Work Design Collaborative

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Feature: The Dismal Science Dives into the Dismal Swamp

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A few months ago (May 2009) we produced an article on what happens when you hit the magic "Reset" button for the economy and society more generally ("Someone Hit the Reset Button"). That one really hit a nerve; thanks for all your comments and feedback.

That article was actually the first of a three-part a series that explored the broad nature of the basic restructuring that we're all experiencing right now.

We are following that series up with this new one about the emergence of new kinds of workplaces that reflect new ways of working and a new focus on local communities—what we like to call "third places" that offer alternatives to corporate facilities and home offices and a greater focus on community and collaborative work.
We began this series in September with "Social Forces Driving a Simpler Way of Working," which addressed the limits to the manageability of large organizations. Now we turn to the dismal science of economics and offer our insights into just which rules have changed, and how.

For us this all started a decade ago with the publication of *Information Rules* by Carl Shapiro and Hal Varian (the link is to Amazon.com; see also http://www.inforules.com/). They were prescient enough to see this transformation coming, but we doubt even they could imagine the magnitude of the changes we have witnessed (and suffered) in the past year or so.

Listen to what economists are saying today:

"When you question the basic premise which you have worked under for the last 15 to 20 years, which is that markets are rational and efficient, there is a case for a different approach both to monetary policy and regulation" (Thomas Meyer, Chief European Economist of Deutsche Bank, *The Economist*, April 25, 2009, p. 74).

And:

"I don't think anyone fully understands this phenomenon." That was President Obama's Chief Economic Advisor, Larry Summers, speaking about why the American economy is shedding jobs much faster than predicted by economic theory (quoted in "Unemployment Nation," *Time Magazine*, September 21, 2009, p. 25).

What has really changed? First of all, fear of change paralyzes action. We are still in the midst of that—but maybe, just maybe, the light at the end of the proverbial tunnel we're now seeing is *not* an onrushing locomotive. There are probably a gazillion things changing before our eyes, but the two of us want to focus on four specific “rules” that we believe are propelling us toward more community-based work and away from large, centralized, standardized places of work.

Old Rule 1: Constraints. In markets constraints create scarcity. Scarcity raises prices; cattle, hogs, and all kinds of commodities are examples. This rule assumes that demand stays constant or increases. But what happens if demand actually decreases—say for commercial real estate?

New Rule: Freedom. Content multiplies at no (or very little) marginal cost. Books are an example. This newsletter is another. What does it cost us to make another copy? Virtually nothing. So the question is: how do you extract economic value for goods (things), which are based on scarcity? We don’t propose to have the complete answer, but we think we are getting closer. *Having* a tool is one thing. Knowing how and when to use it is another—therein lies the value: the application of content.

Old Rule 2: Economies of scale reduce marginal costs, and therefore price—once you get beyond a base investment level in plant and equipment, leveraging repetitive processes. Bigger, faster, is better because economies of scale kick in to increase profitability.

New Rule: No economies of scale, because of the non-uniformity of processes. The age of mass customization has arrived. Everything is just different enough to require incremental added effort. Consider delivery of health care. Every patient is different; each of them requires individual attention, so health care “doesn’t scale,” much to the chagrin of the health insurers. Note: there is a whole science of information economics (that is vastly different from industrial economics), which is a topic unto itself that we will address in a later issue.

Old Rule 3: Fixed costs reduce uncertainty about the expense of the production process. Predictability is desirable because it reduces the need for changes in the process—which would increase costs. The fallacy is the belief that we can control external events, such as the cost of oil production, or competitor moves that affect market demand.

New Rule: The cost of production must be variable. The only way to be sustainable (that is, to survive over the long run) is to be agile. Your costs must be variable so you can shift them (up or down) ***quickly***. Make all your people, buildings, and technology costs as variable as possible. A corollary to this new rule is that long-term capital investments are much riskier than in the past.

Old Rule 4: Closed markets increase prices. Restrictions on who can enter a market, either as a buyer or seller, drive prices up. A variant on Old Rule #1—constrain not only the product but also “access” to it in order to drive prices up.

New Rule: Open markets drive down prices. For example, open source software has made most common applications practically free. We believe that prices do get driven down—but only to a point and then there has to be an exchange of value somewhere or the market goes away. In the new world authors give away their books and charge for personal appearances.

The economy today is still built largely on the assumptions of the “Old Rules.” And trying to translate those rules into the “new world” just doesn’t work. We are being driven to find ways to support value-added economic activity (what we call work) that doesn’t generate enough profit from the constraints of limited supply, the scalability of production and distribution costs, and closed markets.

The bottom line is that “effectiveness in use,” or the utility of goods and services, is the value-added imperative. We have to ask: “What does this product/service do for me? How does it make my life easier/better/less complicated?” That is the fundamental question in the mind of anyone seeking to consummate a transaction in the new economy. It is **not** cost, not quality (within bounds) and not service, except at the very high end, that drives value today.

In summary, we are suggesting that the old rules of economics were built around the idea that ***products*** were the things that people produced and that were exchanged for cash to add value for customers. In today’s economy (which we believe is transitional), ***service*** is king. Information, in the form of directions and guidance, about which things to use and how to use them drives the value proposition today.

The new rules take effect when a basic transaction takes places around content. We are shifting from the “what” through the “how” and ultimately to the “why.” Teach me why what you are selling is important for me. Show me the value.

This then is the first part of our explanation about why work is moving (quite literally) back to communities. Large organizations are outmoded, and basic, product-based economies don’t work well in today’s world. The emergence of so many smaller, locally-based, shared workplaces is a natural outgrowth of these developments.

We have been guided in our thinking by, among others, Oliver Williamson, our newest Nobel Laureate in Economics. His work on “markets versus hierarchies” is just as central to understanding the new economy as the more recent work of Shapiro and Varian. As the costs of transactions go down, there is a natural tendency to shrink large organizations and to depend instead on market-based transactions (again, making as many of your costs variable as possible). But, again, that’s a topic for another time.

Next month we’ll take a look what makes these new, community-based workplaces different, and we’ll focus on the idea of the “triple bottom line” for judging how well (and responsibly) a business is operating.

Please send your comments directly to us. We look forward to learning from you.

About the Work Design Collaborative and *Future of Work Agenda*

Future of Work is a global network of resources – practitioners, thought leaders, researchers, and senior consultants – who are committed to building and implementing physical, social, and technology-based work environments that are cost-effective, socially and environmentally responsible, and personally satisfying.

We are focused on defining the future of work and helping our members and clients achieve new levels of workforce and workplace productivity. *Future of Work* produces and distributes management tools, surveys, benchmark databases, white papers and technical reports, conferences and workshops, newsletters, books and articles, and public presentations on the changing nature of work. The Work Design Collaborative, LLC, provides leadership and infrastructure services for the *Future of Work* community.

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