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The impact of management incentives in intergroup contests

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ABSTRACT

In intergroup contests a manager advises and motivates her group's members. Her rewards often depend on the subsequent contest expenditure of the members. I test whether such incentives undermine the credibility and effectiveness of a manager's efforts. In the different experimental treatments the managers either benefit from very high or low expenditure or get a predetermined payment. The results show that different management incentives shape the expenditure of the group members even if managers have an advisory role only. However, group members follow recommendations more closely if management compensation is not linked to contest expenditures.

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1. Introduction

In intergroup contests managers typically benefit if they push their group's members to ever higher effort levels. Military commanders, for example, can gain glory and promotion if their soldiers fight bravely and risk their lives. Coaches in any team sport win more titles if they encourage high training efforts and frugal lifestyles from their players. In other situations managers prefer rank-and-file members to be less competitive. Corporate mergers, for example, often lead to intra firm rivalry between the different units (Weber and Camerer, 2003). Here, the career perspectives of junior managers depend on the success of their integration efforts, i.e., the minimization of rent seeking activities in their business units. In all these cases the economic incentives of the manager typically differ from the preferences of the group members. In this paper I want to identify whether and how such a conflict of interests between managers and group members impairs the leadership effectiveness of the manager.

In order to study this impairment I investigate the impact of group managers on contest expenditure in an experimental Tullock contest (Tullock, 1980) between groups. More specifically I analyze how managers coordinate group members in such contests, whether they direct group members towards high or low expenditure levels and how management incentives affect this coordination process. The focus is on managers who have a key role in internal communication processes but lack

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formal authority or punishment instruments. This restriction implies that managers cannot alter the financial incentives of the group members in any treatment which facilitates treatment comparisons. The experimental treatments differ with respect to the incentives of the managers, i.e. whether and how they benefit from the conflict expenditure of the group members. I also compare the behavior in these treatments with results from a control treatment in which groups do not have any manager.

The paper provides three distinctive contributions to the literature. This is the first paper that investigates management or leadership effects in contests between groups. Leadership studies in experimental economics typically investigate (endogenous) leadership in public good games or coordination games.[1] They do not study competitive environments and do not look at the role of group leaders in intergroup relationships. Second, I investigate the impact of rather weak managers who can neither set incentives nor lead by example. By doing so, I measure a 'pure' coordination effect that is independent of group members' concerns about managerial retributions. Most studies and textbooks (e.g. Milgrom and Roberts, 1992) in economics study management behavior in the context of principal–agent relationships that allow for incentive contracts. People who lead by example in public good or coordination games can at least reasonably expect that followers have reciprocal preferences and reward their kindness. In this context my study provides a contrast to the interesting article of Sheremeta (2011) where some group members play a key role in the intergroup contest. These members can gain a higher prize than others but all members can invest into the outcome of the contest. Arguably the players with a higher valuation resemble incentivized managers. The treatments in Sheremeta (2011) vary both the asymmetry of the preferences and the 'technology' of the contest success function. As a consequence, the managers' investments become crucial in perfect-substitutes contests (like the one in my paper) and best-shot contests. In contrast, the managers in my experiment cannot make any investment at all.

The third contribution of my paper also relates to the issue of institutionally weak leadership. Since managers can only talk to their group members I provide a new approach to studying the impact of communication on behavior, more precisely how changes in incentives alter this impact. Riechmann and Weimann (2008) and Andreoni and Rao (2011) show the powerful coordination effect of communication. They argue that communication facilitates mutually beneficial coordination and recursive belief formation. Relatedly Brandts and Cooper (2007) and Eisenkopf and Bächtiger (2013) identify communication as an effective tool for third parties to change the cooperativeness of agents. In this paper I investigate whether conflicting incentives between the actual actors and the third party eliminate this benefit. In this context my contribution relates most closely to Kuang et al. (2007) who study the impact of external advisers in coordination games. They find that players are less likely to follow the advice if the advisor benefits from certain decisions. Note also that this paper provides a complementary contribution to the existing literature on communication in intergroup contests. While Sutter and Strassmair (2009), Leibbrandt and Sääksvuori (2012) or Cason et al. (2012) focus on changes in communication structure (i.e. who can talk with whom) I keep this structure constant across the treatments.

It is a key characteristic of contests between groups that any decision of a group member implies two opposing externalities. If one person becomes more competitive she increases the chances of her fellow group members to win the prize but decreases the expected payoffs of the members in the other group. Previous studies have shown that people focus their prosocial behavior on 'in-group' members and discriminate against outsiders (Hewstone et al., 2002; Charness et al., 2007; Chen and Li, 2009; Hargreaves Heap and Zizzo, 2009; Chen and Chen, 2011). Hence it is not surprising that highly competitive investments characterize the behavior of groups in contests but most studies also report substantial differences between the different group members.[2]

The competitiveness of groups is inefficient if the contest expenditure does not imply a positive externality for a third party.[3] The inequality in investments and subsequent payoffs within a group is also clearly undesirable for at least some subjects (Abbink et al., 2010). Communication between group members reduces differences in intra-group investments to some extent but it induces coordination at a rather competitive level (Sutter and Strassmair, 2009; Cason et al., 2012; Leibbrandt and Sääksvuori, 2012).[4] Group managers might actually improve aggregate utility of group members if contest expenditure is wasteful. Hence the preferences and incentives of managers should play a crucial role in rent-seeking

[1] Recent studies on leadership in public good games include Güth et al. (2007), Arbak and Villeval (2011), Rivas and Sutter (2011), Bruttel and Eisenkopf (2012), Gächter et al. (2013). Studies on leadership in coordination games are provided by Weber et al. (2001), Kuang et al. (2007), Brandts et al. (2011). Bruttel (2009) and Bruttel and Fischbacher (2013) investigate leading-by-example in the context of the Bertrand Paradox. Lazear (2012) summarizes the non-experimental literature on leadership in his paper. He argues on p. 92 that this "literature does not lend itself well to the type of scientific analysis and proof that could add additional insight into our understanding of the area".

[2] The observation that intergroup conflicts increase individual willingness to sacrifice self-interest for group causes is one of the most agreed-upon observations in social psychology (Bornstein and Ben-Yossef, 1994, p. 63). More recent studies support this claim in different competitive settings and show that aggregate competitive investments of group members are clearly above the standard equilibrium prediction (Gunnthorsdottir and Rapoport, 2006; Huck et al., 2007; Tan and Bolle, 2007; Burton-Chellew et al., 2010; Ahn et al., 2011). It is also a well-established fact that groups often fail to coordinate (Van Huyck et al., 1990, Ochs, 1995, Bornstein et al., 2002). More recently, Abbink et al. (2010) also find "substantial heterogeneity" (p. 431 and Fig. 3 in that paper) in the investments of individual members in a group.

[3] Examples for positive externalities are sport or research contests or promotion tournaments in firms (Lazear and Rosen, 1981). The administration of natural resource extraction provides an example for the inefficiency of competition between groups (van der Ploeg, 2010).

[4] Abbink et al. (2010) and Leibbrandt and Sääksvuori (2012) show that some subjects spend money to punish fellow group members with lower investments. The availability of punishment options within groups also leads to coordination at an extremely competitive level (see also Goette et al., 2006, 2012).

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