

REVIEW ASSIGNMENT

CREATING INCENTIVES FOR INNOVATION – GUSTAVO MANSO

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LCDB7001 – ENTREPRENEURIAL PERSPECTIVES

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Innovation has been considered as a key mechanism for business development, particularly in the era of fast-paced technology rise. In recent years, innovation has been one of the major interesting research subjects due to its crucial importance, as it is a foundation of competitiveness for firms, regions and nations (Ahmed and Shepherd, 2010). However, building an innovation-focus and risk-taking culture within the business practice to cultivate innovation is not easy. This paper seeks to address the model for motivating innovation by analysing the study of Manso in 2017: “Creating incentives for innovation”. In this study, Manso (2017) use probability theory and experimental evidence to examine a model for motivating innovation within organisations. His study revealed that company leaders should create a culture that tolerates early failure, encouraging experimentation and risk-taking, and reward long term performance as incentives for employees to innovate. In addition, the author extended this work to other fields beyond business such as the academic world and scientific research, where the same method can also be applied to encourage innovation.

In the first part, the author reaffirms the importance of innovation by presenting data from previous studies such as KMPG survey (2016) and PwC poll (2017). Both studies are surveyed with respondents are Chief executive Officer (CEO) of top companies, in which they ranked innovation as the most important aspect for the business. Then he proposed five methods to encourage innovation which are: “toleration of early failure, commitment to long term contracts, explicit contract, feedback and bankruptcy law”. It should be noted, however, that those methods are quoted from his previous study in 2011 (Manso, 2011). Clearly, this result might be biased as the author produced it himself in another study. Also, he did not provide further aspects from other studies that can be added to the model. Figure 1 (see Appendix 1) illustrates the incentives for innovation model that the author used in this article.

The author then justifies this model by giving the practice example of 3M and IBM, as the “world’s most successful and innovative companies”, where they gave their research departments more tolerance of failure and encourage risk-taking decisions. However, Manso (2017) did not provide the source for this information so there is no reliable evidence to justify this aspect of the model. Interestingly, the author did raise the question of whether offering monetary rewards can boost innovation and productivity. He reviewed several literatures on this topic including Lazear (2000) study on windshield installer, Foster and Rosenzweig (1994) study on agricultural workers... (see Manso 2017) to discuss the impact of incentive schemes and innovation. The author discovered that the pay-for-performance scheme might appropriate for repetitive or routine tasks, but it might not be appropriate for open-ended, creative tasks that required “innovative solutions”. For example, the innovation incentives for windshield installers would not be effective with officers who create advertising ideas, business plan or manage a team. He then discussed the five optimal incentives for innovation in business:

- **Termination:** The threat of firing might motivate managers from shirking and get the best possible result from business practice. However, it might encourage the manager to take a safe action rather than innovate.
- **Commitment to long term contracts:** Long term contracts allow managers to have sufficient time to develop ideas, adjust and improve their work thus improve innovation
- **Explicit contracts and corporate culture:** A culture that fosters experimentation, rewards innovation and give employees time and freedom to develop new ideas is essential
- **Feedback:** Regular feedback is vital. The purpose is to give information that guides adjustments and improves the performance
- **Bankruptcy law:** Toleration of failure motivate innovations applied to entrepreneur. The bankruptcy law should permit failed entrepreneur to start over again.

To further support the model above, the author carried out a study with 379 participants to operate a computerised lemonade stand and gave them the option of adjusting decision made by previous managers or come up with their own business ideas, such as moving to a better location or changing the

product. The participants are then divided into five groups with different compensation schemes. The group description and result are presented below:

