

XII RdB Conference, Cagliari, May 29, 2010

“Paying for performance”

Discussion by
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Overview

- An impressive achievement and a very interesting read
- Effectively four papers combined into one:
 - a much needed review of incentive pay across countries
 - three evaluations of specific incentive schemes at the firm/industry level

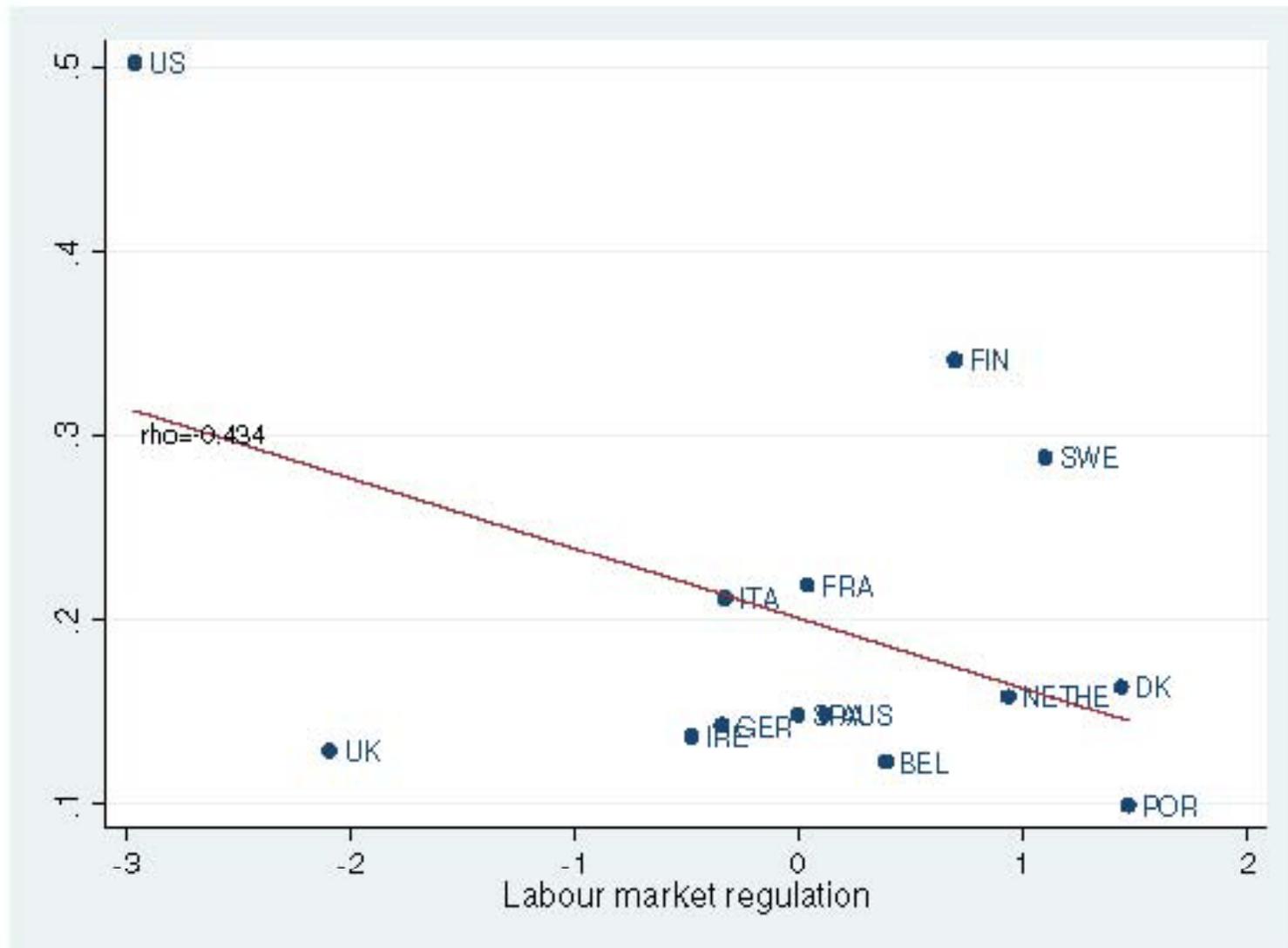
Road map

- General comments and open questions:
 - PP across countries
 - PP across the hierarchy
 - heterogeneous effects across countries
- Detailed comments on evaluations:
 - individual incentives in catering services
 - collective PP in metal engineering

