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Pay Secrecy and Relative Pay

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Many people like to keep parts of their lives private, including how big or small their paycheck is. Of course, there are regional, national and other demographic differences in how close to the vest individuals prefer to keep their compensation information. I have worked for organizations where all compensation was public and for others where all compensation was completely private (or at least where that was the official policy).

Pay secrecy has been discussed by academics since Edward Lawler's work in the mid-1960s, and the issue of relative compensation was discussed as early as Thorstein Veblen in 1899. There is renewed interest in their work by social scientists, and it is obviously of significant interest to organizations designing pay systems.

Should Compensation be Secret?

I teach a fictional case each year to my compensation students at Cornell based on a 2001 *Harvard Business Review* article by John Case that is familiar to many compensation and HR practitioners. In the fictional company, a disgruntled employee accesses HR files and e-mails the compensation of everyone in the company to all employees. Of course, this leads to much consternation and scrambling on the part of top leadership as they must decide how to react. Some leaders want to try to clean up the mess as soon as possible and move on, continuing to keep future compensation secret. Others argue that the company should use this as an opportunity to more carefully communicate compensation and its strategy to employees. After all, if the company can't justify the way it pays people, then it is likely that 1) employees don't understand how the business strategy fits with the compensation strategy, 2) business and/or compensation strategies are not being executed as planned, or 3) some of its people just aren't on board.

In government organizations, making public everyone's pay is not unheard of. After all, it is the taxpayers' money. I previously worked for a state-funded organization where salaries were made public. It was interesting to see employee reactions to their pay increases. And then to see their reactions when the pay increases of everyone else were revealed. Would you rather a $4,000 raise and everyone else in your workgroup get $5,000? Or would you rather a $3,000 raise and everyone else get $2,000? Anecdotal evidence from that organization suggested that some people would prefer the latter, even though it meant they earned less.

But what about some solid evidence on sharing co-workers' actual compensation levels (not just bonuses)?

Relative Compensation and What it Means for Workers

Economics professors David Card, Enrico Moretti and Emmanuel Saez of the University of California at Berkeley, and Alexandre Mas of Princeton University, recently studied the issue of relative income in a National Bureau of Economic Research working paper ("Inequality at Work: The Effect of Peer Salaries of Job Satisfaction," September 2010). According to the paper, in March 2008 *The Sacramento Bee* began publishing the salaries of all state workers (including public universities) in California. In an extraordinarily clever way, the professors took this information and used it to learn about pay secrecy, relative income and how people feel and react to knowing what their co-workers earn.

Professors Card, Mas, Moretti and Saez collected a sample of e-mail addresses (at random) for thousands of employees at the University of California-Santa Cruz, University of California-San Diego and UCLA. The professors told these employees (a subset of all employees) about the Web site published by the *The Sacramento Bee*. The Web site was public, but their e-mail was intended to raise awareness. The professors found that making employees aware of the site dramatically increased its traffic, and that roughly 80 percent of new users looked up information about co-workers from their own departments.

There are many fascinating findings from the study: It turns out that there is a dramatic difference in the response to new information about wages of co-workers, depending on whether an individual has wage and salary pay above or below the median for his or her workgroup. For those who earn below the middle in their group, the new information about the compensation of their co-workers leads them to have lower satisfaction with their pay and job overall. These individuals also said that they were more likely to look for a new job within the next year. On the other hand, for those workers who earn above the middle in their workgroup, the new information about compensation of their co-workers has no effect on job or pay satisfaction or on their job search intentions.

Were those compensated below the median actually lower-performing individuals that the organization would not regret losing?

For more than 100 years, academics have studied relative compensation (off and on; mostly off) and what it means. This new research is an exciting example of how clever social scientists can take advantage of an institutional change to learn something about what happens inside organizations, in this case, universities. Because of the study's careful design and the idea of a treatment and control group, the results are credible. But, of extreme importance for compensation professionals, the work also provides an excellent model for how to take advantage of the learning opportunity that appears when a compensation policy or practice is changed.

Something that could, perhaps, be answered with future research: Were those compensated below the median actually lower-performing individuals that the organization would not regret losing? In other words, did removing the veil of secrecy reveal an effective compensation strategy that, when publicly exposed, also achieved a desirable turnover outcome? WS

The Institute for Compensation Studies (ICS) at Cornell University analyzes, teaches and communicates about monetary and nonmonetary rewards from work, and how rewards influence individuals, companies, industries and economies. ICS research and leading-edge insight address compensation issues challenging employers and employees in today's dynamic global marketplace.

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