

YOUR SOURCE FOR SCIENCE-BASED
BUSINESS KNOWLEDGE
AND IDEAS

MILPRC

REPRINT 0714098099

**Management Control:
Why Performance-based Pay Actually
May Lower Motivation**

by Göran Nilsson

Mercury Magazine 2014, Summer/Autumn
(Special Issue on Sustainability),
Issue 7-8, pp. 098-099.

Mercury Magazine issue No. 7/8, [Summer/Autumn] 2014. Copyright © 2014. The Department of Business Studies, Uppsala University. All rights reserved. Reproduction of the printed magazine in whole or in part without written permission is strictly prohibited. Mercury Magazine ISSN 2001-3272 is published by the Department of Business Studies, Uppsala University, Box 613, SE-751 20 Uppsala, Sweden. This reprint is available for free at www.fek.uu.se/mercury. Annual printed subscription rates for non-alumni and non-students at the Department are 399 SEK, Euro 60, \$60, £35. To subscribe please email your order to info@fek.uu.se.

Mercury Magazine is the official magazine of the Department of Business Studies at Uppsala University



UPPSALA
UNIVERSITET

Department of
Business Studies

CONTENTS/ SUMMER/AUTUMN



020



PHOTO BY JOHANNA HANNO



014 MESSAGE FROM THE HEAD: STEPS FORWARD

Head of Department **Leena Avotie** on recognizing the importance of sustainability, not least in education.

016 SWEDISH SORROWS AND DANISH DELIGHTS

Lars Engwall on the contrasting development of the pharmaceutical industry in Sweden and in Denmark.

018 SUCCESSFUL ENTREPRENEURS ARE SUSTAINABLE

Successful entrepreneurs are characterized by understanding the concept of balance, argues **Ivo Zander**.

020 THE CONCEPT OF COMPLY OR EXPLAIN

Hans Dalborg, Honorary Chairman of Nordea, illuminates a key concept in corporate governance.

023 BOOK REVIEW: 'THE SECOND MACHINE AGE'

A review of the acclaimed new book by **Erik Brynjolfsson** and **Andrew McAfee**.

024 SCIENTIFICATION IN SPORTS

The field of sports is one of many frontiers of ongoing scientification argue **Leon Michael Caesarius** and **Jukka Hohenthal**.

026 NOT BEING LAZY

Lena Zander portrays **Magnús Scheving** [cover] - a social sustainability entrepreneur in the entertainment industry.

034 LEADERSHIP AND SUSTAINABILITY

Carin Eriksson Lindvall identifies four factors that seem to contribute to the creation of intrinsic motivation.

038 SERVICE LOGIC AND PRODUCTIVITY

Bo Edvardsson explains what you need to consider in order to improve service productivity in your organization.

041 PHENOMENA: EMOTIONAL CONTAGION

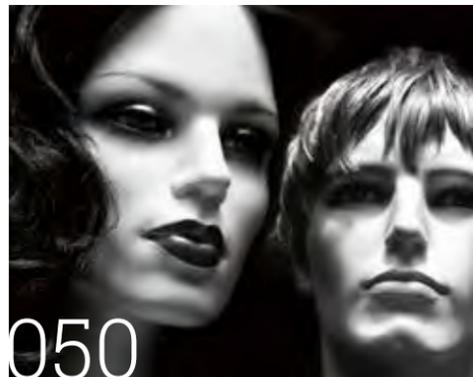
Are users being treated as guinea pigs when Facebook's data science team carries out experiments?

042 CLIMATE CHANGE

Daniel Nyberg and **Christopher Wright** argue that the nature of the corporate world's responses to climate change hitherto can best be described as myths.

050 WHEN SOME CUSTOMERS ARE WORTH MORE THAN OTHERS

Preferential treatment may be unwise, argues **Magnus Söderlund**.



052
MOOCS

Leon Michael Caesarius and Jukka Hohenthal investigate if MOOCs will help redefine the higher education landscape.

060
THE CURSE OF THE COMMUNICATION LITERACY

Josef Pallas is not convinced about the PR-industry's alleged merits. Instead he tries to answer the question: when is it time to fire the PR-consultant?

063
ROCK STAR PROFESSOR

Professor and Managing Director turned rock star – **Henrik Bäckström** is the renaissance man.

064
MONSTROUS LEADERS

Torkild Thanem shows how monstrous leaders constitute a new leadership category and how you can avoid becoming such a leader.

068
CAN WE REALLY AFFORD FINANCIAL CAPITALISM?

Political and economic systems are often deemed as fiascos, but when are we going to make a similar evaluation of financial capitalism, asks **Göran Nilsson**.

074
WHAT YOU BELIEVE IS WHAT YOU SEE

The essence of sensemaking occupies **Henrik Bäckström's** mind.

076
THE FUTURE OF THE MULTINATIONAL CORPORATION

Ivo Zander paints a picture of the future of the well-established multinational corporation.

082
SUSTAINABLE DEVELOPMENT NEEDS STIMULI

Staffan Movin calls for cooperation between society, academia and business.

