European Economic Review 98 (2017) 189–198

Contents lists available at ScienceDirect

European Economic Review

journal homepage: www.elsevier.com/locate/euroecorev

The value and motivating mechanism of transparency in organizations

Leif Brandes[a,*], Donja Darai[b,1]

[a] Warwick Business School, University of Warwick, Scarman Road, Coventry CV4 7AL, United Kingdom
[b] Department of Economics, University of Zurich, Blümlisalpstrasse 10, Zurich 8006, Switzerland

ARTICLE INFO

Article history:
Received 31 July 2015
Accepted 19 June 2017
Available online 3 July 2017

JEL classification:
D23
C91

Keywords:
Transparency
Non-monetary incentives
Communication
Principal–agent relationship

ABSTRACT

The question how transparency in organizations affects performance has received considerable interest from researchers in management, psychology, and organization science. The widely held view is that transparency benefits organizational performance, because it reduces employee uncertainty. However, causal empirical evidence on the value of transparency and its motivating mechanism is still scarce. In this paper, we report the findings from an experiment, in which an agent has only probabilistic beliefs about the true state of nature and needs to choose costly effort that benefits the principal. The true state relates to his fixed-wage, which can either be high or low. The principal needs to decide whether to create Informative Transparency by disclosing the true state to the agent via a costly, fixed-form message. Our results show a considerable value of transparency: even if transparency involves the disclosure of 'bad news' (the low state), effort almost doubles relative to non-disclosure. Looking at the motivating mechanism, we do not find that transparency motivates primarily because it reduces uncertainty for the agent. Instead, we find that Uninformative Transparency that merely involves communication of already known facts is equally effective. Many principals, however, misperceive the value of transparency and disclose information too restrictively.

1. Introduction

Economists have long understood that the success of organizations depends on the effective coordination and motivation of their members (see the recent review by Gibbons and Roberts, 2013). Traditionally, research in the area of motivation focused on the influence of monetary incentives on employee effort in principal–agent relationships (e.g., Holmstrom, 1979). Over the last decade, however, interest in the effectiveness of non-monetary incentives such as respect, attention, job mission or the allocation of decision rights has been on the rise.[2] In this paper, we report on the findings from a controlled laboratory experiment on another, non-monetary incentive mechanism: the level of transparency in organizations.

The question how transparency in organizations affects performance has received considerable interest from researchers in management, psychology, and organization science. Schnackenberg and Tomlinson (2014) offer a comprehensive review

* Corresponding author.
E-mail addresses: leif.brandes@wbs.ac.uk (L. Brandes), donja.darai@gmail.com (D. Darai).
[1] Present address: Universitätstrasse 31, 8006 Zurich, Switzerland.
[2] See Ellingsen and Johannesson (2007) on respect, Dur (2009) on attention, Cassar (2014) on job mission, and Charness et al. (2012) and Fehr et al. (2013) on the allocation of decision rights.

http://dx.doi.org/10.1016/j.euroecorev.2017.06.014

of studies in these disciplines and define transparency as the "perceived quality of intentionally shared information from a sender" (p. 1788). This definition reflects on the authors' argument that at the heart of transparency there lies information disclosure, i.e., the timely provision of relevant information to *otherwise uninformed parties*, together with information accuracy and clarity. An emerging view is that transparency benefits organizational performance, because it contributes to trust in organization–stakeholder relationships (*ibid*). However, causal empirical evidence on the value of transparency for organizational performance is still scarce, because the effect of transparency in extant work is often confounded with other important success factors, such as the pre-existing level of trust in the work environment (Akkermans et al., 2004). The first goal of our paper is to address this gap in the context of employee motivation.

