A Theory of Authority

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June 15, 2015
Introduction: Motivation

The enforceability of rules/orders depends upon their legitimacy.

Legitimacy matters for two reasons.

1. Agents motivated by sense of duty to follow rules/orders when they are seen as legitimate.
2. Agents are also motivated to punish and/or report violations.

The need for legitimacy serves as a constraint.

This paper: explores the implications of such constraints.
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- New manager at Oscar Center Plant: Vincent Peele.
- Peele’s orders seen as illegitimate; faces resistance.
- Firm’s solution: delegate less to Peele, have central office set more rules.
- Cost to the firm: greater bureaucracy.
Introduction: Related Literature

- **Persuasion**: Prendergast and Stole (1996); Hermalin (1998); Majumdar and Mukand (2004); Van Den Steen (2009).

- **Limits to Authority**: Shapiro and Stiglitz (1984); Wernerfelt (1997); Marino, Matsusaka, and Zabojnik (2009); Van Den Steen (2010).

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A Simple Model

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- Principal observes an imperfect measure of $a_1$: $q \in \{h, l\}$. 

- Principal has two tools for incentivizing the agent:
  1. High-powered: $w(q)$.
  2. Orders: $\theta$. 


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- Disobedience is only costly when the order is legitimate:
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  D(\theta) = \begin{cases} 
  \infty, & \theta \leq L \\
  0, & \theta > L
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- Agent has outside option that yields payoff of 0.
A Simple Model

Authority Maintenance: \( \theta \leq L \).
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The Principal’s Problem

- Maximize $\pi$ subject to:
  - (PC), (IC-authority), (AM)
    OR
  - (PC), (IC-no authority), (no AM)
A Simple Model

Solution to Principal’s Problem:

1. $L$ high:
   - $\theta = a_{1}^{FB}$.
   - low-powered incentives: $w(h) = w(l)$.

2. $L$ intermediate:
   - $\theta = L$.
   - low-powered incentives: $w(h) = w(l)$.

3. $L$ low:
   - eschew authority.
   - high-powered incentives: $w(h) > w(l)$.
Bolstering Authority

- Suppose the principal can bolster authority at a cost.
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- Cost of bolstering: \( k(b) \).

- The principal’s authority is given by: \( L = L_0 + b \).
Bolstering Authority

Solution to Principal’s Problem:

1. $L_0$ high:
   - maintain authority/low-powered incentives.
   - no bolstering ($b = 0$).

2. $L_0$ intermediate:
   - maintain authority/low-powered incentives.
   - bolster ($b > 0$).

3. $L_0$ low:
   - eschew authority/high-powered incentives.
   - no bolstering ($b = 0$).
Applications

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- One might hire B rather than A (a costly action taken to bolster authority).
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   ▶ Suppose agent A is a better worker than agent B but agent B considers the principal’s authority more legitimate.

   ▶ One might hire B rather than A (a costly action taken to bolster authority).

   ▶ Examples: dislike of “overqualified” workers (Bewley); family firms.
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- Suppose the principal has more (less) authority over workers than a supervisor.

- This might lead to under-delegation (over-delegation).

- Examples: Gouldner’s Gympsum Company (under-delegation); Ostrom on detrimental effects of forest nationalization (over-delegation).
Applications

3. Multiple Agents

▶ Suppose the principal would like to incentivize two agents (A and B).
▶ What it takes to be seen as legitimate by A is different from what it takes to be seen as legitimate by B (for instance: $L_A = L_0 + b$, $L_B = L_0 - b$).
▶ The principal might exercise authority over one; use high-powered incentives with the other.
▶ Example: problems associated with merging firms with different cultures (see Buono, Bowditch, and Lewis (1985)).
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4. An Alternative Explanation for Efficiency Wages
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- Suppose paying a higher expected wage increases the principal's legitimacy ($L = L_0 + E(w)$).
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► Suppose paying a higher expected wage increases the principal’s legitimacy \((L = L_0 + E(w))\).

► It may be optimal to pay an efficiency wage: that is, set a wage for which \((PC)\) is non-binding.
Concluding remarks

▶ This paper: argues limited legitimacy serves as a constraint on firms/organizations.

▶ Such constraints play an important role in determining organizational behavior and structure.

▶ The paper raises several important questions.

▶ To what extent are persistent performance differences across firms (PPDs) explained by differences in authority?

▶ Relatedly, is variance in firms' management practices due to differences in managerial skill or authority?

▶ Is lack of legitimate authority an important reason for underdevelopment (see Basu (2015))?
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