

Incentive Hierarchies

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Abstract

Because much of work incentives are provided through promotions, their effectiveness depends to a large extent on the structure of the organization's hierarchy. Here we investigate the impact of the incentive motive on the optimal hierarchy using the Auriol-Renault (2000) framework which highlights the role of recognition in the work place. This framework provides a rationale for using promotions as an incentive device which relies on a complementarity between recognition and income: those who earn more should also earn more recognition. We identify factors which affect the hierarchy in terms of number of ranks, population size at each rank and the extent of the differentiation between ranks. We show that the harder it is for an employee to improve performance through effort the more pyramid-like is the hierarchy, with a small group of successful individuals at the top earning high income and recognition. If a high performance may be easily achieved, a seniority based promotion system may be optimal.

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