PAY TRANSPARENCY

Silver bullet or kryptonite?

A Whitepaper for CPA Ontario

Written by:
Kun Huo, Ph.D, CPA, CA
Kate Patterson, Ph.D, CPA, CA

Ivey Business School
WESTERN UNIVERSITY · CANADA

Summary

Employees may call for more transparency, but what they are really after is equity.

There are increasing expectations of pay transparency from governments, employees and customers, with emerging legislation.

Pay transparency is designed to combat inequity and discrimination. But the stakes are high and there is a lack of consensus over the impact. Some believe it enhances morale and performance, others that it breeds envy and discontent.

Much of the thinking behind transparency rests on the notion that people are ultimately motivated by fairness, which places considerable pressure on organizations to ensure that pay is not only equitable, but proven to be equitable.

In this paper we discuss the rationale behind pay transparency, the pros and cons, and the implementation challenges, including a close look at its impact in the world of professional ice hockey.

Highlights

A growing trend

Workers increasingly support pay transparency and legislators are demanding greater disclosure, with new legislation emerging.

Varying impacts

Not every impact of transparency is positive, especially if an employee perceives that a colleague is earning more yet contributing less. 'Self-serving bias' theory argues that people overestimate their own performance and underestimate others'.

Robust data is key

It's vital to establish a shared understanding of good performance, accurately measure that performance, and establish robust ratios between pay and performance.

Above all, know your people

Be aware of possible reactions to pay transparency and tailor your policies to suit the workforce.

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Introduction

According to a recent study, 42% of Gen Z workers, and 40% of millennials have revealed their salaries to coworkers or other professional contacts.[1] Canadians don't traditionally talk about what they earn, but, with the gender pay gap increasingly in the news, it's something we may have to get used to.

Pay transparency is becoming more common.

> **A recent global study by Payscale found that 55% of organizations want to be more transparent about pay ranges, and 34% currently share such details.[2]**

Closer to home, a Maclean's Magazine survey reported that 73% of Canadians support increased pay transparency and feel it's fairer for employees.[3] Ontario's efforts include its 2018 Pay Transparency Act, followed by the federal Pay Equity Act of 2021. Many Canadian provincial and federal governments disclose governmental worker salaries, along with their counterparts in the US. Around the world, governments are increasingly legislating pay transparency for public and private companies.

A peek into the world of elite sports can provide some useful insights into the pros and cons of pay transparency. After seeing their team dumped out of the 2021 Stanley Cup in the first-round playoffs, Toronto Maple Leafs' supporters began to raise questions about their team's salary policy, and more specifically, why 55% of the salary cap was tied up with only five players (out of a total of 23). We decided to look further into income inequality in four different NHL teams: The Maple Leafs, the 2019 Stanley Cup winners St. Louis Blues, the Montreal Canadiens who beat the Maple Leafs in 2021, and the 2021 Stanley Cup champions, Tampa Bay Lightning.

Using the Gini Coefficient,[4] a popular metric of income inequity favored by economists, our analysis revealed that the income of the 2020-2021 Toronto Maple Leafs is the most unequal of the four.

We can only have this conversation about pay disparity because the NHL made player salaries transparent in 1989. Indeed, prior to this, Hockey Hall of Famer Gordie Howe infamously recounted that he was lied to by the Detroit Red Wings management about his pay. Specifically, management told Howe, the captain of the team and one of the league's best players, that he was the highest-paid player in the entire league when he was not even the top-earner on the Red Wings.[5]

1 Fox, M. April 27, 2022. CNBC. https://www.cnbc.com/2022/04/27/young-workers-share-salary-information-as-pay-transparency-gains-steam.html

2 Payscale.com "Compensation Best Practices Report for 2021." https://www.payscale.com/content/report/2020-Canada-Compensation-Best-Pactices-Report.pdf

3 McIntyre, C. February 8, 2018. Maclean's. https://www.macleans.ca/society/pay-equity-statistics-canada/

4 Gini coefficients calculate with the top 23 players' cap hit as per https://www.capfriendly.com

5 Dow, B. April 22, 2013. Vintage Detroit. "Red Wings Didn't Go out of Their Way to Pay Howe Top Dollar." https://www.vintagedetroit.com/red-wings-didnt-go-out-of-their-way-to-pay-howe-top-dollar/

