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BEHAVIORAL FINANCE IN THE FIELD OF COMPENSATION

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Abstract: Behavioral finance in the field of compensation studies how psychological, social, and cognitive factors influence decision-making in aspects such as salary payment, compensation, and other elements of employment relationships. This field combines economic theory with psychological and sociological concepts to understand how people perceive and respond to different payment and reward systems. Within the scope of this article, a survey was conducted among 100 employed individuals over the age of 18, the analysis of which will highlight the key differences between traditional economics and behavioral economics more clearly.

Key words: *behavioral finance, remuneration, salary, motivation, job satisfaction, pay fairness, framing effect, anchoring effect.*

Introduction

Compensation plays a central role in shaping employee motivation, performance, and satisfaction within the workplace. Traditionally, compensation systems have been analyzed through the lens of classical economic and organizational theories, which assume rational behavior and objective decision-making by both employers and employees. However, real-world decision-making often deviates from these assumptions due to the influence of cognitive biases, emotional factors, and psychological heuristics.

Behavioral finance, an interdisciplinary field that integrates insights from psychology and economics, provides a more realistic framework for understanding how individuals perceive, evaluate, and respond to compensation. Concepts such as loss aversion, anchoring, framing effects, and fairness perceptions offer valuable tools for analyzing how employees interpret salary levels, reward structures, and compensation-related policies.

The study of behavioral finance and the implementation of its findings have a very important social aspect. Traditional finance views the individual as a rational being, whereas behavioral finance sees them as a 'normal' being (Bogatyriev, 2019). In other

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words, our decisions are not always the best among the available options; they are influenced by our preferences, biases, and degree of risk aversion. Through the application of behavioral finance, the behavioral characteristics of individuals making managerial decisions are revealed.

This paper seeks to explore the potential relevance of behavioral finance principles within the context of employee compensation. Drawing on both theoretical sources and survey-based data, the study examines selected aspects of how compensation is perceived and the various factors that may influence this perception. The aim is to contribute to a more comprehensive understanding of how psychological and behavioral tendencies can shape attitudes toward remuneration in the workplace.

Research methodology

This study employs a mixed-method approach, combining a literature review with an online survey. A systematic literature review was conducted to identify key behavioral finance theories relevant to compensation. To complement the theoretical framework with empirical data, an online survey was conducted using a random sampling method. Participants included 100 individuals aged 18 and older who are currently employed. Participation was voluntary and anonymous. A correlation matrix was constructed based on the survey data to analyze the relationships between respondents' salary levels, on the one hand, and factors such as age, work experience, educational attainment, and other variables, on the other.

Results and findings

In many manufacturing settings, the most productive employees often outperform their least productive counterparts by a factor of two to three. In certain occupational contexts, the disparity in output can be even more pronounced. While various elements contribute to differences in individual performance, motivation emerges as a primary determinant. However, it is important to acknowledge that motivation is not the sole factor influencing productivity. An individual's performance is shaped by a combination of motivational, cognitive, and environmental variables, including inherent ability, workplace conditions, and broader situational factors.

Motivated behavior is generally characterized as being goal-directed. In everyday discourse, motivation is often explained by associating a given action with outcomes perceived as desirable within a cultural context. For instance, a typical commonsense explanation might state: "Person X is working hard in order to earn more money." While such explanations may suffice in informal settings, they fall short as scientific accounts of behavior. They do not elucidate why monetary gain is valued by the individual, why that particular path (Y) is chosen over alternative behaviors (Z), or why monetary rewards are prioritized over other potential goals.

A scientifically robust explanation must therefore address not only the specific behavior exhibited, but also the underlying reasons for the selection of a particular goal, the preference for that goal over others, and the strategy employed to pursue it.

The distinction between conceptualizing humans as rational, goal-oriented agents versus beings driven by unconscious impulses is of fundamental importance in understanding motivation. Each perspective carries significant implications for organizational

design. If one adopts a view of individuals as governed by unconscious drives, then organizational structures would logically emphasize external controls aimed at monitoring and regulating behavior. Conversely, if individuals are seen as rational actors capable of self-direction, motivation can be shaped through the strategic use of goal-setting, and organizations might rely more heavily on mechanisms that support intrinsic motivation and self-regulation.

