Why Demotion of Older Workers is a No-Go Area
A Vignette Study among Managers

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Abstract:

Demotion – a reduction of an employee's rank and salary - is often mentioned by managers and policy makers as a measure to increase the employability of older workers, but in practice demotion is rarely applied. This paper takes a fresh look at the question of demotion by the use of a survey and a vignette study among Dutch managers (N = 358), carried out in April 2013. The vignette study offers insight into the minds of managers by measuring their stated preferences with respect to demotion for a particular candidate. In this setup, managers make attributions when they infer causes about the poor performance of older workers. The key question is whether these causes refer to internal or external causes and causes which the employee can control and how strong the effects are in preferring demotion as a policy measure. By using some background characteristics on the manager, obtained through survey questions, we can also assess whether the decision to demote is also affected by the context of decision making – the organization – and the expectations of managers on the wider consequences of making demotion standard practice.

Internal causes such as not willing to participate in training, not motivated increase the likelihood of demotion, whereas external causes are of little importance. When the employee is overpaid compared to similar colleagues demotion is far more likely than when the employee is underpaid. The age of older employees does not affect the preference for demotion. A novel finding is that even when an employee scores low points on all possible causes, demotion still is hesitantly considered. Much of this hesitation is connected to the perceived negative externalities which managers expect to materialize once demotion becomes standard practice. In general managers expect adverse consequences of demotion: the motivation to work and loyalty towards management will seriously diminish. Only for the willingness to participate in training courses do managers expect some positive effects of demotion.

1. Introduction

Demotion – a reduction of an employee's rank and salary - is a topic which receives cursory attention in the economics and management literature. Well-known management and economic text books (Lazear 1998; Milgrom and Roberts 1992) primarily focus on promotion as an incentive mechanism to employees, but the term 'demotion' is either missing, relegated to footnotes or is left by the author as a suggestion for future research (Lazear 1995). Perhaps because of this lack of attention some wonder whether demotion is a four-letter word (Kohl and Stephens 1990). Others (Carson and Carson 2007) remark that "Demotion might well be considered management's 'dirty little secret'", the secret being that for decades pleas have been made to systematically examine the topic, but up and till this day the empirical insights into questions when demotion will be applied or how it affects organizations or the employees affected by demotion remain unanswered. This paper presents the first empirical investigation on the question to what extent demotion of workers is preferred by managers as a measure of personnel policy. We examine this question by a combination of a survey and a vignette study among managers to discover the main driving forces behind their preferences to use demotion for specific employees who perform poorly.

The case for flexibility in rank and salary is likely to become an issue as many countries are experiencing the pressures of work force aging. Especially the gap between wage and productivity may put extra pressure on employers and be a serious impediment for firms to hire or retain older workers (Conen, van Dalen and Henkens 2012; OECD 2006; Van Dalen, Henkens and Schippers 2009). One of the driving forces behind the wage-productivity gap is the seniority based payment system and this is quite visible in a number of European countries (Deelen 2012). And one of the measures which can in principle address this misbalance between wage and productivity and enhance the employment opportunities of older workers is the option of demotion, i.e. the decision to demote the function of an employee as well as the accompanying wage (Josten and Schalk 2010). Although demotion may seem an obvious solution to a divergence in pay and productivity, in personnel or management policies directed at older workers the term 'demotion' is conspicuously absent (Munnell and Sass 2009; Taylor 2002). And when it comes down to applying demotion, this option is also rarely exercised (Baker, Gibbs and Holmstrom 1994; Gibbons and Waldman 1999; Gibbs and Hendricks 2004; Josten and Schalk 2010). There can be a number of reasons. First of all, the role of reputations and self-selection mechanisms can be so strong and pervasive that employees will not let things come so far that his or career is tarnished by demotion. For instance, MacLeod and Malcomson (1988) claim that the promotion structure based on performance which is a dominant feature of the incentive structure of large organizations is maintained “by ensuring that it is optimal for employees to quit rather than accept demotion with their present employer” (p.834). The reputation of employees plays a large role in this model as a demotion signals to outsiders that the candidate did not perform well, and recognizing this possible fall in reputation the employee will opt for quitting the firm. Still, this literature demands a lot of rationality on both sides of the labor market. In case of young workers one may suspect that this is a relevant aspect, but it is more or less stylized fact that older workers are better protected and will not voluntarily quit a firm.

The second possible reason why demotion is not observed frequently is that demotion in those cases may very well involve high transaction costs; costs which trigger a number of averting actions. Van Dalen, Henkens and Schippers (2010b) show that within most organizations the first preferred option is to let poorly performing older employees stay in place. A possible explanation for understanding the resistance to demotion is the tension which managers suspect to arise not only among the demotee, who primarily experiences the stigma of failure (Carson and Carson 2007), but also among the colleagues who receive the signal that implicit contracts - promises of upward wage growth either by the principle of seniority and/or by a series of promotions - are not honored. And if the organization uses demotion regularly as an instrument of correcting the divergence between pay and performance, it may backfire on the organization. An incentive structure which makes only the winners but also the losers in a tournament explicit can lead to less effort, certainly when a loss of status is involved (Ederer and Patacconi 2010). Managers therefore have to take account of the externalities of demotion and the possible disincentive effects of demotion in case they want to change the incentive structure. These externalities generally refer to the effects of a breach of contract on the actions of third parties not involved in the individual decision of demotion.

