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BEHAVIORAL ECONOMICS: A NUDGE GUIDE



Using Behavioral Economics Insights in Incentives, Rewards, and Recognition: A Nudge Guide

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How to Use this Guide

This paper offers a concise guide to applied behavioral economics in the incentives, rewards, and recognition field. Behavioral economics is difficult to define. It combines much from several disciplines, including the fields of traditional economics, social psychology, and neuroscience. Behavioral economics (BE) attempts to identify and comprehend the reasons and motivations behind people's actions and behaviors.

Incentives, Rewards, and Recognition (IRR) is a field dedicated to motivating and influencing people's actions and behaviors. Many volumes might be written about how BE can be applied to IRR. This guide contains only enough examples to scratch the surface, and spark ideas in the IRR professionals who read and use it.

The guide is divided into two main parts:

Part One provides a general understanding of behavioral economics, including its origins and evolution, definitions, uses in a variety of fields, and how it impacts incentives, rewards, and recognition.

Part Two examines the use of behavioral economics by governments and organizations. Included are many examples of its practical uses at work, in marketing, and in governing. Go straight to the green-shaded boxes if you're looking specifically for applications in the Incentive, Rewards, and, Recognition (IRR) field.

Highlights

Green text boxes offer practical tips and advice in applying BE to IRR. Read these to find or spark ideas you can put into action and start testing right now.

Gray-shaded text boxes make points that summarize the passages around them. Read the gray boxes if you don't have time to read a whole section of the report and just want the gist of it.

Part One: The Marriage of Economics & Psychology

[ALLAN SCHWEYER]

Introduction

The purpose of this paper is to review and describe insights and techniques from behavioral economics to demonstrate how they can be applied to the everyday design of incentive, reward, and recognition programs. In essence, this paper strives to help incentives professionals design programs that leverage our best and most current understanding of human psychology.

Behavioral economics (BE) is the academic term behind what many practitioners describe as “nudges.”¹ And while nudges and BE can be used to encourage people to make choices that are not in their best interests, this guide is about good-intentioned nudges—the benign *suggestions* that well-meaning organizations and governments (and people in general) use to encourage people toward better decisions and choices.

Benign nudges encourage actions or choices that are good for people such as investing in matching 401(k) programs, or, in the past, adding potatoes to their diet as a hedge against famine (see sidebar). To put it as clearly as possible, behavioral economics, for the purposes of this guide, is about “using a little psychology” on people—honest and transparently—to help them make better choices.

Nudges

It will surprise no one to learn that our common human desire to avoid embarrassment, reduce or eliminate hassles, feel pride, and to fit in can be very powerful forces. Identifying and leveraging these and other human traits is the focus of behavioral economics. From an incentive professional’s perspective, behavioral economics involves identifying subtle incentives—often referred to as nudges—to influence behavior.

Nudges affect our decisions and behaviors every day. To illustrate, consider a day in the life of Sam, a physician’s assistant in a busy urgent care clinic.

Sam’s Story

On a typical day, Sam gets up early, has his coffee, and reviews his e-mails. Today, one is from his insurance company; it asks him to

The Potato King

In the 1700s, famine in Europe occurred regularly—crops failed and invading armies often stole or burned food.

Frederick the Great of Prussia saw in the potato a solution. Highly filling and weather resistant, it was also a difficult crop to steal or destroy. But Prussians wouldn’t have it. Potato eating was considered strange, disgusting behavior.

As King, Frederick could have issued orders and threatened penalties. Instead, he placed soldiers around the potato fields and instructed them not to be very vigilant. People’s curiosity was piqued; their perception of the value of potatoes changed and so did their behavior. At least some of Prussia’s great success in the period can be attributed to Frederick’s understanding of human nature.

See: http://niemann.blogs.nytimes.com/2012/10/11/the-legend-of-the-potato-king/?_r=0-

Nudge

“A ‘nudge’ is essentially a means of encouraging or guiding behavior, but without mandating or instructing, and ideally without the need for heavy financial incentives or sanctions.”

—David Halpern, Ph.D., BIT U.K.

renew his term insurance or risk losing the benefit he signed up for several years before. It points out that his life insurance represents a much needed financial lifeline for his family should he should meet an untimely death.

Next, Sam drives to the DMV because it’s time to renew his driver’s license. The DMV is on the third floor; a sign by the elevator tells him: “Most people use the stairs.” When he reaches the office and signs the papers for his new license he notices the form has the organ donor option pre-selected, if he wants to opt out, he has to indicate so on the form.

After the DMV visit, Sam drives to the clinic where he works. As he is changing into his scrubs he notices a new sign on the wall saying “Hand Hygiene Prevents Patients from Catching Diseases.”² Later, he reviews a medical case and notices a picture of the patient stapled to the file. Sam leaves work that evening and drives home; he collects the mail and sees a letter from his financial advisor. In it his advisor is asking him to consider increasing the monthly amount he currently sets aside for his IRA. The amount suggested represents the average sum people at Sam’s age, and in his salary bracket, choose to contribute, which happens to be a fair bit more than his current contribution.

Later, after dinner, Sam’s daughter says “Last Friday night Sadie’s mom let me sleep over at her house. It’s only fair to invite Sadie here for a sleepover this Friday night.” “Yeah,” says his son, “that seems fair. And Dad, all my friends are going to the Drake concert on Saturday night. Tickets are normally \$150, but I can get mine from Jamie for \$90 because his mom works for Ticketmaster! And I promise to be home by midnight. Can I go?”

In business, organizations can’t command consumers and today’s leaders can’t (or shouldn’t) command workers. Nudging, therefore, has enormous and wide application.

Behavioral Economics at Work: Sam’s Story

In each of these experiences (whether by design or not) principles and lessons from behavioral economics have been used to influence Sam. By tapping his aversion to loss and especially his reluctance to part with things he’s invested in, the company leverages what behavioral economists refer to as the “endowment effect.”³ Sam’s insurance company almost certainly knows he is more likely to renew than if it had simply stated the new amount and the deadline for payment.⁴ Sam’s insurance company also evokes the “availability heuristic” by suggesting a worst-case scenario (his untimely death).⁵

At the DMV, the sign by the elevator uses the technique of “social proofing”⁶ to increase the chance that Sam will take the stairs by almost 50%. And through the practice of “choice architecture,”⁷ the DMV uses what is known as the “default rule.”⁸ Setting organ donor as the default choice more than doubles the odds that Sam and others will become or remain organ donors.⁹

At the clinic, the sign that encourages Sam to wash his hands is effective because it applies pro-social principles.¹⁰ Many people will respond more readily to a sign that asks them to do something for the sake of others than for themselves, especially where the other party is

considered vulnerable. In this case, the hospital can expect hand-washing behavior to increase significantly.¹¹ And by attaching a photo of the patient to case files, managers expect to trigger greater empathy, translating to better patient care.¹²

The letter in Sam’s mailbox works to “anchor” him on a certain IRA contribution amount and also uses a form of peer pressure to influence his choice.¹³ The author of the letter uses what psychologists call “social proof”¹⁴ by subtly suggesting what others in Sam’s peer group do.

Finally, Sam’s children leverage several BE/psychosocial techniques. His daughter uses “reciprocity” to increase the chances that Sam will say “yes”¹⁵ and his son manages to use two. By using the old trick, “everyone else is allowed to go,” he employs “social norms” and by placing a high initial cost in Sam’s head (\$150) he uses anchoring to make the actual cost of \$90 seem reasonable.

Sam’s children demonstrate two important principles of behavioral economics. First, that BE is rooted in common sense. Anyone with a reasonable knowledge of human nature nudges. Many of us, including kids, nudge frequently, without knowing the technical terms. Secondly, because most teenagers can’t command their parents to do things, they have to develop subtle ways of influencing. In business, organizations can’t command consumers and today’s leaders can’t (or shouldn’t) command workers. Nudging, therefore, has enormous and wide application.

Nudging for Good (and Nudging to Manipulate)

Behavioral economics, social psychology, and neuroscience offer many more practical techniques that incentive and reward designers can use to develop more effective programs. Of course, the same techniques and tools can be used to manipulate and influence choices that only benefit the choice architect (designer) and not the target of their programs. While this paper occasionally references the negative and potentially harmful applications of behavioral economics it is intended to help incentive, reward, and recognition (IRR) designers craft programs and influence choices that maximize the benefits of their programs for the organization as well as for the incentive or reward earner.

In their book, *Nudge: Improving Decisions About Health, Wealth, and Happiness*, Professors Richard Thaler and Cass Sunstein argue that “experience, good information and prompt feedback” cause people to make better decisions.¹⁶ Those who design incentives and rewards can use these guidelines to benevolently assist individuals in making choices that most benefit themselves and their organizations. Our goal in this paper is to lay out these practices in clear, practical terms, using relevant examples, so that designers can begin applying the tools immediately.

All Nudges Are Incentives but Not All Incentives Are Nudges

In attempting to achieve our goals, we have explored and integrated empirical, field-tested evidence of which nudges work in helping

“We build products that work with our physical limitations. Chairs, shoes, and cars are all designed to complement and enhance our physical capabilities. If we take some of the same lessons we’ve learned from working with our physical limitations and apply them to things that are affected by our cognitive limitations—insurance policies, retirement plans, and healthcare—we’ll be able to design more effective policies and tools that are more useful in the world. This is the promise of behavioral economics—once we understand where we are weak or wrong we can try to fix it and build a better world.” —Dan Ariely, danariely.com

people make better choices, and how these proven nudges can be applied used in designing programs to influence employees and consumers. Our findings come from the fields of psychology, sociology, neuroscience, evolutionary biology, philosophy, and neoclassical economics—all of which contribute to behavioral economics.

What is “Behavioral Economics”?

Simply defined, behavioral economics is the application of experimental psychology and behavioral psychology to the discipline of human decision-making, including *economic* decision-making. Unlike traditional economics, which, narrowly defined, assumes that human beings always make optimal, rational, value-maximizing decisions, behavioral economics allows for the effect time constraints and emotions have on our choices.

In applying the principles and tools of behavioral economics, it is useful for the IRR designer to possess a basic understanding of its origins. Traditional (or neoclassical) economics posits that people act rationally and in their own best interests when making decisions. If alcohol or tobacco taxes increase, for example, people respond by drinking or smoking less. In fact, traditional economists often refer to people as “econs,” aptly illustrating their view of human behavior.

Behavioral economics builds on traditional economics by allowing room for human nature and emotions, which also influence people’s choices. Simply put, *“behavioral economics modifies the standard economic model to account for psychophysical properties of preference and judgment, which create limits on rational calculation, willpower, and greed. [It] aims at providing ... sound explanations for empirical findings that the standard model has a tough time explaining.”*¹⁷

Behavioral Economics Extends Traditional Economics

Most behavioral economists agree that people *usually* act rationally and in their own best interests, or at least try to. But it rejects the premise that we *always* make rational and logical choices—even where serious and important matters of money, health, happiness, and business are concerned. Human beings use mental shortcuts (heuristics) to make decisions. Usually, these shortcuts steer us in the right direction and equate to rational thinking, but sometimes they fail us.

