

Commentary:

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Robert Gibbons

How organizations behave: Towards implications for economics and economic policy.

by
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Commentary: Robert Gibbons, How organizations behave: Towards implications for economics and economic policy.

As Robert Gibbons suggests, in recent years there has been considerable effort to empirically examine both the internal dynamics of firms and the relationships among firms. As a psychologist, I applaud this growing emphasis on empirical research into the nature of human nature, and share the enthusiasm expressed at the efforts of economists to engage in that research.

What can a social psychologist say to an economist who is interested in institutional design? As a psychologist, I will focus primarily on the micro aspects of Robert Gibbons' paper, leaving macro level reactions to sociologists. On the micro level, empirical research by economists, as well as by psychologists, begins by validating the basic argument of economists that people's behavior in organizations is influenced by formal frameworks of incentives and sanctions. In particular, the formal structure of companies provides a framework, although an incomplete, one for understanding people's rule-related behavior within the organization. People are more likely to adhere to agreements when there are formal and/or informal incentives to do so or sanctions for failing to do so.

The key argument of the relational contract model as outlined by Gibbons is that we need to move beyond the formal structure of organizations, recognizing that formal rules and contracts are incomplete and must be supplemented by more informal "relational contracts" that allow particular people to use their own detailed knowledge of their situation to adapt to new and unique contingencies. Relational contracts offer important advantages over formal contracts, because they can be more flexibly linked to

the realities of particular situations and people. But, they are held in place by weaker organizational forces, making the likelihood of non-adherence a more serious problem for organizations that value relational contracts and want to facilitate their use.

Economists try to understand relational contracts by viewing them within the framework of the theory of repeated games. In that framework, such contracts are viewed as being “self-enforcing”, based upon reputational concerns. That is, people do not break these contracts because they fear that others will not trust them in the future and will not make agreements with them. The risk underlying relational contracts that are enforced in this way is that they are vulnerable to reneging because they are only enforced by reputational concerns, and these can be swamped by short-term considerations of self-interest. An individual may be so tempted by the immediate payoff that they will take the risk of abandoning a contract, even at the risk of destroying their reputation and undermining the possibility of future agreements.

The goal of organizational design is to induce greater levels of adherence by implementing the best possible relational contracts. The question, in other words, is how to design groups or organizations so as to facilitate the maintenance of relational contracts, i.e. to create conditions under which such contracts will be honored even in the face of temptation.

I would like to point to several social psychological literatures that speak to this question and offer insights about how to address the issue raised by Robert Gibbons. Because my space is limited, I will focus on two such literatures: the literature on group based identity and the literature on internal motivations.

Group based identity

Gibbons argues that the key design issue linked to solving relational contract problems involves optimizing the boundary of the firm. The psychological literature on group based identity can be used to argue in support of Gibbons' suggestion that group or organizational boundaries are important. One important issue is the issue mentioned by Gibbons—the issue of identity. There is a large literature within social psychology on social identity and a number of discussions of the influence of identity on conflict and cooperation within and between groups.

Social identity theories argue that it is important where people draw group boundaries because, when they are within a group, people often merge their own identities and the identities of the groups to which they belong (Hogg and Abrams, 1988; Tajfel and Turner, 1979). When they do so, the boundary between self and group blurs, and the interests of the group become one's self-interest.

From the perspective of encouraging cooperation, we would like to have people merging their identities into the groups or organizations to which they belong when we want them to act in terms of the interests of the group, and not in terms of their own self-interest. The social identity literature makes two key points: that the merger of self and group is easily accomplished and that it has strong behavioral consequences.

Consider an example using the “minimal group” paradigm. People come to a lab and are arbitrarily categorized into groups by the flip of a coin. This is a minimal group because the people within it do not share a history, or even have material interests in common. Membership in the group is completely arbitrary. The participants in these studies are then put into situations in which they allocate points across groups.

Immediately people in this situation adopt a strategy of competition on a group level, seeking to maximize the difference between the average points in the two groups (i.e. to beat the other group). Interestingly, people prefer this strategy to a strategy in which they maximize the points given to their own group, thereby maximizing their own personal rewards (see Hogg and Abrams, 1988).

These findings illustrate two ideas: people focus on the group, not themselves; and they adopt a competitive attitude toward other groups (trying to maximize the relative outcomes of the two groups—a principle called positive distinctiveness). It is the first point that I want to emphasize—the motivational goal in this type of setting becomes one involving the interests of one's group, not one's self-interest. What are the implications for groups and organizations? The findings suggest that we ought to encourage people to identify with the group when we want them to take the groups' interests as their own and act on behalf of the group.

