


Organisational performance management in a UK Insurance firm

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A case study in aligning individual performance management practices with business strategy

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Introduction

Corporate Performance Management is ultimately about triggering changes in organisational behaviour that result in improved performance. Much can be done at the organisational or corporate level – through decisions about investment priorities and such like, but most improvements rely eventually upon one or more people choosing to change the way they carry out their work for their organisation (Dearden, 1969).

In an ideal circumstance everyone would know everything about what is important and why, and so be able to select the exact right thing to do at any instance to ensure that the collection of people that make up the organisation do just enough of the right things at the right time to get the outcomes required with minimum effort. But even in small organisations, this rarely happens (Mintzberg, 1990).

This paper addresses this issue by looking at the links between the performance management of individuals and methods of Corporate Performance Management – in particular at ways of aligning goals and incentives at the individual level with those of the organisation the individual is working with and for.

The case study uses material drawn from project work undertaken for a UK based financial services firm to look at two issues related to the performance management of individuals. Firstly, the need for a personal goal setting process that is both economical to deploy and effective in triggering changes in the behaviour of individuals. Secondly, the related need for the content and process of this type of system to be closely aligned to the overall aims of the organisation.

Theoretical Background

Due to the complexity of most organisations, it is both hard for individuals to communicate to other individuals what is needed of them, and for those individuals to be informed at the same time about what everyone else is doing. Civilisation's response to this problem has been the 'hierarchy' – since the earliest military structures the idea has been to simplify the communication needs by categorising people (e.g. by status or role) – thus a General talks with his commanders, who instruct platoon commanders who instruct soldiers. The problem with hierarchies is amply illustrated by the parlour game 'Chinese whispers' – each time you communicate between a layer of the hierarchy, the communication gets slightly less clear and quickly you can end up with meaningless information coming through the pipe. The response to this was the introduction of 'bureaucracy' – where you add to an operational hierarchy a clear set of job definitions: thus even if the communications from above are poor, you know exactly what you are 'supposed to do' (and so does everyone else). Alloy this with programme management that ensures members of the organisation actually do what they are supposed to do and you create what Mintzberg (1990) called the 'machine bureaucracy' – one of the social triumphs of modern civilisation. The benefit is the ability to build an enormously resilient organisation able to plough on with its programmed task almost regardless of the environment around it (e.g. UK Civil Service), the downside is that redirecting or changing the behaviour of the organisation becomes much harder – as not only do you have to change the instructions coming from above, you have to also change the 'structure' of the bureaucracy (e.g. by changing the job definitions).

In the context of performance management, a consequence of "hierarchy" is the need to limit the communication of task data and subsequent performance data around the organisation to be the smallest amount necessary to allow the data to be useful. The key issue is of all the things I could communicate, how do I choose (in either direction) the smallest useful set? Information asymmetry theories (proposed by Oliver Williamson and others) imply that at any point in any organisation there is notionally much more information available that could be communicated than anyone would ever want to receive – if you don't edit this information flow all the pipes get blocked solid and effectively all communication ends (Williamson, 1975; Rothschild and Stiglitz, 1976). In other words, for communication to work one needs to communicate within the hierarchical structure. The nature of structure is such that there is more to say than "bandwidth" to communicate. For communication to be effective, it therefore needs to be concise.

Performance management systems and individuals

Advanced approaches to Performance Management such as the 3rd Generation Balanced Scorecard (Lawrie and Cobbold, 2004) look at how things are communicated about key goals and expectations one way, and concerning performance against critical activities and outcomes the other.

Unsurprisingly the issue of 'alignment' between organisational units surfaces regularly during this work, and is explicitly addressed in established design methods. But a key related question is how to extend this work to encompass the individuals working within an organisation? There are two key issues that colour what could and should be done:

First, we have to acknowledge the existence of the bureaucratic form – individuals already have quite stringent boundaries on activity (some more than others) derived from their job definition, and from the impact of the management processes that have developed to ensure they comply with this definition. The extent to which they can, could or should be able to modify their work in response to communications about overall goals and outcomes is normally small – for most success is usually defined by 'compliance' to some degree with formalised role expectations (von Misus, 2007). One consequence of such constraints is behaviour change at the level of individuals requires more complex changes than simply a more elegant way of communicating goals and assessing subsequent achievement against these goals – it requires change to occur both within job description and management process (Grint, 1993) (and according to some, many other organisational characteristics (Boxall and Purcell, 2000)). However, a typical Performance Management System design project will not have the mandate, budget or time to engage in this type of organisational change (Lawrie and Cobbold, 2004) – focusing on a more modest solution that is compatible with the existing fabric of the organisation will probably be just as effective (as major organisational changes are unlikely to occur otherwise), and probably easier to introduce (as it builds on what is already in place, rather than replacing it).

