

## The Benefits of Tangible Non-Monetary Incentives

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Abstract:

Firms struggle to design incentive programs that will elicit the right level and types of effort from employees for the lowest cost. A critical consideration in the employee's decision to exert effort is the perceived value of the award and the perceived value of earning the award. This paper discusses the psychological constructs of justifiability, evaluability, social reinforcement, and separability and ways that they may cause tangible non-monetary incentives to accomplish a firm's employee motivation goals better than a cash incentive of equal market value.

Firms face the challenge of motivating their employees to put forth the appropriate amount and type of effort. One tool firms use to accomplish this objective is the use of a lump-sum bonus. For example, a firm might give a salesperson a \$5,000 cash bonus for exceeding his or her quota for the year. Alternatively, the firm can provide high-end merchandise or vacation travel such as a trip to Hawaii for which the employee would need to pay \$5,000. I will use the term tangible non-monetary incentive to describe incentives like this trip to Hawaii which are performance based, non-cash, with non-trivial market value. When choosing the type of extrinsic incentive to offer, a firm would like to determine which incentive would be the most motivating for its employees, so that it can receive the most impact per dollar spent. Standard economic theory says that cash is always best due to option value and this result is also found in survey results which confirm that most people state a preference for cash incentives (Hein, 1998). In this paper, I will discuss why cash is not always the best extrinsic incentive to use and why tangible non-monetary incentives may accomplish a firm's objectives better than a cash award of equal market value.

Understanding why and when to use tangible non-monetary incentives is an important endeavor, since U.S. firms spent over \$20 billion on tangible non-monetary incentives in 1999 (Incentive Federation, 2000). While this is a small fraction of the \$4 trillion U.S. payroll, it is still a substantial amount of money, and represents between 5% and 10% of total spending on employee incentives.<sup>1</sup> At a more tactical level, the limited research on the type of extrinsic incentive to use means that this significant amount of money is being spent on incentives with a limited understanding of how tangible non-monetary incentives actually work. The theories to

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<sup>1</sup> Payroll figures from the Bureau of Labor Statistics, percentage calculation based on the assumption that between 5% and 10% of payroll is spent on bonuses of all types.

be presented in this paper will help to understand whether the amount of money spent on tangible non-monetary incentives is appropriate, better inform the choice of a tangible non-monetary incentive, and guide the implementation of such a reward program.

\$20 billion of spending on tangible non-monetary incentives is inconsistent with traditional micro-economic theory. Economists would claim that money is always better (or at least no worse) than any non-monetary incentive of equal market value because cash has option value (List & Shogren, 1998; Waldfogel, 1993, 1996). The economic argument continues by stating that if a firm were to choose a non-cash incentive, it could do no better than matching exactly what a person would have chosen for himself or herself. In fact, the firm will generally do worse, since it is difficult to know another's preferences exactly, much less those of all employees. If given cash, an employee could buy the particular incentive offered by the firm or something else that would provide more utility. Recent psychological research applied to this problem would suggest that this is too narrow a view. This paper will introduce and discuss the psychological concepts of justifiability, evaluability, social reinforcement, and separability and how they affect the motivational properties of tangible non-monetary incentives. These processes can increase the perceived value of a tangible non-monetary incentive or increase the value of earning a tangible non-monetary incentive, causing tangible non-monetary incentives to be more motivating than the retail market value of that award in cash.

Many theories of motivation implicitly assume that effort, while a function of many things, is positively correlated with the predicted utility of the award earned for that effort. For example, expectancy theories hold that effort exerted in pursuit of a reward is positively related to the value of the reward offered for performance (Bandura, 1986, 1997; Porter & Lawler, 1968; Vroom, 1964). Consistent with this and many other valence based theories of motivation, the

propositions put forward in this paper will assume that employees exert effort to maximize their expected utility (Naylor, Pritchert, & Ilgen, 1980).

The first section of this paper will discuss the psychology of tangible non-monetary incentives, outlining ways in which a tangible non-monetary incentive may increase the perceived value of the award, the perceived utility of earning an incentive, or increase the likelihood that an employee will exert additional effort at a specific point in time. This section of the paper will also include a discussion of how employees could simultaneously state a preference for cash incentives while being better motivated by tangible non-monetary incentives. The next section of the paper will discuss the implications of these motivational theories for the design and implementation of incentive programs. That section will also include a discussion of how the implementation of cash incentives can benefit from the theories presented in this paper. The paper concludes with some proposals for future research.