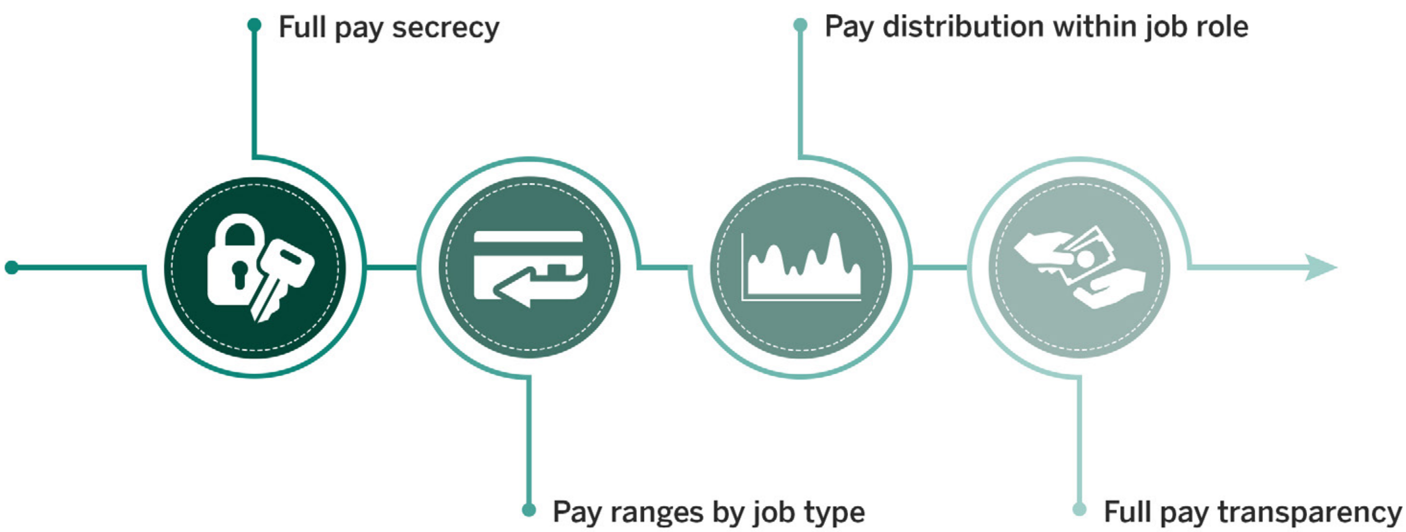
2018-2019 St. Louis Blues	2020-2021 Montreal Canadiens	2020-2021 Tampa Bay Lightning	2020-2021 Toronto Maple Leafs
0.33	**0.34**	**0.39**	**0.42**
2019: Stanley Cup Champions	2021: Beat Toronto Maple Leafs and Advanced to Stanley Cup Finals	2021: Stanley Cup Champions	2021: Lost in First Round of the Playoffs
* Gini Coefficient (1 = completely unequal, 0 = completely equal)			

While pay is only one of many factors that could affect a team's performance on the ice, these findings suggest that income inequality may have wider ramifications. Looking beyond sport, organizations everywhere must consider the commercial, legal, performance and the ethical considerations of pay transparency.

What is pay transparency?

Pay transparency allows employees to identify pay differences between themselves and other workers at all levels. There are several key dimensions of pay: pay level (the rate of pay for a given job), pay structure (a collection of pay grades or bands), and pay basis (salary or performance pay such as commission). For instance, some companies publish pay ranges for each job type, while others provide individual-level pay information. Pay transparency can vary widely: some organizations provide no information, others are completely open, while others are somewhere in between, showing pay ranges for jobs, or pay distribution within roles.[6]

Range of pay transparency



6 Mercer. July 10, 2019. https://www.mercer.ca/en/our-thinking/career/the-new-reality-of-pay-transparency.html

Current policies on pay transparency

As mentioned, the Federal Government of Canada and the Government of Ontario have recently passed enhanced legislation on pay transparency in the past three years. The Government of Ontario's legislation requires organizations to report group-level pay transparency information to the government and to post this information online or in the workplace.[7] However, the planned 2020 implementation of the Ontario Pay Transparency Act was halted after the 2018 election for further public consultation.[8] Government of Canada's Pay Equity Act—which includes pay transparency measures—was enacted in 2021 though implementation times for the Act remain unclear.

Most pay transparency legislation mention the need to combat inequity and discrimination in the labor market. When employees don't know enough about relative pay, it's easier for management to perpetuate discrimination (based on gender, race, age, etc.). For several decades, employees have been legally permitted to share compensation, but we're only just starting to see legislation obliging companies to report such details for specific demographic groups. At such an early stage, it's hard to know how effective pay transparency will be in closing these pay gaps.

