

BAD FOR PRACTICE: A CRITIQUE OF THE TRANSACTION COST THEORY

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Transaction cost economics (TCE), and more specifically the version of TCE that has been developed by Oliver Williamson (1975, 1985, 1993b), has become an increasingly important anchor for the analysis of a wide range of strategic and organizational issues of considerable importance to firms. As argued by some of its key proponents, the theory aims not only to explain but also to influence practice (Masten, 1993). In this article, we argue that prescriptions drawn from this theory are likely to be not only wrong but also dangerous for corporate managers because of the assumptions and logic on which it is grounded. Organizations are not mere substitutes for structuring efficient transactions when markets fail; they possess unique advantages for governing certain kinds of economic activities through a logic that is very different from that of a market. TCE is "bad for practice" because it fails to recognize this difference. We identify some of the sources of the "organizational advantage" and argue for the need to build a very different theory, more attuned to the realities of what Simon (1991) has called our "organizational economy."

In business circles, a story is often told of two hikers who wake up one night to find a tiger lurking near their tent. One of the hikers immediately reaches for his running shoes. On being reminded by his partner that he could not possibly outrun the tiger, he responds that all he has to do is to outrun the partner. At a superficial level, the somewhat macabre humor of the situation also serves as a powerful reminder of the similarities between biological and economic competition. Survival of the fittest, and, hence, the need to be the fittest, is seen as the moral of the tale.

On deeper reflection, however, the story reveals a set of assumptions and their self-fulfilling and ultimately debilitating consequences for the hikers that directly contradict the first-cut analysis. We begin our critique of transaction cost economics (TCE) with this story because much of TCE (Williamson, 1975, 1985, 1991a,b,c,d, 1992, 1993a,b,c) is based on a very similar set of assumptions with similar debilitating consequences for

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