There has been extensive research in both economics and management regarding different types of incentives. Much of this work concerns whether the use of an extrinsic reward will reduce intrinsic motivation to perform a task (Banker, Lee, Potter, & Srinivasan, 1996; Bloom & Milkovich, 1998; Deci 1971; Deci & Ryan 1985; Deci, Koestner, & Ryan 1999; Eisenberger, Rhoades, & Cameron, 1999; Gerhart & Trevor, 1996; Jordan, 1986; Kruglanski, 1975). Research has also been done on how extrinsic rewards interact with other motivational tools such as goals (Jessup & Staehlski, 1999; London & Oldham, 1976; Tolchinsky & King, 1980), job design (Futrell, 1979; Gallagher & Einhorn, 1976; Kelly, 1992), and job challenge (Radhakrishnan & Ronen 1999). In addition to work on extrinsic incentives and performance, a large body of research exists on psychological interventions and their impact on performance (See Guzzo, 1985 for a review). Rather than extend the literature on the debate between

extrinsic vs. intrinsic motivation (see e.g. Beer & Cannon, 2002; Kohn, 1993) this paper discusses the type of incentive to use once the decision to offer an extrinsic incentive has been made. While there are certainly drawbacks to using non-cash incentives, this paper discusses ways in which tangible non-monetary incentives might accomplish firm objectives better than a cash award of equal monetary value.

### **Economic efficiency of non-monetary incentives**

While this paper will focus on the motivating potential of tangible non-monetary incentives, it is important to realize that there may also be pecuniary benefits that accrue to firms that use tangible non-monetary incentives that stem from advantages a firm may have over an individual employee in acquiring these goods at a lower cost. Take for example a trip to Hawaii for which an employee would have to pay \$5,000. Potential recipients might only find the trip to be as valuable to them as, say, \$3,500 in cash; less than its retail cash value. Through some arrangement, this award might be available to the firm for \$3,000. This would make the tangible non-monetary incentive more efficient at motivating this employee than its cost to the firm in cash since the firm would receive the motivational power of something worth \$3,500 but only need to pay \$3,000.

One means by which a firm could provide incentives at a lower net cost is through the use of company products or services as awards. For example, hotel chains often reward their employees with stays in corporate properties, travel agents might reward their employees with discounted trips, and automobile manufacturers could provide new cars to top performers. Even if the firm must purchase the award, it might receive a volume discount unavailable to an employee or at the very least save the employee the transaction costs required to obtain the item. In the extreme, a firm could offer an incentive that the employee could not purchase at any price.

For example, pink Cadillacs cannot be purchased directly from GM, only awarded by Mary Kay Cosmetics. Luxury boxes and hospitality tents at golf tournaments, which are controlled by corporations, are similarly out of the reach of most employees. Presumably, the fact that these are unobtainable except through the firm makes them more valuable than the cash it would cost the firm to provide them.

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Economic advantages such as these can be significant but they do not capture all of the potential benefits created by the use of tangible non-monetary incentives. This section will discuss reasons why employees might exert more effort in pursuit of a tangible non-monetary award than a cash bonus equal to the cost of that incentive, even if employees state a preference for the cash. There are a number of psychological mechanisms that would cause a non-monetary incentive to outperform cash as a motivating tool on a dollar for dollar basis. A non-monetary prize might increase the predicted utility of the award, the utility associated with earning the award, or increase the amount of effort the employee provides on a per unit value basis.

#### **Perceived Value of the Award**

Many scholars have claimed that it is the anticipated enjoyment of an item that carries utility, thus anything that might increase the predicted utility of the award will tend to increase effort expended in pursuit of that award (Vroom, 1964, Naylor et. al, 1980). Several principles of social and cognitive psychology provide reasons to believe that employees may perceive non-monetary incentives to be more valuable than the retail value of that award in cash. This section discusses two mechanisms that are hypothesized to increase the perceived value of a non-monetary award; evaluability and separability.

**Evaluability.** Firms often use hedonic goods or services as non-cash rewards; items that are associated with pleasurable experience rather than more instrumental or functional items (Dhar & Wertenbroch, 2000). When considering whether to exert additional effort in pursuit of a bonus award such as this, the employee must predict what the item offered is worth to them. The hedonic nature of the incentives triggers an affective reaction to the incentive that becomes a more salient attribute than the cash value of the incentive. This fact leads people to use their feelings as information when determining the value of the incentive (Hsee, 1996a; Loewenstein, Weber, Hsee, & Welch 2001; Schwarz & Clore, 1988). Because these feelings are difficult to monetize, cognitive and motivational forces allow for the perceived value of the awards to be inflated.

For example, research on motivated reasoning has found that people tend to imagine best-case scenarios when imagining the consumption utility of a hedonic reward (Kunda, 1990). This means that thoughts about a trip to Hawaii will be about lying on a beach with a Mai Tai rather than any possible negative aspects of the trip (e.g. stopping the mail, finding a pet-sitter, long flying time, or possible bad weather). Even though the thought of a cash bonus may be emotionally charged as well, the economic value of money is more easily calculated. This makes a cash award less prone to the biases which inflate the perceived utility of a hedonic non-monetary award.

