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Fair pay dispersion: A regulatory focus theory view

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ABSTRACT

The authors propose that the debate on the fairness of large pay dispersion can be advanced by considering people's regulatory focus. While some argue that pay dispersion is fair only when it reflects individual contribution differences, others argue that large pay dispersion is fair as employees perceive others' high pay as a signal of their own future pay. Invoking the view of regulatory focus theory, the authors suggest that pay dispersion increases pay fairness perception when employees have a strong promotion focus, whereas pay dispersion decreases fairness perception when employees have a strong prevention focus. Using two multilevel field studies—Study 1 with 827 employees in 137 teams at 42 organizations in South Korea and Study 2 with 186 employees in 46 teams at 5 high-technology organizations in Taiwan—the authors present supportive evidence of the promotion focus moderation effect. Evidence of the prevention focus moderation effect is not found.

1. Introduction

The fairness of rising income inequality is a perennial issue for both policymakers and researchers in various disciplines (Kelly & Witko, 2012; Morris & Western, 1999; Piketty & Saez, 2014). Organizational researchers have attempted to advance this debate by identifying a pattern from the mixed evidence of pay dispersion effects within organizations—a major source of the rising income inequality (Cobb, 2016)—and suggested that the explainability of pay dispersion is a major contingency that determines people's perceptions of fairness (Gerhart & Rynes, 2003; Shaw, 2014; Trevor, Reilly, & Gerhart, 2012). Any degree of pay dispersion is fair as long as it can be explained by legitimate sources, such as employee contribution differences, but is unfair if it is unexplainable (i.e., overly dispersed or overly compressed). The guiding principle of this proposition is equity theory, which postulates that fairness is achieved when individuals' outcome-to-input ratios are equal (Adams, 1963, 1965).

The objective of this research was to investigate whether excessively-dispersed or overly-compressed (i.e., unexplained) pay dispersion can be perceived as fair. We were motivated to examine this possibility for several reasons. First, inconsistent with the equity theory proposition, a signaling perspective (Hirschman & Rothschild, 1973; Manski, 2000), grounded in the discipline of economics, suggests that excessive pay dispersion can be regarded as fair because other people's high pay signals how much one can earn in the future. This signaling perspective has rarely been discussed in the pay dispersion literature (for an exception, see Clark, Kristensen, & Westergård-Nielsen, 2009), and we sought to extend the literature by identifying contingencies that reconcile the conflicting predictions of the equity theory and the signaling perspective. Second, despite the centrality of fairness perception in the pay dispersion effect debate, we found few studies that directly examined how pay dispersion relates to pay fairness perceptions (Shaw, 2014). Third, practitioners express challenges in achieving fairness even when pay is allocated based on legitimate sources such as individual contribution differences (Burroughs, 1982; Gerhart, Rynes, & Fulmer, 2009), because the multidimensionality of contributions (Cook & Yamagishi, 1983; Farkas & Anderson, 1979) intensifies employees' inherent biases in judging their own and others' contributions (e.g., Feldman, 1981; Kruger & Dunning, 1999). Indeed, extant evidence of positive pay dispersion effects appears almost exclusively in contexts that allow clear identification of individual contributions such as sports teams (e.g., Becker & Huselid, 1992; Ehrenberg & Bognanno, 1990a, 1990b; Frick & Prinz, 2007; Frick, Prinz, & Winkelmann, 2003; Trevor et al., 2012) and laboratory experiment settings (e.g., Cadsby, Song, & Tapon, 2007; Harbring & Irlenbusch, 2003). We argue that the practical implications of pay dispersion studies can be extended further by revealing the social psychological contingencies that influence people's focus in construing pay dispersion.

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In this research, we propose that the effect of pay dispersion on fairness perception can be both positive and negative depending on employees' regulatory focus—individuals' strategic orientations in pursuing their desired end states (Higgins, 1997, 1998). Building on the literature that people's motives lead them to filter information in ways that are consistent with their inherent motives (e.g., Kteily, Sheehy-Skeffington, & Ho, 2017), we theorize that when employees have a strong promotion focus, they tend to pay more attention to the future-pay-signal aspect of pay dispersion, whereas when they have a strong prevention focus they tend to pay more attention to the legitimacy of the pay dispersion (Fig. 1). We tested our model using two multilevel field datasets—one from employees in South Korean organizations, and the other from employees in Taiwanese organizations.

2. Effect of pay dispersion on pay fairness perception

Pay fairness perception is a key mechanism of pay dispersion effects, but few studies have directly investigated how pay dispersion relates to employee fairness perceptions and employee attitudes (Conroy, Gupta, Shaw, & Park, 2014; Shaw, 2014). In addition, even those few extant studies present mixed evidence. Trevor and Wazeter (2006) found that pay dispersion among school teachers in a large US state was negatively related to their pay fairness perceptions. Pfeffer and Langton (1993) also showed that pay dispersion among US university faculty was negatively related to satisfaction. However, Clark et al. (2009) found opposite evidence that, in a sample of Danish workers, pay dispersion was positively related to job satisfaction.

