Understanding antecedents and consequences of employee empowerment: a transaction cost perspective

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ABSTRACT: Employee empowerment is touted as the “best practice” for enhancing organizational effectiveness. Drawing on transaction cost economics (TCE), this work challenges the universalistic view of employee empowerment and inconsistent empirical findings on the relationship between employee empowerment and organizational performance. Specifically, this paper argues that performance ambiguity and human asset specificity, as characteristics of employee-employer exchange, predict the adoption of employee empowerment. Moreover, the fit between these characteristics and employee empowerment determines organizational performance and this relationship is moderated by environmental uncertainty. In closing, the contributions of this paper to extant knowledge are stated, before offering some suggestions for further research.

Keywords: job design; HRM performance; employment relations

Over the past three decades, employee empowerment has been of major interest to both management practice and research (Conger & Kanungo, 1988; Kanter, 1977; Lawler, Mohrman, & Benson, 2001; Maynard, Gilson, & Mathieu, 2012). A survey conducted by Lawler et al. (2001) indicated that more than 70 per cent of Fortune 1000 organizations adopted some forms of employee empowerment practices at least in part of their organizations. Employee empowerment entails transferring considerable decision-making authority and responsibility for operational management from higher-level management to front line employees (Birdi et al., 2008; Kanter, 1977; Lawler, Mohrman, & Ledford, 1992). Developed mainly in organizational behaviour (OB) field, the extant studies on employee empowerment indicate that employee empowerment will increase employees’ intrinsic motivation, job knowledge and skills, and initiatives to respond to the constantly changing competitive environment (Lawler, 1992; Maynard et al., 2012; Pfeffer, 1994; Wall, Cordery, & Clegg, 2002). Put differently, employee empowerment is viewed as a general recipe for enhancing organizational performance. While these arguments offer valuable insights into how employee empowerment influences organizational performance, there are some limitations in the current literature.

First, the current research adopts a universalistic view of employee empowerment (Wall et al., 2002). It is assumed implicitly that employee empowerment can enhance the organizational performance through increased employee motivation, knowledge, and skills, irrespective of the
organizational characteristics. This implies that organizations that do not embrace employee empowerment will suffer potential loss. This view is not realistic, as empirical evidence indicates that not all organizations adopt employee empowerment initiatives in their workforces (Boxall & Macky, 2009; S. Wood, Burridge, Rudloff, Green, & Nolte, 2015). Although some scholars suggest that the effectiveness of employee empowerment is contingent on certain conditions, such as workforce characteristics, business strategy, and environment (Bowen & Lawler III, 1995), these arguments tend to be descriptive. Second, studies that have been conducted in this field typically regarded employee empowerment as an antecedent and concentrated on outcomes of employee empowerment. Thus, there is a lack of understanding of organizational factors that are likely to enable or constrain the implementation of employee empowerment practices (Morgeson, Dierdorff, & Hmurovic, 2010). Third, while some empirical studies demonstrated presence of a positive relationship between employee empowerment and organizational performance (Kahai, Sosik, & Avolio, 2004; Maynard et al., 2012), others reported little or no effect of employee empowerment on organizational performance (Staw & Epstein, 2000; Waterson et al., 1999). These conceptual and empirical problems identified in the employee empowerment literature have led to the research questions of this paper: What factors enable or constrain adoption of employee empowerment by firms? Under what conditions does employee empowerment enhance organizational performance?

Employee empowerment is often viewed as an organizational behaviour or practice from a psychological perspective. As such, most studies failed to capture the economic nature of employee empowerment. In this paper, employee empowerment is conceptualized as an organizational arrangement in employee-employer exchange relations. Drawing on TCE, we argue that employee-employer exchange as an economic behaviour needs to be studied via a systematic economic analysis that goes beyond psychological perspective. Employee empowerment is fundamentally a mode of organizing work in employee-employer exchange relations to economize on transaction costs. Figure 1 provides a conceptual framework that integrates characteristics of employee-employer exchange and organizational performance outcome of employee empowerment.
LITERATURE REVIEW

There are two distinct meanings of employee empowerment in the literature: psychological empowerment and structural empowerment. Psychological empowerment focuses on employees’ feelings of intrinsic task motivation and self-efficacy toward the work role (Spreitzer, 1995; Thomas & Velthouse, 1990). Structural empowerment, on the other hand, is concerned with transfer of decision-making authority and power for operation management from higher-level management to lower-level employees (Kanter, 1977; Lawler et al., 2001; Wall et al., 2002). This paper adopts the latter view of employee empowerment, which focuses on organizational structures, policies, and practices initiated by management to allocate more decision-making rights and job discretion to frontline employees (Biron & Bamberger, 2010; Seibert, Silver, & Randolph, 2004). Employee empowerment is viewed as the antithesis of conventional bureaucratic organization characterized by high degree of authority and control to organize work (Mills & Ungson, 2003). In the literature, it is often referred to as high involvement work system (HIWS) (Lawler et al., 1992).