Most people struggle with one or more common behavioral problems, such as lack of exercise, overeating, smoking, drinking, procrastination, or impulse buying. We struggle because our best laid plans—e.g., to diet, exercise more, get a project finished on time, etc.—are made in a “cool state.” Nobel Laureate Daniel Kahneman describes this cool state as our slow, “System 2” brain at work.¹⁸ But then emotion works on us. The immediate gratification of, for example, ice cream enters and we rationalize a delay in our weight loss plans. Ice cream often wins because our brains are wired to favor short-term over long-term gain.¹⁹

Similarly, our aversion to loss and risk often distorts our judgment when assessing the risk of immediate loss versus future gain. For example, in experiments most people won’t risk a 20% chance of losing \$1,000 for an 80% chance of winning \$1,400, even though the latter represents “greater utility” in traditional economics terms, or the “better bargain” in plain speak.²⁰ This phenomenon is referred to as “prospect theory” and is, perhaps, the bedrock of behavioral economics in that it so clearly refutes standard economic theory (i.e., that humans always do what is in their best economic interest).

A Brief History

Pure neoclassical economics uses a structured, clean, and mathematics-based “science,” to describe human behavior. It deliberately relies less on the “soft” influences of psychology, sociology, and philosophy. This limited view of human behavior has come under increasing pressure for the past 60 years or so. In the 1950s, economist Herbert Simon proposed his notion of “bounded rationality” or “satisficing.”²¹ Simon sought to account for the fact that humans simply cannot process all the information for all the choices they make and the uncertainty they face, to always make dispassionate, fully informed, and thoroughly evaluated decisions that result in the greatest economic gains to themselves at the lowest cost.

“It is increasingly important to understand both how we view the world, come to judgments and make decisions. We are not nearly as rational or systematic as we think we are. We often see things as we want them to be, not as they are. The influences of triggers, context, framing, overconfidence, System 1 and 2 thinking, and many unseen factors have a direct impact on our decisions and behaviors. It is important first to understand these influencers and then to ameliorate the incorrect and biased actions.” —Dave Forman, author of *Fearless HR*

Later, in the 1960s and 1970s psychologists joined the debate. Gerd Gigerenzer, Daniel Kahneman, and Avos Tversky demonstrated that humans use “heuristics” (shortcuts or rules of thumb) to manage the volumes of information and choices directed at them.²² Though a psychologist, Kahneman’s work in behaviorism earned him a Nobel Prize in *economics*. Many credit Kahneman and Tversky, along with *Nudges* co-author, Richard Thaler, as the founders of BE.²³

As above, Kahneman built on his and Tversky’s work to arrive at his theory of “System 1 (fast) and System 2 (slow)” types of thinking, which, in part, demonstrate that many of the decisions we make every day cannot be assumed wholly rational if only because we don’t spend much time, if any, thinking about them. Most of what we do every day, we do instinctively or habitually (driving the same route to work each day, for example).²⁴ And in other circumstances, even when we call on our slow, System 2 thinking, we “satisfice,” which means we don’t expect to make the best decision possible because there’s simply too much information and too little time. Instead, we make satisfactory decisions within the boundaries of the efforts we’re willing to expend on them.²⁵ Again, *strict* traditional economics does not account for the act of deliberately making sub-optimal choices.

Today, leading behavioral economists, including Dan Ariely, illustrate the flaws in our thinking through experiments in which even simple prompts—such as asking people to recall the last two digits of their social security number—heavily influences the amounts they are willing to pay for items. If a person has a high number in their head (because the last two digits of their social security is a high number) they are often willing to pay much more for the same item than a person who is anchored²⁶ on a lower number. Remarkably, those anchored within the highest 20% of numbers will pay, on average, three times what those anchored within the lowest 20% of numbers in Ariely’s experiments will pay.²⁷

Kahneman refers to experienced judges who, depending on whether they roll a high or a low number using dice before sentencing, impose jail terms that vary by a margin of 50%.²⁸ These and other experiments demonstrate the fragility of most people’s ability to truly decide based on logic and best interests alone.

Even more obvious are our many biases (e.g., our preference for information that confirms what we believe), our lack of self-control (e.g., poor eating and lack of exercise), a predisposition toward optimism, and, on the positive side, generosity (e.g., a willingness to give money and time without expectation of personal gain)²⁹—all of which strict neoclassical economics cannot explain. While traditional economics is often interpreted as characterizing human beings as inherently selfish, behavioral game theory demonstrates that most people have an aversion to inequity and would rather share rewards than attempt to keep them entirely for themselves.³⁰

“It has been said that man is a rational animal. All my life I have been searching for evidence which could support this.” —Bertrand Russell

Moreover, most people respond to social forces. The values, norms, and taboos of a person’s society and the groups, or “tribes” they belong to significantly impact their choices even when sanctions for violating them come with nothing more than disapproval.³¹

Human nature and emotions also play an important role in our decision-making. Indeed, according to Jim Clifton, Chairman and CEO of Gallup, “*decision-making is generally 70% emotional and 30% rational.*”³² Whatever the ratio, behavioral economics accounts for emotion while retaining the constructs of traditional economics. In truth, much of the criticism of behavioral economics by traditionalists and vice-versa might be due to assuming too strict and discrete a definition of the other.³³ In practice, traditional and behavioral economics overlap significantly.

How Behavioral Economics is Relevant to IRR Professionals

Why should the IRR industry care about esoteric probes into the nuances of economic decision-making? The reasons are simple and compelling. Employees make economic decisions when they decide to remain with their current employer and/or perform at their best. However imperfectly, people calculate reward for effort. They work where they receive the greatest

overall reward (both monetary and intangible). The IRR professional who defines incentives broadly, can use BE-style incentives and other knowledge of human drives to make work more satisfying, enjoyable, and rewarding.

Similarly, customers and other stakeholders will assess providers based on the returns they experience as well. Here too, nudges affect consumer behavior in powerful ways. In short, IRR professionals will see far greater returns

“In general, both standard and behavioral economics are interested in the same questions and topics: the choices people make, the effects on incentives, the role of information, etc. However, unlike standard economics, behavioral economics does not assume that people are rational. Instead, behavioral economists start by figuring out how people actually behave ...” —Dan Ariely, danariely.com

by taking human nature and intrinsic motivations into account—by deliberately working with natural human thinking—rather than, inadvertently, ignoring it or unwittingly working against it.

Though behavioral economics has broad application and implications, its rise and acceptance is perhaps more central and critical for IRR designers than those in many other professions.

Traditional incentives and rewards design is influenced by traditional economics. The conventional approach sometimes supposes that tangible rewards and punishments are solely sufficient to drive the performance desired worker performance and the customer choices.

The behavioral aspects of the traditional IRR approach are often rooted in ideas developed by scientists like B. F. Skinner. Skinner’s work put forward the simple notion that rewarded (reinforced) behaviors are repeated. This mindset appeals to corporate decision-makers because it provides a simple, actionable path to energize and execute the business’ strategic plan without having to worry about complex psychology: 1) create a corporate strategy, 2) determine what specific tasks, goals, and sub-goals are needed to implement the strategy, and 3) reward employees *extrinsically* for completing their tasks and achieving their goals.

While an extrinsic approach is serviceable and relevant, BE posits that an *overreliance* or *sole* focus on extrinsic motivators is based upon an incomplete understanding of human motivation and therefore inefficient. A well-known motivation expert from the industry points out, *“After twenty plus years of focusing on building customer loyalty, are customers any more loyal? After twenty plus years of focusing on greater employee engagement, has employee engagement really improved? For most organizations, the honest answer is either no or only a marginal improvement. And in many cases, things have actually gotten worse.”*³⁴

“From a behavioral economics perspective, high performance organizations recognize the need to understand and accept human nature at the individual level, person by person, and to leverage it to drive performance. Human nature dictates that every individual has a unique set of characteristics, strengths, and weaknesses.” —Gallup, 2009

Behavioral economics allows for the efficacy of extrinsic rewards but also emphasizes the intrinsic—giving IRR designers many more arrows in their quivers.

Today, fewer IRR designers rely *solely* on tangible rewards and punishments in driving behavior and optimal performance. Instead, the designer of today is often a student of engagement theory and the psychology of influence, and recognizes the importance of both intrinsic and extrinsic motivations. As such, they are already pre-disposed to benefits from the tenets of behavioral economics. As part of a broader management team, IRR designers can offer deep expertise in the use of tangible and intangible incentives and rewards, including the art of nudging.

Applying Behavioral Economics

The definition of behavioral economics should be of less practical interest to IRR designers than its application. As our economy increasingly emphasizes ideas, innovation, and creativity, workers’ cognitive skills and abilities come under increasing demand. And to some degree, consumers’ preferences and loyalties become more difficult to understand and capture. The more creative, dynamic, and brain-based the work and our economy, the more difficult it is to motivate workers or consumers using extrinsic rewards alone.³⁵

No wonder then that more and more, leaders demand new and better ways to maximize creative workers’ engagement and performance, and expect ever more original solutions

“[Leaders] must abandon outmoded views of human nature by recognizing that people simply are not the rational maximizers of economic gain assumed by classical economic theory.” —Gallup, 2009

from compensation, HR, IRR, and—where consumers are concerned—from marketing and IRR professionals.

Though this paper focuses mainly on the workplace and minimally on the marketplace, much of what IRR designers learn to apply from BE to affect employee engagement, motivation, and performance, will pertain equally to sales channel partners, customers, and other external stakeholders.

Allowance for human nature is the biggest difference between traditional economics and behavioral economics. BE borrows as much or more from psychology as economics.³⁶ Economics concerns itself with individuals and households only in understanding how they make market decisions. Psychology, however, concerns itself with the actual individual—their behaviors, aspirations, and influences—whereas economics focuses on the market. Accordingly, behavioral economics will have great relevance to IRR professionals as today’s IRR designer spends more and more time crafting individualized incentive plans.³⁷

Regardless of the definition, or where behavioral economics (BE) ought to land as a discipline, its uses are vast. Governments devote significant thought and resources to implementing BE tools and architecting citizens’ choices to nudge them toward decisions that are generally better for society, and for the individual (though sometimes only in the long-run).³⁸

Of course, organizations and businesses make use of BE in myriad ways as well.³⁹ BE is used to encourage better decision-making among employees (for example, to contribute more to retirement accounts, pay more attention to safety policies, and enroll in wellness programs) and to persuade customers.

“We do AB testing to test different variations of the same offer to different people. 10,000 random people might see one version and 10,000 see another, it’s a great way to test several messages and see which one gets the best response.” —Randy Rodriguez, Digital Group Design Director, Accenture.