Second, we have to acknowledge that the design of a sophisticated Performance Management system (such as a Balanced Scorecard, and used as an example in this section) for each individual will have a measurable economic cost to execute – for example in terms of training for managers, facilitators, and staff, the preparation of communications documents, and the execution of the design process with each individual. Such an activity would need to generate a spectacular change in economic value for the organisation if it was to be worthwhile, but as noted above, even if such improvements were theoretically achievable such changes in performance would require substantial organisational structure / role changes that are likely beyond the scope of a typical Performance Management design project. It is most likely therefore, that the economic cost of introducing 'complete' Balanced Scorecards at the level of individuals would outweigh the benefits – and there is some case evidence to support this view from both UK and USA (Delery, 1998; Boxall and Purcell, 2000). One implication of this is that in the short term, the implementation of a the Corporate Performance Management system to individuals is better done through small modifications to existing methods and processes than the introduction of a new Balanced Scorecard based appraisal and reward system. Most complex organisations that are considering the introduction of Performance Management systems as discrete entities already have standing processes for staff appraisal and review, and for the reward of staff. The bulk of the potential benefit that can be obtained simply from improved performance management (through better communication of expectation and performance) can probably be realised through refinement of the existing staff level systems – mainly because the potential benefit that can arise from improved performance management at the individual level is going to be small without matching changes occurring within the bureaucratic form. These considerations lead to the following two options:

1. Use the Performance Management System to improve the awareness of managers as they execute the existing appraisal / goal setting system.

A common weakness in appraisal / goal setting systems is that the discussions to do these tasks take place in a communication 'vacuum' – the manager and team member are probably both relatively unclear about the overall priorities of the business (Grint, 1993) and how they affect individual tasks (one survey found only 10% of shop floor employees were able to relate their company's goals to their own job (Guest et al, 2003)).

One of the side-effects of an advanced Performance Management system being introduced within an organisation is that management teams become much clearer (explicitly) about their

own priorities, how these relate to those of units near them in the hierarchy and how they can assess their delivery of the tasks necessary to get the desired results. Small changes to the existing goal setting / appraisal system to require the discussions to be explicitly informed by reference to the local Performance Management system should be enough to ensure that personal goals are chosen that are overtly aligned with local organisational goals. Provided the development of the Performance Management system has also preserved goal alignment at an organisational level, individual goals will thus implicitly be aligned with overall goals for the organisation.

2. Reduce the detrimental effects of incentive related pay by linking it to a few high-level goals, and simply use the Performance Management system as a tool to help management teams achieve these high level goals.

During the past 30 - 40 years, social psychologists like Deci, Lepper and many others have warned against the Skinnerian type of popular behaviourism characterised by the doctrine “do this and you will get that” (e.g.; Deci and Ryan, 1985; Lepper and Greene, 1978). Their research have demonstrated how rewards used in an attempt to control other people, has a detrimental effect on long-term performance and creativity. When people’s focus shift from the intrinsic motivators (the joy of doing a good job) to extrinsic motivators (the reward for doing a good job), they eventually lose the interest in the job itself. Yet, incentive pay linked to a rich set of measures derived from a Performance Management system is a highly marketable concept – but one that is nigh on impossible to do meaningfully without undermining the utility of the system it is based on – particularly for systems based on the Balanced Scorecard concept (Lawrie and Cobbold, 2004).

The Balanced Scorecard is designed to help management teams dynamically respond to their team’s efforts to deliver medium and long term goals – the system will not be working usefully if all goals set are achieved (as it implies no learning is taking place): as the team learn about which elements of their original plan works and which don’t, they will want to change the Balanced Scorecard to reflect their evolving plans (Lawrie and Cobbold, 2004). Linking a large proportion of Balanced Scorecard elements to incentive pay undermines this – it discourages the initial selection of ‘risky’ objectives that the management team may not be sure to meet (and reflect valuable experimentation and learning behaviours (Guest et al, 2003; Grint, 1993)), and they will be reluctant to change their Balanced Scorecard during the course of an incentive period if they find that they are easily meeting some or all of the targeted values. Further, such changes as are made will leave the team open to suggestions of ‘fixing’ the incentive criteria to allow them to get the bonus (or preventing such changes will lead to the incentive scheme be mis-aligned with the desired outcomes).

