Money–Is it really a motivator?

One of the myths of executive compensation is that the most effective way to motivate people to work productively is through individual incentive compensation (Pfeffer, 1998). While most people agree that money cannot buy everything, in organizations there is a widespread belief that money plays a major role in motivating people. Organizations spend a lot of time, effort and money in designing and implementing the right performance management schemes and incentive schemes to motivate their executives. It is accepted as a matter of fact that if only we could measure desirable behaviors and reward individuals commensurate with their results then all our motivational problems would be solved. But what is the truth of this statement? Are monetary rewards and incentive systems a panacea for all motivational issues?

While money may definitely help attract and retain talented people, we have reason to believe that monetary incentive schemes may also have some undesirable effects on morale of employees. Kohn (1993) argues that monetary rewards only secure temporary compliance and do not build any long term commitment or lasting behavioral changes in people. According to Meyer (1975) the basis for most of the problems with merit pay plans is that most people think their own performance is above average. Since no plan can give a positive feedback to all persons, it threatens the self-esteem of individuals. People cope with this by demeaning the importance of the job or by derogating the source of the reward.

This paper explores the origins of our belief in the motivating power of money and some of the undesirable effects of monetary incentive schemes for executives. We start by trying to understand some of the fundamental assumptions which make us believe that money is a motivator, then we look at some objective evidence on the motivational power of money and finally we focus on some of the dysfunctional effects of relying on money as a motivator.

Sources of the Belief in the Motivating Power of Money

The three pillars on which sustain our belief in the motivating power of money are Adam Smith's theory of rational self-interest, Herbert Simon's theory of bounded rationality and Oliver Williamson's theory of transaction cost economics.

Adam Smith described the theory of rational self interest in his book, The Wealth of Nations. in 1776, where he said: "The directors of such [joint stock] companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company." By assuming that the basic nature of employees was to shirk their responsibility, Smith laid the foundation for some external incentive to ensure that the attention of the employees was congruent with that of its owners.

Herbert Simon (1945: 67) described the task of decision making as involving three steps (1) the listing of all alternative strategies (2) the determination of the consequences of each strategy (3) the comparative evaluation of these sets of consequences. According to Simon, rationality was "the selection of preferred behavior alternatives in terms of some system of values whereby the consequences of behavior can be evaluated." He added that – "it is impossible for the behavior of a single isolated individual to reach any high degree of rationality. Individual choice takes place in an environment of "givens" – premises that are accepted by the subject as bases for his choice, and behavior is adaptive only with the limes set by these "givens" (p. 75). Simon presumes a monetary motivation for most individuals by saying that – "To an employee of a non-volunteer organization the most obvious personal incentive that the organization offers is a salary or wage. It is a peculiar and important characteristic of his relation with the organization that, in return for this inducement, he offers the organization not a specific service but his undifferentiated time and effort. He places his time and effort at the disposal of those directing the organization, to be used as they see fit. Thus both the customer relation and the employee relation originate in contract, but in contracts of very different sorts. The employment contract results in the creation of a continuing authority relation between the organization and the employee. The employee accepts the authority of the organization depending on the nature and magnitude of the incentives that the organization offers (p. 115)."

Williamson (1964: 31) dropped "social service" from his list of motives for working because he considered the possibility of that motive being served in organizations as remote and he did not think that the activities as a result of this motive would be significantly different from other motives. Williamson (1975) considers the transaction as the ultimate unit of economic analysis and defines opportunism as a lack of candor or honesty in transactions, to include self-interest seeking with guile. Hence he considers that self-interest seeking and rational behavior together provide the framework with which to examine economic behavior.

Hence when taken together, Smith tells us that all human beings are selfish, Simon asserts that that they make decisions rationally by considering alternatives and Williamson assumes that given a chance people will be opportunistic, hence the only way to ensure that employees work in the interests of the owners is to have elaborate and strict systems which measure their performance and to carefully align their interests in line with that of the owners.

Authors have severely criticized Williamson for assuming that the sole cause of opportunism is human nature, and thereby converting an unexplained behavior (which he has himself described as an "extreme caricature") into a behavioral assumption (Ghoshal and

Moran, 1996). Even the application of these theories in the form of compensation schemes have been shown to be ineffective. Baker, Jensen, and Murphy (1988) have highlighted aspects of compensation where current economic theory and actual practice is disassociated and have summarized empirical evidence which is inconsistent with traditional economic theory. Opsahl and Dunnette (1966) discuss the incompleteness of four theories of money as a source of motivation. Each of the four theories viz. money as a generalized conditioned reinforcer, a conditioned incentive, an anxiety reducer, a hygiene factor, and an instrument for gaining desired outcomes are shown to have insufficient empirical support to be taken up as conclusive evidence of the motivating power of money. Similarly they cite literature to show job and task variables viz. schedules of pay, secret pay schemes, and pay curves are not evidence enough of money as a motivator.

