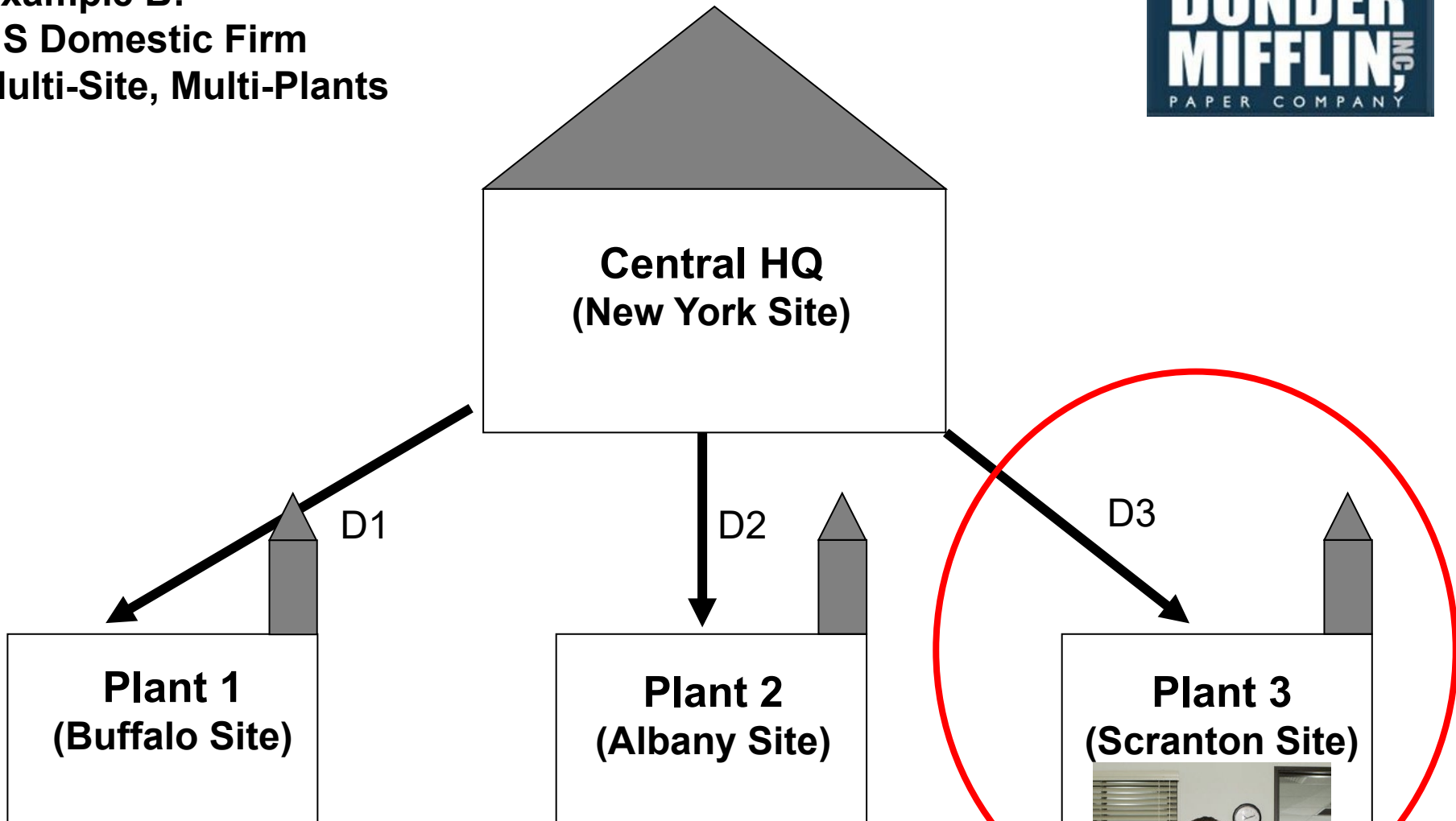
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**Example A:
Domestic Firm
2 Sites, Single Plant**



**Example B:
US Domestic Firm
Multi-Site, Multi-Plants**



The Decentralization Survey Page

Company Name

WUZHILVYU CHEMICAL & ELECTRIC CO.LTD.

Scoring

1

3

5

To hire a FULL-TIME PERMANENT SHOPFLOOR worker what agreement would your plant need from CHQ?

| | | | | |
|--|---|---|---|---|
| | ▼ | No authority - even for replacement hires | Requires sign-off from CHQ based on the business case. Typically agreed (i.e. about 80 or 90% of the time). | Complete authority - it is my decision entirely |
|--|---|---|---|---|

Where are decisions taken on new product introductions - at the plant, at the CHQ or at both?

| | | | | |
|--|---|---|---|--|
| | ▼ | All new product introduction decisions taken at the CHQ | New product introductions are jointly determined by the plant and CHQ | All new product introduction decisions take at the plant level |
|--|---|---|---|--|

How much of sales and marketing is carried out at the plant level (rather than at CHQ)?

| | | | | |
|--|---|--|---|--|
| | ▼ | None - sales and marketing is all run by CHQ | Sales and marketing decisions are split between the plant and CHQ | The plant runs all sales and marketing |
|--|---|--|---|--|

