DO INCENTIVES WORK?

THE PERCEPTIONS OF SENIOR EXECUTIVES FROM THIRTY COUNTRIES

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ABSTRACT

A significant development in executive compensation is the increasing use of performance-based bonuses. Our survey of 205 executives from 30 countries investigates executives’ perceptions of the causes and consequences of this trend. Significant findings which depart from frequently espoused theory of executive incentives are discussed.

Compensation. International.
Over the last decade, there has been a striking increase in the use of bonuses as a means to reward senior executives (Stewart, 1997; HR Focus, 1996; Rich, 1996; American Management Association, 1995). This development has been applauded by some, and decried by others (Business Week, 1997; Crystal, 1991; Kohn, 1993). In their recent review article, Gomez-Mejia and Wiseman (1997) suggest that the early impetus for this trend was a desire to tie executive pay more closely to organizational performance. The original rationale, say Gomez-Mejia and Wiseman, was to make sure that if organizational performance falters and the rank and file are thus subject to lay-offs, senior management is also tangibly affected.

What accounts for the proliferation of performance bonuses for senior management across the corporate landscape? What has caused the spread of this practice to so many American organizations? Various reasons have been proposed. Pennings (1993) suggests that performance bonuses for senior executives fit neatly into the American “cult of corporate heroes.” Brenner (1995) notes that executive bonuses have enjoyed a surge in popularity partly because, in an era of heightened competition and reduced profitability, performance-based bonuses are a way to make pay a variable rather than a fixed cost. Institutionalization may also play a role in the spread of executive bonuses. The bonuses paid by Fortune 500 businesses to their executives receive tremendous attention in the media (e.g. Lublin, 1996, 1995). Other companies may mimic
this practice because they believe executive bonus plans promote performance, or because
they wish to signal their conformity with best practice (DiMaggio and Powell, 1983;

The increasing use of performance bonuses for senior executives raises a number
of interesting questions for scholars and practitioners, questions that the existing literature
does not sufficiently address. We articulate these questions and then present the data we
collected to address these issues.

Most of the empirical research into executive bonuses has been devoted to
establishing a link between executive incentives and company performance (Gomez-Mejia
and Wiseman). Typically, researchers measure the type or extent of executive bonuses in
a sample of corporations, and then search for a statistical relationship to some measure of
performance, such as sales, profits, or ROE (e.g. Gerhart and Milkovich, 1990). Not only
have researchers been unable to establish that incentive compensation is causally related
to firm performance, but in their focus on establishing a link between executive incentives
and corporate performance, they have generally neglected the question of how bonuses
influence performance – that is, how do bonuses shape executive behavior and decision-
making? Based a survey of 205 senior executives, this paper will focus on both these
questions.
An implicit assumption embedded in the prior research is that bonuses shape executive behavior and decision-making, which in turn influence organizational performance. However, each link in that chain needs to be supported by data. Though the prevailing espoused theory in American industry is that incentives motivate and motivation leads to firm performance these links have not been firmly established by empirical research. Those who espouse this theory must illustrate how exactly bonuses shape executive behavior and decision-making? When bonuses are associated with enhanced organizational performance, what is the causal mechanism? Is it that bonuses help attract and retain executive talent? That bonuses motivate executives to perform at their best? That bonuses prevent executive dissatisfaction? When bonuses are associated with impaired organizational performance, what is the causal mechanism? Is it that bonuses hurt cooperation among senior executives (Hambrick and Siegel, 1997)? That bonuses foster gaming and short-sighted decisions? That bonuses consume a disproportionate amount of senior executives’ time and attention? That bonuses for top management foster resentment and dissatisfaction among lower ranks in the organization? Our study explores the possible roles these causal mechanisms might play.

