

Incentivizing behavior works better than incentivizing performance: An overview

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Abstract

This study examines the importance of incentivization within microeconomic theory, focusing on its role in shaping individual and organizational decision-making. While traditional research has predominantly emphasized performance-based incentives tied to measurable outcomes, existing literature remains fragmented regarding the effectiveness and sustainability of behavior-based incentives. This gap limits a holistic understanding of how incentives influence long-term behavioral change. The objective of this study is to critically review and synthesize scholarly work comparing behavior-based and performance-based incentivization, with particular attention to their theoretical foundations, empirical support, and practical limitations. Using a structured qualitative literature review methodology, the study draws on microeconomic theory, alternative economic perspectives, and empirical studies to evaluate the mechanisms and outcomes of different incentive models. The findings suggest that behavior-based incentives offer distinct advantages in promoting sustained engagement and alignment with organizational goals, although they also present conceptual and implementation challenges. The study further reveals that contextual and psychological factors significantly influence incentive effectiveness. These insights contribute to advancing theoretical clarity and informing the design of more effective incentive systems. The implications highlight the value of integrating behavior-based approaches into microeconomic models to support more adaptive and sustainable policy and managerial practices.

Keywords: Behavioral economics; incentives; microeconomics; organizational behavior; performance incentives.

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1. INTRODUCTION

Behavior-based incentivization involves shaping behavior through rewards or penalties, emphasizing the importance of promoting desired actions rather than solely focusing on specific performance outcomes. This approach acknowledges the complexity of human decision-making and recognizes the role of intrinsic motivation and contextual factors in influencing behavior. By incentivizing behavior, organizations and policymakers aim to foster long-term behavioral change and achieve desired outcomes (Li et al., 2025).

This paper provides a critical overview of the literature on incentivizing behavior from a microeconomic perspective, with a specific focus on comparing the effectiveness of behavior-based incentivization and performance-based incentivization. This paper aims to critically review the literature surrounding behavior-based incentives and analyze their efficacy compared to performance-based incentives within the microeconomic framework. By examining theoretical perspectives, empirical evidence, and practical implications, this review aims to provide a comprehensive understanding of the advantages and limitations of behavior-based incentivization. Understanding the potential benefits of behavior-based incentivization is crucial for designing effective incentive schemes that align with individuals' motivations and promote sustained behavioral change. By exploring the literature on this topic, policymakers, organizations, and decision-makers can make informed choices regarding the design and implementation of incentives, ultimately leading to more successful outcomes. In the following sections, this paper will delve into the theoretical foundations of behavior-based incentivization, examine alternative economic schools of thought, review empirical research on behavior-based incentives, and critically analyze the advantages and limitations of this approach. Through this comprehensive exploration, this paper aims to contribute to the existing body of knowledge on incentivizing behavior from a microeconomic perspective.

Incentivizing behavior is a fundamental aspect of microeconomics, as it plays a crucial role in shaping individual and organizational decision-making processes. Traditional approaches to incentivization have primarily focused on performance-based rewards, such as monetary bonuses tied to specific outcomes. However, an increasing body of literature suggests that behavior-based incentives, which target and reinforce desired behaviors rather than specific performance outcomes, may yield more sustainable and effective results. This paper critically examines the literature surrounding behavior-based incentives and their potential advantages over performance-based incentives.

1.1. Purpose of study

The primary objective of this paper is to provide a comprehensive review of the literature on incentivizing behavior from a microeconomic perspective. The specific objectives of this study are as follows: Differentiation of behavior-based incentivization and performance-based incentivization; Theoretical underpinnings and criticisms of behavior-based incentives; Alternative economic schools of thought that offer insights into behavior-based incentives; Empirical evidence from existing studies regarding the effectiveness of behavior-based incentives; Key advantages and limitations of behavior-based incentivization in achieving desired outcomes.

The following questions serve as a framework for examining the literature, analyzing empirical evidence, and discussing the implications of behavior-based incentivization from a microeconomic perspective.