When an item is evaluated on its affective value, its predicted utility is also more ambiguous than that of cash. Cognitive dissonance reductions suggests that if an employee is working hard to achieve the award, then he or she will attempt to convince themselves that the award is worth a great deal to them, bringing their beliefs in line with their actions (Bem, 1967; Festinger, 1958; Quattrone, 1985). This can increase the perceived value of a tangible non-

monetary award through a virtuous circle. The harder the employee works towards an award, the more he or she will think it is worth, in turn leading to more effort. This is not likely to occur with cash awards since the economic value of cash is less ambiguous and less prone to the psychological manipulation of perceived value. If a firm uses an item that is otherwise unobtainable by the employee such as luxury box tickets at a sporting event, this effect will be magnified. Since the cash value of that award is ambiguous at best, there is limited cash value to cognitively evaluate. This will almost ensure that the incentive will be evaluated based upon the affective reaction to the award rather than in its cash value, even if that could be determined.

*Proposition 1: The predicted utility of a non-monetary incentive will be enhanced by the likelihood that the award will be evaluated in an affective rather than cognitive manner.*

An employee could also psychologically lower the value of the award under certain conditions. Much as Aesop's fox convinced himself that grapes just out of his reach were probably sour, employees that are not likely to earn an award may be able to tell themselves that the prize is not as valuable as they believed it to be when the contest began. The ability to raise or lower the value of the outcomes of performance allows an employee to bring himself or herself back into an equity "equilibrium" without resorting to negative behaviors such as leaving the firm, reducing effort, or sabotaging others (Adams, 1965). While it is true that believing the award is of less value might reduce effort, it will also diminish the likelihood that an employee will engage in dysfunctional behaviors towards the firm or other employees.

**Separability.** People do not consider all of their income and assets collectively, but rather they mentally segregate some sources and uses of funds and aggregate others (Thaler 1980, 1985, 1999). Subsets of income may be assigned to different "mental accounts", for example investment income and home appreciation are likely to be placed into different income

accounts than salary would be. Since it is earned as part of the job, it is likely that a cash award will be mentally combined with the rest of the employee's employment income. If this occurs, the neutral reference point for evaluating the cash bonus will be the employee's base salary, and will make the award more subject to the value-reducing effects of diminishing marginal utility (Kahneman & Tversky, 1979). A company could combat this to some extent by issuing a separate check, or by having a ceremony or plaque to commemorate the performance. However, it is likely that employees will have a strong tendency to view this money as an increase in total compensation and aggregate it into their mental account for salary. A quote from David Ridell, Vice President of certificate marketing at Marriott International echoes this sentiment: "We think companies should use cash sparingly because it can be confused with compensation" (*Incentive*, 2000). Because items which firms use for tangible non-monetary incentives are consumed less frequently, they would be considered in relative isolation, or at least placed into a smaller, more specific mental account (e.g. Travel, Entertainment, etc.). The neutral reference point for evaluation of the incentive will be zero (no item) rather than the employee's base salary, leading to less impact from diminishing marginal utility relative to a cash incentive.

For the tangible non-monetary incentive to be more motivating than cash, the award will need to be segregated in the employee's mind so that it is coded in its own mental account. The implication for incentive design is that the award should be crafted so that it cannot be confused with cash. Here as well, the use of an otherwise unobtainable item would carry additional benefits. Since employees are likely to evaluate this award in relative isolation, this type of award will be much less susceptible to the effects of diminishing marginal utility.

*Proposition 2: The predicted utility of a non-monetary incentive will increase with the likelihood that it will be evaluated in isolation or as part of a smaller set of items.*

## **Value of Earning the Award**

The psychological mechanisms in the preceding section dealt with the predicted value of consuming the item received. It may also be the case that the value of earning the incentive might be enhanced if tangible non-monetary incentives are used. There may be some additional value to obtaining the incentive through hard work rather than through purchase. As with the perceived value of the incentive, anything that acts to increase the value of earning the incentive will lead to increased effort. This section discusses two mechanisms through which this might occur; justifiability and social reinforcement.

**Justifiability.** One feature of many tangible non-monetary incentives is that they are things the recipients see as luxuries; things that employees could not normally justify buying for themselves, even if they had sufficient funds. If an item is something that an employee values highly but would never purchase on his or her own, then the opportunity to earn it as a reward for hard work provides a way to obtain the desired object without violating one's standards of justification (Hsee, 1996b). For example, a salesperson might never propose that his or her family take an expensive and "frivolous" trip to Hawaii, but everyone might be pleased if it were earned as a reward for hard work. If the employee is constrained to accept the award available, there is no need to justify its consumption. Hard work thus becomes an attractive means to acquire an otherwise unobtainable good, causing the earning of a tangible non-monetary incentive to carry more value than earning the market value of the incentive in cash.

*Proposition 3: The predicted utility of earning a non-monetary incentive will increase with the difficulty the employee would have in justifying the purchase of the item on his or her own.*

The strength of this effect will no doubt vary across national and organizational cultures, since the determination of what is a justifiable purchase will differ. In cultures where spending

money on whatever one wishes is acceptable, this effect will not be as strong. In the presence of stricter social guidelines regarding appropriate purchases, employees would receive more utility from being able to earn a difficult to justify incentive for hard work since it would be less likely that they could purchase it on their own.