A second key issue that the prior literature does not sufficiently address the reasons companies are using performance-based bonuses. The trend to increase the proportion of executive pay that is based on corporate performance has resulted in stratospheric pay at the top levels in some corporations. This has been particularly the case when performance is measured in terms of stock market outcomes, given the
unprecedented bullishness of the stock market in recent times. The incomes of executives like Michael Eisner and Alfred Dunlop have received tremendous attention in the popular press. In addition to the absolute sums such executives are receiving in bonus payouts, the press has zeroed in on the resulting large discrepancy between pay at the top rungs of the company and pay at the bottom (Business Week, 1997; McNerney, 1995).

This has led some to question the “real” reasons for the trend to make executive pay contingent on performance. Traditionally, bonus pay is justified by drawing, either implicitly or explicitly, on the rationale of expectancy theory or agency theory (Gomez-Mejia and Wiseman). Expectancy theory builds on the simple but powerful notion that rewards motivate performance. Agency theory is rooted in the idea that rewards are a useful tool for aligning the interests of management and the interests of stockholders. Both approaches treat compensation as a tool that can help maximize motivation and performance. But some skeptics have questioned whether the movement to link executive pay to corporate performance is really about motivating executives. Rather, these skeptics suggest that the primary reason for linking executive pay to performance may be to justify or provide “cover” for huge payouts to senior management (Hambrick and Finkelstein, 1995; Crystal, 1991; Zajac and Westphal, 1995).

In general, the field of compensation, and executive incentive compensation in particular, is filled with assertions that have not been proven empirically. Many of these assertions come from compensation consultants and human resource executives concerned
with compensation. They have, however, an interest in pushing compensation as an important and powerful tool in driving motivation and firm performance. Is it possible that the increasing use of executive incentives in the U.S. and, increasingly, around the world is based on a false set of assumptions?

We believe it is critical to measure the views of the executives involved: do they believe in the motivational value of the bonuses they receive? Or do they view performance bonuses as a means of paying out more money, perhaps to attract and keep executives? The failure of prior research to focus on the executives’ views of how incentives work and why incentives are important limits our ability to understand the phenomenon. It seems reasonable that executives’ views of the effects of incentives with regard to their own behavior and that of others and whether those bonuses are justified can tell us a lot about whether executive incentives work in the way they are commonly thought of. Furthermore, do the executives who receive large bonuses believe that the differential between pay at the top and pay at the bottom is fair? Do they see this differential as a manifestation of a meritocracy, or as a potential cause for dissatisfaction among the lower ranks? There is very little data on these questions, yet they seem potentially quite meaningful (Gomez-Mejia and Wiseman).

A third key issue surrounding the increasing use of executive bonuses concerns their spread to countries other than the United States. Until recently, performance-based
bonuses for senior executives have been a particularly American phenomenon (Tully, 1988). Cross-cultural comparisons conducted in the 1970’s and 1980’s indicated that bonuses were much more common, relatively speaking, in the United States than in Europe or the Far East (Pennings, 1993; Bass & Burger, 1979). This difference makes sense in that business organizations are known to reflect the values of the national culture (Zucker, 1977). Cross-cultural investigations have shown that Americans place particularly high value on the values of individualism, masculinity, and tolerance for uncertainty (Hofstede, 1983, 1980). These values are highly compatible with performance-based bonuses. Individualism, as defined by Hofstede, involves a tendency to differentiate among people and to accept large differences in outcomes for individuals. Masculinity involves a respect for agency and achievement, which is clearly consistent with a system that links pay to results. Tolerance for uncertainty involves a willingness to accept an uncertain future, which jibes with making rewards contingent upon (uncertain) future performance.

In Japan, in contrast, payment was more likely to be based on job worth or on “nenko jaretsu” (Beatty, McCune, and Beatty, 1988). This is the notion of the “merit of years” – i.e. that the employee grows in age along with the company. In Europe, bonuses were generally not used as a means to recognize performance due to the high income tax rates; companies relied on perks rather than bonuses (Beatty, McCune, and Beatty). Moreover, the more egalitarian social values of Europeans causes them to have negative views of American executive incentive systems. Differences between Americans and
Europeans have been quite evident in discussions of this topic in a residential senior executive program one of the authors has taught in the last several years.

