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The Power of Awards

Abstract: Every economist worth his or her salt will tell you that monetary compensation is more efficient than all other forms of rewards. Awards have only received scant attention in the economics literature. Yet, they are ubiquitous. They can take many forms and include titles, prizes, orders, medals, and still other types of decorations. We outline the distinguishing characteristics of awards, especially in comparison to monetary rewards, show the potential risks and emphasize where awards are particularly useful.

Keywords: awards; incentives; intrinsic motivation; money; performance pay.

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1 Introduction

Every economist worth his or her salt will tell you that monetary compensation is more efficient than all other forms of rewards. Money is fungible and therefore yields most utility to the recipient. It can be applied marginally, such that the desired performance can (in theory) be directly induced. A second type of material reward is non-monetary and takes the form of fringe benefits such as a company car or a particularly attractive office. These incentives are less efficient but can nevertheless be widely observed. This can at least partly be explained by the tax-related advantages they provide. More recently, intrinsic motivation has been considered as a work incentive. A fourth category – awards – has received only little attention by economists. Exceptions are Hansen and Weisbrod's article in the Journal

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of Political Economy and Besley's unpublished "Notes on Honours." Awards can take many forms and include titles, prizes, orders, medals, and still other types of decorations. They clearly are extrinsic incentives, though not of a material kind.

Awards are ubiquitous in practice. They are bestowed in great numbers by heads of state – monarchs, presidents and chancellors alike. The cultural sector is characterized by award ceremonies such as the *Oscars* or *Grammys*. Success in sports is crowned with medals, trophies and titles like that of the *Sportsperson of the Year*. Managers are elected *CEO of the Year*, while workers strive to be named *Employee of the Month*. Academics are eager to receive awards, too, ranging from honorary doctorates to Fellowships of prestigious academic societies [e.g., Fellow of the Royal Society, or Fellow of the Econometric Society, which is analyzed in an article by Chan, Frey and Gallus (2014)]. Even the Catholic Church relies on an elaborate system of honors, including post-mortem awards such as notably the canonizations, which have in recent years been made great use of. As shown in a working paper by Barro, McCleary, and McQuoid, the beatification rate (the ratio of the number of beatified persons to a pope's tenure) reached 12 for John Paul II (1978–2005), while it had only been between 0 and 2 up until his tenure. Similar increases in the number of awards bestowed are discernible in many areas.

2 Difference between Monetary Compensation and Awards

Awards differ from pecuniary incentives in several ways. From the point of view of the economic theory of incentives the following aspects are of primary importance.

Giving awards is cheap. In the case of awards it is only non-monetary costs that matter. Awards normally consist in a piece of ribbon, a trophy or a document that can be displayed in the office. However, if too many awards are handed out they lose their value. Choosing an unworthy candidate produces considerable costs for the giver because of the resulting image loss. The reputation of the World Wildlife Fund, for instance, was harmed when its *Honorary President*, the King of Spain, was caught hunting elephants and needed to have his title revoked.

In a few cases awards are accompanied by a large prize purse. The winner of an (undivided) *Nobel Prize* gets eight million Swedish kronor (more than one million U.S. dollars). Yet the honor going with the Prize is far more important than the money. It can safely be assumed that most scholars would be glad to accept the Prize even if no money was attached to it – or that they would even be prepared to pay for it. An important function of the money accompanying an award lies in establishing its seriousness. However, the sum of money is no guarantee that a prize will enjoy commensurate prestige. Thus, the *Balzan Prize for Humanity, Peace and Fraternity Among Peoples*, bestowed every 3–5 years, enjoys far lower prestige than the *Nobel Prize* though the winner receives even 2 million Swiss francs (more than 2 million U.S. dollars).

Where performance can only be vaguely determined, awards have a comparative advantage over monetary incentives. "Performance pay" is appropriate only if the performance criteria are precisely determined and measured. This prerequisite is, however, rarely met in the case of complex activities, as argued by Osterloh and Frey in an article in Organization Science. If variable performance pay is applied, the giver must concentrate on those parts of the performance that are measurable. As a result, the potential recipients are induced to behave in a strategic way and perform well only in those dimensions that are measured. For this reason, principal agent theory increasingly favors "encompassing" performance evaluations. Under some conditions, as shown by Holmström and Milgrom in the *Journal of Law*, *Economics, and Organization*, it is even better not to provide any explicit incentives. In that case, work effort is upheld only if work morale happens to stay high.

