Journal of Business Theory and Practice
ISSN 2329-2644
Vol. 2, No. 1, 2014
www.scholink.org/ojs/index.php/jbtp

Original Paper

The Role of Incentives in the Organizational Structure: A model of Performance Maximization

David Pascual-Ezama[1] and Derek Dunfield[2]

[1] Department of Financial Economy and Accounting II, Universidad Complutense de Madrid, Madrid, Spain

[2] Sloan School of Management, Massachusetts Institute of Technology (MIT), Cambridge, MA. USA

[*] David Pascual-Ezama, david.pascual@ccee.ucm.es

Abstract

To optimize firm performance, both individual employee and organizational performance must be taken into account. In this paper, we combine several theoretical models of individual and organizational behavior to propose the Organizational Performance Maximization Model (OPMM), in which individual and corporate performance maximization are combined.

Keywords

incentives, individual behavior performance, organizational behavior performance

1. Introduction

Living in a post-economic crisis world, it has become ever more crucial for firms to optimize their performance. Performance maximization has typically been considered on two very different scales: A corporate framework, where an organization model typically consisting of activities such as coordination, planning, and supervision is implemented to maximize achievement of firm goals, or an individual framework, where companies focus on individual incentives to motivate worker productivity. While firms have always tried to maximize worker performance, the effects of incentives and monitoring, either separate or simultaneous, have only recently been studied empirically. Both types of influence have surprising, non-intuitive results, which tend to be highly dependent on the type of tasks being completed, the type of workers, as well as the type corporate organization. By combining several theoretical models of individual and organizational behavior, here we propose the Organizational Performance Maximization Model (OPMM) which combines both a corporate framework and an individual behavioral frameworks to maximize firm performance overall.

2. An Organization-Workers Approach

One of the main challenges for an organization is choosing how to design an ideal corporate framework to maximize workers' performance. Theoretically, the motivation and effort of volunteers in non-profit organizations should be as high as possible, with dishonest behavior non-existent. If we accept that volunteers in non-profit organizations have roles similar to workers in regular firms, a non-profit framework is the de-facto corporate standard to maximize workers' performance. This corporate framework is based on a simple organizational model with four different phases (Figure 1). Implementation is the first phase, where volunteer roles are supervised and determined by the organization. After the implementation phase, volunteers and organizations undergo separate analysis phases, with volunteers undertaking personal evaluations and organizations evaluating overall performance. If the conclusions of the analysis are similar, volunteer satisfaction will be good and future performance will improve.