Recent data indicate, however, that the Far East and Europe have begun to introduce American-style performance-based bonus plans (Roth and O’Donnell, 1996; Trung, 1995; Across The Board, 1995). There is a growing belief abroad that executive pay should have a contingent component based on performance (Business Europe, 1995). It seems likely that this trend will continue in the future, due to ever increasing globalization, foreign investment, joint ventures, and multi-national corporations.

The spread of executive bonuses to outside the United States raises fascinating questions. As Pennings (1993) notes, the extent to which rewards are motivating depends upon the meaning people attribute to those rewards (Salancik and Pfeffer, 1977). Such meanings are greatly influenced by cultural values. Compensation practices that abide by an American logic may have unpredictable or undesirable effects when transplanted to another nation’s soil (Pennings). This leads us to the further question: is it only the practices that are being transferred abroad, or are the underlying beliefs regarding motivation also spreading beyond the United States? There are two ways to answer this question. Without beliefs, executive incentive practices that are adopted by managers in European or Asian companies, for example, will not work. On the other hand a case can be made, based on the human predisposition to engage in retrospective sense making, that the spread of executive incentives to countries where they are not now used or favored
will ultimately shape the belief of managers regardless of their actual effects. This would not be a bad outcome, if it were not for the possibility that the enthusiasm of American managers, consultants and scholars for executive incentives is not itself a myth. As James March (1997) said so eloquently recently, management rhetoric and practice have their roots in myths and scholars must avoid being caught up in them.

No single study can answer all these questions definitively, certainly not a study such as this one which relies principally on the reports of senior executives. Nevertheless, if executives are asked, as we have done in this research, to describe practices and their effects, not their opinions, it is possible to obtain some interesting insights, particularly if several different estimates of how incentives are affecting behavior and attitudes are compared. Moreover, when, as was true in this research, executives are away from the culture of their own company for ten weeks in a course of study at a university, the likelihood of “objective” estimates are enhanced. It has been our experience that separation from their company for an extended period enables executives to become more dispassionate about the practices of their own companies. They are more open to new ideas and are therefore likely to be relatively more “objective” reporters.
METHODS

Respondents were 205 participants in an international management development program for senior executives held in 1997 at a U.S. university. They were almost exclusively line executives in many different industries including manufacturing, retail, financial services, and professional services. This sample had particular appeal, because one limitation of much executive compensation research is that it relies on HR directors as primary informants. It seems reasonable, as mentioned above, that HR directors may provide an overly-positive assessment of a company’s compensation plan, inasmuch as they have a direct investment in the perceived success of that plan (Brenner). Furthermore, the assessment by HR directors of incentive system effects on attitudes, behavior and performance, even when not swayed by their own positive bias for incentive schemes, is informed by hearsay, not their own direct line experience with such incentives. The members of our sample, in contrast, directly participated in the executive pay plans that they reported on.