Writers in the Operations Improvement field echo the ideas of the social psychologists as described above. For example, W. Edwards Deming argued that the system of appraisal and reward in the Western World “nourishes short-term performance, annihilates long-term planning, builds fear, demolishes teamwork, nourishes rivalry and... leaves people bitter”, he also described it as “the most powerful inhibitor to quality and productivity in the Western world. Yet performance related rewards still seem as popular as ever in many organisations, searching for the right formula (Aguayo, 1991).

In order to minimise the detrimental effects of this type of reward, incentive pay should be linked to some overall measure of success (in purely commercial organisations, financial gain is usually adopted) that is a composite measure of the successful delivery of (in the context of this paper) the team’s Balanced Scorecard – and then the incentive is for the Management Team to use the Balanced Scorecard and the information it provides to generate the improved performance required to achieve the overall measure. Under such a scheme – provided the overall measure is not easily going to be changed by the team themselves, they have an incentive to modify their Scorecard as they learn more about what is important, or to set risky or stretch targets – as if they fail to reach them it will only be a local problem, not a ‘corporate’ one. Provided the overall target is met, their ability to match targets with actual performance is immaterial. Ideally the overall target will be set in line with some higher-level Balanced Scorecard goal(s) to which the team contribute – so provided the higher-level Balanced Scorecard is well set, this value should be too.

In the wider view, the idea that financial incentives for individuals can be an effective engender of performance improvement in the modern complex organisation remains doubtful: the move to more complex task definitions and multi-disciplinary team based approaches seem at odds with the simple

ideas about task and motivation upon which concepts of personal incentive pay are based (Guest et al, 2003).

Theoretical Background - summary

The starting proposition for this case study is based on views in academic and practitioner literature that the performance management of individuals is a necessary and integral part of a corporate strategic control system. In addition, to be effective, individual pay and performance management systems must drive the correct behaviours at all levels of the organisation (Purcell et al, 2003). Much of the literature on how best to drive these behaviours advocates the need for consistency between individual and corporate goal setting and control systems, with two key issues identified from the literature:

- ∞ Firstly, organisations need to provide sufficient, relevant and meaningful information to enable teams and individuals to set objectives against which they can be measured. The content of the performance management system must be made relevant to each level.
- ∞ Secondly, if the practice of performance management is to improve overall firm performance then it must, to a degree, “fit” with business strategy at each level of the organisation (Boxall & Purcell, 2000; Grint, 1993). While firm performance also depends on other factors (Guest et al, 2003), if practices are in conflict with business strategy then organisations can experience negative effects on performance resulting from employee behaviour (McCormack, 1994; Delery, 1998).

In spite of extensive literature surrounding the need for consistency, there is little clarity on how such links might be made. Performance management tools, such as the Balanced Scorecard, are frequently prescribed as devices to link individuals to corporate goals. However, implementing entire performance management systems based on such tools are reported as having mixed results and are based on the premise of rigid top down control. Conversely, misaligned systems also present problems (Pfeffer, 2004). This raises questions over how performance management systems might best link individual and corporate goals in a cost effective, efficient and culturally acceptable manner. The case study that follows attempts to show an example of how these issues were addressed using the 3rd Generation Balanced Scorecard.

Methodology

The research strategy was, of necessity action research. As consultants we were engaged in helping the company design a Balanced Scorecard, and decided to document and reflect, post implementation upon the process. By definition then, we had an impact on the process that we observed, and in part created it. The detailed methodology was that of a single-site case study.

By examining how the company approached the challenges in design and implementation, the case assesses the effectiveness of their adopted approach to ensure alignment and relevance of the content and process of performance management at three organisational levels.

Case Background

The case organisation, IIC, is a small UK subsidiary of a large Japanese insurance company, based in the City of London. As a Lloyds syndicate company, its main activities involved underwriting business risk for large corporate clients, typically through a network of brokers.

Established in 2001, the company had grown rapidly, with 110 staff by September 2004. However, looking forward, the existing management systems no longer effectively supported the organisation. In particular the company believed that an improved approach to communicating organisational objectives and managing individual performance was needed.

In October 2004, the company embarked on a project to improve the approach to managing performance. Core objectives for the project were to:

- ∞ Build a more effective way of informing individual objectives and aligning them with organisational and departmental goals
- ∞ Create an individual performance management process that supported the needs of the organisation and encouraged the correct behaviours from staff and teams.

