“Pay Transparency in Organisations”

Abstract:

Private organisations are increasingly committing to pay transparency — making the amount each worker is paid observable to all others within the firm. I analyse a firm’s decision about whether or not to commit to pay transparency within a simple multidimensional signalling model. Firms pay bonuses to workers in order to signal to them about their productivity which in turn affects their prospects at the firm. When choosing what bonuses to pay, the firm is informed not only of the productivity of its workers but also the opportunity cost of paying a bonus. Committing to transparency means that a worker is able to learn not only from his own bonus, but also the bonuses of others. The additional information learned under transparency can either encourage or discourage workers and so the firm faces this trade-off when deciding whether or not to commit to transparency. My model predicts that greater heterogeneity in the productivity of agents makes transparency more beneficial since it helps the firm to retain more productive workers. These predictions match observations in the real world where pay transparency is seen in technology start-ups. My model can also provide a rational explanation for empirical findings in the relative pay literature that have thus far been attributed to non-standard preferences.