Test Everything

BE instruments and tools, even principles, no matter how tested and consistent, should not be relied upon without first testing your assumptions. In other words, we may know from decades of research that social proofing works, for example. After all, merely telling people how the majority of their peers actually behave or believe (“pluralistic ignorance” and “false-consensus” effects) has changed people’s tastes, perceptions, beliefs, and behaviors ranging from attitudes about racial segregation to behaviors such as alcohol consumption, littering, and even persisting too long with a failing business strategy.⁴⁰

Still, despite the apparent ease in leveraging societal norms to exploit people’s desire to conform, in some cases it doesn’t work, and the reasons remain a mystery. The sign in the clinic used in the introduction above, for example, may have no impact—or even result in fewer hands washed—in another clinic or hospital. A BE tool that works at an ice cream parlor might fail miserably in a clothing store. No one can say why, the point is that the tools of BE aren’t laws.

Instead, IRR professionals should experiment using a variety of BE approaches to see which work in what circumstances. In the United Kingdom, for example, the government’s Behavioral Insights Team (BIT)—a group of experts put together to apply behavioral economics practices to policy issues—published a website that used social proofing in a message to encourage organ donation, “Every day, thousands of people sign up to be donors, please join them.” It failed

completely. However, the BE tool of reciprocity worked extremely well in another variation of the same website: *“If you needed an organ, wouldn’t you want someone to donate an organ?”*

Only by trying several messages using various techniques borrowed from BE and psychology (in this case, eight variations of the message were served randomly to more than one million website visitors) did the BIT get it right, resulting in about 100,000 additional organ donors per year.⁴¹ Multivariate testing on websites, from the basic testing of two variables (AB testing) to more complex multinomial testing of several or many variations is often inexpensive and can be enormously revealing.⁴² This approach, combined with a broader evidence and data-based philosophy, will help IRR professionals better design and evaluate their initiatives.

“A growing body of evidence demonstrates that behavioral science insights—research findings from fields such as behavioral economics and psychology about how people make decisions and act on them—can be used to design government policies to better serve the American people.” — Barack Obama, Executive Order, September 15, 2015

Designers should also include extrinsic incentives in their tests. In some cases, they will work better than behavioral nudges and intrinsic motivators. According to Professor Uri Gneezy, co-author of *The Why Axis*, *“Incentives . . . are not necessarily offensive or morally repugnant devices that only erode natural motivations to do the right thing. Incentives and disincentives are at the root of all activity, sometimes they’re subtle and intrinsic, other times they’re blunt. The key is to experiment with what works and what doesn’t so that you get your offers and incentives right as quickly as possible.”*⁴³

Behavioral Economics at Work

As above, behavioral economics is more psychology than economics. As psychologist Daniel Kahneman points out, the government behavioral insight team set up by the United Kingdom (and subsequently in the United States and many other countries) may be perceived as “doing behavioral economics” but they are in fact “doing social psychology.”⁴⁴

However, leaders might be reluctant to *be seen* to be using psychology. Indeed, when the U.K. government erected the BIT in 2010, the idea was met with heavy skepticism and even public suspicion of its motives.⁴⁵

Due to its string of quick successes, however, Britain’s BIT has overcome most of its detractors’ concerns and grown 400% in size since 2010,⁴⁶ suggesting that BE *at work*—whether one considers it economics or psychology—can offer a great deal to government, businesses, and the IRR professional.

BE gives leaders insight into how employees and customers behave. And although the deliberate use of BE in organizations is only emerging—at least beyond marketing—those firms that use BE principles may already do better than those that don’t (85% better according to Gallup⁴⁷). Indeed, Gallup argues that leaders should view “applied behavioral economics” as the next breakthrough business discipline,⁴⁸ because applying the techniques of BE leads to emotionally engaged employees and customers.⁴⁹

In that BE identifies and leverages the critical role that emotions and other forms of human nature play in our decision-making—whether as employees or consumers—the benefits of understanding BE principles and knowing how, when, and where to apply them is critical and should not be ignored.

For IRR designers, tapping emotional engagement through a sophisticated choice of rewards and incentives, for example, or designing consumer loyalty campaigns that appeal to customers' sense of identity, for example, can yield much higher than normal results. In each scenario, the IRR designer is probably borrowing from the field of BE.

IRR designers may be surprised to learn that they are already using BE tools to motivate and influence the choices of employees, partners, and customers. Much of BE is common sense; a good appreciation of human nature and psychology leads many incentive designers to use the same or similar techniques that the field of BE is credited with “discovering.”

IRR professionals will gain from a more complete understanding of BE. In part, to understand the various ways it can be put to good and ethical use, and also—if they are unaware of the psychological impact of their actions and decisions—to avoid running afoul of the principles unwittingly. Improper framing and ignorance of people's aversion to loss, for example, can turn tough decisions into disastrous choices simply in the way they are presented. In other words, *at the very least* today's IRR professional must be aware of the principles and impact of BE on people's motivations and actions.

Summary Part One

This paper focuses on BE principles, including nudges, and the tools and techniques most applicable to IRR professionals. To help make sense of the hundreds of BE terms, practices, and techniques, in use, the “EAST Framework,” designed by Britain's Behavioral Insights Team ⁵⁰ is referenced in Part Two as a structure for using BE in the workplace.

EAST means Easy, Attractive, Social, and Timely. When initiatives, including incentives systems, are applied using this framework, they are bound to include and align with most, if not all of the principles and techniques of behavioral economics.

The definitions of traditional (aka standard or neoclassical) economics and behavioral economics matter less than how they are applied in organizations—at least for the purposes of this paper. Just as traditional economics has benefited organizations tremendously, behavioral economics—borrowing from a range of disciplines and building on traditional economics—should propel organizations that use it to entirely new and higher levels of productivity and success.

For IRR professionals, an understanding of behavioral economics will help designers know when and what tools and techniques to apply, and assist them to avoid violating BE principles, leading to better incentive program design. IRR professionals might even re-envision their role to include actively helping leaders and professionals across the organization to test and use BE and apply human nature and social psychology techniques to incentivize better choices. IRR professionals who use BE techniques to engage employees, customers, and other stakeholders at an emotional level, and to architect better choices for their organization and its employees and customers, stand to generate tremendous value.

“The ‘reward recognition talk’ is key—emotions drive our decisions, it's not machine-based. We want our hearts to be involved, something that connects us to a higher purpose.” —Incentives expert, Oct 2015

Part Two:

The Practical Application of Behavioral Economics in Incentive, Reward & Recognition Design

Starting as early as 2008, governments, including those in the United Kingdom, Australia, Canada, Denmark, France, Saudi Arabia, Singapore, and the United States, to name just a few, began experimenting with the intentional use of behavioral economics in social policy,⁵¹ in order to introduce “a more realistic model of human behavior into policymaking.”⁵²

By prompting or gently nudging people toward decisions that are better for themselves and society (e.g., the environment, health, crime reduction, tax collection, etc.) politicians and policy makers hope that governments can avoid the more common heavy-handed and expensive “carrot and stick” approach to influence (banning smoking or sugary drinks or enacting bicycle helmet laws, for example); effect much greater positive behavior change, simplify government,⁵³ and save billions of dollars in the process.⁵⁴

Hyperbolic Discounting

“In essence, hyperbolic discounting is the human tendency to prefer smaller payoffs now over larger payoffs later, which leads one to largely disregard the future when it requires sacrifices in the present.”

—Alan Bellows

“Hyperbolic discounting has been applied to a wide range of phenomena. These include lapses in willpower, health outcomes, consumption choices over time, and personal finance decisions.”

—Joseph P. Redden, Behaviorlab.org

Government’s experiences with BE suggest that to the extent that incentives experts are willing to re-imagine their roles in organizations, knowledge and use of BE might contribute across virtually every component of the business. For example, an IRR professional with a good understanding of “hyperbolic discounting”⁵⁵ (see sidebar) might advise compensation experts on a more optimal distribution of bonuses. For example, initiatives with titles such as “fast start” 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. An incentives professional who understands how the timing of a message impacts behavior might assist HR in reducing the incidence of exaggerated expense claims; and one with experience using social psychology might help leaders to better engage and retain their best workers.

In general, many BE interventions in the realms of social policy, healthcare, marketing, and advertising—and at work—have met with tremendous success to date. Most BE initiatives involve simple tweaks or nudges and cost almost nothing. The examples below are pulled from the more

Applying Hyperbolic Discounting in IRR

The human tendency to inertia and procrastination is well illustrated by the “Save More Tomorrow” program. In it, employees have the option of allocating a portion of their future salary increases toward retirement savings. The program leverages several aspects of behavioral economics related to making desired behaviors easy.

Save More Tomorrow recruits employees when they are feeling flush (around raises). Then it asks them to commit to increases in future savings rates down the road, as they earn salary increases. This cuts through people’s “present bias” by pushing the pain off into the future. Hyperbolic discounting suggests that most people tend to weigh present events greater than future ones. For example, experiments show that many people would take \$50 now rather than \$80 a year from now. However, the same people will almost always choose to receive \$800 in six years rather than \$500 in five years.

The Save More Tomorrow approach eliminates friction by making increases in retirement savings automatic each time a person receives a salary increase. In many cases, the program triples average saving rates for retirement plans in relatively short order. The program takes advantage of inertia and procrastination, by making choices automatic. It makes it very easy for people to choose to save.

“By inviting employees to join a few months before their raise, the plan takes advantage of the fact that for most of us, our self-control intentions about the future exceed our implementations in the present. For example, given the option of going on a diet three months from now, many people will agree. But tonight at dinner, that dessert looks pretty good.”

—Richard Thaler, University of Chicago

Interestingly, other experiments have boosted retirement plan participation even further by attaching a digitally altered picture of the employee depicting them at an older age. This triggers emotions, i.e., empathy for one’s future self, borrowing from the BE principle of Attraction (see below).

IRR designers should understand that choice itself is always part of the appeal, as is transparency. For example, in mailings for fundraising in which recipients are given a clear choice to opt-out of future solicitations, significantly more gifts are received than from those that include opt-outs in the fine print or not at all. Giving people the choice may engender more trust and therefore more giving.

How might hyperbolic discounting work in an incentive program? Smaller rewards given immediately may be more motivating than the promise of larger rewards several months down the road. If you want to generate excitement now, about a bigger reward down the road, think about a series of related contests or spot rewards along the way.

than one hundred real-life interventions and field-based experiments examined in this study. Wherever possible, simple and brief examples are used. In each case, suggested use cases are included for IRR professionals, meeting/travel planners, and/or incentives providers. However, readers should imagine how they might employ the techniques to incentivize and influence better decisions and outcomes in their own organizations.

The techniques, tools, and practices illustrated below are best organized and understood using the simple framework referred to in Part One, called EAST. Again, EAST stands for Easy, Attractive, Social, and Timely. Most of the critical techniques from behavioral economics fit into one or more of these categories.

To the extent that incentives experts are willing to re-imagine their roles in organizations, knowledge and use of BE might allow them to contribute value across virtually all components of the business.

