

Social Comparison of Complex Pay for Performance Contracts

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B.Sc. Business Administration

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Purpose/Motivation: In recent years, the trend to base the compensation on the employee's performance increased as researchers found that performance can be improved through pay for performance (PFP) contracts (Cadsby, Song, & Tapon, 2006, p. 20; Gerhart, Rynes, & Smithey Fulmer, 2009, p. 6; Jenkins Jr, Mitra, Gupta, & Shaw, 1998, p. 783). One consequence of performance-enhancing compensation contracts is the associated complexity (Park, 2018, p. 22), which might prevent transparency in the compensation process even when outcome pay transparency is given. Accordingly, it is important to understand the relationship between pay complexity and pay transparency. In this context, the associated fairness perceptions resulting from different combinations of complexity in social comparison is also of great interest.

Theories: The thesis deals with three main theoretical concepts, 1) complexity, 2) pay transparency, and 3) justice perceptions. Complexity is defined based on the number of different elements and their interactions, which Scuricini (1988, p. 94), also called the "plurality of interacting elements". Complexity can be applied to the various PFP plans which are correlated. Pay transparency denotes the disclosure of pay information combined with the employee's understanding of those information and can be categorized in outcome pay transparency and process pay transparency (Fulmer & Chen, 2014, Smit & Montag-Smit, 2019). Concerning the employee's justice perceptions, the focus of this paper is on informational and procedural justice perceptions. Complexity reduces transparency, which in turn affects fairness perceptions of individuals, when comparing to colleagues.

Approach/Methodology: For my literature review, I searched the major databases for literature concerning my theoretical constructs (i.e., complexity, pay for performance compensation, pay transparency, and justice perceptions). To give an accurate definition for the concepts, I used papers describing the general theory and I further reviewed interesting cited literature. For the relationships, I reused the papers for the concepts and additionally searched for literature investigating similar relationships. I narrowed down the paper bases to relevant papers investigating the relationships.

Findings: Deriving from the cognitive load theory (Sweller & Chandler, 1994), I argue that complexity harms the understanding of the compensation contracts. Based on the available

information, informational fairness perceptions develop. Thereby, pay transparency is an important indicator of informational justice (Scheller and Harrison, 2018). The evaluation of procedural justice mainly refers to the differences in the contracts, that is, in my thesis, differences in complexity compared to a referent other and the resulting consequences, see figure below.

		Referent other	
		simple	complex
Ego	simple	Simple-Simple (1) <ul style="list-style-type: none"> - Full pay transparency on both contracts - Objective social comparison - Given informational justice - Given procedural when consistency 	Simple-Complex (4) <ul style="list-style-type: none"> - Outcome pay transparency on both contracts, full pay transparency on own contract - Subjective social comparison - Informational injustice - Mixed perceptions concerning procedural justice
	complex	Complex-Simple (3) <ul style="list-style-type: none"> - Outcome pay transparency on both contracts, full pay transparency on RO's contract - Subjective social comparison - Informational injustice - Mixed perceptions concerning procedural justice 	Complex-Complex (2) <ul style="list-style-type: none"> - Outcome pay transparency on both contracts - Subjective social comparison - Informational injustice - Mixed perceptions concerning procedural justice

Research Limitations: In my thesis, I used several assumptions to simplify propositional reasoning by keeping certain variables constant. Consequently, those assumptions are influencing the results of my paper.

Research Implications: There is a huge lack of literature on the relationship between complexity in compensation contracts and pay transparency. In addition, varying degrees of complexity in compensation contracts among colleagues and their consequences has not been addressed yet. By studying the literature to the topic extensively, I offer propositions that need to be confirmed or refuted by empirical evidence.

Practical Implications: Even though compensation systems are increasingly based on performance, many executives fail to consider the associated complexity and the effect on pay transparency and justice perceptions. I, therefore, emphasize the importance of organizational

justice and motivate to individually adapt the compensation complexity to the respective positions.

Contribution: My paper contributes to the literature of the relationship between pay complexity and pay transparency. Thereby, I point out different propositions concerning different constellations of complex compensation contracts in the context of social comparison.

Paper type: conceptual

Further readings:

For PFP and complexity research:

Park, S., & Sturman, M. C. (2021). When perception is reality, there is more than one reality: The formation and effects of pay-for-performance perceptions. *Personnel Psychology*, 1–27.

Sweller, J., & Chandler, P. (1994). Why Some Material Is Difficult to Learn. *Cognition and Instruction*, 12(3), 185–233.

For transparency and fairness research:

Bamberger, P. A., & Belogolovsky, E. (2010). The Impact of Pay Secrecy on Individual Task Performance. *Personnel Psychology*, 965–996.

Colquitt, J. A. (2001). On the Dimensionality of Organizational Justice: A Construct Validation of a Measure. *Journal of Applied Psychology*, 86(3), 386–400.

SimanTov-Nachlieli, I., & Bamberger, P. (2021). Pay Communication, Justice, and Affect: The Asymmetric Effects of Process and Outcome Pay Transparency on Counterproductive Workplace Behavior. *American Psychological Association*, 106(2), 230–249.

Smit, B. W., & Montag-Smit, T. (2019). The Pay Transparency Dilemma: Development and Validation of the Pay Information Exchange Preferences Scale. *Journal of Applied Psychology*, 104(4), 537–558.

For social comparison research:

Leventhal, G. S. (1980). What Should Be Done with Equity Theory? New Approaches to the Study of Fairness in Social Relationships. Springer, Boston, MA. 1–52.