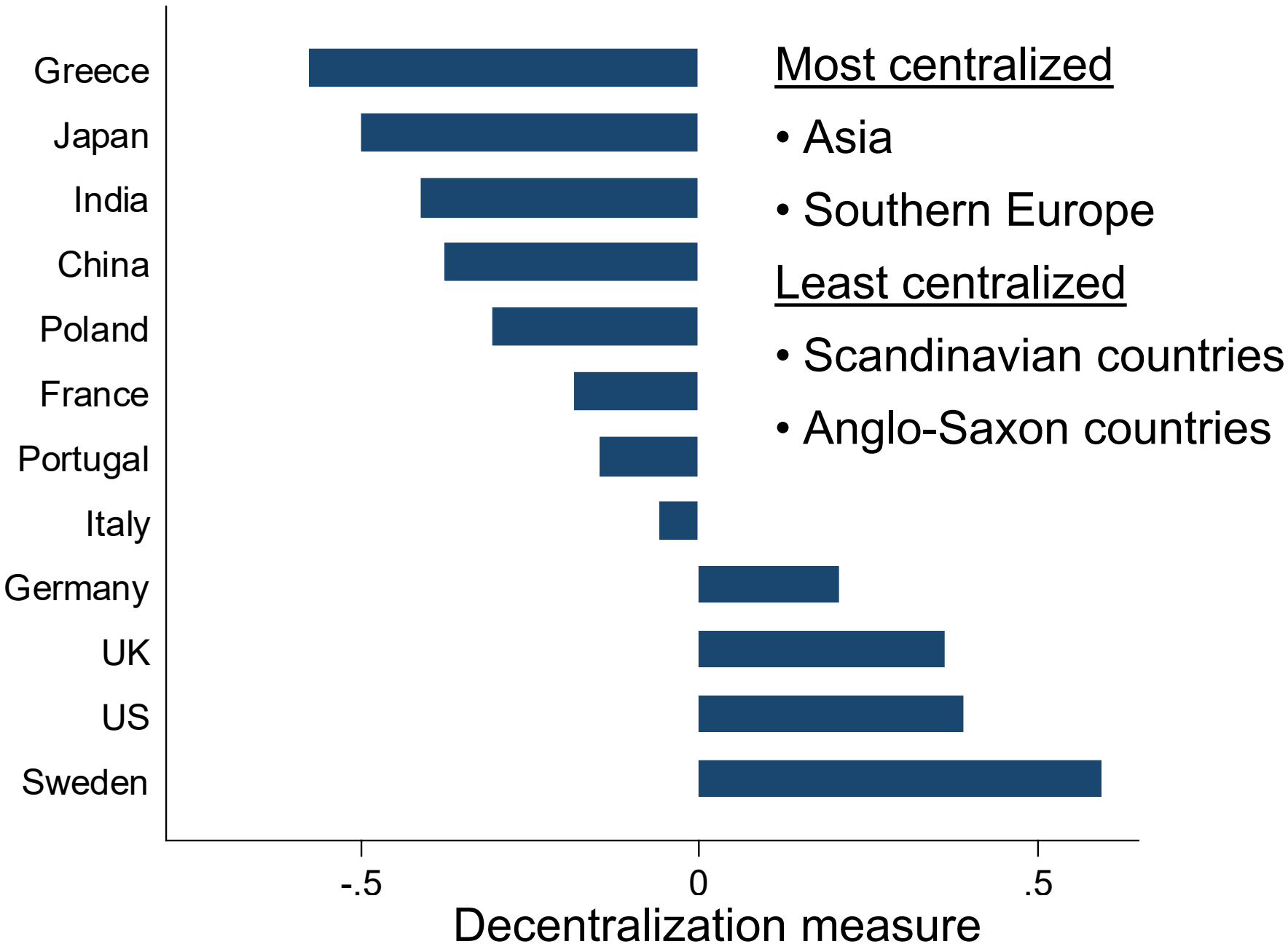


Our empirical decentralization measure

- Main measure averages the z-score (scores normalized to mean 0, standard-deviation 1) of each variable:
 - Hiring senior employees (discrete, 1 to 5)
 - Maximum Capital expenditure (continuous, in \$)
 - Introduction of new products (discrete, 1 to 5)
 - Sales and marketing (discrete, 1 to 5)



Decentralization varies a lot across countries



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- **Factors affecting decentralization**

