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# Signaling in Secret: Pay-for-Performance and the Incentive and Sorting Effects of Pay Secrecy

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# Signaling in Secret: Pay-for-Performance and the Incentive and Sorting Effects of Pay Secrecy

## Abstract

### Key Findings:

- Pay secrecy adversely impacts individual task performance because it weakens the perception that an increase in performance will be accompanied by increase in pay;
- Pay secrecy is associated with a decrease in employee performance and retention in pay-for-performance systems, which measure performance using relative (i.e., peer-ranked) criteria rather than an absolute scale (see Figure 2 on page 5);
- High performing employees tend to be most sensitive to negative pay-for-performance perceptions;
- There are many signals embedded within HR policies and practices, which can influence employees' perception of workplace uncertainty/inequity and impact their performance and turnover intentions; and
- When pay transparency is impractical, organizations may benefit from introducing partial pay openness to mitigate these effects on employee performance and retention.

## Keywords

pay-for-performance, incentives, job performance, pay secrecy

## Disciplines

Benefits and Compensation

## Comments

### Recommended Citation

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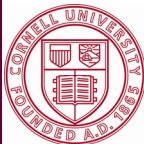
## SIGNALING IN SECRET: PAY-FOR-PERFORMANCE AND THE INCENTIVE AND SORTING EFFECTS OF PAY SECRECY

### Key Findings

- Pay secrecy adversely impacts individual task performance because it weakens the perception that an increase in performance will be accompanied by increase in pay;
- Pay secrecy is associated with a decrease in employee performance and retention in pay-for-performance systems, which measure performance using relative (i.e., peer-ranked) criteria rather than an absolute scale (see Figure 2 on page 5);
- High performing employees tend to be most sensitive to negative pay-for-performance perceptions;
- There are many signals embedded within HR policies and practices, which can influence employees' perception of workplace uncertainty/inequity and impact their performance and turnover intentions; and
- When pay transparency is impractical, organizations may benefit from introducing partial pay openness to mitigate these effects on employee performance and retention.

### Topic: Signaling in Pay Secrecy Affects Performance and Retention Intentions of High Performers

Pay secrecy continues to be a contentious issue among scholars and practitioners alike, with both theory and empirical evidence regarding the implications of pay secrecy remaining equivocal. As noted by Gomez-Mejia et al. (2010), signaling theory suggests that employers may use pay-for-performance system attributes to signal to



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employees the objectives that they deem to be of high priority. For example, choices made by the employer with regard to pay determination criteria may be used to signal to employees that situational constraints are taken into account. Similarly, choices made with regard to the subjectivity of performance assessment may signal to employees an emphasis on recognizing and rewarding the employee's full range of performance, even those not readily measured objectively.

Drawing from signaling theory, the researchers sought to explore how aspects of the broader pay context within which pay communication policies are embedded may condition these effects. Based on the notion that pay secrecy generates information asymmetries that heighten the uncertainty surrounding employees' effort allocation decisions, researchers sought to prove that employees seek to glean whatever information they can from the broader pay context.

More specifically, the Cornell team proposed that employees may infer signals from pay secrecy itself as well as from two attributes of the pay-for-performance system — a dominant aspect of the broader pay context in many organizations enforcing pay secrecy — in order to reduce uncertainty. Accordingly, a theoretical model was developed specifying that these two pay-for-performance system attributes, namely pay determination criteria and the subjectivity of performance assessment, condition the pay-for-performance-related inferences employees draw from pay secrecy as well as the impact of these inferences on both performance and continuation intentions.

The findings of the study suggest that when implemented under conditions of relative pay determination criteria and subjective (vs. objective) assessment, the adverse impact of pay secrecy (vs. pay transparency) is unlikely to be limited only to task performance. Pay secrecy, when implemented under such conditions, may also take a toll on the ability of the firm to retain its best performers (see Figures 3 and 4 on pages 6 and 7, respectively).

### Study Questions

1. Does pay secrecy have a negative impact on employee performance and retention when that employee is managed under a pay-for-performance

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system?

2. What impact does performance assessment method have on the influence of pay secrecy on employee performance and retention?
3. Are high-performing employees more sensitive to the potential effects of pay secrecy?
4. Can pay secrecy amplify an employee's negative perception of other pay system attributes?

## Data

The experiment consisted of 280 Israeli undergraduates. All were paid a base salary of \$5.70 an hour to play a computer matching game. Half of the participants received information about their bonus pay and the bonus pay of their fellow group members in the experiment. The other half received information about bonus pay only. That half was requested to not discuss any pay-related issues during the experiment.