Demotion remains therefore a case of ‘blackboard economics’: in theory demotion is an obvious solution when performance and pay diverge, in practice it is rarely used. It may perhaps suggest that demotion does not take place within contracts but that most of the downward mobility takes place when workers switch jobs. However, research by (Bowlus and Robin 2004; Bowlus and Robin 2012) for the US and Europe shows that by taking a comprehensive overview of labor market demotions – defined in their terms by downward wage movements – are still very rare, the wage decreases are small, and clearly outranked in size and frequency by promotions.

This paper provides an in-depth study of the potential use of demotion within organizations. It contributes to the existing empirical literature of labor economics and human resource management in three ways. First of all, it breaks new ground by offering the first empirical investigation of employer preferences for demotion as an instrument of personnel policy.

Second, this paper provides a comprehensive study on demotion by integrating two sets of factors in one explanatory model of demotion: characteristics of the individual worker to which the manager attributes poor performance, as well as the (expected) externalities which might arise from introducing demotion as a personnel policy in an organization. Managers may have a different assessment of the wider organizational consequences of introducing demotion as personnel policy, which may make them reluctant to apply demotion in individual cases. By incorporating employee and employer characteristics, this method offers the possibility to elicit preferences about the demotion of a specific employee, it also covers the extent by which the decision maker internalizes the expected externalities of such individual action. The present contribution may be seen as offering complimentary insight as to what goes on inside in the head of the decision maker who contemplates changing the rules of the game inside an organization. As such the findings of this paper fit in with the strand of applying insights from behavioral economics to understanding the behavior of organizations (Camerer and Malmendier 2007), but it may also shed light on questions asked in management on how attribution theory sheds light on human resource strategies (Harvey et al. 2014) and on how contracts within firms are perceived and sustained (Dabos and Rousseau 2004).

By combining survey data and a vignette study one may be able to obtain a broader perspective on demotion; a phenomenon which may generate intended or unintended effects beyond the individual decision or evaluation made. The vignette study and survey were carried out among Dutch managers (N = 358) in April 2013. These managers answered a series of questions about the pros and cons of demotion for their personnel and the organization in general. Next the managers are provided with detailed descriptions of hypothetical older workers. Managers were asked to state a preference for demotion for specific underperforming employees and under specific firm conditions.

2. Theories of demotion

There are two intertwined strands of literature which help to understand the preferences of employers with respect to demotion. The first strand of literature can be traced in organizational psychology where attribution theory is applied and in this particular context it is applied in describing how managers and employees make attributions when they infer causes about particular outcomes. As Harvey et al. (2014) emphasize in a review of the literature this theory is of considerable importance in understanding behavior and organizational outcomes. And in the present case it enlarges our understanding of the use of demotion as an instrument of human resource management.

The second strand is to be found partly in the domain of management sciences (Bosse, Phillips and Harrison 2009; Cropanzana, Bowen and Gilliland 2007) where fairness is perceived to an important element in personnel management and partly in personnel economics (Lazear 2000) where the choice of incentive structure is a key research question. Demotion fits in this strand as this choice penalizes underperformance and thereby not only makes the spread in wages larger but also makes the ‘losers’ visible. When status is a driving force behind work effort this can have consequences for the effort which employees display depending on the degree of risk aversion of employees (Ederer and Patacconi 2010). In gauging the effects of demotion these incentive and disincentive effects are key to understanding the behavior of employers who will consider what type of signal a demotion sends other employees and more in particular how it affects the behavior of these employees. Certainly in an environment in which demotion is rare or even considered a taboo one can expect that demotion can possibly non-productive behavior, such as showing less loyalty to management, becoming less motivated to work, sabotaging organizational procedures (Ambrose, Seabright and Schminke 2002). But on the other hand it may also generate productive behavior such an increased willingness to participate in training.

As far as these effects affect third parties which are not immediately tied to the decision of the demotion of a specific employee, we will term these effects the expected externalities of the demotion.

Perceived causes of poor performance

Two issues stand out in the organizational literature which focuses on performance ratings: (1) what are the underlying causes as perceived by supervisors? And (2) which actions do supervisors subsequently take based on their attribution of performance? The implicit assumption in this strand of literature is that supervisors are assumed to act, in line with the view of the path-breaking work of Heider (2013), as naïve psychologists who have an interest in learning the causes of success and failure within their firm, in particular of their subordinates. In the case of demotion they are faced with an employee displaying poor performance (low productivity, sloppy work) and it is in their interest is to trace the cause of this poor performance. By a set of informational indicators or outcomes they try to attribute the cause of the poor performance. In the burgeoning social psychological literature several attributional dimensions are identified (Weiner 1995) which are of importance in understanding organizational behavior: locus of causality, stability and controllability. The locus of causality is the most often studied dimension and this refers to the whether a cause is internal to the employee under evaluation, such as low effort or motivation or external (bad luck). Stability refers to the perceived variability of a causal factor. And controllability is the extent to which a supervisor perceives the cause of an outcome to be under the control of an employee. Although the locus of causality and controllability have much in common, some causes are internal to the employee but relatively uncontrollable, such as ill health or problems at home. Supervisors will generally trace the cause for structural poor performance of an employee to internal causes (low effort, motivation) under the volitional control of the employee and this is also what is revealed by the work of Mitchell and Wood (1980) and Wood and Mitchell (1981), who carried out experiments in a number of hospitals to see how supervisors attribute poor performance to internal and external causes and how to respond to this evaluation. In general, punishments are more likely when poor performance is attributed to internal, controllable causes: employee characteristics or behavior such as lack of effort, motivation or ability. All dimensions are relevant when supervisors have to decide whether or not an employee should be demoted. When the cause is perceived to be external, a temporary issue, beyond control of the employee, demotion is hypothesized to be less likely that in the case poor performance is attributed to lack of motivation. In line with this strand of literature we formulate the following hypothesis:

Attribution hypothesis: Managers will tend to be more in favor of demotion if an employee displays poor performance which can be attributed to internal causes, whereas attributed external causes are negated.

