Perceived Fairness in Compensation

By Jonas Johnson, Ph.D.
Senior Researcher
Fairness in Compensation

The market data research is done, salary planning has been accomplished in line with your organization’s compensation philosophy, and you’re ready to communicate the results with employees. How you approach such conversations may impact employees’ ideas of fairness regarding your organization’s compensation system, regardless of the market pricing legwork behind the scenes. This paper outlines potential problems associated with perceptions of fairness within the context of compensation, examines how individuals perceive fairness, and provides practical ways to help employees understand how their salaries are set. These practices may help organizations to avoid potential consequences related to employees’ perceptions of compensation.

There are two sides to fair compensation: objective fairness and perceived fairness. Objective fairness covers whether an outside observer, unaffected by compensation decisions, would view a compensation program as fair. Perceived fairness is whether the individual employees in an organization view their compensation as fair. Do your accounting clerks believe they are being compensated fairly? Would an outside observer agree with them? Not necessarily — objective fairness and perceived fairness are independent of each other. Because of this, an organization with objectively fair compensation practices can have employees perceive their compensation as unfair. Fortunately, there are steps that organizations can take to help employees perceive their compensation as fair.

There are some very good reasons why you should care that your employees view their compensation as fair. Specifically, a variety of negative factors have been found to be related to employee perceptions of unfairness. These factors are generically called Counterproductive Work Behaviors (CWB). CWBs can be seen as the following undesirable employee outcomes: litigation, absenteeism, turnover, withdrawal, theft, and workplace violence (Colquitt et al. 2001; Greenberg, 1990; Jones, 1998). Additionally, unfair pay procedures have been linked to a reduction in employee helping behaviors (Aquino, 1995). To reduce these outcomes, it is critical to consider employees’ perceptions of fairness. An organization can spend time and energy designing a compensation procedure which pays employees fairly, but if the employee does not perceive his or her compensation as fair, the organization’s hard work can be wasted. Thus, perceived fairness can be as important as the objective fairness of a compensation system.

How Individuals Perceive Fairness

Before we discuss how to reduce perceptions of unfairness, it is necessary to examine how individuals decide whether they are being treated fairly. When an individual is assessing whether one is being fairly compensated, the first step will be to compare oneself to another individual who is deemed comparable. If the individual decides that one compares well with this peer, then the individual will be more likely to view the pay as fair. However, if the individual does not compare well, or if there isn’t enough information to do a comparison, the individual will attend to additional information to form an opinion of whether one is compensated fairly (Adams, 1965; Colquitt et al. 2001). In other words, a forklift driver will compare oneself to other forklift drivers in the organization instead of employees in the corner office. However, because compensation is frequently a conversation which is not discussed, employees may not be able to ascertain their standing regarding others in the organization. In this case, they may make decisions regarding fairness based on tangential or incorrect information. One scenario where employees may incorrectly decide that they are being compensated unfairly is if they seek out free information from an incorrect or biased online source.

Additionally, in a situation where an individual does not have enough information to tell how one stacks up against a comparable person, the individual will look at how the decision was made. This question of “how” generally revolves around an examination of the procedure (or lack of procedure) that was used to decide on a specific wage. If the individual deems a procedure to be fair, the individual will be more likely to view his or her compensation as fair. Human resources or com-
Compensation professionals can help with transparency by ensuring that procedures conform to a series of criteria, and that employees are kept aware of the procedures. There are six criteria a procedure should meet if it is to be perceived as fair (Colquitt et al. 2001; Leventhal, 1980; Jones, Scarpello, & Bergmann 1999). Procedures should follow these criteria:

1. be applied consistently across people and across time;
2. be free from bias (i.e., ensuring that a third party has no vested interest in a particular settlement);
3. ensure that accurate information is collected and used in making decisions;
4. have some mechanism to correct flawed or inaccurate decisions;
5. conform to personal or prevailing standards of ethics or morality; and
6. ensure that the opinions of various groups affected by the decision have been taken into account (Leventhal, 1980. p.426).

