The Economist, 2025

# Rewards and Individual Behavior

ARE 112

# Big Picture

- Evaluation systems translate behavior into rewards.
- Companies that emphasize performance (vs those that don't) have (McKinsey, 2024):
  - 30% more revenue growth
  - 4.2x more likely to outperform

https://www.mckinsey.com/quarterly/the-five-fifty/five-fifty-getting-performance-reviews-right

# Big Picture


https://www.mckinsey.com/capabilities/people-and-organizational-performance/our-insights/in-the-spotlight-performance-management-that-puts-people-first

# Reed Hastings

- highly-talented people don't like policies, they want freedom.

2. **Regular, honest feedback.** Early on, Netflix did away with performance reviews, finding them too ritualistic and bureaucratically burdensome. Instead, the company expected staff to give routine, candid feedback to other employees, regardless of rank. Withholding disagreement or constructive input was on par with being disloyal to Netflix. Employees were also encouraged to highlight their own mistakes, known as "sunshining."

https://www.library.hbs.edu/working-knowledge/freedom-fear-and-feedback-should-other-companies-follow-netflixs-lead

# Big Questions

- How are reviews **perceived** by employee?
- How to **motivate** through review?

# Economic Framework: Evaluation and Reward

- **Incentive Design and the Principal–Agent Problem**
  - In personnel economics, the firm (principal) must motivate workers (agents) whose effort is not fully observable, so they design contracts linking pay to performance.
  - Classic models show that stronger links between performance and pay increase effort **if** the worker's effort is measurable and rewarding.
  - But when performance is noisy or multitask (some dimensions measurable, some not), tying pay narrowly to one metric can distort effort (multitasking problem).

# Purpose of Evaluation

- Judgmental.
  - Provide a basis for reward allocation.
  - Identify high-potential employees.
  - Validate the effectiveness of selection procedures.
  - Evaluate previous training programs.
- Development.
  - Stimulate improvement.
  - Develop ways of overcoming performance obstacles and barriers.
  - Identify training and development opportunities.
  - Establish agreement on performance expectations

# Evaluation: Relevant Behaviors

- Weighting of Relevant Behaviors (Avoid below!)
  - Deficiency- The evaluation doesn’t cover all aspects of the job.
  - Contamination- Activities that are not part of the job are included in the evaluation.
  - Distortion- Improper emphasis is given to various job elements.

# McKinsey (2024): Performance Review

**In designing an effective performance management system, company leaders face a defined set of choices.**

| | | Design choice | Potential options | | |
|---|---|---|---|---|---|
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| **Ongoing development** | 5 | Development levers | **Assessment and rating** | **Individual growth** | Combination of **both** |
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***Degree of differentiation.*** The simplest and best option for many organizations is a single performance management system to address the needs of all employees.

- Not possible for all (manufacturing)

***The nucleus of performance***. traditionally placed a strong emphasis on individual performance, rooted in the belief that individual accountability drives results.

- Recent shift toward recognizing the importance of the team in achieving overall organizational success.

# Google’s OKRs (Objectives and Key Results)

Google evaluates employees based on measurable objectives rather than subjective impressions. OKRs are public inside the company, encouraging transparency and alignment with firm-wide goals.

