STRATEGIC BUSINESS DECISIONS

Why Cash is a Less Effective Incentive

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BI WORLDWIDE

Just as sharks need to keep moving to stay alive, sales executives must continue to grow their business to remain successful.

When adding more reps is out of the question and the field is as experienced as they're ever going to be, the best way to increase results is to increase each rep's productivity. The challenge is to find a way for each rep to sell more.

As a preliminary step before investigating new incentive structures, it is helpful to examine some fundamental questions about staff, structure and the market.

- Are the reps fully trained, knowledgeable, and experienced at their jobs?
- Does the market have capacity to buy more of what the reps are selling?
- Are the products and services they're selling priced appropriately?
- Is the distribution channel set up to support what's being sold?

If the answers to these fundamental questions point to greater opportunity in the market then a new approach to incentives may be in order.

Common wisdom to increase production would dictate a change in the monetary compensation plan. Pay more cash and get more results. Everyone likes money – it is a simple and rational choice. And if money is so desirable, why not use it as a reward to induce more desired behavior?

Many corporations do just that. It is undeniable that money works to drive behavior, and money used as an incentive yields positive results – up to a point. The fact, however, is that money is **not the optimal reward** to get extra effort from people.

When considering financial efficiency, ROI or total results there are superior alternatives to cash for incentives. This paper discusses the reasons why.

Behavioral Economics

In the 1980's, American economic professors began to question classical economic theories as they relate to individuals. They created a field of study called behavioral economics, with the focus on what people **actually do** rather than what classical economic theories **say** they will do.

Today, this growing field of study has proven what we have known on an intuitive level: people are often inconsistent and irrational in the actions they take. So knowing that we humans sometimes act irrationally, how can this knowledge help us drive desired behavior?

At the University of Chicago, Richard Thaler, PhD, uses behavioral economics to demonstrate that money is not the most efficient motivator. There are many factors that influence our behavior beyond rational thinking — most notable among these are our emotions and the desire to seek pleasure. In a study of New York City cab drivers' activity on rainy afternoons, Thaler found that most cab drivers knocked off early — at the point in time they met their personally-set daily 'quota' for fares.[i]

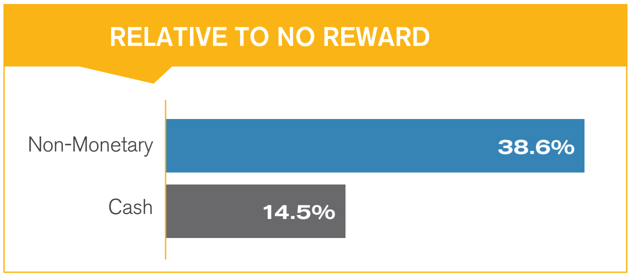
> The cognitive, rational response— **in this case make more cash for the same number of hours worked**—is not consistent with the way we behave.

Why would they do this? The rational response proposed by classical economists would be for them to work the same number of hours and make more money on rainy days. However since demand for a cab is higher on rainy days, "quotas" are met earlier in the day — cabbies would rather enjoy an early afternoon off than earn extra money.

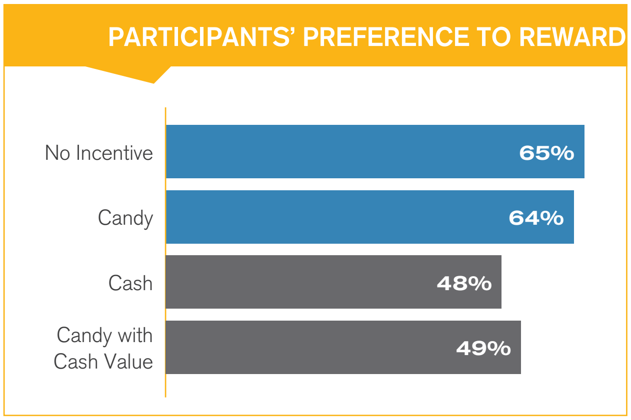
This research was confirmed by CultureWorx, a human resources consulting firm, when they noted: "If money were the ideal motivator, commissioned salespeople would operate at peak efficiency at all times. But what actually happens is just the opposite. The salesperson becomes 'income adjusted' … [either they] earn the same amount of money for selling fewer products and services or earn more money for selling the same amount of products or services."

