



# SELF-MANAGED TEAMS, AGENCY RISK,

While most corporations have many self-managed teams and elevated levels of agency risk, they have not adopted the appropriate control system, at least not in earnest.

# AND MANAGEMENT ACCOUNTING

THOMAS JACKSON

**N**ow that the pandemic is over, corporate leaders are ordering their workers back to the office. Why is that? As an economist, I would suggest a simple answer: agency risk. Agency risk arises when managers who, as fine examples of *homo economicus*, tend to maximize their own utility at the expense of their corporations' shareholders. The deficiencies of *homo economicus* include hiding information, misleading others, and maintaining a long list of inherent psychological biases. Today, of course, we are all self-managed to one degree or another. Twenty years ago, in their book *Beyond Budgeting*, Robin Hope and Jeremy Fraser pointed out that our organizations had become collections of empowered workers and self-managed teams.<sup>1</sup> They said we were "radically decentralized" and recommended the reform of management accounting. I'll come back to this later.


How dangerous is the agency risk associated with radical decentralization? I can think of two ways to measure it. The first way is to count the number of self-managed teams or units and compare the sum to some previous standard or benchmark. The second way is to look for behavioral responses to increased levels of self-management. By either measure, the risk

seems to be fairly severe. This was true even before the pandemic.

Let us assume that, prior to COVID-19, organizations were configured, as Hope and Fraser observe, as collections of self-managed teams. Toyota is famous for exemplifying empowerment and teamwork, so it can serve as an example here. In 2022, Toyota had approximately 373,000 employees globally.<sup>2</sup> It is said that Toyota prefers a team size of five members. That would mean that Toyota is a collection of roughly 74,600 self-managed teams, give or take. What might we compare this to? A good benchmark in the automobile industry is General Motors (GM), which in 1919 was reorganized by its CEO, Alfred Sloan, into a collection of about ten independent or "self-managed" divisions. Based on the number of formal, self-managed units, Toyota in 2022 was roughly 7,460 times more decentralized than GM was in 1919. If agency risk is a simple multiple, or some increasing function of the number of formally self-managed units, then, as a metric, the number 7,460 points to a *lot more risk*. The shockingly large number gives weight to the term "radically decentralized."

---

THOMAS JACKSON is an economist recently retired from 34 years of consulting on lean manufacturing, lean health care, total quality management (TQM), and strategy deployment. Tom can be reached at t.lindsay.jackson@gmail.com.



**HOSHIN KANRI  
SUPPLEMENTS THE  
INTERNAL AUDIT  
WITH SHORT,  
FREQUENT  
MEETINGS  
CONDUCTED NOT  
BY AUDITORS BUT  
BY MANAGERS  
THEMSELVES.**

The reader may object that my estimate of Toyota's self-managed teams is too high. However, the number grows even larger if we include the self-managed teams of Toyota's famously integrated supply chain. I might even have chosen to measure self-management in terms of the number of empowered employees, in which case Toyota's measure of relative decentralization would rise to  $5 \times 7,460 = 37,300$ . So I will stand by my first estimate. At least, we can say that Toyota today is more decentralized than GM (circa 1919) by *several orders of magnitude*.

The reader might object further that my counting exercise is simply not a credible method. To this I respond that economists have compared human organizations to computers for over 70 years. The same counting exercise occurs in computer science, where the number of information processes or computing "cores" is tracked meticulously and is connected to improvements in speed and efficiency. Why not take this approach to human organizations? Perhaps I stretch the metaphor too far, but I believe we can view self-managed teams as examples of parallel computing, with comparable improvements in speed and efficiency. At Toyota, speed is measured in terms of lead time reduction while efficiency is measured in terms of the number of machines each employee can operate in a self-managed production cell. Based on the explosion of self-managed teams since Japan's first "quality circle" (circa 1962) — the prototype of every kind of self-managed team — it is safe to say that, by any metric, agency risk levels are highly elevated.

We arrive at the same conclusion by observing the behavior of business organizations in response to notable increases in decentralization. Although we can find examples in deeper history, GM in 1919 will serve as our baseline again. GM knew it had a problem. To check the power of its independent divisional leaders, GM invented a new control system: management accounting, our system of annual budgets and internal audits. We have already mentioned that Hope and Fraser recommend *changes to this system in response to radical decentralization*, including the elimination of budgeting cycle and the replacement of managers' fixed performance contracts focused on the annual budget, with

relative performance targets designed to encourage critical thinking about improving the business.

