Productivity versus Efficiency:
The Effect of Incentive Focus on Target Setting in Participative Budgets

Firms typically design incentive systems to motivate employees and advance firm objectives. Two prominent objectives driving firm profitability are productivity (i.e., maximizing output) and efficiency (i.e., minimizing input). However, there remains little empirical research on the potential psychological effects of adopting a productivity versus efficiency focus on employee risk perceptions and decision-making. To address this important gap, we examine how different incentive foci (productivity versus efficiency) affect employee target setting under participative budgets. We predict and find that employees perceive an efficiency incentive that rewards input minimization as riskier than an economically equivalent productivity incentive that rewards output maximization, and this heightened risk perception leads to lower target setting. Furthermore, we find this effect is robust across production environments with different levels of outcome uncertainty. In additional analyses, we also observe that employees are significantly more likely to achieve their target and have lower error rates under productivity incentives relative to efficiency incentives, despite setting more challenging targets. Our findings have important implications for organizations, as utilizing productivity incentives instead of efficiency incentives may lead to lower levels of risk-reducing budgetary slack and higher target-setting.

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