

# The Power of Differentiation? - On the Incentive Effects of Bonus Plans

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## **Abstract**

It is often claimed that supervisors do not differentiate enough between high performing and low performing employees when evaluating performance. This in turn should reduce the incentive effects of bonus plans. Hence, we study the impact of differentiation in bonus payments on subsequent performance empirically with a large panel data set. We find that on average stronger differentiation indeed has a substantial positive effect on future performance. This effect is the larger the higher the hierarchical level. But differentiation may become harmful at the lowest hierarchical levels.