

The Choice of Salary Transparency

—Based on the Value of Equity Theory

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Abstract

Based on the view of equity theory, this article divides salary transparency into four conditions through two arrangements—result equity and process equity. The paper draws a conclusion that the effect of salary transparency on staff's sense of fairness will vary with enterprise actual situation and then it discusses the key factors of the influence of choosing the salary transparency. On this basis, according to the financial reporting, the article recognizes enterprise life cycle and chooses the corresponding salary transparency plan as well.

Keywords

Equity Theory, Salary Transparency, Financial Reporting, Enterprise Life Cycle

1. Introduction

There always has been a debate. Should salary system be public or secret? In China, most of enterprises implement pay secrecy policy. However, at the beginning of 2007, some people shared their salary information on the internet. At the same time, The CSRC promulgated the measures for the management of the listed company information disclosure, requiring the annual report of listed companies to disclose executives' pay. In 2011, five power generation groups of China released the worker wages on request. Those phenomena reflected people's desire to have open and transparent pay. The sense of fairness makes for employee behavior, which can motivates staff to take positive actions and thus achieves enterprise's goal better and improves the corporate performance. How to design the pay system to guarantee workers' sense of fairness? Dose transparent pay surely mean salary justice while secret pays mean salary injustice? With Adams equity theory, this paper researches the influence different growth stage; enterprises' salary transparencies have on staff's psychology with financial reporting and offer the solutions of salary transparency choosing based on those stages.

2. Equity Theory

Equity theory is a kind of incentive theory, including the result justice, process justice and interactive justice. Because the transparency is related to the salary formulating process and salary result, and interactive activities are always interspersed with them, so we focus on discussing result justice and process justice [1].

2.1. Result Equity Theory

The core idea of equity theory is that in order to judge one's pay to obtain the sense of fairness, when a person devotes to work hard and obtains the reward, he is care about not only his absolute earn but his relative earn. A person's making judgment on the fairness about earn mainly comes from two aspects: on the one hand, he compares the ratio of his efforts and reward now with that ratio in the past. On the other hand, he compares the ratio of his own with the ratio of others' in the same time. When the ratios are equal, he feels justified.

2.1.1. The Connotation of Result Equity Theory

Adams's equity theory can be described by formula as $Q_p/I_p = Q_o/I_o$. O_p represents the earn a person feels should have at present, I_p represents the input a person feel he has had at present. Q_o represents the feeling about earn a person think others should have and I_o means the feeling about input a person think others should have had. The others means other people or other his own past time. When the O_p/I_p is less than Q_o/I_o , people will feel jealousy. When the O_p/I_p is more than Q_o/I_o , people will have sense of quilt. Both jealousy and quilt are negative emotions, they can bring about psychological imbalance of people's. Only when O_p/I_p is equal to Q_o/I_o , can people feel justified.

2.1.2. The Influence on People's Behavior about Result Theory

Adams's research indicates that when a person feels unjustified, he will take actions as follows: (1) change the factor of I_p —his input, reduce efforts to get a balance state he feels the earn worth; (2) change the factor of O_p —his earn, require employer to increase earn to get the sense of fairness; (3) change the perception of O_p/I_p —try to convince himself that what he had own is equal to others. (4) change the factor of I_o —change others' thoughts, take some actions to make others put more efforts or have less earn. (5) change the comparison, reduce the source of unfairness; (6) leave the original department, search for a fair environment [2].

2.1.3. The Standard of Result Equity

There is no unitive judgement of result fairness. The sense of fairness is one's subjective perception, it is affected by gender, education background, age and personal experience etc. Meanwhile, people always overrate their input but underrate their earning, so their jealousy more strongly than guilty. How to judge the result fairness has no objective measure. Furthermore, some work is too complex and less measurable to compare (Li, S., 2004) [3]. Adams equity theory mainly focuses on result fair, so it is called result justice.

2.2. Process Equity

The Connotation of Process Equity

Leventhal thought that employees would be motivated more greatly and work harder if they realized the process of salary distribution is fair [4].

This article is based on the transparency of the salary system to analysis which plan is fairer for staffs.

