Developing financial consciousness reader
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Estimated reading time: 30 minutes

You will read about...

- money and intrinsic/extrinsic motivation
- equity theory and the importance of fairness in salaries
- money and job satisfaction
- performance-related pay

The text is edited from excerpts from:

- Furnham, A. (2014): The New Psychology of Money. Routledge.
- Judge, T. A. et al. (2010): The relationship between pay and job satisfaction: A meta-analysis of the literature. Journal of Vocational Behavior 77:157-167.

Money and Motivation

In a society, the income of individuals is one of the most visible hallmarks of success; it is a form of social approval: low pay indicates low skills and less important work to most people. Considering this, it is quite surprising that jobs that provide this are not particularly satisfying for people: we know from many researches that the relationship between the level of salary and job satisfaction is quite modest. There is also evidence that beyond a reasonable level, the absolute amount of pay is not as important to well-being as the comparative amount and also that although money is important for people, pensions and other benefits are valued more than salary alone.

So, the central question is: how, when, for whom and why money acts as a motivator or demotivator at work.

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Intrinsic and extrinsic motivation

Intrinsic satisfaction implies that merely doing the job is, in itself, its own reward. Therefore, for such activities no reward and no management should be required. The activity is its own reward. But the naive manager might unwillingly destroy this ideal state of affairs. If a person is happy (absorbed in a state of flow) doing a task, for whatever reason, but is also "managed" through explicit rewards (usually money), the individual will tend to focus on these obvious, extrinsic rewards, which then inevitably have to be escalated to maintain satisfaction.

This is therefore a paradox: reward an intrinsically motivated person by extrinsic rewards and he/she is likely to become less motivated because the nature of the motivation changes.

Unless a manager can keep up the increasing demands on the extrinsic motivator (i.e. constant salary increases) the person usually begins to show less enthusiasm for the job. The use of reinforcers – i.e. paying people – is often counterproductive when the task is intrinsically interesting. That is, **intrinsic motivation decreases with extrinsic rewards**. Deci and Ryan demonstrated 30 years ago that reinforcement of progressively improved performance produced no loss (or gain) of intrinsic interest. Some activities are rewarding because they satisfy curiosity, some because they produce an increased level of arousal. Deci proposed that intrinsic motivation is increased by giving a sense of mastery and competence, through the use of skills, and also by a sense of control and self-determination by autonomy to choose how the work is done. Both of these factors have been found to increase motivation. In addition to the enjoyment of competence, leisure research shows that people often enjoy the sheer activity, e.g. of dancing, music, or swimming, though they enjoy these things more if they are good at them. The most controversial work in this area suggests not only that intrinsic motivation is far preferable to extrinsic motivation, but also that extrinsic rewards are actually demotivating. The most powerful and popular advocate of this is Kohn who in 1999 suggested that rewards can only create temporary compliance, not a fundamental shift in performance. Kohn offers six reasons why this seemingly backward conclusion is, in fact, the case:

- **Pay is not a motivator.** While the reduction of a salary is a demotivator, there is little evidence that increasing salary has anything but a transitory impact on motivation. This was pointed out 50 years ago. Just because too little money can irritate and demotivate does not mean that more money will bring about increased satisfaction, much less increased motivation.

- **Rewards punish.** Rewards can have a punitive effect because they, like outright punishment, are manipulative. Any reward itself may be highly desired, but by making that bonus contingent on certain behaviours, managers manipulate their subordinates. This experience of being controlled is likely to assume a punitive quality over time. Thus, the withholding of an expected reward feels very much like punishment.
- **Rewards rupture relationships.** Incentive programmes tend to pit one person against another, which can lead to all kinds of negative repercussions as people undermine each other. This threatens good teamwork.
- **Rewards ignore reasons.** Managers sometimes use incentive systems as a substitute for giving workers what they need to do a good job, like useful feedback, social support, and autonomy. Offering a bonus to employees and waiting for the results requires much less input and effort.
- **Rewards discourage risk taking.** People working for a reward generally try to minimise challenge and tend to lower their sights when they are encouraged to think about what they are going to get for their efforts.
- **Rewards undermine interest.** Extrinsic motivators are a poor substitute for genuine interest in one's job. The more a manager stresses what an employee can earn for good work, the less interested that employee will be in the work itself. If people feel they need to be "bribed" to do something, it is not something they would ordinarily want to do.

This literature essentially says this: one can distinguish between **intrinsic motivation** to partake in some activity out of sheer enthusiasm, joy or passion and **extrinsic motivation** which involves offering a range of incentives to do an activity rather than the activity itself. The intrinsically motivated worker is therefore easier to manage, happier and possibly more productive. More controversially it has been suggested that extrinsic rewards like money can actually decrease joy and passion and even productivity in the long run. Of course, all jobs are a combination of both: some are done "just for the money" because the tasks are so unintrinsically motivating. Questions also arise about specific issues: should you pay for the job or performance on the job; and should you pay for talent or effort?

