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Why Can't We Wait (To Spend) and the Law of Unintended Consequences: Potential Negative Impact on Minority Employees from Well-Intentioned Organizational Compensation Practices

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Abstract

The presenter outlines a theoretical argument suggesting that organizational attempts to increase short- and long-term motivation and loyalty may unwittingly exacerbate career and financial growth problems for some "minority" workers. Research on ethnic cultural tendencies and individual differences in spending propensities is used to support the notion that the use of incentive-based compensation systems and retirement programs could lead to employees being both undermined in terms of financial health and "slotted" into divergent career paths.

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In this time of increasing uncertainty about business viability and stability, many organizations are looking to gain control of their "bottom line" by strengthening the link between organizational outcomes and employee rewards. Long gone are the days of steadily and automatically increasing worker salaries as a hoped-for method of expanding productivity. Indeed, there is a school of thought that suggests that automatic pay increases act as a "demotivator" for many individuals. The more common approach currently is to utilize incentives (i.e., additional compensation/rewards given for performance beyond normal expectations) as a way of enhancing employee work motivation, thereby leading to increases in organizational performance. These incentives can be either short-term in nature (e.g., paying a certain rate per unit produced) or take more of a long-term perspective (for instance, profit sharing programs). In and of themselves, such compensation practices seem to be sound business practices. However, there is a distinct possibility that taking a blanket approach to implementing incentive programs, i.e., not taking individual differences between employees into account, may result in an unintentional "slotting" of certain ethnic and racial groups into career paths that will be detrimental to their long-term financial and employment health. The remainder of this essay sets forth the theoretical underpinnings for that conclusion.

In their research paper examining relationships between different theories of pay preferences, Schaubroeck and Shaw (2000) identify a construct they refer to as "income sensitive consumption" which is "the extent to which individuals spend in proportion to their current income rather than their expected income" (p.2). Ostensibly, a highly income sensitive employee would spend a $500 bonus almost immediately after receiving it, as opposed to putting some or all of it into long-term holdings (e.g., a savings account). The implications of the income sensitive consumption construct can be contrasted with those of the "permanent income hypothesis." This hypothesis holds that over the course of a lifetime, a particular individual will spend at a relatively constant rate, based on that individual's average "expected" income. For such an individual, the $500 "windfall"/bonus would not be spent right away; rather, the money would more likely be consumed gradually over the remainder of that person's life, along with any other forms of income. Relative to an income sensitive worker, then, someone operating according to the permanent income hypothesis would devote much more of his or her earnings to savings, pensions, etc.

A number of inferences can be drawn from those rudimentary deductions, one being that income sensitive consumers will probably prefer short term incentives more so than will permanent income consumers. The logic behind the determination is that since income sensitive consumption prompts spending of current income, individuals exhibiting that behavior pattern would likely attempt to increase income in the short term. In that context, work motivation should increase when pay is tied directly to performance, as in a piece rate system. In contrast, permanent income consumers would be predicted to be drawn more toward compensation systems, such as profit sharing, that incorporate long term payment mechanisms. Since the permanent income consumer theoretically makes spending decisions based on projections of lifetime earnings, profit sharing, along with other post - employment forms of compensation would better enable such predictions than just relying on short term incentives.

Another difference arising from a comparison of short term and long term incentives is that the latter generally engenders a much greater degree of uncertainty than does the former. For instance, a person who is paid by the amount of units produced per hour knows within sixty minutes how much income has been earned. Conversely, profit sharing and pension plans by definition require a much longer time to determine the benefit amount and in some cases carry no guarantee that the intended recipients will actually receive it. Consequently, one would predict that the individuals who tend to avoid uncertainty would prefer short term incentives relative to those with a higher tolerance for ambiguity. By extension, then, income sensitive consumers would be predicted to have less tolerance for uncertainty and permanent income consumers predicted to have more tolerance for the uncertainty.

Geert Hofstede, a Dutch scholar and organizational researcher, surveyed over 100,000 employees in 53 countries in an attempt to categorize cultural differences between nations (Hofstede, 1984). Hofstede identified four dimensions of national culture; individualism, masculinity, power distance and uncertainty avoidance. Of primary relevance to the propositions of the present paper is the uncertainty avoidance dimension, defined as the degree to which people of a particular culture tolerate risk and unstructured situations. Examples of countries rated low in uncertainty avoidance (i.e., exhibiting a greater tolerance for risk) include the United States, Denmark and Sweden. High uncertainty avoidance rates were found in such nations as Mexico,
Peru and Venezuela. The examples cited here are not coincidental. Many of the countries found to have high uncertainty rates are those often referred to as being "Third World." The ethnic derivation of many "people of color," particularly Latinos and African Americans also traces to these same nations. While the African nations were not included in Hofstede's study, he did find a strong negative correlation between the degree of uncertainty avoidance and the degree of individualism (the tendency of people to look after the interests of themselves and their families, as opposed to counting on the larger group to provide protection for the individual.) Individuals from collectivist cultures, such as those in Africa and Latin America, or those with collectivist ethnic backgrounds, would therefore be much more likely to avoid uncertainty in their choice of incentive

programs.

With these theoretical predictions as a foundation, we may make some plausible speculations about the effects on Blacks and Latinos. It is a nearly universally tenet of economic principles that a reliance on short-term spending, combined with a concomitant failure to commit a significant proportion of earnings to savings, is a prescription for long-term financial pain. Yet this is precisely the prediction one would make for black and Latino workers based on the propositions made earlier in this paper. As a point of fact, while savings rates are very low in the United States overall, there are differences between ethnic and racial groups, with African Americans and Latinos ranking in the lower tiers.

From the employment perspective, short-term incentives, such as piece rate systems in manufacturing settings are commonly found in the lower level "production" areas of the workplace. Longer-term rewards for building the wealth of organizations are more often the province of the executive suite. With the great time frame needed to build long-term wealth comes more risk and uncertainty, but also often greater rewards. Among these rewards are promotions up the corporate hierarchy. To the extent that a preference for short-term incentives governs job choices, then, it would be easy to see how some groups (i.e.., blacks and Latinos) might more easily get "stuck" at lower levels of a company. In the context of the career trail, as with personal finance, it would seem that the predicted preferences of Black Americans and Latinos would almost necessarily lead to dead-ends. Either outcome would not be conducive to job satisfaction and lowered job satisfaction usually leads to lowered productivity and retention, both negative markers of business health. Thus, sound organizational practices (i.e., the use of short-term and long-term incentives for motivational purposes) may lead to a counterintuitive outcome.

It goes without saying that the propositions in this paper, though based on logical inference, are just that, propositions. Much empirical work is needed in order to move them from the realm of speculation to the domain of statistical "evidence." To acknowledge that, however, does not render them useless. The face of the United States workplace is becoming increasingly heterogeneous, particularly in terms of racial and ethnic diversity. Those of us who study or manage organizations have a responsibility to incorporate this "new" reality by continuing to move from a "one size fits all" approach to our research and administration, if for no other reason than our own self - interest. To the degree that we can improve the lots of our fellow citizens by doing so, a "win - win" situation may result for all.

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