# Improving Evaluations

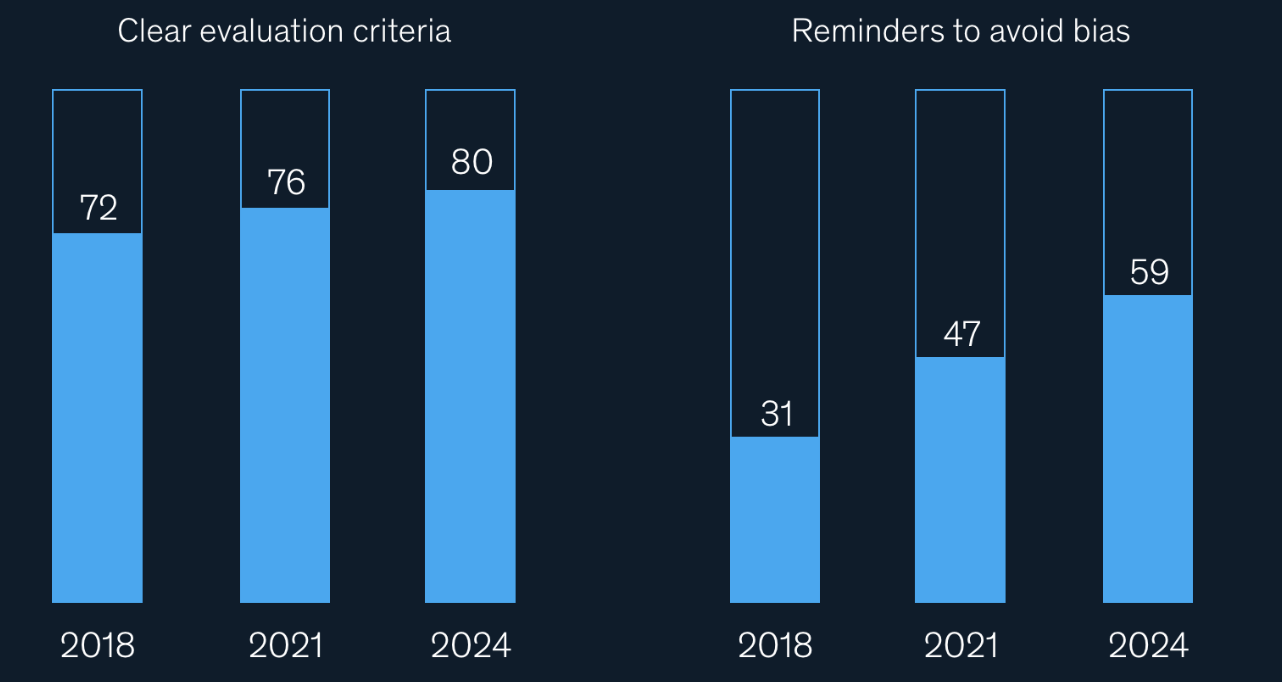
- Maximize use and acceptance of evaluations.
- Increase employee participation in the evaluation process.
- Set specific performance goals.
- Provide manager training in evaluations.
- Evaluate on how effectively the duties were performed.
- Communicate results to employees.
- Actively recognize and reinforce good performance.
- Evaluate performance on a continuous basis.

# Performance Evaluation Feedback

- Provide Feedback After Performance Evaluations.
  - Explain what went into the evaluation.
  - Explain how to improve or sustain performance.
  - Avoid generic phrases.
  - Managers generally fear giving feedback.

