

# Awards as compensation

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## Abstract

Awards are non-material, extrinsic compensation taking the form of orders, medals, decorations and prizes. They have been widely used in monarchies and republics, private organizations, not-for-profit and profit-oriented firms. Nevertheless, they have so far not received much attention. This paper develops empirically testable hypotheses, analysing the determinants of the supply of awards. The hypotheses refer to the possibility of using awards, the effectiveness of awards, and the capacity to maintain the scarcity value of awards. As the number of awards bestowed cannot (at least so far) be measured adequately, empirical evidence is adduced by way of illustrative examples.

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## Awards are omnipresent

Awards in the form of orders, medals and decorations exist everywhere in society.<sup>1</sup> Governments and all manner of non-governmental organizations hand out awards in the civil and military sectors, in academia, in culture, in the media and in religion, as well as in sports. All around the world,<sup>2</sup> officers are highly decorated; sometimes their entire chests are covered with orders and decorations. In the arts, in culture and in the media, prominent examples are the *Academy Awards (Oscars)*, the prizes handed out by the film festivals at Cannes, Venice or Berlin, the *Emmy Awards* and *Grammy Awards*, the *Booker Prize* and the *prix Goncourt* in literature, or the *Pulitzer Prize*. Art institutions, such as museums, bestow titles, such as *benefactor* or *patron*, upon their supporters. In the field of sports, there are regular, often yearly, competitions for the title *Olympic Champion* or *World Champion*. Athletes are given the honour of being elected '*Sports Personality of the Year*' (by the BBC) and are admitted into the Halls of Fame. The International Football Association bestowed upon Pelé (Edson Arantes do Nascimento) and Franz Beckenbauer the '*FIFA Centennial Order of Merit*' for being the best footballers of the 20th century. Religious organizations, such as the Catholic Church, award the titles *Canon*, *Monsignore* or *Archbishop*, and beatify and canonize distinguished persons, which can be considered a post-mortem award.

It might be thought that academia, as the place of rational discourse, would be an exception. However, the opposite is true: academia has an elaborate and extensive system of awards. Universities confer many titles, such as

*honorary doctor* or *honorary professor* or *senator*. Professional associations award an enormous number of medals, ranging from the *Fields Medal* in mathematics to *Nobel Prizes* (Weinberg and Galenson, 2005). Prestigious fellowships exist in Academies of Science (e.g. Fellow of the *Royal Society FRS*, founded in 1660; Fellow of the *American Academy of Arts and Sciences*, founded in 1780; Fellow of the *Royal Society of Edinburgh FRSE*, founded, among others, by Adam Smith in 1783; or *Fellow of the Academy of Social Sciences in Australia FASSA*); and in associations such as the *Econometric Society* (Hamermesh and Schmidt, 2001). And then there is the flood of *best paper awards* handed out at conferences and by journals (Coupé, 2003).

Even more surprising is the widespread use of awards in the corporate sector of a market economy where the only reward, after all, is supposed to be money. Firms commend their employees for being '*Salesperson of the Month*' or '*Employee of the Week*'; there seems to exist no limit to the ingenuity of inventing new awards. Most for-profit firms extensively use awards as a form of compensation in addition to monetary benefits. Awards have a strong signalling function. They serve as an indication of what kind of (extra-role) behaviour is desired by the management above and beyond normal duties. Awards also serve a signalling function for the recipients. They improve career opportunities and indicate superior talent and motivation to outsiders. Awards may bring recipients material benefits in economic interactions (Ball *et al.*, 2001). Awards certainly represent more than just money, and the recipients experience them as a special form of *social distinction*, setting them apart from the other employees.



I argue that there are major differences between awards and monetary compensation, which makes the separate analysis of awards worthwhile. At this point, it suffices to mention the following differences:

- The material costs of awards are quite low for the donor but the value may be very high for the recipient. The costs mainly consist in the selection and presentation at a special ceremony. A quite different type of cost is the decreased value of an award if it is handed out too freely.
- Accepting an award establishes a special relationship, in which the recipient owes (some measure of) loyalty to the donor. It is in the interest of the recipient to show this loyalty or respect to the bestower because doing otherwise would reduce the value of the reward received. The respective contract, however, is tacit, incomplete, and difficult, or impossible, to enforce by the donor *ex post*.
- Awards work better as an incentive instrument than monetary payment, when the recipient's performance can be only vaguely determined.
- Awards are less likely to crowd out the recipients' intrinsic motivation than monetary compensation.
- Awards as such are not taxed, while monetary income is (but the money possibly coming with awards is, or rather should be, taxed).
- Awards are discrete and discontinuous, while monetary income is continuous.