**Social reinforcement.** One of the most important rewards for a job well done is the acknowledgement of your performance by peers, supervisors, family, and friends. This social reinforcement comes from others knowing about your good performance rather than the receipt of an incentive per se. This is one of the central tenets behind most reinforcement theories (Alport, 1954; Bandura, 1969; Hamner, 1974; Luthans & Stajkovic 2000; Mahoney, 1974; Stajkovic & Luthans, 1997). Certain incentive awards may prove to be better at enhancing this social utility than others. For example, while it may be seen as poor taste to brag about a cash award, there is no such proscription regarding the discussion of a tangible non-monetary incentive. In most situations, employees would not feel comfortable bragging about cash, but would feel free to talk about the golf clubs or vacation they received from the firm. Thus the chance of earning a tangible non-monetary incentive would provide a means with which to indirectly bring attention to one's good performance.

A tangible non-monetary incentive is also more effective than cash awards at enhancing this social utility because this class of award is a visible prize that others will know about, making it unnecessary for the employee to advertise that he or she earned the prize. Rather, friends and colleagues will broach the subject of the award with questions like, "So Bill, how are those golf clubs the firm gave you, have you played with them yet"? While cash also may be highly visible, it is less socially acceptable to say "So Bill, how's that \$1,000?" This enhances the social utility available through the earning of a tangible non-monetary incentive. If the award

is otherwise unobtainable, this will even further enhance the motivational power of social reinforcement. A unique prize will elicit more admiration in colleagues and provide an even easier way to initiate a conversation regarding good performance.

The employee could feasibly buy something frivolous like expensive golf clubs with their cash bonus, provided they could clear the justifiability constraints discussed above. In fact, research shows that the marginal propensity to consume windfall gains is higher than that of expected income such as salary (Arkes, Joyner, Pezzo, Nash, Siegel-Jacobs, & Stone, 1994, Thaler & Johnson, 1990), yet the justification hurdle would still remain. A purchase of the same item by the employee would not carry the same social value as if it were awarded by the firm. Once the money is given to the employee it becomes the employee's money and therefore anything purchased with it is something the employee chose to purchase rather than something the firm gave to the employee. Family, friends, and colleagues will also be more likely to view the trip or other purchase as something the employee bought rather than something they received for good performance. These issues make the link between the company and the award weaker and so would not provide the same means of discussing good performance.

An additional side benefit to the use of tangible non-monetary incentives is that they serve as reminders of the good performance that led to their receipt. Physical goods like a big screen television will remind the employee every time they turn it on. Vacation travel will provide memories, pictures, and mementos that will do the same thing. Cash awards can also do this provided they are awarded with some physical marker such as a certificate or a plaque of some sort. What makes a tangible non-monetary incentive more effective is the visibility of this type of award and the lack of social norms against discussing this type of award.

*Proposition 4: The predicted utility of earning a non-monetary incentive will increase*

*with the social utility of the award. The social utility of the award will increase with the ease with which that award can be discussed with others.*

As with the issue of justifiability, the nature of reinforcement obtained from a tangible non-monetary incentive is likely to vary across organizational and national cultures. Some organizational cultures have fewer proscriptions against discussing cash bonuses. For example, investment bankers are often expected to brag about their income. Social recognition lavished on an individual in a collectivist culture might lead to less utility conveyed from the award, whereas earning admiration from one's group may be highly valued (Hofstede, 1980; Markus & Kitayama, 1991). These forces however will still enhance the social utility of an award if it is given to a group rather than an individual. An employee can still feel pride over their group's performance and this feeling can be enhanced by the visibility of a tangible non-monetary incentive.

### **Incremental Decision to Exert Effort**

Bonus systems are generally concerned with performance over a specified period of time. Rewards are often offered for meeting sales goals, production goals, cost reduction goals, etc. To achieve this level of performance, employee output, and therefore effort, should be maintained at some average level over the performance cycle. Consider for example a production team that must meet its monthly quota to receive a performance bonus. In order to reach this level, they may plan out how much they need to produce each day or week. This will translate into the effort level that must be applied on average to reach the goal and earn the award.

In contrast, the calculus of expectancy theory is based on marginal calculations. While an employee or team might be able to calculate the overall level of performance and effort required

to earn a reward, each employee attempts to determine whether increased effort *in the moment* is somehow “worth it”. In order for an employee to exert additional effort, the marginal cost of that effort must be less than the increase in the probability of earning the award, given the additional effort, multiplied by the predicted utility of the award. If it is not, then effort will not be increased and may in certain circumstances be decreased (Eisenhardt, 1989; Holmstrom, 1979).

