Pay Secrecy—Help or Hindrance?

How You Handle the Controversy Between Secret vs. Open Pay Systems May Affect Your Company’s Bottom-Line

By William F. Muhs, D.B.A.
Assistant Professor of Management
The University of Texas at El Paso

New salaried employees frequently receive the following instruction: Discussion of salaries is grounds for dismissal. While such an extreme warning may be the exception, a policy of keeping pay secret is not. A survey by the Bureau of National Affairs revealed that a majority of construction firms had secret pay policies and indicated that 60 percent of the managers surveyed prefer secret pay plans or at least some degree of secrecy concerning compensation practices.

The controversy about secret versus open compensation systems has led to a dilemma for many of today’s business owners. The topic of pay secrecy generates considerable discussion when managers are confronted with the issue. Typically the issue is viewed from an either-or-standpoint, often reflecting the manager’s value system.

Readers are not expected to be convinced that secret pay practices are appropriate or inappropriate; that decision properly rests with the individual manager or managers of a firm. Rather, the intent is to focus on the major factors underlying the issue of pay secrecy, which may affect the success of compensation systems in organizations.

The use of wages as a motivating incentive is not a modern innovation. The first known utilization of wage
“Pay secrecy increases the tendency for employees to perceive the compensation system as unfair whether it is or not. A potential impact of perceived unfairness is that an employee performing at a high level may reduce his performance to that of lower performers who he believes to be receiving the same pay.”

Incentives can be found in the textile mills of Babylonia under King Nebuchadnezzar over 2500 years ago. In Babylonia, wages were paid in the form of food, the amount based upon individual output in spinning and weaving operations. More recently, wage incentives became quite common by the beginning of the 20th Century after early management pioneers such as Henry Towne, Frederick Halsey, and Frederick Taylor prepared such plans in hopes of increasing worker productivity and efficiency.

Since that time the role of money as a motivator has become a major question in the minds of managers and behavioral scientists alike. The issue is an important one since pay is the most common extrinsic reward offered by organizations. In recent years, management scholars have made significant progress in answering the question, “Is money a motivator?”

There is considerable evidence that before money, or any other reward, can serve as a motivator a number of conditions must be met:

1. For a reward to serve as a motivator, it must first be valued by the employee. This system recognizes that people do vary in terms of what rewards they prefer. For example, some individuals want more time off, more fringe benefits, a more interesting job, or more money.
2. The individual must be reasonably certain about what performance is required to obtain the reward. In many situations, it is not clear what behavior leads to what rewards. The employee cannot be automatically ex-
pected to increase his performance when it is not clear to him what behavior is required. A high degree of ambiguity about what is required on the job can also lead to emotional stress and job dissatisfaction.

3. Assuming that the employee knows what is expected of him, he still must believe that the desired performance will actually lead to the reward. A typical example is the remark, “Yes, I can work harder and better but why bother since there is nothing in it for me.” In short, the reward must be tied to performance, preferably on an individual basis, and not some arbitrary or subjective measure.

4. Not only should the employee feel that the amount of effort be commensurate with the reward, but he must also perceive the reward to be fair in relationship to the effort and rewards of other employees. The question of equity will be discussed in more depth in the next section.

Despite the existence of simplistic approaches, motivation in work organizations is complex. There are potentially many interacting factors which influence the quality and quantity of job performance. Although the discussion above is not an exhaustive treatment of motivation in organizations, the four conditions are important to understanding the implications of secret pay policies.

Perceived Unfairness . . .

Man is a social animal, typically making comparisons between himself and others, especially in a work environment. He asks himself, “How does my pay and performance compare with others?” The comparison process reflects man’s basic desire to know where he stands in relationship to others in his organization. It must be emphasized that the comparison process is based on relative-rather than absolute-monetary values.

Pay secrecy is much more likely to cause employees to rely on rumors and inaccurate information. Studies have shown that managers employed by firms with secret pay plans display some interesting tendencies. When asked to estimate the pay of other managers in their organization, they tended to overestimate the pay of peer managers and of those managers one level below them and underestimate the pay of managers one level above them.

Thus secret pay policies had the opposite effect of that intended by management. Pay secrecy increases the tendency for employees to perceive the system as unfair whether it is or not. Lawler states that those managers who did not accurately perceive the pay of others were more dissatisfied with their own pay. On the other hand, those with more accurate perceptions of the pay of others were more satisfied with their own pay.

A potential impact of perceived unfairness is that an employee performing at a high level may reduce his performance to that of lower performers who he believes to be receiving the same pay. This is the employee’s way of eliminating his anxiety about such an “unfair” pay system. Recall that it is his perception of reality that affects his behavior. This is true whether the perceptions are accurate or not.

Another potential situation is the employee who underestimates the pay of his supervisors. In this situation the employee may feel, “Why should Z work hard for a promotion when it pays little more than I am now getting?” Of course he may not want the promotion for other reasons but he may not be motivated to work harder because he believes the pay is not commensurate with the increased duties and responsibilities. But, in fact, his boss is generally making considerably more than he thinks. The potential effect on employee motivation in these two cases is obvious.
Evaluating performance is always difficult and never perfectly accurate. If differences in employee performance and salary cannot be supported, then moving to an open pay policy will in effect be opening the proverbial Pandora’s Box.”

A third potential implication of pay secrecy is that it may create considerable uncertainty and possible mistrust that higher performance will lead to a pay increase or some other reward. The employee may feel, “Why should I bang my head against the wall all year, it never leads to anything around here!” This situation reflects the importance of tying pay to performance in motivating employees. Unfortunately, in too many organizations, pay is in fact not tied to performance.

Finally, pay secrecy can create a breeding ground of uncertainty in terms of what specific performance is required to obtain a reward or even what rewards are available. Many firms do not communicate this information to employees. Interestingly, the managers of these firms may complain: “I don’t have any motivated employees!” The organization may have desirable rewards, but the motivational force is greatly reduced if employees do not know about their existence and what level of performance is necessary to obtain them.

Pitfalls Exist . . .

There are many potential pitfalls with pay secrecy which can reduce the motivational force of money and other rewards. However, merely adopting an open pay policy will not by itself eliminate these potential pitfalls.

As Professor Lawler admits, there can be difficulties in implementing open pay systems. First, under openness, those identified at the low end of each salary or merit level, may feel threatened since they may view themselves as the least valued employee. Another potential result of openness is some managers would then feel underpaid when before, under secrecy, they were satisfied with their pay. In both of these cases, it is very important that feedback be given to the employee on the reasons for his pay level. This relates directly to the point which was made earlier. The employee should know what performance was required to obtain a given amount of pay. Merely making salary information public does not automatically tie pay to performance!

A final consideration is that evaluating performance is always difficult and never perfectly accurate. If differences in employee performance and salary cannot be supported, then moving to an open pay policy will in effect be opening the proverbial “Pandora’s Box.”

The real issue is whether or not the compensation system is well managed, equitable, and consistent. When it is not, then monetary incentives will lose much of their motivational power under either a secret or open pay policy. In practice, however, some degree of openness is necessary in order to convince the employee that the organization does in fact provide monetary rewards tied to specific performance levels on equitable basis.

An important consideration for any manager, even though it is easy for many to avoid, is how the employees feel about the compensation and incentive systems. It is management’s responsibility to review the pay systems periodically. Quite possibly it may be in the best interest of both the employees and the organization to increase the employees knowledge of the organization’s compensation policies and practices.