The desire for social distinction that lies behind the demand for awards can be taken to be innate to human beings. The firms bestowing awards organize special ceremonies to present them, publish the occasion in their newsletter, and exhibit the awards in well-visible locations. These facts create a tension between the employees' desire for social distinction and their effort to stay in a good relationship with their work colleagues. The tension is reflected in the observation that when employees are asked whether they would like being honoured in a social occasion when receiving the award regularly expresses that they prefer not to have one, but, nevertheless, are greatly pleased when their superiors organize such an event.<sup>3</sup>

The awards mentioned have, of course, many different properties. For some purposes, it is necessary to carefully distinguish between, for instance, a (British) *Lord* and a *Knight*, as the former brings legislative power (he/she becomes a member of the House of Lords) while the latter is purely honorific. And it is certainly not the same gaining huge recognition and publicity through winning the *Nobel Prize* as a sign of scientific achievement or, say, receiving the little known *Balzan Prize* (although the latter comes with more money, roughly one million Swiss Francs, or US\$ 770,000). Awards bestowed within private institutions including for-profit firms differ from other awards mainly that the money going with them is of greater importance. But superiors nevertheless use them to give special recognition to chosen employees going above and beyond pure material compensation. Awards thus are not just a substitute for money but have special features. Huberman *et al.* (2004) show experimentally that people value status independently of any monetary consequence and are indeed willing to incur material costs to obtain it.

It is characteristic of awards that they can only be broadly defined. In this paper, awards are cover *extrinsic, but non-material compensation*. Some awards such as the title 'Manager of the Month' are not intended to compensate recipients for their achievements; they are therefore excluded from consideration in this paper. Awards differ from material, in particular monetary, compensation and also from purely intrinsic rewards (see Frey, 1997; Bénabou and Tirole, 2004). The broad nature of awards is no mere accident, but an important feature of awards. An analysis is difficult because the quality aspect is essential. It makes little sense, for example, to just count the number of orders given out, because they differ in many respects, most importantly in the appreciation accorded to them. Thus, there is a world of difference between a person receiving the *Most Noble Order of the Garter* created in 1348, or an *MBE (Member of the Order of the British Empire)* created in 1917. At the present state of research, it is not possible to evaluate the number and quality of awards using any one single measure. Moreover, there are serious data limitations. To my knowledge, there is no comprehensive list of the different types and classes of awards in the various spheres of society (government, the arts, culture, the media, sports, religion, academia, not-for-profit and for-profit enterprises), countries and time periods. A statistic of awards handed out in each category, and for each country and time period is even more elusive. Only partial, spotty and inconsistent evidence is available from scattered sources. This applies, in particular, to the many awards given by private institutions, such as non-profit organizations, clubs and firms. Orders given by monarchs or governments are somewhat better documented.<sup>4</sup> Because no internationally comparable data on awards are available, the propositions outlined below are illustrated with examples. They serve to make the presentation more vivid but they are not meant to substitute for a rigorous quantitative test.

The science of *phaleristics* (the Greek and Roman word for award) has produced a large literature on *specific* awards, in particular on orders, decorations and medals. This literature is historically oriented and mainly devoted to presenting legal rules and regulations, as well as facts. Examples are Risk (1972) on the *Most Honourable Order of the Bath*, or Galloway (2002) on the *Order of St Michael and St George*. Very useful discussions (including some data) on the present state of orders, focusing on Britain, are provided by Phillips (2004) and in the report by the House of Commons (2004). Only a few works cover orders across several countries, for instance Kletmann and Neubecker (1984), Honig (1986), and Mericka and Marco (1990).

There is a considerable literature on awards in sociology. Examples are Bourdieu (1979), Goodin (1980), Elster (1983), Braudy (1986), Walzer (1983) or Baurmann (2002). Of special relevance are the works on status, see for example, Marmot (2004) and de Botton (2004). With few exceptions, these works address awards and distinctions in general, but do not look at awards as a form of compensation and do not use a comparative perspective. There is a small literature in administrative science devoted to public service awards in particular countries (e.g. Borins, 1999, 2000).

