ELSEVIER

Scand. J. Mgmt. 21 (2005) 19–40

SCANDINAVIAN JOURNAL OF Management

www.elsevier.com/locate/scaman

Transaction cost economics and business administration

Oliver E. Williamson[1]

University of California, Berkeley, USA

Abstract

This paper traces the origins of transaction cost economics to three seminal people who had an intense interest in business: Ronald Coase, Chester Barnard, and Herbert Simon. By contrast with the neoclassical theory of the firm, which is a top-down construction, the transaction cost economics theory of the firm is a bottom-up construction—which is to say that it is much more microanalytic (the transaction is made the basic unit of analysis) and is comparative in its mode of analysis. Several top-down maxims that have their origins in economic theory are examined in a bottom-up way, which serves to uncover conceptual and/or implementation problems with each. I furthermore examine growing applications of transaction cost reasoning to business administration and within the social sciences.

Keywords: Transaction cost; Economics; Business; Administration; Real-world; Coase; Barnard; Simon

The relation between economics and business administration is commonly described as one where economics provides the theory that informs the practice. So described, the relation is mainly top–down. The resource allocation paradigm of the microeconomics textbooks, especially the neoclassical theory of the firm, is a central construction.

E-mail address: owilliam@haas.berkeley.edu.

[1]The author is Edgar F. Kaiser Professor Business, Professor of Economics, and Professor of Law at the University of California, Berkeley. The assistance of Ian Larkin is gratefully acknowledged.

0956-5221/$ - see front matter
doi:10.1016/j.scaman.2005.02.002

Useful though this apparatus has been for many purposes, it operates at a high level of generality, makes limited contact with many of the problems with which students of business administration are concerned, and has often been the source of public policy error. The reasons are as described by Harold Demsetz: it is "a mistake to confuse the firm of [neoclassical] economic theory with its real-world namesake. The chief mission of neoclassical economies is to understand how the price system coordinates the use of resources, not the inner workings of real firms" (1983, p. 377).

As discussed herein, the theory of the firm as governance structure is much more of a bottom–up construction. That is partly because three of the key figures to which this theory traces its origins—Ronald Coase, Chester Barnard, and Herbert Simon—had business training, experience, and/or pedagogical commitment. Not only do the inner workings of real firms matter for each of them, but these inner workings are made the object of analysis.

The paper is developed in four parts.[2] The business background to which I refer above is sketched in Section 1. Hitherto uncontested top down maxims are re-examined with the benefit of transaction cost economics (TCE) in Section 2. Evidence bearing on the proposition that the influence of TCE has been growing, both in general and with respect to business administration, is set out in Section 3 and is borne out by this conference. Concluding remarks follow.

1. Business-based origins

As developed herein, TCE—by which I mean the comparative contractual approach to economic organization in which economizing on transaction costs is treated as the main case—owes many of its good ideas and early development to those who had prior training or experience in business administration and/or were central figures in reforming business education. On my interpretation this was not adventitious. To the contrary, Coase, Barnard, and Simon (CBS) were able to identify lapses in orthodoxy and perceive the needs of a new theory of the firm because their business backgrounds brought them much closer contact with the inner workings of real firms. Rather than focus exclusively on the market—prices and output, supply and demand—CBS were also concerned with identifying and interpreting the properties of and purposes served by hierarchy.

1.1. Ronald Coase and business education

It is uncontested that Ronald Coase had a talent for uncovering lapses in what others regarded as unproblematic.[3] His path-breaking paper on "The Nature of the

[2]This paper is the front end and the back end of a (yet unfinished) longer paper that deals additionally with the operationalization of the transactional approach and the pragmatic methodology out of which it works. Prior discussions of the operationalization and methodology of transaction cost economies can be found in Williamson (2002) and Williamson (2004), respectively.

[3]On this, see Coase (1988, 1992), Douglass North (2000), Lars Werin (2000), Oliver Williamson (2000), and Claude Menard (2000).