The research suggests that high-performing participants were more sensitive than others when they perceived that there was no link between performance and pay. It follows that pay secrecy may hinder a firm's ability to retain top talent.

When students in the pay secrecy group were told they were being paid based on how they performed compared to peers, performance and retention went down. However, negative effects of pay secrecy on employee performance and retention thinned when workers were told that performance was assessed objectively on a scale of absolutes, rather than subjectively (see Figure 3 on page 6).

The study suggests that subtle "signals" in the way HR policies are communicated and put into practice can influence employees' perception of workplace uncertainty and inequity, leading to poorer performance and higher turnover intentions.

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### The Takeaway

- Increase in pay, a critical driver in pay-for-performance systems, adversely impacts individual task performance by increasing the amount of uncertainty surrounding the perceived workplace pay range and by appearing to serve as a method of managerial opportunism or deception.
- The negative effects of pay secrecy on employee performance and retention are attenuated when performance is assessed objectively rather than subjectively.
- Pay secrecy may hinder a firm's ability to retain top talent, as high performers seem to be most sensitive to negative pay-for-performance perceptions.
- Even if pay secrecy in isolation does not negatively impact employee pay-for-performance perceptions, it can lead to negative behavioral consequences (i.e., decreased performance and increased turnover intentions) when paired with other policies which raise employee concern, namely, relative pay determination. Decreased performance and increased turnover, for example, can result when pay secrecy is paired with other policies – namely, determination of pay based on what others earn – which raise employee concern.
- Partial pay openness can mitigate effects on employee performance and retention. Organizations can also take steps to heighten rater accountability to negate the paired impact of subjective assessment and pay secrecy on employee behavior.

### Future Research

Future studies might examine empirically the extent to which seniority attenuates the negative effects of pay secrecy on pay-for-performance perceptions, task performance and retention intentions.

It may be important to test cross-cultural generalizability of the findings. For example, it may be that in cultures characterized by norms and values promot-

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ing transparency about pay-related issues, pay secrecy might be more likely to signal deceptive intent. In contrast, in cultures in which the disclosure of any information related to income or wealth is considered taboo, employees may be less likely to infer from pay secrecy malevolent managerial intent.

## Results

**FIGURE 2**  
 Moderation of the Effect of Pay Communication Policy on Pay for Performance Perceptions

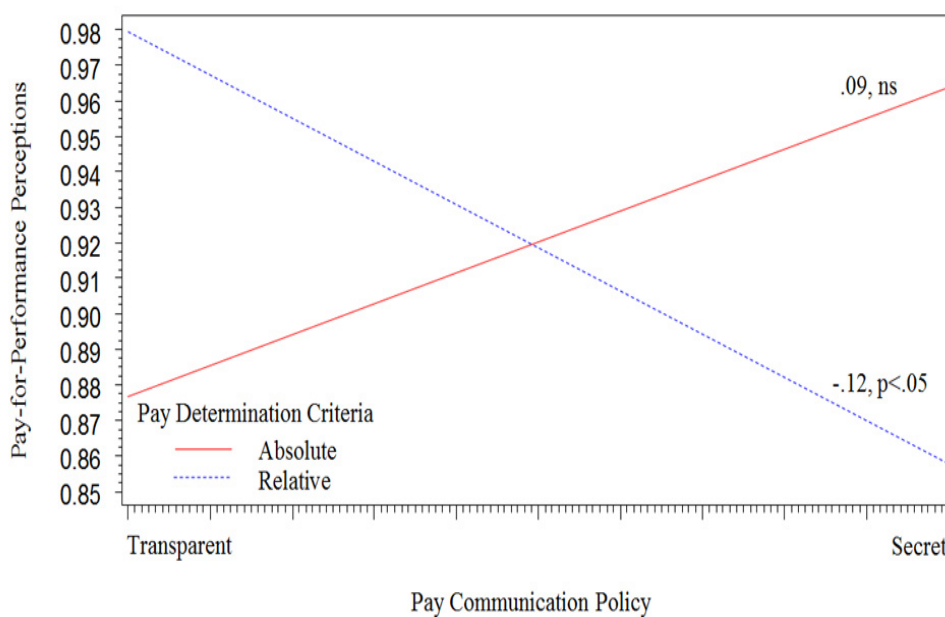


Figure 2: Pay secrecy is associated with weak employee pay-for-performance perceptions when paired with other policies, which raise employee concern, namely, relative (i.e., peer-ranked) pay determination criteria (as opposed to absolute).