“Sometimes it’s about how the reward is given. Many in the workforce want to know why their work is important—what their role is and to be able to connect it to a purpose and mission. So to make the non-cash reward more personal and memorable, make it more than a deposit into a bank account. The reward & recognition talk is key because emotions drive our decisions not machines. We want our hearts to be involved, something that connects us to a higher purpose. The European Economic Association recently did a study of 139 working students. They all earned the same base salary but one group was given a small performance based bonus, and the other group just received a talk about the purpose and meaning of their work, including the impact it had on others. The motivational talk increased performance 20% more than in the performance bonus group. This is at the heart are a lot of the BE principles—emotion, purpose, meaning and giving.” —IRR industry practitioner and expert

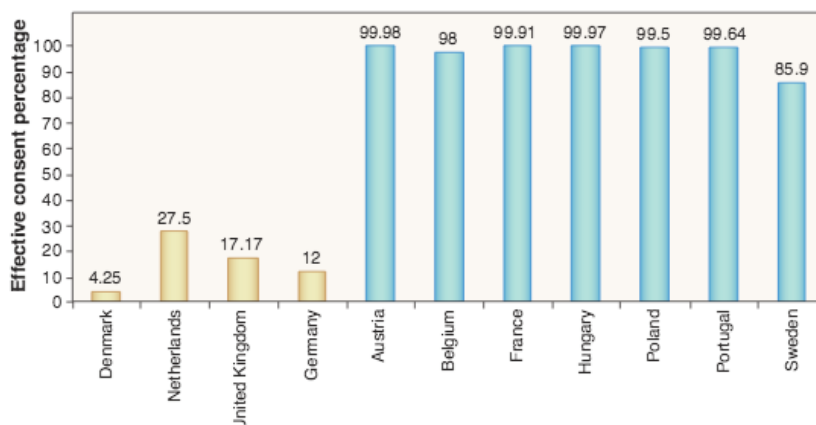
E – Easy

Default Options and Choice Architecture: Easy but Powerful

The designer wields great power in simply choosing the default option on a form. Consider that between 1995 and 2002, more than 45,000 people died in the United States alone waiting for organ donors, and more than 120,000 are on current waitlists.⁵⁶ 85% of Americans are in favor of organ donation, yet only 28% choose to consent to donate their organs in the event of death.⁵⁷ In other words, many Americans who want to be organ donors aren’t. They need a friendly nudge.

This is a perfect opportunity for a government that doesn’t want to restrict or remove choices, but wants to encourage people to make better decisions—in this case for society and also to help people do something they want to do. In nations that have made consent the default option, organ donation jumps to nearly 100% (see Figure One).

“We can only process so much information. The organization has a duty to process, or curate it for employees. A lot of our work in program design is in creating clarity and simplicity around ‘what do you want me to do, and how do you want me to do it,’ and then adding the feedback along with the recognition and rewards of ‘what’s in it for me?’ We’ve moved way past the salary and bonus, it’s a methodological approach in our design intended to reduce the complex to the simple, and getting as much clarity as possible at the employee level.” —IRR industry practitioner and expert



Effective consent rates, by country. Explicit consent (opt-in, gold) and presumed consent (opt-out, blue).

Figure One: The Default Option in Organ Donation

But the “easy” principle goes beyond choice architecture. As described in Part One, one of the foundational components of BE is our use of heuristics (mental shortcuts) in making decisions. Rather than gather and analyze all the information we need to make many choices, we use shortcuts, such as “if it ain’t broken don’t fix it.” Making decisions takes time and requires most, if not all of our attention. It’s hard, so we avoid it.

A good example comes from Lowe’s Hardware. In 2008, the company wanted to save money by encouraging employees to accept home delivery of prescription medications. At the start, uptake by employees was stuck at 5%. Lowe’s teamed with Express Scripts (a supplier of “select home delivery”) to intervene with its employees at pharmacies and by mail to ask them to make a conscious choice—continue to go to the pharmacist to fill their prescriptions or accept home delivery.⁵⁸ Express Scripts offered to remove any hassle by completing the required paperwork itself and contacting patients’ physicians on behalf of those who signed on for home delivery. In short order, home delivery went up 300%⁵⁹, saving Lowe’s millions dollars year after year. The lesson is that many Lowe’s employees wanted home delivery but they required a simple nudge and they needed it to be made easy.

Using the Default Option and/or Choice Architecture in IRR

A large national railroad in Europe wanted to drive a little extra revenue for the company by influencing customer’s choices using a nudge. The railroad charges a small fee for passengers who want to reserve seats when they purchase tickets using the railroad’s online system. However, only 9% of passengers chose to do so. By changing the default option so that seat reservations are included automatically with ticket purchases, 47% of passengers pay the additional fee (a few Euros). Passengers can easily deselect the default option and not reserve a seat, but only about half do so. A simple nudge now earns the railroad an additional \$40 million each year.

IRR professionals might use the default option nudge to encourage employees to sign up for incentive contests, or to participate in company retirement savings programs, for example. According to researchers, “smart defaults can take age and income into account when determining investment allocations for new employees who are joining retirement plans.”

Governments and companies have learned that as with organ donation, simply changing the default option on retirement savings plans leads to an enormous uptick in the numbers who participate and amounts saved. Indeed, the simple and inexpensive technique of making participation the default choice results in participation rates that are 8.4% higher in the United States than those without the default option and up to 48% greater among newly hired workers.⁶⁰ In the United Kingdom, switching the default option on general public retirement savings program increases participation rates from 60% to 80%.⁶¹

Making it Easy: Simplification & Clarity

The government of Singapore wanted to encourage greater retirement savings among its citizens. In Singaporean fashion, the eventual solution would be made mandatory, but the government wanted to ease its introduction, gain support, and avoid backlash. It used the BE principle of ease and simplification to reduce the number of savings plans from 12 to 4, and it pre-selected the plan (the default option) that it felt made the most sense for the average Singaporean (both examples of choice architecture). It also borrowed from the principle of “attraction” (the “A” in EAST, see next section) by changing the name of the plan from the CPF Longevity Insurance Scheme (which people associated with a death benefit) to CPF Lifelong Income for the Elderly or “CPF LIFE.”⁶²

“Our work in incentive program design is in creating clarity and simplicity. We’ve moved way past the salary and bonus. It’s a methodological approach in our design—reducing the complex to the simple, and getting to clarity at the employee level.” —Industry expert and practitioner

The change in name above also draws on the BE technique of “framing.” In this case, the name change positions the program differently to avoid an initial negative reaction or inaccurate understanding of the program.⁶³ Using similar techniques, opponents of the Affordable Health Care Act in the United States used the term “death panels” to frame a component of the new health care law, thus creating doubt and fear in the minds of many Americans.⁶⁴

Perhaps the most famous example of choice architecture by limiting options comes from—of all places—the jam business. In 2000, psychologists Sheena Iyengar and Mark Lepper demonstrated that small displays featuring only six varieties of jam resulted in ten times more sales than large displays with many more choices.⁶⁵ It is important, however, not to infer from studies like the above that choice is undesirable, the lesson is that the clarity, simplicity, and ease of limited choice is often better.

Curating Choice in IRR

Like the museum curator who filters our choices so that we are not overwhelmed, incentives designers must find the balance between too little and too much choice. This relates to our psychological need for heuristics (shortcuts) to manage the onslaught of information we face every day. Organizations that offer good shortcuts can reap significant gains.

Consider whether catalogues of merchandise reward options might be overwhelming, for example. Might having to choose between an array of possible rewards attract some people to the easy choice of cash? Where providers offer businesses reward solutions, less might be more. Especially if less means better curated and well-selected options as opposed to everything under the sun.

Making it Easy: Eliminating Hassle

In the early 1990s, the United Kingdom deregulated energy markets, but by 2010 only 10% of households had switched energy providers, despite average potential savings of about \$350 per year.⁶⁶ In deregulating the markets, policy makers assumed people would act rationally and in their best interests per the tenets of standard economics. Few did.

Even though 91% of U.K. consumers knew that switching was possible and that it was likely to save them a significant amount of money, the problem persisted.⁶⁷ The U.K. government's BIT determined the main barrier: switching is a hassle. Changing providers requires knowing who your current provider is, learning something about your usage patterns and then shopping for the best alternative among many providers.

In 2015, the U.K. government's BIT won approval to require energy companies to add QR codes to customer bills, containing usage patterns and cost information. QR codes allow customers to scan their energy bills using a smartphone. Then, using a free switching app, they can instantly assess their usage patterns against offers from each energy company. Within a few seconds consumers learn which option is the best for them. This process removes much of the hassle from the process and, based on early indications, is expected to increase switching at least four-fold and save consumers millions.⁶⁸

In organizations as in nations, leaders struggle with the amount of information they should disclose. In the United States, a recent push for transparency has led to the principle of "smart disclosure,"⁶⁹ in which governments aim to convince retailers, insurance companies, and others to provide information to people, about themselves, that can remove barriers and make it easier to make better decisions. More information leads to more innovation—like smartphone apps that make quick sense of the information—and ease the path to better decisions by making them easier.

In Denmark, the non-profit Danish Nudging Network tested a variety of approaches to reduce littering in public places. One-third of Danes used to litter regularly even though 90% claim to be concerned about it. By painting large green footprints leading to trashcans, (BE Term: "action devising") littering was reduced by 46%.⁷⁰ Danes care about clean streets, and littering is a violation of social norms; yet busy Danes still need prompts and nudges to remind them—they need the hassle of looking for a trashcan removed so that they can do the right thing. Conventional wisdom might have resulted in using a sharper stick (fines) to combat littering, but the gentle nudge worked significantly better. Copenhagen is now ranked among the eight cleanest cities in Europe and trending toward number one.⁷¹

Designers should never underestimate the power of making a desired behavior easier or more difficult depending on the behavior they wish to encourage. In the United States, under-privileged students' college applications were made easier by using computers to pre-fill most of the fields (recall Lowe's efforts to get employees to switch to home delivery of prescription drugs). As a

Easy, for the purposes of BE, means making a behavior or action involve more or less hassle.

If the behavior or action is desired, make it easier. If it isn't desired, make it harder. This sounds simple but it has been shown to be powerful enough even to effect suicide rates.*

*see David Halpern, *Inside the Nudge Unit: How Small Changes Can Make a Big Difference* (WH Allen: 2015), Loc. 1005

result, college applications among the target group increased more than 25% and scholarships by more than a third.⁷² It seems a large number of people don't go to college or collect free scholarship money—highly consequential decisions—because filling out the forms is too much of a hassle.

A foundational principle of behavioral economics is that we all look for “easy” when making hard decisions, which is the entire premise for heuristics or shortcuts. Again, heuristics are necessary and usually beneficial, but they can also lead us astray. “Reputation mining,” for example, played a central role in the 2008 financial crisis. Before the 1970s, credit rating agencies were independent. Since then they have gradually collected a higher portion of their fees from investment firms. Before 2008, ratings agencies that awarded low ratings tended to receive less business. Rating agencies had grown reliant on the very organizations they were meant to assess and report on.