- Feedback provides instruction and motivation

**Companies reporting the following actions as part of performance review process,** % of respondents



# Feedback Model

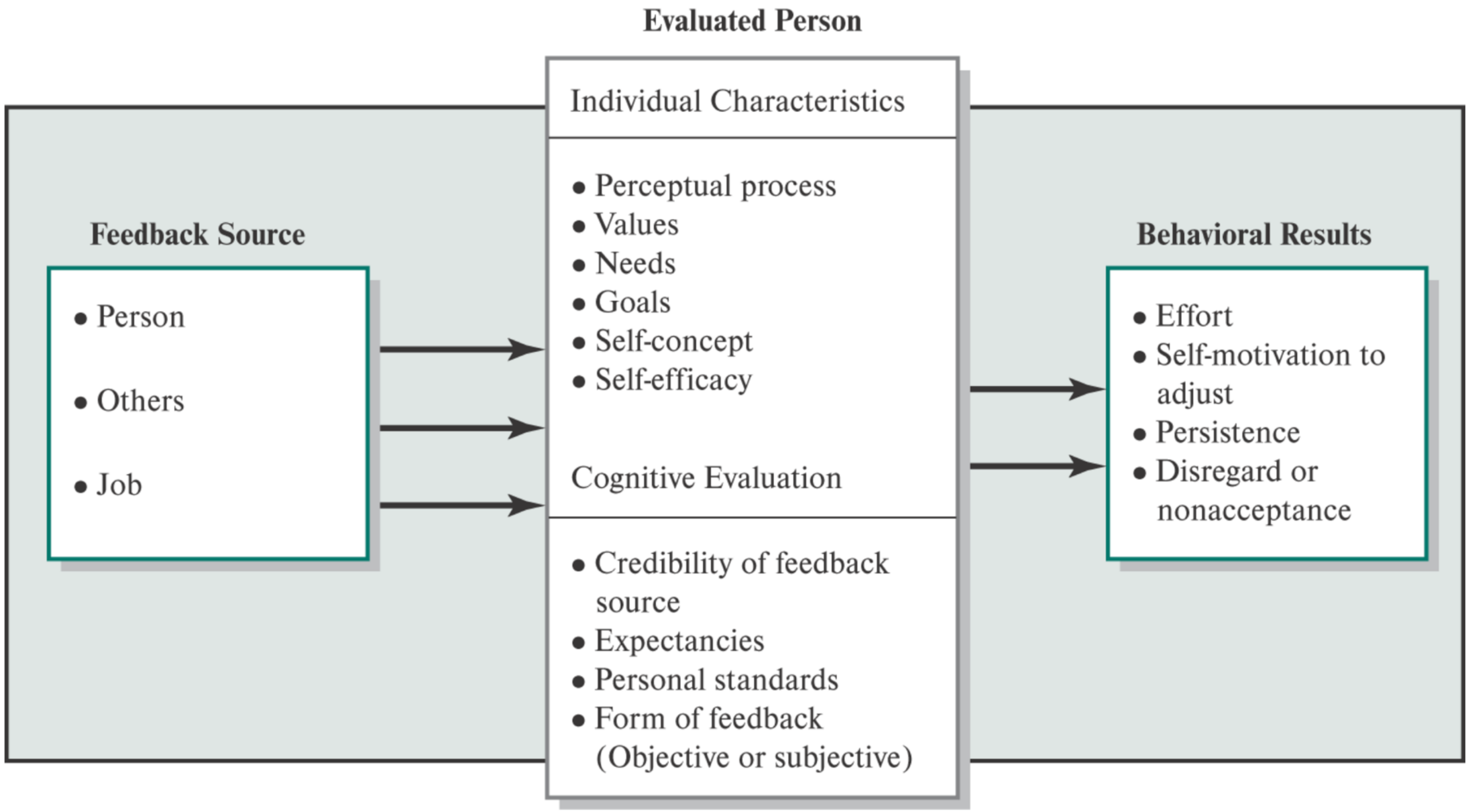



**EXHIBIT 7.1** **Cognitive Model of Feedback: Sample of Sources, Characteristics, Cognitive Evaluation, and Behavioral Results**

**Sources:** Based on A.N. Kluger and A. DeNisi, "The Effects of Feedback Interventions on Performance: A Historical Review, a Meta-Analysis, and a Preliminary Feedback Intervention Theory," *Psychological Bulletin,* March 1996, pp. 254–84; R. Kreitner and A. Kinicki, *Organizational Behavior* (New York: McGraw-Hill/Irwin, 2004), pp. 325–6.

# Best Practices Feedback

1. Give Feedback often
2. Allow evaluated to participate in feedback sessions
3. Should include praise as well as criticism
   i. Praise recognition and encouragement
4. Address results, goals, goals accomplished
   - Not performance characteristics
   - Do NOT attack personality, attitudes, or values

*"When a review is something that only happens once a year, it can feel very consequential and anxiety-inducing, but if it's happening on a more regular basis, it makes the stakes for any one of these conversations feel a bit lower"*
*- HBR 2025*

# Feedback: Rank?

- Should they compare members of their team relative to one another or evaluate everyone independently?

# Feedback: Rank Feedback

- Charness et al. (2014) examine whether subjects are willing to alter their performance and, thus, their rank position, either by sabotaging others' performance or by buying extra output. Their findings indicate that offering relative rank feedback increases output with regard to the baseline no-feedback treatment, and subjects are willing to engage in costly sabotage and cheating activities to improve their relative rank, thus offsetting the positive effects of relative rank feedback.

# Multisource (360) Feedback

- Up to 90% of Fortune 1000 firms use some form of multisource feedback program.
- Increasing use came from calls for fairness, clarity, and credibility.
- In a 360-degree program, evaluators could include creditors, peers or team members, supervisors, subordinates, and the person being evaluated.

