Incentive Research Foundation

# How to Effectively Harness Behavioral Economics to Drive Employee Performance and Engagement

**A White Paper on the IRF Research Study *Using Behavioral Economics Insights in Incentives, Rewards, and Recognition***

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## The Incentive Research Foundation's (IRF) *Using Behavioral Economics Insights in Incentives, Rewards, and Recognition* presents new insights—and challenges long held assumptions—on what makes employees work their hardest.

Offering practical takeaways to apply immediately in incentives, rewards, and recognition (IRR) programs, the IRF's report highlights proven behavioral economics approaches that make sense of—and capitalize upon—the powerful role of emotions in employee performance.

Emerging in recent years as a discipline in its own right, behavioral economics has long been overshadowed by the more readily accepted traditional economics which suggests, among other things, that:

1. People tend to act rationally and in their own best interests when making decisions
2. Money is the most effective motivator of employees

However, because behavioral economics recognizes that 70% of human decision-making is emotional—as opposed to rational—it proves to be a more useful tool than traditional economics in helping employers understand *what* actually motivates employees, *why* some incentives are more effective than others, and *how* they can strategically apply these principles to their own businesses.

Studies indicate that typically only about one-third of employees care about their work. But companies that incorporate proven techniques from behavioral economics into employee motivation programs and other aspects of their business models have a competitive edge and enjoy higher levels of productivity, engagement, and retention among employees than those relying solely on traditional monetary incentives. In most cases, an understanding of the person being incentivized and an appropriate experiential or merchandise reward will result in a far more memorable and impactful reward than cash.

***IRR professionals should test and use the tools and practices in* Using Behavioral Economics Insights *to help determine the rewards and incentives that are likely to generate more emotional impact and produce better employee performance results.***

How do IRR professionals decide which rewards to use and how exactly to use them? It's hardly a surprise that factors like an employee's age, income, and family status all play into how strong an impact a particular reward has on that particular employee. For a truly effective incentive campaign, IRR professionals should also give careful consideration to these subtle, though perhaps seemingly inconsequential variables:

**Ease of selection:** Is the incentive system user-friendly for the employees being rewarded? Do employees need to make multiple decisions or fill out multiple forms? Are there too many rewards to choose from? Are there enough?

**Reward type:** e.g., experience, merchandise, or monetary

**Motivation type:** e.g., internal vs. external; cooperative vs. competitive

**Personalization:** How can the reward be made most meaningful for and therefore most effective at motivating this particular employee? Who does the recognizing? Does the recognition seem to come from an HR representative, an executive level manager, direct supervisor, or the rest of the team?

**Timing:** How frequently should rewards be given? What time of year is best to recognize employees? Does it depend on the type of reward? Should the employee know about the reward in advance or should it be a surprise?

**Desired impact:** What are the long-term goals of the IRR program? How will these be tracked? How can employers and IRR professionals work together to achieve these goals?

The IRR community might be astounded by some of the IRF's findings, many of which are downright counterintuitive. However, the study also sheds light on how to best use these findings and proposes numerous ways to successfully apply these insights in the constantly evolving workplace.

## Top Recommendations

Here are the top recommendations, and the rationale behind them, from *Using Behavioral Economics Insights in Incentives, Rewards, and Recognition:*

### Ease of Selection

**Incentive programs should focus on using nudges (subtle incentive tools/practices) to make the reward system user-friendly and to maximize the program's emotional impact.** Emotionally compelling rewards hit the mind harder, are remembered longer, produce quantifiably better results from employees, and influence the internal brand the most.

### Reward Type

**Employers need to move beyond programs that rely solely on monetary rewards.** For large rewards in particular, experience-type programs involving travel tend to generate warm memories and appeal to more than two-thirds of an IRF survey's respondents over the cash equivalents.

**IRR programs should offer material items and formal recognition more frequently while using intense experiential rewards more sparingly.** *Experiential rewards* (e.g., a tropical getaway or box seats at a premiere sporting event) and *material rewards* such as plaques each have their own unique value as reward types and should be used in strategic combination to complement each other. One type tends to deliver more intense happiness, while the other serves as a more permanent reminder of appreciation.

## Motivation Type

**Reward a top performing team as opposed to using a system in which members of a team all compete against each other for a single reward.** In today's workplace, *cooperative* incentives are more effective and valuable than *competitive* incentives. Emotional pressures cause people to do things they don't really want to do; but it doesn't cause them to do those things well.

**Don't underestimate the value of rewards that reinforce *internal* motivation.** *Intrinsic* rewards increase the recipient's self-esteem by establishing or affirming a sense of purpose, fueling a desire to live up to expectations of peers and social norms, or helping the recipient master new skills. Intrinsic rewards create a long-lasting desire to perform well. For instance, simply celebrating reward-earners publicly by listing their names has measurable, favorable effects on productivity.

## Personalization

**Employers need to depart from a generic, one-size-fits-all model and incorporate creativity and personalization (based upon what matters to the individual and his or her peer group) into rewards.** For instance, a "working vacation"—toiling, for a fee, at a family farm, bakery, vineyard, brewery, or in another romanticized trade—is an increasingly popular example of a reward that incorporates both *intrinsic* and *extrinsic* elements. These "vacations" which include mentoring by experts and impart a new specialized skill upon participants are often a far more appealing choice to individuals who might get restless and bored on a beach vacation.

**Who does the recognizing and how personalized or public that recognition is can have an impact on the employee's emotional response and ultimately the employee's productivity.** One employee may value and appreciate public recognition while another might respond more favorably to private acknowledgement from an esteemed colleague.

## Timing

**Surprise the employee with the reward after the goal has been achieved to avoid the entitlement effect and make it more meaningful.** A reward that is explicitly promised in advance to an employee if he or she achieves a particular goal loses its impact much more quickly than a reward received unexpectedly by the same employee in recognition of reaching said goal.

**Use *hyperbolic discounting* to determine the optimal distribution of bonuses.** *Hyperbolic discounting* refers to humans' tendency to prefer smaller payoffs now over larger payoffs later. In other words, individuals tend to disregard the future when it requires sacrifice in the present. IRR professionals can make the most of this nearly universal phenomenon, by offering initiatives with titles such as "fast start" which accelerate payouts of incentives in the first few months of the program, making the incentives more tangible and generating more early excitement about the incentive opportunity.

## Desired Impact

**Implementing emotionally meaningful incentives in IRR programs has benefits that extend beyond just improving employee productivity.** The more valued a company's employees feel, the better the internal brand impression. Internal brand impression will be talked-up on social media and thereby attract the most talented employees. Eventually, high-performing employees turn into brand ambassadors who extoll the company's virtues to non-employees—including current and potential customers, vendors, and media.

**Ideally, every incentive and reward program will align to purpose and meaning in some way.** If employees believe in the company and its purpose, freely invest in the company, trust their leaders, and develop caring relationships with the people they work with, then the employer becomes an asset in the employees' ledgers that they will instinctively protect. In this situation the employee feels like an owner as opposed to a renter and will act accordingly.

**Rewards programs that prove you truly care about your employees are the most effective ones.** This last insight from the paper ironically draws upon a principle of traditional economics—*nothing ventured, nothing gained*. Many of these recommended practices for designing a rewards system based on behavioral economics require employers to actually care about their people—something that can't be faked. Pulling off emotionally meaningful rewards, in other words, may require a cultural change and a mind-set change on the part of the board, executives, managers, and superiors.

***To view/download a copy of the full study, please visit: http://theirf.org/research/how-to-effectively-harness-behavioral-economics-to-drive-employee-performance-and-engagement/2072/***