3. The Transparency of the Salary System

According to equity theory, people not only care about the fairness of result, but also focus on process. X.Y. Mao (2011) divided the transparency into four situations. This paper reference this method and we name the four aspects A1, A2, A3, A4 as shown in Figure 1 [5].

The horizontal ordinate means the degree of transparency of salary process, the vertical coordinate represents the degree of transparency of salary result. A1 means the secret process and open result, A2 represents open process and result, A3 represents secret process and result, A4 represents open process and secret result.

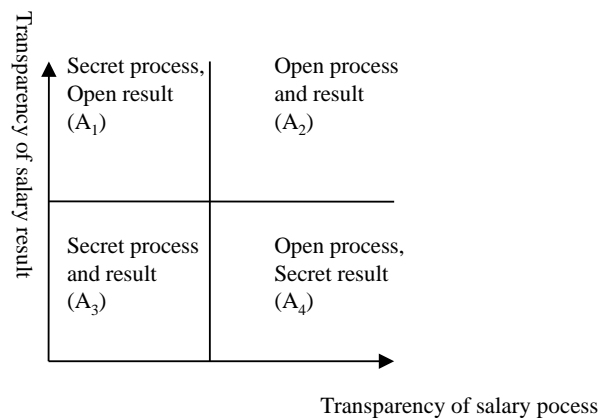


Figure 1. Dimension table about transparency of salary.

3.1. Result Transparency

The result salary includes basic wage, call-back pay, subsidy, money award, profit sharing, stock subscription, insure, employee services and privileges, paid leave and other benefits. Result transparency means employees know the final salary each other.

3.2. Process Transparency

Process transparency represents three parts—publishing in formulation procedure, release channel, position rank and performance evaluation.

Publishing in formulation procedure. Formulation procedure refers to the process and the order enterprise makes in related to salary system, documents, and all kinds of measures. The main factor of process transparency is employee engagement. If enterprise allows staffs to participate in making measures, it indicates that enterprise is open. Meanwhile, the regulation made by the masses represents the will of people and the respectful attitude company has for employees' opinion. This is regarded as process transparency.

Release channel. It means which way enterprise will choose to announce salary information. At present, there are some cases as follow:

- No announcement, no approach.
- Know the affairs of others, seek insights through the grapevine.
- Issue the employee handbook and make an announcement. The first and third ways are no use to salary's transparency. Majority of enterprises don't take initiative to publish salary information, so staff have to ask in person and some enterprises even don't have clear salary regulations and forbid staffs to ask. Those actions are all regarded as salary opacity. Otherwise, enterprise publishes news via employee handbook or announcement and other convenient and fast ways, it makes the process transparent, and it is called release channel.

Position rank and performance evaluation. Position rank mainly refers to what criteria enterprises will base on to rank in the process of evaluation. The performance evaluation refers to what kind of way and standard enterprises will adopt to measure the performance of the worker's. The staffs' having the right to know how the rank and evaluation make is the most important part of it. The more the staffs know about the procedure, the more transparent the enterprise is.

4. The Influences of Salary System Transparency

The main influences of salary transparency are multiplex and multi-dimensional. Based on the divisions of salary transparency above, we can divide the factors of transparency into two cases—the one is the factor of process transparency and the other one is the factor of result transparency.

The main factors of result transparency:

- Compensation gap of inner-enterprise. Employees' feeling of unfairness with Adams equity will be strong if the compensation gap in enterprise is big. In this case, it is better to have a secret salary system rather than

have an open one, which can relatively reduce the sense of unfairness.

- The development of enterprise. As for immature enterprise, it is deficient on design and execution. The evaluation system is incomplete and evaluation tool is unadvanced. In this case, the staffs have suspicion and distrust attitude towards salary system, it is better to have a secret salary as well.
- The maintenance of privacy. It is part of the privacy of personal salary, so keeping secret on salary is a protection of private information. Especially for lower paid people, it is a thing that attacks the confidence of staffs' and reduces the enthusiasm of work. Furthermore, the open salary will intensify colleagues' contradictions, which produces a poor interpersonal atmosphere. In this case, salary secret is better than salary open (Sen. H., 2008) [6].

