



TRANSPARENCY IN COMPENSATION: TRENDS AND BEST PRACTICES



Executive Summary

When we think about tools like Expedia and Yelp, we realize the value of transparency in the marketplace. The underlying issue is information asymmetry - when one party has more information than the other, that party has additional leverage in a discussion or negotiation. Leveling the playing field between two parties in an exchange helps both to feel like they got a fair deal, which is essential in an employment situation. This specifically applies to compensation as well. There is value in openness, and companies that find the right balance can reap the benefits of pay transparency.

Research Supports an Open Approach

Research points out that companies where employees understand the pay philosophy are more likely to see engagement from employees. A sense of trust and openness at work can create bottom-line business results. On the other end of the spectrum, pay secrecy has proven to limit business impact. This combination of factors clearly makes the case that businesses need to seek transparency at some level.

Trends in Transparency

A wide variety of trends have contributed to this increased demand for compensation transparency. From the deep insights offered by tools like Charity Navigator (and other online transparency sites) to the media sharing stories of corporate corruption and scandal, many drivers have created an environment that is ripe for additional openness.

Delivering a High-Quality Employee Experience

The good news is that any organization can improve pay transparency. Using tools like transparency audits and frameworks, companies can deliver a culturally-appropriate level of openness that improves the employee experience. These methods help organizations to make decisions (both big and small) in search of the right balance of transparency.

The Business Case for Transparency

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Several years ago, Dan Ariely, a behavioral economist and professor at Duke University, performed an analysis of country-specific organ donation rates¹. His findings showed that countries like Austria and Poland had higher than 99 percent donation rates, but countries like Denmark had dismal rates in the single digits. He wanted to find out what made each group different, because Denmark is very similar to its neighbors in terms of culture, religion, and other socioeconomic factors.

It turned out that the key influencer was not an intrinsic one at all. Each country's Department of Motor Vehicles actually used a different method for enrolling someone in organ donation. For Austria and Poland, the enrollment form's default was to participate in the program. For countries like Denmark, the enrollment form required them to opt into the program. That small difference led to significant impacts on organ donation and availability, and it offers a compelling lesson on how our default reactions can shape outcomes.

The lesson here is, given the choice, we should default to transparency. For some business leaders, it is reflexive to protect information, keeping it secret unless they have a good reason to share. While working as an HR leader, I performed plenty of coaching with my executive team focused on the concepts of pay transparency and business transparency in general. I always told them their **default** should be to share openly unless there are specific reasons not to. The benefits of this approach include greater awareness and engagement. Consider these statistics that support the premise:

- Salary.com's 9th Annual Compensation Outlook Survey² found that 85% of organizations with employees that understand the compensation philosophy also had high levels of engagement.
- A 2002 study by Watson Wyatt, based on a survey of 12,750 workers across multiple industries, showed that high trust organizations outperformed low trust organizations in total return to shareholders by 286 percent³.

Clearly there is value in openness, and this report is focused on helping you bridge that gap in your organization.

¹ <http://danariely.com/2008/05/05/3-main-lessons-of-psychology/>

² <http://companalyst.com/wp-content/uploads/Compensation-Outlook-Survey-Infographic.pdf>

³ <http://shell.cas.usf.edu/~pspector/alum/greaner.pdf>

Trends Driving Transparency

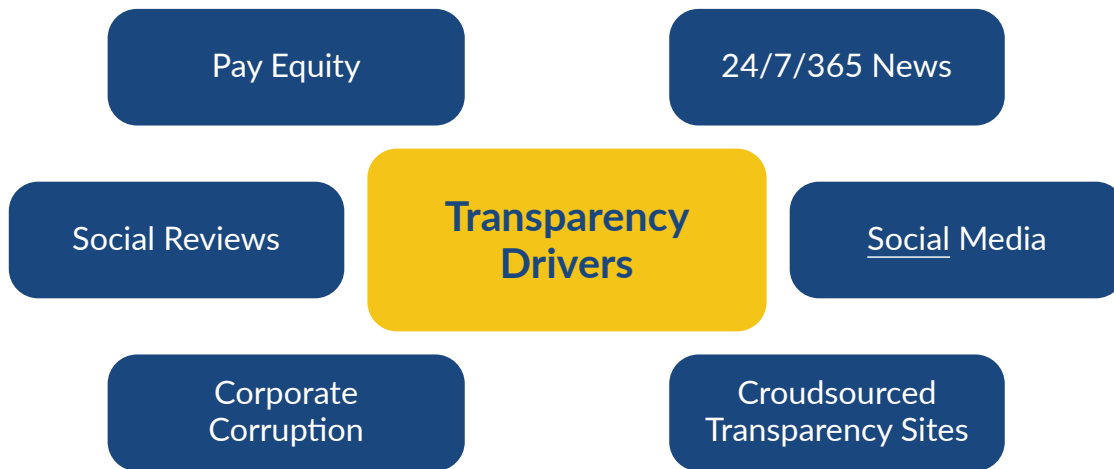


Transparency is a topic we hear about often, but in a variety of contexts. Over the past few years, the concept of transparency has become even more pervasive due to several cultural, technological, and social shifts:

- **Social media**
- **Always-on news**
- **Scandals and corporate corruption**
- **Sites that attempt to create clarity around financial decisions** (example: CharityNavigator)
- **Social/crowdsourced reviews**
- **Greater demand for pay equity**

This group of trends has contributed to the increased demand for transparency in the corporate arena. Culturally, compensation is treated differently throughout the world. In some European countries, people are not hesitant to share their earnings. On the flip side, the United States has a population that is generally very protective of wage information. The concept of pay transparency is not mutually exclusive with this cultural norm. Companies can strike a balance between employee needs and company culture to offer the right amount of transparency for engaging workers without causing unintended consequences.

Figure 1 - Contributors to Business Transparency



In addition, we have seen the growth of conversations around pay transparency in recent years. While this owes some of its origins to the trends above, other specific points that drive this include legislative change and the appearance of new, high-profile companies with open salary data. This group of trends is creating pressure for organizations to be more transparent, and that can deliver positive rewards if managed appropriately.

Public, Private, and Semiprivate Philosophies

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In my work experience, I've been on both sides of the compensation discussion. Working as an HR Director, I held all the information about pay rates, ranges, and decisions in the palm of my hand. I knew each person's financial contributions to the company and how their compensation stacked up against their peers. In other roles, I was an individual contributor. I had no visibility into the pay structures and couldn't have open conversations with managers because they didn't seem to know anything either.

The type of compensation transparency philosophy a company will follow depends on its culture, industry, and geography. I mentioned earlier the types of geographic differences a company will see, but there are significant variations due to the other factors as well. Below are a few examples of what companies look like across the spectrum of transparency.

When it comes to open pay transparency, the company that many think of is Buffer⁴. The technology firm uses transparency to set itself apart, listing data publicly on its website around categories like salary, revenue, diversity, and pricing. This is a radical example, but it helps to illustrate the extent to which some companies will go in the pursuit of transparency. This is also a great illustration of how culture affects pay transparency. Buffer's leadership strongly believes in authenticity and openness, even going as far as opening up emails internally so any employee can see any email message sent within the firm. Not all people will find this level of transparency appealing, which is helpful during the recruiting process for weeding out poor fit candidates.

The other extreme can include any number of companies, large and small. Some of the factors that contribute to pay secrecy may include:

- **Private ownership:** publicly traded companies have to report data and make it available for investors while privately held firms do not.
- **Competitive industries:** some industries often have low transparency to prevent competitors from copying business models, compensation ranges, and bonus structures.
- **Small firms:** larger companies have more people, which means more opportunities to find someone with a similar job or similar pay. Small companies have fewer workers, which can often breed competitive attitudes, keeping pay private.

Despite much of the research⁵ pointing out that pay secrecy harms the business and its employees, this is still a very common practice.

⁴ <https://buffer.com/transparency>

⁵ <http://bit.ly/2nlZLCm>

Finally, we have the semiprivate approach. Between those opposite ends of the range lies a continuum of openness, allowing companies a great deal of flexibility to find the appropriate level of transparency for meeting business objectives and giving employees enough information to feel informed. One example of many is The Lampo Group. The parent company for a popular radio show, the firm's 550 employees gather each month to participate in profit sharing reviews, exploring the latest expense and revenue data. That information is then used to calculate regular profit sharing payments to all employees. While pay data is not posted on the break room bulletin board, everyone has clarity and accountability for the profit sharing results, giving them a sense of engagement and connectedness to the company⁶.

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Challenges of Full Transparency

While we are exploring the positive aspects of transparency and how to make the most of it, there can also be a dark side to the practice. It's important to see the potential downsides in order to make an informed decision, make the right choices, and mitigate any issues that may arise.

In a 2016 research paper published by Princeton⁷, Alexandre Mas examined changes in employment after municipal salary data was made publicly available. In the study, he saw that the highest paid managers saw compensation fall by an average of 7 percent. In addition, the quit rate for this group increased by a shocking 75 percent.

Let's imagine for a moment that these highly paid managers were also the top performers: do you think these municipalities are better off without their managers? This is one example to demonstrate that total transparency may not be right for every organization.