Externalities of demotion

The externalities of demotion involve the perceived costs and benefits of making demotion an integral part of personnel policy. It is no longer an isolated case, but the incentive structure is fundamentally altered. As such this regime change may be at the back of the mind of the employer as an actual decision to demote becomes part of the jurisprudence of the organization. The perspective on who breaches the contract and how the contract is perceived has many sides (Robinson 1996). The decision to demote a specific employee is probably seen by the employer as a breach of contract on the side of the poorly performing employee. The incumbent personnel staff may, however, also view this as a breach of contract on the side of the employer because demotion was never part of the incentive structure when they entered into a contract. In other words, the rules of the game are changed during the game. Employees may perceive their labor contract as complete and hence such a move may be viewed quite differently and may trigger reciprocal actions from the side of employees. We assume that employers will have expectations on how their staff perceives measures like demotion. Depending on the perceived fairness or unfairness they will reciprocate such a decision by management (Bosse, Phillips and Harrison 2009). But they could also respond in line with the changed incentive structure, as careers not only include promotion but also demotions. Ederer and Patacconi (2010) analyze this issue in some detail as a choice between promotion-based and demotion-based tournaments in which employees care about relative standing in an organization. Promotion-based tournaments generally dominate demotion-based tournaments as profits are higher and when the wage spread between highest and lowest wage is optimally chosen, effort is always higher. The basic reason why profits and effort are higher in their setup is that status losses and gains affect the firm differently. Demotion leads to status loss which the firm has to correct if it wants to keep motivated to participate. A promotion on the other hand, generates what Ederer and Patacconi term ‘ego rents’ by making the winners of a tournament visible but which also generates more effort. The basic insights of their model resounds in the work of Fehr and Schmidt (2007) who show in a model of enforceable contracts with fines and bonuses that principals rarely select fines. A related idea can be found in the model introduced by Ishida (2006), who combines insights from economics and social psychology. Employees obtain a sense of themselves by how others perceive them, which is known in the literature as the looking-glass effect. A principal who has superior knowledge (or a keen eye) about the productivity of the agent is tempted to use promotions “to boost the agent’s self-confidence”. One of the reasons why demotion is rare and promotion is the rule can be traced to the simple fact that an employer recognizes that one can also reverse the noted effect: the self-confidence of employees can also be destroyed by using demotions. We assume that managers take these expected responses into account in deciding on a demotion. Our baseline hypothesis is that when managers perceive that employees will reciprocate or react to making demotion standard practice by showing less commitment towards management or less work effort than the manager is less willing to consider demotion a reasonable step to take, or rephrasing this more formally:

Externalities hypothesis: Employers will be less likely to favor demotion in an individual case, when they perceive the externalities of demotion for the organization as a whole to be negative.

Of course, one cannot rule out the idea that managers expect that making demotion standard practice has beneficial effects in a very competitive environment. In industries where performance is highly visible (sports, orchestras, lawyers) linking pay to performance in labor contracts may well be the norm.

Other influences on demotion

As a final note in understanding demotion we want to mention that demotion may not imply incompetence or negligence on the part of the employee. For instance, when structural developments make reorganization necessary the employer can use the instrument of demotion, which is usually framed in terms of ‘delayering’ of functions (Littler, Wiesner and Dunford 2003). As such, demotion can be seen as renegotiating the terms of the incomplete contract as for instance, technological developments have made it necessary to reconsider the structure of the organization (Shavell 2009). Indeed, re-organizations are indeed often mentioned in labor contracts as grounds for considering demotion as a policy instrument. One the sparse contributions in this field by Dohmen, Kriechel and Pfann (2004) shows that for the case of large Dutch aircraft manufacturer Fokker that promotion rates fell and demotion rates rose when the firm entered the stage of demise. Furthermore, in collective wage agreement in the Netherlands the issue of demotion is often linked to situations where reorganization takes place: reorganization is a valid reason to consider demotion.

3. Data and methods

To answer the research questions, a combination of survey research with a vignette study was designed. Vignette studies or conjoint analyses are widely used in the social sciences (Cattin and Wittink 1982; Finch 1987; Green and Srinivasan 1978; Kapteyn, Smith and Van Soest 2007) as they shed light on the preference structure of people who evaluate a situation or make decisions. A vignette study can offer substantial insight as one does not ask for attitudes or expectations which refer to evaluations or decisions in general but actual situations which are evaluated by respondents. By tracking the influence of vignette characteristics one can unravel the elements which make a specific employee fit for demotion. The survey was carried out to gather information on the expectations of the managers contemplating the decision to demote. And the vignette was designed to see how managers evaluate a certain case of an older employee who performs poorly. We collected the data by accessing the sample of the Longitudinal Internet Studies for the Social Sciences of Tilburg University (http://www.lissdata.nl/lissdata/). LISS is an Internet panel that consists of approximately 6,500 individuals. All individuals are selected based on a true probability sample of households drawn from the population register by Statistics Netherlands. In this paper we use a small subsample referring to managers (N = 358). These data were collected in April 2013 and the response rate was 84 percent.

Participants

Managers in the LISS panel were identified based on the question whether they supervise others in their current occupation. We examined the preferences of a total of 358 managers of which 35 per cent were female, and the mean age of respondents was 47.8 (range 24-67 years, SD=10.3). Table 1 offers an overview of all the relevant variables used in the statistical analysis, distinguished by the different levels: vignettes and the managers who evaluated the vignettes.