To deliver these objectives, the company chose to introduce a performance management approach

based on the 3rd Generation Balanced Scorecard (Lawrie & Cobbold, 2004). It was hoped that the 3rd Generation Balanced Scorecard would inform individual objective section while aligning corporate, team and individual goals (Figure 1).

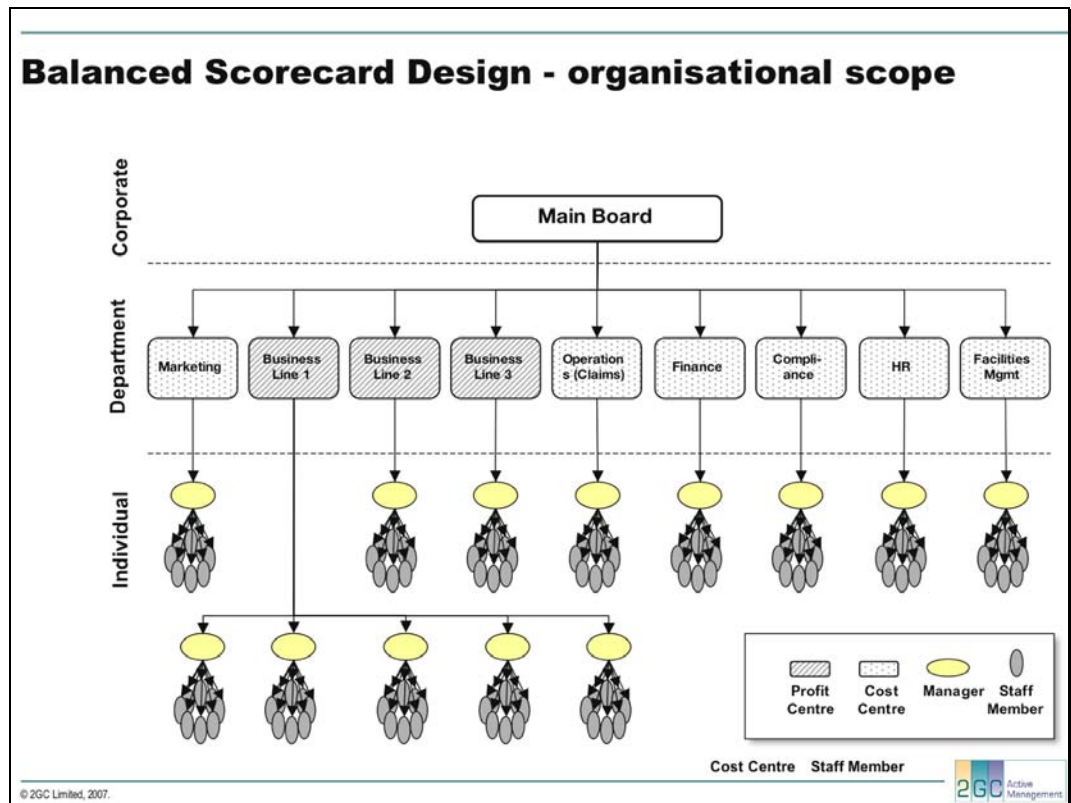


Figure 1

The structure of the individual performance review process was then designed based on an informed view of the organisational behaviours desired. The system adopted involved different objective setting approaches at three levels:

- ∞ **Top (corporate) level: 3rd Generation Balanced Scorecard:** i.e. a Destination Statement (three-year goals) and Strategy Map (annual objectives) that were collectively and consensually developed by the extended senior management team through workshops.
- ∞ **Departmental level: 3rd Generation Balanced Scorecard (Strategy Maps only):** i.e. Annual objectives that would support Top Level goals chosen by Departmental management teams.
- ∞ **Individual level:** Annual individual task and developmental objectives chosen by employees in conjunction with their line manager.

The outcomes for each of the three levels were developed in a four-step design process (figure 2). The process was designed and facilitated by 2GC, but was largely resourced and delivered by client staff so that knowledge and skills transfer was inherent in the process. 2GC worked closely with the client project team to ensure that the organisation was well equipped to support the system. By the time the third stage was reached, internal staff members were delivering most of the project activity.