Simon, the proponent of bounded rationality himself admitted that monetary incentives have their limitations by saying – "initially organizational objectives and goals are imposed by exercise of authority, but soon these become internalized and he acquires an attachment or loyalty to the organization that automatically i.e. without the necessity of external stimuli, guarantees that his decisions will be consistent with the organizational objectives (p. 189)."

Despite criticism and lack of empirical support, these theories have influenced our common knowledge and organizational practice. Is it that these theories and assumptions are inherently true or is there some other factor that helps sustain these beliefs in society?

Self-Fulfilling Nature of Economics Theories

Simon (1945) highlighted a unique feature of social sciences by saying that – "If there is a fundamental difference between social and natural sciences, it derives from the fact that the social sciences deal with conscious human beings whose behavior is influenced by knowledge, memory and expectation. This does not mean that it is impossible to state valid laws of human behavior. It simply means that one of the variables to be included in the statement of social laws is the state of knowledge and experience of persons whose behavior the law purports to explain."

Like Simon, others (Ghoshal & Moran, 1996; Ferraro, Pfeffer and Sutton, 2005; and Ghoshal, 2005) have also argued that economics theories can influence human and organizational behavior significantly through a self-fulfilling prophecy.

Ferraro, Pfeffer and Sutton (2005) claim that economics theories like those of self-interested behavior, agency theory and free market efficiencies can influence human behavior through the mechanisms of institutional design, social norms, and language. They argue that institutions are designed under the assumption that persons will be narrowly self-interested and motivated only by extrinsic incentives. These processes and mechanisms produce the very same behavior (i.e. self-interested and extrinsic motive seeking behavior) that they assume and hence become self-fulfilling and institutionalized. Ghoshal (2005) describes this process as the double hermeneutic mechanism which works through social institutions like business schools and churns out hordes of professionals who believe that all managers are self-interested agents who have to be either kept constantly in check or whose interests have to be aligned to the shareholders' goals though mechanisms like profit sharing and stock options. This was validated in a longitudinal study of business school students over a period of five years where it was found that self-oriented values like "a comfortable life" and "pleasure" became more important and others-oriented values like "being helpful" and "being polite" become less important over a two-year program (Krishnan 2003).

But these arguments do not provide us with conclusive evidence about human nature and the extent to which human beings are self-interest seeking rational beings. Some empirical studies help provide an understanding of how these mechanisms operate at an individual level.

Miller and Ratner (1998) found that there is a tendency for individuals to over estimate the impact of self-interest in others. Individuals believe that self-interest powerfully guides people's behavior. People were so strongly convinced that self-interest drives people's behavior that it affected their predictions even though it did not affect their own behavior. An outcome of this phenomenon is that it is often the belief that only self-interested people will act leads only self-interested people to act. Liberman, Samuels, & Ross (2004) showed that just by changing the name of a prisoner's dilemma game from "Community game" to "Wall Street game" there was far greater impact on player's choice to cooperate vs. defect. The findings suggest that most persons have a range of cognitive schemas that could be applied to a given situation and our own behavior may depend on whatever factors determine which schema happens to be selected by chance or by the context.

Hence it seems as if human beings are not by nature self-seeking, rational and opportunistic beings as some economics theories would have us believe, however it is the design of social mechanisms and organizations which make them behave in this manner. But having been a victim, to these social structures, and having learned self-interested, rational behavior, should not human beings respond well to monetary motivators? Our findings still do not explain why individuals who have been socialized by self-seeking, rational, and opportunistic behavior promoting organizations and systems still do not always respond to monetary incentives.

Intrinsic and Extrinsic Motivation

Hackman and Oldham, (1976) propose a model specifying the conditions necessary for development of intrinsic motivation as consisting of five "core" job dimensions viz. skill variety, task identity, task significance, autonomy, and feedback. These five job dimensions promote three psychological states which in turn lead to a number of beneficial personal and work outcomes. The linkage between job dimensions and psychological states and between psychological states and the outcomes are shown to be moderated by individual growth need strength. In the entire theory, there is no mention of monetary benefits and hence it appears as if money has no role to play in the development of intrinsic motivation. But are monetary award neutral to intrinsic motivation or is it likely that they may be counterproductive to the development of intrinsic motivation?