The factors of process transparency:

- The measurement of work's difficult degree. If the quantifying of the work is difficult and there is no perfect measurement, the enterprise will be challenged when choosing salary scheme.
- The difficult degree of performance evaluation. The same as the measurement of work, if the performance is not easy to evaluate, the standard is hard to design, some responsibilities of position are not able to assigned to everyone, it's difficult to satisfy the six principles of process equity. In this case, it's better to choose open salary.

Above all, when it comes to salary transparency, it should consider both the result transparency and process transparency. Meanwhile, there is no superior between the salary of openness and secrecy. Only basing on the practical situation of enterprise and considering the factors which we have discussed to choose the salary transparency design, can we make the best use to let employees feel fair and realize the motivation on them [6].

5. The Choice of Salary Transparency

Different enterprises have different operation patterns and management systems and they have difficulties in size, structure and enterprise culture, so there are different salary systems between them. Financial reporting is one of the most audio-visual and normative information tool about describing enterprise. We can judge the stage enterprise has been in by financial reporting's main indexes such as main business income, net profit, total assets and profit growth, business activities generated cash flow, investment activities generated cash flow, financing activities generated cash flow, to analysis what characteristics the enterprise has and then make the best salary transparency design.

This article divides enterprise stages into four aspects—bud, growth, maturity and decline. Because the decline has the complex reasons and different enterprises may choose different strategies, they may have new opportunity or may go broke, so we only discuss stages of bud, growth and maturity.

5.1. The Choice of Salary Transparency in Bud Stage

Because being in the initial stage, the enterprise has low market penetration and immature consumer groups, the operating activities can't bring a comfortable income, so the main business income is low. The human resource, technology and equipment cost is so high that it reduces the profit. The enterprise is in the exploring stage, the profit growth is not too fast and the size is not too large, its assets are not huge. The operating cash flow is less, investment activities increase. There is a lot of demands for capital and financial activities cash flow is large. The enterprise doesn't share or shares a little dividends. The financial characteristics as follow (Table 1) [7].

Because the enterprise is in the bud stage, the scale is small and the organization structure is simple, the operating process and organization construction is not stable, it's not clear about the job responsibilities and it always appears the phenomenon of overlaps of job functions. The measurement of work and performance of evaluation are difficult. In this situation, according to the taking secret salary process can reduce the sense of fairness of staff dues to the difficulty in work and performance evaluation. On the other hand, the gap salary in enterprise is not so large, the salary is general average, employees always pay attention to entrepreneurial passion

Table 1. Feature of financial reporting bud enterprise.

Financial index	Main operating income	profit	Total asset	Profit growth rate	Operating activities cash flow	Investment activities cash flow	Financial activities cash flow
Feature	Positive (low)	low	Very low	Increase Slow	negative	negative	positive

rather than fame and position. The aim in enterprise is consistent. In addition, the number of staffs is relatively small, people can get the information in private more easily. The secret salary may increase the distrust in enterprise, so open salary result is appropriate. To sum up, enterprise in bub stage should choice A1 module [8].

5.2. The Choice of Salary Transparency in the Growth Stage

When the enterprise is in the growth stage, it has certain market penetration and a part of loyal consumers. The sales performance rises fast. It has an enormous potentiality. The profit increases constantly and the scale of enterprise is become large, the assets are accumulate. The operating cash flow becomes positive, the good opportunities come frequently. The investment activities need to further enlarge. The operating cash flow is not satisfied with the exploration. The enterprise still has to raise money by external financing. The enterprise will pay the share for shareholders (Table 2).

Because of the increase of scale, the operating pattern and organization structure become complex, the company begins to pay attention to build regulatory framework. The main operating process and the organization framework is stable, the management regulation get standardized. The complexity of organization makes the jobs division hard, the performance evaluation becomes difficult. In this situation, the open salary process will make the staffs feel unsatisfied [9].

