

A Theory of Teams Based on Image Concerns

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Abstract

The purpose of the paper is to analyze theoretically how social image concerns affect motivation problems in team production. One prominent feature of teams is mutual monitoring. Under close teamwork it is likely that team members can observe their effort each other, and they care about how their intrinsic motivation toward team performance and extrinsic incentives to do well for their own sake are evaluated by (some of) the other members. Image concerns can either attenuate or aggravate the free-rider problem. When the free-rider problem is mitigated by image concerns, increasing team size brings two positive incentive effects into the team. The first direct effect is that the agent cares more about his image concerns in larger teams because "more eyes" are observing his behavior. Second, even if the first effect is absent, the average team effort can still increase with team size because the weaker monetary incentives in larger teams raise the marginal reputational return to effort. Furthermore, these two effects interact with each other. I show that the average team effort per agent can even be increasing in team size. I next classify the agents into two categories, "insiders" and "outsiders" and show that replacing insiders by outsiders may have positive incentive effects. The results explain why increasing the number of independent directors or hiring a new CEO from outside ("new blood") can have significant and positive effects on firm performance.

JEL CLASSIFICATION NUMBERS: D82, D86, D91, M12, M52.

KEYWORDS: Social image, social pressure, reputational concern, team production, free-riding, team size, board of directors, new blood

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