1. PP across countries

- this paper provides much needed evidence on PP diffusion across countries
- relies on self reported pay information from existing surveys
- useful to compare to the bespoke managerial practices survey by Bloom and Van Reenen
- a quick glance shows similarities and intriguing (worrying?) differences

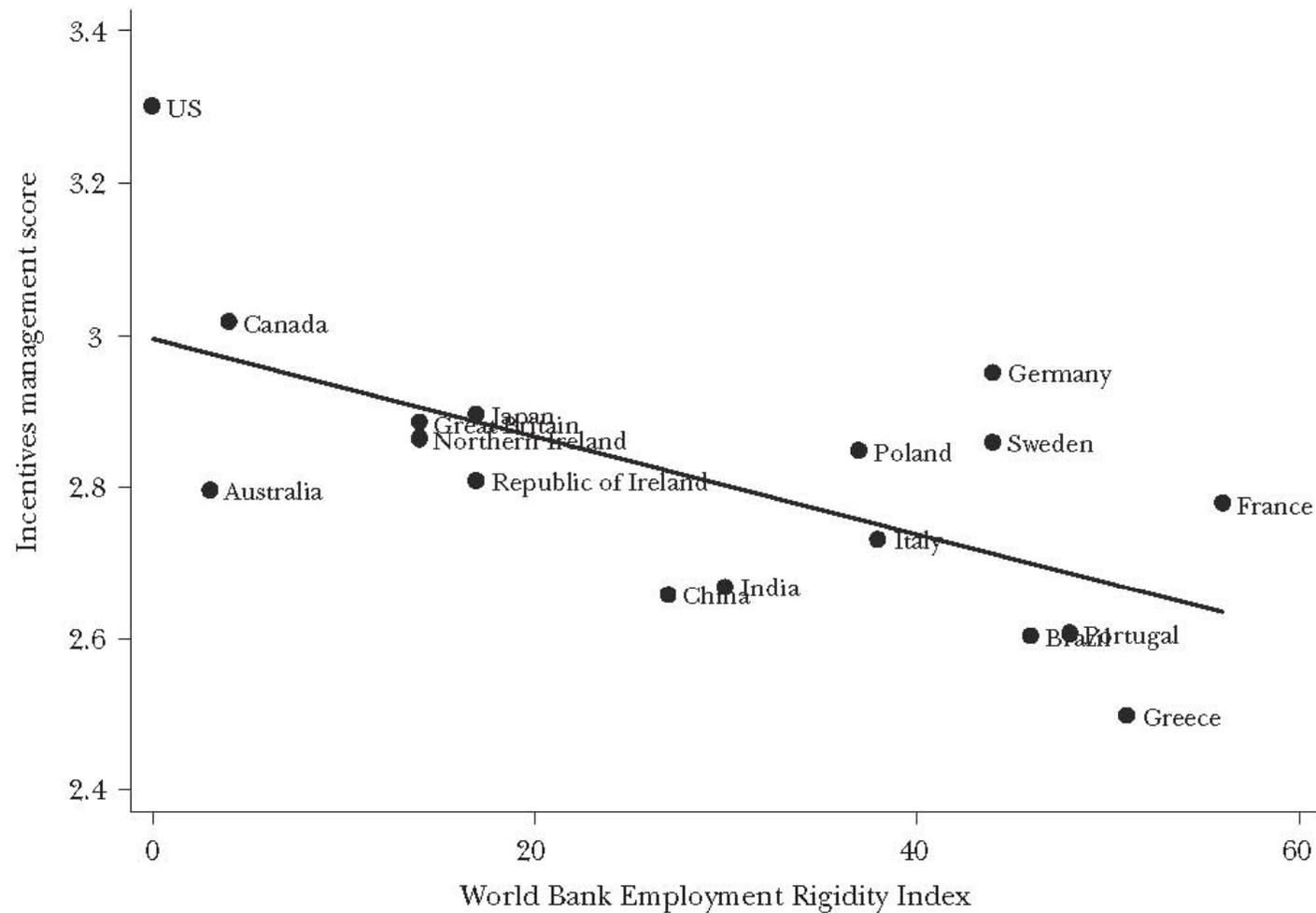
Bryson et al



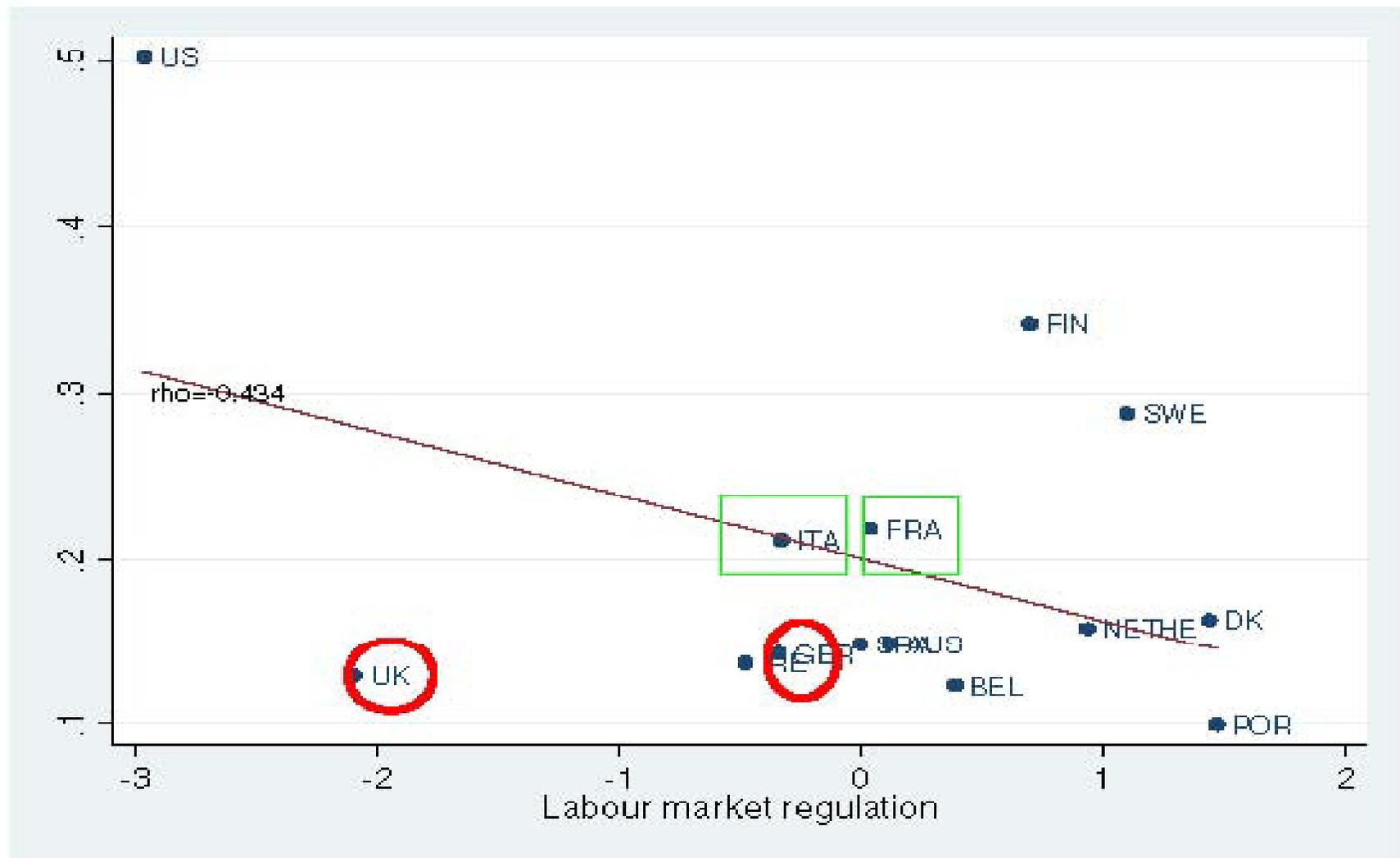
Bloom and Van Reenen

Figure 3

Labor Market Regulation and Incentives Management



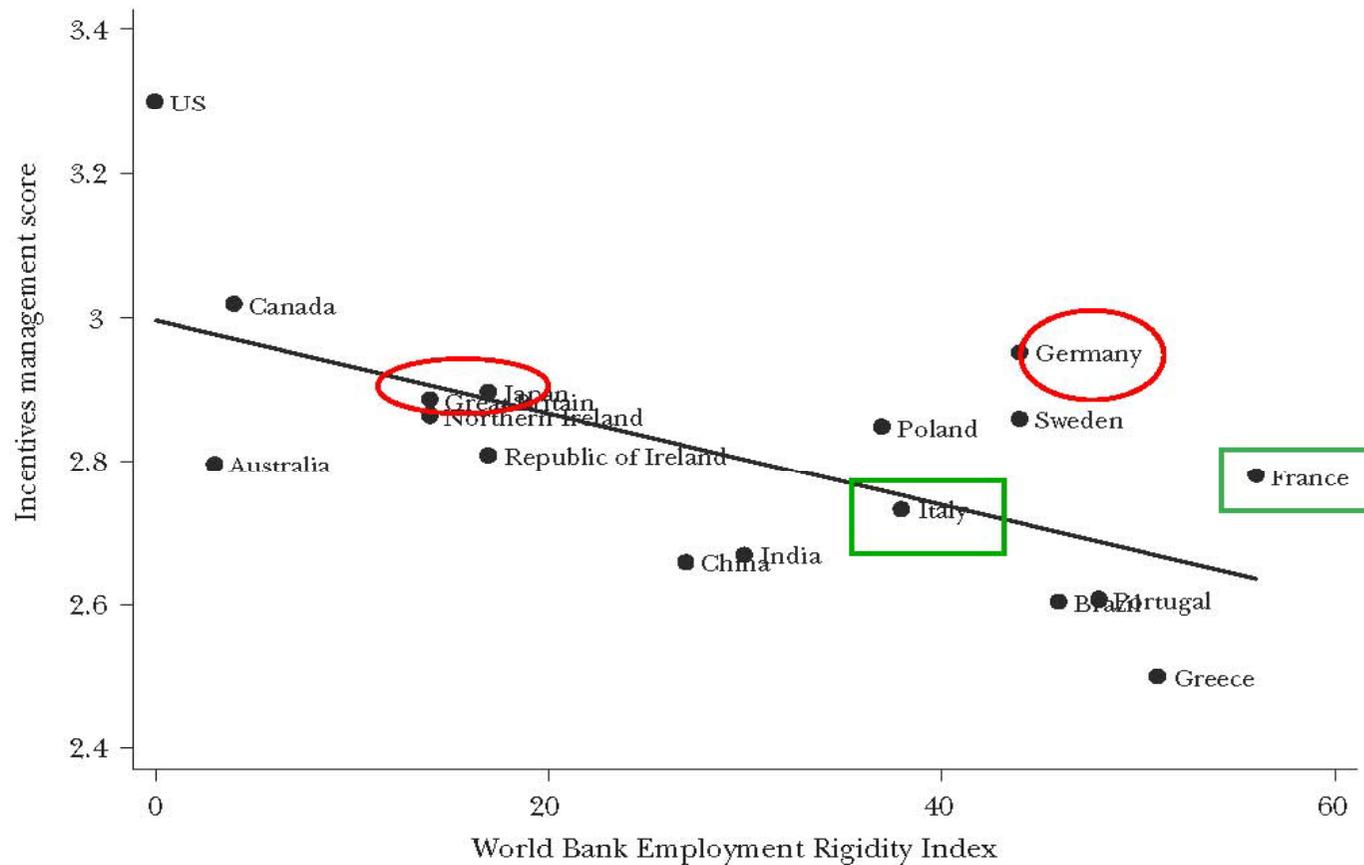
Bryson et al



Bloom and Van Reenen

Figure 3

Labor Market Regulation and Incentives Management



1. Reconciling the differences

- Definition of PP
 - might be more sophisticated in GB and GER-missed by simple survey questions
- Sectors (all vs manufacturing)
 - GB and GER have a comparative advantage in offering incentives for manufacturing?
