

15.320 Strategic Organizational Design

Internal markets

How can activities be linked?

- **Networks**
 - People are motivated to cooperate for various reasons (trading favors, cultural expectations, etc.)
- **Hierarchies**
 - People are motivated to do what managers tell them
- **Markets**
 - People are motivated to make mutually beneficial exchanges involving some kind of currency

Types of markets

- Prediction markets
- Resource markets
 - External
 - » Outsourcing
 - Internal
 - » Transfer pricing
 - » Internal markets

Why are internal markets becoming more desirable?

- **Markets often have more efficient and flexible results than hierarchies.**
- **Markets can use more information and more people's minds simultaneously than centralized hierarchies.**
- **IT lowers the costs of running markets and thus makes them more feasible in more situations.**

Market prices for product futures

Product (100 units)	Location	Time (weeks)						
		0		1		2		...
		Bid	Ask	Bid	Ask	Bid	Ask	
A	1	2	3	4	5	10	11	
A	2	5	8	6	7	10	11	
B	1	10	11	10	11	12	13	
B	2	10	11	10	11	12	13	
...	...							

When are internal markets desirable?

Structure	Strengths	Weaknesses
Internal Markets	<ul style="list-style-type: none">• <i>Efficiency</i> Maximizing your own benefits, results in efficient overall allocation (the invisible hand)• <i>Flexibility</i> More information and minds applied to figuring out how to adjust Individual variation can be accommodated• <i>Motivation</i> People are often more motivated and creative when they are rewarded directly for the results of their own actions	<ul style="list-style-type: none">• <i>Incentive problems</i> Sometimes agreements that would be good overall aren't in the individual interests of one or both parties involved.• <i>Communication</i> Lots of communication usually needed to find and compare alternatives and to negotiate agreements.

When should you decentralize?

Potential benefits

- Motivation
- Creativity
- Many minds on same problem
- Flexibility
- Individualization

Potential costs

Difficulties in...

- Making decisions quickly
- Managing risk and quality
- Exploiting economies of scale
- Sharing knowledge effectively

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Spring 2011

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