- a. What are the key differences between behavior-based incentivization and performance-based incentivization?
- b. What are the theoretical foundations and criticisms of behavior-based incentives within the microeconomic framework?
- c. How do alternative economic schools of thought, such as behavioral economics and psychological perspectives, contribute to our understanding of behavior-based incentives?
- d. What empirical evidence exists regarding the effectiveness of behavior-based incentives in driving desired behaviors?

- e. What are the advantages and limitations of behavior-based incentivization compared to performance-based incentivization?
- f. What factors influence the effectiveness of behavior-based incentives in achieving desired outcomes?

2. METHOD AND MATERIALS

This paper follows a structured approach to conduct a literature review on incentivizing behavior from a microeconomic perspective. The methodology employed in this study involves the following steps:

2.1. Identification of relevant literature

To ensure a comprehensive review, a systematic search strategy was employed to identify relevant literature. Multiple academic databases, such as JSTOR, PubMed, and EconLit, were utilized to search for scholarly articles, books, and reports. Keywords including "incentivizing behavior," "behavior-based incentives," "performance-based incentives," and "microeconomics" were used to refine the search results and focus on the specific topic of interest.

2.2. Selection criteria

The initial search results were screened based on predetermined inclusion and exclusion criteria. Inclusion criteria included scholarly works that specifically discussed behavior-based incentivization and its comparison to performance-based incentivization within the microeconomic framework. Studies published in English and within a specified time frame were also considered. Non-academic sources, opinion pieces, and articles not directly related to the research questions were excluded.

2.3. Data extraction and analysis

Selected articles and relevant literature were thoroughly read and analyzed. Key themes, theoretical frameworks, empirical findings, and arguments about behavior-based incentivization were identified and categorized. The data extraction process involved extracting pertinent information, such as authors, publication year, research methods, and main findings, for further analysis.

2.4. Synthesis and critical review

The extracted information was synthesized and critically reviewed to identify patterns, similarities, and discrepancies in the literature. Theoretical perspectives, empirical evidence, and practical implications were analyzed to provide a comprehensive overview of the advantages and limitations of behavior-based incentivization. Contrasting viewpoints, gaps in the literature, and areas requiring further research were also identified and discussed.

2.5. Framework development

Based on the analysis and synthesis of the literature, a conceptual framework was developed to organize the key findings and present a structured review of behavior-based incentivization. This framework guides the presentation of the literature review, including sections on theoretical perspectives, empirical evidence, and critical analysis. The methodology employed in this study ensures a systematic and rigorous approach to reviewing the literature on incentivizing behavior from a microeconomic perspective. By following this methodology, the study aims to provide a comprehensive and balanced analysis of behavior-based incentivization and its comparison to performance-based incentivization.

3. RESULTS

3.1. Incentivization: Theory and concepts

3.1.1. Definition and types of incentives

Incentives can be broadly defined as rewards or penalties designed to influence individual and collective behavior (Liu & Liu, 2022; Gneezy et al., 2011). There are different types of incentives, including extrinsic and intrinsic motivations, tangible and intangible rewards, and positive and negative reinforcement.

3.1.2. The rational choice theory and its application in incentivization

According to Levin and Milgrom (2004), rational choice theory has been a dominant framework in microeconomics if individuals make decisions based on self-interest and rational calculation of costs and benefits. Ainsworth (2020) examines how rational choice theory has influenced the design and implementation of performance-based incentives and explores its limitations in explaining and predicting behavior.

3.1.3. Critiques of rational choice theory in the context of behavior-based incentives

As per Abraham & Voss (2004), while the rational choice theory has contributed valuable insights, it faces criticisms when applied to behavior-based incentives. Aguinis et al. (2013) discuss these criticisms, focusing on the limitations of monetary rewards as the primary motivator and the importance of intrinsic motivation in shaping behavior.

3.2. Alternative economic schools of thought

3.2.1. Behavioral economics

According to Posner (1997), insights on incentives and behavior in behavioral economics challenge the traditional assumptions of the rational choice theory and incorporate psychological factors into economic analysis. Most studies explore the contributions of behavioral economics to understanding behavior-based incentives (Ben-Ner & Ellman, 2013; Esposito & Mastromatteo, 2024), such as prospect theory, loss aversion, and social preferences (Kremer et al., 2019; Garces-Velastegui, 2024).