In the 2000s, complex derivatives, including “mortgage-backed securities” attracted many buyers with their good returns. Few understood the securities, but consistent good returns provide a powerful mental shortcut in making investment decisions. Another shortcut available to investors was the rating agencies. After all, the agencies were trusted, having played an honest and competent role in the U.S. financial system for almost 100 years prior. The raters awarded mortgage-backed securities the highest “triple-A” rating 2007–2008. People were sold what was essentially a rotten product at premium product prices. The agencies probably knew the securities were rotten, but were silent. As long as the buyers took the bait, bankers offered the rotten fruit until the entire system imploded.⁷³

The 2008 financial crisis provides many examples of applied BE. In this case, because firms know that investors have to make complicated investment decisions using shortcuts (heuristics), they exploited the weakness and very nearly collapsed the world's economy as a result.

Removing Hassle in IRR

Designers can follow several simple guidelines in removing hassle to encourage behaviors and actions. For example, an incentives professional with knowledge of BE might work with HR to develop easier health insurance coverage forms by reducing their complexity or even designing default options that suit the various demographic groups in the company.

IRR professionals that want to discourage certain behaviors or choices, for example, might deliberately add inconvenience and hassle to the process. In designing defaults for joining the 401(k) program, for example, simply making people deliberately complete and sign a part of the form to opt out will increase the number of people who opt in to 401(k) plans.

IRR professionals can encourage greater enrollment in a rewards program or in a peer-to-peer recognition platform by simply ensuring that hyperlinks lead directly to the registration page rather than an interim landing page—this alone has been shown to increase registrations by 20%. Designs that pull information from other systems so that registration and other forms complete themselves, to the extent possible, result in even greater enrollment.

Attraction: Clarity, Personalization

Obesity has reached epidemic proportions in the United States and elsewhere. One third of American adults and children are reported to be obese today, and at current trends, 50% will be obese by 2030.^{74 75} Schools in the Netherlands have found (no surprise to parents anywhere) that children’s consumption of whole grain brown bread doubles just by cutting it into appealing shapes—a BE technique that falls under “attraction.”⁷⁶

Similarly, the U.S. government has simplified its food guide graphics over the years from the confusing diagram in Figure Two to the clear message in Figure Three.



Figure Two: USDA Food Pyramid 2005

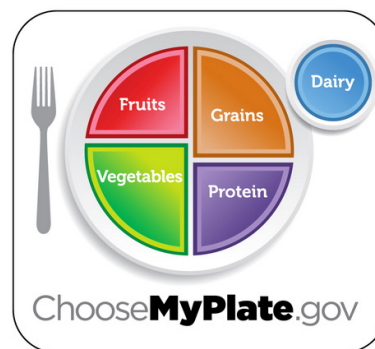


Figure Three: Food Guide 2015

In school and workplace cafeterias around the world, other experiments have succeeded in changing diners’ behavior by presenting healthier choices at eye level or putting whole fruit in convenient places (e.g., at checkout) and by juxtaposing the colors of various fruits and vegetables to exploit their natural appeal. By combining the BE principle of ease with the principle of attraction, the effects are compounded. Many cafeterias have found that by introducing a slight hassle—moving candy, chips, and chocolate to less convenient places—consumption decreases and the selection of healthy choices improves by up to 70%.⁷⁷

Attractive in BE terms means nudging people by drawing their attention to words or things in order to influence their choice.

In other experiments, the use of smaller plates to discourage large portion sizes has been shown to reduce consumption.⁷⁸ And, of particular interest to IRR professionals, when designers add direct incentives, the effect might be amplified yet again, at least for some audiences. Experiments in Chicago, for example, revealed that children choose cookies over dried apricots as a snack nine times out of ten. However, when a small prize, like a pen or wristband is offered with the fruit, 8 out of 10 choose the fruit and almost 4 in 10 continue to choose fruit (without a prize) even a week later.⁷⁹

In Australia, the government’s nudge team wanted to change citizens’ behavior to encourage payment of traffic tickets. The team sent variations of a letter to violators to see which worked best. Inserting “Pay Now” in red letters at the top of the form increased payments by about 15%. And by adding the traffic camera photo of the person’s car in the letter, payments increased by another 20%.⁸⁰

Imagery and Salience in IRR

Wherever possible, IRR professionals should use personal messages aimed at individuals by name, whether attracting people to an incentive or in presenting awards. This might seem more obvious than using imagery to make something more attractive, but IRR professionals and meeting planners make full use of the beauty of their destinations in promoting their programs. Designers could go further by using imagery to help potential reward earners visualize themselves in an exotic location or using a coveted type of merchandise, for example. Even photos featuring people they know from prior years in which offsite travel has been awarded will connect much better with most people than the commercial brochures from those places alone.

In Melbourne, officials contracted an artist to paint a spectacular mural on the staircase of its Southern Cross transit station, through which about 800,000 commuters pass each day. The artwork led to roughly 25% more people taking the stairs during rush hour, and 140% more during the rest of the day.⁸¹

Increasing the attraction or salience of a message by adding better images and graphics and using people’s names, emotional imagery, or an attractive painting—as in the Melbourne example above—make your messages stand out.

S – Social

Social: The Power of Social Norms

The need to fit in is a powerful and universal driver of human behavior. Most theories of motivation, from Maslow’s hierarchy (love & belonging)⁸² to Lawrence and Nohria’s “Four Drives”⁸³ (“bonding”) include it as a central tenet.

Behavioral economics leverages the drive to bond using a variety of nudges, each simple and remarkably easy to use. In causing people to make better choices about their health, for example, nudging using social norms has improved millions of people’s decisions concerning the five leading causes of death—heart disease, cancer, stroke, lung disease, and diabetes.⁸⁴

In the United States and elsewhere, binge drinking on campus is considered a serious problem—one that sometimes leads to other negative consequences including higher drop-out rates and increased incidence of assault. A number of experiments have shown that telling students the truth about other students’ drinking habits reduce alcohol consumption.⁸⁵

On most college campuses, a significant majority of students do not drink to excess. Yet, because it is easier to see and hear students who are partying than students who are studying, many overestimate the amount of drinking other students are doing. In behavioral economics terms, this effect is known as the “availability heuristic,”⁸⁶ which means that we use the loudest or closest information as a shortcut—extrapolating and generalizing it, often in error.

“Social proofing plays a big role in what we do. We look to our networks to learn and then to share and broadcast what we’re doing. The influence of those around us is rooted in Human nature and there is a growing appetite for using this type of science in IRR.” —IRR industry practitioner and expert

To nudge students toward making better decisions about alcohol consumption, universities have placed posters around campus stating the actual percentage of students who do not drink to excess (i.e., “Did you know that 64% of XYZ University students consume fewer than 6 alcoholic beverages per week?”). This simple technique can reduce alcohol consumption on campus significantly.⁸⁷ Moreover, by adding other techniques—for example, from attraction, by addressing messages by name to individual students, and citing the same statistics (by mail, e-mail, text, etc.)—the effect is amplified. As above, personalizing messages adds salience, another BE technique.

In BE terms, “social” involves the influence of norms, peer pressure, and the human desire to fit in as powerful means of influencing their behavior and choices.

Applying the Availability Heuristic in IRR

For the IRR professional, it is important to take heed of the availability heuristic because employees or consumers who do not see others being rewarded may consciously or subconsciously conclude that the organization doesn’t value them. Simply celebrating reward-earners—listing their names, or in the case of consumers, sharing stories about how the organization rewards its best customers—is necessary. And, of course, this is a commonplace practice—again, much of BE is common sense but it is important to remember the principles nonetheless.

Social Forces: Peer Pressure

Most nonprofits and charities know that “matching grants” generate more donations, in part due to social forces. Yet whether you match donations 1:1, 2:1, or even 3:1, the increase is the same.⁸⁸ However, in the case of political fund raising campaigns, if you have a liberal cause and you send a matching grant campaign to liberals in a conservative state, you’ll get more donations (per person) than from liberals in liberal states.⁸⁹ Matching grants may have more appeal when donors feel they must band together to have an impact. This effect demonstrates nuances in the broader social principles of BE and are discussed in more depth in Part Three, in which the drive to defend is discussed.

Social Influences in IRR

With 80,000 worldwide employees, and wanting to be “One Roche,” Roche Pharmaceutical has a big challenge involving different languages, geographies and cultures, not to mention the enormous variety of job roles and functions. But Roche has managed to move everyone onto one enterprise platform for work processes, and it uses the universal platform to emphasize common company values, including a social tool around peer-to-peer recognition.

In the first year of its deployment, Roche saw great improvements in team dynamics and team recognition. Designers kept it simple, helping users make decisions very quickly about how to recognize their peers. More than 500,000 recognitions in manager and peer-to-peer recognition occur now each year and across all roles. Roche sees this as a vital tool in reinforcing its values, in creating alignment across the organization, and in building a culture of recognition.

T – Timing

Timing: The Right Message at the Right Time

Behavioral economics has been used in sales and marketing for decades, long before it was discussed or labels were put to it in academia. Retailers allow us to buy now and pay later, fully tapping our “present bias” and our tendencies toward hyperbolic discounting. Visit any software-as-a-service website or car dealership to see how marketers use the default option and various other forms of choice architecture to suggest packages of service. Many nudge us further by telling us the option most people choose (social norms).

Savvy retailers are well aware of the negative effect too many choices can have on their sales; they simplify things for us by reducing our options and making it as easy as possible to buy while sometimes making it very difficult to quit, (e.g., service subscriptions, memberships, etc.) They trigger “loss aversion” as well: credit card and other loyalty programs know we are loath to forfeit the points or miles we’ve accumulated and will pay annual dues and other fees rather than cancelling our cards.

From a “timing” perspective, marketers take advantage by influencing our choices to sign annual versus single use contracts with fitness clubs, often in January after we’ve made our New Year’s resolutions. Nonprofits and charities send most of their donation appeals in the weeks or months before Christmas.

Timing: Data Analytics

But timing is often used in very subtle ways as well. An insurance company felt sure that many of its customers underreported the number of miles they drove in a year in order to receive lower premiums. Normally, insurance forms include declarations of honesty and accuracy at the bottom of the form where the applicant signs. By moving it to the top of the form (timing), the company reminded customers of their own self-image as honest people and saw an increase of 15% more miles claimed by applicants.⁹⁰

In a now famous example of timing, retailer Target figured out how to data-mine its way into predicting when a woman is pregnant (and in which trimester) depending on her shopping patterns. Target, like many other retailers, assigns every customer a Guest ID number, tied to their credit card, name, or e-mail address that becomes a bucket that stores a history of everything they’ve bought and any demographic information Target has collected from them or acquired from other sources. Using that data, analysts look at historical buying data for all the women who sign up for its baby registries.