The distinction between man as a rational, goal-oriented being and man as a being governed by unconscious drives is a very important one. If we accept a view of man as a rational being, then the very design of organizations needs to be different from what it would be if we accept the instinctual model of man. The instinctual model calls for an organization dominated by controls by which the organization tries to monitor and direct the behavior of people. The rational model suggests that motivation can be influenced by the use of goals and that self-control is possible. These models also suggest very different ways of approaching the study of motivation. One argues for trying to understand how people's goals develop and how people learn to obtain their goals. The other suggests trying to understand instincts and the analysis of individuals' fantasies, thoughts, and actions in order to understand what unconscious motives may be in operation (Lawler, 1994, Byrne & Brooks, 2008, Obolikshto, 2014).

Although traditional motivation theories, such as Maslow's hierarchy of needs (1943) and Herzberg's two-factor theory (1959), provide a foundational understanding of employee behavior, they often rely on the assumption of rational decision-making. However, in practice, decisions related to salary and compensation—on the part of both employees and employers—are frequently shaped by cognitive biases, emotional reactions, and imperfect information. This discrepancy between theoretical assumptions and real-world behavior highlights the relevance of behavioral finance (Leković, 2020). By integrating its principles, we can gain a more nuanced understanding of how individuals perceive and react to compensation structures, bridging the gap between motivation theory and the behavioral aspects of remuneration.

In the context of salary structures and compensation decisions, several key concepts from behavioral finance provide important insights into employee behavior and perception. These mechanisms challenge the assumptions of classical economic rationality by illustrating how cognitive biases and psychological factors shape attitudes toward remuneration (Yi, 2024, Xu, 2023, Kahneman & Tversky, 1979).

- ✓ Anchoring Effect: Individuals often rely disproportionately on the initial salary figure presented to them, which then serves as a psychological anchor for evaluating subsequent offers. This effect persists even when the anchor is objectively misaligned with market standards or the individual's true economic value. For instance, an initial salary offer may distort perceptions of fairness or adequacy in later negotiations, influencing long-term compensation expectations.
- ✓ Framing Effect: The manner in which salary information is presented significantly influences how it is interpreted by employees. Identical remuneration amounts can elicit different psychological responses depending on their framing. For example, an annual salary stated as "4.5 million drams per year" may be perceived differently from a monthly breakdown of "375,000 drams per month," despite being numerically equivalent. This underscores the importance of presentation format in shaping salary satisfaction.

✓ Loss Aversion: Rooted in prospect theory, loss aversion refers to the tendency of individuals to experience the pain of losses more acutely than the pleasure of equivalent gains. Applied to salary dynamics, employees often react more negatively to a pay cut than positively to a similar increase, even when real wages are adjusted for inflation. This asymmetry can create lasting dissatisfaction and affect employee morale.

✓ Hedonic Adaptation: Over time, individuals tend to psychologically adjust to changes in income levels, a phenomenon known as hedonic adaptation. As a result, the initial satisfaction derived from a salary increase diminishes, and employees may revert to their baseline level of contentment. This can lead to reduced appreciation for continued high compensation and necessitates periodic recognition or goal-setting to sustain motivation.

✓ Affective Forecasting Errors: Employees frequently overestimate the long-term emotional impact of salary increases. This misjudgment, known as ineffective happiness forecasting, may lead to inflated expectations regarding job satisfaction and overall well-being following a raise. When these expectations are not met, it can contribute to disengagement or disappointment despite objectively favorable pay conditions.

✓ Perceived Pay Fairness: Beyond absolute compensation, employees are highly sensitive to relative pay and perceived equity. Even when salaries are competitive, a sense of unfairness may arise if workers believe they are compensated less than colleagues performing comparable roles. This perception of inequity can negatively influence motivation, commitment, and overall job satisfaction.

The same bonus system can be perceived differently by different employees. For example, one may be highly motivated to earn bonuses, while for another, it may not seem justified — in other words, it may not be reasonable for them to put in extra effort to receive the offered bonus.

Depending on the sector, employees should be compensated and therefore motivated in different ways (Shivhare, n.d.).

