PHYS ORG

When performance comparisons spur risky behavior

2 March 2015, by Greg Muraski

When you're at work, there are two types of people you compete with: People with similar responsibilities at your own company, and rivals with similar duties at other companies. How do those different flavors of competition shape behavior?

According to new research from the University of Maryland's Robert H. Smith School of Business, being outperformed by the people in your own company is more likely to lead you to make risky moves in the hope of improving your standing quickly. Getting outperformed by outsiders also inspires people to change their behavior, but change inspired this way is less likely to be risky.

The problem, of course, is that risk-taking can lead to a great comeback for an employee, but it also raises the chances of crashing and burning, which affects not just the employee but the firm and the firm's clients.

There are lots of reasons to guess that "inside" competition might cause more intense pressure and spur more daring attempts to improve than competition with outsiders. "Those people are physically and socially proximate," says Christine M. Beckman, a co-author of the new study. "They are the people your managers compare you to."

Her co-authors are Aleksandra Kacperczyk of MIT's Sloan School and Thomas P. Moliterno of the University of Massachusetts at Amherst.

It's a challenge, to say the least, to objectively track how someone is doing relative to her inside and outside rivals. That's where the mutual-fund industry, where objective comparisons are not only available but widely publicized, came in handy.

The three researchers looked at the performance of 3,225 actively managed funds from 1980 to 2006. Large mutual-fund companies such as Vanguard, T. Rowe Price, and Janus Funds often have several funds that overlap in both their goals and the assets they invest in. So fund managers are measured not just against rivals but against people down the hall.

Beckman, Kacperczyk and Moliterno tracked what happened as funds fell behind their internal or external rivals. First, they looked at whether fund managers changed tactics, then how. Risky change might mean increasing the holdings of assets that are more volatile than the typical asset held by a similar fund (shifting from mid-cap to low-cap stocks, say). Other change may not be risky, such as altering the concentration of stocks (which could include higher or lower volatility stocks) or raising fees paid by clients.

While both kinds of competition led to changes in behavior, internal competition was most likely to lead to risk-taking. And people were especially likely to make risky changes when they were outperformed by peers in their firm who were demographically close to them: Near their own age or an alumnus of the same college.

One explanation for the finding is that when you're beat by an external rival, you—and perhaps your supervisor—can attribute the problem in part to broader corporate failings. There's no such excuse when you're drubbed by an internal peer.

The authors collected qualitative evidence that internal comparisons are intense by interviewing fund managers. "It's a cut-throat competition," one said. "You are always being compared with peers in your firm. If you are at the bottom, then you better prepare to move."

Managers should be aware of the consequences of setting up competition among their employees. "It's important to understand that you are incentivizing people to take risk," Beckman says. "If that's something that you don't want, you may not want to play up these social comparisons. You can imagine scenarios that lead to really unhealthy risk-taking, to a cycle of people flaming out which may be damaging to the firm."

More information: "Disentangling Risk and Change: Internal and External Social Comparison in the Mutual Fund Industry." *Administrative Science Quarterly* 0001839214566297, first published on December 29, 2014 DOI: 10.1177/0001839214566297

Provided by University of Maryland
APA citation: When performance comparisons spur risky behavior (2015, March 2) retrieved 28 October 2021 from https://phys.org/news/2015-03-comparisons-spur-risky-behavior.html

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.