Consider a salesperson leaving a client site at 4:30 on a Friday. He or she could make one additional sales call, or get an early start on the weekend. The decision will be made by comparing the cost of this additional effort with the potential reward for additional outcomes. The cost of this effort will be salient, since the salesperson will be cognizant of their physical and emotional state, however the benefits of the additional effort such as additional commission or a bonus may be less salient. If this is the case, the costs of effort will be over-weighted relative to any potential benefits of the additional effort. To counteract this tendency, the firm must try to make sure that the rewards for effort are salient in the employee’s mind while he or she is making the marginal decision to apply effort.

If a tangible non-monetary incentive is more salient in the mind of the employee than a cash award would be, then this type of incentive will be better at eliciting more effort *in the moment*. Research has shown evidence of savoring for hedonically rich items but not for cash (Loewenstein, 1987; Loewenstein & Thaler. 1989). These researchers found that people would prefer to delay a kiss from their favorite movie star but would not prefer to delay the receipt of a cash award. The increased vividness and savoring of an affect rich item such as the ones often used as tangible non-monetary incentives makes the employee more likely to perceive increased effort as worth it.

*Proposition 5: The effort exerted in pursuit of an incentive will increase with the salience of that reward. Tangible non-monetary incentives will be more salient and vivid to employees while working, causing those incentives to be more motivating than cash incentives of equal market value.*

### **Other Potential Benefits**

The firm may receive additional benefits from specific rewards. Vacation travel might pay back in improved productivity for rested employees. Providing free stays in the other properties of a hotel chain allows employees to become knowledgeable about them, which makes them more valuable employees. Also, if there is reason to believe that non-monetary rewards attract a specific type of employee, and that type of employee is more productive in a certain type of firm, then providing this type of incentive can help attract a better group of employees to that company. For example, a hotel wants to attract employees who like hotels. By awarding employees stays in corporate properties, people who enjoy hotels will self-select into those firms.

Beyond effort exerted to receive an award, a firm profits if the incentive system used creates longer-term benefits such as organizational commitment (Mowday, Porter, & Steers, 1982; Steers, 1977) and organizational citizenship behavior (Organ, 1988; Organ & Ryan, 1995; Smith, Organ, and Near; 1983). The firm must also be concerned that extrinsic rewards might crowd out intrinsic motivation (Deci, 1971; Deci & Ryan, 1985; Kruglanski, 1975). There is reason to believe that tangible non-monetary incentives might be better at obtaining these long-term benefits in addition to the short term motivational impact. These ideas will be discussed further in the directions for future research.

### **Motivation vs. Stated Preference**

The propositions discussed above all deal with effort exerted in pursuit of an incentive, either cash or non-cash. Propositions have been presented that claim that tangible non-monetary

incentives will elicit more effort than the market value of that award in cash, but no discussion has been presented regarding employee preference. Economists have claimed that when faced with a choice between an item and the market value of that item in cash, people should choose cash due to option value. The cash could be used to purchase the item offered, or it could purchase something that carries higher utility. This would imply that cash should be the best incentive to offer to employees since that is what they should choose to receive. In fact, it has been found that employees do state a preference for cash (Hein, 1998).

These economic theories and survey results address stated preferences rather than improved performance. If the psychological processes that determine stated preference are different than those that drive the decision to exert effort, then it is critical for a firm to understand this difference. Any divergence is important to understand, since employees may state a preference for cash incentives but perform better in pursuit of non-monetary incentives. This exact result was found in a laboratory study where participants working in pursuit of a tangible non-monetary incentive performed better on a challenging mental task, but overwhelmingly said they would prefer to receive the cash value of the award (Jeffrey, 2002). In that experiment, justifiability concerns were found to be a key driver of improved performance as well as stated preference. The more difficulty participants would have in justifying the purchase of the incentive used, the better their performance under the non-cash incentive, and the stronger their preference for cash.

This is consistent with research that shows that people do not always choose what they believe will provide more utility (Hsee, 1999). In a series of experiments, decision makers were presented with a choice of two items. Choice sets were designed so that one of the two goods would appear somehow “better” in pure economic terms (e.g. higher quantity, larger, more

expensive, etc.), while the other item would appear more pleasant. Participants in these experiments often predicted that they would prefer the more pleasant item, yet chose to receive the economically “better” item. For example, one choice set consisted of a smaller chocolate bar shaped like a heart (more pleasurable), and a larger candy bar shaped like a cockroach (presumably a better objective value but less pleasurable to consume). Participants often predicted that they would enjoy the heart more than the cockroach but chose to receive the cockroach anyway. It was interpreted that participants in these experiments did not feel justified in choosing the option which they felt would provide more utility. Rather, they were also concerned with what they felt they should choose. Note that this choice pattern would also be predicted by work on reason-based choice (Shafir, Simonson, and Tversky, 1993); there are more “rational” reasons to choose cash over a trip (e.g. pay bills, save for retirement, college, etc.).

