RESEARCH BRIEF

Center for Executive Succession

Pay for Performance and Human Capital Deployment

New research to appear in the *Strategic Management Journal* investigates the ways firms use their human capital and spread work among top managers. When managers have autonomy in choosing their projects, allocating capital based on the availability and expertise of managers can be a problem. Researchers found that incentives play a key role, because managers who get paid for performance have incentive to take on projects themselves rather than letting them be allocated to others. This can spread their expertise too thin, rather than optimizing the allocation of work. Paying managers on the basis of firm outcomes like profits can alleviate this problem and result in a better allocation of human capital resources.

Key Takeaways:

- Individual pay for performance can incentivize the most experienced managers to take on more projects than they should.
- Misallocation of human capital results in less opportunity for some managers, and prevents firms from assigning the most capable and available managers to projects.
- A more optimal workload is achieved when top managers' pay is based on the firm's financial outcomes.

The authors examined the assignment of law firm partners in the UK to 1,298 merger and acquisition deals between 2003 and 2005. Partners working on more deals were substantially less likely to be assigned to new deals, and that partners paid on firm profit were more sensitive to their current caseload. Those with merit-based pay systems sought new deals despite an already high workload, and more experienced partners were better able to secure those new assignments. The authors reasoned that more experienced partners had more influence and knowledge about the internal system for assigning new cases, and used those advantages to secure more projects for themselves, at the expense of the firm's overall efficiency and performance.

The findings contradict the idea that high-powered individual incentives are always useful because they motivate more effort and better performance. The research team notes that individual incentives might still be useful for firms if the drive to take on more work results in bringing in new projects instead of just impacting the allocation of human capital to existing projects.

Chatain, O., & Meyer-Doyle, P. (2016). Alleviating managerial dilemmas in human-capital-intensive firms through incentives: Evidence from M&A legal advisors. *Strategic Management Journal, In Press.*