084
TOTAL VALUE OF OWNERSHIP

When you calculate customer profitability, ask not if your company makes money of customers but if your company helps your customers to make money, says **Torkel Strömsten**.

090
VALUE VS VALUE

Magnus Frostenson focuses on the hard predicament of sustainability.

092
STUDYING CONTROLLERSHIP

Frank G. H. Hartmann draws on experimental studies to increase our understanding of controllers' conflict of interest.

098
WHY PERFORMANCE-BASED PAY ACTUALLY MAY LOWER MOTIVATION

Göran Nilsson explains why financial incentives sometimes fail.

WHY PERFORMANCE-BASED PAY ACTUALLY MAY LOWER MOTIVATION

Göran Nilsson draws on Motivation Crowding Theory to explain why financial incentives sometimes fail.

I doubt that there is any part of management control that gets so much interest from people as financial incentives.

Looking at top management in listed companies we are likely to find that performance-based pay is a widely used practice, but also a highly criticized one. Financial incentives have been the target of significant criticism from researchers, journalists, ministers of government, stock holders, union representatives and even from managers themselves. Do financial incentives actually increase motivation? Perhaps, but I will argue that the opposite may as well be true. One of many examples when this seems to be the case was when a survey was sent out to a number of people living in a certain area of Switzerland, where they were asked if they were willing to store nuclear waste in their area, given that the same area would receive substantial compensation for it. About 25 percent answered yes, but the interesting thing was that an equal number of other people were asked exactly the same question, although without any mentioning of compensation. Perhaps a bit surprising, now about 50 percent, i.e. twice as many said yes!

I will ground my claims in a theory called Motivation Crowding Theory, which is part of a larger psychological theory called Self-Determination Theory. This theory has a very strong empirical foundation in experimental research and is literally based on hundreds of experimental studies. A very simple example of one of these studies would be a number of students who were invited to participate in a research experiment in exchange for some dollars. When the students first arrived the researchers measured how motivated they were to participate. Then the students were told that they had been wrongly informed about the compensation; they were not going to get any. After that the students' motivation was once again measured the same way as before and, believe it or not, it had actually increased! Whether the poor students got their dollars or not in the end I really cannot say.

The explanation for this effect, according to this theory, is that extrinsic motivation, such as money, may crowd out intrinsic motivation, such as interest or believing it is important or just fun. If an increase in the extrinsic motivation crowds out even more intrinsic motivation the total motivation will decrease. The compensation in the nuclear waste case seems to be an example where the extrinsic motivation (compensation) crowded out more intrinsic motivation (perhaps in the form of willingness to contribute to society). The student case is an example of the other way around, namely that when the extrinsic motivation (a few dollars) was withdrawn, the intrinsic motivation (perhaps contributing to research) seems to have increased more than the extrinsic motivation decreased.

But why then, do we see this strange crowding out effect? The explanation is that extrinsic interferences, including extrinsic rewards, may harm a person's feeling of being in control as well as their self-esteem. In the example of the nuclear waste, the introduction of compensation may have made people think something in line with: If they offer me compensation in order to influence my choice, they are probably trying to trick me. I better be aware because this is probably more dangerous than I first thought! Maybe my children will get blood cancer from the waste? The reduced self-esteem is more in line with a manager that is offered a bonus thinking something like: Ok I appreciate the bonus offer, but why do they think they have to offer me a bonus? Don't they think that I am motivated enough by myself or do they perhaps think that I am lazy? Don't they trust me? These thoughts are of course not necessarily as explicit as here; it may very well be a question of feelings rather than clear thoughts.

However, extrinsic rewards do not always crowd-out intrinsic motivation. In fact, they may even increase it. What determines this is whether the extrinsic rewards are perceived as controlling, as in the examples above, or if they are perceived as supporting. An extrinsic reward that often, but not always, is perceived as supporting, is appreciation from a superior manager taking an interest in one's work. But even performance-based pay can be perceived as supporting, and jobs with this type of compensation therefore tend to attract certain types of people. I have one example from a case study performed by some of my students. The case concerned a company selling cars, where the car salesmen of course had performance-based pay. Every one of the salesmen turned out to be male and athletes! For them getting a bonus was probably just a substitute for winning prizes.

But perhaps not all jobs are best suited for the particular type of person attracted to bonus systems? This is at least the opinion of the late Professor Sumatra Ghoshal from London Business School, who argues that the way we manage and reward managers does not give us the leaders that are best suited for the jobs. And perhaps he is right; maybe we would do better with leaders that possess an intrinsic motivation to create something with lasting value, compared to those who are mostly interested in maximizing their bonuses? ■



Göran Nilsson is Assistant Professor of Accounting at the Department of Business Studies, Uppsala University. He is Mercury's columnist on management control issues.

/ The explanation for this effect is that extrinsic motivation, such as money, may crowd out intrinsic motivation, such as interest or believing it is important or just fun. If an increase in the extrinsic motivation crowds out even more intrinsic motivation the total motivation will decrease. /