The following issues in the pertinent literature motivated this research: the universalistic view of employee empowerment and the inconsistent empirical findings of the relationship between employee empowerment and performance. Firstly, most researchers exploring this issue adopted a universalistic view on the relationship (Biron & Bamberger, 2010; Lorinkova, Pearsall, & Sims, 2012; Wall et al., 2002). Drawing on motivational and cognitive theoretical perspectives from psychology, advocates of employee empowerment claim that granting employees power and authority to perform their tasks will meet their higher growth need, enhance their intrinsic motivation, and develop their work-related knowledge and skills. In turn, these increased motivation and knowledge benefits lead to the desired organizational performance (Boxall & Macky, 2009; S. J. Wood & Wall, 2007). In contemporary management field, employee empowerment is portrayed as the “best practice” (Hardy & Leiba-O'Sullivan, 1998; Pfieffer, 1994). This view implicitly assumes that employee empowerment will promote organizational performance regardless of organizational context characteristics (Morgeson et al., 2010; Wall et al., 2002). This is problematic because not all organizations adopt employee initiatives (Lawler et al., 2001; S. Wood et al., 2015). Furthermore, some researchers
reported findings indicating that employee empowerment does not affect employees’ motivation and knowledge level (Biron & Bamberger, 2010; Biron & Bamberger, 2011; Miller & Monge, 1986). This incongruence in the extant study findings suggests deficiency in the explanatory power of the motivational and cognitive theoretical argument.

Secondly, the inconsistent empirical findings need to be explored further. Several studies showed that employee empowerment does not always yield better outcomes than traditional hierarchy approach (Kahai et al., 2004; Lorinkova et al., 2012; Yun, Faraj, & Sims Jr, 2005). Researchers examining HIWS also reported inconsistent findings on the association between employee empowerment and organizational performance (Cappelli & Neumark, 2001; Waterson et al., 1999; S. Wood et al., 2015). This empirical evidence reveals some notable limitations of the universalistic view of employee empowerment research.

Drawing on TCE, this paper aims to address the conceptual and empirical problems in the employee empowerment literature. We argue that TCE is relevant in examining the questions guiding this study because employee empowerment as an organizational arrangement emerges from employee-employer exchange relations. Employee-employer exchange as an economic behaviour can be usefully examined from a systematic economic perspective.

**EMPLOYEE EMPOWERMENT: A TRANSACTION COST PERSPECTIVE**

A transaction or an exchange is “each individual gives something of value (for example, labour) and receives something of value (for example, money) in return” (Ouchi, 1980, p. 130). In market, exchange is coordinated by price mechanisms. On the other hand, in organizations, employee-employer exchange is mediated by employment relations, where an employee earns wages in exchange for accepting employer’s right to direct and monitor the employee’s work activities (Ouchi, 1980). Although manifested as a different form of exchange compared with discrete market exchange, employee-employer exchange, in essence, is a form of economic exchange. This provides the basis for TCE analysis.
Transaction cost refers to the cost incurred by information searching, negotiation, and enforcement of contract during an economic exchange. TCE aims to economize on transaction costs by identifying the characteristics of transactions and assigning a corresponding efficient organizing mode to coordinate the exchange relations. The combination of human factors and transaction characteristics gives rise to transaction cost. Since parties to the exchange may seek one’s interest at the expense of others, a state of information asymmetry arises when the parties make asset specificity investment. This information asymmetry calls for special governance mechanisms to reduce transaction costs. In addition, when the transaction is characterized by a high degree of environmental uncertainty, the level of information asymmetry increases. Thus, to understand employee empowerment as an organizing mode from a TCE perspective requires first identifying the characteristics of the employee-employer exchange, namely asset specificity, performance ambiguity, uncertainty, and frequency (Vázquez, 2004; Williamson, 1985).

Human asset specificity refers to firm-specific job skills and knowledge an employee gains through work experience (Williamson, 1985). For example, it may pertain to employees’ skills and knowledge to produce the firm’s unique products or services. Moreover, employees’ deep knowledge of a particular firm’s organizational routines, procedures, and culture may also be firm-specific. Performance ambiguity pertains to employer’s ability (or lack thereof) to monitor and measure employee performance (Williamson, 1985). This condition may arise from interdependence of work relations among employees, whereby failure of one employee to complete his/her work will cause great loss to others (Alchian & Demsetz, 1972). In addition, employees’ jobs and tasks requiring a high degree of initiative and judgement may also cause performance ambiguity (Russell, 1985).