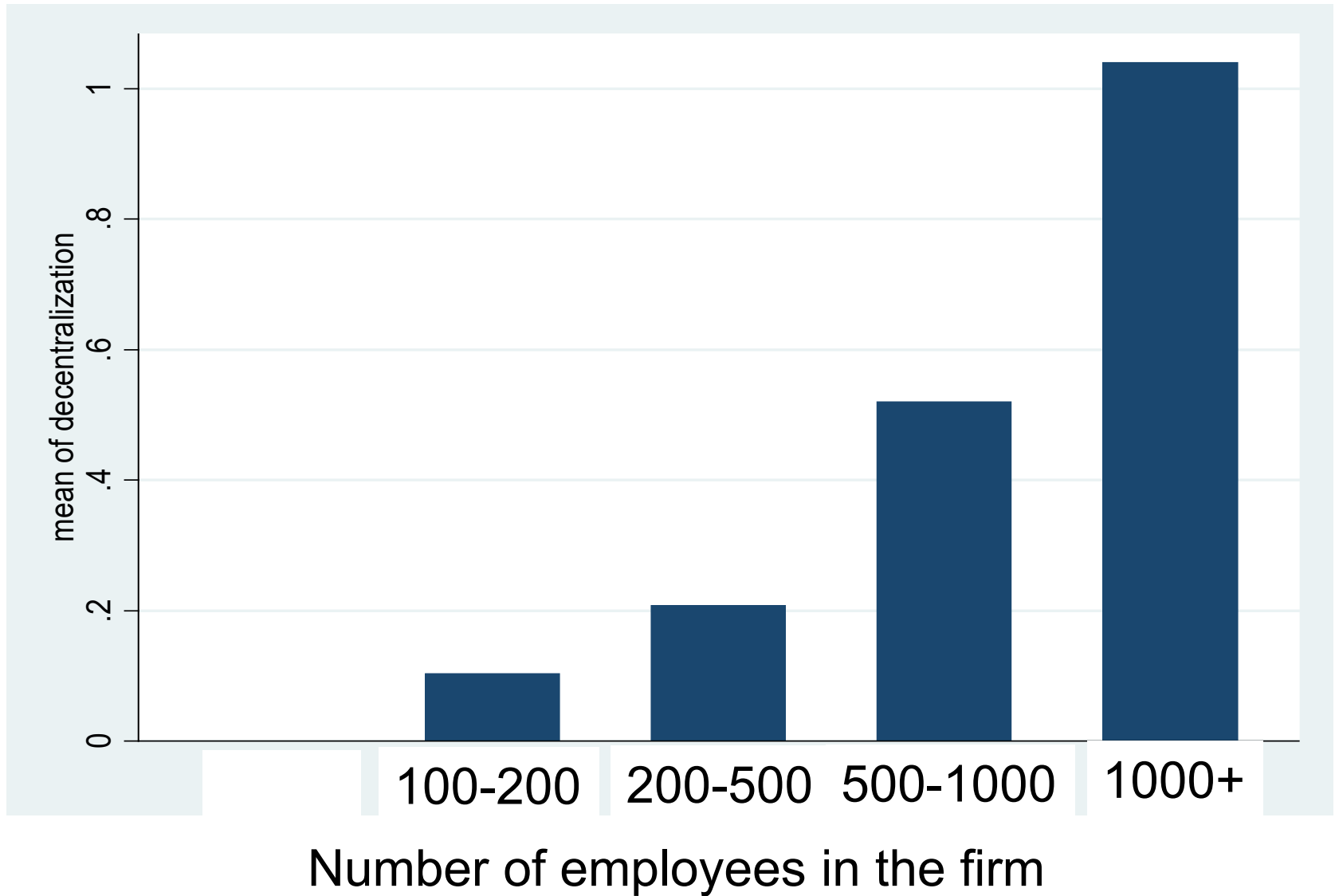


Larger Firms: More or less decentralized?

100-200 200-500 500-1000 1000+

Number of employees in the firm

Larger Firms are more decentralized



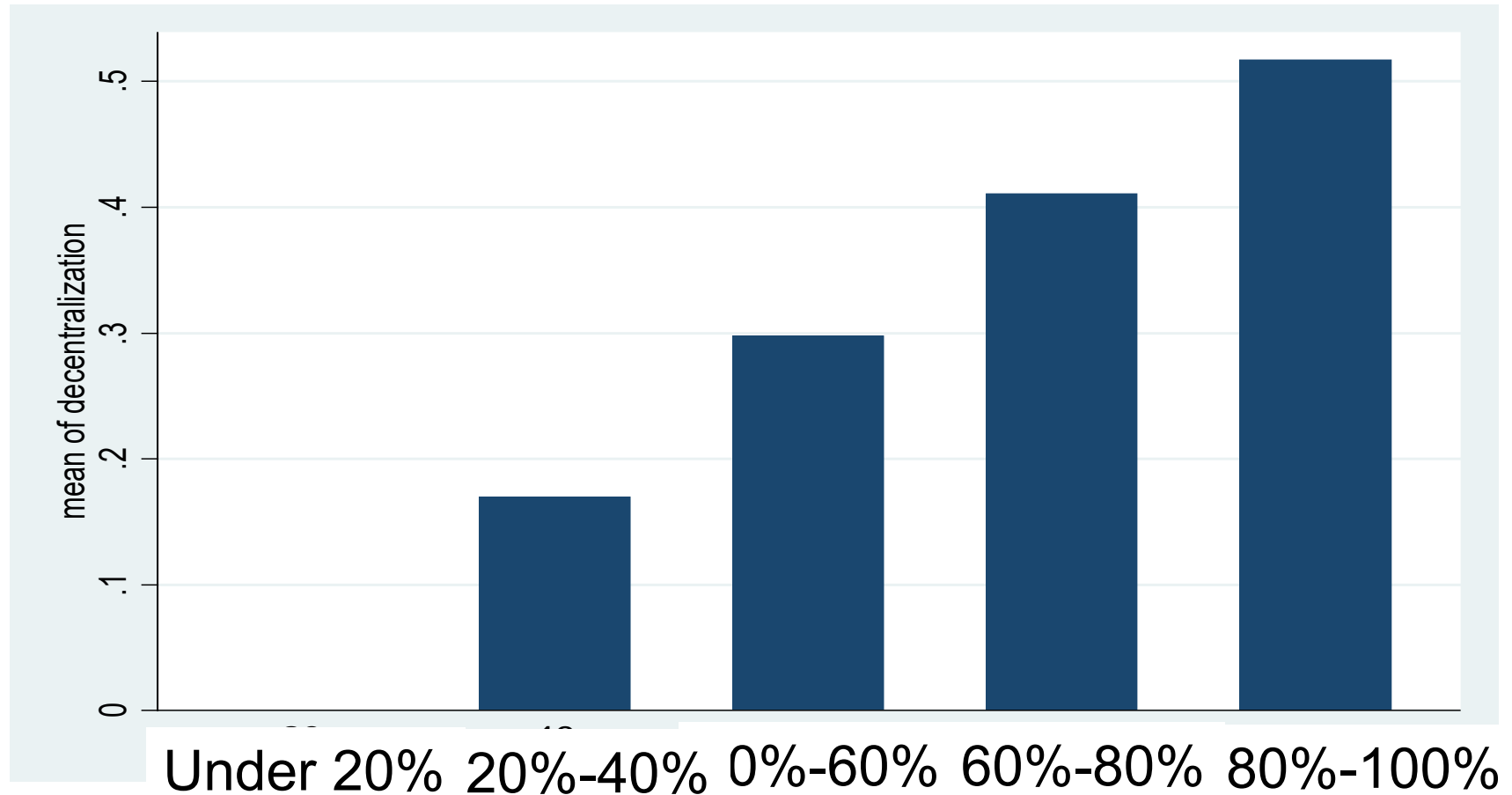
Firms with more skilled workers?

Under 20% 20%-40% 0%-60% 60%-80% 80%-100%

Proportion of employees with a college degree



Firms with more skilled workers are more decentralized (complements)



Proportion of employees with a college degree



Legal and Cultural Factors affecting Decentralization

- Trust
 - Alibaba's key competitive advantage was building trust with customers.
 - But trust more important generally?
 - In high trust areas (e.g. Sweden, US) managers likely to be trusted to carry out more activities than low trust (e.g. Southern Italy, parts of India)
- Rule of Law
 - In strong rule of law areas (e.g. US) top management less worried about theft by middle management



Trust and decentralization

- How to measure trust? World Value Survey (10,000s of individuals from different countries) asks question:

“Generally speaking, would you say that most people can be trusted or that you can’t be too careful in dealing with people?”