TABLE 1 HERE

Vignettes

Vignettes are often used to elicit complex social evaluations or decisions on subjects that are sensitive or which are difficult to observe in the field. As such this method is well adapted to the issue of demotion. The basic item of the survey is a vignette, which is a short description of a situation or a person, generated by combining characteristics randomly manipulated by the researcher. Table 2 shows the order in which the vignette items were presented as well as the possible values presented. For an example of a vignette used in the study, see Figure A1 in the appendix.

HERE TABLE 2

In a vignette design, the unit of analysis is the vignette. Various hypothetical older workers who were eligible for demotion were described by several characteristics. To make the decision problem relevant we have designed vignettes to cover elements of productivity which lie within control of the individual – willingness to participate in training, work motivation, pay-productivity divergence - and some which are beyond his or her control – age and health. Beforehand the manager is given the information that the employee under review is not performing well and some personal characteristics are randomly selected to generate a profile of an employee. To see whether the employer also takes into account elements which inhibit performance but which lie outside the bounds of control of the firm, we have added the stress which some employees experience from problems at home. To gauge the monetary value of poor performance we introduced a vignette describing the gap between pay and productivity. We have tried approximate the divergence between pay and productivity by typifying whether the employee's pay is either higher or lower than that of colleagues of the same job level. By designing this vignette item one can make clear how an employer values a clear divergence between pay and productivity, either positively or negatively. Because the divergence is related to similar workers a possible effect may reveal how the employer deals with issues which Cropanzana, Bowen and Gilliland (2007) classify as 'organizational justice'. Finally, to control for the firm context we have designed a vignette item which captures the financial situation of the firm.

To summarize, the seven vignette characteristics are: (1) organizational context; (2) age of the employee, (3) motivation to work; (4) health status; (5) willingness to participate in training; (6) problems at home; and (7) the wage/productivity gap. Table 1 provides the various values for each vignette item. Given all possible combinations of the variables and their respective categories, the universe of 384 unique vignettes was created (i.e. 3x4x2x2x2x2x2). None of the vignettes contained impossible combination of the factors. In our study, each manager received a random sample of 5 vignettes (random selection with replacement) which concerned circumstances which may explain the faltering performance of the older worker. Each manager rated each vignette on a 10-point scale, ranging from 0 (very unreasonable) to 10 (very reasonable). For each vignette managers were asked "How reasonable would it be to consider demotion for the specific employee?"

Expected Externalities

We measured perceived externalities of demotion for the wider organization We presented the managers a series of survey questions about the consequences of demotion being introduced in personnel policy within the organization. The expected consequences are all *indirect* consequences of a specific demotion and some of these are clearly intended but some may be unintended. The exact question on which the scale are based are: "What do you expect will be the consequences of making demotion standard practice for your organization?" They were asked to evaluate these consequences for the following five issues:

- Loyalty of the staff towards the management of the firm
- Motivation to work of the staff
- Power to attract new work staff
- Willingness to train of the staff
- Solidarity between young and old work staff

The answering options amount to 1 = will increase strongly; 2 = will increase somewhat; 3 = no change; 4 = will decrease somewhat; and 5 = will decrease strongly. To check whether the underlying items measure one or more concepts these items were submitted to principal components factor analysis. The analysis yielded one factor with an eigenvalue greater than 1, suggesting the items measure one underlying concept, which we refer to as 'expected externalities'. Based on this analysis we constructed one 5-point scale variable. The Cronbach's alpha statistic is 0.80 which suggests that the scale is a reliable summary of underlying information in the separate items.

Analyses

As each manager judged five vignettes, our factorial survey data have a hierarchical structure by design, therefore observations are not independent (Wallander 2009). Multilevel analysis is used to deal with the hierarchical structure of the data (Hox 2010). Fixed models were estimated with two levels: (1) variables included in each model comprised variables at the level of managers (managers' expectations of demotion and some background characteristics); and (2) variables related the individual attributes included in the vignettes. The total model which is estimated boils down to:

$$Demotion_{ij} = \beta_0 + \beta_{1c}\, Employee_{ij} + \gamma_e Externalities_j + \gamma_c Controls_j + u_j + \epsilon_{ij} \quad (1)$$

where *Demotion* refers to the evaluation (on a 10-point scale) which employers *j* make with respect to a specific vignettes describing the *employee* with a vector of certain characteristics *c*. In addition to these characteristics we also include some variables which characterize the manager *j*. Of these characteristics the expected *externalities* of demotion is the focus of attention. Error terms are split up into two elements related to the levels of analysis: u_j and ε_{ij}, where u_j denotes the random effect tied to the evaluation of each employer j and the term ε_{ij} is the overall error term.

The central hypotheses which we want to test in this paper concerns: (1) $\beta_{1c:}$ the characteristics *c* of a specific employee *i* which a manager would attribute to poor performance and consider reasonable to opt for demotion, where characteristics *c* which the employee controls are will have a higher weight in the evaluation to demote than characteristics which are outside the bounds of control; and (2) γ_e: the employer's expectations about the externalities of demotion. The latter test could possibly show whether an employer takes a group-encompassing view ($\gamma_e \neq 0$) or whether he or she evaluates each and every worker on his own merits ($\gamma_e = 0$).

4. Explaining preferences for demotion

The central elements of our theory in explaining demotions consist of the attributed causes of poor performance and the expected externalities resulting from demotion. Before we delve deeper into the estimation results it may be helpful to see what managers expect at a very descriptive level. Figure 1 shows that most managers expect the consequences to be negative: the loyalty towards management, the motivation the work of incumbent personnel, the solidarity between young and old workers, the attractiveness of the firm in attracting new employees, are all expected to decrease. It is only with respect to the willingness participate in training that demotion can have salutary effects according to the manager.

