The potential pay-off from applied psychology: The human component of organizations

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There are four salient facts about the relevance of psychology as a discipline. First, and possibly most importantly, people matter, even if we consider «matter» just in terms of the economic importance of human and social capital and how it is managed.

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As has been documented in numerous studies (see Appelbaum, Bailey Berg & Kalleberg, 2000; Becker & Huselid, 1998; Pfeffer, 1998, for reviews), the human resource practices organizations use – their implementation of a set of high commitment or high performance work practices – affects in both a statistically and substantively significant way, organizational performance as measured along numerous and various dimensions ranging from productivity to profits to quality to employee attitudes and turnover to, in the case of small, entrepreneurial organizations, survival and time to an initial public offering (Baron & Hannan, 2002; Welbourne & Andrews, 1996). In fact, how people are managed probably has a greater effect on organizational performance than either organizational size or the industry in which the company operates (Pfeffer, 1998). In terms of understanding organizational behavior and performance, organizational culture is also an important concept (Tushman & O'Reilly, 1997), while the social bonds that connect people to each other and their organizations – sometimes called social capital – are important for understanding organizational innovation, performance, and organizational effects on individual attitudes and psychological well-being (e.g., Coff & Rousseau, 2000; Coleman, 1988).

Moreover, because the skills of people management and the organizational culture that is created are often tacit and based on the mental models of human behavior and organizations that managers hold, how people are managed is more difficult to directly observe and copy than things such as physical technology or information systems and software. The social ties that bind people to each other and their organizations are also not easily replicated. That difficulty of understanding and imitating people management, culture, and social capital makes people management a much more sustainable source of competitive advantage than other, more readily copied aspects of organizations such as plant and equipment or even information technology. The relative importance of people management for producing sustainable competitive advantage is completely consistent with the resource-based view of competitive strategy (e.g., Barney, 1991).

The underlying psychological dynamics

Second, the psychological sciences, with their ever-growing empirical base and theoretical sophistication, have much to tell us about how to design social institutions including both for-profit and non-profit organizations to accomplish various goals more effectively. So, for instance, we know, from the extensive literature on the self-fulfilling prophecy (e.g., McNatt, 2000) how to design schools and learning environments to be more effective, even if we often do not put this knowledge into practice. Currently in the United States there is great debate about the use of social promotion – letting children advance to the next grade level in school even if they have not mastered the material in their current grade. Numerous cities, including Chicago and New York, have tried ending social promotion, and numerous political figures, including Presidents Clinton and Bush, have spoken out against the practice, arguing that promoting children who have not mastered the educational material sends a bad signal about the maintenance of academic standards and does not help the child learn the necessary skills. But in spite of the ideological appeal of holding students to uncompromising standards, the evidence from numerous studies is clear: children held back in school drop out at much higher rates and are, therefore, less likely to complete high school (Hauser, 1999). This outcome is predictable from social psychological theories, in that children held back lose their social ties to their classmates and get the message that they are troubled, academically inadequate, or both. This labeling has its predictable, self-fulfilling prophecy effect in causing those so stigmatized to become even more troubled and give up making an effort in school.

Or consider two examples from the world of human resource management that illustrate how social psychology can elucidate why various management practices are likely to work. It is well known that decentralization and delegation of decision making authority almost invariably increase organizational performance (e.g., Levine & Tyson, 1990). The underlying reasons for this effect come straight from social psychology. People are more likely to be engaged in and committed to decisions they have made – the effect of behavioral commitment (e.g., Cialdini, 1988). Furthermore, because of the tendency toward self-enhancement (e.g., Alicke, 1985; Campbell, Rudich & Sedikides, 2002), people will think decisions they were involved in making are better than decisions where they had less input (Pfeffer, Cialdini, Hanna & Knopoff, 1998). As a second example, high commitment work arrangements typically involve investments in training people and providing some degree of employment security (Pfeffer, 1998). Again, the underlying psychological dynamics are clear: the norm of reciprocity (Gouldner, 1960) means that people will be likely to reciprocate organizational investments (training) and organizational loyalty and commitment to them (employment security) by expending discretionary effort and being more loyal to their organizations.

