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Improving De-Escalation Strategy: Monitoring Control, Bonus Incentive and Escalation of Commitment

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ABSTRACT

Managers continue to perform irrational behavior by escalating the wrong decision hoping that the situation will change. The irrational escalation of commitment brings negative influences on organization performance. Previous studies have found several mitigation strategies. One of the strategies found is called monitoring control in private information situations. However, this strategy has not considered the agency problem that can occur between owners and managers. For this reason, this study seeks to improve the de-escalation monitoring strategy by adding agency theory. The Experimental method with factorial design of 2x2x2 is applied to answer research problem. The first factor is information (public vs private), the second factor is monitoring control (present vs absent) and the third factor is bonus incentive (present vs absent). The participants in this study were 159 undergraduate students who were taking principles of investment course. As a result, there are interaction effects from the variables of monitoring control, information availability, and bonus incentive. The interaction effect distinguishes participants in making decisions. Companies can consider giving monitoring control and bonuses together to differentiate managers' decisions when assessing projects. Further study may explore more detail on the bonus procedures with more in-depth bonus mechanism.

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INTRODUCTION

Rationally, individuals will change decisions that have been taken when those decisions produce unexpected results. However, individuals tend to maintain and continue decisions that have produced negative results with the assumption that these results will change. This phenomenon is known as escalation of commitment (Staw, 1976). This phenomenon has led to problems that cause losses due to wrong decisions that are still maintained. Escalation of commitment has influenced various fields of study such as finance, economics, marketing, accounting, and various other social science fields such as social psychology (Sleesman, Conlon, McNamara, & Miles, 2012).

Since it was first investigated, the escalation of commitment has become one of the phenomena that is widely researched. Researchers are trying to find ways to mitigate the problem (Chong & Suryawati, 2010). Cheng, Schulz, Lucket and Booth (2003) found one mitigation strategy. They apply a hurdle rate to each project so that the escalation of commitments can be overcome. Kadous and Sedor (2004) found that when third-party consultants gave specific instructions, escalation of commitments could be prevented. Booth and Schulz (2004) also found that the ethical environment can help organizations in preventing the escalation of commitments.

Ku (2008) found that emotions can prevent the escalation of commitment. Lee, Keil, Wong (2014) examined the relationship between goal and commitment escalation. As a result, the greater the commitment to the goal the more managers will continue the decisions that have been made even though the results are negative. Li and Wang (2015) also found that there is a relationship between authority and escalation of commitment.

Chong and Suryawati (2010) found a de-escalation strategy. Their research analyzes the impact of control through monitoring of project evaluation decisions. They found that although information about the project was only known to decision makers, when decision makers were monitored, the tendency to escalate commitments would be reduced.

Research conducted by Chong and Suryawati (2010) opens opportunities for development. The research has not considered the effect of agency problems that can occur. According to Jensen and Meckling (1976) the agents (managers) will make decisions that are not in line with the interests of the owner because the agents are only concerned with their own interests. This is supported by Staw (1976) who raised one theory called the theory of self-justification. This theory states that managers who have already made decisions will not change decisions even though the results are negative because they feel they are right. When personal interests are concerned, agency problems occur (Jensen and Meckling, 1976).

According to Baiman (1990), agency problems can be overcome in several ways. One way that can be used to overcome agency problems is to give bonuses to agents (managers). For this reason, this study develops previous research conducted by Chong and Suryawati (2010) with the aim of testing whether bonuses can influence decision making specifically in preventing escalation of commitment.

Literature Review and Hypothesis Development

Escalation of commitment is the process by which individuals continue commitments made previously. If continued decisions produce profits, then there is no problem, but if they produce failures, then continuing it will bring harm to the organization (Sleesman, Conlon, McNamara, & Miles, 2012). For this reason, a de-escalation strategy is needed, which is a strategy to reduce excess commitment to failing projects. (Chong & Suryawati, 2010)

Rationally, individuals will stop decisions that have a negative impact. The behavior exhibited by decision makers is the opposite. Individuals will tend to keep the previous decision. Cognitively, the negative consequences caused by decisions will be distorted so that decision makers will turn their attention to the hope that there will be positive changes in the decisions they make. Individuals tend to rationalize their previous decisions or behavior to counter negative consequences (Staw, 2976). Steinkuhler, Mahlendorf, and Brettel (2014) found that self-justification is a strong motivation for decision makers to continue decisions that have negative consequences. Through this motive, optimistic perceptions and strengths emerge, causing an escalation of commitment.

Festinger (1957) had first found the root of the escalation of commitment. Cognitive dissonance theory suggests that when there is a difference between actions and beliefs, it will increase dissonance so that decisions made will be distracted by the existence of these differences. According to Staw (1976) a person's ego through a process of self-justification interferes with individual decisions to create distortions on the negative and individuals will continue their decisions.

