The Effect of Performance Measures on Risk in Capital Investment Decisions

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Background

Growth and innovation involve risk, and firms often struggle to get managers to take sufficient risk.

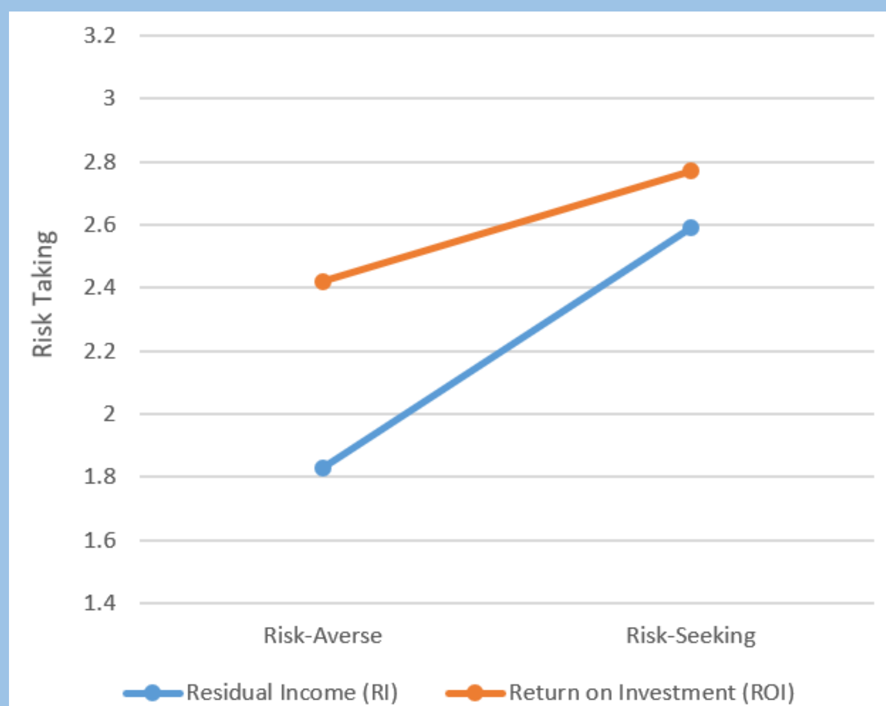
Accounting perf. measures (ROI, residual income) may affect risk-taking, and effects may differ based on individuals' inherent risk preferences.

No prior empirical evidence on effects of ROI and residual income on behavior.

Conclusion

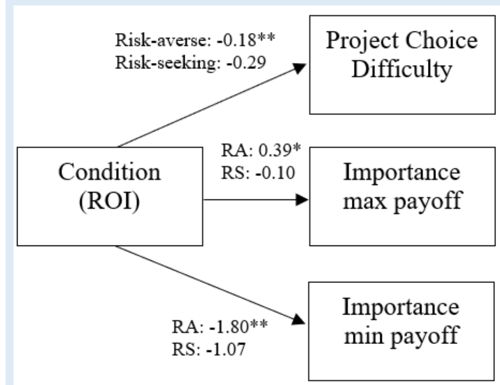
Using ROI as a performance measures leads individuals to make riskier project selections than when residual income is the measure used.

The performance measure used interacts with individuals' inherent preferences for risk – increased risk-taking under ROI is found mainly in relatively more risk-averse individuals.



Additional Results

Process evidence: ROI may allow individuals to more easily meet aspiration for positive outcome, freeing them to pursue more risk.



Experiment Design

100 Ps from Amazon Mechanical Turk; Repeated risky project choice. Performance measure manipulated between Ps.