The fully open approach has pros and cons, and we can see them play out in many civil service positions where transparency is built into the structure. Samantha Brinkley, a former Personnel Manager for the City of Sacramento, said this about the pros and cons of working as the HR leader in a transparent compensation environment:

“There were certainly positive aspects to the approach. Pay raises were consistent, it was difficult for managers to discriminate based on wages, and there were clear expectations from workers. At the same time, the challenges were quite difficult to deal with. Compensation was not based on performance or results, we had difficulty motivating our top performers, and if any business or financial concerns materialized, we were already committed to a publicly open pay scale.”

⁶ Source: *EntreLeadership* (Howard Books, 2011)

⁷ <https://www.princeton.edu/~amas/papers/transparency.pdf>

The best approach for any organization lies somewhere on the spectrum of openness that aligns with the culture and business model. As in the examples above, companies can offer a variety of transparent approaches without going overboard.

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The Transparency Audit

One of the executive coaching tools I've relied on over the years is the transparency audit. While it can be applied in a variety of ways, for our purposes we'll focus on pay transparency.

The process is fairly simple to administer. The first step is to offer employees the opportunity to tell you how transparent current compensation practices, structures, and processes are on a scale of one to ten--one being completely secret and ten being completely open. Then, in a parallel communication, ask managers and executives the same question.

The responses to this type of audit are fairly predictable. The table below offers a preview of typical results, but each organization's will vary.

	Employees	Leaders
Perceived Pay Transparency	Average score: 2-4	Average score: 6-8

Once the results are returned, then the audit truly begins. If the results mirror those in the table above, this presents a coaching opportunity for leaders and an educational opportunity for employees:

- For starters, **the wider the gap** between the employee and leader scores, **the more severe the transparency issues**.
- Leaders need help with understanding how to communicate current practices and offer insights for employees. It's common for this audience to expect HR or compensation subject matter experts to complete this task, but it's important to push it back on the managers since they ultimately decide on a pay level for each individual employee.
- Employees need education about the current processes in general, but they also need frank discussions with their own leaders about how their specific compensation is determined and what factors into the overall ranking. This is supported by research, as the Salary.com Outlook Survey also pointed out that **less than half of all managers** are capable of having effective compensation conversations.

The end goal of this transparency audit process is to close the gap based on company culture and practices. While we may not always be able to bring both groups into total alignment around transparency, regular measurement and maintenance can help ensure that the gap remains small enough to have a negligible impact on engagement and performance.

A Framework to Improve Transparency

Your company may not aspire to fanatical levels of openness; however, there are ways to increase the level of transparency in your organization without scrapping the current approach completely. The following PRESS framework can help any company to improve relative transparency, regardless of size, industry, or geography with five key strategies.

Figure 2 - PRESS Framework for Pay Transparency

Process	Have a clearly defined compensation process and be open about how it works. The last thing you want is a “black box” approach where nobody understands the outputs.
Ranges	Even if you don’t publish publicly, having internal pay ranges available during salary discussions can help employees to feel more informed and engaged.
Equity	Put fairness front and center. Help employees to see that your organization is committed to ensuring that all employees, regardless of race or gender, are on a level playing field.
Stretch	Always be looking for ways to share something, even if it makes leaders a bit uncomfortable. Remember: default to transparency unless there’s a compelling reason not to.
Solicit	Be willing to solicit feedback (whether in the form of an audit or a survey) to understand the evolution of expectations and perceptions around transparency.

Source: Lighthouse Research & Advisory

Key Takeaways

<p>Gather some of the data points from this report to help build your own unique business case for transparency. Focus on engagement and business outcomes, not on soft measures that have no sway with the C-suite.</p>	<p>Evaluate your company culture and philosophy around pay. Determine what level of transparency makes sense for your business and set that target with your executive team. Create milestones and accountability to ensure incremental progress.</p>	<p>Leverage some of the tools provided to understand the current expectations and perceptions of your employee base around openness, then use the framework as a delivery and feedback mechanism for future compensation strategy.</p>
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Ben Eubanks is the Principal Analyst at Lighthouse, providing insights for today's talent leaders and vendor partners. Prior to joining Lighthouse, Ben worked as a research analyst for Brandon Hall Group, focusing on learning, talent acquisition, and talent management. During his tenure, he published more than 100 pieces of research and provided advisory services to executives from some of the largest and most respected organizations in the world.

He also has hands-on experience working as an HR executive, leading both strategic and tactical talent practices. Ben is the host of We're Only Human, a podcast focused on the intersection of people, technology, and the workplace. In addition, he runs upstartHR.com, a website serving HR leaders that has reached more than 750,000 readers since its inception.

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