This sample was also noteworthy for its international range. Prior studies that incorporated cross-cultural comparisons have usually included only a handful of countries in their comparisons (e.g. Roth and O’Donnell, 1996; Pennings, 1993). Our respondents came from 30 different countries.
The survey instrument included questions that assessed the extent and design of performance bonuses for senior executives at the respondent’s company (viz.: Are performance-based bonuses paid to top management at your company? What percentage of total pay do such bonuses represent? Are these bonuses based on unit performance or on corporate performance? What percentage of the bonuses is based on non-financial measures of performance such as management development and morale-building? Is the executive pay plan in your company fair? What are the top reasons your company has a bonus system?) Also included in the survey were questions that explored more general features of the company’s pay plan. (viz.: What is the ratio of the CEO’s total compensation to that of the lowest non-managerial pay grade in the company? Does your company have a company-wide profit-sharing or gain-sharing program that applies to all employees? Does your company have a stock option plan?) Finally, the survey also measured organizational variables that intuition and prior research suggested could play a moderating role (viz.: company size as indexed by revenues, company performance, the extent of a team-oriented corporate culture, and country). Respondents’ estimate of company performance also served as an ultimate outcome variable against which many of other variables could be regressed. Except for estimates of percentages and factual questions, items were statements of a condition in the company (My company’s performance has been quite good in the last decade.) and respondents were asked to rate on a Likert scale the extent to which they agreed or disagreed that this condition existed.
The survey data were supplemented by semi-structured interviews with 30 volunteers from the sample of 205 respondents. The interviews averaged 1 hour in length. All interviews were taped and transcribed. The interviews were used to gain a deeper understanding of the survey data and to check that the inferences drawn from the survey data were sound. The 30 volunteers represented a cross-section of the countries in the sample. The interviews addressed the following questions: 1) What is the current design of the executive bonus plan at your company, and how does it fit into the overall approach to compensation? 2) Does this bonus plan represent a change from prior practice? If so, how? 3) Why does your company design executive bonuses in the way it does? Are the espoused reasons the same as the actual reasons? 4) What impact does the executive bonus plan have on your behavior and decision-making? Respondents were encouraged to provide concrete examples in response to every question.

Data from the survey was also fed back to executives in a class setting to promote a discussion that would deepen their and our understanding of the data. Interviews and class discussions of the data led to insights about the role incentives play in organizations. These informed the inferences we draw later in this paper, though space limitations prevent us from reporting the qualitative data in a systematic manner.
RESULTS

Descriptive statistics for continuous variables are reported in Table 1. The most noteworthy finding is that, in general, the executives surveyed did not view either the potential positive effects of a performance bonus (attracts and retains talent, motivates executives, prevents executive dissatisfaction) or the potential negative effects of a performance bonus (hurts cooperation, causes gaming and short-sighted decisions, consumes too much time and energy, causes dissatisfaction among lower ranks) as particularly strong. The average response on all of these variables was close to 3.0, where 1 = strongly disagree and 5 = strongly agree. Thus the overall impact of bonuses on executive behavior and decision-making was viewed as relatively slight.
TABLE 1

Descriptive Statistics, Continuous Variables

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>St. Dev.</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Percentage of pay represented by bonus</td>
<td>30.75</td>
<td>17.27</td>
<td>4</td>
<td>100</td>
</tr>
<tr>
<td>2. Ratio between pay at top and bottom</td>
<td>82.0</td>
<td>202.0</td>
<td>0</td>
<td>1500</td>
</tr>
<tr>
<td>3. Extent of team culture</td>
<td>3.05</td>
<td>1.12</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>4. Organizational performance</td>
<td>3.20</td>
<td>1.33</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>5. Percentage of performance based on morale and management development</td>
<td>6.67</td>
<td>7.83</td>
<td>0</td>
<td>30</td>
</tr>
<tr>
<td>6. Our executive bonus plan helps attract and retain talent</td>
<td>3.13</td>
<td>1.19</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>7. Our executive bonus plan motivates executives to perform</td>
<td>3.18</td>
<td>1.14</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>8. Our executive bonus plan promotes organizational effectiveness</td>
<td>3.64</td>
<td>.96</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>9. Our executive bonus plan hurts cooperation</td>
<td>2.34</td>
<td>1.12</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>10. Our executive bonus plan fosters gaming and short-sightedness</td>
<td>2.57</td>
<td>1.07</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>11. Our executive bonus plan consumes a great deal of executive time and energy</td>
<td>2.18</td>
<td>.95</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>12. Our executive bonus plan causes dissatisfaction at lower ranks</td>
<td>2.63</td>
<td>1.02</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>
Interviews and discussions with executives supported this overall findings. Executives said they did not make daily business decisions based on a calculation of how it would affect their incentives or that of their people. This finding was surprising to us given the strong conviction executives and the compensation establishment hold that incentives motivate behavior. Did executives provide this view because they did not want to be seen as motivated by money? We cannot be certain except to say that there was variability in the ratings. Moreover, in class discussions about compensation executives were quite open about less socially desirable practices than being motivated by incentives. They admitted “low balling” (setting low performance standards to ensure an incentive payout). This gives us some confidence that executive responses were honest.

