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# Massive bonuses might actually cause poor performance

Dan Ariely Forbes.com

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**Forbes.com** Wall Street's multimillion-dollar bonuses have long roused the populist ire. Bankers routinely defended their excessive pay saying it simply amounted to exceptional rewards for exceptional performance. The implication was that if you cut bonuses, you'd cut performance. My research suggests otherwise. Very large bonuses actually can cause job performance to deteriorate. Super-sized pay can take executive's minds off their jobs and onto their bonuses.

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A year and a half ago, I presented this assertion to a group of 25 high-powered executives - at a (then) very large bank - and suggested that with a large enough research budget and their participation, we could test my theory. Perhaps unsurprisingly, they were not at all interested. The executives assured me that their own work would not follow this pattern.

I now suspect they were too quick to discount my research.

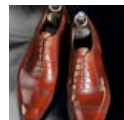
What do we really know about the relationships between very large bonuses and job-performance? To look at this question, my colleagues Uri Gneezy of the University of California at San Diego, George Lowenstein of Carnegie Mellon, Nina Mazar of the University of Toronto and I conducted a few experiments.

In one experiment, we presented 87 participants with an array of tasks that demanded attention, memory, concentration and creativity. We asked them to fit pieces of a metal puzzle into a plastic frame, to play a memory game and to throw tennis balls at targets, among other tasks. We promised them various payments if they performed any of these tasks exceptionally well. About a third of the subjects were told they'd be given a small bonus, another third were promised a medium bonus and the last third could earn a very high bonus.

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We did this study in India, where the cost of living is relatively low so that we could pay people amounts that were substantial to them but still within our research budget. The low bonus was 50 cents - equivalent to one day's work in rural India. The medium bonus was \$5, or about two weeks' pay, and the very high bonus was \$50, roughly five months' pay.

The results defied conventional wisdom. The group offered the highest bonus did worse than the other two groups - in every single task. On top of that, the people offered medium bonuses performed no better or worse than those offered

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low bonuses.

We replicated these results in a study at the Massachusetts Institute of Technology, where undergrads were offered the chance to earn a very high bonus (\$600) or a lower one (\$60) by performing two four-minute tasks: one that called for some cognitive skill (adding numbers) and another that required only mechanical skill (tapping a keypad as fast as possible). We found that as long as the task involved only mechanical skill, bonuses worked as we usually expect: the higher the pay, the better the performance. But when the task required even rudimentary cognitive skill (as we hope investment banking does), the outcome was identical to the India study: A higher bonus on the line led to poorer performance.

Financial rewards are a double-edged sword. They provide motivation to work well, but they also cause stress and preoccupation with the reward that can actually hurt performance. If our tests mimic the real world, then higher bonuses may hinder executives from working to the best of their ability.

Money isn't the only thing that compels better (or worse) performance. We also conducted a variation of the same experiment, at the University of Chicago, to look at a different kind of motivator: public scrutiny. We asked 39 participants to solve anagram puzzles, either privately or in

front of the others. We assumed their motivation to do well would be higher in public and improve their performance. In fact, they did worse.

So it turns out that social pressure has a similar effect to money - it too is a double-edged sword. It motivates people, especially in tasks that demand effort and no skill. But it can provide stress, too, and at some point that stress overwhelms the skill.

This is not to say we should outsource investment banking to rural India. But that compensation is a complex issue that fuses economic incentive stress, and other aspects of human behavior that we don't really understand all that well. The assumption that more money leads to better performance is not true--at least not all the time. If it was, wouldn't we expect that those who got tens of millions in annual bonuses would be optimal performers? Maybe even perfect? The fact that these high earners failed so miserably should add to the evidence against a direct link between higher rewards and better performances.

Now that our current crop of banks are essentially insolvent, why don't we incentivize the creation of new banks with a new pay structure - promote the idea that bankers aren't greedy bastards but have a crucial social responsibility, so that the next generation will take this approach and want these positions. The "old bankers" who claim they need to be paid millions can try and compete in this new market. But who would want them?

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