When evaluating your compensation procedures in light of these criteria, you should ensure that compensation decisions conform with these standards:

- made by a neutral party based on criteria set forth prior to when the decision was made;
- based on compensation data compiled by quality data providers;
- subject to review when an employee voices a concern; and
- in line with common standards of ethics.

By following these criteria, an organization can ensure that its compensation procedures are objectively fair. However, just because procedures are objectively fair, it doesn't mean that employees will view the procedures as fair. In the next section, we'll discuss how to structure the way you communicate compensation with employees so they will be more likely to view their compensation as fair.

Affecting Change in Perceived Fairness

The current paper presents an alternate method of communicating compensation decisions with employees. This approach stands in contrast to an unstructured approach where compensation data are kept private and conversations regarding compensation are taboo. Below are outlined a number of steps which may be expected to increase employees perceptions of compensation fairness.

1. **Have a Neutral Party Involved:**
   Employees can be expected to attend to who is making compensation decisions. Because of this, organizations should ensure that the individual who decides compensation is neutral. Organizations may want to remove managers from the position of deciding compensation increases. Certainly, performance information from the manager should be taken into account when deciding compensation, but separating the actual compensation decision making process reduces the charge of “playing favorites.”

2. **Show Employees Market Data:**
   By showing employees market data and explaining the rationale behind why a salary is offered, an employer has the opportunity to increase employee perceptions of fairness concerning pay. Showing data sources will not only allow employees to ensure that the decisions are based on accurate information, it will also enable employees to view what other comparable individuals in the same job are paid. Thus, allowing employees to view data sources will address the first step employees take in deciding if pay is fair (comparison to others), and it will address the second criteria of fair compensation procedures.

3. **Provide a Safe Environment:**
   Having a neutral party administer compensation may allow an organization to ensure that employees have a place to go where they can discuss their compensation without fear of reprisal. This will also allow them to feel that they have a voice in the process.
4. Communicate the Organization's Compensation Philosophy:

Finally, having expressly outlined procedures that the organization follows will allow employees to see that the organization follows ethical procedures when making compensation decisions.

In sum, if you are compensating employees fairly, it may be beneficial to be open with them regarding why you believe the compensation is fair and the steps you go through to ensure that fairness is achieved. This does not suggest that compensation conversations need to be held publicly. Furthermore, not all information relative to an organization’s compensation structure needs to be revealed. Conversations can still be held privately and larger picture pieces of confidential information can be withheld, but the procedures and information behind the compensation decision should be clearly stated in a manner that conveys information relative to each of the above points.

Perceived Fairness and Legal Compliance

Another potential benefit of attending to employee perceptions of fairness in your organization’s compensation practices may be reduced litigation risk. Clearly writing compensation policy, ensuring that an employee understands the procedures used, and sticking to the procedure internally will help ensure that the organization adheres to the laws set forth by Congress. Furthermore, if employees understand that compensation fairness is attended to by the organization, they may be less likely to consider FLSA litigation or another suit involving unfair pay discrimination of a protected group. Naturally, any compensation procedures enacted to increase perceptions of fairness (and all compensation procedures for that matter) should be vetted by the legal department prior to being enacted.

Conclusion

By taking the steps outlined previously, with the goal of increasing employees’ perceptions of compensation fairness, an organization may be able to reduce undesirable employee behaviors, all of which cost organizations time and money. Individuals who are unable to determine what procedures are used may be less likely to view their compensation as fair as individuals who are able to access pay procedures. Basically, employees who don't have enough information to make an informed decision may make an uninformed decision regarding the fairness of their compensation. By providing information up front, an organization may increase perceptions of compensation fairness without an additional outlay of compensation. By using a legally vetted procedure, an organization may decrease risk of a variety of negative outcomes such as litigation, absenteeism, turnover, withdrawal, theft, and workplace violence. For these reasons, consider how your employees perceive fairness within your organization and what you can do to improve these perceptions.

References:


