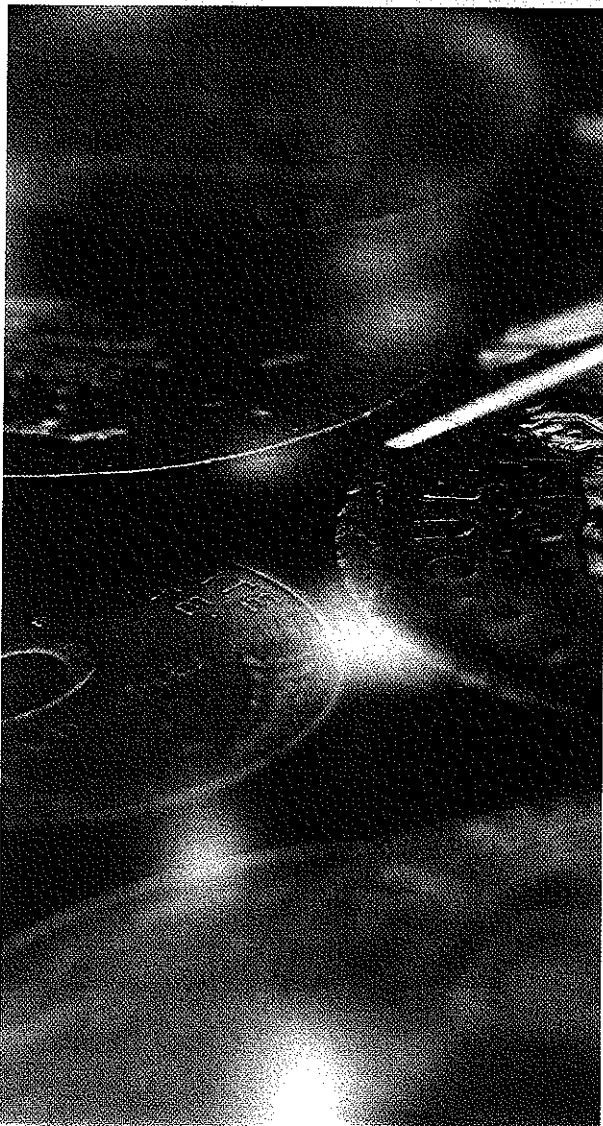


The hidden costs of performance-linked remuneration

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Motivation is beset by contradictions. On the one hand, it seems obvious that "employees who are willing to perform have a high working morale". On the other hand, it also seems reasonable to say that "people work all the harder, the more they are paid for it". For quite some time now performance-linked remuneration has been regarded as a distinguishing feature of progressive management structures. Companies, government departments, even universities are supposed to become more efficient by aligning remuneration increasingly to success-related performance criteria. The allocation of bonuses or stock options in particular is widely regarded as the embodiment of performance-promoting remuneration: salaries should be linked as closely as possible to the employee's individual performance.



This idea corresponds to the traditional economic intellectual approach. Human beings are regarded as selfish individuals who are primarily interested in income ("homo oeconomicus"). According to this theory, individuals respond systematically to externally specified incentives: if they receive more money for doing something, they will also increasingly pursue this activity. This view of humanity has been applied very successfully to fields other than the economy. It is especially suitable for explaining many phenomena in the fields of the environment, politics ("public choice"), law ("law and economics"), sport, crime and even the family and the arts.

However, for some years now economics has increasingly been turning its thoughts back to its roots in social science. It is endeavouring to expand its view of humanity by incorporating findings from the fields of social psychology and sociology. The focus is on behavioural motivation: people work in order to earn money (extrinsic motivation).



However, they often also work because they have an “inner fire”, in other words, they are enthusiastic about the work as such.

Reasons for intrinsic motivation

Employees can be intrinsically motivated for three different reasons.

First, an activity can provide enjoyment in itself, i.e. generate a “stream-of-pleasure experience”. Examples of this are resolving tricky problems or talking to colleagues about pending problems at work.

Second, standards can be maintained for their own sake. These can be ethical norms – for example, not maliciously hurting other people. Standards of fair play and rules for participating in teams (“team spirit”) are also especially important in organisations.