HERE FIGURE 1

As mentioned above, these various effects are summarized into one scale variable describing the externalities in general, which can be found in Table 3. Three models are estimated. Model I focuses on the vignette items which mostly refer to the employee. Model II takes only into account the characteristics of the manager (of which the expected externalities are the central element), and finally model III combines the two sets of variables of models I and II.

HERE TABLE 3

The dependent variable – the preference for demotion - is based on a scale from 0 to 10 hence all the coefficients can be interpreted as adding or subtracting points to the base evaluation (the constant in the various models). The intra-class correlation across the models varies from 0.39 (model II) to 0.48 (model I). If we focus on model III, then one say that 46 percent of the variance in evaluations is due to differences across managers and 54 percent is attributable to individual differences. It demonstrates that grouping by managers is of value in understanding the preference for demotion.

In judging whether a candidate is up for demotion we would expect the total evaluation to generate an evaluation grade which substantially exceeds the value 5. Around the value 5 the manager is indifferent and substantially below 5 suggests that managers do not prefer demotion as a reasonable step to take. The estimation results of model I give a good impression of the employee characteristics that matter in considering demotion. We find strong support for the attribution hypothesis that poor performance attributed to external factors, i.e. factors which lie primarily beyond the control of the individual employee, have a much lower impact on preferences for demotion than internal factors. The work motivation, his or her willingness to participate in training and the relative wage which the employee receives are the most important elements entering the mind of the manager. In short, the estimation results suggest that managers really consider aspects of work which the employee can control and which matter in the workplace. This aspect explains why health and problems at home do not weigh heavily in the mind of the manager. An employee in whose health status is not so good is more likely to be considered for demotion (0.2 points higher) than someone who is in good health. Another (external) factor which does not affect the manager's evaluation is the age of the specific older worker. A priori, one would not expect age to be of influence on the decision to demote as it a character trait which is by definition not under the volitional control of an employee. The fact that age does not influence a manager's evaluation suggests that age discrimination is not an issue when demotion is at stake. Whether an employee is 45 or 60 does not make a difference.[1] In other words, the manager abstains from making a decision or evaluation based on stereotypical views about aging and productivity (Skirbekk 2004; Van Dalen, Henkens and Schippers 2010a). As a final remark about model I one should take note of the relatively low score for the financial position of the firm. Compared to a situation where the manager is working for an organization in a sound financial position, the managers who works in a financially vulnerable organization and or an organization in financial problems is quite low: such a manager considers demotion for a candidate 0.25 points higher.

Model II sheds more light on the construction of a preference for demotion by focusing solely on the manager's perceived externalities of demotion policies for the wider organization. The results provide evidence that if managers expect the consequences of demotion to be negative, they are much *less likely* to prefer demotion of an individual worker that in case the externalities of demotion are perceived to be modest. For instance, a manager who thinks that the consequences will have no effect whatsoever will have a higher preference for demotion (by 1.06 points) then the manager expects demotion to have strong negative effects. Other insights generated by model

[1] Of course, one should make the proviso that age discrimination is not an issue within the group of older workers (as this was stated in the vignette description).

II are the fact that the being an owner-manager makes one more willing to consider demotion and the fact the background characteristics sex and age of the manager do not matter.

In general it appears that firm context matters considerably in labour market analysis and in the case of demotion this may also be expected to be of value. Finally we expect that the position within the hierarchy matter for making decisions. The sample population consists of managers and in general managers are also employees and their interests will differ from the man or woman at the top who owns the business or who bears the risks and returns of business. Within this sample there are also managers who own their own business and this feature offers for us the opportunity to see to what extent this hierarchical position matters. A priori, one would expect this to be the case if the firm is small and horizons are short because those owner-managers have less opportunities to spread their risks over time and a poorly performing employee could very well mean the downfall of such a small enterprise.

Model III incorporates the two sets of explanatory variables in one explanatory framework. The estimation results reveal that that both sets of factors are full complements. All the coefficients on the vignette characteristics remain stable and the same can be said about the manager's expected externalities. Both two sets of factors prove to be important and independent forces in explaining the preference for demotion.

To obtain a total overview of how important all the factors are, a simulation of the preferences for a number of situations may offer some help. In Table 4 we present the simulations based on the model III of Table 3 for a variety of the attributed (internal) causes: the motivation to work, relative pay and the willingness to train. To see the difference between managers we present in the two columns two extremes: a manager who expects demotion to generate strong positive spillover effects and one who expects these effects to be strongly negative.

HERE TABLE 4

Again, one can see how demotion becomes far more likely when the manager expects the spillover effects of demotion to be positive. In the worst case scenario – an overpaid employee with no work motivation and willingness to train – the total evaluation score is 7. However, as shown by a manager who expects strong negative effects the evaluation score is 4.9. In other words, the manager becomes quite hesitant for this strong case of demotion. As one can see from

Figure 2, most managers either think there will be no spillover effects or they expect these effects to be negative.

HERE FIGURE 2

The bottom panel of Table 4 shows how the evaluation for candidate having a high motivation compares to that of one with a low motivation. A general observation to be made is that only in for the case where the manager has an positive view of how demotion works out for the organization as a whole, demotion becomes a real option to consider if an employee scores low on two or three characteristics. And once more, if the manager fears a backlash from demotion, all these results are overturned and demotion becomes indeed the rare event as it is depicted in the empirical literature.

