



Seminar

“Risk aversion and effort under incentive pay schemes with additive and multiplicative noise: theory and experimental evidence”

(in English)



Professor Nikolay Zubanov

**Professor of Management Science and Strategy,
Goethe University Frankfurt, Germany**

Date: 8 October 2015 (Thursday)

Time: 2:30pm – 4:00pm

Venue: WYL314, Dorothy Y. L. Wong Building

Biography:

Nick Zubanov is a professor of management science and strategy at Goethe University Frankfurt. After completing his doctorate at the University of Birmingham (UK) in 2007 he worked at CPB Netherlands Bureau for Economic Policy Analysis, and then moved back to academia, holding positions at Tilburg University and Erasmus University Rotterdam before coming to Frankfurt. He is an empirical labour economist by training, with research interests in HR practices and firm performance. His recent work includes papers on knowledge spillovers and firm productivity, monetary incentives and employee recognition.

Abstract:

We study how an agent's risk aversion affects his optimal effort choice under a given incentive pay scheme. We consider two cases: i) the "additive noise", in which output uncertainty is independent of the agent's effort; and ii) the "multiplicative noise", in which uncertainty multiplies with effort. The multiplicative noise case, though it resembles many real-life situations, is not studied as well as the additive noise case. Our theory predicts that the agent's risk aversion will not affect his effort choice under a given linear incentive scheme with additive noise, whereas under the same scheme with multiplicative noise more risk-averse agents will put in less effort. Running an experiment in which each participant had to go through additive and multiplicative noise treatments in random order, we find our predictions to hold for 77% of the participants. Implications of our results for the design of incentive pay schemes - in particular for the design of performance targets - are discussed together with some preliminary empirical evidence.