# Multisource Feedback: Best Practices

- Best practices:
  - Use primarily for individual development.
  - Integrate feedback with other activities.
  - Link the feedback process with the overall strategy and direction of the firm.
  - Exert administrative control over every aspect of the process.
  - Make senior management role models.
  - Use highly trained internal coaches.
  - Evaluate the effectiveness (ROI) of the process.

# Multisource Feedback: Pros and Cons

- Argument for the approach.
  - May address the constant concern about fairness and credibility in evaluation programs.
- Arguments against the approach.
  - Source may fear that negative comments will harm the person’s career or salary progression and inflate their ratings.
  - Limited observation of employee behavior by many evaluators.

# Google: Performance Review Overhaul

- Before: biannual system that categorized employees into a multitude of performance tiers.
  - Involved peer reviews and the creation of substantial documentation.
  - Perceived as complex and lacking transparency
  - 47 percent of Google employees thought the old performance review system was waste of time.

- Now: GRAD (Googler Reviews and Development)

https://www.dice.com/career-advice/googles-new-performance-review-system-offers-radical-change

# Google: Performance Review Overhaul

- Twice-yearly reviews with standardized metrics: Instead of relying on potentially ambiguous or loosely defined goals, Google now employs more concrete and consistent metrics that are directly aligned with specific job levels and overall team outcomes.
    - This aims to provide a more objective basis for evaluation.
- A reduction in performance ratings tiers: The previous model incorporated numerous and often finely differentiated performance categories. The new system simplifies these evaluations into a smaller number of clearer and more broadly defined bands.
    - Examples: "Meets Expectations," "Exceeds Expectations," and potentially others indicating different levels of performance.
        - This reduction aims to make the evaluation outcomes more readily understandable.

https://www.dice.com/career-advice/googles-new-performance-review-system-offers-radical-change

# Google: Performance Review Overhaul

- Stronger emphasis on manager feedback: Managers now play a more central and influential role in the evaluation process. They are expected to provide more direct guidance on performance and to actively mentor their team members throughout the entire year, not just during the formal review periods.
  - This increased managerial involvement aims to foster more continuous development and feedback.
- Feedback delivered earlier in the review cycle: Employees now receive preliminary feedback and insights into their performance earlier in the formal review cycle.
  - proactive approach allows for a greater amount of time for employees to understand areas for improvement, make necessary adjustments to their work, and engage in constructive dialogue with their managers regarding their performance.

https://www.dice.com/career-advice/googles-new-performance-review-system-offers-radical-change

# Google: GRAD Results

- GRAD placed six percent of Google employees into a lower category that might have put their jobs at risk
- Employee Reactions:
    - **Appreciation for transparency:** Some employees have expressed that the clearer performance expectations and the provision of feedback earlier in the review cycle have contributed to an improved sense of confidence and understanding throughout the evaluation process.
    - **Increased pressure:** Conversely, a number of employees report feeling that the new system has led to heightened performance expectations without a corresponding increase in the level of support, resources, or adjustments to workloads.
    - **Frustration around subjectivity:** Despite Google's efforts to standardize the evaluation process through metrics and clearer guidelines, employees continue to express concerns regarding the potential for subjectivity, with some reporting that factors such as perceived favoritism and individual manager interpretation still appear to play a significant role in the outcomes of reviews.
    - **Perceived intensification of scrutiny:** Increased frequency and directness of feedback, while intended to be helpful, can also be perceived as a more constant form of evaluation.

https://www.dice.com/career-advice/googles-new-performance-review-system-offers-radical-change

# Amazon: Performance Review Redo

- Categorizes employees into five performance tiers and setting fixed percentages for each