A positive relationship was found between executive bonuses and the size of the differential between pay at the top and pay at the bottom rungs of the company \((r=.45)\). In other words, companies that devoted a larger percentage of executive compensation to bonus payouts were more likely to have a larger differential between the pay at the top and the bottom of the company. Though far from definitive, this finding together with the previous finding regarding motivation gives rise to the speculation that incentives, regardless of intention, affect level of pay more than they affect motivation.

Frequency data for categorical variables are reported in Table 2. By far the most often cited reason for instituting executive bonuses was their perceived motivational power. The second most often cited reason was their ability to attract executive talent.
Respondents were much less likely to view performance bonuses as a means to justify large payouts.


<table>
<thead>
<tr>
<th>Reasons Cited for the Company’s Executive Bonus Plan</th>
<th>%Yes</th>
<th>%No</th>
</tr>
</thead>
<tbody>
<tr>
<td>68% of respondents identified: “Top management believes it will motivate executives.”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>48% of respondents identified: “Other companies that hire from the same labor pool do it.”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>24% of respondents identified: “We’ve always had it.”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>23% of respondents identified: “It’s a way of justifying executive compensation to shareholders and the capital market community.”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18% of respondents identified: “Our board of directors insists upon it.”</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Questions</th>
<th>%Yes</th>
<th>%No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does your company have an executive bonus plan?</td>
<td>90</td>
<td>10</td>
</tr>
<tr>
<td>Does your company have an organization-wide gain-sharing or profit-sharing plan?</td>
<td>66</td>
<td>44</td>
</tr>
<tr>
<td>Does your company have a stock option plan?</td>
<td>63</td>
<td>37</td>
</tr>
<tr>
<td>Is your bonus plan based primarily on unit performance?</td>
<td>31</td>
<td>69</td>
</tr>
<tr>
<td>Is your bonus plan based primarily on corporate performance?</td>
<td>25</td>
<td>75</td>
</tr>
<tr>
<td>Is your company headquartered in the United States?</td>
<td>31</td>
<td>69</td>
</tr>
</tbody>
</table>
More important than the descriptive statistics are the relationships we observed between the variables we measured. These relationships expressed as correlation coefficients and regression betas enable us to draw tentative inferences about the causal relationship between the existence and design of an incentive scheme and a variety of effects, particularly when these data are put into the context of other research on motivation and incentive systems. Clearly, however, correlations and regressions do not establish causality.

Table 3 reports the results of stepwise regression analyses designed to address the question: when are performance bonuses more likely to have a positive impact on executive motivation, behavior and decision-making? In other words, under what conditions will a bonus plan be more likely to attract and retain executive talent, motivate executives to perform, and prevent executive dissatisfaction? Predictor variables included aspects of the executive bonus plan (viz.: the percentage of total pay which the bonus represents, whether the bonus is based on unit or corporate performance, whether the executive bonus plan is perceived as fair, and what percentage of the bonuses is based on non-financial measures of performance such as management development and morale-building), general features of the company’s pay plan (viz.: the ratio of pay at the top rung to pay at the bottom, whether the company has an organization-wide profit-sharing or gain-sharing plan, and whether the company has a stock option plan) and organizational features (company size as measured by revenues, company performance, the extent of a team-oriented corporate culture, and country).
TABLE 3
The conditions under which executive bonuses are more likely to have a positive impact

Dependent variable: Type of positive impact
(Table contains standardized betas)

