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

• 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
  – Former BTL lead Japanese quality movement in 1980s
  – Methodology summarized in his “Fourteen Points”