

Measuring and Managing Performance in Organizations

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- **Robert D. Austin**
- **Dorset House, 1996**
- **Executive with Ford Motor Corporation Europe**
- **Based on his Ph.D. thesis at Carnegie Mellon University**
- **Now on the faculty of the Harvard Business School**

State Employment Agency Blau 1955, Ridgway 1956

- **Initially: number of interviews**
 - No placements were made
- **Added: ratio of interviews to placements**
 - Records of interviews without placements destroyed
- **Finally: grew to eight different measurements**

Economic Theory of Agency

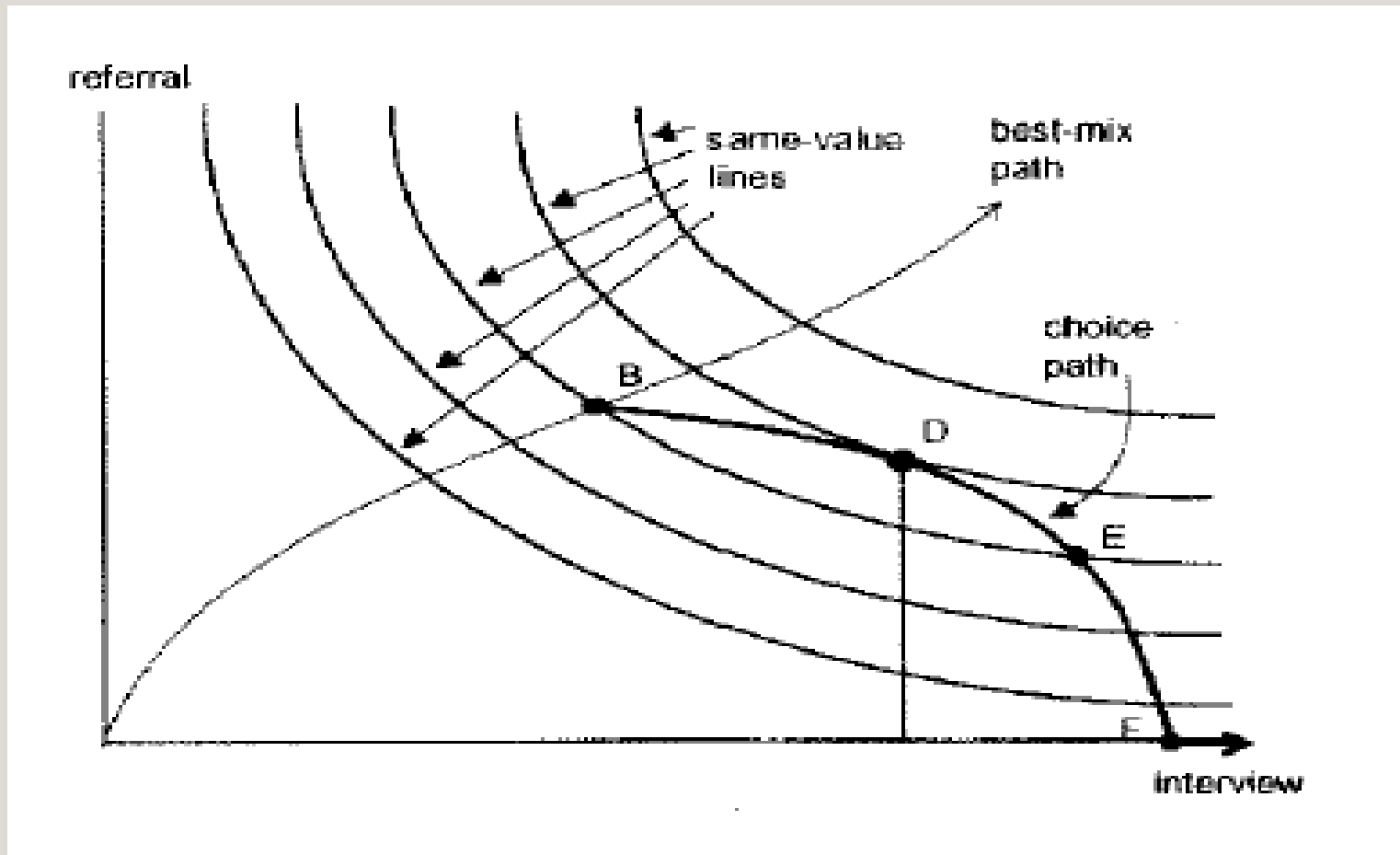
Ross 1973, Holstrom 1979, Milgrom 1991

- **Abstract roles: Principal, Agent**
- **Agent's effort more expensive as effort increases**
- **Increasing agent's effort no guarantee of more revenue**
- **Assumes single dimension of agent effort**
- **Assumes ability to accurately measure agent's effort**
- **Model justifies modern incentive programs**
 - **Overtime, bonuses, tying payment schedule to revenues**
- **Model is also basis of modern contract law**

Extension of Model Austin 1996

- **Agent effort represented as a mix of activities**
- **Measured in several “critical” dimensions**
- **E.g. Referrals versus Interviews**
- **Added role: Customer**
- **Contour lines indicate constant customer value**
- **Implies an optimal allocation for maximum value**
- **The optimal mix of activities is the “best-mix path”**
- **The chosen mix of activities is the “choice path”**

Austin, p. 135



Incentive Distortion

“A system of incentives is dysfunctional if the resulting effort allocation provides less value to the customer than when there is no supervision.” (Austin)

- **Form of “Measurement Dysfunction”**
- **A.K.A. Unintended Consequences**
- **Integrity versus Obligation**
- **Motivational versus Informational Measurement**
 - **Informational measurement can still lead to dysfunction**

Modes of Supervision

- **Full Supervision**
 - Requires all critical dimensions be measured
- **Partial Supervision**
 - Some critical dimensions cannot be measured
 - Because too expensive, not possible, or approximate
 - Results in measurement dysfunction
- **No Supervision**
 - Motivation by methods other than measurement

Principal does not get to choose the mode

Measurement versus Delegation

- **Full Supervision: incentives via measurement**
 - **Relies on extrinsic motivators**
 - Money
 - Continued employment
 - “Forcing Contract”
- **No Supervision: incentives via “delegation”**
 - **Relies on intrinsic motivators**
 - Pride of workmanship, joy in being part of the team
 - Identification with the company’s values and goals
 - Desire to please the customer

Intrinsic versus Extrinsic Motivators

- **Intrinsic motivators are much more powerful**
- **But appear to be overridden by extrinsic motivators**
- **Japanese versus American management styles**
 - **Japanese rely heavily on delegation**
 - **But it is cheaper for them**
 - **It is both a strength and a weakness**
- **Delegation may not be cost effective either**
- **Sometimes neither style works**
 - **“Large software development firm”**

Summary

- You may think you have full supervision
- But you are almost certainly wrong
- The ship's wheel is not directly connected to the rudder

- Austin versus Deming
 - W. Edwards Deming, *Out of the Crisis*, MIT Press, 2000
 - Former BTL lead Japanese quality movement in 1980s
 - Methodology summarized in his “Fourteen Points”