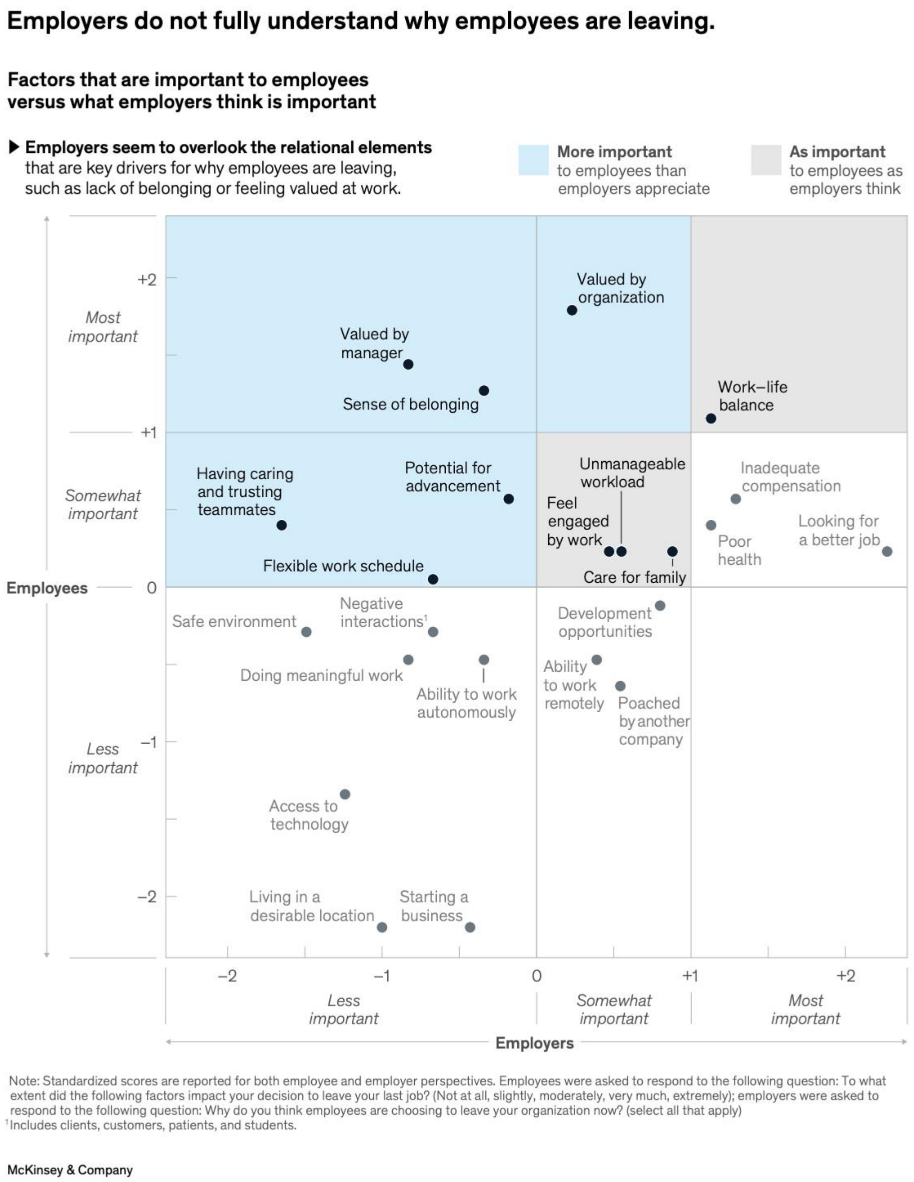
# Rewards and Incentives

- Why do they matter?
  - According to Forbes, studies have shown that a top reason employees leave their jobs is lack of recognition. As many as 66% would leave if they did not feel appreciated — and that number jumps to 76% among Millennials. That's as many as three-quarters of today's workers.

https://hr.un.org/sites/hr.un.org/files/Private%20Sector%20Recognition%20and%20Rewards%20A%20Collection%20of%20Examples.pdf

# Why Employees Leave

- “three noncash motivators—praise from immediate managers, leadership attention (for example, one-on-one conversations), and a chance to lead projects or task forces” were “no less or even more effective motivators than the three highest-rated financial incentives: cash bonuses, increased base pay, and stock or stock options.” (McKinsey, 2024)




https://www.mckinsey.com/~/media/mckinsey/business%20functions/people%20and%20organizational%20performance/our%20insights/in%20the%20spotlight%20performance%20management%20that%20puts%20people%20first/in-the-spotlight-performance-management-that-puts-people-first-v2.pdf?shouldIndex=false

# Reinforcement Theory [1]

- Reinforcement is a Key Principle of Learning.
  - Positive consequences increase the strength of a behavior and the probability of repetition.
  - Negative consequences decrease the strength of a response and the probability of repetition.
  - **Operants** -Behaviors that can be controlled by altering the consequences that follow them.