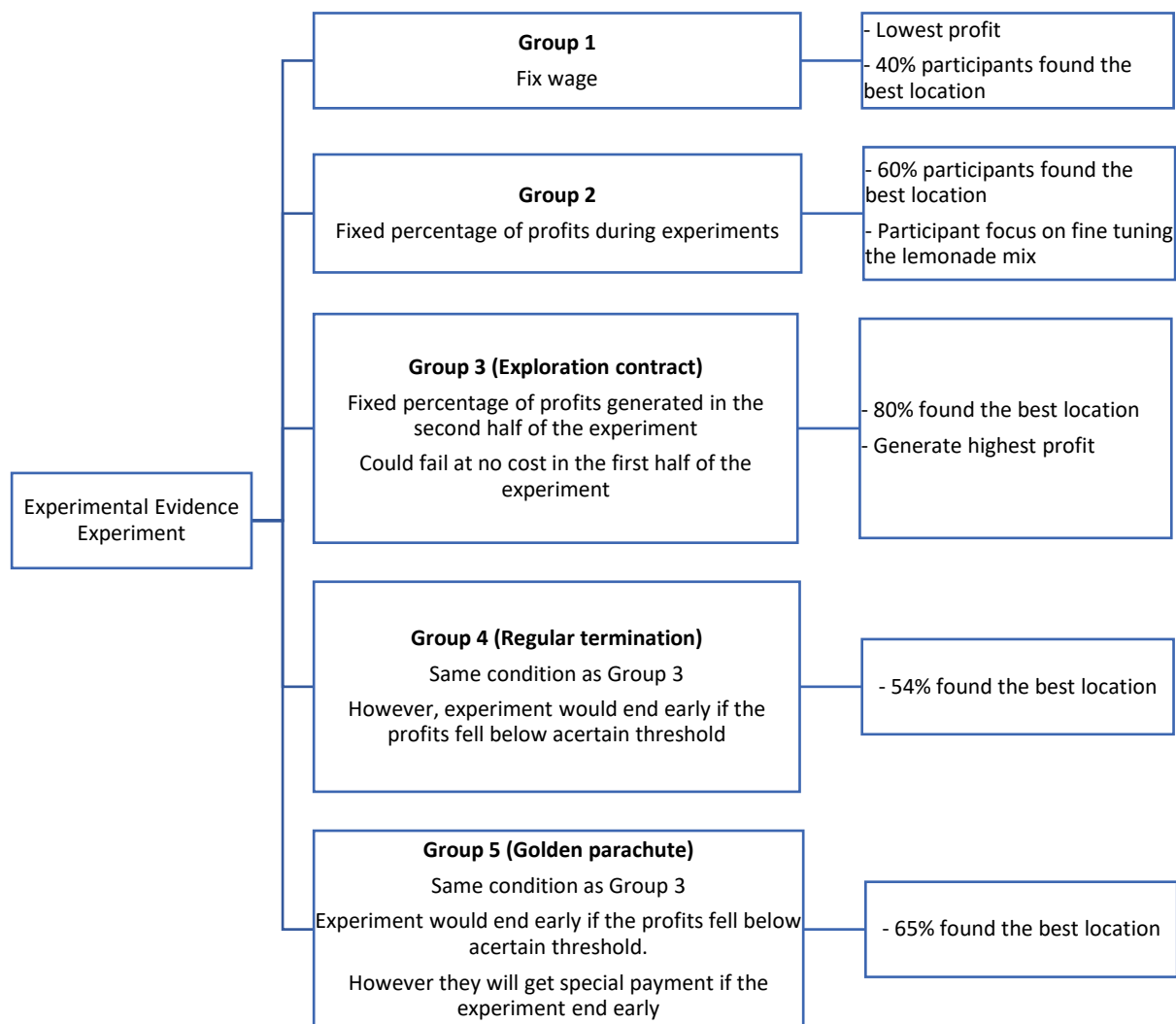


Figure 1: Laboratory experiment by Manso (2017)

From the result of this experiment, the author concluded that the participants are more likely to perform well in an environment that tolerates early failure, encourage risk-taking and reward long term result. They also perform much better than their counterparts who under fix-wage and pay-for-performance incentive schemes. Additionally, the threat of termination might undermine the incentive for innovation, but by giving reward for trying, those innovation-reducing effects can be minimised.

Similarly, the author also examines another study in scientific research and found similar results to those obtained in business. He highlighted that the research funding program which rewards long term success, offer feedback and encourages experimentation to generate more scientific breakthroughs than normal funding, also the researchers within this scheme published more high-impact articles. The unique of this study exists in the fact that the author also considers other fields beyond business, such as scientific research and academy. The contribution of this study is obvious as the resulting outcomes can be capitalised as guidelines to motivate innovation within many fields rather than business. In conclusion, the article has discussed about the importance of innovation and illustrate the relevant incentives of innovation in organisation. The author also made his original contribution to this topic by carrying out his experiment. However, the article contains bias as the author only discuss the model

from his previous research. In addition, there has been little discussion about innovation within the small and medium scale business, as innovation is key for their competitive advantages.

Reference

Ahmed, P. Shepherd, C. 2010. Innovation Management: Context, Strategies, Systems and Processes. Pearson Prentice Hall

Manso, G. 2017. Creating incentives for innovation. California management review. 60(1). pp 18-32. DOI:10.1177/0008125617725287.

Appendix 1: The incentive for innovation (Adapted from Manso, 2017)

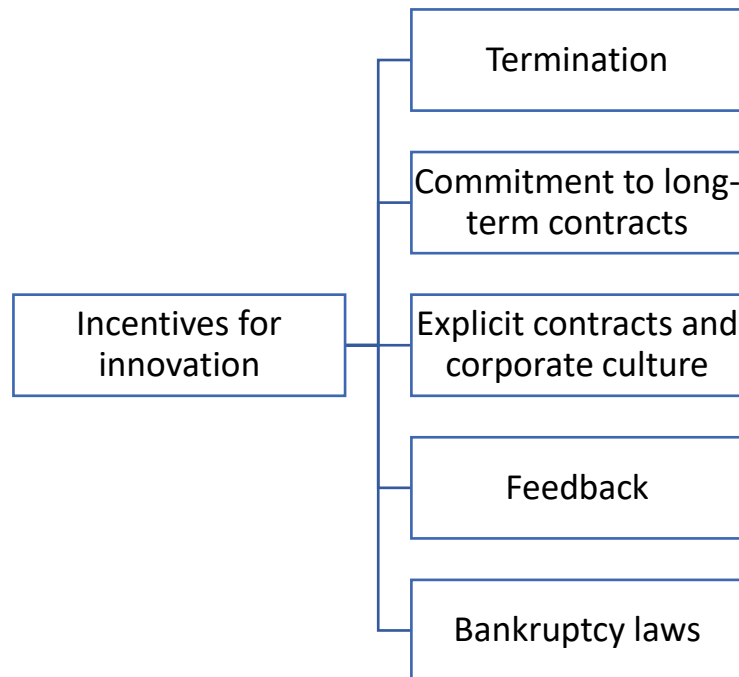


Figure 1: Incentives for innovation (Adapted from Manso, 2017)