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Getting Executives to Perform for Owners, Society… and Themselves

Executive pay is much debated in terms of profit, ethics and social responsibility. How well do diverse types of compensation motivate managers? Are there hidden side effects? Two decades of research (showing economic rewards aren't enough and sometimes can be harmful) are integrated in a new paper by professors Knut Ims and Lars Pedersen from BMI founding partner NHH Norwegian School of Economics, with Laszlo Zsolnai of Corvinus University. Writing in the Journal of Business Ethics, they piece together key findings and add fresh insights toward a fuller model of effective compensation. We summarize their proposals.

Agency theory underpins the use of wages, bonuses and stock options to align the interests of owners and managers. Based on the notion of a simple work-effort supply curve, this approach presumes instrumentality (behaviour is always utility-oriented and opportunistic) and economic rationality (e.g., people who work overtime do so to earn more money).

It is a one-dimensional view of performance and reward. Human goals and motivations, however, are multi-dimensional.

In the Western world, at least, technical/instrumental approaches to problem-solving dominate. Yet human beings by nature are social, their motivations involve complex interpersonal dependencies. Plus, problems always relate to a larger whole, so solutions must be seen in their broader systemic context. And of course existential issues impact motivation: people's search for meaning, life-projects, desires for personal growth. The authors thus challenge the assumption that money is always a good way "to increase the effort and well-being of employees," noting that sometimes alternative perspectives are more fruitful.

Management distortions can result from undue or exclusive use of economic incentives, both logic and research evidence show. Intrinsic motivation – when people value a task in itself – is a powerful driver of performance and naturally valuable to organizations. Yet those with intrinsic motivation tend to lose it, at least partly, when extrinsic incentives are imposed. This so-called "crowding out" occurs when instrumental thinking replaces previous moral and social motivations, and the relevance of actions changes from "existential" to just "transactional".

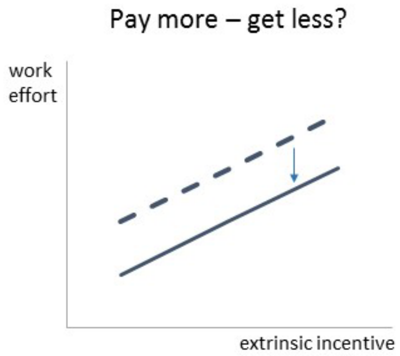
The loss of intrinsic motivation is, in effect, a shift of the work-effort supply curve so that more external reward is required to achieve the same level of effort. Moreover, if the external goal becomes all important, managers may pay less attention to whether the means used are ethical, socially responsible and in line with the overall good of the organization. The focus becomes hitting the precise targets that are measured, within the specified period, in order to get the bonus. There is incentive to ignore other issues that may be of long-term importance for the company but won't impact pay-outs or stock prices in the near term.

Agency theory-type rewards and controls are based on lack of trust and disbelief in altruism. And so they actually encourage the opportunistic behaviour they seek to guard against. Statements of vision and values become shallow formalities, and CSR just "a strategic act". Personal identification with the company and its goals diminishes, as does personal pride in the efforts one makes. Mental health may suffer, and burn-out is more likely.

Finally, special pay-outs to executives can easily be seen as unfair by team members who contribute heavily to meeting targets without getting similar rewards. This may fuel personal conflicts, de-motivate staff or otherwise destroy "the social and cooperative fabric of the organization".

Potential safeguards against such dangers lie in a more complete, holistic view of the company and the human person. It's important to recognize intrinsic motivation that exists, respect it, encourage it, not dismiss it as naïve or insincere, nor "crowd it out" with big extrinsic incentives. In this regard, the authors cite evidence that, where intrinsic drive exists, relatively small variable pay can quite effectively support employee engagement without changing the basic nature of motivation. That is, without shifting the work-effort supply curve.

Then there are factors with a "crowding in" effect, things that tend to boost employees' intrinsic motivation: procedural fairness, assuming/expecting magnanimity and commitment to social ideals, communicating trust and personal responsibility through "incomplete contracts", fostering a sense of community and connectedness. These approaches mostly address the social dimension of motivation,



recognizing performance as a collective phenomenon and using value-based leadership to inspire participation in a common vision.

Existential dimensions, among the most neglected according to the paper, offer strong potential to motivate executives for intrinsically-motivated long-term performance. It requires treating managers not as mere economic machines, but as people of sufficient depth and complexity to have a personal identity, a life project… or at least to be seeking one. And the conviction that leadership requires some form of service beyond self-interest.

New models of executive compensation are called for, given the clear pitfalls that research links with relying unduly on economic incentives – less efficiency, less social responsibility and less personal fulfilment. The most powerful and reliable drivers of effective performance are commitment to important existential, social and ecological/systemic values. But these don't quite work when they are instrumentalised for material selfish goals.

To move forward here, responsible organizations can invoke self-selection, "offering existential-spiritual, social and ecological pay-offs" to attract the type of top managers who can sync with and thrive under a more holistic approach to people management.

-- by Bryan P. Bradley for BMI, based on: Ims K.J., Pedersen L.J.T. and Zsolnai L. "How Economic Incentives May Destroy Social, Ecological and Existential Values: The Case of Executive Compensation." *Journal of Business Ethics* (2014) 123:353-360.