

e3c-LoyolaECON SEMINAR

Tuesday 14th of February 2023
12:30 p.m. – 13:30 p.m.

“Examining relative thinking in mixed compensation schemes”

By

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Webex link to the seminar: <https://loyola.webex.com/meet/rede3c>

Abstract: Studies show that people exhibit relative thinking: they are affected by relative price differences even when these are irrelevant. The main evidence is based on hypothetical-scenario experiments in consumer-behavior contexts. This study attempts to show relative thinking in the context of receiving payments for a job, using mixed compensation schemes (which include a fixed payment and a pay-for-performance payment). Subjects were offered to do real-effort tasks of finding letters on pages and all of them were paid the same amount for every correct answer. However, there were two versions that differed in the fixed payment that was added. Effort was lower when the fixed payment was higher. This is explained by relative thinking: the higher fixed payment makes the per-task payment seem smaller compared to it, and therefore results in less effort. This finding has important implications because mixed compensation schemes are prevalent in many jobs, and are also a common feature of experiments (a fixed show-up fee and a payment that depends on performance). Our study offers the first demonstration of relative thinking in the context of mixed incentive schemes.

Keywords: relative thinking; compensation schemes; decision-making styles; pay-for-performance; heuristics and biases