Jensen and Meckling (1976) put forward agency theory. They argue that the owner (principal) and manager (agent) should have the same goal. When the agent's goals are different from the owner's goals, agency problems occur. The costs caused by the agency problem are very large because it is detrimental to the owner. Furthermore, Cheng, Schulz and Booth (2009) explain that when managers continue to maintain decisions that have negative consequences it will harm the owner. This condition is caused by different beliefs and actions that create dissonance. Differences in actions and beliefs result from self-justification so that agents will continue to fail projects (Staw, 1976).

Festinger (1957) explains that there are three ways to reduce dissonance. First, individuals can adjust trust with actions that have been made, but this method will be difficult when individual trust is a basic and important belief, so it is difficult for individuals to change it. Second, individuals can change the actions that have been made. This can be done with the basis of motivation as a mobilizer. Emotions such as feelings of disappointment and regret can be a factor for changing actions. Third, individuals can change perceptions of action. One's perception can be trained and one's rationality can be adjusted to the existing conditions.

Chong and Suryawati (2010) use a third method to reduce dissonance. According to them, when agency problems occur, agents will tend to hide information from owners and will tend to increase opportunities for escalation of commitments. They apply control through monitoring to change the rationality of decision makers so that even in conditions of private information with monitoring given then agents tend not to escalate commitments.

Monitoring is the process of evaluating projects based on actions made by decision makers. Private information is a situation where only managers can access information without the owner's knowledge (Chong & Suryawati, 2010). Furthermore, according to Baiman (1990) when faced with an agency problem, the owner can reduce the problem by giving a bonus. The bonus is a gift to an agent (manager) in cash or ownership (shares). Giving bonuses can reduce the agent's desire to pursue his own desires so that the company's goals can be achieved. Through these arguments, it can be hypothesized:
H1: Availability of information, monitoring, and providing incentives interact with decision making.
H2: Decision makers will change their decisions more with negative consequences accompanied by monitoring and bonuses in the condition of private information than without monitoring and bonuses.

Research methods

This research used a 2x2x2 factorial experimental method between subjects to answer the existing problems. The first factor is the condition of information which consists of two categories, the condition of private information and the condition of public information. The second factor is monitoring which is divided into two categories, monitoring and without monitoring. The last factor is the bonus, which is divided into two, giving bonuses and without giving bonuses. The design of the experiment can be seen in table 1

Table 1 Experiment Design

	Without Bonus	
Information availability	Without Monitoring	Monitoring
Public	Cell 1	Cell 2
Private	Cell 3	Cell 4

	Bonus	
Information availability	Without Monitoring	Monitoring
Public	Cell 5	Cell 6
Private	Cell 7	Cell 8

The sample of this study is students who are taking courses in the basics of investment. The basis for selecting the student is that the student has passed the Business Finance course that discusses agency relationships and has also been explained in class about the theory which is one of the basic theories in this study. Students are assumed to be

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able to understand the experimental material in this study. 159 students who have studied business finance were eligible to be taken as participant for this study.

According to Nahartyo (2013) and Nahartyo and Utami (2016) the use of students as participants must be done carefully. They continued that the use of students as research subjects could be done with the assumption that the study did not require professional experience, the level of difficulty was not high, and could understand well the experimental assignments given. This research tries to develop ways to reduce the self-justification that exists in the decision-making process without the need for professional experience. So, taking into account these factors, students are chosen as subjects in this study.

A minimum of 80 participants (10 per cell) who passed the manipulation test would be selected to take part in this research experiment. Before carrying out experiments, a pilot study was conducted to see the understanding of material. The pilot study was done to ensure the understanding of the materials.

Participants will be randomly assigned to one of the experimental conditions (Table 1). The eight experimental conditions are based on manipulation of three independent variables, the availability of information (public or private), monitoring control (present or absent), and bonuses (present or absent). The subject is then asked to play the role of investment manager in a company. The financial manager delegates investment managers to identify and be responsible for investment projects. The subject is then informed that the subject is given full autonomy over the decisions on the project and is fully responsible for the success or failure of the project.

Participants were given information that in year 0 the subject gave a recommendation of 10 billion for investment in the Chocolate project in the purchase of a new machine. The estimated lifetime of the machine is 7 years with net cash income of 4.5 billion per year. Performance regarding the project is provided. In the first year the cash that came in was 5 billion, the second year was 4.5 billion. The problem came in the third year where the cash coming in was 4 billion less than expected. Subjects were told that they were there at the end of the third year. Projections for the past four years have been provided where cash will continuously decrease. Despite the poor performance of the project, the board of directors decided to add 10 billion to additional promotional funding to increase sales demand.

Subjects that are in the condition of public information are informed that every month the company always publishes all project reports. So, information about the project is known to all parties. On the other hand, subjects who are in a state of private information are told that information about project performance is only known by them. Furthermore, subjects who were in a state of control were told that the CEO had agreed to the advice of the consulting firm to create a Project Evaluation Department. For this reason, all information about the project will be evaluated by the department. Contrary to this, subjects who were in a state of no supervision were told that the consultant's proposal was rejected by the CEO so there was no project evaluation department.