Awards have been analysed in economics particularly in the context of incentives (e.g. Prendergast, 1999), in particular non-monetary ones (Ward and Sloane, 2000; Prendergast and Stole, 2001; Jeffrey, 2004). Ginsburgh and van Ours (2003), Ginsburgh (2003), and Ginsburgh and Weyers (2005) discuss Academy Awards (*Oscars*) in film, the *Booker Prize* in literature and the *Eurovision Song Contest*. Glejser and Heyndels (2001) deal with one of the most important piano competitions, the *International Queen Elisabeth Prize*.

The goal of this paper is to analyse awards as a special form of compensation. This helps us to better understand the important role awards play in society and in particular organizations. The *supply of awards* depends on three sets of determinants. Firstly, there are the *possibilities available* to the principal. Compared to financial compensation, more awards are offered,

- (1) when the principal has little financial resources; and
- (2) when it is difficult to *ex ante* formulate and monitor work effort.

Secondly, the principal's actions depend on the *effectiveness* of awards as incentive mechanisms compared to other instruments. Compared to financial rewards, awards are used less,

- (3) when the principal is able to control the supply of awards;
- (4) when the positional externality produced by a particular award is high; and
- (5) when awards are likely to crowd out intrinsic motivation.

Finally, in order to present a valid alternative to material (financial) compensation, awards must have *scarcity* value for the recipients. The value of awards will be the higher,

- (6) when the risk of giving awards to unworthy persons is smaller;
- (7) when fewer persons refuse awards; and
- (8) when the principal's time horizon is longer, that is, when the probability of staying in power is greater.

The discussion proceeds as follows: the following section discusses when and why people like to receive awards and the further section analyses the conditions under which awards are supplied. A principal-agent setting with incomplete contracts is used to highlight particular features of awards. The various theoretical propositions are illustrated by examples and the final section concludes.

### When are awards valued?

Individuals are taken to have an *innate desire to distinguish themselves from other individuals*. People have a strong urge to be better than others. What matters to people is the relative, and not the absolute, ranking (Frank, 1985). The quest for social distinction is assumed to be a hard-wired trait of human nature. This assumption is in line with the socio-biological and evolutionary literature; see for example Henrich and Gil-White (2001) or Zizzo (2002). It follows that awards are valued most highly by prospective and actual recipients when they establish a *social distinction not achievable by other means*.<sup>5</sup> In the context of firms, awards are therefore particularly highly valued when for some

reason such distinction cannot be reached through monetary compensation. This may occur under various circumstances:

- (1) The monetary compensation received by other employees is not, or at least not well, known. This is the case in most European firms (but less so in the United States).
- (2) The extent of fringe benefits, say the use of the jet, fancy cars and hotels, or vacation homes offered by the firm to particular employees is not well known or not feasible.
- (3) The firm is committed to small differences in salary. While this condition is of lesser importance in classical for-profit firms, it does play a significant role in many not-for-profits, in cooperatives and also in owner-managed firms. In these types of firms awards are a welcome additional compensation instrument.

An award is also the more valuable to a recipient, the higher the recognition enjoyed by the award giving body. An award bestowed by an institution of high prestige and legitimacy is valued more highly than one bestowed by a body which is little known and not highly appreciated. When the award giving institution has a bad reputation, an award is a cost, rather than a benefit to the recipient (and is therefore normally rejected).

### When are awards used?

The institution (or person) bestowing an award can be taken to be a principal maximizing utility by inducing the agents, as the recipients of the awards, to act in the principal's interests. The principal-agent relationship between the donor and recipient of awards involves a *tacit and incomplete contract*. The terms of the *award contract* are not precisely specified, and are often left deliberately vague. The recipient exhibits some measure of loyalty to the award giver. The higher the value of an award, the higher the recognition and legitimacy enjoyed by the award giving body, and, therefore, recipients have an incentive to bolster the donor's prestige. The award received would be devalued if the recipients criticized the donor unfairly or excessively. Rather, they benefit from speaking in favourable terms, and acting in support of, the award giving institution. An example is the *Nobel Prize Committee* who makes great efforts to ensure that the recipient of a Prize does deserve it. The committee consults extensively with the scientific community. It even checks whether a scholar can be expected to behave in an appropriate manner at the award ceremony, where the Swedish King bestows the *Prize* (see e.g. Nasar (1998) for case of John Nash).