Human assets are the most critical resources

Third, in spite of the foregoing examples of how social psychology can provide practical guidance for the design of social systems, and even though there is general recognition that in today's economy, human assets are the most critical resources for both organizational success and regional economic growth, psychology and other similar social sciences such as organizational behavior play second fiddle to economics – and an increasingly conservative, neoclassical version of economics at that (Kuttner, 1996) – when it comes to the formulation of either public or organizational policy.

> *This agenda seems to imply a more activist role for psychology, being more willing to engage in debates about organizational and social policy*

Consider, for example, the organizational problem of motivating employees and inducing them to expend effort on behalf of the organization. Economic theory presumes that people are effort averse and will shirk unless induced to provide work through the use of extrinsic incentives such as pay, and preferably variable pay, so that those who expend more effort and produce more receive more rewards

(Lazear, 2000a, 2000b). Consequently, there is a proliferation of variable pay schemes and increasing reliance on the use of financial incentives in all domains of life, at the least in the United States. So, for example, there are efforts to introduce incentive pay for school teachers, the city of Albuquerque, New Mexico, has incentive pay for garbage truck drivers, there are efforts underway to introduce variable pay into the Federal government's personnel policies, and by 2002, some 80 percent of organizations surveyed by compensation consulting firm Hewitt reported using at least one type of variable pay, up from 59 percent in 1995. But as Heath (1999) has noted, in surveys going back 25 years pay typically ranks third of five dimensions of people's jobs, with «important work» typically being ranked first. Heath's insightful study shows that individuals accurately perceive themselves as not being primarily motivated by extrinsic incentives, but believe that others are much more motivated by money. The adverse consequences of this bias in beliefs about how others are motivated are profound. Deci and Ryan (1985) reviewed extensive literature showing that the use of extrinsic rewards can undermine intrinsic motivation. And, of course, relying on financial incentives and underemphasizing other, more important aspects of work both costs money and is less effective that management practices that are more veridical with people's actually psychology.

A more activist role for psychology

And fourth, it follows logically from the foregoing that social psychology has an important task before it: to offer an alternative conceptualization of human behavior and to draw out the implications of that conceptualization for organizations and the larger society. This task will require several things. First, social psychology needs to develop more integrated, theoretically coherent, and parsimonious depictions of human behavior, as one of the advantages economics has is its theoretical parsimony and deriving predictions from first principles. Second, offering alternative models of human behavior that affect policy will require psychology to more directly confront and challenge economics, something that one sees in the domain of behavioral decision theory (e.g., Bazerman, 2001; Kahneman & Tversky, 1979) but not much elsewhere.

This agenda seems to imply a more activist role for psychology, being more willing to engage in debates about organizational and social policy and not cede the field to others. As Bazerman (in press) has argued, sociology, social psychology, and organizational behavior have been much more reluctant than economics to be prescriptive and to actively engage in making recommendations about organizational practices and social policy. Whether or not that statement is empirically true, it is almost certainly the case that social psychology has been generally less willing to be imperialistic about its expertise and implications than has, for instance, economics, thereby ceding much contemporary discussion and debate to this other social science. One manifestation of this self-imposed reticence is the tendency for research to use economic models and predictions as the base case and departures, for instance, from assumptions of rationality as interesting anomalies to be explained. This approach could be contrasted with using social psychological theories, for instance, of human information processing and decision making, as the base case and treating economic assumptions of utility maximization and hyperrationality as interesting exceptional phenomena that need to be explained.

As Bazerman (in press) has suggested, there are numerous domains of public and organizational policy and practices where economics is wrong in its predictions and its implications and where psychology, and certainly organizational and social psychology, have much useful to say and contribute. Let us hope that the future research and writing not only continues to enrich and develop our understanding of behavior, but also becomes more seriously incorporated into the decisions that are made every day about people and social institutions.

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