- Hierarchy level (all vs managers)
 - substitution between manager and worker incentives?

2. PP across the hierarchy

- Most studies of PP focus on one level only (workers, managers, CEO)
- Lack of PP measures at the firm level
- We don't know:
 - whether firms that offer high powered incentives to CEOs, do the same for managers and workers
 - whether the power of incentives at different levels of the hierarchy are substitutes or complement

2. PP across the hierarchy

- Any reasonable behavioural model would predict that the effect of workers PP depends on managerial incentives and vice-versa.
- Yet, most empirical studies analyse one layer in isolation
- Miss an important source of heterogeneity, can misinterpret results

3. Can we export US (Japan) estimates?

- Most estimates of PP come from countries that use it extensively (US for individual PP, Japan for collective PP)
- Policy implications crucially depend on whether these can be exported
- No research in economics (yet) but evidence from OB indicates that PP schemes that succeed in the US often fail in other countries-why?

Case Study 1: Sales vs Profits as Performance Measures for Store Managers

- Exploit PP change in large catering service company:
 - From sales-based to profit-based
 - Bonus increases by 50%, on average (not clear whether a change in slope or level)
- Focus on first, although the two are contemporaneous
- Find that productivity increases, worked hours, sales and profits fall

The profit puzzle

- When managers' pay is an increasing function of profits, profits fall.
- Why didn't managers stick to their previous behaviour yielding higher profits and higher pay?
- Current explanation: managers reduce labour inputs and this reduces the marginal product of managerial effort, hence profits fall
- Yet, managers could prevent this by not reducing labour

The profit puzzle

- Alternative explanation 1: the new bonus system is so generous that the increase in the managerial wage bill swamps the increase in productivity
- This can be tested directly by building a profit counterfactual, assuming away changes in bonus levels
- Alternative explanation 2: decreasing trend

Unexplored mechanism: manager-store matching

- The reform might change the matching between managers and stores
- As managers are now rewarded for profits, it makes sense for the most profitable managers to move to the most (potentially) profitable stores
- Individual managers and store FE do not account for this, thus the estimated effects are not pure “incentive” effects