6. Conclusions and discussion

Why is demotion a no-go area for managers? Ample studies have shown that demotion is rarely practiced and this stylized fact is difficult to reconcile with a spot market view of the labor market. In such a world demotion would not be an issue and never practiced as pay and performance would be equal at every point in time. Although implicit employment contracts are gradually being eroded (Hallock 2009), it remains key to understand organizational behavior and why the obvious 'blackboard' route is not so obvious. Managers know that fairness and a violation of principals of justice incites reciprocal and adverse behavior (Bosse, Phillips and Harrison 2009; Cropanzana, Bowen and Gilliland 2007). In this paper we have taken a fresh look at the question of demotion by looking through the lens *and* using the mind of the manager in discerning the preference for demotion. The novelty of this study is to not only discern perceived causes of poor performance which make demotion more likely, but also to use the mind's eye of a manager in answering the question: what happens to the organization at large once the manager makes demotion an integral part of the incentive structure? Managers are particularly vigilant in assessing the possibility of demotion by looking at the motivation to work and the willingness of an employee to train in addition to the approximated divergence between pay and productivity: employees who receive a wage which is higher than the wage of colleagues who have a comparable job within the firm. In short, they attribute the cause of poor performance to elements which are internal and under control of the employee under review.

Elements which lie outside the direct control of the individual, like age, health or the financial situation of the firm are of little influence on the preference for demotion. However, this assessment of employees by the manager is generally attenuated by the expected consequences of carrying out a demotion on the firm as a whole. Managers fear the adverse consequences of demotion for their own organization: dwindling work motivation and loyalty towards management. Only a minority of the managers expects demotion to generate benefits once it becomes standard practice, viz. they expect that the willingness to participate in training courses will improve.

The fact that the perceived consequences of demotion are a major force in holding back the manager in using demotion is as far as we can see a novel contribution which has far-reaching consequences for understanding organizational behavior. An alternative interpretation of this finding is that this effect points out that demotion is not an isolated management decision, but instead a socially embedded organizational decision. As the sociologist William Goode (1967) once pointed out in trying to understand demotion: "The protection of the inept is a group phenomenon." The feasibility of demotion of an employee is not only evaluated against the background of the characteristics of this employee, but also in view of the broader consequences that might spread out through the organization. An organization can be seen as a myriad of implicit contracts and because of the tacit nature of these promises the implied incentives as well as the social forces are extremely important in understanding organizations and the behavior of employers such as their aversion to demotion. But this finding may also touch upon broader problems. To reiterate the problem stated by Goode: the dilemma which firms have to face is whether protection *of* the inept is perceived to be more valuable than protecting the group *from* the inept. Apparently most managers choose to protect the inept instead of protecting the group from the inept.

An open question is how these preferences evolve once population aging becomes more visible to employers or when (global) competition intensifies. There may come a time when protecting the inept becomes less valuable than protecting the group from the inept. The post-world war experience of Japan shows that demotion may become a standard part of the working career by incorporating it in labor contracts and splitting a career in two parts (Clark and Ogawa 1996). Over time employers in Japan realized that lifetime employment with a firm was a suitable instrument to attract the young and skilled workers, but also a very expensive human resource strategy. The same may very well be happening in Europe, where the gap between pay and productivity is expected to increase as the work force ages (Van Dalen, Henkens and Schippers 2009). E.g., in the Netherlands, Belgium, France and Germany the presence of seniority wages plays a dominant role in the labor market and firms are reconsidering how to reconcile an aging work force with the current incentive structure. Indeed, the Dutch based establishment of the global acting [IT consultancy firm CapGemini] announced in January 2013 to lower wages for its 400 older employees. It was argued by the CEO that their salaries are no longer in line with their performance. Later on the management of CapGemini had to withdraw this suggestion by pressure from unions and even from pressures of an employer organization in the IT sector claiming that "young talent could be discouraged by discussions of this type of employment conditions". What this case suggests is that contractual agreements do not automatically translate into behavior. Although a considerable percentage of labor contracts in the Netherlands allows firms to consider demotion in times of large-scale reorganization, the results in this study suggest that firms running into financial stress are not going to consider demotion quite seriously. And an earlier study of Van Dalen and Henkens (2013) among European employers shows that cutting wages is not a popular option when firms have to reorganize or downsize. It goes to show how difficult the road to reform will be if countries want to tackle long standing institutions. But perhaps closing the gap between wages and productivity will not be done by the through the 'blackboard economics' of demotion, but sooner through labor mobility as older workers are forced to move[2], or perhaps the Japanese way of splitting careers by the institution of relatively young mandatory retirement age.

[2] The bridge jobs which early pensioners in the Netherlands take up as a second career show that working at a lower rank and with lower pay is possible, although one must acknowledge that these voluntary moves are made with a comfortable pension. The second career is so far an encore in which wage income is a nice supplement to a relatively good pension.

Appendix:

Figure 1A: **Example of a vignette**

In the Netherlands more and more people are trying to get demotion – the lowering of wages when employees show decreased performance – on the agenda. Below you will find the description of a number of older workers who for one reason or another show a strong decrease in performance.