<table>
<thead>
<tr>
<th></th>
<th>Motivates Executives</th>
<th>Attracts Talent</th>
<th>Promotes Org. Effectiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of pay represented by bonus</td>
<td>.019</td>
<td>-.031</td>
<td>.175</td>
</tr>
<tr>
<td>Bonus based on unit rather than corporate performance</td>
<td>-.178</td>
<td>.038</td>
<td>-.188</td>
</tr>
<tr>
<td>Performance includes measures of morale &amp; mgmt. Development</td>
<td>-.042</td>
<td>.016</td>
<td>-.114</td>
</tr>
<tr>
<td>Presence of a gain-sharing or profit-sharing plan</td>
<td>.316**</td>
<td>.234*</td>
<td>.355*</td>
</tr>
<tr>
<td>Presence of a stock options plan</td>
<td>-.039</td>
<td>.067</td>
<td>-.125</td>
</tr>
<tr>
<td>Extent of team culture</td>
<td>.133</td>
<td>.184</td>
<td>.074</td>
</tr>
<tr>
<td>Corporate performance strong for last decade</td>
<td>.419***</td>
<td>.456***</td>
<td>.090</td>
</tr>
<tr>
<td>Company size (revenues)</td>
<td>.102</td>
<td>.028</td>
<td>.084</td>
</tr>
<tr>
<td>R-squared</td>
<td>.266</td>
<td>.255</td>
<td>.126</td>
</tr>
<tr>
<td>F</td>
<td>9.98***</td>
<td>9.43***</td>
<td>7.78**</td>
</tr>
</tbody>
</table>

* p < .05
** p < .01
*** p < .001
Table 3 indicates that executive bonuses are more likely to be seen as having a positive impact on executive behavior and decision-making when: organizational performance is strong, the executive pay plan is viewed as fair, and there is a company-wide profit-sharing or gain-sharing program. These findings suggest that the nature of the incentive scheme - company-wide vs. unit based - is a very important consideration in the design of executive incentive plans and that the context in which the incentive system operates is key to the efficacy of any incentive system. The fact the effect of incentive systems is moderated by organizational performance raises questions, not answerable by this research, about whether incentives produce performance or whether good business performance is requisite for an incentive system to be perceived as fair and effective.

Table 4 reports the results of stepwise regression analyses designed to address the question: do executive bonuses, or any other aspect of compensation, predict organizational performance? Results indicate that no aspect of a company’s pay plan design predicts the company’s performance. The only variable that significantly predicts company performance is the extent to which the culture is one of teamwork. This finding is startling given the rhetoric in the U.S. about the importance of incentives in producing agency. It takes on even more significance in light of a very strong relationship between the extent to which a company had a team based culture and its performance. Apparently a culture of team work is more crucial to performance than having an incentive system.
TABLE 4

Predicting performance from compensation and other organizational features

Dependent variable: Corporate performance
(Table contains standardized betas)

<table>
<thead>
<tr>
<th>Variable Description</th>
<th>Beta (Standardized)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of pay represented by bonus</td>
<td>.023</td>
</tr>
<tr>
<td>Bonus based on unit rather than corporate performance</td>
<td>.010</td>
</tr>
<tr>
<td>Performance includes measures of morale &amp; mgmt. Development</td>
<td>.006</td>
</tr>
<tr>
<td>Presence of a gain-sharing or profit-sharing plan</td>
<td>.018</td>
</tr>
<tr>
<td>Presence of a stock options plan</td>
<td>.013</td>
</tr>
<tr>
<td>Extent of team culture</td>
<td>.578 ***</td>
</tr>
<tr>
<td>Company size (revenues)</td>
<td>.002</td>
</tr>
</tbody>
</table>

R-squared .334
F 48.15

* p < .05
** p < .01
*** p < .001
Table 5 reports the results of stepwise regression analyses designed to address the question: when are performance bonuses more likely to have a negative effect on executive behavior and decision-making? In other words, under what conditions will a bonus plan be more likely to hurt cooperation, cause gaming and short-sighted decisions, consume too much time and energy, and cause dissatisfaction among lower ranks? Predictor variables again included aspects of the bonus plan’s design, general features of the company’s pay plan, and organizational features.
TABLE 5

The conditions under which executive bonuses are more likely to have a negative impact