3.2.2. Psychological perspectives

As Kremer et al. (2019) have examined Intrinsic Motivation and Extrinsic Incentives, Psychological theories provide valuable insights into the role of intrinsic motivation and the impact of extrinsic incentives on behavior. Here, the concepts such as self-determination theory, self-efficacy, and the over-justification effect highlight the importance of aligning incentives with intrinsic motivations (Gagné & Deci, 2005).

3.2.3. Socioeconomic factors and cultural influences on behavior and incentives

According to Eliasen et al. (2014), behavior and incentives are also influenced by socioeconomic factors and cultural contexts. Socioeconomic status, social norms, and cultural values shape behavior (Ishii & Eisen, 2020) and their implications for designing effective behavior-based incentives (Roos et al., 2021).

3.3. Empirical evidence on behavior-based incentives

3.3.1. Case studies

Ishii and Eisen (2020) show Success Stories of Behavior-Based Incentives, which presents and analyzes case studies that illustrate successful implementations of behavior-based incentives in various contexts, such as healthcare, education, and environmental conservation (Volpp et al., 2009). Case studies highlight the effectiveness of behavior-based incentives in driving positive behavioral change (Kullgren et al., 2016).

3.3.2. Experimental research

Design and Findings Experimental research provides controlled settings to examine the impact of behavior-based incentives on behavior (Kullgren et al., 2016). Bucklin et al.'s (2024) study investigates the effectiveness of behavior-based incentives in motivating desired behaviors, identifying key design considerations, and discussing the findings.

3.3.3. Longitudinal studies

Assessing the Sustainability of Behavior-Based Incentives Longitudinal studies offer insights into the long-term effects (Scheepers & Hoogendoorn-Lanser, 2018) and sustainability of behavior-based incentives (Huber & Hirsch, 2017). Longitudinal research tracks the impact of behavior-based incentives over time, identifying factors that influence their effectiveness and exploring potential challenges (Liu & Liu, 2022; Albarracín & Wyer, 2000).

4. DISCUSSION

This section critically analyzes the advantages of behavior-based incentivization compared to performance-based incentivization. It discusses the ability of behavior-based incentives to promote intrinsic motivation, foster habit formation, and address complex problems with multiple dimensions.

While behavior-based incentivization offers numerous benefits, it also faces limitations and challenges. The study examines potential drawbacks, such as the difficulty of measuring and monitoring behaviors accurately, the risk of unintended consequences, and the need for careful incentive design.

Tolchinsky and King (1980) shown that the effectiveness of behavior-based incentives is influenced by various contextual factors, such as the relevance of incentives to the desired behavior, the clarity of expectations, the presence of social and environmental cues (Maki et al., 2016), and the degree of autonomy and choice given to individuals (Clayton, 2015).

Drawing from the analysis and discussion, this part discusses the implications of behavior-based incentivization for policymakers, organizations, and decision-makers, as Hertwig and Grüne-Yanoff (2017) explained. It also highlights the importance of considering behavioral insights and tailoring incentives to specific contexts (Last et al., 2021) and target populations (Kullgren et al., 2016).

5. CONCLUSION

This section summarizes the key findings and insights obtained from the literature review. It highlights the advantages of behavior-based incentivization in promoting intrinsic motivation, habit formation, and addressing complex problems. It also acknowledges the limitations and challenges of implementing behavior-based incentives. Based on the gaps identified in the literature, this study provides recommendations for future research. It suggests avenues for further exploration, such as the integration of multiple theories and perspectives, the examination of cross-cultural variations, and the investigation of long-term sustainability.

In conclusion, this paper critically reviewed the literature on incentivizing behavior from a microeconomic perspective. It explored the advantages of behavior-based incentivization over performance-based incentivization, examined alternative economic schools of thought, presented empirical evidence, and analyzed the findings. By doing so, this review paper contributes to the understanding of the effectiveness and limitations of behavior-based incentives in achieving desired outcomes. It emphasizes the need for a nuanced approach to incentivization, considering the complex interplay of individual motivations, social influences, and contextual factors.

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Approval: The study adheres to the ethical guidelines for conducting research.

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