Trust by region of the country defined as % of people answering “yes” to first part of the trust question

- Experiments show this question linked with trust/trusting behavior



Trust, rule of law and decentralization

| | | | |
|----------------------------------|---------------------|---------------------|--------------------|
| Trust (region) | 1.196*** (0.429) | 0.825*** (0.290) | 0.732** (0.298) |
| Rule of law (country) | | 0.473*** (0.102) | |
| Observations | 3549 | 3549 | 3549 |
| Country dummies | no | no | yes |
| Other controls | no | no | yes |

Notes: Other controls are SIC3 dummies, noise controls (interviewer dummies Interviewee tenure and seniority, etc.), public listing, CEO onsite, plant size, competition



Also look at multinationals as another test of trust

- Could worry about bias due to trust proxying for other country/regional variables
- So look at affiliates of foreign multinationals and investigate whether trust in their home country also matters
- **Bilateral trust:** (on average) how much do people in the multinational's home country trust people in the country where the subsidiary is located (Eurobarometer Survey)



Decentralization and trust in multinational firms

| | | |
|--|---------------------|---------------------|
| Trust (region of location) | 0.563 (0.843) | 0.446 (1.908) |
| Trust (country of origin) | 0.749*** (0.301) | 0.152 (0.152) |
| Trust (bilateral from origin cty to location cty) | | 1.809*** (0.768) |
| Full set of controls | Yes | Yes |
| Regional dummies | No | No |
| Country origin dummies | No | No |
| Clustering | Region | Origin country |
| Observations | 867 | 280 |



Does decentralization matter for economic performance?

- *Short run*: generally depends on firms circumstances (e.g. country, industry and technology).
- *Long run*: to be large you need some decentralization, so key for growth (Penrose 1959 and Chandler 1962)



Wrap-up

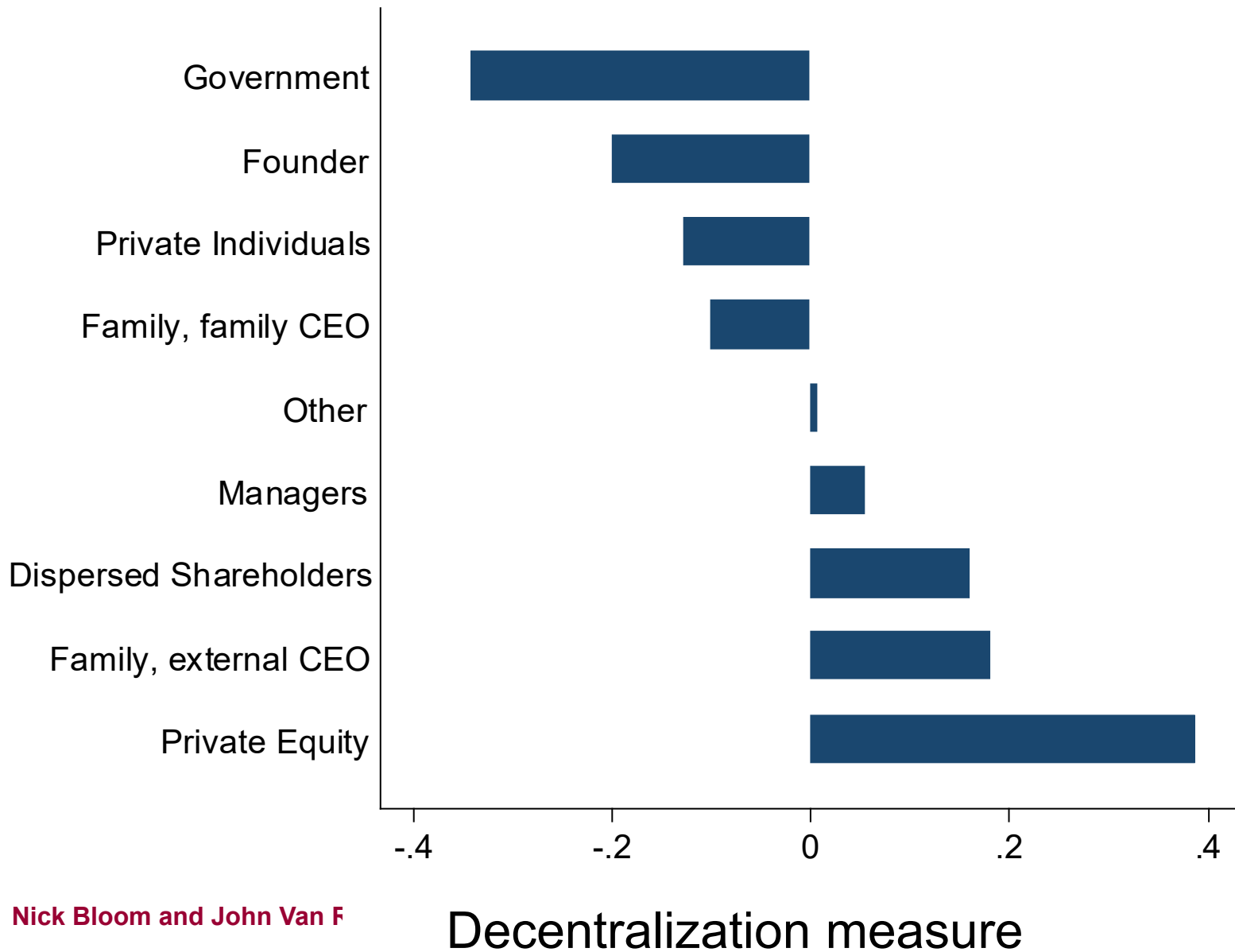
- Alibaba shows the benefits of decentralization, but also costs
 - Initiative/incentives vs. co-ordination
- Complementarity of organization with strategy (people, pay) and circumstances (high growth China, volatile technology)
- Decentralization
 - Varies a lot within and between countries
 - Varies systematically technological, economic and cultural factors
 - More general importance for economics growth