If employees say that they want cash but act as if they want non-monetary incentives, which is “correct”? Whether the use of tangible non-monetary incentives makes employees better or worse off is a debatable point, probably better left to philosophers. Some might claim that employees would be better off receiving cash that could then be spent on the item that is either most necessary or most desired. The justifiability issues brought up earlier in the paper suggest that employees may not purchase that which they find most valuable. Others might say that the theories presented in this paper rely on subterfuge; somehow fooling the employee to believe that the incentives are of higher value than they really are. There are multiple ways to respond to this criticism, with the first being to tentatively agree. It must be acknowledged that the interests of an employee and the firm are in opposition. Employees want to receive the highest pay for the least effort while firms want to maximize effort for the lowest cost. The purpose of an incentive program is to elicit the right type and level of effort out of their

employees for the lowest cost, not to match employee's preferences. Whether this is a noble goal and truly in a firm's long term interest is open to debate and cannot be resolved in this paper.

## **IMPLICATIONS FOR INCENTIVE DESIGN AND PROGRAM IMPLEMENTATION**

In order to capitalize on the proposed mediators discussed above, the right incentive must be chosen and the program must also be implemented correctly. This section will discuss the selection of awards, the implementation of award programs, how to potentially enhance cash incentive programs, as well as discuss some potential drawbacks of tangible non-monetary incentives.

**Selecting the Incentive.** The incentives chosen should be unique so that the award is evaluated in relative isolation, so that there will be less impact from diminishing marginal utility. This also suggests that the award must be changed over time; if the item is given frequently, it may quickly become "more of the same", making it subject to the value reducing effects of diminishing marginal utility. The chosen award should also be hedonic rather than utilitarian in nature. Not only does this make the award's purchase less justifiable, but it will also trigger a more affective reaction, necessary for the value enhancing evaluation process discussed earlier. A cold cognitive evaluation of the award will not allow for these value enhancing processes, and will also make the loss of option value associated with a non-cash incentive more salient.

To increase the perceived value of earning the award, the prize should be something that is infrequently purchased. If the employee is less likely to purchase the item on his or her own due to justifiability concerns, this will increase the value of earning the award, and thus increase effort expended in pursuit of that award. Social reinforcement can also be increased by using an infrequently purchased item or service as an incentive. Since these items are not frequently

purchased, these types of award are easier to use as a means to discuss the performance that led to their receipt. In addition, items that are not frequently purchases are likely to attract the attention of colleagues, increasing the so-called “trophy value” of the award. Since the employee’s colleagues, friends and family will admire the award, it will be easier to use that award to broach the subject of the performance that led its receipt.

**Implementation.** To encourage an emotional rather than cognitive evaluation of the prize, employees should not be told the market value of the prizes for which they are working. If there is a monetary value attached to the prize, it becomes more like cash, and will be more likely to trigger a cold cognitive evaluation. Knowing the value of the prize also makes it more difficult for the employee to psychologically alter the predicted utility of the award. This will reduce the ability of the employee to mentally increase the value of the award while working towards it or to decrease the value when it appears that the award will not be earned.

To make it more likely that the employee will increase effort in the moment, the firm should keep the reward for good performance salient in the employee’s minds. One way to accomplish this is by constantly reminding employees of the prizes available for specific levels of performance. Since tangible non-monetary incentives are naturally more available in an employee’s mind while working, the firm does not need to take this action as frequently as they would have to with a cash award. In addition to this benefit, if employees are frequently thinking of the hedonic attributes of the award, this will trigger an affective evaluation process which will tend to increase the perceived value of the item.

There is one additional point that is important for the design and implementation of non-monetary incentives. As discussed in the introduction of the paper, cash awards can be used by the employee to purchase that item which carries the most utility. Non-cash awards do not

generally have such flexibility, even if the award is something “near cash” like a gift certificate.

The general problem with non-cash rewards is that the firm cannot be sure to pick something that every targeted employee likes. Some employees will find the chosen prize to be more valuable than others find them. On average, this will make a non-monetary award less motivating to the employee population as a whole (Waldfogel, 1993). A way to solve this problem is through the use of a cafeteria style incentive program. For each performance level, employees should be able choose from a list of prizes, so that they can receive the prize that they like the best. This will still capture the benefits of non-monetary incentives; yet minimize the downside associated with diverse employee tastes.

**Enhancing cash awards.** The theories presented in this paper could also enhance the value of earning a cash incentive. For example, a firm might try to encourage employees to think about “splurging” their cash bonuses on hedonic items such as those used as tangible non-monetary incentives. By planting the idea in the employee’s mind that they will purchase some difficult to justify hedonic item, the firm might be able to capture the additional effort associated with justifiability concerns as well as the capture the benefits of an affective evaluation. However, it is unclear whether this would be as effective as simply using a tangible non-monetary incentive.

To increase the social utility associated with a cash award, firms can and often do provide ceremonies and plaques or certificates of achievement along with a bonus award. While it may be difficult to use a cash prize to broach the subject of performance, there would be fewer restrictions on doing so using a certificate or plaque. There is also a question as to whether this will be as effective as simply using a non-monetary incentive. Colleagues may perceive any discussion of the plaque or certificate as boasting because it has no inherent value except as a

symbol of the performance. This reduces the social utility of the plaque or certificate relative to a tangible non-monetary incentive.