Dependent variable: Type of negative impact
(Table contains standardized betas)

<table>
<thead>
<tr>
<th></th>
<th>Impaired Cooperation</th>
<th>Gaming &amp; Short-term</th>
<th>Eats Time &amp; Energy</th>
<th>Dissatisfaction Below</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of pay represented by bonus</td>
<td>.021</td>
<td>.042</td>
<td>.240*</td>
<td>.016</td>
</tr>
<tr>
<td>Bonus based on unit rather than corporate performance</td>
<td>.011</td>
<td>.323*</td>
<td>.261*</td>
<td>.127</td>
</tr>
<tr>
<td>Performance includes measures of morale &amp; mgmt. development</td>
<td>.053</td>
<td>.077</td>
<td>-.034</td>
<td>-.246**</td>
</tr>
<tr>
<td>Presence of a gain-sharing or profit-sharing plan</td>
<td>-.114</td>
<td>-.139</td>
<td>.142</td>
<td>.108</td>
</tr>
<tr>
<td>Presence of a stock options plan</td>
<td>.132</td>
<td>-.113</td>
<td>.013</td>
<td>.045</td>
</tr>
<tr>
<td>Extent of team culture</td>
<td>.060</td>
<td>.054</td>
<td>.046</td>
<td>.031</td>
</tr>
<tr>
<td>Corporate performance strong for last decade</td>
<td>.033</td>
<td>.041</td>
<td>.103</td>
<td>-.105</td>
</tr>
<tr>
<td>Company size (revenues)</td>
<td>.109</td>
<td>.028</td>
<td>.121</td>
<td>.043</td>
</tr>
<tr>
<td>R-squared</td>
<td>.014</td>
<td>.104</td>
<td>.068</td>
<td>.061</td>
</tr>
<tr>
<td>F</td>
<td>.98</td>
<td>6.50*</td>
<td>4.08*</td>
<td>7.43**</td>
</tr>
</tbody>
</table>

* p < .05
** p < .01
*** p < .001
Table 5 indicates that executive bonuses are more likely to be seen as having a negative impact on executive behavior and decision-making when the bonuses are based on unit rather than corporate performance. Apparently, pushing down agency too far in the organization can be counterproductive, particularly in view of the fact that having an executive incentive system is not associated with performance.

Regarding comparisons between U.S. and non-U.S. companies in their approaches to executive bonuses and to compensation more generally, the data suggest that executive bonuses in American companies generally represent a larger percentage of overall pay (t = 2.75, p = .008), are more likely to be viewed as having a positive impact on executive motivation (t = 1.97, p = .05), and are more likely to be viewed as fair (t = 2.27, p = .026). Also, American companies are more likely to have a company-wide profit-sharing or gain-sharing plan (chi-square = 3.59, p = .05), to have a stock option plan (chi-square = 9.54, p = .002), and to have a large ratio between pay at the top rungs and pay at the bottom (t = 3.16, p = .004). All of this is consistent with the strong belief in executive bonuses, expressed in class, by American executives in the sample in comparison to executives from Europe and Asia.

The findings regarding the differences between the report of U.S. executives and those from other countries reinforces the view that executive incentives are a distinctly American phenomenon, at least up to this point in time. It raises an important
unanswered question. Are the positive convictions about incentive compensation held by U.S. executives based in reality or are they socially constructed myth? The fact that no aspect of incentive system design was associated with executives ratings of firm performance supports, but does not establish, the social construction inference.

DISCUSSION

Given the espoused theory of the American business establishment that executive incentives are important motivators that will enhance firm performance, the survey results are quite startling. When taken as a whole, the results seem to suggest a very different picture of the role executive incentive plans play in corporations. We sketch this picture below.