The same vein of research has been pursued by Ran Kivetz, PhD, a professor at the Columbia Graduate School of Business. In numerous studies, his work reveals that people act in what appears to be an irrational manner. That's because their actions are driven by their emotions to, as Kivetz says, "precommit to luxury."[ii] We do this because we have so much already yet we want more. Compensation — in the form of money — is first used to meet our living needs and what's left over, after paying our bills, can be used for the luxuries we desire. Because paying our bills drains the emotion out of the reward, money ends up being a less efficient motivator.

While Scott Jeffrey, PhD, was getting his doctorate at the University of Chicago, he investigated which rewards would be the most effective in getting University staff members to improve speed and accuracy[iii] in the University's incentive lab. In a controlled study he tested hard cold cash against a variety of non-monetary rewards, such as massages and tangible rewards. He used only a verbal "thank you" for the control group. Jeffrey found that even a simple thank-you can have a positive impact on performance. (Managers take note!) The cash reward, as one might expect, drove a significant improvement in performance: 14.6% over the thank-you group. Most notable, however, was the tangible rewards group — the massages — that drove a 38.6% increase over the thank-you group.



Yet, when Jeffrey asked participants in a post-program survey to rate their preference for cash, two-thirds of those who earned massages indicated they would prefer to have the cash value of the prize rather than the prize itself. Yet it was that very group that outperformed the people who earned the cash in the first place. When it comes to rewards, what we say we want and what really motivates us are **two different things**.



Finally, Dan Ariely, PhD, a professor at MIT, discovered that people treat rewards with explicit cash values differently than those presented without an explicit cash value. Ariely's study was based on people being asked if they'd help change a tire in exchange for different rewards.

The researchers found that 65% of all those asked — when no reward was introduced — said yes and saw similar results when offered a reward in the form of a piece of candy (such as a wrapped peppermint). However, when offered $0.50 as a reward for changing the tire, many people felt insulted and only 48% of those asked were willing to help.[iv]

Ariely's subtle and important discovery came when the researchers combined the candy with a monetary value. They positioned their request to the study participants this way: "Would you help me change my tire for a fifty-cent piece of candy?"

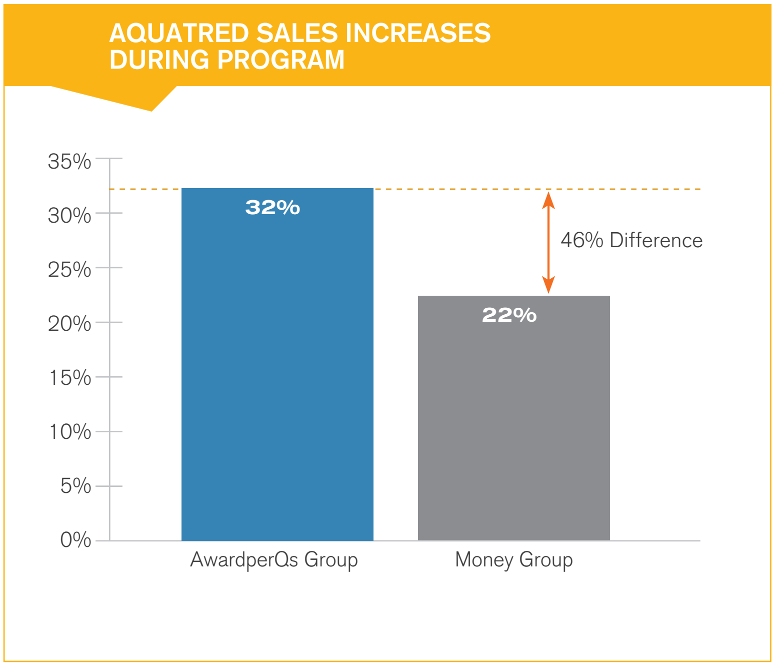
They held out the same peppermint used with other participants and **got the same response** as when cold cash was offered.

