

Team Production

1. Minimization of contractual costs in team production

1.1. Hypothetical example: let us organize a consulting firm and think different ways of dividing profits

1.2. Technology of team production:

- Costly to measure individual productivity → free riding on effort (more for larger teams)

1.2. Need of artificial “control system”:

- assignment of decision rights +
- evaluation of *individual* performance +
- compensation of *individual* performance

1.3. Free riding (more for larger teams) possible in both

- Work effort → shirking by team members
- Control effort → shirking by controlling parties / agent / body

1.4. Conventional control system (Alchian & Demsetz'72):

- Residual compensation of controller →
→ compensation asymmetry:
 - non-controlling members paid for *individual* performance
 - controller paid for *team* performance: residual profits
- Decision rights of controller → main problems solved:
 - team membership → adverse selection
 - to measure and compensate performance → moral hazard
 - to alienate his position → avoids horizon problem

1.3. Applications

- Conventional firm
- Cooperatives

2. Comments

2.1. Assumptions on human behavior influence predictions about the effect of a lack of control

- To what extent?
- For how long?

2.2. Costs of mutual control: *But in partnerships:*

- Loss of specialization in control — *professionals*
- Free riding in controlling effort — *specific human capital*

2.3. Pay for *individual* performance \neq
 \neq Compensation based on *team* performance (e.g., profits)

2.4. Pay for *individual* performance \neq Short-term incentives

2.5. How regulation affects the ability of the controller to exert decision rights?

- Hiring and firing
- Pay for performance
- “Acquired rights” Directive

3. Discussion & extensions

3.1. Hierarchies as sets of hierarchical teams

3.2. Profit sharing experiences

- Impact difficult to distinguish from other policies:
 - easy to compare after / before sharing policy
 - difficult to compare with / without it
- Small sums involved
- Communication device?

3.3. Who is in control of corporations with specialization of

- ownership and
- control?

3.4. The Holmstrom critique: the hypothetical “budget breaker”—methodological issues