

# On the elements and practices of monitoring

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## Abstract

Politicians and businessmen have to address the principal-agent problem whenever delegation of power occurs. Installing a monitoring scheme may help to ensure that the officers perform the desired functions. Checks and balances are the theme in the political arena, while management and control are the routines in the business world. Throughout history numerous monitoring networks have been deployed to overcome the difficulties. Comparing how those monitoring networks solved the controlling issues may shed light on the incentive structures embodied. Furthermore, the evolution of institutions and organizations could be discerned via the changes in incentives.

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## 1. Introduction

Whenever there is delegation of power, the concerns for the principal-agent problem may arise, whether in an empire or a company. The emperor has to rely on his ministers to manage the state due to the limits of his ability and time. The same is true for the chief executive officer (CEO) in running a company. Both situations involve the principal-agent problem, in which the principal knows little about the agent. The emperor is uncertain about his ministers' integrity or competence, while the CEO is not sure whether the managers are honest or capable. In this case, the emperor or the CEO can be looked upon as the principal and the ministers or managers as the agents. The principal has to implement certain measures to control the agents.

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Recruiting is the foremost task and the employees need to be decently rewarded; the principal cannot recruit competent personnel without paying fair salaries (Rasmusen, 1994, 206–7) and high salaries may serve as a deterrent to employees' misdemeanor (Shapiro and Stiglitz, 1984). However, agents may still commit frauds, no matter how much they are paid. Other measures have been applied to solve the issue. A trial period is one way to know more about the employees before entrusting them with further duties, while deploying monitors to supervise them is another. To some extent, the agents' performance depends on the competence of the monitor. Therefore, another monitor may be necessary to oversee the monitor. As Juvenal said, "Who will guard the guards themselves?" Applying this monitoring concern to the extreme, an infinite number of monitors may be needed to enforce every instruction. The agency problem was challenging to ancient regimes and early European trading companies (ETCs), considering especially the lack of modern communication devices and the immense areas involved.

Sa (1975a) depicts concisely the monitoring system of the Former Han Dynasty (FHD) (206 BC–AD 7), which paid officers higher than the market. Officers ranked 600 dan<sup>1</sup> could have a comfortable living, while those ranked higher were able to accumulate wealth. Hence, the remuneration provided plenty of incentives to recruit capable persons. Besides, a network was installed to monitor the officers of the central and local governments, with monitors controlling officers and supervisors evaluating subordinates. Lower rank officers checking higher ones and monitors' mutual monitoring were the features of the monitoring system of FHD.

As for ETCs, the difficulty lay in the communication between the main office and the colonies, which could take from 18 months up to 2 1/2 years (Carlos and Nicholas, 1988). To control the employees and to increase the cost of opportunism, bonding was required to join the company. Later on, to enhance the cohesiveness within the company, recruitment was made from a specific group and a family atmosphere was cultivated (Carlos, 1991). Orders had to be followed strictly; violators would be heavily punished, and the reward was generous for outstanding performance. In addition, the correspondence between the agents and the directors had to comply with an established format, and all details regarding operations had to be reported (Chaudhuri, 1996, 196–7). The knowledge gap between directors and agents was filled by meticulous requirements of record keeping as well as information gathering from other possible sources.

The military monitoring is even tougher because battles could cause one's own death and persuading people to make efforts that could end their own lives seems to be an impossible mission. Brennan and Tullock (1982) analyze the incentives of waging wars from an economic perspective. Victories on the battlefield, indeed, depended on proper applications of carrot and stick. Numerous monitoring systems have been deploying throughout history. Certain companies and dynasties had been noted for their success due to the monitoring networks nurtured. Analogous applications of monitoring were attributed to some of the successes in military maneuvers. Comparing these systems could reveal some common features, and the evolutionary path of organizations could be retrieved through the changes of the incentives of monitoring. The discussion will start with the incentives.

## 2. The incentives

No pains, no gains. To sustain the pains, however, the gains must be substantial enough to compensate the pains. A Chinese maxim says, "a person may make a living out of murdering

<sup>1</sup> Dan is a measurement unit of corn.

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