Third, people can act on the basis of intrinsic motivation if they wish to achieve an objective they have set themselves. This is the case even if achieving this is anything but enjoyable, such as writing a paper in order to pass an examination.

Hidden costs of extrinsic incentives

There is no additive connection between intrinsic and extrinsic motivation. Externally specified incentives cannot simply be defined without influencing intrinsic motivation at the same time: monetary performance incentives in particular have an adverse impact on intrinsic motivation under a variety of conditions.

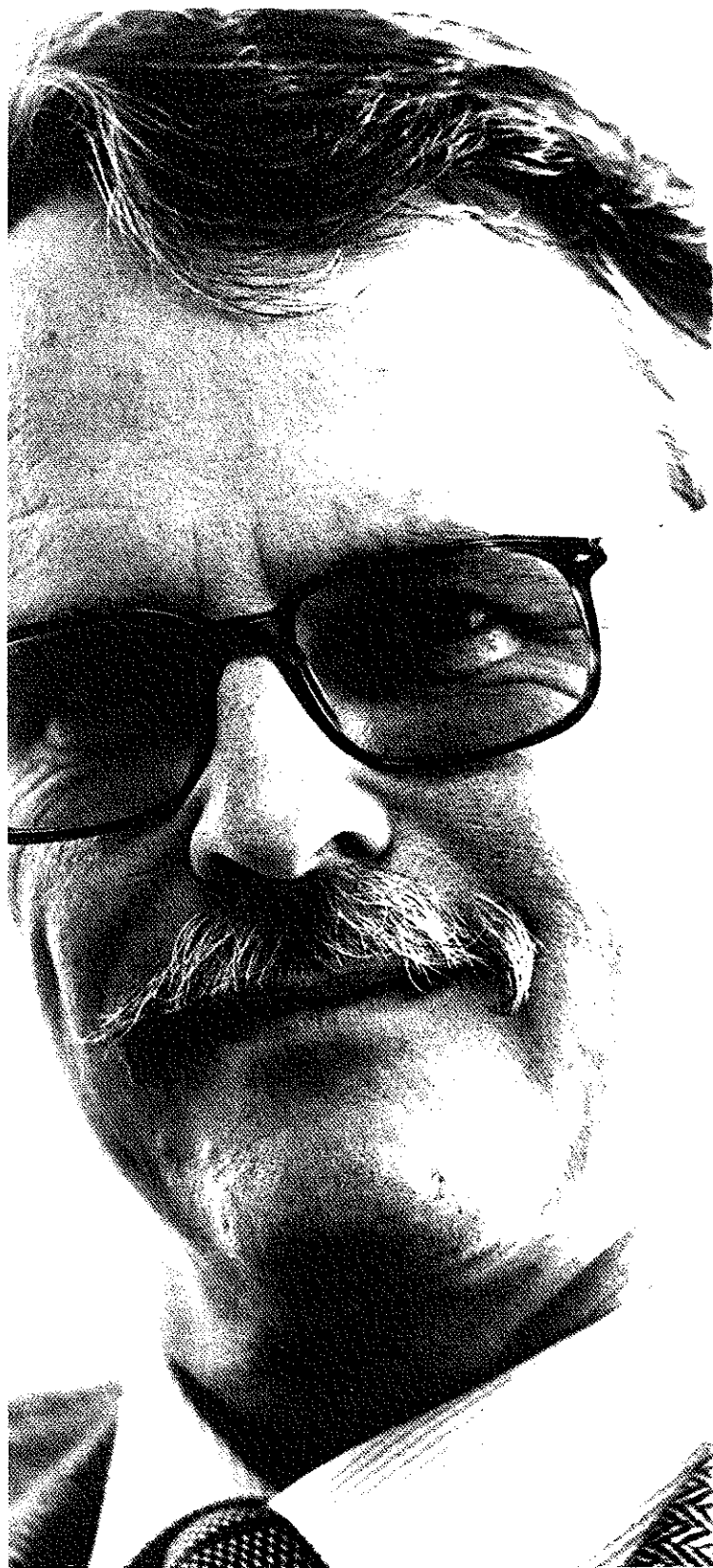
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Parents know about this effect. Children who were originally interested in their schoolwork lose this interest to some extent if they are offered the prospect of a reward for doing the work. In this way parents create a situation where children will do their schoolwork only in return for monetary reward. A repression effect has thus been created. In extreme cases, the child will only consent to take out the household rubbish if it is paid to do so.