A widely held belief is that the value of transparency derives from the disclosure of uncertainty-reducing information to employees. For example, a number of recent articles in the business press document considerable non-transparency in firms about changes in corporate policies, goals, visions, and financial results (e.g., CNN-Money, 2013; WSJ, 2012), and warn that such uncertainty exposure results in reduced employee commitment and productivity. Along similar lines, scholars in management and psychology interpret the disclosure of relevant information that helps employees to "understand and contextualize their workplace" (p. 295) as informational fairness from managers (Collins and Mossholder, 2014). Informational fairness in turn represents an important dimension of organizational justice (Bies, 2001), which relates positively to employee trust (Cohen-Charash and Spector, 2001) and performance (e.g., Ambrose et al., 2002; Reb et al., 2006 and Sklarlicki and Folger, 1997). While these are compelling explanations for the value of transparency, they largely neglect another, potentially motivating mechanism of transparency: the positive effects of interpersonal communication as a common vehicle for information disclosure.

Considerable evidence in economics demonstrates the broad behavioral impact of interpersonal communication in strategic interactions. In the context of a weak-link game, for example, Brandts and Cooper (2007) show that one-way communication from a manager is more effective than financial incentives alone in overcoming coordination failure between employees. More broadly, communication has also been observed to affect transfers in the dictator game (e.g., Andreoni and Rao, 2011; Mohlin and Johannesson, 2008 and Bohnet and Frey, 1999) and offers in the ultimatum bargaining game (Zultan, 2012). Andreoni and Rao (2011), for example, find that communication from the receiver increases transfers, and conclude that this effect stems largely from heightened empathy of dictators. While receivers in Andreoni and Rao (2011) were allowed to make specific transfer requests from the dictator, Zultan (2012) reports that communication does not have to be 'strategic' to be effective: even when pre-play communication was restricted to topics other than the game itself, offers in the ultimatum bargaining game were higher than without pre-play communication. Could it thus be that the interpersonal communication involved is the real driver behind the hypothesized value of transparency? The second goal of our paper is to address this question.[3]

Knowledge about the motivating mechanism is of great relevance for practitioners, because of its implication for the management of transparency in the workplace. For example, if the value of transparency derived primarily from the provision of uncertainty-reducing information, the timing of communication would be crucial: information disclosure would only be motivating, as long as the involved information had not started to diffuse within the organization. If, however, employees mainly responded to the interpersonal communication from managers, disclosure would actually be motivating beyond this point of information diffusion.

To achieve both our research goals, we design an experiment, which consists of a series of one-shot principal–agent games. In each iteration of the game a principal is matched with a different agent who needs to choose effort, which is costly for the agent and beneficial to the principal. The principal has an information advantage compared to the agent. That is, the principal knows the agent's exogenously assigned wage level prior to the agent's effort choice. Importantly, she also has the opportunity to disclose it to the agent via a costly, fixed-form message. Without disclosure, non-transparency prevails, which implies that the agent faces uncertainty about his wage level when choosing his effort: all he knows is that a random draw determines whether his wage level will be high or low and that both outcomes are equally likely.

This experimental condition, labeled *Informative Transparency*, allows us to measure the causal effect of transparency on performance, and to calculate separate values of transparency for the disclosure of the low and the high wage. While it is intuitive to assume that the disclosure of good news is more motivating than the disclosure of bad news, it is less clear whether the disclosure of bad news is motivating at all. We are unaware of previous research on this question. Furthermore, observing a series of one-shot interactions enables us to study the values of transparency when subjects gain experience. These values are of central interest for decision makers, because in most organizational contexts, both agents and principals are experienced with the setting.

In a control condition, labeled *Uninformative Transparency*, we remove one of the central components of the game: the principal's information advantage. Now, both the principal *and* the agent are always truthfully informed about the wage level. All other aspects of the *Informative Transparency* condition remain the same. In particular, the principal can still disclose the wage level to the agent via a costly, fixed-form message. However, it is common knowledge that such disclosure does not reduce uncertainty for the agent as there is no informational value of interpersonal communication. Comparing

[3] A growing literature discusses the positive association between empathy and trust (see e.g., Feng et al., 2004; Silvester et al., 2007; Williams, 2007 and Williams, 2012). Accordingly, evidence in support of communication as the primary motivating mechanism would still be consistent with the view in Schnackenberg and Tomlinson (2014) that transparency improves performance through greater trust in organization–stakeholder relationships.