

Designing rewards Carrots dressed as sticks

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An experiment on economic incentives

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PEOPLE are contrary creatures. A man may say he would not pay more than \$5 for a coffee mug. But if he is told that the mug is his, and asked immediately afterwards how much he would be willing to sell it for, he typically holds out for more. Possession, it appears, lends things an added allure.

This makes little sense in the world of standard economic theory, where the value of something depends on what it is. But it can be explained by behavioural models in which the value people attach to objects is affected by what they already have, and people abhor losses more than they like equivalent gains.

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In a new paper Tanjim Hossain of the University of Toronto and John List of the University of Chicago explore a real-world use of these insights. The economists worked with the managers of a Chinese electronics factory, who were interested in exploring ways to make their employee-bonus scheme more effective. Most might have recommended changes to the amounts of money on offer. But Mr Hossain and Mr List chose instead to concentrate on the wording of the letter informing workers of the details of the bonus scheme.

At the beginning of the week, some groups of workers were told that they would receive a bonus of 80 yuan (\$12) at the end of the week if they met a given production target. Other groups were told that they had “provisionally” been awarded the same bonus, also due at the end of the week, but that they would “lose” it if their productivity fell short of the same threshold.

Objectively these are two ways of describing the same scheme. But under a theory of loss aversion, the second way of presenting the bonus should work better. Workers would think of the provisional bonus as theirs, and work harder to prevent it from being taken away.

This is just what the economists found. The fear of loss was a better motivator than the prospect of gain (which worked too, but less well). And the difference persisted over time: the results were not simply a consequence of workers' misunderstanding of the system. Economists have always been advocates of using carrots and sticks. But they may not have emphasised appearances enough. Carrots, this research suggests, may work better if they can somehow be made to look like sticks.