Transaction uncertainty refers to the changes and complexity of the exchange circumstances, which may include natural, social, technology, and economic environmental factors. According to TCE, the level of environmental uncertainty has implications only for employee-employer exchanges where human asset specificity and performance ambiguity is high (Williamson, 1985). Thus, we will first discuss the influence of performance ambiguity and human asset specificity on employee empowerment. Frequency refers to how often the exchanges between two parties occur. Although
the occasional labour exchange exists, such as repair or replacement service, in line with
Williamson’s (1979) labour market analysis, the focus of this paper is on the recurrent type of
employee-employer exchange in internal organizations.

**LINKING CHARACTERISTICS OF EMPLOYEE-EMPLOYER EXCHANGE TO EMPLOYEE
EMPOWERMENT**

Conventional bureaucratic organizations grant employers authority and power to monitor,
evaluate, and direct employees’ activities (Williamson, 1975). The establishment of authority mode
of organizing work in bureaucratic organizations also incurs costs. As Ouchi (1980) pointed out, the
authority mode of organizing is based on a system of monitoring, evaluation, and direction, and thus
requires the employer to possess necessary employees’ performance information to organize and
control their work activities. Jones (1983, 1984) also posited that the costs of bureaucratic
organization are derived from activities involved in coordinating organizational members’ work. In
this regard, transaction cost arises from information or coordination issues in organizations. This is in
line with Hayek’s (1945) claim that organization’s performance relies on integrating decision-making
power with the knowledge required to make that decision. Since knowledge or information is
dispersed among organizational members, transaction cost arises due to the need to identify and
evaluate the information necessary to make decisions (Milgrom & Roberts, 1992). In conventional
bureaucratic organizations, the employer plays the role of identifying and evaluating necessary
information to make decisions and direct employees’ work activities. However, from the TCE
perspective, the effectiveness of this authority mode of organizing may be dependent on the
characteristics of the employee-employer exchange.

When performance ambiguity and human asset specificity is low, the authority mode of
organizing is appropriate. Under these conditions, the employer can easily identify and measure
employees’ performance. In addition, as employees invest limited amount of firm-specific human
capital, jobs or tasks tend to be standardized and the employer can compare each employee’s
performance with that of other workers in external labour market. This results in a low degree of
information asymmetry between employees and the employer. As such, the cost of identifying and
collecting necessary information and knowledge to organize and direct employees’ activities will be
low. Examples of this type of employment relations include migrant farm workers, and standard, piecework mass production manufactory. However, under certain circumstances, the authority mode of organizing becomes less feasible and employee empowerment as an alternative mode of organizing work tends to emerge.

When performance ambiguity is high, the authority mode of organizing and coordinating employees’ work activities becomes inappropriate. Performance ambiguity arises when employees’ jobs and tasks are highly interdependent (Masten, Meehan, & Snyder, 1991; Williamson, 1985). These jobs and tasks also tend to require significant amount of initiative and judgement from employees (Putterman, 1981). Because of this interdependence and initiative, employees accumulate more knowledge and information about the work than their supervisors and employers possess (Anthony, 1978; Lawler et al., 2001). Accordingly, there is a high degree of information asymmetry between employees and employers, making it difficult for the employer to measure employees’ performance. For instance, as it is very difficult for a supervisor to identify and collect detailed performance information from R&D employees working interdependently, the conventional authority mode of organizing is inappropriate. A more suitable alternative is to assign the power of decision-making to those employees, as they possess the most relevant knowledge of their work.

Employee empowerment is adopted to overcome performance ambiguity problems. It reduces the cost of identifying and assessing information from employees by delegating relevant decision-making power and authority to employees. When confronting new problems at work, empowered employees can quickly respond and make decisions to solve the problem using their expertise instead of consulting their supervisors or rules for a solution (Bowen & Lawler III, 1995). Given that performance ambiguity tends to be associated with jobs or tasks requiring extensive initiative and judgement (Putterman, 1981), employee empowerment grants employees substantial self-determination and initiative (Spreitzer, 1995). Empowering employees reduces the time and resources required for transferring and communicating ambiguous and socially complex information to employers, thus economizing on transaction cost.
Proposition 1. The higher degree of performance ambiguity, the more likely employee empowerment will be adopted by firms.

