

MR. WATSON, ARE YOU THERE?

The Economics of (some) Information

Back in February, Yahoo president and CEO Marissa Mayer created a brief firestorm with her directive to company colleagues that they would no longer be permitted to work from home. They would have to change from pajamas and slippers into whatever constitutes business attire in California and now clock-in at the office.

This specific policy decision is actually one part of a larger subject in economics—cases of asymmetric information, situations in which one party in a transaction, whether it be employer or employee, car buyer or seller, or prospective spouse is relatively more well-informed than the other, or possesses private information that he or she may not want to divulge.

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In adverse-selection situations a sample of products or people may not be representative of the population as a whole. For example, it has to cross the mind of an insurance agent talking to someone who wants to buy a \$1 million life insurance policy: What is there about this person that I do not know that would change the odds of a healthy-looking 40-year-old male not living to age 80? Thus the agent poses questions about the applicant’s family history (“Are your parents still living?” and if the answer is no, then: “At what age did they die and from what cause?”) and would require a physical exam. Whether the person is a smoker or likes to skydive are other considerations. And policies preclude the company from having to pay beneficiaries should the policy holder commit suicide, a complementary way to deal with this informational deficiency.

The tendency of an imperfectly monitored employee to shirk—Go on, admit it: You’ve done it!—brings up moral-hazard and principal-agent problems, as well as questions of how to structure compensation to align incentives to ensure that the worker is acting in the best interests of the employer or firm. Slacking off or taking on-the-job leisure time is always a concern when monitoring is difficult for the “principal” and/or the “agent” can’t be trusted. (The same is true for a firm’s stockholders—the principals—in ensuring that the CEO and the Board of Directors—the agents—do what is in the best interests of investors and not be squandering resources on expensive art work, travel, or relatives.)

In restaurants in the United States, discretionary tipping is one way to ensure that the servers—the agents—contribute to a positive experience for diners that will lead to repeat business, something the owner—the principal—counts on for long-term viability. In a college classroom setting, examinations and taking attendance are means through which the principal—the instructor—can coax agents—students—into mastering the material. Signs on cash registers at some take-out eateries, like Dunkin Donuts or O’Hare concessions, that indicate your pur-



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chase is free if you do not get a receipt, is a way to keep employees from stealing from the franchise’s owner (who is likely not present) by not ringing up the transaction.

This is less of a problem when information is readily available or observable—new cars, with ample reviews, word of mouth, and Internet price information, or a coach and his/her players. It can be a problem in the used-car, used-house or used-spouse markets, though in many cases private inspections and contract clauses can be used to address them.

For Yahoo, Mayer may have suspected that a non-negligible fraction of her at-home employees were spending too much time playing with their dogs or managing their fantasy league teams. Or she may have felt that there are creative, productive synergies from having her employees interact with each other in formal meetings and water-cooler conversations.

Sometimes compensation can be structured—piece-rate pay, performance bonuses—to address principal-agent and moral-hazard problems. And technologies that allow an employer to track performance and activity, such as tracking keystrokes, video surveillance or installing GPS devices, are modern ways of monitoring.

In Chicago, scandals involving criminal misconduct and rampant corruption, including torturing and framing those in custody, have plagued the police department in recent years. In 2012 alone taxpayers had to shell out \$22.5 million in one settlement and \$10.25 million in another, plus millions of dollars in legal fees to defend these officers. Perhaps CPD contracts could be structured such that their members would have pay for these aberrant behaviors from their own pension funds. That would be one way to re-align the incentives. Or appoint Ms. Mayer our police chief! □