# Reinforcement Theory

- A reinforcement is different from a reward.
  - A reward is perceived as desirable, and is provided after performance.
  - Not all rewards are reinforcers.
  - Reinforcers increase the rate of behavior.
- Positive reinforcement: increase frequency of response by removing a negative reinforcer immediately after response.
- Negative reinforcement: increase frequency of response by removing a negative reinforcer immediately after response.

# Reinforcement Theory

- Punishment.
  - An uncomfortable or unwanted consequence for a particular behavior response.
  - Can suppress behavior if used effectively, but is controversial.
  - Should be used only after careful and objective consideration of the situation.
- Extinction- Reducing unwanted behavior.
  - If positive reinforcement for a learned response is withheld, the behavior continues for some time.
  - If non-reinforcement continues, the behavior decreases in frequency until it disappears.

# Reinforcement Schedules and Their Effects on Behavior (Based on Exhibit 7.2)

| Schedule | Description | When Applied to individual | When Removed by Manager | Organizational Example |
|---|---|---|---|---|
| Continuous | Reinforcer follows every response. | Faster method for new behavior. | Faster method to cause extinction of new behavior. | Praise after every new sale and order. |
| Fixed interval | Response after specific time period is reinforced. | Some inconsistency in response frequency. | Faster extinction of motivated behavior than variable schedule. | Weekly, bimonthly, monthly paycheck. |
| Variable interval | Response after a variable time is reinforced. | Produces high rate of study responses. | Slower extinction of motivated behavior than fixed schedule. | Transfers, unexpected bonuses, promotions. |
| Fixed ratio | A fixed number of responses must occur before reinforcement. | Some inconsistency in response frequency. | Faster extinction of motivated behavior than variable schedule. | Piece rate, commission on units sold. |
| Variable ratio | A varying number of responses must occur before reinforcement. | Can produce a high rate of response that is steady and resists extinction. | Slower extinction of motivated behavior than fixed schedule. | Random checks for quality yield praise for doing good work. |

# Reinforcement Frequency

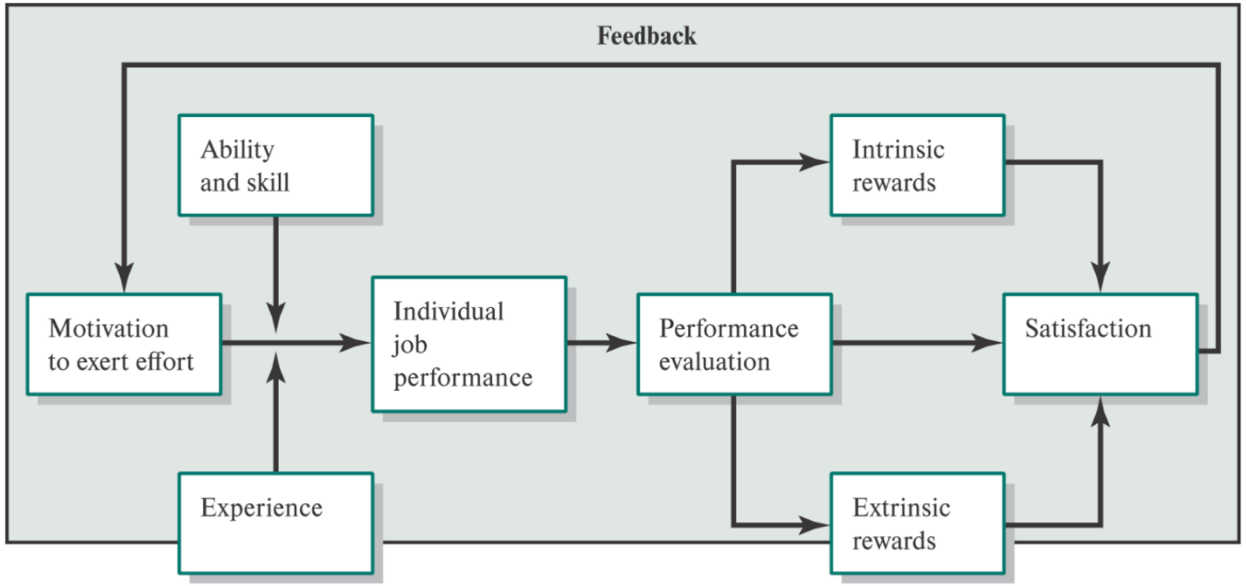
- PayScales' Compensation Best Practices Reports, the percentage of organizations offering annual-based performance rewards has decreased by nearly 20 percent from 2016 to 2020, while during the same period the percentage of organizations offering monthly rewards has doubled (PayScales, 2018, p. 19, 2020)