As interest in pay transparency from the public and policymakers grows, the stakes of such decisions become higher. Our readings suggest that, though the policy makers' goals are laudable, not enough thought has been spent anticipating what employees and managers will do with the new information. For example, would employees find it challenging to work for someone making 50% more than themselves? Would team performance suffer or improve? To put organizations in the best position to succeed, we suggest paying closer attention to current academic research on pay transparency. Through the method of experimentation, academic research can provide insight into the matter even if evidence from practice is still scant.

Will pay transparency improve equity?

Pay transparency remains a controversial topic because there is a lack of consensus on its effect on organizations. Supporters argue it enhances morale, increases competition, improves employee effort, helps to retain high performers, and decreases pay gaps.[9]

> **Detractors are concerned that transparency causes envy between co-workers leading to dissatisfaction, and lack of motivation and cooperation.[10]**

With such mixed signals, leaders may struggle to determine whether pay transparency, or what level of transparency, is suitable for their organization.

When considering this thorny issue, leaders must first acknowledge that pay transparency will impact behaviors – both positively and negatively. Second, they should recognize that transparency affects different people in different ways. Third, they need to tailor the policy according to their organization's unique task environment.

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7 The Government of Ontario, Pay Transparency Act, 2018; Kirkness, "Ontario Unveils Pay Transparency Legislation."

8 Ibid.

9 Colella, A., Paetzold, R. L., Zardkoohi, A., and Wesson, M. J. 2007. Exposing pay secrecy. *The Academy of Management Journal*, 32(1), 55–71. Retrieved from **http://www.jstor.org/stable/256263**

10 Zenger, T. 2016. Harvard Business Review. **https://hbr.org/2016/09/the-case-against-pay-transparency**

Thought experiment

Pretend that you were the general manager of the Toronto Maple Leafs, and it was 1980, before salary information was mandated to be public. Knowing the income distribution of the team, with five players making 55% of the team's payroll, would you make pay information transparent? How would you communicate this to the less well-paid players? What about the media and fans?

Potential consequences of pay transparency

Satisfied employees are likely to be productive employees. The equity theory by J. Stacy Adams, a landmark study in psychology, suggests that people are motivated by fairness and demotivated by unfairness. For instance, if they learn that a peer doing the same job earns, more, they will choose to do less to create fairness.[11] Equity theory has been extensively tested for decades and has become a foundation of organizational justice. Balancing the ratio of input (production) and output (pay) in a company's compensation policy is recommended even if pay remains secret, but as subsequent research in psychology and accounting reveals, pay transparency may create unforeseen consequences and complicate matters:

We identify five potential impacts of pay transparency:

1. Transparent pay information may strengthen the effect of pay equity, with employees scrutinizing input/output ratios more closely and holding management accountable for discrepancies. For example, the value for money argument is popular among NHL players, fans, and agents today, having been virtually nonexistent before 1980.
2. Transparent pay may exacerbate self-serving bias. A popular academic finding is that 88% of people believe they are above-average drivers, which is mathematically impossible.[12] It is not surprising that such biased beliefs can permeate the workspace, especially when one does not have first-hand knowledge of other individuals' productivity. Knowing what others get paid may cause some employees to resent others, believing that they are working less hard – even if data proves otherwise.

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11 Adams, J. S. 1965. Inequity In Social Exchange. *Advances in Experimental Social Psychology*, 2, 267–299. https://doi.org/10.1016/S0065-2601(08)60108-2

12 Roy, M. M., and Liersch, M. J. 2014. I am a better driver than you think: examining self-enhancement for driving ability. Journal of Applied Social Psychology, 43(8), 1648–1659. DOI: 10.1111/jasp.12117

3. Related to the 'above-average' effect, employees could also exhibit what psychologists call the fundamental attribution error (FAE).[13] The FAE states that individuals tend to attribute their successes to internal factors, such as skill and effort, and conversely, attribute failures to external factors, such as bad luck.[14] Yet, people tend to do the opposite for others in the organization, blaming others' poor performance on lack of effort and attributing successes to luck. As a result, employees who receive higher compensation than others often feel that this distribution is fair. In contrast, the employees who receive low compensation will feel the system is unfair.

4. While 2) and 3) are categorized as biases, which could be corrected by resetting erroneous perceptions, some employees may become jealous of co-workers' higher pay – regardless of relative performance. Research has shown that pay transparency is associated with higher envy due to people's tendency to compare themselves to other people.[15] This effect is stronger for individuals possessing a less independent sense of self, as they rely on social comparison, for which pay level is a cue, to define themselves.