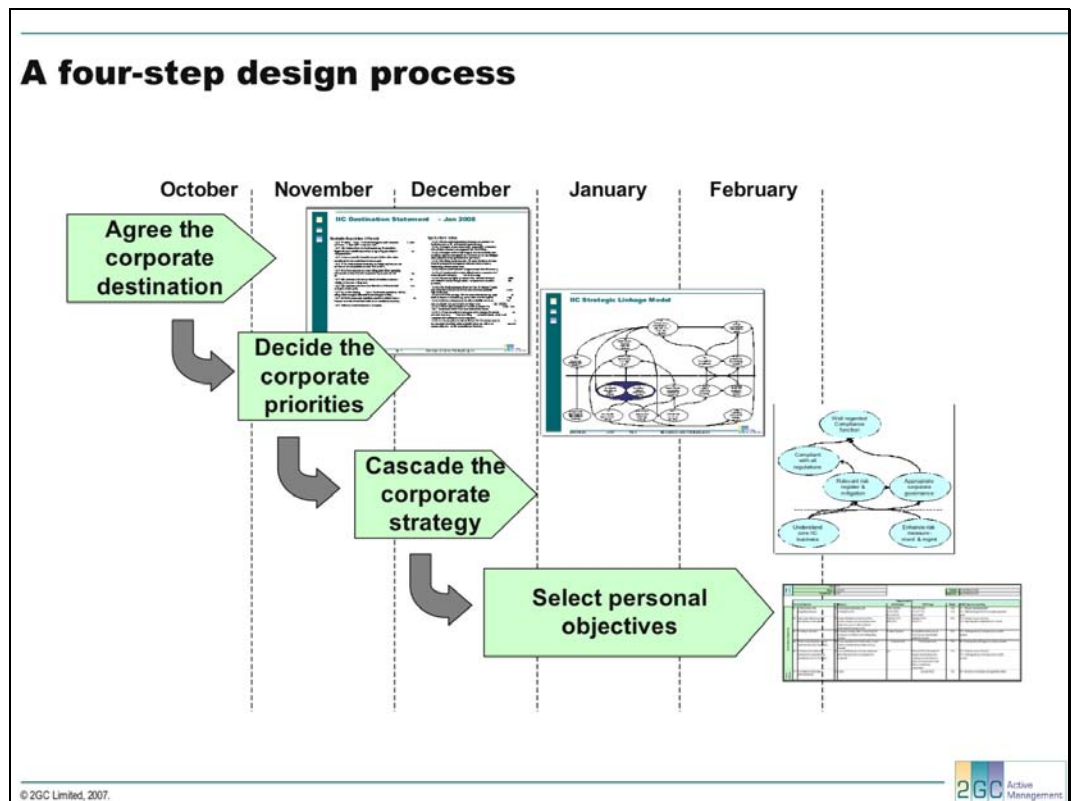


Figure 2

The first two steps are representative of a “standard” 3rd Generation Balanced Scorecard design, and have been discussed in considerable detail elsewhere (Lawrie and Cobbold, 2004) so will only be outlined in brief here. Instead the remainder of the paper will focus on steps three and four.

The Destination Statement

In brief then, the design process began with the construction by the executive board of an agreed corporate Destination Statement. This was a well-defined picture of the future (out to a 5 year time-horizon) for IIC. The Destination Statement comprised some 2 pages and 52 meaningful statements about the intended future state of IIC.

The purpose of the Destination Statement is to:

- ∞ gain consensus on strategy;
- ∞ provide an effective tool for internal strategic communication;
- ∞ enable departments, teams and staff to identify their potential contribution to achieving the destination;
- ∞ provide a degree of long-term context and scale for the setting of intermediate-term targets, and critically;
- ∞ to inform the development of a Strategic Linkage model, the next stage in the process.

The Strategic Linkage Model

The Senior Management Team moved on to design a Strategic Linkage model (SLM). The SLM documented IIC’s strategic objectives, and the causal relationships amongst objectives. A mix of Activity-type and Outcome-type Objectives showed diagrammatically the priority items that the Management Team needed to focus on over the next 12 to 24 months in order to progress towards the Destination Statement (Figure 3).