Analysts noticed that women on the baby registry load up on supplements like calcium, magnesium, and zinc sometime in the first 20 weeks of pregnancy, and women buy larger

“In BE terms, timing can be a very effective choice driver. From when we make offers to when and in what context we share information, to creating forms that place critical information (in order to effect the sequence in which a person reads it) we can dramatically influence decisions.”—Industry expert

“We’re living through a golden age of behavioral research. It’s amazing how much we can figure out about how people think now.” —Eric Siegel, Predictive Analytics World

quantities of unscented lotion around the beginning of their second trimester, for example. Another analyst noted that many shoppers purchase soap and cotton balls, but when someone suddenly starts buying scent-free soap and extra-big bags of cotton balls, in addition to hand sanitizers and washcloths, it signals they could be getting close to their delivery date.

By combining data from its baby registry with shopping patterns, Target developed a “pregnancy prediction” score, which allows it to send specific promotions to any woman (not just those on its baby registry) who meets its profile including coupons timed to very specific stages of their pregnancy. From a timing perspective, Target’s approach works because there tend to be only a few points or events in a person’s life when they are open to broad habit change, such as switching their loyalty to a new store (not only for baby related items, but whatever else it offers) and pregnancy is one of those times.⁹¹

Timing: Anchoring

Marketers are also savvy in giving us the perspective they want us to have by suggesting an item’s value to us. *The Economist*, for example, offered subscribers the online edition of their magazine for \$56 per year, or the print version plus the online version for \$125. The great majority selected the first option until the magazine added a third: Print only for \$125. With the new frame and perspective in mind, and a new anchor set, subscribers flocked to the online plus print option at \$125 that the magazine had hoped to sell in the first place.⁹²

In the world of online sales and marketing, the implications of more behavioral economics and big data are profound. Aviv Revach, Founder & CEO of Commerce Sciences writes:

“By leveraging behavioral studies, collaborations with top behavioral experts and big data analysis—we decipher the shoppers’ DNA. Our Behavioral Suite enables online retailers to increase sales by predicting each shopper’s buying concerns & psychological motivations and automatically targets them with a relevant behavioral experience. For example, our algorithms can detect hesitant shoppers before they leave the store and automatically trigger the best relevant experience. This can include addressing their concerns (such as store safety, product questions, price, etc.) or catalyzing motivation (by highlighting scarcity, authority, social proof, reducing choice to focus attention—i.e. ‘paradox of choice’, emphasizing specific information to create a basis for a decision—i.e. “anchoring”, achieving pre-commitment, etc.)”⁹³

But timing is a big factor in people’s behavior outside of their buying patterns. At work, our behavior may change throughout the day, whether we’re aware of it or not. Judges making decisions whether or not to grant early parole, for example, have been shown to go from two-thirds favorable decisions throughout most of the morning to almost zero just before lunch, then back up to two-thirds after lunch, but gradually trending toward zero again as the day drags on. Similar results have been seen with other professional groups. Doctors deplete their “psychic energy” throughout the day, for example, in resisting patients’ requests for antibiotics for viral infections. Physicians know antibiotics do no good in fighting viruses (and have the potential to do societal harm). Like the judges, however, their resistance ebbs and flows following similar daily patterns.⁹⁴

Timing in IRR

An IRR professional who wants to nudge top performers toward a greater appreciation of the annual group incentive travel reward, might use a combination of several BE techniques. First, they should personalize their message to specific employees (salience), next they might leverage social norms by asking some of last year's reward earners to share their positive thoughts about the experience or even enlist some to encourage their close colleagues to compete for a spot in the program. Designers might also time their communications to nudge as well. According to the BE principles above, a person is often more inclined to pursue reward travel (rather than a cash reward) just after they've received their paycheck, a raise, or a bonus.

IRR professionals helping managers with performance issues might suggest timing techniques in the arrangement of work to align with natural ebbs and flows of energy throughout the day. For example, structuring more difficult work in the morning and after lunch, and work that requires less psychic energy late in the morning or late in the day. Here the IRR professional might advise on matters of well-being too, such as nudging employees out of their chairs and into exercise in order to stimulate thinking and smooth out the ups and downs of energy flow during the day.

To increase the effectiveness of its on-boarding program, Google sends detailed and personal e-mails to all managers with new employees—called Nooglers—with proven and referenced best practice checklists on how to engage and support them right from the first day. Nooglers receive a similar checklist with actions designed to accelerate their acclimation period. Both checklists draw on tips from Google's most successful managers of new hires and from Nooglers who were especially quick to productivity. The messages are timed to coincide with the new employee's first days on the job.

Other Important Behavioral Economics Tools and Practices

Unfortunately, not all of the most important BE techniques and tools fall neatly into the EAST framework above. IRR professionals should also be familiar with the powerful BE effects and techniques listed below:

1. Loss Aversion

As introduced in Part One, most people would rather lose the opportunity for gain than suffer a loss. As Professor Haim Mano of the University of Missouri points out, "... golfers make a much higher percentage of their putts for par than for birdies."⁹⁵ Loss aversion stems from prospect theory, which is a fundamental principle of behavioral economics. In short, prospect theory is based on people's consistent preference for options that allow them to hold on to a certainty—say \$700—than risk it on a larger reward, like an 80% chance at \$1,000. In this case, a rational person would risk the \$700, but it is somewhat rare to find a person who will.

In general, most people will not risk having something of value that they already possess for the chance at winning something of greater value, even if the odds are in their favor.

Successful experiments in the Chicago Heights neighborhood of Chicago also demonstrated the power of loss aversion and hyperbolic discounting (immediate gratification). In this case, failing and borderline students were paid \$50 per month to stay in school and achieve an average grade of C. The plan rewarded students each month—as opposed to other plans that delayed the reward until the end of the year—and included monthly lotteries for larger prizes, including cash, experiences, and merchandise.

On one hand, replacing what should be intrinsic motivations to learn and discover with a cash payout might seem questionable. On the other hand, the cost of the incentive is small versus the personal and social economic cost of young dropouts. Where intrinsic incentives are too

late, and the living and school conditions are such that there is no interest in learning, cash and other extrinsic incentives may be the best option.⁹⁶ In this case, the program boosted student achievement by about 40%.⁹⁷

The combination of incentives and timing them to coincide more closely and frequently with the activity being rewarded, works well, in this case, as does the use of fun, play, and games introduced by the lotteries and the celebrations that go with them.

Perhaps even more remarkably, when kids in poorer neighborhoods received a \$20 bill before they were about to take a standardized test and were told they could keep it if they do better on the test than last time, their test scores improved roughly to the level of kids in wealthier neighborhoods, despite having no additional preparation time.⁹⁸ Kids who were promised \$20 immediately after the test if their score improves also did better, though not to the same degree. However, students who are told they would get their \$20 reward a *month* after the test did not improve at all.⁹⁹ And for younger kids—in grades 2 to 4—the offer of an inexpensive trophy worked even better than cash.

Likewise, paying teachers ahead of time for improved student outcomes also resulted in dramatically better effects than the promise of bonuses afterward, which essentially have no effect on student performance.¹⁰⁰ In the same set of experiments in Chicago Heights, teachers received checks at the start of the year for \$4,000 and were told they would have to return the money if their students don't achieve higher test scores at the end of the year. Again, the results were good enough to close the gap with wealthier students.¹⁰¹

Finally, parents in poorer neighborhoods who were paid immediate rewards to attend school meetings and help their children with homework saw significant improvement as well and better results versus parents who were offered the same incentives deferred until college.

It appears that under extreme conditions at least, students, teachers, and parents each respond to tangible incentives, especially when they are immediate and of sufficient value.¹⁰²

Again, the tools and techniques of BE only offer ideas, they are not guaranteed to work in all conditions. IRR professionals, like the BIT groups in the United Kingdom, United States, and elsewhere, must test the tools and techniques they borrow from BE in the context of the behaviors they hope to influence.

“The human tendency is to minimize risk and loss at the cost of potential gains, so we might design a reward solution accordingly. The way we design incentives makes people feel more engaged and certain about the choices they’ve made. What’s the right amount of choice? We might provide 4–6 high quality experiential rewards versus 24 tropical beach destinations, for example. When you have too many choices, the one that you choose often leaves you with a feeling of loss when you consider the ones you didn’t choose.” —IRR expert and practitioner

Applying Loss Aversion to IRR

Why should an IRR professional care about prospect theory and loss aversion? Because one of the more promising and controversial advances in thinking about pay for performance comes from the principle of loss aversion. When it comes to performance pay, few traditional pay-for-performance schemes appear to work, possibly due to hyperbolic discounting in which we severely discount the value of a future reward.

A controversial but possibly more effective method of paying for performance is to pay bonuses for performance up front and require them to be remitted should performance goals be missed. Professor Uri Gneezy of the University of California, San Diego, refers to a Wall Street client that gives executives a bonus of \$400,000 at the start of the year, based on reaching their goals throughout the year. The executives have to start writing checks to pay it back if they miss interim goals. Gneezy points out that this is not an experiment, there is no control group. His client's executives have found that it is very painful to write back a check.

Gneezy has seen the same practices used with salespeople. For example, when one of his clients had an important new product to push, salespeople were incentivized to go to current customers to sell the new product by paying them their commissions in advance. Then, like the Wall Street executives, they had to pay it back if they didn't achieve the expected sales. Again, our aversion to loss is more powerful than the promise of gains, in both cases, according to Gneezy, early indicators suggest reverse pay-for-performance can work.

2. Games and Competition

For students at Chicago's South Side high schools, violence and gunshots are daily events and murder is not uncommon. The CEO of Chicago's public school system, Ron Huberman, experiments regularly with solutions. The best incentive so far was running a contest among the area's 32 most violent schools, featuring a Kanye West concert ticket for each student from the winning school. All of the schools in the contest improved and the winning school saw violent incidents drop by 30%, a level that has remained since the contest ended.¹⁰³

Lotteries (aka games) have proven very effective as incentives in other instances as well. In Sweden, speed cameras capture violators and law-abiding citizens alike. The latter are placed in a lottery and each month, one wins a portion of the fines collected from the former. Average speeds are shown to fall from 32 KPH to 25 KPH.¹⁰⁴

3. Play, Purpose, and Potential vs. Pay, Pressure, and Procrastination

People perform for a range of reasons. At work, employees perform at their best when incentivized through the direct motivators of what bestselling authors Neel Doshi and Lindsay McGregor term play, purpose, and potential. Where the work stimulates them and sparks their creativity, this constitutes play, the most powerful of the positive motivators. And when you attach genuine meaning and mission to the work—a purpose—you get another enormous productivity boost. Finally, when you give a person work that provides a path to something they want to accomplish—potential—their performance increases yet again. In order, according to Doshi and McGregor's research, play drives the greatest effort, then purpose, and finally, potential.¹⁰⁵

But Doshi and McGregor point out that people work for six main reasons, not three. Play, purpose, and potential drive higher performance but the remaining three: pay (including tangible rewards), pressure, and procrastination are powerful as well. Pay, purpose, and procrastination—the indirect motivators—motivate but they diminish performance.

Games and Competition in IRR

In general, it may be better to avoid competition-based incentives and emphasize cooperation instead.