Does this mean that people will then inevitably compete with other groups? Not necessarily. Other work on group level identification is more positive in its implications for group dynamics and the relationship among groups. Let me illustrate with the example of the recategorization work of Gaertner, Dovidio, Anastasio, Bachman and Rust (1993). This work shows that when people who are in separate subgroups are led to more strongly identify with a common superordinate group they consequently act in ways that are designed to achieve the objectives of the larger group, in this case placing those larger superordinate group interests above their own interests, or the interests of their subgroup.

These findings support the argument that group identification can have both positive and negative consequences. The positive consequences involve the influence of group identification on people's behavioral choices. People who identify with a group act to benefit the group, rather than themselves. As Dawes, van de Kragt, and Orbell (1990) suggest: "Our experiments have led us to conclude that cooperation rates can be radically affected by one factor in particular, which is independent of the consequences for the choosing individual. That factor is group identity: Such identity—or solidarity—can be established and consequently enhance cooperative responding in the absence of any expectation of future reciprocity, current rewards or punishments, or even reputational consequences among other group members (p. 199)".

This argument suggests that one important way for groups to support relational contracts is to encourage identification with the group. This identification makes the influence of personal self-interest on behavior less powerful. Greater identification may also have the negative consequence of encouraging competition with other groups, but studies suggest that this is not inevitable (Hewstone and Greenland, 2000; Tyler and Blader, 2002).

The research outlined above considers identification with groups in the context of relationships among groups—intergroup dynamics. It is also possible to directly test the influence of identification with a group on the behavior of people within the group—i.e. to focus on intragroup dynamics. Does identification encourage loyalty to the group and to the agreements and decisions made within a group? Abrams, Ando, and Hinkle (1998) demonstrate that employees who identify with their work organization are less likely to quit, while Tyler and Blader (2000) show that identification predicts job performance and

rule following in work groups. Both studies support the argument that greater identification with a group leads to higher levels of cooperation within the group.

These findings support the argument that identification is important when we are looking for ways to encourage adherence to relational contracts, compliance with which is potentially being undermined by issues of immediate self-interest. People are less tempted by immediate personal self-interest when they feel identification with their group. Hence, they are more likely to be motivated to uphold relational contracts that benefit the interests of their organization. As Gibbons mentions, economists have recognized the importance of issues of identity (Akerlof and Kranton, 2000), so these arguments are not unique to psychologists. But the social psychological literature on identity supports the argument that identity is important.

How do we encourage identification?

What psychologists can do is to talk about how we might encourage identification with groups and organizations? Studies suggest that there are two basic reasons that people identify with groups. The first is that the organizations provide them with desired resources. People want to feel that they are and will continue to receive reasonable levels of desirable resources from organizations and, if they do, they merge themselves more completely into those organizations. We can refer to this as an effect of outcome security. Outcome security is communicated by two issues: (1) receiving favorable levels of outcomes in the present and expecting to receive in the future and (2) thinking that one is receiving the level of resources that one deserves (distributive fairness).

In addition, people identify with groups when they feel that doing so has desirable status implications. In other words, if being closer to the group leads to higher self-

esteem, greater feelings of well-being, and more positive feelings about the self.

Desirable status implications occur when people: (1) Feel that they are respected and valued by others in one's group (respect); (2) feel that the group is one in which membership is desirable because the group is a high status group (pride) (Tyler and Blader, 2000, 2001). If people receive signs that their identity is secure when they are connected to the group, they are more willing to merge themselves into that group. We can refer to this as an effect of identity security.

People feel that they have identity security in an organization when they experience that organization is being managed via fair procedures—i.e. when their organization has an ethical organizational culture. Studies link procedural justice to a wide variety of desirable organizational behaviors, including cooperation with others in groups (see Tyler, Boeckmann, Smith, and Huo, 1997). It is the experience of fair procedures that is found to be especially central to feelings of identity security.

The fairness of procedures is linked to: (1) the quality of decision-making; neutrality, accuracy, consistency of rule application; and to (2) the quality of interpersonal treatment; respect for rights, treatment with dignity and respect; benevolent motives. Both factors shape procedural fairness judgments. Further, people react both to the fairness of the formal rules of their organization and to the informal rules and norms that govern their interpersonal relations. This procedural influence has also been recognized by economists, in particular by Bruno Frey, who labels it “procedural utility” (Frey, 1997).