Equity theory

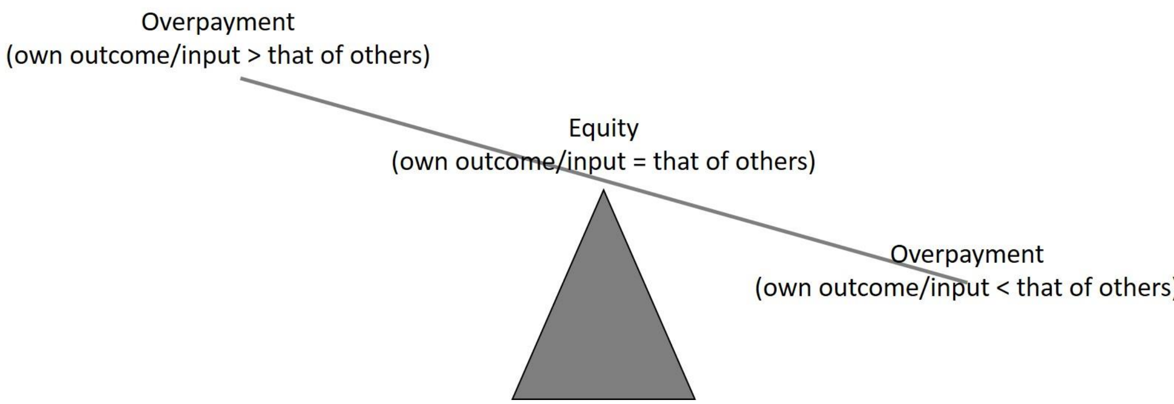
Equity theory, borrowed by psychologists from economics, views motivation from the perspective of the social comparisons that people make among themselves. It proposes that employees are motivated to maintain fair, or "equitable", relationships among themselves and to change those relationships that are unfair, or "inequitable". Equity theory is concerned with people's motivation to escape the negative feelings that result from being treated unfairly in their jobs once they have engaged in the process of social comparison. Equity theory suggests that **people make social comparisons** between themselves and others with respect to two variables – outcomes (benefits, rewards) and inputs (effort, ability).

- **Outcomes** refer to the things that workers believe they and others get out of their jobs, including pay, fringe benefits or prestige.
- **Inputs** refer to the contributions that employees believe they and others make to their jobs, including the amount of time worked, the amount of effort expended, the number of units produced, or the qualifications brought to the job.

Equity theory is concerned with outcomes and inputs as they are perceived by the people involved, not necessarily as they actually are, although that in itself is often very difficult to measure.

Not surprisingly, therefore, workers may disagree about what constitutes equity and inequity on the job. Equity is therefore a **subjective, not objective, experience**, which makes it more susceptible to being **influenced by personal factors**. Equity theory states that people compare their outcomes and inputs to those of others in the form of a ratio. Specifically, they compare the ratio of their own outcomes/inputs to the ratio of other people's outcomes/inputs, which can result in any of three states: overpayment, underpayment or equitable payment (Figure 1).

Figure 1: States of equity and inequity



Source: Own construction

- **Overpayment inequity** occurs when an individual's outcome/input ratio is greater than the corresponding ratio of another person with who that individual compares himself/herself. People who are overpaid are supposed to feel guilty. There are relatively few people in this position.
- **Underpayment inequity** occurs when an individual's outcome/input ratio is less than the corresponding ratio of another person with whom that individual compares himself/herself. People who are underpaid are supposed to feel angry. Many people feel under-benefited.
- **Equitable payment** occurs when an individual's outcome/input ratio is equal to the corresponding ratio of another person with whom that individual compares himself/herself. People who are equitably paid are supposed to feel satisfied.

According to equity theory, people are motivated to escape the negative emotional states of anger and guilt. Equity theory admits two major ways of resolving inequitable states: behavioural and psychological reactions.

Behavioural reactions to equity represent things that people can do to change their existing inputs and outcomes such as working more or less hard (to increase or decrease inputs), or stealing time and goods (to increase outputs). In addition to behavioural reactions to underpayment inequity, there are also some likely psychological reactions.

Psychological reactions to equity suppose that inequitable states may be redressed effectively by merely thinking about their circumstances differently. For example, an underpaid person may attempt to rationalise the fact that another's inputs are really higher than his/her own, thereby convincing himself/herself that the other's higher outcomes are justified.