Though lotteries and games should be used selectively, in the right spirit they can be highly effective motivational tools. Lotteries have been known to work very well, for example, as incentives to get employees using corporate wellness programs. In an experiment to incentivize weight loss, for example, employees in random group one were entered into a lottery with small daily prizes and a grand prize of one hundred dollars at the end of the program. Participants maximized their chances by calling in every day to report their progress. Employees in random group two played a game in which they had to put up their own money. Each day, if they lost weight, they got their money and an equal sum back. If they didn't lose weight, they would forfeit the amount they risked. The lottery group lost 13.1 pounds on average in 16 weeks, the games group lost an average of 14 pounds, and the control group 3.9 pounds. This suggests that the lottery and the game were strong motivators.

Games and contests, and the relatively new practice of “gamification” (using “game design elements” in non-game situations), appeal to people’s natural sense of both competitiveness and play (see next section). And while contests have traditionally been used to motivate salespeople, the notion of points, badges and even small tangible rewards have become common elements of peer-to-peer reward and recognition systems. Of course, competition is a core element of many, if not most incentive programs, but the artful use of gamification has tremendous potential to draw people in and engage them more fully.

In 2007, for example, Warner Bros. began to place movie posters for the Dark Knight movie. It didn't take long for fans to notice some letters were bolded, and when strung together they spelled out “WhySoSerious.” Of course, some fans went to whysoserious.com and became immersed in the backstory. They were invited to join the Joker’s team of henchmen. They started to receive cryptic messages with instructions and puzzles to be solved. One message said only, “arwoeufgryo”. Some recipients—the savvier ones—decoded the message and were tipped-off to go to www.whysoserious.com/steprightup (“arwoeufgryo” shifted one letter over on the keyboard).

Decoding “arwoeufgryo” (step right up) brought them to a website with a carnival game with ratty looking teddy bears that had street addresses printed on them. Each address was for a bakery where they were to pick up a “very special treat” held for “Robin Banks.” Those who got this far found cakes with a single playing card (the Joker) inserted, indicating that they were now accomplices of the Joker.

This was repeated in 21 cities and attracted more than 1.4 million players. Eventually, game players were rewarded with preview IMAX screenings of the movie. Warner Brothers and partners generated worldwide buzz, contributing to a blockbuster that went on to earn over \$1 billion as the second highest grossing Batman movie of all time. In its groundbreaking use of gamification to reward and nudge what might be termed “superfans” of the franchise, promoters developed an immersive experience that blurred the line between fiction and reality. Could incentive professionals create something similar to build buzz and excitement around an incentive travel reward program, for example?

The first and weakest—emotional pressure—causes people to do things for the wrong reasons. Doshi and McGregor use the example of playing piano at a young age. If you played mainly to please a parent, you were motivated by emotional pressure and likely performed worse than your friend, who may have played for himself (i.e., intrinsic reasons). Even now, you might stay in a job mainly because it confers high status. 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.¹⁰⁶

The second indirect motivator, economic pressure, includes salaries, bonuses, and other tangible incentives or rewards to perform. As McGregor says, *“Money isn’t good or bad, but does it change the way you think about work, so if you get up in the morning saying I am only going into work for the money, it is a negative motivator. Even though you need the money, if, on any given day you are going to work for some other reason—a meeting you’re looking forward to, a challenging project, etc., it is much better. That’s positive. The key is to focus employees on the purpose and meaning rather than the pay. So many organizations have a great purpose but they don’t help their people see and feel it every day, they don’t hear stories of the impact of their work; they don’t interact with customers to hear what’s happening on the front lines. Every week in a meeting, make sure you talk about the impact you had the week preceding, if you do that once a week it dramatically increases engagement.”*¹⁰⁷

IRR professionals should view their role in terms of “total motivation.” It is especially important to understand the power of purpose as one of the most potent drivers of human behavior. Ideally, every incentive and reward program will align to purpose and meaning in some way.

Similarly, where a person strives to do something just to earn recognition, they tend to underperform, for example, the chess player who practices in order to earn fortune and fame, versus the player who practices because he or she is drawn into a state of blissful flow. Of course, you can’t run an organization or a government without economic incentives, recognition, and rewards but you must combine them with other motivators to drive the highest possible performance. Finally, the sixth motivator—inertia, or procrastination—diminishes performance by the greatest amount. It occurs when a person simply stays in place because they can’t muster a reason to move or change. They effectively quit their jobs but stay, doing the least work possible.¹⁰⁸

“The science of neurology shows us that people respond to social threats the same way they do to a tiger growling at them. In other words, the boss yelling at you limits your creativity because it puts you in limbic flight or fight mode, which is not conducive to optimal performance.”

*—Dr. Joseph Pulichino,
NeuroLeadership Institute*

Doshi and McGregor argue that leaders and IRR professionals should emphasize “play” above all else. The Gallup organization is another proponent of play, having emphasized strengths-based leadership and motivation over most of their other twelve key drivers of engagement. “Play” means designing work to align with employees’ natural drives to innovate, master their fields, experiment, and continuously improve. Through “Dabble Time” or other initiatives, Google, Virgin, 3M, W. L. Gore and several other famously innovative and successful organizations combine play and other intrinsic motivators with pay and extrinsic rewards to drive new ideas, employee engagement, and higher productivity.¹⁰⁹

The Power of Purpose

Most motivation research over the centuries speaks to the fundamental motivators of security, bonding and belonging, mastery, self-determination, and purpose (or meaning). IRR designers should never lose sight of these powerful drivers of engagement and performance. The four and five drive theories of motivation (see Part Three) describe each of the drives above very well, except, perhaps, that of purpose, which, according to some BE, psychology, and workforce engagement experts, is the strongest driver of all.

In an interview with Wharton business and psychology professor, Adam Grant shared a simple illustration of the power of the purpose and incentive. A colleague asked Grant how he could increase donations to the university’s scholarship fund. Funds were raised in a call center, a repetitive, draining job, with much rejection. Reps were incentivized with bonuses based on call volume and money raised.

Grant invited a scholarship recipient into the call center to talk to one shift of reps about the impact their work had on his career and life. The talk lasted five minutes. The other reps on other shifts didn’t get the talk. Grant came back one month later and looked at the stats. The reps that got the talk spent on average twice as many minutes on the phone with prospects, and they brought in vastly more money: a weekly average of \$503, up from \$186—almost three times as much after a five-minute talk.¹¹⁰ Grant and others have repeated this and variations of this experiment many times. The results are consistent.

Play, Purpose and Potential in IRR

At Microsoft, HR analytics has been used for years to build profiles of likely leavers and predict the attrition of key talent. The firm has become progressively better at this analysis, but according to Dawn Klinghoffer, Microsoft’s Senior Director of HR Business Insights, some of the most valuable insights have come from data on what causes employees to stay.

Although Microsoft’s previous practice of providing additional retention pay or stock options for those that the company didn’t want to lose can be assessed as successful in many cases—the company has recently changed its tactics and is now focused on retaining key personnel by providing choice project assignments. The results have been remarkable. A few years ago Microsoft tested this hypothesis with one particular business, targeting a subset of the population that was at highest risk to leave. Within two years it was able to reduce attrition to zero for that segment of the population.

Says Klinghoffer, “They were passionate about the work they were doing, they believed in the product they were working on, and they wanted to see it succeed in the marketplace.” In this case, Microsoft used longitudinal data combined with passive data and predictive analysis to reveal insights into what works and what doesn’t in retention incentives. This approach can help organizations avoid “conventional wisdom” that simply doesn’t produce the long-term desired results.

Microsoft is far from the only organization to discover the powerful incentive of aligning people’s work to their passions. Most organizations fail to realize the costs of denying people their natural drive to mastery and play. IBM was one of the first to discover the benefits. In the 1960s, IBM’s leaders became alarmed at the number of first rate researchers and scientists they were losing—not necessarily to the competition, but to themselves. Because IBM, like most organizations, offered limited career opportunities outside of the management career track, promising scientists were taking junior managerial positions because they had no other means of climbing the corporate ladder. So IBM created its now famous Fellows Program.

2015 marks the 21st year in a row that IBM has filed the most patents of any organization in the world. IBM fellows have won five Nobel Prizes and helped put a man on the moon. Today, for most scientists and researchers, becoming a fellow is more desirable and prestigious than becoming IBM’s CEO.

4. Happiness

BE and neurology emphasize the role of emotions in decision-making. IRR professionals should be aware of the power of happiness in particular as it relates to employee and customer emotional engagement. Tangible and intangible incentives and rewards should be chosen with emotional impact in mind. As professor Haim Mano says: *“The reward should act as a trophy, it’s more psychological than just the prize, it is pride. And it’s not only how much the reward is worth but how you present it. The moment you make it an entitlement you lose the impact. So give people rewards after the thing they achieved, rather than as an incentive to achieve. Also be sure to calibrate the reward to the person’s income. As long as they are in the right income category, I know employees are happier with a reward experience—a trip, for example—than the money. However, the trip to Hawaii doesn’t solve my issues if I am a minimum wage employee.”*¹¹¹

Consider experience-based tangible rewards as well as merchandise rewards where possible. Research demonstrates that material goods provide an initial lift, whereas experiences can provide lasting memories. Indeed, the more time that passes after an exotic vacation, for example, the more fondly most people look back on it.¹¹² Under certain conditions if you simply ask a person whether they would like an exotic trip or the equivalent cash amount, most will choose the cash.¹¹³ This makes sense from a BE perspective in that people tend to attach more weight to a tangible reward they understand than one of more esoteric value.¹¹⁴ Also, remember that if a cash reward option is offered immediately versus an experiential reward a few months in the future, people’s preferences for immediate gratification and the hyperbolic discounting effect described above will come in to play.

IRR professionals can counter individuals’ preferences for cash and immediately available rewards by carefully designing and describing alternative rewards and focusing on the total reward experience—including who gives the award, how it’s communicated, and what career implications it has. In a 2015 Incentive Research Foundation study, for example, conjoint analysis revealed that for large rewards especially, a personalized total reward experience that included travel appealed to more than two-thirds of respondents over the cash equivalents.¹¹⁵

IRR professionals should test and use the tools and practices in this paper to nudge people toward rewards and incentives that might generate more emotional impact and produce better results for them and their organizations. That is not to say that everyone will benefit from experiential rewards over cash or merchandise. Many factors are at play, including income, family status, and—as is discussed in Part Three in the follow-up report—an individual’s wiring in terms of preference

*“Insights into how to make yourself happier are also relevant for any organization in the business of trying to make others happy.” —Elizabeth Dunn and Michael Norton, *Happy Money**

“Incentivizing and rewarding with experiences versus material things is interesting. Material rewards certainly have a place, for example in lower intensity but more frequent awards, and they can lead to happiness. Experiential rewards deliver a more intense happiness, and over time reward earners have more appreciation when they look back at the experience. So we should use material things for frequent rewards and recognition and experiences where the reward is less frequent but will deliver more intense happiness and memories.”
—Elizabeth Dunn, Author Interview (February 2015)

“Maslow stated that the only happy people he knew were the ones who worked well at something they consider important. Therefore, a second measure of unleashing human potential is a sense of fulfillment a person has in the work they personally do.” —Motivation and Incentives Expert

for adventure over stability. The key is in understanding each employee and their preferences, interests, and passions. 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.