Herbert H. Meyer (1975) once said, “To the extent pay is attached directly to the performance of the task, intrinsic interest in the task itself decreases. When pay becomes the important goal, the individual’s interest tends to focus on that goal rather than on the performance of the task itself.” Meyer’s statement is a reflection of a growing body of literature which criticizes the belief that people can be made to perform better simply by linking their salaries more closely with their performance.

The earliest empirical studies on intrinsic motivation were done by Edward Deci. His experiments showed that when money was used as an external reward for some activity, subjects lost intrinsic motivation for that activity. On the other hand, when verbal reinforcement and positive feedback were used as external rewards, the subjects’ intrinsic motivation increased (Deci, 1971). He suggested that this could be because of the connotation and use of money in our culture, which made it act as a stimulus leading people to cognitively reevaluate the activity from one which is intrinsically motivated to one which is motivated primarily by the expectation of a financial reward. Similar results were seen by Condry (1977) who found that task-extrinsic incentives may undermine performance of and interest in the rewarded activity. When subjects were aware of and in anticipation of the reward, their behavior was significantly different from that of comparable subjects who received the same reward unexpectedly.

The empirical studies of Deci and Condry show how the introduction of an extrinsic reward can undermine an intrinsic interest in the job while this may be damaging enough for an executive personally, it may even have implications on the organization as a whole through the actions taken by such extrinsically motivated executives.

Pittman, Emery, and Boggiano (1982) showed that intrinsic motivation orientations are characterized by preference for activities that are relatively complex, challenging, and entertaining while extrinsic motivational orientations are characterized by preference for activities that are relatively simple, predictable and easily completed. By introducing task-contingent rewards an extrinsic motivation was fostered in the subjects and this orientation could carry over into subsequent interactions with the activity, even when the conditions that originally fostered those orientations are no longer present.

Perhaps this may explain some of the short term focus and opportunistic behavior of organizations where executives are continuously measured and rewards based on quarterly results. Given the high focus on extrinsic rewards, it is likely that executives would tend to take short cuts which appear relatively simple in their quest to attain targets rather than go for long term organizational building activities which are more complex and challenging. This may account for some of the dysfunctional behaviors stemming from a faulty performance management system (Kerr, 1975), low innovation, creativity, and workplace performance (Amabile, 1988).

Conclusion

In this paper we have seen some of the limitations of money as a motivator for individual performance. Organizations should consider the utility of monetary incentives beyond motivating individual performance. Cowherd and Levine (1992) provide evidence that egalitarian, inter-class rewards lead to perceptions of fairness and increase product quality. Besser (1995) studied the Toyota Motor manufacturing in Kentucky and found that rewards were not tied directly to individual performance, but instead were used to nurture the bonds within the work team and reinforce belief in a common fate. The work team having a belief in the common fate positively impacted individual cooperation in organizational goal achievement thereby enhancing the influence of rewards on individuals.

Finally organizations must also account for cultural aspects in the design of compensations and incentive schemes. Shamir (1991) explains how most theories of work motivation assume an individualistic-hedonistic bias and have an over-emphasis on cognitive-calculative processes. As such these theories and their subsequent applications in the form of merit performance schemes may not be relevant in countries which have a more collectivistic orientation such as India. Singh and Krishnan (2005) have developed a model for leadership in India based on a study of 250 managers. Among the seven sub dimensions of transformation leadership, three dimensions are of interest to us. Firstly “simple-living-high-thinking” which includes behaviors like simplicity and a focus on hard work. Secondly “self-sacrifice” which includes behaviors like not taking credit for success and not focusing on ones own interests. And finally the “giving model of motivation” which includes behaviors like focusing on long term goals and not short term performance targets, and highlighting group identity. It seems as if the model of merit pay and personal monetary incentives would go contrary to these three facets of transformational leadership in the Indian context. A high salary and incentive for the individual performance of the leader may actually hamper his or her ability to lead by reducing follower perceptions significantly in these three areas.

According to Vroom's (1964) theory of work motivation, the valence of effective performance increases as the instrumentality of effective performance for the attainment of money increases, assuming the valence for money is positive. Hence the key factor in determining whether of not to go in for a monetary incentive system is valence for money of the employees. This can be determined scientifically or based on organizational, social and cultural factors. In any case it is foolhardy to assume that all employees would be driven to the same extent by the same motivator.

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