How people will react to inequity **depends on how they are paid**. If they are paid by the time they are there they can reduce the rate of work, but if they are on piece work they may reduce the quality of work. Similarly, a salaried employee who feels overpaid may raise his/her inputs by working harder, or for longer hours or more productively. Likewise, employees who lower their own outcomes by not taking advantage of company-provided fringe benefits may be seen as redressing an overpayment inequity. Overpaid persons (few though they are!) may readily convince themselves psychologically that they are really worth their higher outcomes by virtue of their superior inputs. People who receive substantial pay rises may not feel distressed about it at all because they rationalise that the increase is warranted on the basis of their superior inputs, and therefore does not constitute an inequity.

Compensation: Pay satisfaction and job satisfaction

A great deal of research has been dedicated to the question many people think is self-evident: the relationship between pay and job satisfaction. While people are happy to acknowledge the fact that pay/salary/money is but one "reward" for work, it is considered by far the most important.

Pay satisfaction is a core component of job satisfaction but there are a whole host of other factors (relationships at work, autonomy on the job, physical working conditions) that also play a part.

There are various dimensions to pay satisfaction that are interrelated: pay level, pay rises, benefit level and pay structure/administration. Further, various factors are related to pay satisfaction, like worker money attitudes, race, gender, income and also pay equity comparisons. Most studies have examined pay satisfaction in those of average as well as low pay. Some have shown self-evident findings such as the idea that personal attitudes to pay actually influence pay satisfaction.

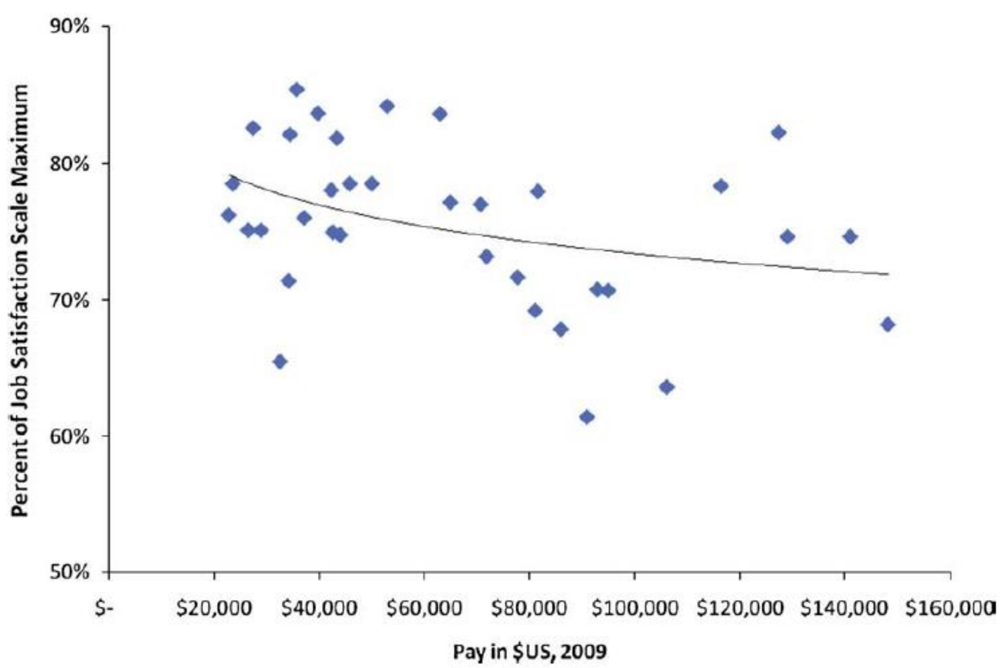
One important study (that of Williams in 2006) looked at the evidence for the relationship between seven factors: age, gender, education, tenure, salary grade, and job classification as well as actual salary/wage. There were two particularly interesting findings from this analysis. The first was how **low the correlations were, indicating little or no relationship between things like gender and tenure and different types of pay satisfaction over various different samples**. The second was that all the higher correlations were negative: thus older people were less satisfied with pay rises and structure; education and pay structure; salary grade and pay rise satisfaction. The authors believe the results suggest that older people may be less satisfied with pay because their expectations for the reward of service were not met. Similarly, the higher paid may be less happy because they too had higher expectations of the things that they received.

Dozens of researchers have done small-scale (relatively few people) studies correlating pay and satisfaction at any one point in time. It is possible to summarise this extensive research effort:

Nearly all studies find a **positive relationship between pay and job satisfaction but it is small** ($.10 < r < .20$). Pay is not a strong factor in job satisfaction: external rewards are relatively ineffective in driving motivation, performance and satisfaction. (Figure 2)

The results in this area show that pay is weakly related to job satisfaction, which is determined by many factors. Further, it is clear that the assumption that satisfaction leads to (causes) productivity is too simple as there is evidence that in certain circumstances the direction of causality goes the other way.