The consequence of the repression effect is that an external intervention undermines an activity which is pursued for its own sake. Many observations point to the importance of the repression effect in the economy and society. It also has considerable empirical support. External interventions suppress intrinsic motivation under certain conditions – especially if a relationship has hitherto been based on voluntary cooperation and mutual consideration, but now becomes a business relationship as a result of payment. One example of this is an employee who has voluntarily worked overtime in an urgent matter because she likes to do good work. She will also be prepared to do this in future if her boss expresses his appreciation with a bunch of flowers, for example. However, if this extra work is simply recompensed with cash, it is reduced to a purely business matter. In future the employee will only be prepared to work overtime if she is paid directly for it.

Intrinsic motivation cannot be directly controlled. However, the conditions can be created so that a high level of intrinsic motivation is developed and maintained in employees. This can be achieved in particular by encouraging employees to do their jobs



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Bruno S. Frey was born in Basle in 1941 and attended school and university there. He was awarded his doctorate in economics in 1965. After a two-year stay in the USA he qualified as a lecturer in Basle in 1969. He was appointed a full professor at the University of Constance in 1970, and since 1977 he has been a full professor at the University of Zurich. His research activities are concerned mainly with the application of economics to non-economic fields, including politics, the environment, the family and conflicts. For some time now he has also been studying the link between economics and psychology.

independently and providing opportunities for them to have a voice in organising their work.

The repression effect can be attributed to the psychological process of reduced self-determination. An external intervention which is perceived as exercising control communicates a feeling of external control, and intrinsic motivation is suppressed. On the other hand, an intervention which is perceived as informative reinforces the employee's sense of competence and even accentuates intrinsic motivation. Depending on which aspect is uppermost, intrinsic or extrinsic motivation is promoted in a self-reinforcing process.

The importance of intrinsic motivation

Against the background of the repression effect, the vigorous application of variable, performance-linked salaries seems inappropriate. For many reasons, companies depend on the intrinsic motivation of their employees.

Companies are established because not all activities can be satisfactorily purchased on the market as external services. These include all activities of employees which have an impact on other employees, although these effects cannot be allocated precisely. Examples are a company's good name, its special corporate culture and good relations with customers and suppliers. Totally self-seeking employees make no voluntary contribution in this respect. They are merely freeloaders. Common property specific to the company is created only if it can be ordered and supervised by a superior. This is hardly possible in the case of the intangible resources described. By contrast, intrinsically motivated employees make efforts in this case to make a contribution to the common good.

Nor can the transfer of indefinable, implicit knowledge really be enforced by payment or command. Companies are therefore largely dependent on the intrinsic motivation of their

employees. Nowadays new knowledge is the most important strategic competitive advantage. The intrinsic motivation of employees is therefore becoming a central strategic resource.

Creative, innovative activities are largely based on intrinsic motivation. On the other hand, extrinsic motivation impedes the pace and intensity of learning. The pace of learning and conceptual understanding are reduced by supervision. Less demanding levels of learning performance are preferred under the pressure of the prospect of a reward. Work is performed more cursorily.

These considerations underpin the importance of intrinsic motivation. Nevertheless, extrinsic motivation cannot be dispensed with in companies and other organisations. Employees' motivation should serve the objectives of the company. This can often be achieved most easily by means of externally specified incentives. However, in this case no attempt is made to ignite employees' "inner fire". Intrinsic motivation can also have undesirable features. Envy, the thirst for revenge and the craving for recognition are no less intrinsically motivated than altruism, conscientiousness and love. By contrast, extrinsic motivation can discipline undesirable emotions.

Management by motivation

Appropriate intrinsic motivation must be maintained and encouraged in companies – and also in the economy and society as a whole. Especially in companies where employees' knowledge is a central resource, knowledge management must be complemented by appropriate management of motivation.

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