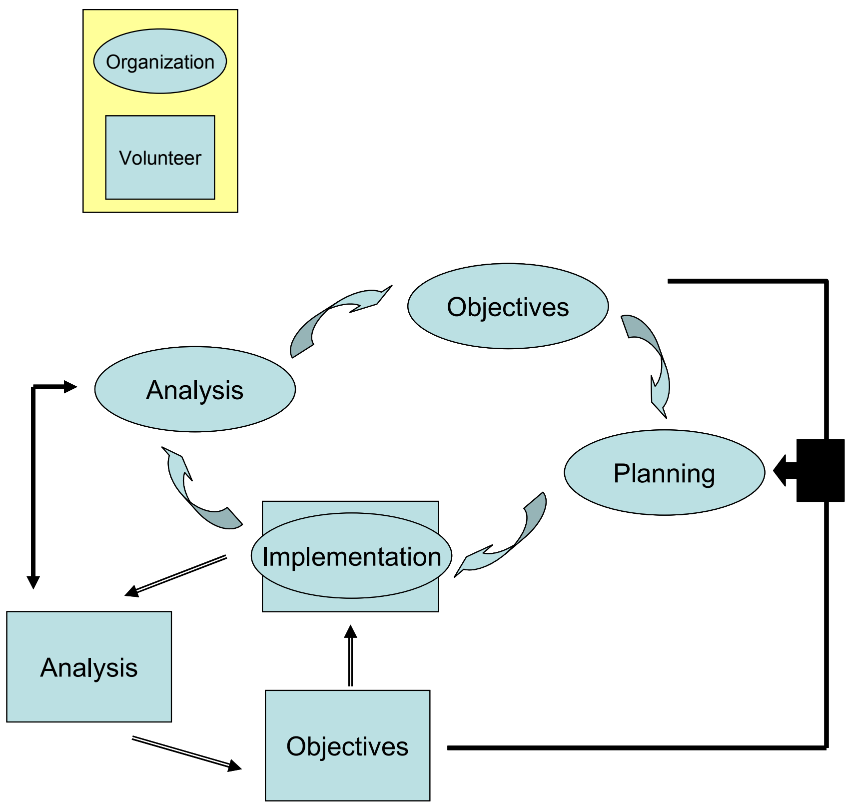

Figure 1. Non Profit Organizations Organizational Model

(Pascual-Ezama et al., 2010)

While the non-profit corporate framework may be theoretically sound for motivated volunteers, workers in regular firms may not fit the volunteer mold perfectly. For example, unlike volunteers, regular workers are paid for their time, yet (without surprise) a worker's salary guarantees neither motivation nor correct performance. As such, for real firms, this idealized corporate framework is not complete. Using a performance maximization model, we explore how real worker motivation can be influenced by both corporate supervision as well as other incentives (Figure 2).

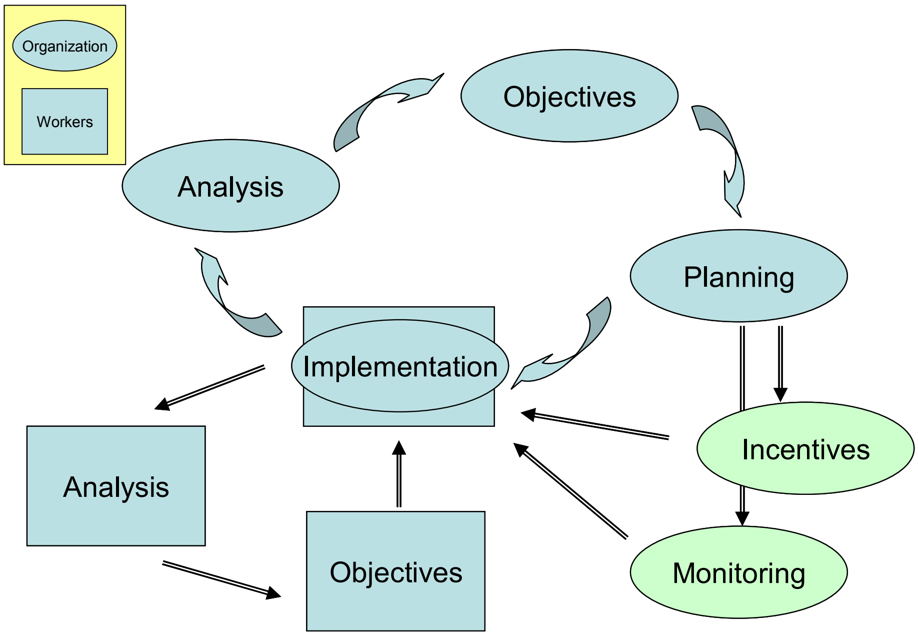

Figure 2. Profit Organizations Organizational Model

3. An Incentives-Monitoring Approach

Due to inefficiencies in the labor market, it is common practice for firms to employ both incentive systems as well as monitoring systems to motivate workers and assure adequate performance. According to Ariely et al, 2009, the expectation that increasing performance-contingent incentives will improve performance rests on two subsidiary assumptions: (1) that increasing performance-contingent incentives will lead to greater motivation and effort and (2) that this increase in motivation and effort will result in improved performance. Even if these assumptions hold, however, firms must still combat other types sub-optimal behavior, such as dishonesty. To account for dishonesty in the workplace and its effect on effort and output, firms may employ a monitoring system, such as direct supervision. To be effective, individual performance models must take into account all these points: incentives, monitoring, deception, motivation, effort, and ultimately performance (Figure 3).