Figure 2: Between-study relationship between average pay level and average level of job satisfaction



Source: Judge et al 2010. p. 162.

Every job has an inducement/incentive and hopefully an agreement between inputs (amount of work) and outputs (e.g. pay). This wage–work bargain is in fact both a legal and a psychological contract that is often very poorly defined.

Organisations determine pay by various methods, including: historical precedents, wage surveys and job evaluations (using points). They have to benchmark themselves against the competition so as to meet or exceed the market rate. Certainly, it is believed that monetary rewards are better at improving performance than such things as goal setting (management by objectives) or job-enrichment strategies.

There is a rich literature on what professionals and lay people think about pay systems. Nearly everyone is paid for work in money but **organisations differ widely in how money is related to performance**. The question of central interest to the organisational psychologists is the power of money as a motivator. There are several ways of doing this:

- Piece work: Here workers are paid according to how much they produce. It can only be judged when workers are doing fairly repetitive work where the units of work can be counted.
- Group piece work: Here the work of a whole group is used as the basis for pay, which is divided between them.
- Monthly productivity bonus: Here there is a guaranteed weekly wage, plus a bonus based on the output of the whole department.
- Measured day work: This is similar except that the bonus depends on meeting some agreed rate or standard of work.
- Merit ratings: For managers, clerical workers and others it is not possible to measure the units of work done. Instead their bonuses or increments are based on merit ratings made by other managers.
- Monthly productivity bonus: Managers receive a bonus based on the productivity of their departments.
- Profit-sharing and co-partnership: There is a guaranteed weekly wage, and an annual or twice yearly bonus for all based on the firm's profits.
- Other kinds of bonus: There can be a bonus for suggestions that are made and used, and there can be competitions for making the most sales, finding the most new customers, not being absent, etc.

- Use of other benefits: Employees can be offered other rewards, such as medical insurance or care of dependents.

A topic of considerable interest is the whole issue of **performance-related pay**: the idea of linking pay with performance. The idea of these systems is that by linking pay with performance people are more inclined to direct and sustain desirable, goal-specified work-related behaviours. The idea is that money has both instrumental and symbolic motivational properties. It establishes behavioural criteria by which rewards are allocated and aligns employee behaviour with organisational values and objectives.

There are different types of PFP (pay for performance) systems depending on **who is included** (to what levels), **how performance will be measured** (objective counts, subjective ratings or a combination) and **which incentives will be used** (money, shares, etc.). For some organisations the experiment with PFP has not been a success. Sold as a panacea for multiple ills it has backfired to leave a previously dissatisfied staff more embittered and alienated. There are various reasons for the failure of PFP systems. First, there is frequently a poorly perceived connection between pay and performance. Many employees have inflated ideas about their performance levels, which translate into unrealistic expectations about rewards. When thwarted, employees complain, and it is they who want the system thrown out. Often the percentage of performance-based pay is too low relative to base pay. That is, if a cautious organisation starts off with too little money in the pot, it may be impossible to discriminate between good and poor performance, so threatening the credibility of the whole system.

The most common problem lies in the fact that, for many jobs, the lack of objective, relevant, countable results requires heavy, often exclusive use of performance ratings. These are very **susceptible to systematic bias** – leniency, halo, etc., which render them neither reliable nor valid. Further, many PFP plans have failed because the performance measure(s) which are rewarded were **not related to the aggregated performance objectives** of the organisation as a whole – that is to those aspects of the performance which were most important to the organisation. Also, the organisation must ensure that **workers are capable of improving their performance**. If higher pay is to drive higher performance, workers must believe in (and be capable of) performance improvements. PFP plans can work very well indeed, providing various steps are taken. First, a **bonus system** should be used in which merit (PFP) pay is not tied to a percentage of base salary but is an allocation from the corporate coffers. Performance appraisal must be taken seriously by **making management raters accountable for their appraisals**; they need training, including how to rate behaviour (accurately and fairly) at work. Information **systems and job designs must be compatible with the performance measurement system**. More importantly, if the organisation takes teamwork seriously, group and section performance must be included in the evaluation. It is possible and preferable to base part of an individual's merit pay on team evaluation. Finally, special awards to recognise major individual accomplishments need to be considered separately from an annual merit allocation.

After reading this reader and watching the video lesson, you can quickly **test yourself** at **https://create.kahoot.it/share/money-and-motivation-test-yourself/0e789d5c-a6d3-4fc0-adbb-6ef5fbfef5b1**

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