- *Time-Based Compensation:* This method motivates employees by providing stability and encouraging them to fulfill their duties during working hours. Employees who receive an hourly or monthly salary usually focus on the quality performance of their duties and do not need to exert additional effort. This method is suitable for jobs where responsibilities are difficult to measure quantitatively.
- *Piece-Rate Compensation:* In this case, employees are motivated to increase the volume of their work because their income is directly linked to the results. This encourages employees to improve productivity and efficiency in order to earn more.
- *Premium-Based Compensation:* Rewards are used to motivate employees to achieve or exceed specific goals, performance indicators, or standards. This can stimulate teamwork, leadership, innovation, and increased productivity.
- *Commission-based Compensation:* In this case, employees are motivated to achieve high results because their income is directly linked to the volume of sales or the revenue they generate for the company. This encourages active effort from employees and the continuous improvement of their personal sales skills.
- *Mixed (Time-Piece) Compensation:* This system combines the advantages of different approaches and allows for motivating employees both on stability (fixed part) and high performance (variable part). In this case, employees can receive a stable income for

performing their main duties and strive for additional earnings through bonuses, rewards, and other incentives.

Case study

In order to more clearly discuss the behavioral approach in the field of compensation and draw relevant conclusions, an online survey was conducted within the framework of this article among 100 respondents over the age of 18 who are employed. The survey was designed to explore key behavioral finance concepts, such as perceived fairness, relative income comparison, and bounded rationality, in the context of salary compensation. These dimensions were examined through the correlation of salary levels with age, education, work experience, and perceived fairness. The correlations observed in the survey suggest that salary perceptions are not solely determined by objective factors like experience or education. For instance, the significant relationship between perceived fairness and income level reflects behavioral patterns, such as reference dependence and social comparison.