Other members of society clearly recognize this *psychological bond* established by accepting an award. A recipient who later turns against the bestowing institution faces disapproval by other members of society who argue or at least believe that the particular person should not have accepted the award in the first place if he or she does not side with the bestowing institution. The psychological contract (Rousseau and McLean Parks, 1993; Rousseau, 1995) between the donor and recipient of an award differs significantly from a trade contract in a market, in which an agent is promised payment by the principal for a well-defined performance (for instance for delivering a good).



If the principal accepts the performance as satisfactory, the agent receives the payment and is then free of any further obligation. In particular, such a monetary exchange does not establish any special bond; the agent is perfectly free to offer the goods to any prospective buyer. An employment contract also differs from an award contract. In an employment contract, performance is often explicitly and precisely specified, and monetary compensation is paid after the service has been rendered. Once the employment contract is fulfilled, the employee is free to offer the services elsewhere. But such contracts mainly apply to simple tasks. Employment contracts for more qualified tasks share some of the features of award contracts. The tasks to be performed are incompletely specified, and can be only partially monitored and enforced by the principal. In that case, the agent is expected to exhibit loyalty towards the principal. However, in contrast to award contracts, once the employment relationship has ended, no further loyalty is owed.<sup>6</sup> Managers can therefore be observed switching freely from one firm to another, or soccer players transferring (with the approval of their present club) to an archrival. While a person may receive awards from other donors (e.g. an order from a monarch of another country), this in no way ends the obligation to maintain loyalty to the previous donor.

#### Possibilities of using awards as incentives

Institutions short of income often turn to awards in order to provide incentives to their agents. Awards are extremely inexpensive in monetary terms. Sometimes awards simply consist in a piece of ribbon. In many cases, the recipients must even pay for the insignia of the order bestowed upon them. For the donor the only material costs involved consist in the organization of the actual ceremony where the award is presented. These costs are, in general, quite low. The low costs make awards particularly attractive to donors short of funds.

The more strongly an institution is *restrained by a lack of income*, the more it turns to awards rather than to money to provide incentives. The role of income constraints on the supply of awards applies in particular to three institutions. *Monarchies* were strongly income-restrained in the past, and today often have no independent source of income. They, therefore, tend to turn to awards more than republics benefiting from tax revenue do. The more income-constrained *dictatorships in poor countries* are, the more they use awards as incentive instruments. *Not-for-profit firms* are often very income-constrained and, therefore, use awards more frequently than for-profit firms.

Recent research on incentive systems and corporate governance (see the surveys by Prendergast, 1999; Daily *et al.*, 2003) suggests that monetary compensation does not always work well. This holds, in particular, when the task to be performed is difficult, or impossible, to specify *ex ante*, or to monitor *ex post*. In this case, it is hard to make a monetary payment which is considered to be fair by the recipients. 'Soft' awards (e.g. Holmstrom and Milgrom, 1991, 1994), which endeavour to take a broader view of the agent's efforts, become more useful then. Such awards are well suited to that purpose. With a few exceptions in the military branch,<sup>7</sup> orders, decorations and prizes are given to honour more general efforts, rather than very specific efforts.

When it is *more difficult to formulate specific contracts ex ante*, and to *monitor ex post*, awards function more efficiently as incentives, compared to monetary compensation.

This difficulty is reflected by how the *Nobel Prize* is awarded. According to Nobel's testament, the prize should be given every year to those scientists who made the most important contribution to science during the previous year. The fact that the *Nobel Prize* is awarded, in the overwhelming majority of cases, on the basis of a scholar's overall life performance, suggests that prizes serve this purpose well. On the other hand, one rarely observes a person being given a sum of money for his/her life achievement. If it were done, the question would immediately arise why the sum is not higher or lower. An evaluation in euros and cents of what one has achieved, and how one has performed in life, is difficult, to say the least, and many would consider it offensive to have their life evaluated in these terms. The same question also arises with respect to awards, but it is less harmful, exactly because the value of awards is *purposely* left vague. Moreover, it is precisely this property that makes awards so efficient in compensating people for outstanding achievements.

There are parts of society in which specific tasks are difficult, or impossible, to define *ex ante*, and to monitor *ex post*, and where an overall evaluation of effort is more efficient. Provided suitable data will be available in the future, the importance of awards can be evaluated by looking at the lower monetary compensation in sectors and occupations with more awards, compared to those with fewer awards (compensating variation).