The candy accompanied by an explicit monetary value produced more than 15% less response than the candy alone. It's not rational, but it's how we behave. Using cash as a reward leaves a significant group of people out because it lacks emotional content.

If the objective is to engage people in an activity they already know how to do but aren't doing, we must appeal to their emotions in order to get their best effort.

Real World Results

Comparative reward studies in the field with real workers doing real jobs are rare since companies find it difficult to justify spending time and energy learning about something they are convinced they already know. This section shares analytical work from our own knowledge base on what drives behavior in a work environment.



BI WORLDWIDE's study with Goodyear Tire & Rubber is the most cited research on cash versus tangible rewards.[v] Tom Gravalos, a then marketing manager at Goodyear, embarked on a project to end the fruitless cash/non-cash debate and determine which reward was more effective. Tire dealerships in the USA were split after being stack-ranked with one group rewarded cash and the other group rewarded with an equivalent value in points (point values were disguised so participants wouldn't perceive the reward as money). The results were clear: the dealerships rewarding points sold 46% more tires than the group rewarded with cash.

Culling from BI WORLDWIDE's own Results Library of more than 10,000 individual metrics from programs we've operated, we see similar results. The key observation regarding efficiency of rewards can be summed up this way: BI WORLDWIDE's non-monetary award points (AwardperQs®) are 15% more effective at getting participants to deliver results than cash or cash equivalents (including monetary rewards such as gift cards or debit cards).

Simply stated, $1.00 spent on a cash reward is less efficient at driving behavior than $1.00 spent on a tangible non-monetary reward. This is because **people get more engaged and produce greater results under a non-monetary system**.

The Aberdeen Group estimates that cash incentives cost $0.12 per incremental dollar, while non-cash incentives average just $0.04 for the same incremental dollar.[vi] Also, non-cash programs cost just 3-5% of a company's compensation budget, compared to 5–15% for cash reward programs. It takes more cash to get the same attention and motivation acquired through non-monetary rewards.

Finally, cash rewards raise long term compensation implications as they become viewed as entitlements to the recipients and lose motivational effectiveness.

Summary

Many sales executives believe that because we can think rationally about a reward, it's potential impact on our lives, and the energy required to acquire it, that their sales staff will behave in a rational manner to achieve these rewards.

However, that's not how humans function. Our rational thinking and anticipated rational behavior are usually superseded by our emotions. To make the most efficient use of resources, sales executives must leverage that powerful interrupter, emotion, by maximizing the use of non-monetary rewards.

End Notes

i Camerer, C., Babcock, L., Loewenstein, G., & Thaler, R., “Labor Supply of New York City Cab Drivers: One Day at a Time,” Quarterly Journal of Economics, May 1997, pages 407-441.

ii Kivetz, Ran. Kivetz, R. & Simonson, I., “Self-Control for the Righteous: toward a Theory of Luxury Pre-Commitment,” working paper, June 2001.

iii Jeffrey, Scott, “Theory of Tangible Rewards,” presented 2003 at a private conference.

iv Ariely, D. & Heyman, J., “Effort for Payment: A Tale of Two Markets,” American Psychological Society, Volume 15 – Number 11, 2004.

v Jack, J. & Gravalos, T., “The Trouble With Money,” privately published by BI WORLDWIDE, 1995.

vi Aberdeen Group, “Compensation and Incentives: The Evolving Role of Financial Rewards,” February, 2007.

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