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## Incentives

The second main question addressed by organization theory concerns the means of motivating individuals in organizations to achieve high performance. To address this issue, traditional “agency theory” focuses on the trade-off between risk and incentives. Consider motivating a real estate agent. Real estate agents earn a combination of salary and commission. In most areas, real estate commissions are around 6% of the sale price. This amount is split between two companies—a listing agency and a selling agency. The listing agent was hired by the seller to place advertisements, post the house in the Multiple Listing Service (MLS), advise on showing the house, and so on. The selling agent brought the buyer to the house. In many areas, the portion of the commission going to the selling and listing companies is split equally, with 3% going to each agency. These may be the same company, of course. The 3% going to the listing company is equally split between the listing agent and the company, so the listing agent receives  $1\frac{1}{2}\%$  of the sale price as a commission, and the company keeps the other  $1\frac{1}{2}\%$  to cover its expenses (offices, secretaries, and the like). Usually, the agency pays a salary in addition to the commission to the agent. The salary is a fixed monthly amount that does not depend on sales.

To increase their incentives, an agency can reduce the salary and increase the commission, and this is precisely what the RE/MAX agency does. Agents at RE/MAX receive little or no salary and keep around 95% of the commission—nearly 3% of the sale price. RE/MAX agents consider that they have stronger incentives and hence work harder. The RE/MAX agency, of course, attracts agents who perform better—better performing agents will make more money at RE/MAX than poor performers.

In contrast to traditional agency theory, modern incentive theory focuses on the side effects of increased incentive pay. The RE/MAX scheme, by creating strong incentives to be either a listing agency or the selling agent, reduces the in-