A fascinating paradox emerges with regard to the question of incentives and motivation. Executives seem to believe that incentives have only a slight ability to motivate executive performance. Yet, when asked why their company has instituted bonuses, the most important reason cited (ranked number one among several alternatives) is that bourses motivate. What is myth and what is reality? These data do not answer this question, but they raise serious questions about the real role of incentives. We can only speculate at this point. It is interesting that “other companies hiring from the same labor pool do it” was the second-ranked reason executives in the sample cited for why their company had an incentive system. This is consistent with the what executives said
when challenged during the feedback of this data about why they felt so strongly about incentives given their near neutral (as noted above, all means were very close to the midpoint of the scale, indicating neither agreement nor disagreement) ratings of its motivational value. Indeed, they maintained that their companies simply could not attract executives unless bonuses were part of the package. Based on these data, labor market theories would seem to offer a better explanation of why incentive schemes are adopted than theories of motivation.

Of course, when put together with our finding that incentives had stronger positive effects with respect to attraction and motivation of executives in the U.S. relative to other parts of the world, we wonder whether the belief in executive incentives is a social construction. Americans managers believe in incentives, so they install them in their companies. Because American executives believe in the potential of the individual to make a difference they choose to work at companies with incentive systems, assuming that they will be the ones to be paid above the average. Given this belief, companies are forced into incentive systems to compete in the labor market, but they use motivation as the rhetoric to justify their actions. Furthermore, given that for the sample as a whole there was no significant relationship between the percentage of compensation at risk and firm performance, one might speculate that incentive systems have a different purpose from that which is commonly espoused. Attracting and keeping executives seems to be the true purpose. The by-product is that incentives make executives richer. This hypothesis is supported by the fact that percentage of pay at risk was positively
associated with the ratio of pay at the top compared to that at the bottom. This inference is also supported by the finding that American companies put more pay at risk and had the highest top to bottom pay ratio.

Though our findings are only suggestive, several survey findings raise questions about how important the design of a carefully crafted contingent incentive system really is. Contextual factors such as high firm performance, an American setting, the presence of a company-wide gain-sharing plan, and an incentive system based on corporate rather than unit performance were all moderators of the relationship between percentage of pay at risk and positive and negative effects on executive behavior. This suggests that careful design of an incentive system to make pay contingent on unit performance, something on which companies spend considerable compensation consulting dollars, may be misplaced, despite the prescriptions of expectancy and agency theory. A company-wide gain-sharing plan, which does not “motivate” individual behavior in an instrumental sense, seems to play an important role in the effectiveness of executive incentives. And when the company is performing well these incentive systems work best. When put together with our finding that a team culture is the only variable in the survey that is positively related to performance and that perceptions that the incentive system is fair is a powerful moderator of the relationship between bonuses and behavior, it seems reasonable to speculate that management is better served investing in the development of the corporate context than in the design of the incentive. Effort in designing pay systems might best lag rather than lead efforts to improve the effectiveness and performance of the firm. This
inference is consistent with research in organizational change which has shown that formal human resource programs do not usually succeed in producing change. Instead, multiple changes that focus on changing the context are the key (Beer, Eisenstat and Spector, 1990).

The importance of context, particularly an American companies, raises questions about the world-wide trend toward the use of more executive incentives. Since other countries do not have the context for effective implementation of an incentive system, the odds of such systems succeeding may be decreased. If incentive schemes do not motivate or do not account for better firm performance, why introduce them in the first place? Once introduced, they will create a labor market that forces companies to introduce incentive systems in order to attract and keep talent.

In this discussion we have gone considerably beyond the data. We have tried to put several findings together and based on their combination make a number of inferences. Clearly much more and a different kind of research is required. The limitations of this research is in its reliance on executive reports about compensation practices and their effects rather than on observation of actual effects. However, we did craft questions to obtain as unbiased a report as possible rather than an opinion. Furthermore, we make inferences based on a patterns of relationships between items, not the opinion of executives about incentive compensation. Nevertheless, to sort out the difference between reality and myth regarding compensation much more than survey research will be needed. More than likely a range of research methods will be needed to unravel the
complicated reason why incentive systems are used and their effects. This study is only a small step in this direction.


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