Keeping any award salient can increase effort per unit value, and therefore frequent reminders of the rewards available for performance might work for cash awards as well. If these actions make the cash rewards more salient in the employee's mind, it becomes more likely that the employee will decide to exert more effort at the margin. However, there is a danger in using this strategy for cash rewards. Continually reminding employees that they are working for a cash reward reinforces an exchange relationship, which fosters the belief that the employee is only performing the task for money (Mills & Clark, 1982; Fiske, 1992). This has possible negative implications with respect to organizational commitment, pro-social behavior, and intrinsic motivation (Brief & Motowidlo; 1986; Deci et. al., 1999; Mowday, Porter, & Steers, 1982; Organ, 1988)

**Potential Drawbacks of Tangible Non-Monetary Incentives.** As with the use of any extrinsic incentive, there are possible drawbacks to using tangible non-monetary incentives. If a firm switches from a cash incentive program to a non-cash incentive program there will be issues of loss aversion and other problems created by a contrast effect. Loss aversion causes the negative utility caused by losing something to be higher than the utility that would be gained by receiving the same item (Kahneman & Tversky, 1979). In Kahneman and Tversky's words, "losses loom larger than gains" (1979, p. 279). Some estimates put this loss aversion coefficient between 2 and 2.5 (Tversky & Kahneman, 1991). This means that if a firm takes away a cash incentive worth \$100, it would need to replace it with an award worth between \$200 and \$250 for the employees to be satisfied with the exchange. This would be difficult and probably not in the firm's best interests. Note that this disadvantage may not be unique to tangible non-monetary

incentives, in the sense that replacing this type of incentive with cash may induce loss aversion as well. A problem unique to tangible non-monetary incentives is that they may be compared to the previous cash incentive, causing the award to be evaluated in a more cognitive and less emotional manner, eliminating any benefit gained through the evaluation mode. The implication here is that firms should only utilize tangible non-monetary incentives as a new incentive scheme rather than a replacement.

The uncertain value of tangible non-monetary incentives could make them less effective if employees do not trust the firm. For example, employees may think that the firm is just trying to save money by somehow cheating workers. This would have a negative effect on the motivational power of the incentive and negative long term consequences for the employees' relationship with the firm (Guzzo, 1979). If the relationship with the firm is somewhat negative to begin with, an employee may attribute the firm's actions to a greed motivation. If the relationship is good, the employee is more likely to think the firm is doing something nice for them. Therefore, it is critical to understand the nature of the employment relationship prior to implementing a tangible non-monetary incentive program.

There are also possible problems if the actual consumption utility of the award varies greatly from the predicted utility of the award. For example, the employee may have been looking forward to receiving a home entertainment system, but then be disappointed when they actually use it. They may feel that they worked too hard in exchange for the prize they actually earned. If the employee is disappointed over the prize received it may reduce the effort exerted in pursuit of future tangible non-monetary incentives. It could also feasibly change the employee's perception of the firm and the firm's motives. Research on cognitive dissonance suggests however that this may not be a major problem. If the employee believes that the value

of the award is high, then they will be motivated to enjoy it as much as they predicted (Bem, 1967; Festinger, 1958; Quattrone, 1985).

### **DIRECTIONS FOR FUTURE RESEARCH**

Perhaps the most important research that needs to be done is to confirm the contribution of each of the hypothesized mediators discussed earlier in the paper. The importance of each of the proposed mediators of justifiability, evaluability, separability, and social reinforcement should be understood. It may also be the case that there are other mechanisms through which tangible non-monetary incentives increase work performance; future research should attempt to find these mediators if they exist. Tangible non-monetary incentives may also have different levels of efficacy across different tasks, and with different types of employees. Finally, there may be long term benefits associated with the use of tangible non-monetary incentives.

Research has shown that cash rewards tend to crowd out the intrinsic motivation necessary to perform creative work if they are seen as trying to control behavior (Amabile, Hennessy, & Grossman, 1986; Collins & Amabile, 1998). Using tangible non-monetary awards may diminish this problem, particularly if they are seen as reinforcing behavior rather than trying to control it (Amabile, 1998). As another example, employees may stay at a task requiring persistence for a longer time due to the natural vividness of tangible non-monetary incentives.

It may also be the case that non-cash rewards are more effective with certain types of employees. Those employees who place high personal relevance on cash might not respond well to non-monetary incentives (Mitchell & Mickel, 1999). There may also be financial boundary conditions associated with the effectiveness of non-monetary incentives. If an award were too large a part of an employee's salary, the option value of cash would become more salient. While a person making an annual income of \$30,000 might like a \$5,000 trip to the Bahamas; he or

she might realize that if they were to go to a firm offering cash bonuses, they could earn more money to better provide for basic necessities. At much higher levels of salary however these basic needs become satisfied, making the use of expensive tangible non-monetary incentives more appropriate. The key implementation issue is that incentive awards should be scaled to the wages of the target employees.