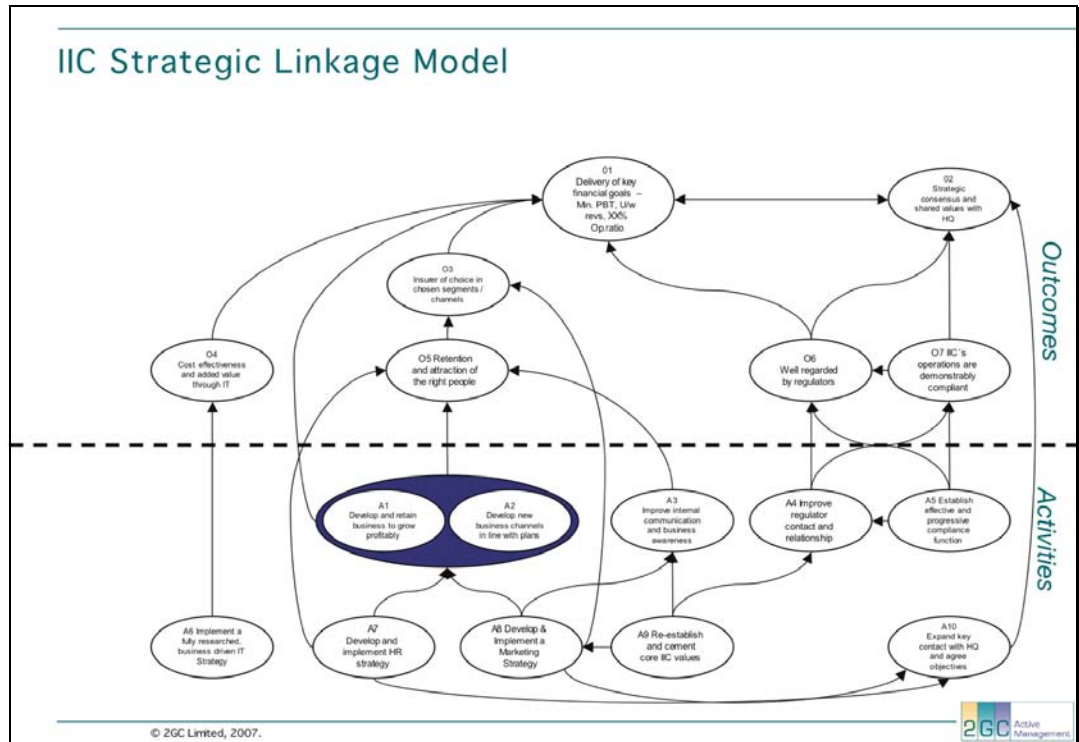


Figure 3

IIC’s activity-type Strategic Objectives (“below the line” in Figure 3) related to items like: developing new lines of business; strengthening internal communications; improving regulator relationships and building compliance capabilities, etc.

IIC’s outcome-type Strategic Objectives (“above the line”) related to items like: achievement of key financial goals; gaining HQ strategic consensus; becoming “insurer of choice;” developing positive regulator perceptions, etc..

At the corporate level, these Activity and Outcome objectives were developed into detailed Objective Statements, with corresponding Measures and Targets.

Cascading the Corporate Strategy

Departmental management teams next designed mini SLMs for their departments. Each SLM documented the department’s Strategic Objectives. Derived from the corporate Destination Statement, SLM and Strategic Objective definitions, the departmental SLMs identified how the department would contribute to achieving corporate goals. In order to reduce complexity departments took a maximum of 5 activity-type Objectives and 5 outcome-type Objectives. The Objectives were revised and validated with the responsible IIC director in a form of contracting with their departments. Finally, the each departments’ SLM was shared with all other departments thus promoting strategic communication. Figure 4 shows an example of five compliance-related Activity type Objective cascaded to a “partial” SLM for the Compliance Department.