Decorations are both extremely important and abundant in the *military*,<sup>8</sup> as the specific tasks to be performed, especially during combat, are largely unpredictable and cannot be contracted *ex ante*. The United States, for instance, knows only three civilian state awards, but offers about 170 different military decorations (of which over 60 are currently in use), such as the *Medal of Honor*, the *Distinguished Service Cross*, the *Distinguished Service Medal*, the *Silver and Bronze Star*, the *Legion of Merit*, the *Distinguished Flying Cross*, the *Soldier's Medal*, the *Meritorious Service Medal*, the *Air Medal*, the *Army Commendation* and the *Purple Heart* (Robertson, 2005).

For the public sector, it is expected that more awards are handed out, as it tends to be more difficult to formulate an efficient *ex ante* contract than is the case in the market sector. The report of the House of Commons (2004: 3) refers to 'the special generosity to state servants stemming from the relative modesty of public sector salaries when compared to the private sector'. In recent years, salary levels have improved substantially, and, at the same time, 'the long term trend was clearly away from the state sector'. Yet, civil servants still receive 'favourable treatment' (House of Commons, 2004: 3–4). Fifty years ago, roughly 40 per cent of all British state awards went to public servants, while today's percentage is below 14 per cent.

#### Effectiveness as a compensation instrument

Awards only serve as an effective instrument of compensation if the prospective recipients value them. The principal must therefore be able to control the supply process. For

this reason, the institution must be able to credibly restrict the number. Institutions with a long history and high stability find it easier to establish and observe such self-constraints. Moreover, other principals must be prevented from handing out the same, or similar awards.

**Proposition 1:** The more the principals are able to *control the supply* of awards, the more effective are the awards as incentive instruments.

Self-imposed restrictions that control the number of awards handed out serve as a means to maintain their quality. In contrast, when several institutions are able to hand out similar awards, a typical public good situation arises. A particular principal only takes into account the costs incurred in providing the awards, but not the costs of diminishing the quality of the rewards falling upon all principals handing out awards. But he is also burdened by the costs imposed by other principals handing out awards. Each prefers to act as a free rider, in the sense that there is too low an incentive to keep the number of awards down, and therewith keep their quality up.

A principal faced with no or only a few competing award givers, therefore, can more easily maintain the quality than a principal who has to act in a system with many award givers. Proposition 1 suggests that political decentralization increases the supply of awards compared to the supply in a fully centralized country. It follows that the value (price) of awards is lower in a decentralized than in a centralized polity. The hundreds of principalities existing in Germany before the foundation of the German Reich had distributed a large number of orders many of which were of low value. The same holds for Italy before the Risorgimento. The resulting inflation of orders reduced their value.

Military decorations are also handed out more liberally when there is no strong central command, but the various branches of the military are in competition with each other and can to some extent act on their own. In tandem with this expansion of different types of awards, the number of awards bestowed also increases greatly. The gradual emergence of competing branches in the armed forces of the United States is consistent with the large increase in the bestowment of the most prestigious military decoration, the *Purple Heart*.<sup>9</sup> In the Revolutionary War, there existed only one Military Force under General Washington's command. The *Purple Heart* was only awarded three times. In contrast, during WW (World War) II in one battle alone, at Iwo Jima, the US suffered 28,686 casualties (of which 6821 died), each of which received a *Purple Heart* (Cowen, 2000: 93). Today, the American forces are composed of the Army, the Navy and the Air Force, and more recently also of the Marines and the Coast Guard, each one having its own command, with a good measure of independence. The highest award of the US military, the *Medal of Honor*, was originally issued to members of the US Army. In 1947, the US Air Force began issuing its own version of the *Medal of Honor*, followed later by the US Navy and the Marines. There is also a US Coast Guard version.

