

## Experimental Evidence of the Effects of Incentive Design on the Value of Communication

**Hung-Chao Yu**  
National Chengchi University

**Tay-Chang Wang**  
National Taiwan University

**Wu-Chun Chi**  
Chung-Yuan Christian University

### Abstract

This paper experimentally examines the interactions between incentive intensity and the value of communication between owner and manager. Seven hypotheses based on the comparative statics predictions of a Bayesian game model are tested. The experimental results from six laboratory market settings reveal several important conclusions. First, communication is valuable in mitigating manager's dysfunctional behavior of giving up innovation project. Second, the value of communication could be hurt by a high incentive intensity. This result may partially explain the empirically weaker incentive intensity than theory prediction. Finally, a project's outcome uncertainty

affects subjects' perception about the connection between their actions and the corresponding payoffs. The strength of this "salience ambiguity" in turn constitutes a key condition under which model predictions may or may not predict subjects' strategic behavior. In particular, we find that the predictive power of our model substantially improves when subjects' salience ambiguity decreases due to lower outcome uncertainty. These findings expand the managerial accounting literature by showing how incentive-related variables (i.e., project's outcome uncertainty and incentive intensity) may affect the effectiveness of a participative budgeting system.