In fact, at least half of what Hope and Fraser recommended in 2003 was put in place by several leading Japanese companies, but especially at Toyota, by 1965. I am speaking of *hoshin kanri*. The practice of *hoshin kanri*, or policy deployment, emerged in response to a change in the Deming Prize criteria that required applicants to demonstrate a link between their quality improvement activities and their respective strategies. At Toyota, managers receive their marching orders by means of "A3s." An A3 is essentially a team charter or contract written on a large piece of paper. The marching orders include relative improvement targets for quality, cost, and, where appropriate, revenue. By placing the emphasis on improvement, A3s certainly meet most, if not all, of the requirements of Hope and Fraser's relative performance contracts. Budgets are finalized *after* strategy has been communicated and confirmed through a negotiation process known as "catchball." Upon receiving strategic targets on the A3s of their senior leaders, managers draft their own A3s to propose how they plan to meet those targets.<sup>3</sup> Only then is the budget finalized.<sup>4</sup> The result is that every self-managed team has a very clear set of instructions that is directly linked to its firm's strategy — and its financial performance.

*Hoshin kanri* goes further — much further than Hope and Fraser — by addressing alternatives to the internal audit as the main mechanism of feedback and control. It supplements the internal audit with short, frequent meetings conducted not by auditors but by managers themselves. Meetings are often held in dedicated big rooms or *obeya*, where progress toward the company's targets are charted daily and discussed quarterly, monthly, or more frequently, if required. Large strategic initiatives or projects may have their own *obeya*, where the cadence of review is far more frequent, even in real time. In robust implementations of *hoshin kanri*, senior leaders themselves perform a "president's diagnosis." This is a kind of internal Deming or Shingo Prize, if you will, in which leaders apply detailed criteria to check that all business units are using the scientific methods of total quality man-

agement (TQM), lean, etc., to improve the firm's standard processes and procedures. Moreover, leadership behaviors during review meetings and the president's diagnosis are conducted in the spirit of coaching for improvement, not mere checking for compliance. Because it is infrequent and often conducted by outside compliance officers, the internal audit is a mere formality in comparison to the far more frequent feedback and self-control of *hoshin kanri*.

The agency risk of self-managed teams was, and is, very high, whether we measure that risk in terms of the proliferation of teams or in terms of industry's behavioral response. As we have mentioned, the heightened agency risk of the new organizational structure was obvious 60 years ago. It was so obvious, at least to the Japanese, that it inspired an entirely new control system. Obviously, *hoshin kanri* rises to the level of a new control system, one that was specifically designed to control the activities of the self-managed teams, first the teams of TQM but later the teams of Lean, Six Sigma, Lean Six Sigma, total productive maintenance (TPM), and now, Agile. This raises the obvious question: Why hasn't the world adopted the new control system by now?

The answer: Making industrywide changes in organizational structure and control is an excruciatingly slow process. After GM's divisionalization and its invention of management accounting in 1919, Ford Motor

Company waited until 1948, the year of Henry Ford's death, to follow suit; European corporations did not divisionalize until the late 1960s.<sup>5</sup> It should be no surprise that current corporate leaders may not fully understand what has happened or how to respond. Meanwhile, most corporations have many self-managed teams and elevated levels of agency risk, but they have not adopted the appropriate control system, at least not in earnest. Counting the number of their self-managed teams, embracing *hoshin kanri*, and frequently monitoring progress in big rooms would be good moves for leaders to make right now. And if leaders resist, their boards of directors should insist that they do it anyway — to protect the shareholders from their increasingly numerous and all-too-human managers. ■

---

#### NOTES

<sup>1</sup> Hope, J. and Fraser, R., *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap*. (Boston: Harvard Business School, 2003).

<sup>2</sup> "Toyota/company information, company profile/overview," (Jan 27, 2023). Available at: <https://global.toyota/en/company/profile/overview/>.

<sup>3</sup> For an introduction to using A3s to form and deploy strategy in the style of Toyota see: Jackson, T., *Hoshin Kanri for the Lean Enterprise: Developing Competitive Capabilities and Managing Profit*. (New York: CRC Press, 2006).

<sup>4</sup> *Hoshin Kanri: Policy Deployment for Successful TQM*. Akao, Y. (Ed.), (Portland, OR: Productivity Press, 1991): 192.

<sup>5</sup> Servan-Schreiber, J. J., *The American Challenge*. (New York: Atheneum, 1968).