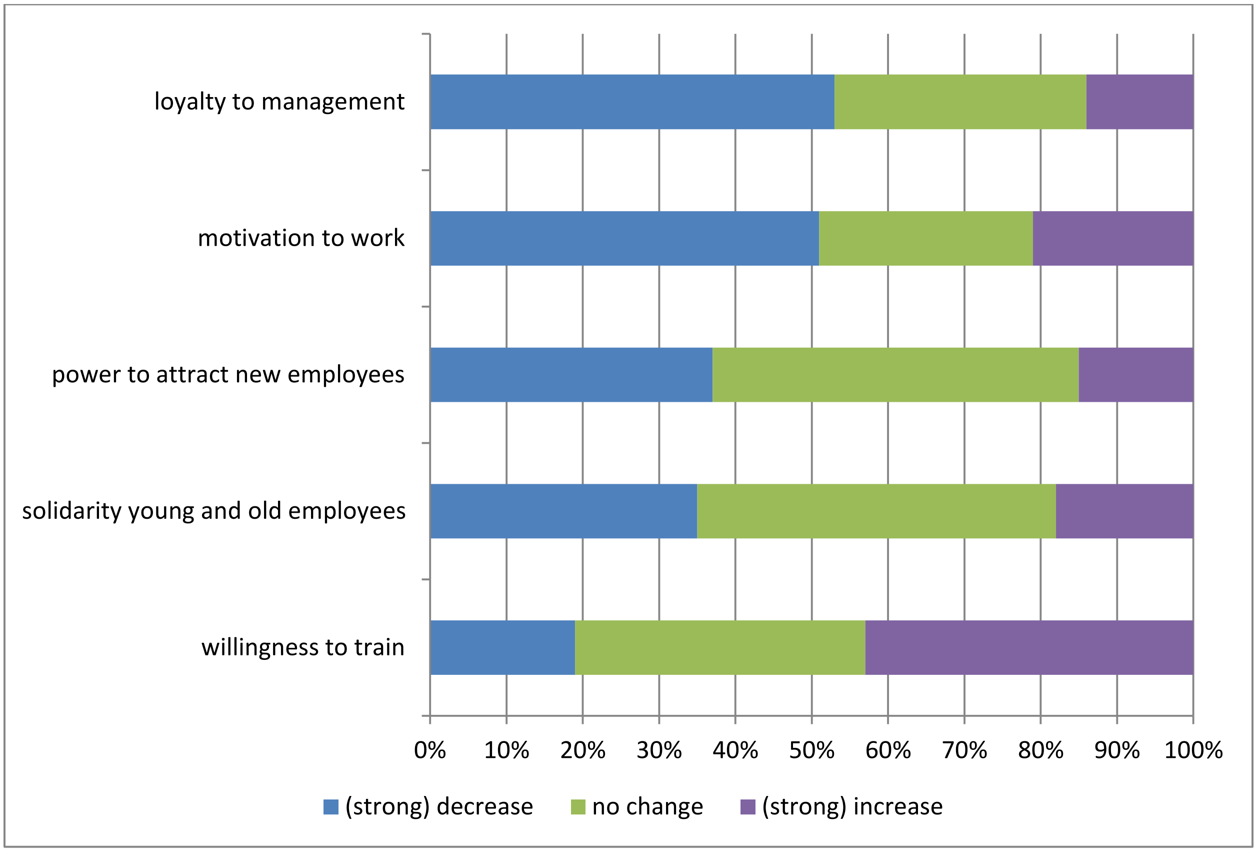
Please indicate, for each profile, how fair or reasonable it would be to consider demotion of the specific employee?

Context	
Financial position organization	Financially sound
Applicant	
Age (years)	50
Motivation to work	High
Willingness to participate in training	Low
Health	In good health
Problems at home	Yes
Wage level in comparison to colleagues with the same function	Higher than comparable colleagues

To what extent to you consider demotion in this specific case reasonable?

0	1	2	3	4	5	6	7	8	9	10
Very unreasonable					Neutral					Very reasonable

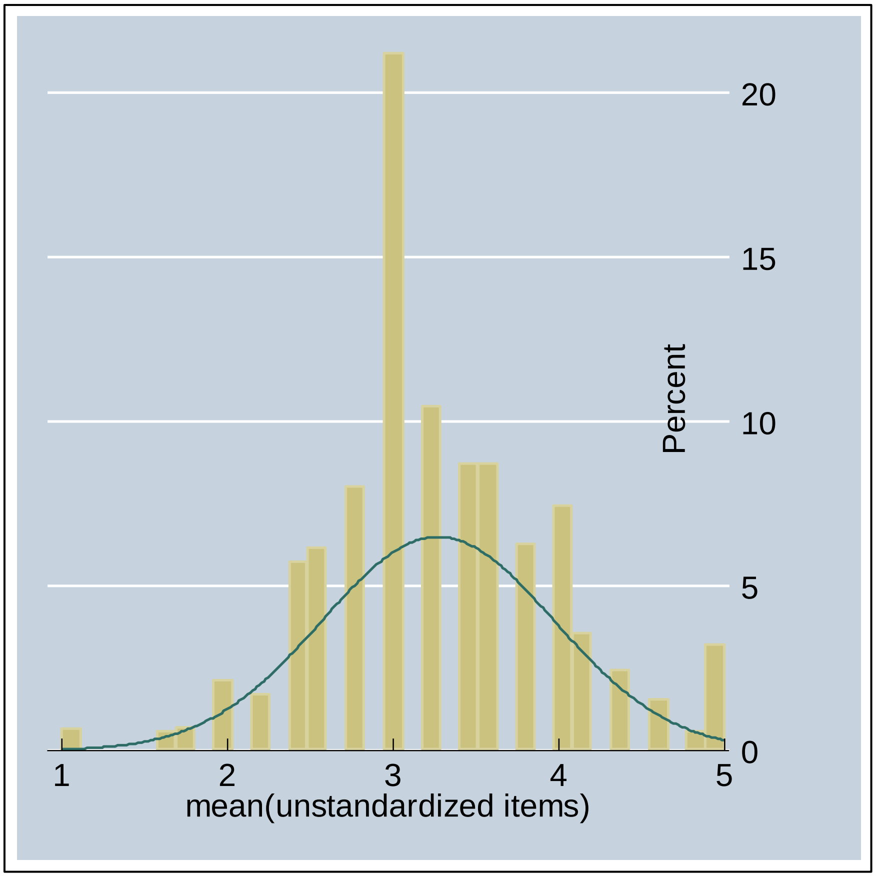
Figure 1: Average expected consequences of demotion by Dutch managers, ranked by potentially negative effects of demotion becoming standard practice within the firm



