

Incentive Gaming

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Organizations and institutions frequently use financial incentives to motivate productive behavior. The majority of people dislike effort to some degree, which forces authorities to either monitor people intensely to ensure that they contribute, or to pay them based on their observable performance. Salespeople are given commissions, bankers are given bonuses, and even teachers are paid for student performance.

The problem with these incentives, of course, is that you need to decide on which metrics to base the incentives, and then communicate those rules to people in order to motivate their performance. You can only pay people based on what you observe, and you can't observe everything. Which is why we get incentive gaming.

Incentive gaming is when people manipulate pay-for-performance schemes in ways that increase their compensation without benefiting the party that pays. Often referred to as "rewarding A while hoping for B", incentive gaming is an example of how opportunistic and strategic people can be when there are financial rewards involved. People will focus all their effort on those incentives that pay them the best, and will even manipulate information to represent their performance on those dimensions as higher than it actually is.

The financial crisis of 2008 provided several excellent examples of incentive gaming. Some mortgage brokers, who were paid commissions for originating mortgages, quickly learned they could earn more money if they relaxed the credit requirements for homebuyers. They were compensated based on originating a loan, not on whether that loan defaulted in subsequent years, a costly outcome for the bank and homeowner. The incentives designed to motivate effort and entrepreneurial behavior also motivate people to increase their earnings in ways that hurt both their customers and market efficiency.

Examples of incentive gaming are everywhere. When teachers are paid based on the standardized test performance of their students, they focus much of their effort on teaching to the test and hurt student education. When salespeople are given bonuses for reaching monthly sales targets, they offer customers unnecessary discounts to buy now rather than later. When workers are paid based on their relative rankings, they may focus their effort on sabotaging their coworker instead of improving their own performance.

The implication of incentive gaming is that managers and policy-makers need to understand that humans are clever and opportunistic beings. If you give them an incentive system, many of them will figure out how to manipulate it to maximize pay and minimize effort. Designers of incentive-based compensation systems must think carefully about unintended consequences, putting themselves in the shoes of their employees, and ask, "If I were given these incentives, what might I do to game them?"

Questions for classroom discussions: Incentive Gaming

1. When have you been paid based on your performance, and how did this alter the way you approached your job (for the better and for the worse)?
2. Grades are partly intended to provide incentives for quality work. How do students strategically game grading systems in ways that might pervert this intent?
3. As a manager, what questions should you ask before implementing incentives for your employees?
4. Is gaming unethical, or is it just rationally responding to the incentive system? Whose responsibility is it to stop gaming: the person who designs the incentive system, or the person who exploits it?
5. How do you draw the line between gaming and cheating?
6. What are the long-term implications if students or employees frequently game systems? How might this hurt the way that organizations or society functions? How does this relate to trust?