Back-up



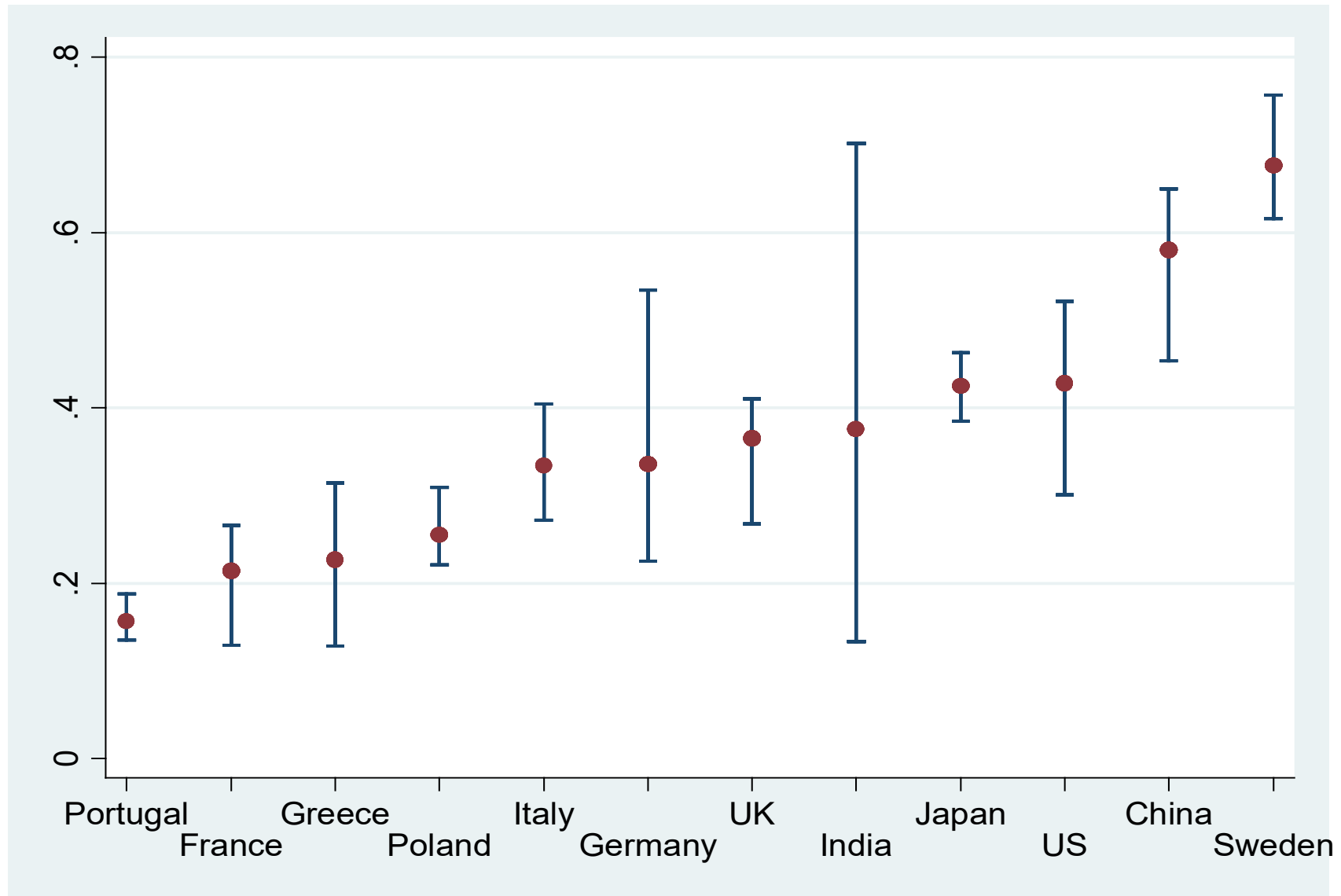
Decentralization also varies across ownership types – with founder and government firms centralized