The negative effect of pay dispersion on attitudes has often been explained from the perspective of equity theory. According to equity theory (Adams, 1963, 1965), pay dispersion must reflect employee contribution differences so that employees have equal pay-to-contribution ratios. Thus, some degree of pay dispersion should be fair, and it is overly-compressed or overly-dispersed pay that is unfair (Brown, Sturman, & Simmering, 2003). However, within teams and organizations where individuals work interdependently toward a common goal (March & Simon, 1958; Thompson, 1967), large pay dispersion is likely to be perceived as unfair because the inherent interdependence of works makes it difficult to identify each individual's distinctive contribution relative to others (Shaw, Gupta, & Delery, 2002). Indeed, studies that have adopted the equity theory perspective consistently reported negative consequences of large pay dispersion (e.g., Trevor & Wazeter, 2006), with a few exceptions that tested the theory in the context of a sports team (e.g., Trevor et al., 2012) or laboratory experiment (e.g., Harbring & Irlenbusch, 2003).

Inconsistent with the equity theory prediction, a signaling view, grounded in the field of economics, proposes that large pay dispersion should increase employees' pay fairness perceptions because others' higher pay levels signal one's own future income. This perspective posits that people have limited information on their future prospects and that others' pay levels help them update their expectations about how much they can earn in the future (Hirschman & Rothschild, 1973; Manski, 2000). Hence, people withhold any possible negative affective reactions and instead expect that they will also be able to earn as much. Clark et al. (2009) adopted this signaling perspective when they found a positive association between pay dispersion and employee job satisfaction. Thus, from the signaling perspective, large pay dispersion can be regarded as fair even when it creates imbalance between individuals' pay-to-contribution ratios, because it provides employees opportunities to earn more in the future.

Research shows that people's motives influence them to filter information differently, in ways that make them pay more attention to those that are aligned with their motives while disregarding those that are misaligned (e.g., Bakshy, Messing, & Adamic, 2015; Barberá, Jost, Nagler, Tucker, & Bonneau, 2015; Kteily et al., 2017). Building on this literature, we argue that the conflicting predictions between equity theory and signaling perspective can be reconciled by considering employees' motivational orientation in construing pay dispersion. Notably, our argument departs from previous pay dispersion studies that highlighted the use of pay-for-performance as a way to reconcile conflicting pay dispersion effects (Kepes, Delery, & Gupta, 2009; Shaw, 2015; Shaw et al., 2002). Instead, we argue that even when not fully explained by pay-for-performance, both large and small pay dispersion can increase pay fairness perceptions, depending on whether people are motivationally oriented to focus on the future-pay-signaling aspect (i.e., signaling perspective) or the explainability aspect (i.e., equity theory perspective) of pay dispersion.

3. Regulatory focus as a contingency

Regulatory focus theory (Higgins, 1997, 1998) posits that people are motivationally oriented to use different strategic means in following the hedonic principle—approaching pleasure and avoiding pain (Freud, 1920/1961). When guided by ideal states—their own or significant others' wishes, hopes, and aspirations—people are in a *promotion focus* and regulate themselves to reduce the discrepancy between their current state and the ideal states. When guided by ought states—their own or significant others' beliefs about their obligations, duties, and responsibilities—people are in a *prevention focus* and regulate themselves to reduce the discrepancy between their current state and the ought states. People with a strong promotion focus are strategically inclined to seek means and opportunities for advancement, and strive not to miss those opportunities (i.e., they ensure against errors of omission).

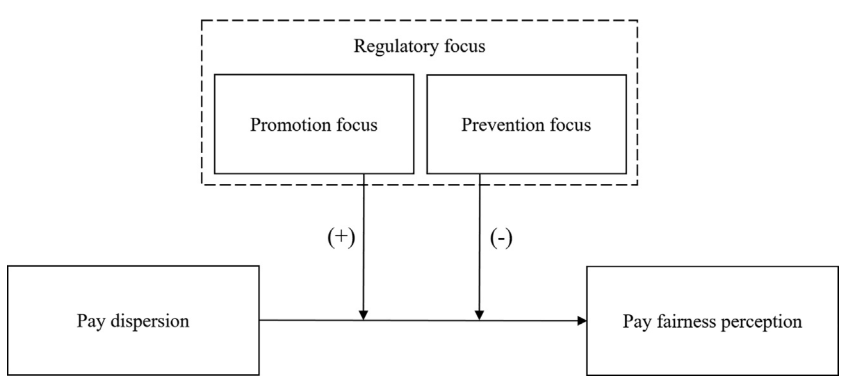

Fig. 1. Theoretical model.