

**Knowledge Capsule**

# **Valorising The Dispersed Knowledge: A Bottom-Up Strategy For The Firm.**

“When Henry Met Fritz”: Rules as Organizational Frameworks for Emergent Strategy Process

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## Key Idea

A five-year plan is a temptation not only for a Soviet politburo but also for many enterprises. Since Economics often succumbed to the temptation to engineer every process, Business and Management practitioners followed later on. A breeze of change came with Henry Mintzberg who, in line with many Hayekian principles, spoke about the need to valorise dispersed knowledge and to conceive of a (non-designed) bottom-up dynamic for a new management strategy.

## Academic prequel

Many leading business scholars such as Igor Ansoff, Ken Andrews, and Michael Porter, devised a formal approach to strategic planning based on the use of centralized and expert knowledge where a top decision-maker plays the main role. It is a rationalist-dominant approach hinged on **content** and on a great confidence in the ability to rationally plan human affairs.

In Economics, **Hayek** had previously identified the problem of coordination of knowledge as the central problem in Economics: fleeting, subjective and tacit knowledge was seen by him as the key element of spontaneous order. In an unpredictable market, through a perpetual game of trial and error, every individual has some advantage over all the others since she/he possesses a unique (despite incomplete) set of information. Given the impossibility of collecting such tacit knowledge in order to address it to a higher and central authority, there emerged the challenge of finding an efficient way to convey the dispersed information among people. The solution that emerges is the free market and a process of decentralization.

Similarly, in the Business and Management field, **Mintzberg** changed the process of strategy by devising an adaptive, bottom-up and dispersed-knowledge-based approach to strategy.

Mintzberg observed:

- a) Continuous environment changes and
- b) Dispersed and tacit knowledge

... and revolutionized this field with the following implications:

- Knowledge-based view of the firm,
- Greater attention to the middle-management strategic initiative,
- Attention for the practice dimension,
- Emphasis on adaptation in dynamic environments.

## Critique Of The Rational Planning Ideal In Strategy

↓ CENTRALIST/TOP-DOWN PERSPECTIVE ↓		HAYEK'S RETORT	↓ BOTTOM-UP PERSPECTIVE ↓
<b>Thinking</b>	VS	<b>Learning</b>	
Rationalist-dominant approach focused on content.		<i>"As the factors which have to be taken into account become numerous and complex, no one centre can keep track of them. The constantly changing conditions [...] can never be fully known [...] by any one centre".</i>	System of "structure of unstructured decisions" in which "learning" is crucial → trials and errors are repeated and the best way to work is found through the test of different intuitions. In this way, strategies constitute the fit between external threats and opportunities and internal distinctive competences.
<b>Concentration</b>	VS	<b>Dispersion</b>	
Knowledge can be made explicit and can be concentrated in one man or one board.		<i>"we are not in fact able to state all the rules which govern our perceptions and actions ... [W]e always know not only more than we can deliberately state but also more than we can be aware of ... and that much that we successfully do, depends on presuppositions which are outside the range of what we can either state or reflect upon"</i>  And also: <i>"it is by no means regularly the established entrepreneur, the man in charge of the existing plant, who will discover what is the best method".</i>	Knowledge is not concentrated in one single mind, it is dispersed. It is necessary for the strategist to be IN the firm in order to know the situation, the strengths and weakness of the organization and the opportunities and constraints of the market.
<b>Formulation</b>	VS	<b>Implementation</b>	
The "age of enlightenment ushered in a new model which recognized the importance of cognition in the affairs of man. In this model, decision-making is the first stage, followed by implementation of the decision. It became the standard model of the natural sciences, and it was the model used in the early prescriptions for strategic planning" (Ansoff).		<i>"There are few points on which the assumptions made (usually only implicitly) by the 'planners' differ from those of their opponents [...]. It is, perhaps, worth stressing that economic problems arise always and only in consequence of change".</i>	Changing circumstances (by internal or external factors) and tacit knowledge make omni comprehensive plans impossible; then adaptive frameworks are required. Strategic changes involve new experience and some kind of risk.
<b>Structure</b>	VS	<b>Strategy</b>	
Strategy should be fully formulated and only in this way it can shape both the structure and the processes in an organization.		The Hayekian "cycle theory" acknowledges capital and human structure to have strong specificities since they cannot be quickly turned in other uses (read <a href="#">How Entrepreneurs Optimize Attributes and Timing in Their Asset Combinations</a> ).	It is opportune for managers and entrepreneurs to base their thinking on the reality in which they find themselves: the existing organizational structure will influence the optimal strategy.