Nick Bloom and John Van F



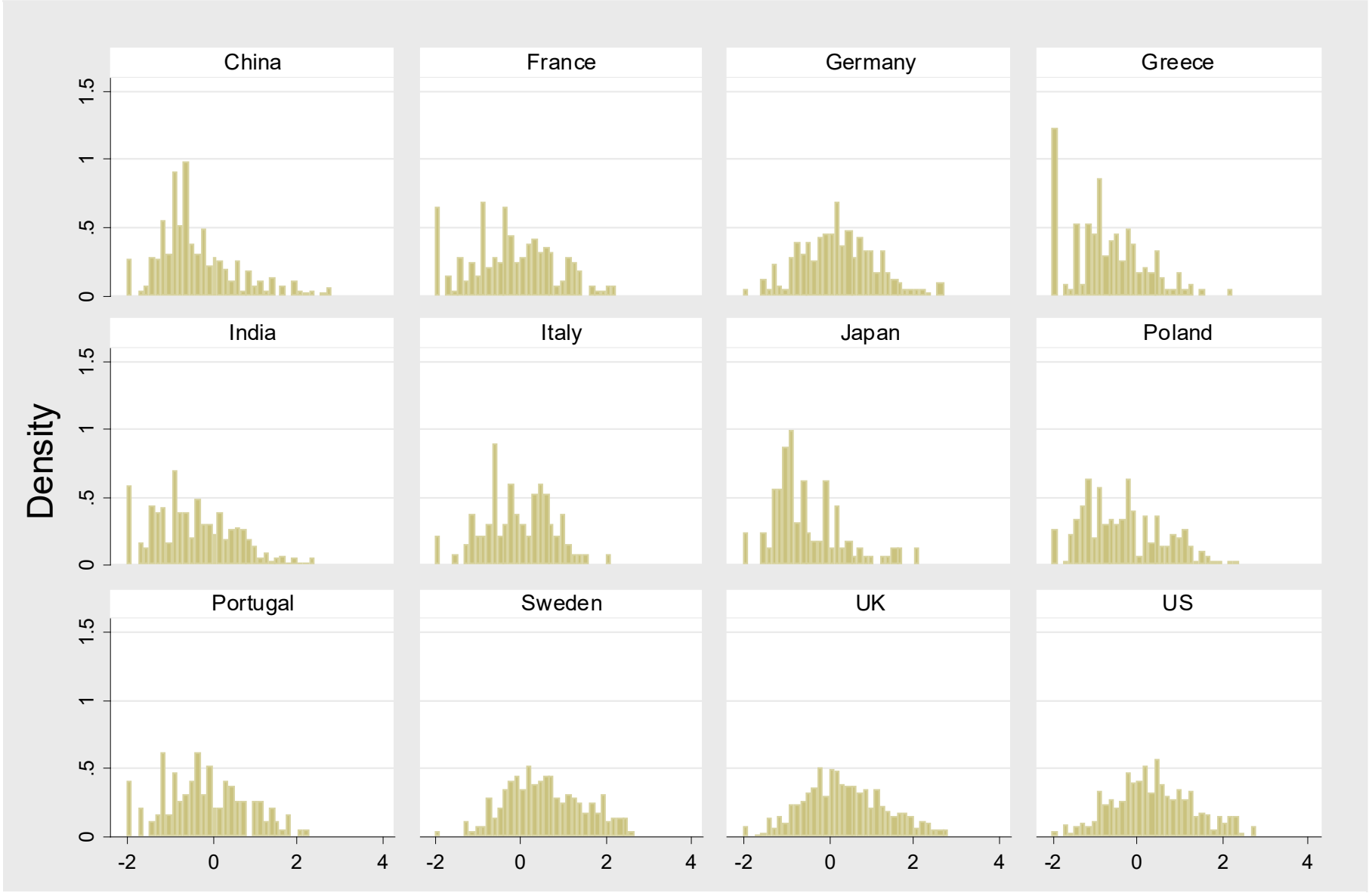
Trust by country (means and regional spreads)



The graph shows median level of trust. The vertical bars denote minimum and maximum levels.



Decentralization also varies across firms



Nick Bloom and John Van Reenen, 504, 2012



Decentralization measure (higher number is more decentralized)

Are things really changing?

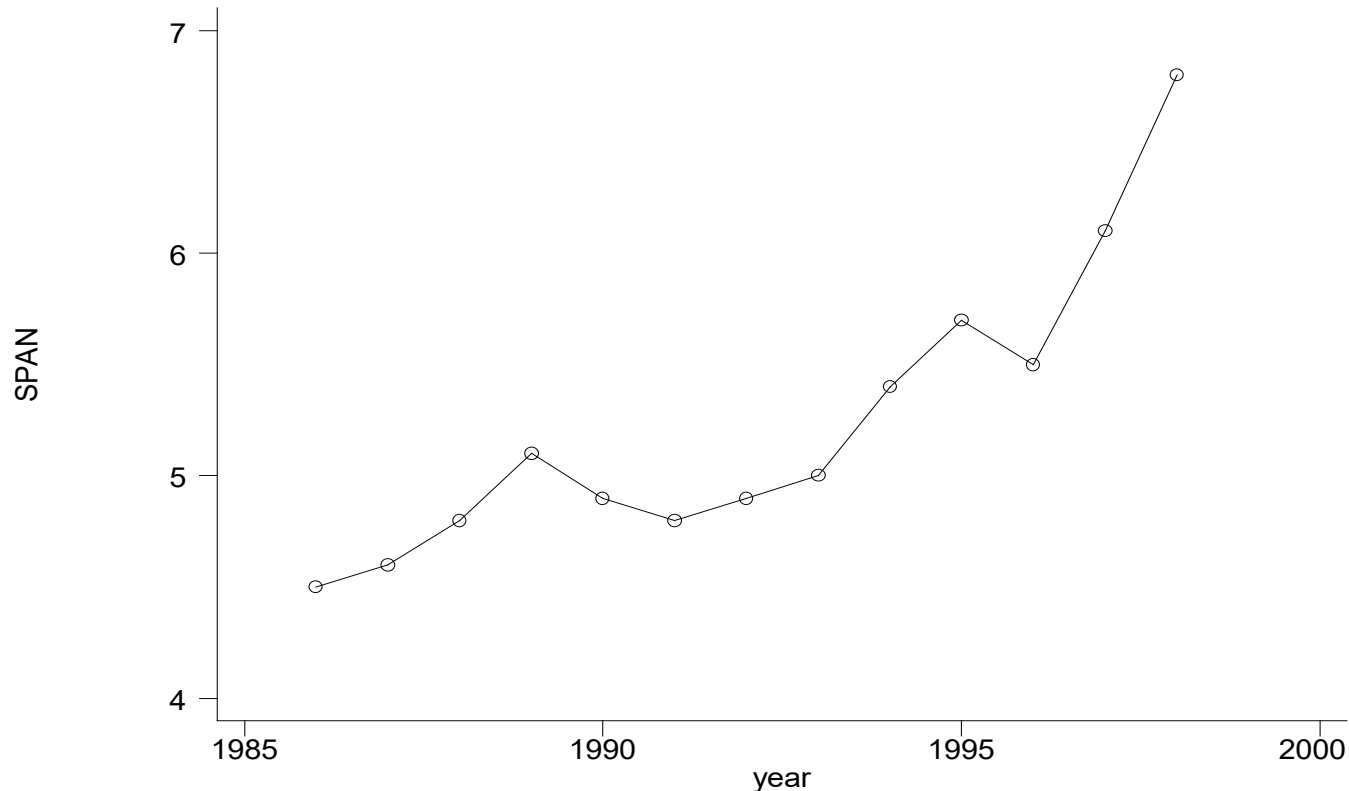
"Globalization and the arrival of the information economy have rapidly demolished all the old precepts. The management of global companies, which must innovate simultaneously and speed information through horizontal globe-spanning networks, has become a daunting challenge. Old, rigid hierarchies are out"

Business Week The 21st Century Corporation, cover story August 21-28, 2000.



