

It's Not Just the Money That Matters

One of my grandmother's
favorite adages was
“it's not what you say,
it's how you say it.”

New research on performance pay might have surprised her.

Using variable pay plans for motivating employees to achieve business objectives has been increasing over the past two decades, along with concerns about its effectiveness. Today, more than 88 percent of organizations have a variable pay plan, up from only 47 percent 20 years ago (Hewitt Salary Increase Survey, 1990-2009). Organizations are focusing more intently on evaluating and measuring the results of their variable pay programs. This is driven in part by the deepening of variable pay programs: A greater percentage of the workforce is now included in incentive plans.

A new study by Ola Kvaløy, Petra Nieken and Anja Schöttner (“Hidden Benefits of Reward: A Field Experiment on Motivation and Monetary Incentives,” *European Economic Review*, March 2015) uses an interesting experimental design to shed some light on why some times performance pay works well and other times it may appear that performance pay crowds out workers' intrinsic motivations. If workers are uncertain about the value of the task, the character of the manager or supervisor, or even of their own abilities, could monetary incentives by themselves create a negative signal that lowers intrinsic motivation? In their paper, Kvaløy, Nieken and Schöttner propose that “motivational efforts by a leader telling her employees how diligent they are and how important their work is ... potentially changes the perception of performance pay.”

To test this idea, the authors conducted an experiment at the University of Bonn in which students were hired to enter data drawn from official game reports of the German ice hockey league into an Excel spreadsheet. The participants



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were not informed of their involvement in an experiment, and were recruited via a written flier advertising a one-time job opportunity for entering data for two hours. In the flier, compensation was stated at 10 euro per hour (slightly higher than the hourly wage rate of a student assistant at the university).

Participants were divided into four treatment groups:



All participants, regardless of treatment, were given a plain explanation of the task to be completed. In the two treatments with performance pay, students were informed at the end of the instructions that they would receive a small piece rate of 10 euro cents for each game report they entered in addition to the fixed payment of 20 euro for participation. In the two treatments with motivational talk, participants were exposed to two bits of motivational encouragement, one at the beginning of the instructions and one at the end:

Beginning of instructions:

Welcome to the CIP Pool of the Juridicum. I am glad that you decided to assist us by recording the data for a research project. In the framework of a large research project, we analyze sports data, in this case ice hockey, to investigate the behavior of teams and competitive situations. We are certain that you, as competent students of the University of Bonn, are able to record the data quickly and precisely.

End of instructions:

I know that the work might be exhausting and tiring, but I also know that you are diligent students who are able to concentrate on these kinds of tasks for longer periods. If you decide to leave the room, try to be quiet to avoid disturbing your colleagues. You are welcome to adjust the screen to your convenience or alter the zoom in the Excel sheet. If there are no more questions, let's start working!

The authors note that these are “moderate” motivational sentences, leading participants to infer that they are participating “in a valuable project and are likely to do a good job, which will be to the benefit of a likable employer” (p. 191).

To assess whether performance pay enhances the effect of motivational talk, and vice versa, the authors used statistical regression analysis to study the interaction between the two variables — pay and motivational talk. They found that:



- | **Motivational talk** alone has no significant effect on overall performance
- | **Performance pay** alone has a significant negative effect on performance
- | The interaction of **motivational talk and performance pay** has a significant positive effect on performance.

The authors went on to examine whether performance pay and motivational talk affect the quality of work (defined as the error rate in the completed task). The results of this analysis indicate that adding motivational talk to performance pay makes a difference, reducing the average error rates by more than 40 percent.

In sum, the authors concluded that “subjects respond to motivational talk by increasing their performance only if they also receive performance pay. Moreover, performance pay decreases performance unless it is accompanied by motivational talk” (p. 194).

The practical implication of this experiment is that neither performance pay nor motivational communication is enough on its own. In order to get the greatest benefit from either, the other is necessary. Communicating the value and importance of the work, along with your confidence in the employee’s ability to perform that work to a high degree of excellence, is critical to realizing the positive effects of performance pay.

It turns out that the world is more complicated than my grandmother believed. It is both what you say through performance pay and how you say it, with words that motivate. **W&L**

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