N = 358

Source: LISS data, April 2013

Figure 2: Distribution of expected consequences of demotion



Constructed by: histogram cons1, percent normal

Table 1: Descriptive statistics of vignette characteristics and background variables

Vignette items		
Dependent variable	Mean	s.d.
Preference for demotion[a]	4.78	2.19
Independent variables		
Financial position firm (sound = 0)		
Vulnerable	0.36	0.48
In financial problems	0.32	0.47
Characteristics of employee		
Wage level compared to colleagues (higher = 0)		
Lower	0.50	0.50
Motivation (high=0)		
Low	0.51	0.50
Willingness to train (high = 0)		
Low	0.53	0.50
Age (45 =0)		
50	0.25	0.43
55	0.25	0.43
60	0.25	0.43
Health (good =0)		
Not so healthy	0.52	0.50
Problems at home (no=0)		
Yes	0.54	0.50
N vignettes =	1790	
Characteristics of manager		
Age (in years)	47.80	10.32
Sex (male = 0)	0.35	0.48
Owner-manager (employee = 0)	0.11	0.31
Expected consequences demotion (5-point scale)[b]	3.24	0.73
N managers =	358	

(a) Preference is assessed is the answer given to the question: "To what extent would you find a demotion in this particular case reasonable?" (0) very unreasonable to (10) very reasonable.

(b) Scale variable based on expected consequences on a five-point scale with respect to (1) loyalty personnel to management; (2) motivation to work; (3) power to attract new personnel; (4) willingness to schooling; (5) solidarity between young and old staff members. The scale reliability coefficient (Cronbach alpha) is 0.80. Scale 1 = strong increase to 5 = strong decrease.

Table 2: Organizational contexts and employee's attributes in the vignette

Item	Categories
Organization	
Financial position of the organization	• Financially sound • Financially vulnerable • In financial problems
Employee	
Age	• 45 years • 50 years • 55 years • 60 years
Motivation to work	• High • Low
Willingness to participate in training	• High • Low
Health status	• In good health • Not so healthy
Problems at home	• Yes • No
Wage level in comparison to colleagues with the same function	• Higher than comparable colleagues • Lower than comparable colleagues

Table 3: Multilevel analysis of vignette experiments with respect to preference for demotion

Vignette items	Preference for demotion[a]					
	Model I		Model II		Model III	
Characteristics of employee	Coeff.	s.e.	Coeff.	s.e.	Coeff.	s.e.
Wage level compared to colleagues with same function (lower = 0)						
Higher	1.07**	0.08	-	-	1.07**	0.08
Motivation to work (high=0)						
Low	1.04**	0.08	-	-	1.05**	0.08
Willingness to train (high = 0)						
Low	0.61**	0.08	-	-	0.60**	0.08
Age (45 =0)						
50	-0.05	0.11	-	-	-0.06	0.11
55	-0.11	0.11	-	-	-0.12	0.11
60	-0.08	0.11	-	-	-0.08	0.11
Health (healthy =0)						
Not so healthy	0.17*	0.08	-	-	0.16*	0.08
Problems at home (no=0)						
Yes	-0.05	0.08	-	-	-0.05	0.08
Firm characteristic						
Financial position firm (sound = 0)						
Vulnerable	0.24**	0.09	-	-	0.23**	0.09
In financial problems	0.25**	0.09	-	-	0.25**	0.09
Background variables: characteristics of manager						
Age	-	-	-0.00	0.01	-0.00	0.01
Sex (male = 0)	-	-	0.12	0.17	0.17	0.17
Owner-manager	-	-	0.59*	0.26	0.64**	0.26
Expected externalities	-	-	-0.53**	0.11	-0.54**	0.11
Constant	3.23**	0.15	6.46**	0.58	4.80**	0.59
S.d. (manager)	1.42**	0.06	1.33**	0.06	1.35**	0.06
S.d. (residual)	1.47**	0.03	1.68**	0.03	1.47**	0.03
Intra-class correlation	0.48		0.39		0.46	
N =			1790			

(a) The preference for demotion is the answer given to the question: “To what extent would you find a demotion in this particular case fair?” (0) very unreasonable to (10) very reasonable.

Table 4: Predicted[a] score of demotion (on 10-point scale) across manager' expected externalities of demotion

Characteristics	Managers expecting:	
	Strong negative externalities of demotion	Strong positive externalities of demotion
Work motivation = high		
Willlingness to train = high		
overpaid employee	3.2	5.4
underpaid employee	2.2	4.3
Willlingness to train = low		
overpaid employee	3.8	6.0
underpaid employee	2.8	4.9
Work motivation = low		
Willlingness to train = high		
overpaid employee	4.3	6.4
underpaid employee	3.2	5.4
Willlingness to train = low		
overpaid employee	4.9	7.0
underpaid employee	3.8	6.0

(a) The assumptions underlying the scores are the following: the vignette items are set at financial situation firm = sound; age = 45 years; health = good; problems at home = none; the manager characteristics are sex = male; age = 48 years (sample average); employment status = employee. Because the dependent variable lies between 0 and 10, one can interpret these scores as chance that a manager considers demotion reasonable.

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