Evidence is limited, but appears yes, firms are decentralizing

Delaying – Number of positions reporting to CEO



Source: Rajan and Wulf, 2006, 300+ large US corporations

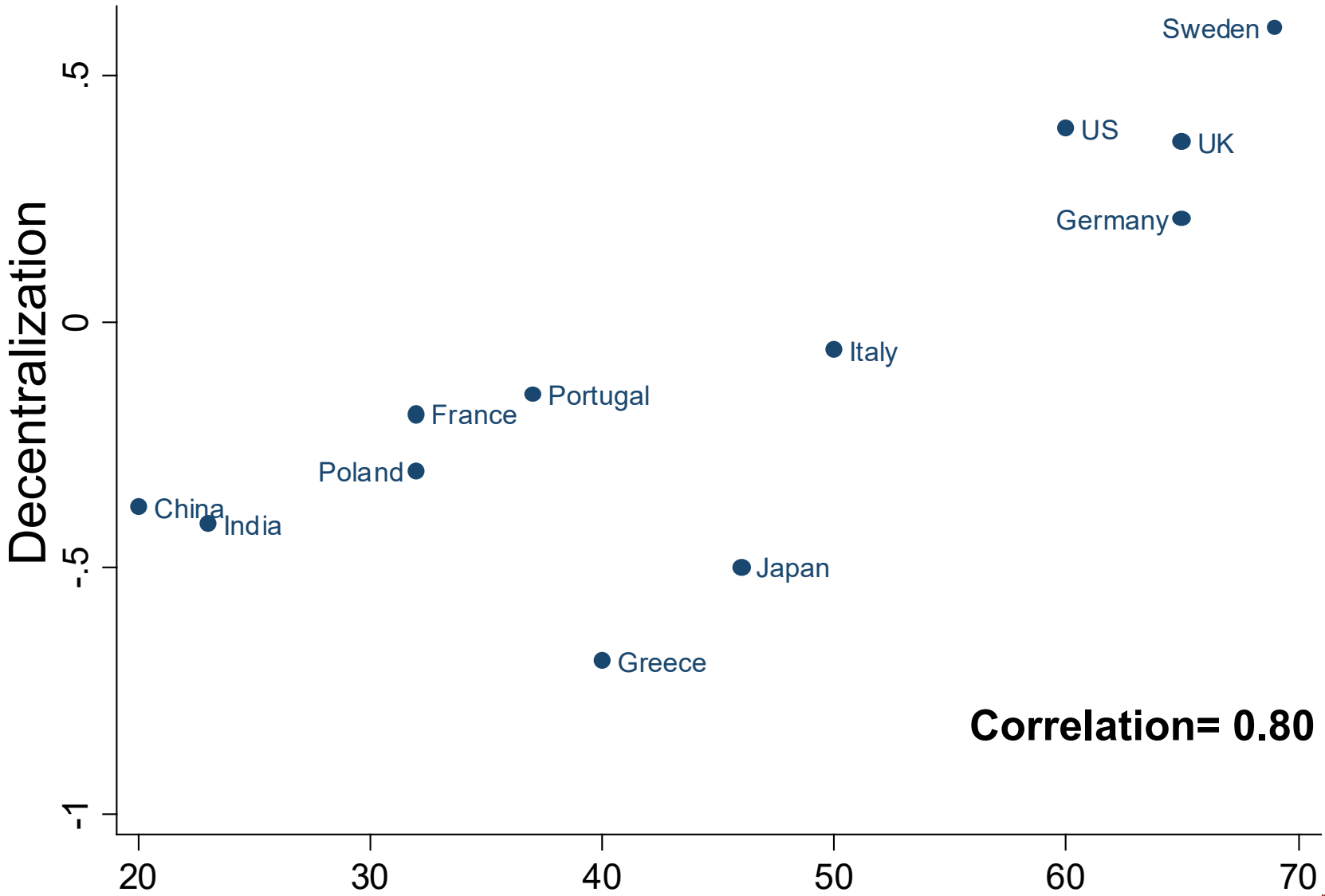


External validation – decentralization over time

- Only prior firm decentralization measure to cross-check against we are aware of is from Hofstede
 - Surveyed c.100,000 IBM employees across 50 countries during the 1970s & 1980s
 - Questions on management style (autocratic/paternalistic or consultative) and *preferences* for delegation
 - Combined into *Power Distance* index (1-100), low means limited (preference for) delegation



'Power distance' measures from 1970s & 1980s matches our 2000s decentralization data quite well



