When Clans Control: Optimal Organizational Control Mechanisms with Other-Regarding Preferences

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ABSTRACT

This work proposes an analytical model that integrates two parallel streams of literature characterizing optimal organizational design: market-based agency theory and organizational control theory. Specifically, we examine three mechanisms of organizational control: outcome control (contracting on the outcome), effort control (contracting on the signal on action), and clan control (employing an agent whose preferences are partially aligned with the principal's goal through a socialization process). In doing so, we expand standard agency frameworks and provide new insights into organizational control design by capturing clan control mechanisms through the introduction of other-regarding preferences. Formalizing measurement problems faced by the principal, we then identify conditions under which outcome control, effort control, or clan control is optimal. We show that three forms of measurements—outcome measurement, behavior measurement, task programmability—and socialization costs jointly determine the optimal control mechanism. Finally, we conduct a Monte-Carlo simulation to illustrate these analytical results. Overall, by integrating various features important in organizational control, agency theory, and behavioral economics, we sharpen ideas from earlier organizational control research and gain further insights on the design of optimal organizational control mechanisms.