The British monarchy has been successful in imposing restrictions on the number of titles conferred in some of the orders. One of the reasons the *Most Noble Order of the Garter* and the *Most Ancient and Noble Order of the Thistle*

(which are bestowed personally by the Sovereign) are held in such high esteem, is that the number of *Knights/Ladies* is restricted to 25 and 16, respectively (Phillips, 2004). The highest British order, the *Victorian Cross*, has only been bestowed 1354 times since its establishment 150 years ago. In contrast, the Italian Republic, which has a similar population as the UK, hands out state awards very liberally. The *Order of Work* has no fewer than 850,000 living members, and each year a further 20,000 are added. The French Republic has maximum limits on the five ranks of its *légion d'honneur*, but in fact greatly exceeds the limits.<sup>10</sup>

These observations are consistent with Proposition 1. The British monarchy is time-honoured and very stable, whereas the Italian and French governments count as two of the most highly unstable governments in Europe. Consistent with our analysis, orders and titles in Britain have been able to retain much of their esteem (see Phillips, 2004), while this is clearly less so in Italy and France.

Another determinant of the value of an award is that the award is kept scarce. When awards are bestowed in large numbers to persons of low distinction, they are certainly accorded less prestige than those awards that are bestowed only in rare instances and only to a few persons of high standing.

The more an award is conceived as a pure positional good (Frank, 1985; Frank and Cook, 1995; De Botton, 2004; Marmot, 2004), the higher is the utility to the recipient, but the more strongly it is counterbalanced by the utility loss of those not receiving it. In the aggregate, the incentive effect may even be counterproductive. Awards may have not only a positive incentive effect on the persons receiving them, or hoping to receive them, but may also have a *negative external effect* on the persons who are disappointed or angry at *not* having received them. This aspect was clearly expressed by Winston Churchill in a House of Commons speech on 22 August 1944: 'A medal glitters, but it also casts a shadow. The task of drawing up regulations for such awards is one which does not admit of a perfect solution. It is not possible to satisfy everybody without running the risk of satisfying nobody. All that is possible is to give the greatest satisfaction to the greatest number and to hurt the feelings of the fewest' (House of Commons, 2004: 1).

**Proposition 2:** The greater the *positional externalities* produced by an award, the less productive it is in the aggregate as an incentive instrument and the more rarely it will be used.

Award givers are aware of this effect and react to it. One possibility to mitigate the negative external effects on non-recipients is to introduce marginal changes in the system. When people have the possibility of slowly climbing up a social ladder of classes of an award, or if the recipient must have a minimum age, outsiders are less inclined to perceive the award in terms of a positional good, and suffer a smaller negative external effect. The *Order of Merit* of the Italian Republic does this by requiring a minimum age of 35 years and by not allowing people to jump grades; recipients must work their way up from *Cavaliere*, *Ufficiale*, *Commendatore*, *Grande Ufficiale*, *Cavaliere di Gran Croce* to *Cavaliere di Gran Croce decorato di Gran Cordone*.



There is another external effect award givers have to take into account. The recipients themselves may under-perform after getting an award due to a ‘distraction’ and ‘extraction’ effect. An empirical study (Malmendier and Tate, 2005) of US CEOs with ‘superstar’ status, that is, those who were appointed ‘*Best Managers*’ by Business Week, indicates that there is a decline in performance following the receipt of the CEO award. Stock market performance and accounting profits of the corporations of the respective managers tend to fall. One reason is that the CEOs start writing books and sitting on more boards of other firms. Another is that they extract much higher rents from their company and exert more control over their earnings.

Monetary compensation has been shown to crowd out intrinsic motivation under specific circumstances, that is, when the agents are perceived to be controlling (e.g. Frey, 1997; Osterloh and Frey, 2000, Frey and Jegen, 2001, Frey and Osterloh, 2002, Bénabou and Tirole, 2004). This motivation crowding effect may overcompensate the relative price effect of the monetary incentive. The larger this perverse effect of monetary compensation is, the more important the intrinsic motivation becomes for a task or sector. When an award is received, most persons take it as a gesture of support, rather than of control, and it is therefore likely to have a positive, rather than a negative, effect on performance.

**Proposition 3:** In sectors and activities where *intrinsic motivation is important*, and is likely to be *crowded out by monetary compensation*, awards are relatively more efficient.

Intrinsic motivation is of particular importance in the volunteering and humanitarian sectors, academia, the arts, the military and certain sectors of public services (Frey, 1997). The list on awards compiled by Robertson ([www.medals.org.uk](http://www.medals.org.uk)) documents that awards do indeed play a major role as an incentive instrument in these sectors. Examples can be found in many countries bestowing awards for voluntary work in the Red Cross, in the Fire Brigade or in the Lifeguard.