Happiness: Giving and Volunteering

Similarly, research demonstrates that where cash is used as a reward, spending it on other people makes most people happier than spending it on themselves. It is well established that beyond a point, more money does not equate to more happiness.¹¹⁶ However, experiments done by happiness researcher Elizabeth Dunn and colleagues, demonstrate that when subjects are given a sum of money, such as \$20, and half are instructed to spend it on themselves with the other half spending it on someone else (BE term: “prosocial spending”) the latter half reports significantly higher levels of happiness afterward, and the happiness lingers.¹¹⁷

“The more money people have the less they report savoring the little experiences of life. So, for example, when people come across a beautiful waterfall on a hike, the more money they have or earn, the less they are likely to hop in or even admire it.” —Elizabeth Dunn, 2016

Some organizations have implemented peer-to-peer recognition systems that include small rewards employees can give to other employees. These have been successful, in part, because giving nudges workers into closer relationships and because of the effect giving has on our happiness.¹¹⁸ At Grace Haven Assisted Living in St. Johns, Michigan, for example, turnover and disengagement were rampant until the organization implemented a simple peer-to-peer recognition program. Within three months of the program’s implementation, employee satisfaction increased 66% and employees’ perception of other employees’ commitment to quality work increased 116%.¹¹⁹

Similarly, IRR professionals can generate lasting memories and tap positive emotional engagement through experiential volunteer-type rewards. Pepsi, for example, eliminated its expensive Super Bowl ads in 2009 to pay for its “Pepsi Refresh Project” that granted funds for community renewal projects nationwide. Votes for who should receive the grants exceeded the total vote count for the 2008 presidential election (demonstrating the level of engagement in Pepsi’s external community). Internally, employees rallied to the cause and reported heightened pride by association.¹²⁰

At IBM, high performers compete vigorously for a chance to participate in IBM’s Corporate Service Corps, a one-month volunteer abroad program that is among the most sought after reward for young leaders in the company. Employees gain new skills and IBM improves its brand. Program participants stay at IBM longer and the program attracts top talent to the organization.¹²¹

Leveraging Happiness in IRR

Before it makes changes or introduces new programs organization-wide, Google always tests new nudges and initiatives with small groups to see what works and what doesn’t. Google has found that experience-based rewards are usually more effective in motivating employees than other types of incentives, such as cash bonuses.

The preponderance of research backs Google up. Yet, when given the choice, the great majority of top performers who qualify for exotic—even once in a lifetime—trips, will take the equivalent cash if it is offered. IRR professionals should use BE nudges to help reward earners make the “right” choice between cash and an experiential reward, such as travel, if choice is offered. This may be the classic use of BE in IRR. Like governments who use choice architecture and default options to encourage citizens to do what is better for themselves and society, IRR professionals can help employees do what’s better for them and the organization.

Researcher Elizabeth Dunn agrees, “We are looking at rewards as time. More free time, for example, finding creative ways to reward employees with time—an afternoon off, a day with no meetings and no e-mail. Concepts like W. L. Gore’s ‘Dabble Time’ give people time to do what they want. The commuter service at Google makes commuting time productive and employees clock in during their commute, this means less work at home and shorter office hours. Some organizations are rewarding employees by spending more on direct flights rather than make people take connecting flights. The time and energy saved rewards employees and organizations because employees are less stressed, arrive fresher and more ready for their meetings or work.”

5. The Pygmalion Effect

IRR professionals should be aware of various powerful biases, including our tendency to use heuristics (mental shortcuts) to label people very quickly after we have met them or been told about them. Leaders are particularly susceptible to “The Blame Bias,”¹²² a propensity to point to the employee—incompetence, a character flaw, laziness, etc.—as soon as a failure occurs.

“Eight out of 10 participants in the Corporate Service Corps program say it significantly increases the likelihood of them completing their career at IBM.” —Stanley Litow, VP of Corporate Citizenship & Corporate Affairs, IBM

But consider an experiment conducted by the Israeli Defense Force, in which trainers were told which of their trainees were top and average performers. Though the ratings were randomly assigned (entirely fabricated), those trainees randomly tagged as top performers did much better than average performers. Believing the trainees were top performers, leaders looked to the system or themselves for faults when a recruit failed at anything. For average performers, the blame bias remained—it had to be the trainee’s fault.

This influence repeats itself in countless experiments and in many ways—you probably know it as the “Pygmalion effect.” When you believe in a person they tend to perform, when you don’t, they don’t. To combat people’s natural blame bias, first look to the system for flaws rather than the person. Try to assume people’s good intentions, look for the reasons for the behavior you want to change and then use the direct motivators to change it. As a designer, see if you can conduct an experiment at work like what was done with the Israeli Defense Force, the results might surprise supervisors and managers enough to change their behavior.

Summary: The Ethical and Careful Use of Behavioral Economics

As demonstrated in Part Two, behavioral economics principles, tools, and practices are a potent force. For their long-term effectiveness in organizations—whether with employees, partners, or customers—designers should resist manipulative or unethical uses of BE. Outside of the frequent (but short-term) experiments organizations should conduct to test various BE-based approaches, the subjects of nudges should be aware of them. For example, designers who use default options to encourage certain selections should say so, by, for example, stating why the pre-selected option is offered—even including references to the psychology, where possible—and explaining that a subject can change the option for one they prefer, easily and without consequence.

In all cases, choice architecting by designers should include only those options that are potentially better for the individual *and* the organization, versus maneuvering people toward decisions that benefit the organization alone.

IRR designers should also be aware of the unintended consequences of using BE-based incentives, just as they are or should be in creating incentives based on tangible rewards. A good example comes from a day care center in Israel that wanted to reduce or eliminate a growing problem—parents picking their children up late.

The day care started its analysis off well by acknowledging social norms. The day care believed the problem was worsening because parents noticed other parents doing it, and despite the rules and various appeals from the day care, the mental shortcut: “every other parent is doing it, so I may as well too” proved powerful. In truth, the great majority of parents weren’t picking their children up late, but parents who did pick their kids up late tended to see other parents doing the same thing, causing them to put more weight in what they observed than what they didn’t (the availability heuristic).

If you’ve read this far, you know the day care should have used social norming techniques to address the problem. They could have simply sent violators an e-mail stating that most parents pick their children up on time. By addressing each e-mail to each parent specifically (saliency) they would improve the desired behavior change. An even better design would add a picture of a teacher to the letter (to trigger empathy). And if near 100% compliance wasn’t achieved at this stage, they could go further, using the BE technique of reciprocity by asking the parent whether they would like to leave work on time and shouldn’t the teacher be allowed that courtesy also?

Instead, the day care immediately imposed a fine on parents (a stick) that grew in size depending on how late they were. It won’t surprise many seasoned IRR professionals (or busy parents) to learn what happened next. Parents began arriving even later and more parents took advantage, happily paying the fine because it eliminated the guilt they felt (a social norm), which was a much more powerful disincentive.¹²³

Designing incentives, as most IRR professionals know, is difficult. Whether using BE principles and tools or not, ideas should be tested before they’re implemented. In this case, a fine might have been useful to catch the few hardcore parents who weren’t swayed by social norms or reciprocity. And for parents whose jobs make it impossible for them to be on time some days, perhaps a fee should be introduced to cover the cost of keeping the daycare open and paying a teacher to stay.

Use nudges and BE only for the good of the individual and the organization, never to manipulate or coerce.

Beware the power of nudges and the damaging potential of unintended consequences.

About the Author

Allan Schweyer is the founder and executive director of TMLU, Inc. a nonprofit focused on performance research and learning. He is the author of *Talent Management Systems* (Wiley, 2004), *Talent Management Technologies* (HCI Press, 2009) and co-author of *Enterprise Engagement Strategies* (EEA Press, 2014).¹²⁴

Interviews & Acknowledgments

In addition to conducting a targeted literature review of the topic, we relied on several invaluable conversations with industry leaders, academic thought leaders, and hands-on practitioners to round out our understanding of the impact behavioral economics is having and might yet have on the world of incentives, rewards, and recognition. In truth, the information and insights provided by the generous people who agreed to be interviewed (listed below) gave this paper its flavor as well as much of whatever originality it might contain.

Some of our interviewees are not quoted in the paper but were essential in helping us to frame the topic before we started reading and writing; they set us on new paths of research, pointed out papers and resources we'd missed, and made us think much more laterally about the topic than we would have otherwise. We are incredibly grateful to everyone who took the time to speak with us.

B. J. Fogg, Ph.D.	Randy Rodriguez	George Loewenstein, Ph.D.	Paul Zak, Ph.D.
Uri Gneezy, Ph.D.	David Forman	Haim Mano, Ph.D.	Sandra Daniels
Mary Beth McEuen	Bruce Bolger	Elizabeth Dunn, Ph.D.	Lindsay McGregor
Kim Abel	Charlotte Blank	Ashley Whillans	Chris Winkelspecht
Dave Ulrich, Ph.D.	Joe Pulichino, Ph.D.		Stanley Litow

Key Resources

Though more than one hundred books, articles, videos, interviews, blogs, and papers are referenced throughout the footnotes in this guide, a few resources stand out as extraordinarily influential.

Nitin Nohria and Paul Lawrence's classic book *Driven: How Human Nature Shapes Our Choices* is referenced in each section of the paper and extensively in Part Three. Lawrence and Nohria's Four-Drive Model is perhaps the most directly relevant and applicable BE-based model of motivation in existence.

Daniel Kahneman's book *Thinking, Fast and Slow*, has become the standard in BE, but even more, the body of his work with the late Amos Tversky (for which Kahneman received the Nobel Prize), provides much of the foundation on which any report about behavioral economics must rest. Kahneman and Tversky are referenced throughout the paper and Kahneman's *Thinking, Fast and Slow* is extensively summarized in Part Three.

Much of our reference to neuroscience and its connections to BE and IRR rely on the astounding work of Antonio Damasio over the past several decades. Paul Zak guided us in our interpretation of Damasio's work and of his own exceptional research in the field. An interview with Uri Gneezy's and a careful dissection of his excellent book, *The Why Axis*, provided many case studies and illustrations for the paper, as did interviews with Lindsay McGregor, co-author of this year's bestseller, *Primed to Perform*. In Parts One and Two, multiple references are made to the 2015 book *Inside the Nudge Unit*, which details the first five years of operations in the U.K. government's Behavioral Insights Team (BIT). This is essential reading for anyone interested in the practical application of BE.

(Endnotes)

- 1 See: Richard H. Thaler and Cass R. Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (New Haven: Yale University Press, 2008; London: Penguin Books, 2009).
- 2 Daniel H. Pink, *To Sell Is Human: The Surprising Truth About Moving Others* (New York: Riverhead Books, 2012), p. 216.
- 3 See: <http://endowment-effect.behaviouralfinance.net/>
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