

In this volume, Michael C. Jensen and his collaborators present the foundations of an integrated theory of organizations. Treating business organizations as entities existing in a system of markets, Jensen argues that the cost of transferring information makes it necessary to decentralize some decision rights in organizations and in the economy. This decentralization in turn requires organizations to solve the control problem that results when self-interested persons do not behave as perfect agents. Capitalist economies solve these control problems through the institution of alienable decision rights. But because organizations must suppress the alienability of decision rights, Jensen argues that three critical systems, which he calls the organizational rules of the game, are necessary to substitute for alienability in organizations: (1) a system for allocating decision rights among agents in the firm, (2) a system for measuring and evaluating performance in the firm, and (3) a system for rewarding and punishing individuals for their performance. These systems offer a major competitive advantage for organizations.