Internal motivations

Social psychologists typically divide the motivations for behavior into two classes: external contingencies (rewards, punishments) and internal motivations. One type of internal motivation involves motivations for doing things that help one's organization. One such motivation is intrinsic motivation—i.e., liking one's work—and another is commitment to the organization—i.e., liking one's organization. Both of these motivations lead people to perform their jobs better. The other type of internal motivation is the motivation not to do things that undermine group policies or agreements. This involves feeling a sense of personal responsibility and obligation to support group decisions.

As already mentioned, one set of mechanisms supporting relational contracts are the reputational consequences associated with breaking an agreement. People do not want to break agreements because doing so undermines their reputation, with the consequence that others will not trust them in the future. This concern is one of external contingencies and indicates that there are long-term consequences to immediate actions, and that the knowledge of these long-term consequences shapes people's immediate behavior. In other words, people are influenced by the contingencies (rewards, punishments) in their immediate and anticipated future environments.

But, people are also influenced by their internal motivations. In particular, people feel a loyalty to the group and a sense of responsibility to support its decisions and policies. These feelings of responsibility are ethical/moral values and act distinctly from and often in tension with motivations of personal self-interest. Hence, organizations seeking to motivate adherence to relational contracts benefit when they can activate

ethical/moral commitments. Let me give one example, from a study of social dilemmas. Brann and Foddy (1988) studied a situation in which a common resource was being depleted. In this situation the self-interested response is to take more resources, something that, when undertaken by everyone, destroys the common resource pool. However, in this situation, those who were motivated by ethical feelings of obligation to the group took less resources, seeking to aid the group at the expense of their own immediate self-interest. Those not so motivated acted on their self-interest and took more resources when they saw the pool being depleted. Hence, ethical motivations acted to protect the group in this situation.

Studies of people's behavior in organizations also generally support the argument that internal motivations in the form of ethical values have a positive influence on whether people act to aid their groups and organizations, leading people to act in ways that support their organizations even when it is not in their self-interest to do so. This is true when we study people's adherence to laws (Tyler, 1990); their acceptance of the decisions of authorities (Tyler and Huo, 2002); and their deference to informal decisions and agreements in work settings (Tyler and Blader, 2000). In all of these situations, activating the ethical values of the people with an organization encourages greater levels of adherence to formal and informal agreements. Hence, a second mechanism that might be used to enhance relational contracts is to activate people's feelings of responsibility and obligation to obey those contracts.

Which organizational factors activate internal motivations?

How can feelings of personal responsibility and obligation be activated? Studies suggest that the key antecedent of personal feelings of responsibility and obligation is the

ethical character of the work organization. Hence, the antecedents of internal motivations are similar to those of identification. In fact, identification with an organization is intertwined with having strong internal motivations. Those who merge themselves with their organization and identify with it more strongly feel more responsible for accepting its policies and decisions and are more rule adherent in their behavior. They also perform their jobs better, both by more effectively doing their jobs and by investing more of themselves in extra-role and creative behavior.

Tyler and Blader (2003) examine the relationship between organizational characteristics and deference to corporate policies and rules in two samples of employees. The first is a sample of corporate employees, the second a sample of employees drawn from a random sample of American workers. Both studies show that the primary organizational characteristics that shapes the degree to which people act on their feelings of internal responsibility for following organizational rules is the assessment of the fairness of the procedures of the organization—i.e. the ethical climate in the organization.

Conclusion

Gibbons paper highlights the important role that behavioral economics can play in understanding the dynamics of firms. My comments are directed to the issue of how a better understanding of human nature can help to resolve the problems associated with relational contracts. The psychological literature acknowledges the role that reputational influences linked to incentives and sanctions have in shaping cooperation in group. It also suggests that there are social mechanisms that move beyond reputational influences and help us to explain additional aspects of rule adherence. In these comments I

elaborate on two such mechanisms: identity and internal motivations. I suggest that both are important.

The question most likely to be of importance to institutional theorists is how to encourage identification and activate the internal motivations of people in organizations. The findings outlined suggest that both can be activated by creating an ethical climate in an organization. In the current era of corporate scandals, everyone is looking for organizational designs that will restrain the operation of self-interest. Psychological research argues that when people experience justice from organizations, they invest themselves in those organizations. This psychological investment leads people to be more willing to focus on the group, and less upon concerned about their self-interest.

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