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An upfront bonus pays over the long term

By Adam Grant

The evidence suggests it is more effective to dole out rewards in advance

Most companies pay employees for high performance. But according to some behavioural economists, they are doing it all wrong.

In a study for the National Bureau of Economic Research, researchers investigated whether financial incentives to teachers in publicly funded schools could boost student achievement. The economists, led by Harvard University's Roland Fryer, randomly assigned teachers to receive extra pay based on their students' performance in standardised maths tests. The reward to a typical teacher was worth 8 per cent of salary, but student marks failed to increase significantly after the reward was introduced.

The intuitive explanation is that teachers are not motivated by incentives. As Daniel Pink argues convincingly in his book *Drive*, if teachers already intrinsically care about student learning and achievement, pay for performance is not the best approach.

But another group of students did spike in achievement after teachers were given an incentive. Prof Fryer's team had varied the timing of the rewards being paid. At the start of the school year in September, one group of teachers learnt they would be rewarded for student performance in June. These teachers achieved few gains with their students.

The other group of teachers received a cheque worth 8 per cent of the average salary – the same amount as the others – but they got it upfront. If their students did not meet their targets, the teachers would have to give the money back in June. Their students improved significantly, to the tune of nearly 10 percentiles.

Why was it more effective to dole out the rewards to teachers in advance? The researchers

point to loss-aversion: the prospect of a loss yields greater pain than the comparative pleasure of a gain. When the bonus is promised for June, it is an abstract possibility. But when it arrives on the day the promise is made, it becomes a meaningful sum here and now that is worth working at to avoid losing.

However, I believe that there is a social side to the story. Doling out a bonus in advance communicates trust and high expectations, which are known to encourage greater effort and better results. When teachers receive extra pay for student performance in advance, it is clear that leaders have confidence in them, and the teachers may be more likely to rise to the expectations.

What would happen if all organisations doled out bonuses like this? At first glance, it does not seem very friendly to hand out a reward then take it back. But the data show that, under such circumstances, employees are more likely to earn the reward. Ultimately, this means better performance and more bonuses – both desirable outcomes.

Another concern is unethical behaviour: employees might cut corners or falsify results. In schools, this could involve teaching only to the test, or even changing students' answers. Interestingly, Prof Fryer's team found little evidence of cheating: the students whose teachers received bonuses in September also improved on tests that were not part of the deal.

Of course, in some cases, unethical behaviour will be a risk if employees are more motivated to keep a bonus than to earn one. There is a way around it, though, which was tested by John List and Tanjim Hossain in a Chinese factory in another NBER study. Instead of giving the bonus early, the company announced having provisionally allocated productivity bonuses for the coming week. If employees fell short of targets, the allocation would be reduced. Simply framing the bonus as allocated in advance led to 1 per cent higher average productivity over a six-month period.

In a world in which quick results are paramount, it is understandable that managers still cling to financial incentives. After all, money matters, and it is easier to quantify, transfer and exchange than most rewards. It can also be fair: meritocracy requires rewards for the value contributed by employees.

To assess the merit of incentive schemes, it makes sense to rely on evidence, not intuition. This evidence is new, and we still have much to learn about how and where advance rewards are effective, and if they work for rewards other than pay.

But next time you plan to pay employees after they have achieved a target level of performance, it is worth asking if it would be more effective to give the bonus upfront.

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