Given that growth enterprise has multifarious organization structure, we can classify the staffs as operating staffs, technical staffs and managers. The work of operating and technical staffs is simplex, so it's easier to measure. For managers, the work is related to analysis and decision and it is related to performance as well, so it is more difficult to judge. As to operating and technical employees, it can choose the open process of salary system. The transparent salary not only brings them fairness but also great motivation. As to managers, they are the important figures in the company, their decisions can make a great affection on enterprise, so they usually get higher reward than others, which is a means for enterprise to attract talents. Furthermore, the performance of managers are not easy to assess, so the reward for managers are not relevant to performance. Publishing the process of salary certainly will lead to the bad mood of staffs. Above all, as to growth enterprise, the choice of process transparency should base on two cases. It should choose open process of salary for operating and technical staffs and secret process of salary for managers.

As to result transparency, the plenty post levels and salary ratings will lead to the compensation gap. Open salary result will make people have comparison, which results in contradiction between them. In this case, secret result of salary may help reduce the sense of fairness of staffs. To sum up, A4 is suited for ordinary staffs (operating and technical staffs) and A3 is suited for managers.

5.3. The Choice of Mature Salary Transparency

When the enterprise is in the mature stage, the main business income is getting highest and the profit is largest. But the rate of increase dosen't go up and will keep in a number. With the more and more competitors, the market share reduces, companies will break awkward situation through external expansion to seek now opportunities, or through acquisition and reorganization to import technology and management experience to optimize resources. The total assets are very high, operating activities product enormous cash flow, which can supports normal operating and investments. The investment cash flow become reduced and the external financing activities is negative. The enterprise will pay a lot of share (Table 3).

Comparing with growth company, mature company has more perfect salary system, advanced measurement and systematic evaluation. The supervision is strict and there is a nice enterprise culture, staffs' privacies will be protected. The company has known itself well. Scientific salary system can be designed on its own actual. The method measuring work and performance can't cause discontent. The staffs believe in the company. The open process of salary can let staffs know their basis of salary well. In addition, it is good for staffs to clarify their

Table 2. Feature of financial reporting growth enterprise.

Financial index	Main operating income	Profit	Total asset	Profit growth rate	Operating activities cash flow	Investment activities cash flow	Financial activities cash flow
Feature	Positive (high)	High	Large	Increase fast	Positive	Negative	Positive

Table 3. Feature of financial reporting mature enterprise.

Financial index	Main operating income	Profit	Total asset	Profit growth rate	Operating activities cash flow	Investment activities cash flow	Financial activities cash flow
Feature	Positive (highest)	Positive (highest)	Positive (highest)	Decrease slow	Positive	Positive or negative	Negative

values and developing directions. Just as the same with growth company, the open result of salary is not important and necessary, secret salary result can protect the privacy. The enterprise can choice A4 module.

6. Conclusion and Suggestion

It should base on actual when making a choice of salary system. Budding company has simple structure, immature salary system and irregular supervise, so it can choice secret process and open result salary system. Growth company has difficulties on work measurement and performance evaluation, so it can have choices by two cases—for ordinary staffs (operating and technical staffs), it may choose open salary over process and result. For managers, it may choose secret salary. Mature company has more perfect salary system, advanced measurement and systematic evaluation. It also has a good company culture, so it can choice the open process and secret result salary systems [10].

Secret salary should have basis. Secret salary is aimed to prevent people to compare irrationally to have sense of fairness. However, secrecy doesn't mean design as will. It is forbidden to make decisions by personal emotion and power, which can gain his own earn and reduce others. Enterprise should built the reasonable salary making standard and carry out seriously. In this way, secret salary system can make the best use.

Build an equitable company culture. Pay great attention to communication with staffs, including listening the opinions of staffs about salary designs. In the procedure of salary making, it is important considering not only on transparency but also one's psychological ability and self-respect, which can reflect the idea of human-oriented management and make for mobilizing the initiative of employees. Meanwhile, equity culture can give an invisible constraint to managers. So it is important to build an equitable company culture.

Perfect the supervision of salary system. Perfect supervising reduces the possibilities of unfairness and is in favour of discovering questions and solving questions timely. Company can make salary by different departments, which can supervise each other. Encourage staffs to report the unfair phenomenon. In addition, enterprise should pay more attention to managers to prevent rent-seeking behavior and obtaining gray income.

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