Diagram 1.
The age distribution

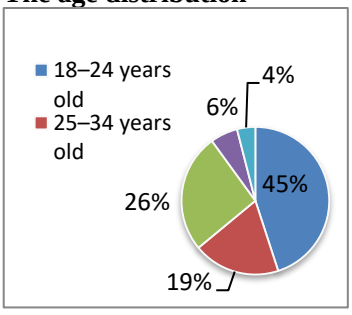


Diagram 2.
Educational attainment

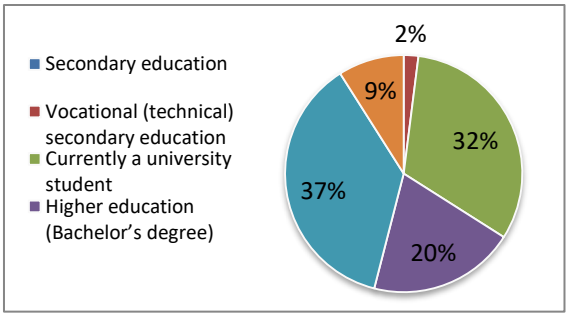


Diagram 3.
Employment Sector

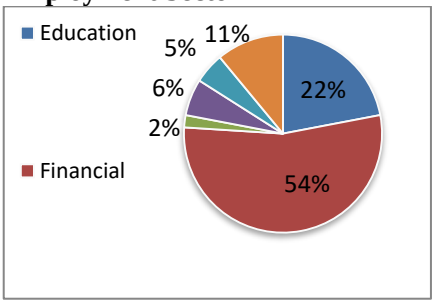


Diagram 4.
Work Experience in the Given Field

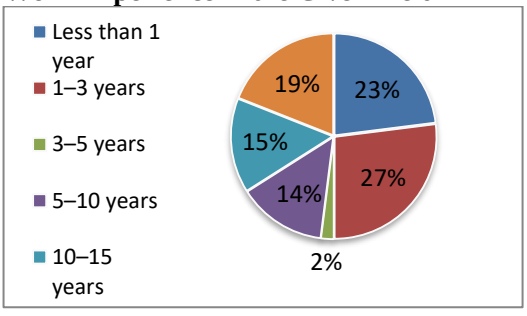


Diagram 5.
Salary Level

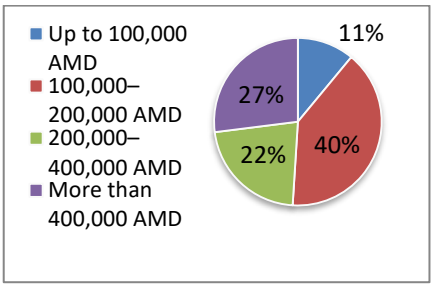


Diagram 6.
Perceived fairness of the amount paid for the work performed

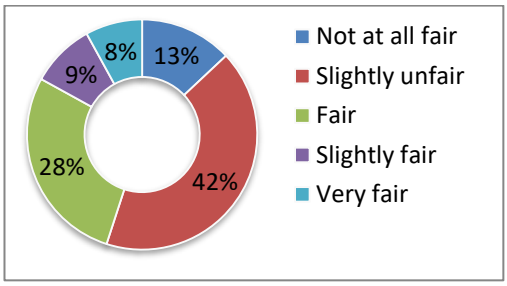


Diagram 7.
The employee's perceived salary level relative to the market

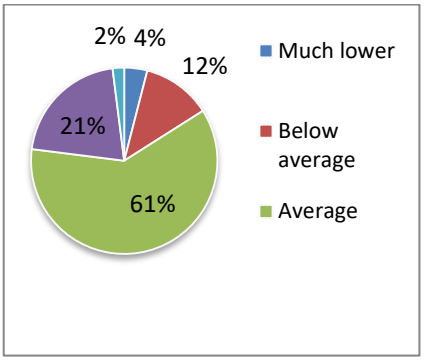


Diagram 8.
The role of salary level in job satisfaction

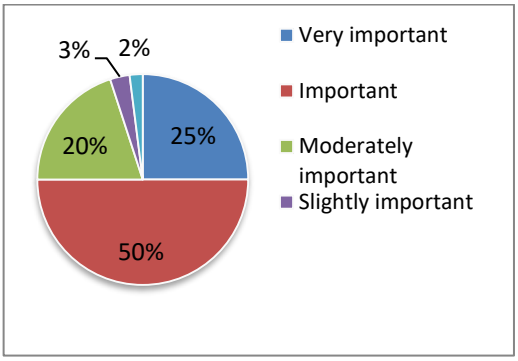


Diagram 9.
Which is important?

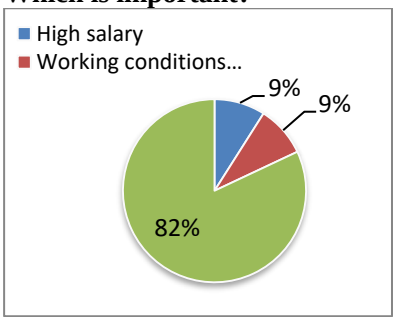
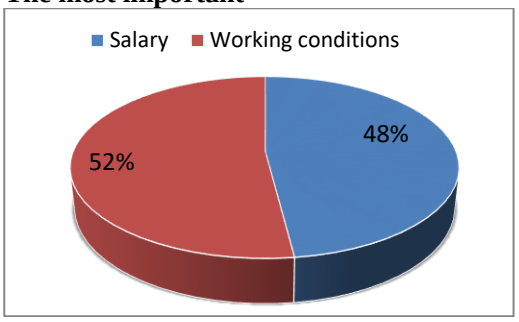


Diagram 10.
The most important



Source: *Developed by the authors based on survey results.*

Let us briefly comment on the results reflected in the diagrams.

According to Diagram 1, 45% of the respondents were between the ages of 18 and 24, 26% were aged 35–44, 19% were 25–34, 6% were 45–54, and only 4% belonged to the 55 and older age segment. Diagram 2 presents the respondents' level of education, showing that the largest share—37%—held a higher education degree (Master's level),

32% were still students, 20% held a Bachelor's degree, 9% had a scientific degree (PhD or equivalent), and only 2% had a vocational secondary education.

In terms of the employment sector (Diagram 3), 54% of respondents were engaged in the financial sector, 22% in education, 6% in IT, 5% in services, 2% in healthcare, and 11% in other sectors. It should be noted that "other" includes all responses that individually accounted for only about 1% of the total. Respondents who worked in more than one field were asked to indicate the sector of their primary employment.

Diagram 4 shows the length of respondents' professional experience in their respective sectors: 27% had worked in the sector from 1 to 3 years, 23% had less than 1 year of experience, 19% had more than 15 years of experience, 15% had worked for 10–15 years, 14% for 5–10 years, and 2% for 3–5 years.