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### Results (cont'd)

FIGURE 3

Moderation of the Effect of Pay for Performance Perceptions on Individual Task Performance

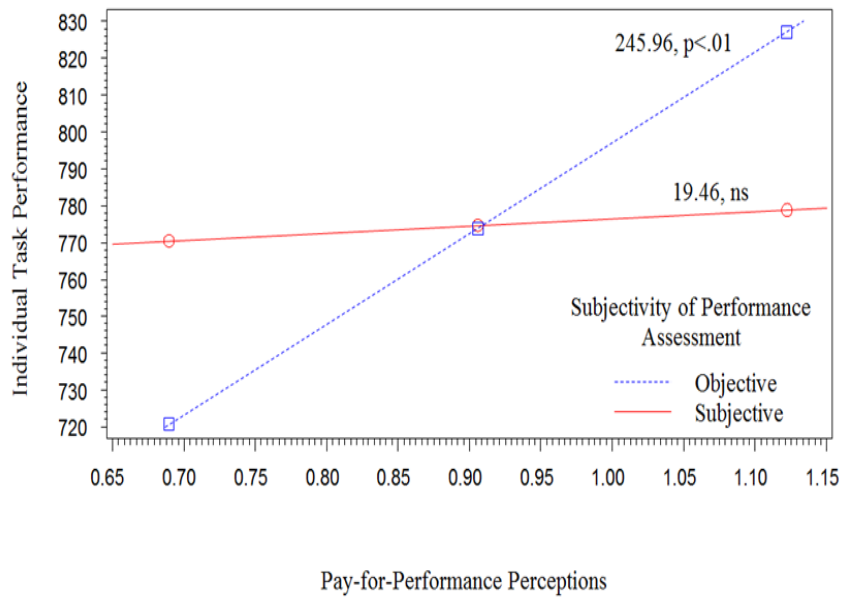
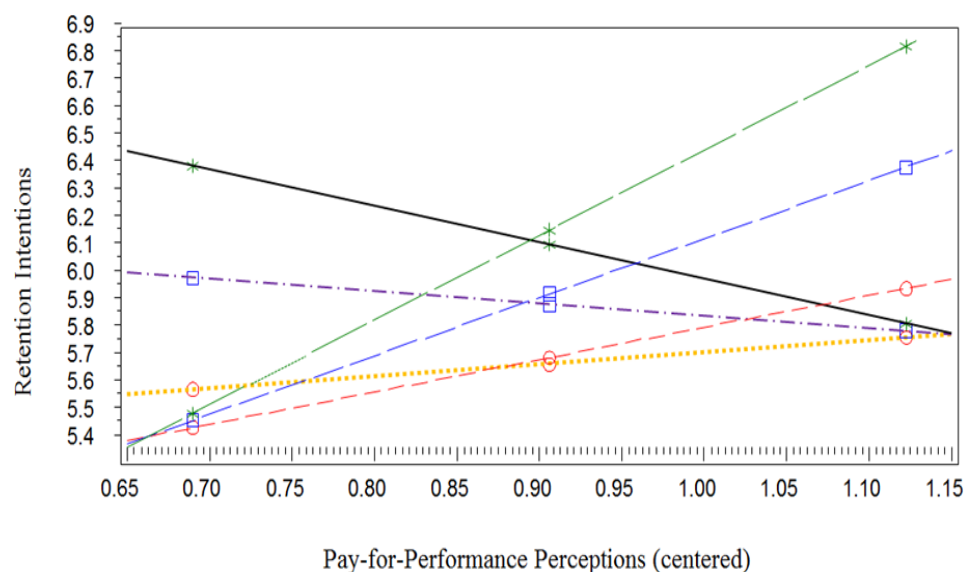


Figure 3: The positive impact of pay-for-performance perceptions on performance is being amplified when performance assessment is objective (as opposed to subjective).



## Results (cont'd)

**FIGURE 4**
**Moderation of the Effect of Pay for Performance Perceptions on Retention Intentions**


- Objective performance assessment and high (centered) performance level (+1SD) = 3.09,  $p < .05$
- Objective performance assessment and mean (centered) performance level (Mean) = 2.13,  $p < .05$
- Objective performance assessment and low (centered) performance level (-1SD) = 1.18, ns
- Subjective performance assessment and high (centered) performance level (+1SD) = -1.32, ns
- Subjective performance assessment and mean (centered) performance level (Mean) = -.45, ns
- Subjective performance assessment and low (centered) performance level (-1SD) = .43, ns

Figure 4: The positive impact of pay for performance perceptions on retention intentions is amplified when performance assessment is objective, particularly among high performers. It follows that high-performing participants are more sensitive than others when they perceived that there is no link between performance and pay, and pay secrecy may hinder a firm's ability to retain top talent.

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For the full article in the *Academy of Management Journal*, go to:  
<http://amj.aom.org/content/early/2014/01/13/amj.2012.0937>

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