

Abstract

The paper investigates the effect of four differently framed payment contracts on the agent's effort provision and performance in a real effort experiment. The four incentive payments are framed as a base wage and bonuses (one immediately pays bonuses, the other only after an initial performance-independent part), penalties or a combination of bonuses and penalties. The base wage that is offered, induces the reference point. The participants provide real effort and are paid for finding pairs in a customized Memory game. The bonus-only frame elicits the highest effort, whereas frames with penalties lag behind. Ability positively complements the effect of effort on performance. The combination of penalties and bonuses minimises the costs of the principal only for low levels of performance employing heterogeneous agents. For higher performance levels, framing a base wage with bonuses is cost-effective.