While dishonest behavior may seem less likely than a worker's lack of motivation, it is in fact very common, especially for high executives. Executives admit taking real economic actions to meet earnings projections (Granham et al. 2005): 80% would decrease spending on R&D, advertising and maintenance; 55% would delay a start of a new project; 40% would book revenues now rather than next quarter; 39% would provide incentives for customers to buy more; 28% draw down on reserves previously set aside; and 8% alter accounting assumptions. Although the relationship between the incentives and supervision seems intuitive (more effort should result in better performance and increased monitoring should result in more effort) empirical research shows that our intuitions are rarely correct.

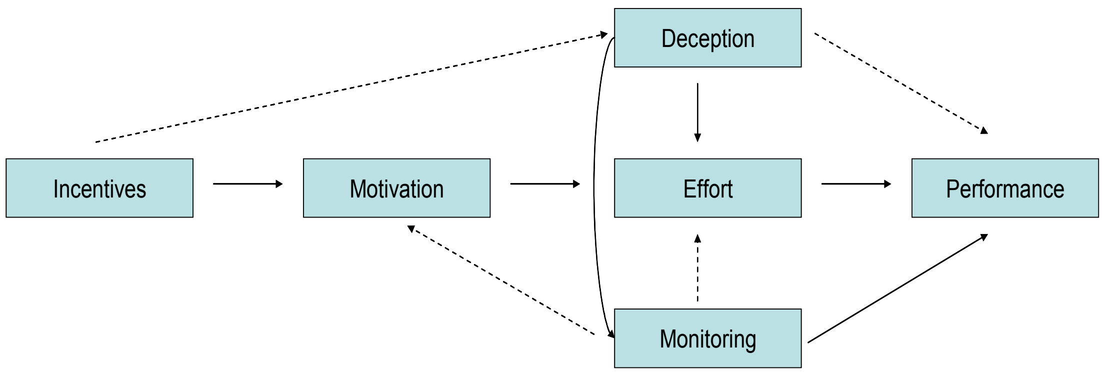

Figure 3. Performance Maximization Model (PMM)

According to standard economic reasoning, an increase in the financial incentives provided for an activity will improve performance. However, there are some notable exceptions. Gneezy and Rustichini, (2000), show that people who are unpaid tend to exert greater effort than those paid only a small amount. Alternatively, Ariely et al. (2009), demonstrate that when incentives are too high, people may "choke under pressure," resulting in very bad performance. In the first case, motivation decreased with small incentives compared to a non-incentive condition, causing both effort and performance to decrease as well. In the second case, incentives caused both high motivation and effort, but performance was bad. While these are only two examples, they illustrate how incentives can effect motivation, effort and performance in unexpected ways, making it difficult to define a clear relationship between them.

Much like incentives, the main effects of supervision on effort can also be non-intuitive. Supervision is often necessary to both guarantee good performance and to inhibit dishonest behavior. In the academic literature, however, it is unclear what effect monitoring has on motivation and effort. Some researchers, such as Falk and Kosfeld (2006), have suggested that close supervision of workers might undermine intrinsic motivation. Whereas, other authors like Ariely et al (2008) have recently proposed that the way in which monitoring is framed crucially influences its effect on motivation. Regardless of which approach is correct, however, supervision is effective at reducing dishonest behavior (Pascual-Ezama et al, 2013). Unfortunately, because of its expense, many firms chose to rely solely on economic or social incentives, which (without supervision) can actually increase deception in the workplace (Pascual-Ezama et al. 2013).

The results of these empirical studies, among others, point to the necessity of developing an organizational model that captures all the connections between incentives and monitoring and their effects on workers performance. This combined model would provide a deeper understanding about how firms can integrate the realities of individual behavioral drivers into their corporate framework.