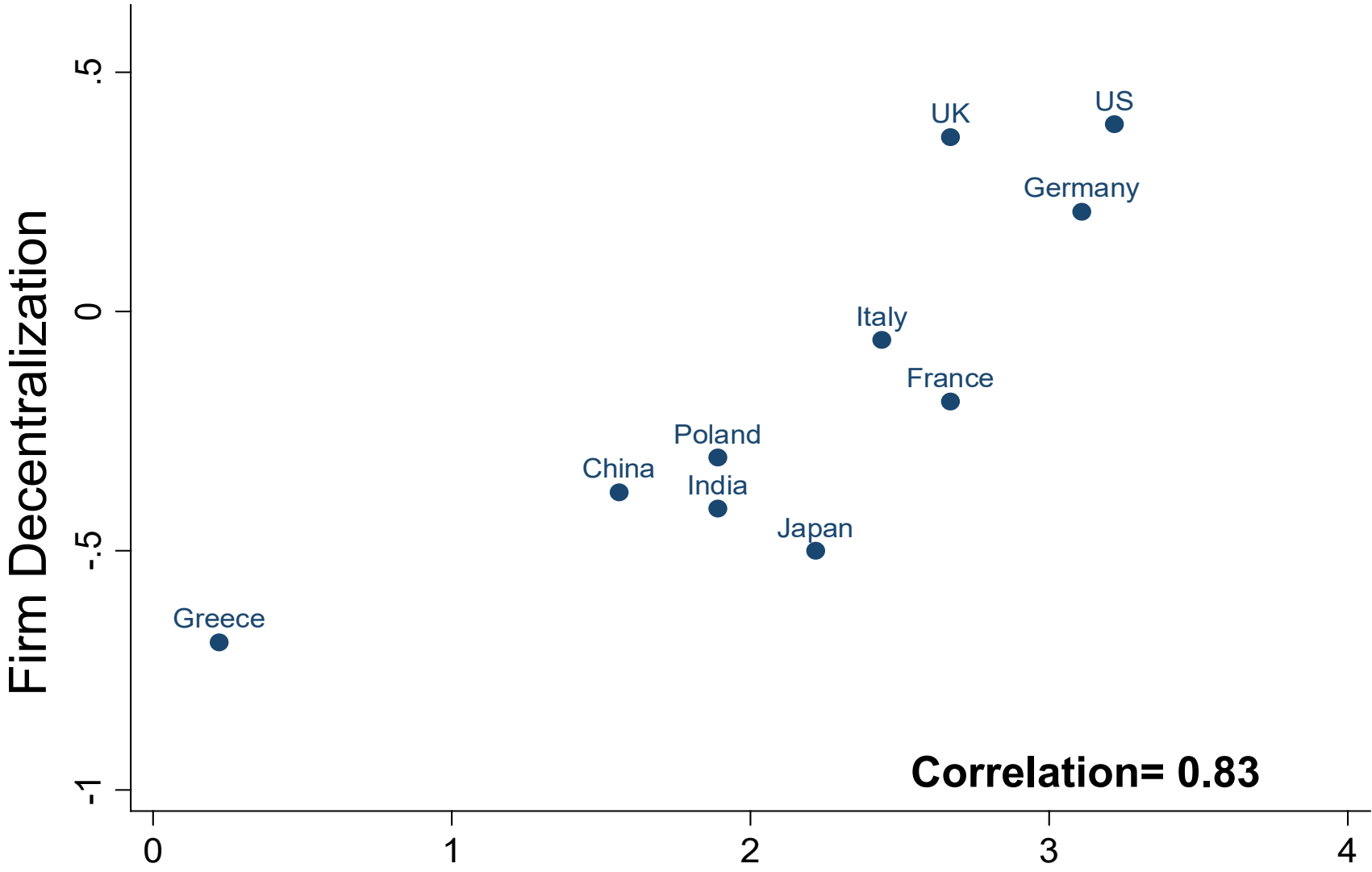
Nick Bloom and John Van Reenen,

Power distance

Correlation= 0.80



Fiscal decentralization (whether Governments are centrally run) looks similar – so something cultural?



Nick Bloom and Joh

Fiscal Decentralization
(Arzaghi and Henderson, 2005)



ICT has a mixed impact on decentralization

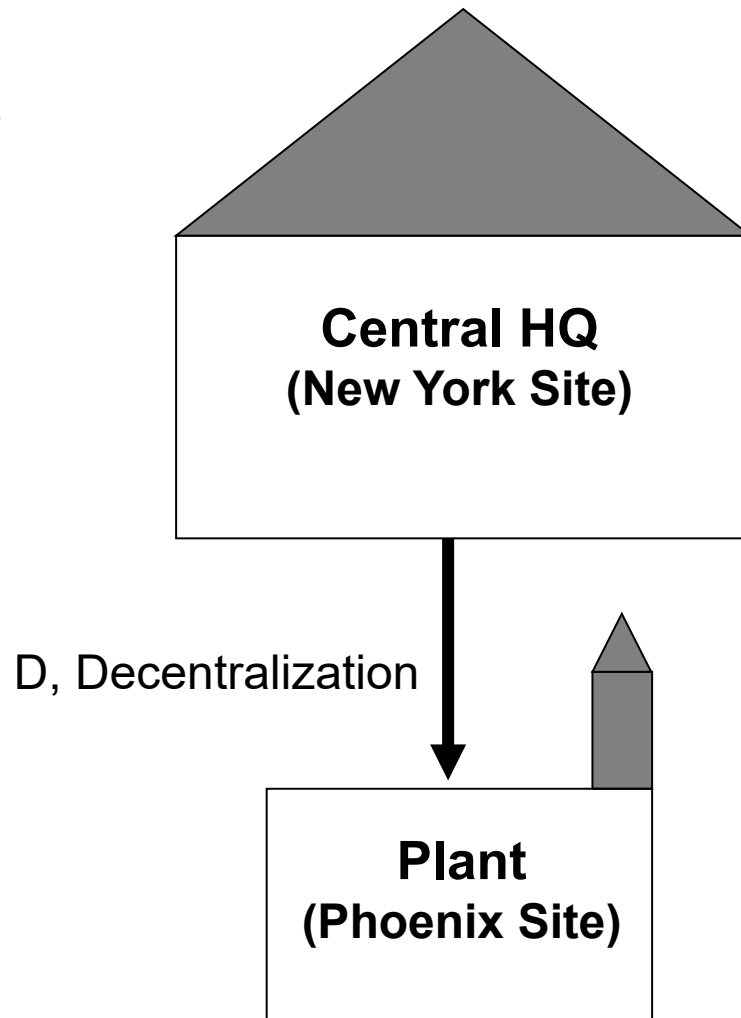
| | | | |
|-------------------------------------|----------------|----------------|-----------------|
| Enterprise Resource Planning | 0.104* | | 0.116** |
| <i>Information technology</i> | (0.054) | | (0.054) |
| NETWORK | | -0.098* | -0.110** |
| <i>Communication technology</i> | | (0.053) | (0.053) |
| Computers/Employee | -0.041 | -0.021 | -0.031 |
| | (0.031) | (0.031) | (0.031) |

- Information technology (IT) increase decentralization
- Communications technology (CT) decreases decentralization

Notes: Controls are SIC3 dummies, country dummies, noise controls (interviewer dummies Interviewee tenure and seniority, etc.), public listing, CEO onsite, plant size,



**Example A:
Domestic Firm
2 Sites, Single Plant**



Example D
Japanese MNE