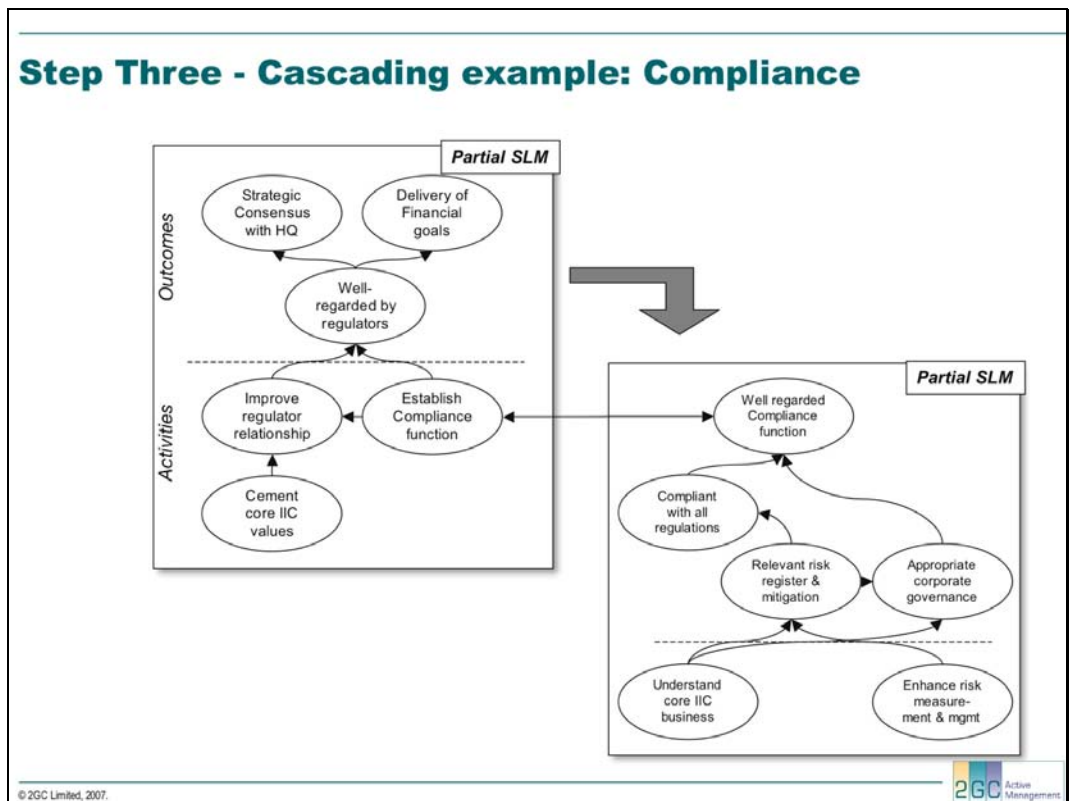


Figure 4

The rationale for building these departmental Strategic Linkage Models was that they enabled departmental consensus on short to medium term priorities. Further, they clarified the few departmental strategic activities required and the few strategic outcomes sought, in support of corporate strategy. Finally, as will be explained in the next section, they would help with measures selection at personal level.

The final step – selecting personal objectives

All staff defined a handful of personal objectives for the year ahead. The principles of personal objective selection were as follows:

1. A maximum of 5 business objectives and 2 development objectives (eg. training) were selected per person.
2. Personal (business) objectives were to directly support a departmental or corporate Strategic Objective.
3. Objectives would be weighted for importance, with a maximum weighting for development goals: 20% for new hires, and 5% for experienced staff.
4. Managers were expected to have more outcome-type objectives, staff more activity-type objectives.
5. Each personal objective was to have a measure and target for the year ahead.
6. Objectives and targets across individual members of a department should 'add up' to departmental objectives and targets.

Figure 5 shows an example of personal measure selection, in this case for a member of the Underwriting staff. The cascaded "partial" SLM is shown at the top of the figure and the table below shows details of personal objectives, measures, baselines and targets, as well as a clear indication of which SLM Objective the measure is supporting.

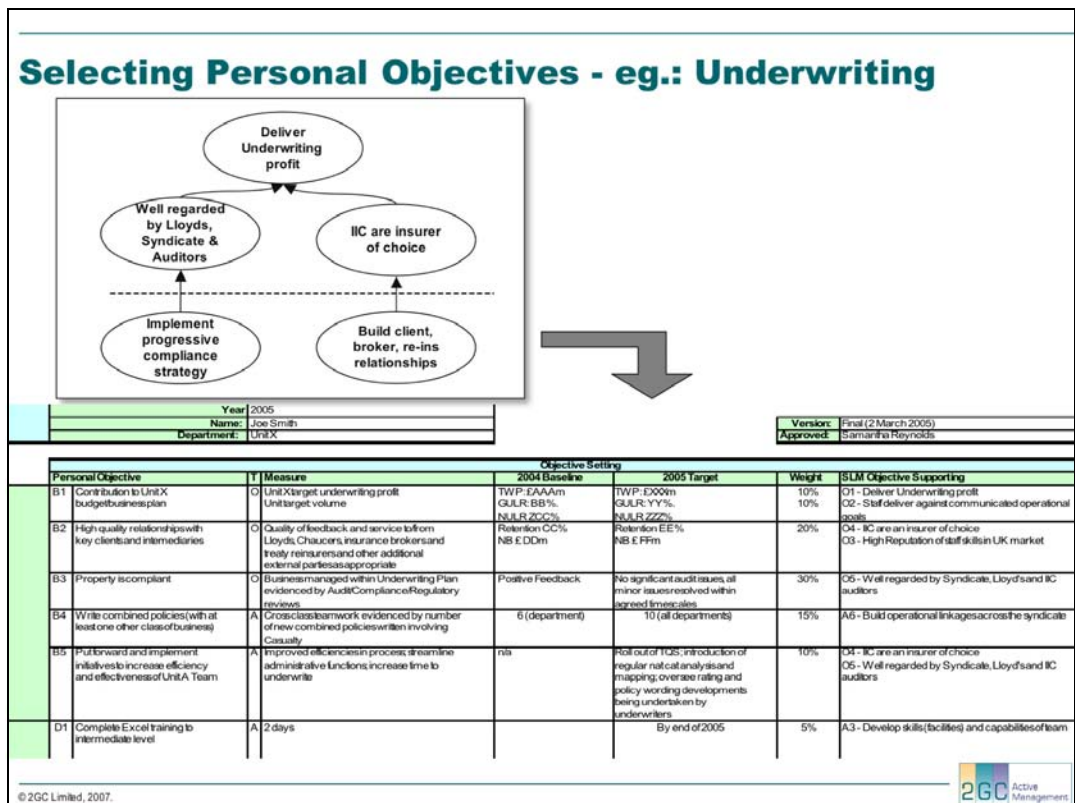


Figure 5

The approach taken in personal measure selection ensured employee objectives directly supported strategy. Additionally, the work fostered team dialogue on goals and targets, both shared and individual. Also developed was a clear, shared understanding of personal objectives – between staff member and manager was also developed in the process. Balanced sets of personal objectives (with measures and targets) were defined, and the activity also supported the employee-capabilities development strategy. When the system was operational it allowed much more objective appraisal of actual staff performance (not 99% of staff meeting or exceeding expectations) than was available previously, achieving a high degree of “granularity” in appraisal. Finally, with the system allowing reward to be logically linked to corporate and/or departmental and/or personal performance, appropriate levers of control were now available.

Naturally there were issues of concern that would have to be managed carefully during implementation. One of these concerned whether the entire department SLM was being worked on, across the department, in other words, there was a concern that no objectives were “orphaned?” The implementation team were also conscious that people would naturally select objective weightings influenced by what they thought they were most likely to deliver.

Findings and Conclusions

Analysing the approach taken produces a number of additional insights to existing literature for organisations looking to improve their approach to individual pay and performance management. The main findings from this case are as follows:

- ∞ Locally relevant content: Rather than a traditional directive “top-down” objective setting process, allowing local autonomy in the choice of the objectives to support the organisation ensured that the content of departmental objectives was more relevant to employees. In addition, engaging teams and individuals in setting objectives helped create more buy-in to their delivery. With its simple structure and engaging process, the 3rd Generation Balanced Scorecard approach proved a particularly effective mechanism to clearly communicate and gain buy-in to objectives. Using a Strategic Linkage Models with only two perspectives (activities and outcomes) allowed each management team to neatly illustrate to employees the

-
- focus for the next year.
 - ∞ Process fit between HR and Business Strategy: Creating a Destination Statement at the top level (a clear, one page description of what the organisation needed to look like in three-years time) was an excellent mechanism to inform HR management practices, including individual performance management practices. It helped ensure that HR strategies could support improvement and more specifically helped inform the design of the individual performance management process. The Destination Statement also helped to prevent HR practices that would create organisational conflict and conflicting employee behaviours.
 - ∞ Performance Management approaches at different levels: Using different management processes to set objectives at different levels of the organisation produced a flexible, simple and efficient system of control. Using a system that was the same format for each level of the organisation, i.e. personal Balanced Scorecards, would have been too burdensome on the organisation and probably not a useful way of managing performance of staff.
 - ∞ As a final conclusion this reflective piece of case research, while creating useful insights, was only based on observations from a single organisation, and therefore has limitations. Further research and development in this area, perhaps replicating this style of performance management system, is required in order to gain a full understanding of how good performance management design can bridge the consistency gap between individual and corporate goal setting and control systems.

About 2GC

2GC is a research led consultancy expert in addressing the strategic control and performance management issues faced by organisations in today's era of rapid change and intense competition. Central to much of 2GC's work is the application of the widely acknowledged 3rd Generation Balanced Scorecard approach to strategic implementation, strategy management and performance measurement.

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