5. Recognizing that employees may exhibit behaviors outlined in points 1) to 4), managers may strategically change their evaluation and compensation practices. When choosing a bonus for their team, most managers tend to keep the pay difference narrow to avoid conflict, especially when individual performance information is hard to obtain.[16] For instance, how can a manager tell whether an accountant came in under budget, or that person just 'ate the time' to manage impressions?

The above points outline a dilemma, that pay secrecy may inadvertently increase pay inequity, at least the perceived kind. Pay inequity, real or perceived, can have very harmful consequences, such as loss of employee satisfaction, unwillingness to help better-paid colleagues, and loss of due diligence among professionals. In a study involving lawyers, researchers find that partners are more likely to accede to clients' wishes when pay is transparent, but performance evaluation is subjective.[17] This finding has important implications for those working in professional services. Specifically, pay transparency and the desire to compare favorably among one's peers could encourage lawyers and accountants to act less independently. And, if junior employees feel that managers cannot give them the rewards they believe they deserve, overall morale would fall. High performers are especially likely to have reduced motivation and higher intention to quit.[18,19]

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13 Harvey, J. H., Town, J. P., & Yarkin, K. L. (1981). How fundamental is" the fundamental attribution error"?. *Journal of personality and social psychology*, 40(2), 346.

14 Libby, R., and Rennekamp, K. M. 2016. Experienced financial managers' views of the relationships among self-serving attribution bias, overconfidence, and the issuance of management forecasts: A replication. Journal of Financial Reporting, 1(1), 131-136.

15 Bamberger, P., and Belogolovsky, E. 2017. The Dark Side of Transparency : How and When Pay Administration Practices Affect Employee Helping. *Journal of Applied Psychology*, 102(4), 658–671.

16 Arnold, M. C., Hannan, R. L., and Tafkov, I. D. (2018). Team member subjective communication in homogeneous and heterogeneous teams. *The Accounting Review*, 93(5), 1–22. **https://doi.org/10.2308/accr-50982**

17 Kelly, K., Dinovitzer, R., Gunz, H., and Gunz, S. P. 2020. The Interaction of Perceived Subjectivity and Pay Transparency on Professional Judgment in a Profit Pool Setting: The Case of Large Law Firms. *The Accounting Review*, 95(5), 227-246.

18 Bol, J. C. 2011. The determinants and performance effects of managers' performance evaluation biases. *The Accounting Review*, 86(5), 1549-1575.

19 Card, B. D., Mas, A., Moretti, E., & Saez, E. 2012. Inequality at Work : The Effect of Peer Salaries on Job Satisfaction. *American Economic Review*, 102(6), 2981–3003.

Two examples of pay transparency outcomes

Pay dissatisfaction	Changes for pay equity
The University of California published its database of employee salaries due to a policy change. When employees learned that they were paid below the median for their pay unit and occupation, researchers reported lower job satisfaction and a higher likelihood of looking for a new job, while above-median earners did not change their attitudes.	A more uplifting story involves Gordie Howe. Upon learning how his salary compared to his peers, Gordie confronted the owner of the Red Wings, Bruce Norris, about this situation and increased his salary by 100%.

Maximizing the benefits of pay transparency

Decisions on pay transparency should aim to realize the many benefits and minimize the known harmful effects.

> **Before going transparent, organizations should know whether they have the data to explain pay discrepancies. If such data exists, we believe organizations should try to correct any injustices before revealing pay information.**

Here are some suggestions on how firms and CPAs themselves can leverage accounting information and management control systems to address employee misunderstandings and correct biases, as well as helping managers to better achieve pay equity:

1. **Clarify the performance-reward relationship**
   There is extensive research evidence to show that if employees understand and approve how their performance is translated into rewards, their performance will increase. Such knowledge can also be used to establish a shared understanding of good performance among employee groups. If the formula is known and the criteria are objective, then there is a higher chance that employees will feel that their – and others' – pay is fair. A good example is Buffer's decision to publish its salary formula based on the type of experience programmers at different levels are supposed to have.[20] Buffer's strategy worked not because it reduced pay disparity, but because its pay policy was understood and accepted as meritocratic.
2. **Provide relative performance information**
   Employee scoreboards show relative performance information (RPI), comparing employees to one another rather than against a set benchmark. RPI can be used to track individual or team performance. The presence of information about others can add competitive fire and gamify the workplace. The theory behind RPI is that people have an innate desire for social comparison and to look favorable compared to peers. Therefore RPI, if used appropriately, can motivate employees to do their best.[21] Numerous studies in accounting have shown that