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4. Organizational Performance Maximization Model

Based on the conclusions of the literature and combining previous theoretical models of individual and organizational behavior, our objective is to propose a new model, the Organizational Performance Maximization Model (OPMM, Figure 4). The OPMM combines the Organizational Model (Figure 2) with a Performance Maximization Model (Figure 3), allowing us to account for both individual and corporate performance to maximize firm performance overall.

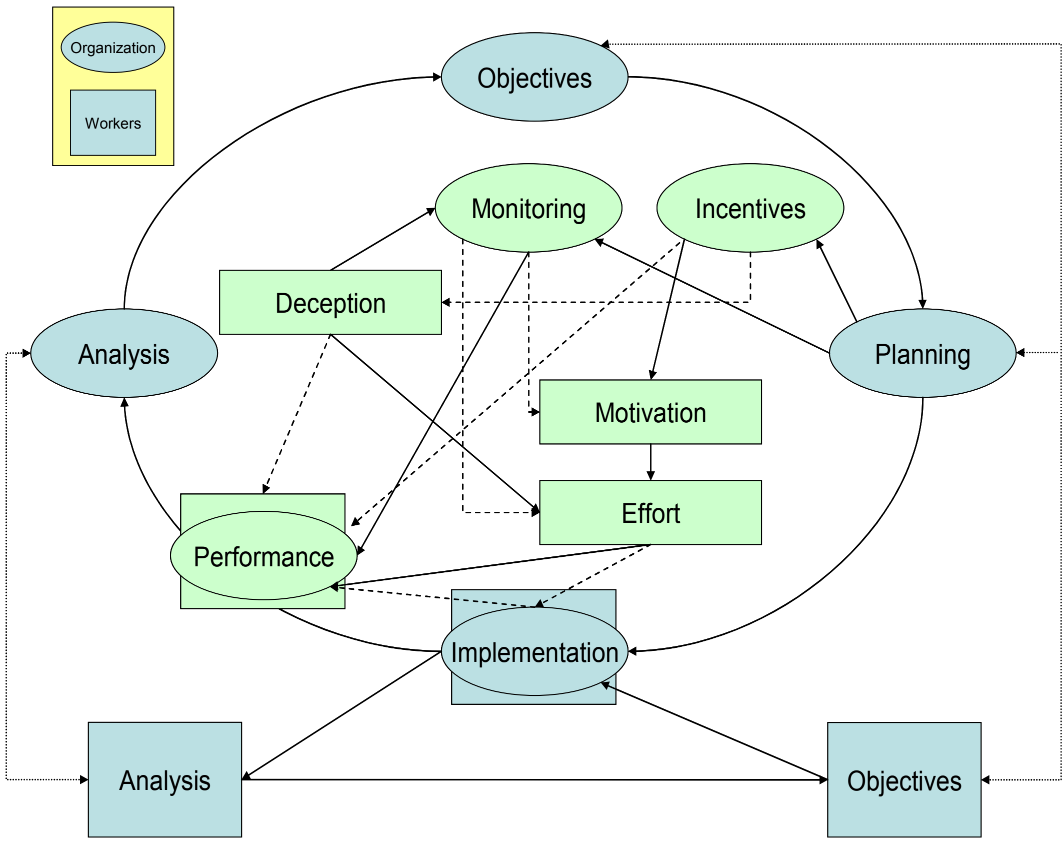

Figure 4. Organizational Performance Maximization Model (OPMM)

5. Conclusions

The OPMM serves as both a model of the complexities of performance in the workplace, as well as a template for further academic research investigating the correlations between individual performance and corporate structure. Because our intuitions about the effects of incentives and supervision on performance are often incorrect, it is imperative that such a model exists to allow firms to make better decisions and ultimately improve both worker efficiency as well as corporate decision-making.

Acknowledgments

The authors appreciate the help and collaboration of Drazen Prelec from Sloan School of Management in the MIT.

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Note

Note 1. David Pascual-Ezama was visiting in the Sloan School of Management in MIT (Boston) from March 2011 to august 2011 and from April 2012 to July 2012.