When human asset specificity is high, the authority mode of organizing tends not to be feasible. Under this condition, jobs and tasks are likely to be unstandardized and require employees to invest firm-specific knowledge and skills. As this knowledge and skills is acquired through learning by doing on the job (Williamson, 1975), employees may have more sophisticated knowledge of their work than their supervisors or employers do. This is particularly the case when substantial specific tacit knowledge is acquired by employees on the job. Information asymmetry emerges between employees and the employer. More importantly, both employees and the employer invest substantial firm-specific human capital. While employees’ firm-specific skills and knowledge are of less value for any other employer, it is also difficult to hire new employees with the required firm-specific skills and knowledge in the market, creating a “lock-up” situation. As a result, unwanted employee turnover would incur potential economic loss to both parties.

Employee empowerment is adopted to protect human asset specificity invested in employee-employer exchange. In commercial transactions, when transaction-specific asset value is substantial, TCE proposes that parties to the exchange can internalize the transactions into firms by establishing a unified governance mechanism under a common ownership (Williamson, 1979). This unified governance mechanism helps economize on transaction costs. Using this analogy, employee-employer exchange can be viewed as a special kind of transaction. Thus, when human asset specificity is high, unifying employee-employer exchange becomes unfeasible in today’s society. This condition arises because, as Williamson (1979) noted, “limits on indenture foreclose this option for labour market transactions” (p. 257). While parties in commercial transactions can internalize transactions and become owners of commodities of the transaction, employers and employees cannot become a unified ownership entity in which one party possesses full knowledge and control of the other party. In such cases, Williamson (1979) suggested that “instead of ‘merger’, complex contracts designed to tie the interests of the individual to the organization on a long term basis are negotiated” (p. 257) and “a sense that management and workers are ‘in this together’ furthers all of those purposes” (Williamson, 1985, p. 247). Based on this connection, drawing on psychological ownership theory,
we argue that psychological ownership can function as a substitution of the formal or legal ownership, providing an alternative way of realizing ownership unification.

An implicit assumption of TCE is that formal ownership is a necessary condition for aligning one party’s interests with those of the other party to overcome information asymmetry and opportunism problems. However, psychological scholars posited that psychological ownership can achieve the purpose of interest aligning and psychological ownership may arise without the presence of formal ownership (Pierce & Furo, 1991; Pierce, Kostova, & Dirks, 2003). Psychological ownership is defined as “the state in which individuals feel as though the target of ownership or a piece of target is ‘theirs’” (Pierce et al., 2003, p. 86). In this regard, we argue that a unified ownership between employees and employer can be realized through a psychological identification process. When employees develop psychological ownership feelings, a sense of attachment and belonging to the firm emerges. Accordingly, the firm as the target of ownership feelings will play such a dominant role in the individual’s identity that it will become part of the person’s extended self (Pierce et al., 2003). As a result, psychological ownership will prompt employees to think and behave as the owner of the firm. Thus, psychological ownership may act as a substitution for a formal unified ownership for employee-employer exchange. In organizational behaviour literature, employee empowerment is widely regarded as a proxy of psychological ownership. In addition, employee empowerment reflects mutual trust and commitment between employers and employees, which protects the employment relations (Hansen & Alewell, 2013). Findings of a recent meta-analysis indicated that employee empowerment is negatively related to employee turnover (Seibert, Wang, & Courtright, 2011). Therefore, we propose that:

Proposition 2. The higher the degree of human asset specificity, the more likely employee empowerment will be adopted in organizations.

When both performance ambiguity and human asset specificity is high, the potential interaction of the two characteristics increases the pressure on employers to implement employee empowerment. Human asset specificity is likely to deepen the extent of performance ambiguity. Russell (1985) distinguished two types of human asset specificity: employee-specific and firm-
specific knowledge and skills. Although both knowledge and skills are acquired from the employee’s unique job experience, employee-specific knowledge and skills are stored and locked in the particular employee’s mind (Russell, 1985). For example, as a part of their work experience, employees may establish important personal ties to certain customers or develop intimate knowledge of particular production or markets. In this scenario, as this knowledge and skills are imbedded in employee’s mind and much initiative and judgement is required from employees, employee performance may become more ambiguous. Therefore, it will be more difficult and costly for the employer to identify and assess performance information pertaining to individual employees in order to direct work activities. At the same time, human asset specificity requires the employer to involve employees into organizational operations and decision-making as much as possible in order to prevent unwanted employee turnover. Due to this dual pressure, employee empowerment is more likely to be adopted to counter these problems.