Awards can be used when monetary compensation would induce strategic behavior. They allow the principal to take into account non-contractible activities, such as helping a colleague. Awards are meant to honor general forms of performance, as is the case with *Lifetime Achievement Awards* given, for example, at film festivals. In many cases, the *Nobel Prize* is bequeathed for a life's work rather than for a specific research success achieved in the preceding year (although this would correspond to the original intent of the founder).

Awards fulfill an important signaling function, which is analyzed in detail in a paper by Frey and Gallus (2014). They are particularly valuable for their recipients when revealing their talent and commitment, allowing award winners to engage in beneficial new commercial and personal relationships. By bequeathing awards, the givers also send signals about themselves. They can use the awards to show which values they honor. Given the publicity and the important ceremonial component of award programs, they can also be employed for public relations aims.

Under specific conditions, monetary payments reduce work effort. They crowd out intrinsic motivation if performance measurement is perceived as controlling. If this crowding-out effect is stronger than the relative price effect, the incentive will even induce a decrease in performance. Giving money may moreover distort the positive signaling effect of "good deeds." It becomes unclear whether the action was undertaken for its own sake, or with the goal of receiving the money in return. The net effect on performance therefore can be positive or negative. These considerations constitute a considerable extension of standard economic theory. In contrast to monetary compensation, awards tend to foster intrinsic motivation. They neither require an explicit performance measurement, nor do they negatively affect the recipient's self-evaluation or reduce the latter's self-determination. Rather, awards support their recipients' activities as well as their self-image.

Awards also forge special ties of loyalty. A recipient of an award enters a bond of loyalty with the giver. Outsiders would consider accepting an award but then turning against the giver as being inconsistent. The respective person should have refused the award if he or she does not agree with the general views held by the giver. The giver also accepts to establish special ties to the recipient. His or her prestige suffers if the recipient proves to be unworthy or rejects the award. For these reasons, award givers carefully check whether the potential recipients are worthy and whether they are likely to accept the award.

Monetary payments do not establish any such bond of loyalty above and beyond the performance contracted. In many cases people emphasize that they perform a particular task solely for the money, and that they have no further connection or obligation to the person giving the money.

3 Awards Raise Welfare

Honoring a person serves to bolster the norms of others undertaking similar activities or upholding similar attitudes. These persons experience an improved self-evaluation and rise in the regard of third parties, which increases their utility. Moreover, awards can substitute for other means of getting social approval, such as luxury consumption, which induces negative external effects. Awards change the implicit relative price in favor of the activities they honor. They are often used to remunerate social engagements. This allows persons engaging in similar activities to identify themselves with the award recipients and "bask in reflected glory." The many awards received by Mother Teresa may serve as an example. Honoring a person for his or her performance moreover shifts the reference point of other persons for their own behavior. This effect can increase effort in the activity concerned.

4 Potential Risks

As awards need to be kept scarce so that they retain their value, many persons will not be honored. Especially in the context of organizations, where the group of candidates who might have been awarded is clearly delineated, this risks entailing negative reactions by non-recipients. Lower job satisfaction and performance, refusal to cooperate, or outright sabotage may be the result. For award bestowals to have a positive aggregate effect, givers need to take this risk into account and make corresponding adjustments to the awards they employ (e.g., with respect to the number, frequency, and variety of awards bestowed).

5 Where are Awards Particularly Useful?

Awards have a comparative advantage if the conditions for performance pay – encompassing and precise performance measurement – can be fulfilled only at high cost, or not at all, or if a marked crowding-out effect of intrinsic motivation is to be expected. Awards therefore play an important role in the voluntary sector.

Awards are, of course, unsuitable in many situations – as are other extrinsic incentives.

The gist of this contribution is to question the materially oriented focus on motivation and incentives. Non-monetary rewards, in particular providing honor through awards, should be accorded more attention in the economics literature. The stress on monetary rewards as the most important driver of motivation is ill-conceived. Rather than focusing on variations of material incentives, decision-makers should think about how to motivate people by conferring honors.

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