

Bonuses and performance evaluations

Individual bonuses do not always raise performance; it depends on the characteristics of the job

Keywords: bonus, compensation, variable pay, incentives, performance evaluation, evidence-based bonus design

ELEVATOR PITCH

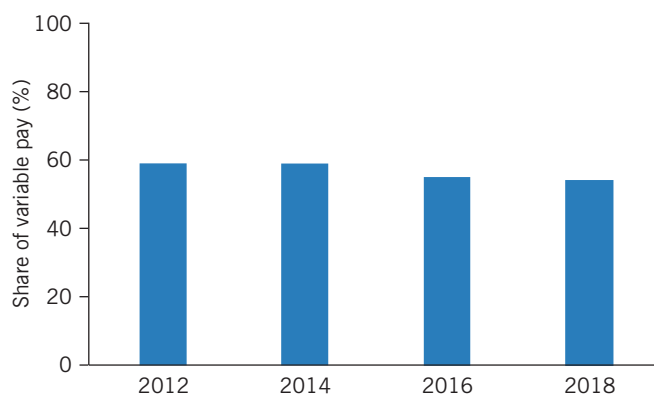
Economists have for a long time argued that performance-based bonuses raise performance. Indeed, many firms use bonuses tied to individual performance to motivate their employees. However, there has been heated debate among human resources professionals recently, and some firms have moved away from individual performance bonuses toward fixed wages only or collective performance incentive schemes such as profit-sharing or team incentives. The appropriate approach depends on each company's unique situation, and managers need to realize that individual bonus plans are not a panacea to motivate employees.

KEY FINDINGS

Pros

- ⊕ Bonuses may raise performance when objective measures are available that assess the key aspects of performance and if workers have sufficient leeway to increase their performance.
- ⊕ Bonuses motivate people who exhibit low task motivation.
- ⊕ Team bonuses can raise performance as peer effects and social preferences can mitigate the so-called free-rider problem.

The prevalence of variable pay has decreased in Germany



Source: Author's own compilation using LPP data. Online at: https://fdz.iab.de/en/Integrated_Establishment_and_Individual_Data/lpp.aspx

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Cons

- ⊖ Bonus schemes can cause distortions when employees work on multiple tasks and efforts for important tasks are hard to assess.
- ⊖ Performance-based bonuses may have limited effects for employees with a conscientious personality.
- ⊖ Bonus payments may affect, and potentially even undermine, other management practices used to motivate employees.
- ⊖ Bonuses based on individual performance often have to rely on subjective performance evaluations and these evaluations tend to be biased.

AUTHOR'S MAIN MESSAGE

Recent empirical evidence on the effects of bonus schemes shows that details of their implementation matter. Bonus schemes may work well for easily measurable tasks when employees have low intrinsic task motivation and performance is hard to monitor. In other contexts, however, there are several factors that limit their benefits. Bonus schemes must thus be carefully evaluated in the specific context of the organization in which they are to be implemented. Firms and academics should pursue evidence-based bonus design by implementing scheme changes for subgroups of employees that allow for robust evaluation of the observed consequences.