#### Maintaining the value of awards

The *quality of an award* depends on its rarity. This has been clearly expressed by Winston Churchill in a speech in the House of Commons, 22 August 1944: ‘... a distinction is something which everybody does not possess. If all have it, it is of less value’ (House of Commons, 2004: 1). The award-giving institution therefore has a strong interest in maintaining the quality of the awards. They must take measures to guard the award against a decline in quality due to bestowing them to the wrong persons.

**Proposition 4:** The more a donor can ensure that awards go only to *deserving persons*, the more its value is maintained.

The Catholic Church has an elaborate system to ensure that only those persons are beatified and sanctified who, according to their carefully formulated standards, deserve it. It has used an ingenious institution for that purpose, the *advocatus diaboli*. This person is officially given the task of

finding potentially harmful aspects in the life of people proposed as *beati* or *sancti*. Accordingly, one rightly speaks of a ‘process’, in which both the positive and the negative sides are represented. The Church is well aware that its reputation would suffer badly if a (recently appointed) saint would turn out to be unworthy. But, due to its long-standing experience and history, it has managed admirably, and saints are venerated by a huge number of church members and non-church members alike. Mother Teresa having been canonized is a good example.<sup>11</sup>

A relatively safe way to avoid giving honours to unworthy persons is to give them only after they have proved loyal to the donor. For that reason it can be observed that orders – where the issue of loyalty is most important – are predominantly given at an advanced age (for Britain, see the extensive documentation in the House of Commons, 2004; Phillips, 2004). Where loyalty is of lesser importance, and present work effort matters more, awards are given to younger people. Examples are the American *John Bates Clark Medal* or the German *Leibnizpreis*. These observations are consistent with Proposition 4.

The quality of an award suffers when the donor bestows it, but the person chosen does not accept it. As a result, the award becomes less effective as an incentive instrument. The damage to the award’s reputation is greater, the more widely known the refusal becomes. The damage to the donor’s reputation and to the award’s reputation is greater still if recipients turn out to be unworthy.

**Proposition 5:** The quality of an award is better maintained, the *lower the probability* that the award is *publicly refused*.

Institutions handing out rewards can be seen to make great efforts to ensure that the persons chosen will accept the awards. Refusal of an award reduces the prestige of the award giving body. This is demonstrated by the British system of bestowing orders. After having been chosen by carefully selected committees, and after having been scrutinized by the Ceremonial Secretariat of the Cabinet Office, the prospective recipients are asked whether they will accept the honour. Only if they formally agree is the list put forward to the Queen and then officially published in the *London Gazette* (House of Commons, 2004). Ninety-eight per cent of those offered an award accept it, and the majority of the 2 per cent who decline do so for private reasons (Phillips, 2004: 5). This procedure ensures that a refusal is not made public, except when a leak occurs. In Britain, orders and medals enjoy high prestige and respect and receive solid public support (House of Commons, 2004: 3). This is consistent with the care that is taken to avoid refusals (Phillips, 2004: 5).

The *Nobel Prize* Committee is more restricted in this respect. As the conferral is kept secret, the prospective recipients cannot be asked whether they will accept. The Committee must make its own inquiries, and carefully deliberate the risk of refusal. Nevertheless, it sometimes happens, the best-known example being Jean Paul Sartre’s refusal of the *Nobel Prize in Literature*. This particular *Nobel Prize* is indeed more controversial, and is generally less valued, than the *Nobel Prizes in the Sciences* where few, if any, refusals are known. These observations are consistent with proposition 5.

The shorter the time horizon of the principals, the more they rely on awards, because the costs, in the form of award inflation, will only occur in the future.

**Proposition 6:** *The lower the probability of remaining in power (in a democracy, the lower the re-election probability), the larger the number of awards supplied.*

Before his resignation in 1976, the British Prime Minister Harold Wilson did great harm to the honours system by handing out far too many awards to Labour supporters (which was heavily criticized, see De-la-Noy, 1985: 141). When a regime fears for its survival, the time horizon is short and there is a great incentive to try to forestall this fate by using awards as incentives to supporters. Examples are the German *Iron Cross*, established in 1813, and highly esteemed up until the 20th century. But it lost much of its lustre when it was given out to 5,400,000 soldiers in WWI, in which 13.2 million German soldiers were engaged, that is, on average, 40 per cent of all soldiers received an Iron Cross. As some soldiers received several *Iron Crosses* of different grades, historians estimate that about 20 per cent of the German soldiers were decorated in this way. Similarly, in WWII, 5,000,000 *Iron Crosses* were awarded by the *Wehrmacht* (Kellerhoff, 2004). In both Wars, the Germans were on the losing side. The war leaders were, quite early on,<sup>12</sup> aware of the fact that their chances of winning the war were small and ever diminishing.