20 Costa, M. October 21, 2021. Digiday. https://digiday.com/marketing/its-crucial-to-fighting-pay-gaps-how-tech-companies-are-leading-the-way-in-salary-transparency/

21 Tafkov, I. D. 2013. Private and public relative performance information under different compensation contracts. *Accounting Review*, 88(1), 327–350. https://doi.org/10.2308/accr-50292

RPI can be a powerful motivator even in the absence of financial rewards.[22] Since RPI necessarily involves co-workers, it can also correct input/output ratio misconceptions as productivity information is available. However, RPI requires relatively objective performance measures and independent work environments, as individual performance is hard to measure in a highly interdependent work setting. In a promising recent study, accounting researchers have shown that RPI can promote team cohesion and increase creativity when teams compete against one another.[23]

3. **Reduce performance measurement error and biases**
Data objectivity and accuracy are always important; however, we recognize that many jobs do not accurately measure an employee's output. Working in teams can further mask individual contributions. For example, professional hockey players' performances are more challenging to measure than professional baseball players. In hockey, delivering hits to the opposing team may increase the team's morale and lower the opposition's morale. Still, the effect of hits on the game's outcome is less direct than goals and assists. Yet, if the hit had not been delivered, the opponent may feel encouraged to make game-changing plays.

   In comparison, baseball is very individualist, and there is a statistic for almost every action. Therefore, it is not surprising that 'moneyball', or the reliance on advanced analytics, first found success in this sport. There is no magic formula that can instantly improve measurement accuracy. However, the increasing availability of connected tracking tools makes it easier and cheaper to generate employee data. While monitoring can reduce privacy, we remain hopeful that the additional information can help improve our performance measurement and make pay transparency more appealing.

4. **Know your employees**
It can be a cliché, but leaders need to know their employees, both as subordinates as well as people, because personalities shape behavior. As discussed earlier, some employees are more prone to self-serving bias and envy than others. Recent research incorporating management control systems and personality variables shows that employees who score high on the Dark Triad personality measure (showing socially undesirable traits) are more likely to sabotage others.[24]

   Leaders should strive to understand employees' personalities and, like a coach, tailor the management controls such as pay transparency to suit the workforce. In a study comparing high vs. low psychological entitlement (another personality measure), researchers find that more entitled individuals respond better to negative feedback delivered by superiors rather than peers.[25] The takeaway is that, while pay information will provide negative performance feedback to some employees, the source of the news and the communication after the news can change an employee's job outlook. We recognize that implementing pay transparency at the individual or even departmental level is impractical. Given that psychometric measurement has become more popular in human resource management, leaders could, and should, get a sense of how a change in pay transparency policy will affect the employees in their organizations. At the individual level, managers can identify employees with certain personalities for training and coaching.

22 Hannan, R. L., McPhee, G. P., Newman, A. H., and Tafkov, I. D. (2013). The effect of relative performance information on performance and effort allocation in a multi-task environment. Accounting Review, 88(2), 553–575. **https://doi.org/10.2308/accr-50312**.

23 Chen, C. X., Williamson, M. G., & Zhou, F. H. (2010). Reward System Design and Group Creativity : An Experimental Investigation, (October).

24 Wang, L. W. (2017). Recognizing the best: The productive and counterproductive effects of relative performance recognition. *Contemporary Accounting Research, 34*(2), 966-990.

25 Holderness Jr, D. K., Olsen, K. J., & Thornock, T. A. (2017). Who are you to tell me that?! The moderating effect of performance feedback source and psychological entitlement on individual performance. *Journal of Management Accounting Research, 29*(2), 33-46.

Beyond pay transparency

After Gordie Howe received the pay raise from the Red Wings, he went on to play for Detroit for two more seasons (completing 25 seasons in total) before retiring for the first time and joining the team's front office. Money was clearly not the most important thing to Mr. Hockey, and his story shows that the employee-employer relationship can continue once justice is restored. After the debacle in the 2021 Stanley Cup Playoffs, the Toronto Maple Leafs has kept the same salary structure and made the playoffs again as one of the top seeds. The experience of the Maple Leafs shows that even though pay disparity exists, organizations can still overcome these problems and push employees toward a joint goal.

We would never know how much Gordie Howe, who retired for good in 1980, would be paid compared to other players in the transparent pay era, nor would we know whether the Maple Leafs' salary allocation would have worked out better in the secret pay era. This is why research, which provides evidence through experimentation (in the field or the lab), is valuable. Research tells us that pay transparency will not be the silver bullet to heal a failing firm's woes, nor kryptonite to a super firm's success. What it can be, is a catalyst for the pursuit of equity.