Stakes and Mistakes

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Abstract

The assumption that all incentives are created equal can lead principals to construct inefficient pay programs that ignore the critical component of incentives that drives their efficacy -- their value to the targeted agent. I will begin my talk by addressing the misleading divide between material compensation and psychological affects: traditionally, economists focus on extrinsic motivation such as money while psychologists emphasize intrinsic motivation such as job satisfaction. I argue that this separation misses an important interaction effect: the signal sent in creating the incentives. This signal is what determines the meaning of pay. Considering this signal and its interpretation is therefore crucial for optimizing pay. After discussing ways in which incentives can affect intrinsic motivation in either positive or negative ways, I will draw insights from behavioral economics research to demonstrate how even small differences in the structure of pay programs can change the interaction between intrinsic and extrinsic motivation, and consequently greatly impact effectiveness.