The same policy can be observed when the principal has a short-term time horizon due to bad health. Pope John Paul II, who had been in bad health for a number of years, and whose imminent death was often an issue, greatly increased the number of canonizations. He beatified and sanctified many more people than all the other popes of all centuries combined (Cowen, 2000: 94). Over the 26 years of his pontificate (1978–2005), John Paul II recognized 488 saints and beatified 1338 persons, putting them on the path to sainthood. The press commented ‘... as with everything, inflation produces devaluation’ (Hennerberger, 2002).

### Concluding remarks

Awards form an important part of the compensation system in a society. In many respects, they deviate systematically from extrinsic incentives in monetary or material form, as well as from intrinsic incentives. Awards constitute a type of *non-material extrinsic reward*, extensively used in all spheres of society, including the economy.

The *supply side* has been analysed in the context of a principal–agent relationship between the award donor and the award recipient, involving a tacit and incomplete contract. The terms of the *award contract* are not precisely defined, and are often left rather vague. Awards turn out to be suitable instruments to elicit the work effort and support desired by the award donor.

The propositions are, on the whole, consistent with the way awards are handed out. Awards as instruments of compensation are proposed to be more efficient, and to be used more extensively,

- The smaller the principal’s financial resources are
- the more difficult it is to *ex ante* formulate and monitor work effort;

- the less the principal is able to control the number of awards handed out;
- the less awards have the character of positional goods;
- the smaller the likelihood of crowding out intrinsic motivation;
- the smaller the risk of giving out awards to unworthy persons;
- the fewer the persons refuse awards; and
- the shorter the principal expects to stay in power.

The unavailability of reliable and consistent data on awards prohibits the use of econometric techniques to test these propositions. For that reason, the propositions have been illustrated by examples.

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### Notes

- 1 Part of this paper was conceived and written during his time as a Distinguished Visitor at STICERD, London School of Economics. The paper has profited much from the excellent detailed comments by the referees and the editor, Bruce Kogut.
- 2 The only exception seems to be Switzerland, where the (central and cantonal) governments hand out no awards whatsoever in the form of orders, medals or decorations. This applies to the military branch too (but the military managed to be allowed to wear foreign decorations). The Irish do not hand out civil honours, but there are a small number of medals for the personnel of military and emergency services (Phillips, 2004: 59).
- 3 Personal communication of a manager of a prominent American high-tech firm located in Switzerland.
- 4 A useful source is the article ‘List of prizes, medals and awards’ in wikipedia (<http://en.wikipedia.org>) and *Medals of the World* by Megan C. Robertson ([www.medals.org.uk](http://www.medals.org.uk)). Phillips (2004) and the House of Commons (2004) give a useful survey of (part of) the orders in Britain, as well as some limited information about other countries, according to the present situation.
- 5 The demand for awards is more fully discussed in Frey (2005) and Frey and Neckermann (2006). See also Hansen and Weisbrod (1972) and the unpublished notes by Besley (2005).
- 6 An exception is when the employee has acquired firm-specific secrets.
- 7 Some orders, such as the *Victoria Cross*, are given for specific acts of valour, but most military decorations are not. The United States, by 1969, had given awards of valour, such as the



- Purple Heart*, to 56 generals who served in Vietnam, although only one general died from enemy fire at that time (Cowen, 2000: 93).
- 8 The fact that the Swiss army is the only exception can be attributed to the fact that it consists almost entirely of conscripted citizens and has not been involved in war for 200 years.
  - 9 Needless to say, there are many other explanations possible.
  - 10 For instance, the number of Commanders is restricted to 1250, but there are actually 3626; the respective numbers for Officers are 10,000 and 22,401 (wikipedia, article on *légion d'honneur*).
  - 11 Pope John Paul II changed the rules. There is no longer an *advocatus diaboli*, but the task is given to a commission. This can be expected to greatly affect the procedure, and may well harm the Church's reputation by leading to more errors.
  - 12 Empirical evidence for WWII is provided in Frey and Kucher (2000).

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