\* Quotes are fully referenced in the original paper

## Rules Based Framework

Emergent strategy should be orchestrated through a limited frame of rules confined to:

- Firstly, of course, defining an “original judgement” in order to give an orientation about investments and production.
- Then, defining a few rules, as simple as possible, to enable a dynamic environment to emerge from the bottom. In this way, interdependent undesigned systems come to light, which:
  - a) Integrate each-other the most of the:
    - dispersed and tacit knowledge,
    - intuitions,

### PRACTICAL EXAMPLE

E.g., the entrepreneur's hunch for new products. The same is valid for employees' hunches coming from the different firm functions: from taxes to quality control, R&D... A deeper insight is available in [The Role Of Imagination In Business](#)

- experiences.

This information is unique and bespoke to each organisation therefore, by definition, non-transferable and difficult to impart;

### PRACTICAL EXAMPLE

Routines store firm-specific knowledge and allow the organization to learn through implementation. Often, they experience slight variations over time as the environment changes, as people find smarter and more clever ways to do their job and so on.

- b) Facilitate decision-making under conditions of uncertainty;
- c) Test and experience through action in a fast-moving environment in which untypical and unforecastable events can take place. Rules will not be given “out there”: undesigned institutions will have room to evolve gradually, coherently to the needs of the environment.

Enterprises will be more likely to succeed when they can capture and accommodate unanticipated and fleeting opportunities and make them coalesce into a strategic plan in a bottom-up process. It will be up to the top management to find the best equilibrium between how much of this knowledge to integrate and how much adaptation to preserve in the face of unforeseen contingencies in an “*exploitation/exploration*” trade-off.

Decisions can be delegated to managers and employees who should be motivated in order to do their best given their information about the organization and the external environment. Since strategy is about the future, it emerges and it is linked and based on a process of “*learning by implementation*”.

As the market system efficiently allocates resources thanks to a price system, in the same way an enterprise can aim for the most efficient resource allocation by creating the incentive and the room for employees and partners to freely convey their knowledge and skills.

#### PRACTICAL EXAMPLE

A tool in this direction may be to deal with employees and partners with a system of bonuses to when they reach some results. For examples, prizes to acknowledge:

- to the sales reps when they reach a certain turnover,
- to the production team when they can keep an agreed level of quality,
- to the logistics department when they deliver on time and without mistakes,
- etc...

A short “profit and loss” sheet can be made and updated in order to monitor the income and/or the costs of each department. If for the main departments it is possible to calculate the unit cost of an output (good or service) it is useful to check, over time, if it is produced efficiently in comparison with a benchmark period.

A panel of key performance indicators (KPIs), on the other side, may mitigate a risk of a moral hazard and delineate some boundaries: some potential biases are important to be avoided since every department may be tempted to focus only on some bonused results (e.g., turnover for sales reps) ignoring other dimensions (e.g., average price, receivables, a good level of cooperation with the corporate functions...).

Furthermore, a system of budget allocation can transform the departments of a firm into mini-enterprises run by their managers in which flexibility, ideas, intuitions can rule their functioning in an entrepreneurial way.

## Summary and Key Takeaway

Dispersed and tacit knowledge (e.g., intuition and experiences), uncertainty and an ever-changing environment make convenient for entrepreneurs and the top management to get their hands dirty and to design few simple rules and incentives in order to generate a spontaneously emergent order from the bottom.