*Proposition 3. The higher the degree of human asset specificity and performance ambiguity, the more likely employee empowerment will be adopted by firms.*

**EMPLOYEE EMPOWERMENT, UNCERTAINTY AND PERFORMANCE**

TCE takes an economizing view of transactions. The main argument of TCE is that efficiency will be enhanced when transactions are appropriately aligned with the governance structures. In contrast, transactions that are not properly aligned with the governance structures will suffer performance loss and even fail. Employee empowerment can economize on transaction cost when human asset specificity and performance ambiguity is high. However, employee empowerment is not established without cost. Empirical evidence indicates that extensive training is needed to help employees learn how to use decision making in the work activities, how to communicate and cooperate with other team members and how to align individual behaviours with the organizational cultures and goals (Bowen & Lawler III, 1995; Cappelli & Neumark, 2001; Hansen & Alewell, 2013). Additional cost is incurred by changes in organizational structures and systems (Biron & Bamberger, 2010). Thus, whether employee empowerment mode of organizing would be adopted is determined by a comparative analysis of different characteristics of employee-employer exchange. Based on this line of reasoning, we propose that:
Proposition 4. Employee empowerment that can be predicted by performance ambiguity and human asset specificity will have a positive effect on organizational performance.

Finally, we discuss environmental uncertainty as the last characteristic of employee-employer exchange. Research in the OB field suggests that employee empowerment is more effective when environment is characterized by high levels of uncertainty (Bowen & Lawler III, 1995; Wall et al., 2002; Wilkinson, 1998). From the TCE perspective, environmental uncertainty makes tasks or jobs more difficult to be programmed or routinized (Perrow & Perrow, 1970). When there is frequent change in the environment, tasks requirements and duties tend to be difficult to specify precisely (Evans & Davis, 2005). As the employees’ jobs or tasks became more ambiguous and fluid (Murphy & Jackson, 1999), additional costs associated with identifying and assessing relevant performance information to direct employees’ work activities will occur. Under these circumstances, employee empowerment is much more capable of alleviating the information asymmetry between employees and the employer. Thus, employee empowerment will be more likely to enhance organizational performance. Empirical research on teams suggests that the relationship between team authority and performance is moderated by task uncertainty (Cordery, Morrison, Wright, & Wall, 2010; Haas, 2010). Therefore, we propose that:

Proposition 5. The higher degree of environmental uncertainty, the stronger the positive impact of employee empowerment on organizational performance.

Discussion and Conclusion

This paper makes two main contributions to the extant academic knowledge and organizational practice. Firstly, drawing on TCE theory, this research examined employee empowerment through an economic lens. Previous studies largely focused on the impact of employee empowerment on organizational effectiveness through the mechanisms of employees’ psychological benefits. On the other hand, we interpret employee empowerment as an organizational arrangement, which may be explained economically via transaction cost analysis. Within this analysis, we conceptualize employee empowerment as a mode of organizing work in employee-employer exchange relations. In this work, employee empowerment was adopted to economize on transaction costs of employee-employer exchange. Thus, we further challenge the underlying universalistic view
of empowerment in OB literature and provide a new contingency view of employee empowerment. This contribution is important because extant studies yielded inconsistent findings on the relationship between employee empowerment and organizational and employee performance. This economic view of employee empowerment may resolve this controversy and further advance the theoretical development of employee empowerment literature.

Secondly, we extended the TCE analysis to internal structures of the firm. While TCE has been widely employed to explain inter-organizational transactions, thus far, it has received relatively little attention in the context of intra-organizational transactions, i.e., employee-employer exchange. Several scholars claimed that the emphasis of TCE on opportunism and hierarchical control limits its application and generalization in contemporary organizations characterized by employee empowerment structure and practices (Aoki, 1989; Ghoshal & Moran, 1996; Pfeffer, 1994). This research challenges this view, as it shows that TCE is a useful tool for analyzing internal employee empowerment structures and practices in organizations. Furthermore, drawing on psychological ownership theory, we argue that psychological ownership may act as a substitution of formal ownership in creating a unified governance structure in employee-employer exchange. This contributes to the current TCE analysis on employee-employer exchange by showing that psychological ownership may complements formal unified ownership, which underlies standard TCE analysis.

Further research should delve deeper into the effectiveness of psychological ownership to align employees’ interests with those of their employer. For example, since there is no legal obligation for psychological ownership, it would be interesting to explore how long psychological feeling could persists over time, especially when firms experience economic decline. This research also opens fruitful avenues for testing the propositions presented in this paper. As an economics lens was adopted here to examine the effectiveness of employee empowerment, further studies could integrate our economic approach with the OB approach to employee empowerment to construct a more comprehensive theoretical analysis of employee empowerment.
REFERENCES


FIGURE 1. A Conceptual Framework of Antecedents and Consequences of Employee Empowerment