Newman, A.H., Tafkov, I.D., Waddoups, N.J. and Xiong, X.G., 2024. The effect of reward frequency on performance under cash rewards and tangible rewards. *Accounting, Organizations and Society*, *112*, p.101543.

# Individual Rewards Model

- Three Main Objectives of Reward Programs.
  - Attract qualified people to the organization.
  - Keep employees coming to work.
  - Motivate high levels of employee performance.

**EXHIBIT 7.3** The Reward Process



# Individual Rewards Model

- The reward process attempts to integrate.
  - Satisfaction
  - Motivation
  - Performance.
  - Rewards.
- Motivation alone is insufficient to cause good performance.
  - Performance also requires ability, skill, and experience.

# Individual Rewards Model

- Lawler and Reward Satisfaction
  - How much is received and how much people think should be received.
  - Comparisons with what happens to others (equity theory; input-out)
  - How satisfied one is with both intrinsic and extrinsic rewards.
    - Intrinsic: feeling of accomplishment, achievement

# Individual Rewards Model: Intrinsic or Extrinsic?

- Extrinsic rewards.
  - Salary and wages.
  - Employee benefits.
  - Interpersonal rewards.
  - Promotions.
- Intrinsic rewards.
  - Completion.
  - Achievement.
  - Autonomy.
  - Personal growth.

# Evaluating Rewards

- Lawler evaluates rewards plans:
  - How effective is it in relating that pay is related to performance?
  - How well does it minimize perceived negative consequences of good performance?
  - How well does it contribute to perception that rewards other than pay contribute to performance?

# Rewards Interact: Intrinsic and Extrinsic

- Do intrinsic and extrinsic rewards have an independent, additive influence on motivation?
  - If one is experiencing a high level of intrinsic rewards, additional extrinsic rewards may decrease motivation or reduce intrinsic rewards.
    - Crowding out!

# Administering Rewards

- Positive reinforcement.
- Expectancy theory.
  - **Motivational Force (MF) = Expectancy x Instrumentality x Valence**.
- Modeling & social imitation.

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# Employee Rewards and Organization Outcomes

- Organizational outcomes influenced by rewards
  - Absenteeism and turnover
  - Job Performance
  - Organizational Commitment
    - (1) a sense of identification with the organization’s goals, (2) a feeling of involvement in organizational duties, and (3) a feeling of loyalty to the organization.

# Innovative Rewards

- Skill-based pay.
- Broadbanding.
- Concierge services.
- Team-based rewards.
- Part-time benefits.
- Gain sharing.
- Employee stock ownership plans.

# Rewards: Key for Mgt

- Employees must perceive a “real” linkage between performance and rewards.
- Setting a clear line of sight is difficult, and should be considered when designing a job.

# Key Takeaways

- Evaluation systems translate behavior into rewards. Effective systems align employee effort with organizational goals and reduce principal–agent problems.
- Fairness and clarity matter. Avoid deficiency, contamination, and distortion in evaluation criteria to maintain trust and motivation.
- Feedback drives improvement. Ongoing, specific, and balanced feedback, rather than annual reviews, builds learning and engagement.
- Reinforcement works through consequences. Positive reinforcement and clear recognition increase the likelihood of desired behaviors; punishment and extinction should be used cautiously.
- Intrinsic and extrinsic rewards interact. Overuse of financial incentives can “crowd out” intrinsic motivation, but a thoughtful mix of both fosters sustained performance.
- Innovative practices are emerging. Firms like Google and Netflix emphasize continuous feedback, transparency, and autonomy, showing that adaptive systems outperform rigid, hierarchical ones.
- Perceived linkages are critical. Employees must believe that performance truly drives rewards for systems to motivate effectively.