Diagram 5 presents respondents' salary levels: 40% received a monthly salary ranging from 100,000 to 200,000 AMD, 27% earned more than 400,000 AMD, 22% earned between 200,000 and 400,000 AMD, and 11% earned less than 100,000 AMD.

Diagram 6 illustrates the respondents' subjective perception of the fairness of their salary. 42% considered their pay slightly unfair, 28% considered it fair, 13% viewed it as completely unfair, 9% perceived it as slightly fair, and 8% believed their salary to be very fair.

Respondents were also asked how they perceive their salary compared to that of colleagues in similar positions (Diagram 7). 61% considered their salary average, 21% above average, 12% below average, 4% very low, and 2% very high.

According to Diagram 8, 50% of respondents believed that the amount of salary plays an important role in job satisfaction, 25% considered it very important, 20% considered it moderately important, 3% gave it low importance, and 2% did not consider salary level to be a factor in their job satisfaction at all.

Finally, Diagram 9 shows that 82% of respondents considered both high salary and good working conditions equally important. However, when asked to choose only one factor (Diagram 10), 52% gave preference to working conditions, while 48% chose salary.

The data collected through the survey served as the basis for constructing a correlation matrix (Figure 1) and conducting the corresponding analysis within the scope of this article.

Figure 1

Correlation matrix

	X1	**X2**	**X3**	**X4**	**X5**	**X6**	**X7**	**X8**
X1	1							
X2	0,7	1						
X3	-0,1	-0,2	1					
X4	0,8	0,7	-0,1	1				
X5	0,3	0,4	0,2	0,4	1			
X6	-0,2	-0,1	0,1	-0,2	0,3	1		
X7	0,0	-0,1	0,2	-0,1	0,4	0,5	1	
X8	-0,1	0,0	0,1	-0,1	0,0	0,2	0,2	1

Source: *Developed by the authors based on survey results.*

where:
X1 represents age,
X2 the level of education,
X3 the field of employment,
X4 work experience,
X5 salary level,
X6 the perceived level of fairness from the employee's perspective,
X7 the comparison of one's salary to that of colleagues performing similar work,
X8 the role of salary in overall job satisfaction.

Disregarding variables that currently show either no relationship or extremely weak correlations, we focus on those that demonstrate weak, moderate, or strong associations with each other. As might logically be expected, the variable representing age shows a strong positive correlation with both the level of education and work experience. Likewise, there is a strong positive correlation between education level and work experience. A moderate positive correlation is observed between the perceived fairness (X6) and the perception of satisfaction with one's salary in comparison to others (X7).

The results also indicate weak positive correlations between age and salary level, education level and salary level, and work experience and salary level. This suggests that, although these factors would be expected to have a significant influence on salary from a rational perspective, their actual impact appears to be relatively limited.

It should be noted that the results of this survey cannot be generalized to the entire labor force due to sample limitations; the patterns observed support the relevance of behavioral finance theories in understanding salary satisfaction. Future research could include experiments or longitudinal studies to validate these findings.

Conclusion

From a rational perspective, it can be inferred from the above that all the factors which were expected to have a strong relationship with the level of remuneration do, in fact, exert some influence, but not to the extent that was anticipated. This is precisely why it is crucial to take into account the behavioral characteristics of both decision-makers and employees when making managerial decisions. It is worth noting here that traditional economics, which is based on models of rational behavior, often fails to explain the actual decisions people make. For example, instead of acting as "rational agents," individuals often make decisions guided by emotions, intuition, and limited information. Behavioral economics helps explain why traditional models, such as human capital theory, do not always adequately account for employee behavior. For instance, many decisions related to salaries, rewards, and bonuses are not based on objective productivity metrics, but are often influenced by emotions, expectations, and social factors. Some employees may be motivated not so much by money as by recognition of their work, a sense of fairness in the compensation system, and even by how they perceive their status and the attitudes of their colleagues toward them. This is particularly evident in the data presented in Diagram 9, where 82% of respondents indicated that they value both salary level and working conditions equally. In Diagram 10, when respondents were asked to choose between two options—whether they would prioritize salary or working conditions if forced to make a decision—52% indicated that they would prioritize working conditions. Therefore, it is crucial to apply the principles of behavioral economics to

develop more effective and equitable compensation systems. For example, an understanding of the anchoring effect, as mentioned earlier, could assist companies in establishing fairer salary structures, among other considerations.

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