

Incentives in Organizations: An Introduction

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Why Are Incentives Important?

- ▶ In most firms, labor cost is the larger component of the cost of production.
- ▶ Wrong incentives schemes may not only be costly to the firm in terms of labor cost, it may also cause workers to exert less effort and reduce productivity.
- ▶ Incentives play a role also in
 - ▶ Politics
 - ▶ The Law
 - ▶ Social Media
 - ▶ Financial contracts

In Organizations

- ▶ The design of incentives must be carried out jointly to all agents.
 - ▶ So we must think of an organization as a team
- ▶ Teams give rise to peer effects and externalities
 - ▶ The scheme offered to one agent affects the incentives of his peers.
- ▶ Agents' information about each other is crucial in designing incentives schemes.

1995 Continental Airline

- ▶ Knez and Simester (2001)
- ▶ Feb 1995 CA introduced the “Go Forward Plan” to improve on-time departures and arrival performance.
- ▶ \$65 to every CA employee in every month that CA’s on-time performance is ranked top 5.
- ▶ Profits 1992-1997:

1992	1993	1994	1995	1996	1997
-125m	-199m	-613m	224m	319m	385m

Preview of Topics

- ▶ Incentives and Discrimination.
- ▶ Optimal Incentives in Sequential Production.
 - ▶ Optimal Assignment of Agents and Tasks to Production Slots.
- ▶ The Effect of Information about Peers on Incentives
 - ▶ Functional-Based vs. Process-Based Teams
- ▶ Incentive Reversal

Preview of Topics

- ▶ Sub-Contracting among Peers
- ▶ Incentive Mechanisms vs. Public Good Mechanisms.
- ▶ Participation Mechanisms
- ▶ Raising Capital
- ▶ Relevant Empirical and Experimental Results on Peer Effects.