Endogenous manager-store matching

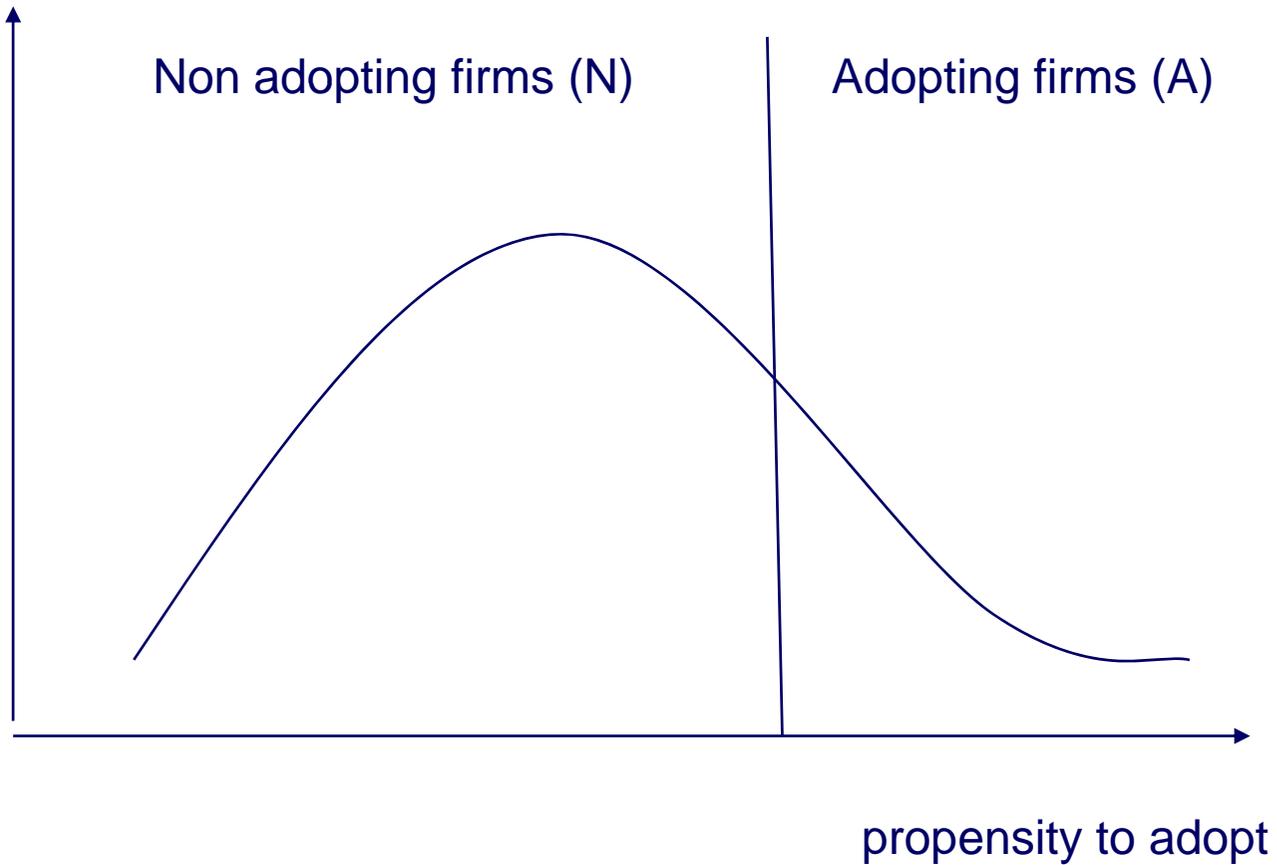
- Controlling for managerXstore FE allows to measure the pure incentive effect for those managers who did not move
- Comparing the estimated mXs FE on profits before and after the reform shed light on whether matching changed

Case Study 2: Collective PP in Metal-engineering

- Exploit cross-sectional variation to identify the effect of collective PP on productivity, hire and separation rates, wage inequality.
- Acknowledge that PP adoption is unlikely to be orthogonal to outcomes of interest
- Exploit 1995 as “natural experiment”: compare firms who adopted after the 1995 reform to those that did not

A note on identification

- Without reform:

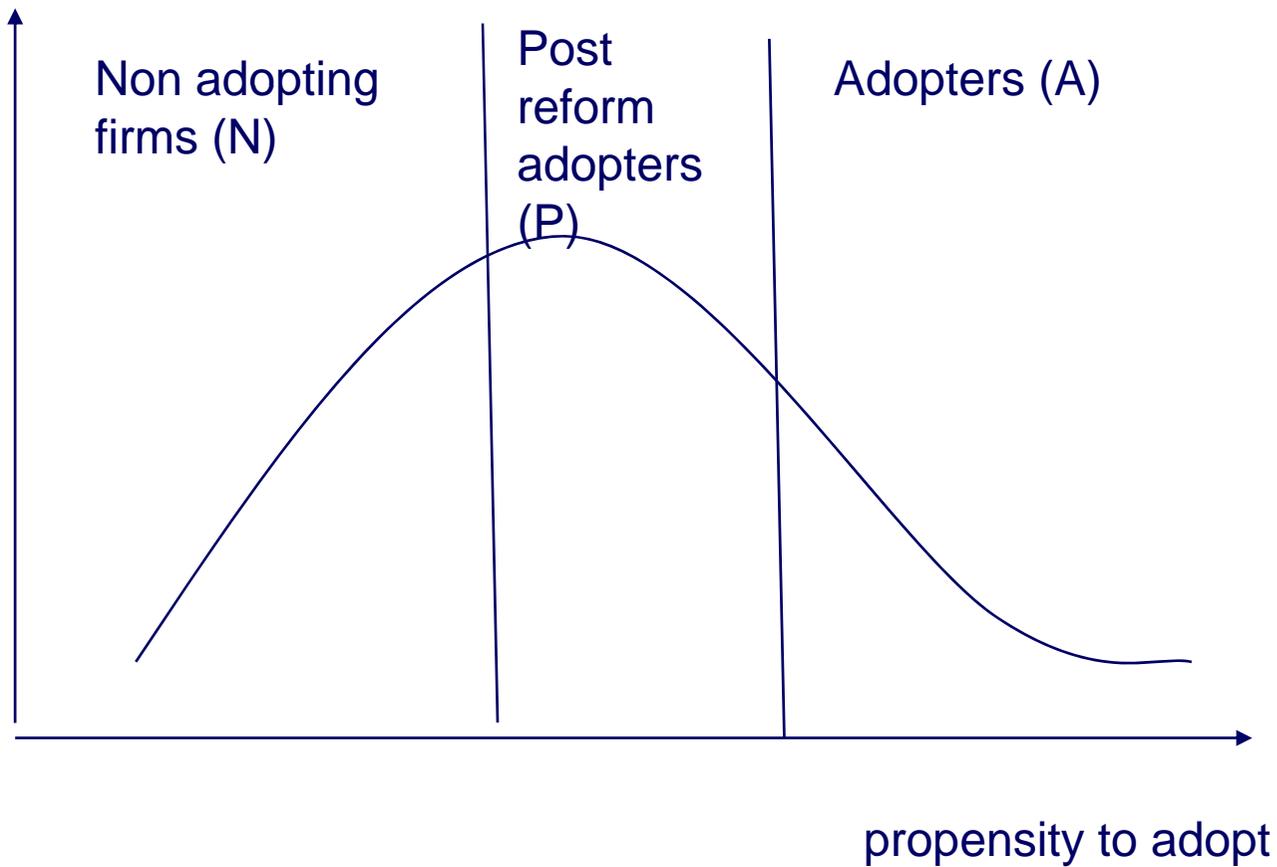


A note on identification

- comparing N and A lead to biased estimates as the propensity to adopt is likely to be correlated with performance
 - e.g. more profitable firms have a higher propensity to adopt

A note on identification

- After the reform



A note on identification

- while the reform is exogenous to firms' characteristics, the choice to introduce PRP after the reform is not
- the comparison of P and N suffers from similar problems as the comparison between A and N
- table 6.2.1 make clear that P and N are quite different

Reform as IV

- Use the reform as IV for adoption
- Not clear whether this is powerful enough, as the reform applies to all firms at the same point in time

DiD with Matching

- Matching: find the set of N firms that are most similar to P on observables
- Use historical data to set up a placebo DiD test of the equal trend assumption

Incentive vs Selection Effect

- the workforce composition changes
- productivity data on the same workers before and after PRP is not available,
- hence incentives and selection effects on productivity cannot be disentangled

Incentive vs Selection Effect

- PRP is a small fraction of salary and does not depend on individual effort \Rightarrow incentive effects are likely to be weak
- As the wage premium is the same for every worker, increase in wage inequality must entirely be due to selection \Rightarrow new workers better paid and more productive