Furthermore, subjects who are in a bonus condition will be notified that any decision made either to continue the project or stop the project will get a cash bonus. Subjects that are in a condition that there are no bonuses will not get a cash bonus and will not get the information.

After that, subjects are asked to make managerial decisions namely to continue or stop the project. After the decision is taken, subjects are asked to answer manipulation test questions. The first question asks whether information about the project is available to other parties or not. The second question asks whether there is a project evaluation department or not. The last question asks whether they get a bonus or not.

RESULTS AND DISCUSSION

2x2x2 Analysis of Variance (ANOVA) is used to test the hypotheses that have been made. There are 3 factors tested in this study. Those factors are the availability of information (public or private), monitoring control (present or absent), and bonuses (present or absent). These three factors are the independent variables in this study while the decision to continue or not continue the project is the dependent variable. Descriptive test results and ANOVA can be seen on the following table.

Tabel 2 ANOVA Result

Source	Sum of Squares	df	Mean Square	F	Sig.
Information_Availability	2.756	1	2.756	.401	.527
Monitoring_Control	.416	1	.416	.061	.806
Bonus_Incentive	19.616	1	19.616	2.855	.093
Information_Availability * Monitoring_Control	40.887	1	40.887	5.952	.016
Information_Availability * Bonus_Incentive	7.940	1	7.940	1.156	.284
Monitoring_Control * Bonus_Incentive	5.100	1	5.100	.742	.390
Information_Availability * Monitoring_Control * Bonus_Incentive	35.728	1	35.728	5.201	.024
Error	1037.366	151	6.870		
R Squared = .087 (Adjusted R Squared = .045)					

A grand mean of 5,204 means that overall the participants decided to stop the project that was not profitable. The total number of participants in this study were 159 students who were taking investment principles courses. Another test was also conducted to test whether the relationship between each variable is influenced by extraneous variables. ANOVA test results concluded that all external variables both gender, majors, age, and GPA did not make any difference in participant decision making. It can be concluded that there are pure differences that are given independent variables to the dependent variable without the intervention of other variables.

To confirm the hypothesis that has been developed, the ANOVA results are shown in table 2. Partially both the information availability, monitoring control and bonus incentives did not make any difference to the decision making to proceed or stop unprofitable projects (sig = 0.527, 0.806, 0.093 respectively). However, the interaction between the three factors makes a difference in the decision to proceed or stop the project that is not profitable. This provides support for the first hypothesis that simultaneously these three factors differentiate decision making.

These results support previous research conducted by Chong and Suryawati (2010) and add new insights into the agency theory literature. In addition to the availability of information and monitoring control, the granting of bonuses can also influence an individual's decision to proceed or stop an unfavorable project. According to Keil (1995) managers will withhold negative information that will hinder the manager's career.

Another matter was added by Berg, Dickhaut, and Kanodia (2009) who concluded that when threatens from outside, individuals will tend to prove themselves. Information asymmetry was one of the variables measured in the study. They found that information asymmetry was one of the important factors in explaining the phenomenon of commitment escalation. This is proven in this research, monitoring control, availability of information, and the provision of bonuses can distinguish the decision to continue or not continue. Giving bonuses is one way to overcome agency problems caused by asymmetry information (Gitman & Chad 2012).

To test the hypotheses both Bonferroni and Turkey's post-hoc tests were conducted to see differences in significance in each experimental cell. Post-hoc test results indicated that there was no significant difference between each factor on decision making. Through statistical tests it is proven that Hypothesis 2 built in this study is not supported. One that causes the absence of differences between each cell is due to emotions. According to Sarangee, Schmidt, Calantone (2018) and George and Dane (2016) the escalation of

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commitment can occur due to someone's emotions that cannot be controlled logically. This study does not examine the emotional impact that can affect individual decision making.

CONCLUSION

Managers can be trapped in situations of self-justification that will lead to an escalation of commitments to unprofitable projects. Furthermore, the manager who will evaluate the project and will make the decision to continue or not continue will give different responses according to different conditions such as the availability of information for public or private, whether there is monitoring control or not, and there is an incentive scheme or not. These three factors together differentiate the participants in making decisions. For this reason, the contribution of this research is for the management of the company to make these three factors a consideration in the project management system. This research also contributes to the escalation of commitment literature and agency theory by adding factors that can differentiate decision making. This research did not find out which scheme would make managers stop the project or continue the project.

There are several limitations in this study. First, this research uses an experimental method that has a low level of generalization and situation simplification. For this reason, it is necessary to be careful to apply to different situations. Second, participants can also experience central tendency bias where the subject tends to focus on the middle Likert scale, this can be seen from the grand mean in the results of the study. Third, this research also has not included extraneous factors, such as emotions that can influence decision making.

Future studies can consider incorporating emotions into the research model that has been built. Future studies can also use research designs in different contexts such as share purchase and sale commitments. Some theories such as prospect theory, cognitive dissonance, and other biases in testing the models that have been built. Future studies can also assess team work decision making.

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