Finally, the proposed short-term mediators will certainly vary in their strength across different national and organizational cultures. For example, collectivist cultures might be more likely to have prohibitions regarding the discussion of individual performance. More collectivist cultures will also be more concerned about the social utility of awards. With an increasingly diverse workforce and large multi-national companies operating across national borders, it will be essential to address these cross-cultural questions in future research.

**Long Term Benefits.** Future research on tangible non-monetary incentives should also identify any long term benefits that accrue to firms using this type of award. There are several reasons to believe that tangible non-monetary incentives may be more beneficial for a firm. The choice of incentive might have an impact on the nature of the relationship between the employee and firm, change the employees' perception of the firm, and have implications for organizational commitment and intrinsic motivation.

Research has shown that intrinsic motivation to perform a job is diminished when interventions are viewed as directly trying to control behavior (Deci, 1971; Deci & Ryan, 1985; Deci et. al., 1985; Eisenberger et. al, 1999; Kruglanski, 1975). Other types of incentives that are viewed as supportive rather than controlling may actually “crowd-in” intrinsic motivation, making the job itself more interesting (Cialdini, Eisenberg, Green, Rhoads, & Bator, 1998). Supportive interventions include recognition for a job well done, and rewards for performing

well in general rather than for specific actions. If a tangible non-monetary incentive is perceived as a reward for good performance or recognition from the firm rather than an attempt to control behavior, there will be less crowding out of intrinsic motivation (Frey, 1997). If these incentives are viewed in this manner, there will also be implications for perceived organizational support (Eisenberger, Huntington, Hutchinson, & Sowa, 1986; Shore & Shore, 1995).

Higher levels of perceived organizational support can lead to more committed employees and more organizational citizenship behavior (Brief & Motowidlo, 1986; O'Reilly & Chatman, 1986; Organ 1988; Organ & Ryan, 1995; Puffer 1987; Smith, et al., 1983). More highly committed employees are less likely to withdraw from the firm, and engage in more pro-social behavior towards the firm such as helping others, volunteering for extra work, and other activities not recognized by the formal reward system that enhance sustainable competitive advantages (Barnard, 1968; Katz & Khan 1978; Pfeffer 1998). Any positive mood created by memories or physical reminders of tangible non-monetary incentives earned in the past may also lead to more citizenship behavior (George & Brief, 1992; Isen & Levin, 1972).

Tangible non-monetary incentives are also remembered longer and more clearly than a cash bonus (Hein, 1999). An easily remembered reward, particularly one that generates some physical reminders, will be associated with the performance that generated the reward for a longer period of time which will lead to more of that positive behavior in the future (Bandura, 1969; Hamner, 1974; Luthans & Stajkovic 2000; Mahoney, 1974; Stajkovic & Luthans, 1997; Welsh, Luthans, & Sommer, 1993). Naturally, this will only be the case if a trip or merchandise creates fond memories. If the consumption experience is negative, for example a hurricane while on a vacation, then the firm will share in the blame of sending the employee on a bad trip. If this were to happen, it could reduce the motivational impact of similar rewards in the future.

## SUMMARY AND CONCLUSIONS

While a substantial amount of money is spent on tangible non-monetary incentives, it is only a small percentage of the total spent on employee compensation. This paper has discussed some reasons that suggest firms may be underutilizing this type of incentive. Psychological evaluation processes can raise the perceived value of an earned award, the perceived value of earning the award, and even the instantaneous decision to apply effort in pursuit of the award. This paper has also discussed implementation methods that will better inform the use of this type of incentive as well as how the motivational power of cash incentives might be improved through clever implementation.

Each psychological process that leads to the increased motivational power of tangible non-monetary incentives is both cognitive and emotional. This idea is consistent with research showing that both of these seemingly different processes can work together in judgment and decision making (Finucane, Peters, & Slovic, in press; Mano, 1994). Justifiability is cognitive in the sense that people must consider the difficulty they would have justifying the purchase of a hedonic tangible non-monetary incentive. However, the sources of these justifiability concerns are more affective in nature. The utility gained from social interactions is cognitive in the sense that employees must think about using the prize earned to discuss good performance, but the utility received from others knowing of your performance is decidedly affective. An emotional rather than cognitive evaluation will tend to enhance the perceived value of a tangible non-monetary incentive but the actual evaluation process where this feeling is converted into value is cognitive.

There has been much work on whether or not to use extrinsic incentives for employees but relatively little on what type of extrinsic incentive should be used; cash or non-cash. Work in

this area can determine the type of incentive to be used, the circumstances under which they should be used, with which type of employees they will be most effective, and how these incentive systems should be implemented. Understanding how tangible non-monetary incentives increase employee motivation has the potential to greatly improve the effectiveness of all incentive programs.

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