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## PAY SECRECY: PROS AND CONS\*

### Tajnost zarada: za i protiv

#### Abstract

Pay secrecy is an intriguing, and also a controversial policy in human resources management with hardly anything written on the subject. As a form of systematic withholding of information from the employees on all or some aspects of salaries within a company, pay secrecy offers both advantages and disadvantages. The disadvantages are misconceptions about distribution of compensation; negative evaluation of distributive justice; reduced motivation, satisfaction and productivity of the employees; decline of the employees' loyalty and trust in the company; decrease in management's capability to influence and guide the behaviour of the employees; establishment of authoritarian culture and leadership style; as well as erroneous decisions made by the employees with respect to their job and career selection. Advantages of pay secrecy are reflected in better managerial control of organisation's processes; less conflict; better options for differentiating good from bad workers; less turnover and better position of the management in individual negotiations on salary with the employees. In each company, the management should decide whether pay secrecy is a preferable or ill-advised policy for the company in question. The factors that are relevant to the policy choice which should be considered while making the decisions about pros and cons of pay secrecy are the following: workforce characteristics, job design and technology, degree of trust between employees and management, organisational culture and leadership style, and trade unions. Some contextual factors exert the same influence on all companies: labour market, national culture, and transition of the company from socialist to capitalist institutional pattern.

**Keywords:** *compensation, human resources management, management, workforce, distributive justice*

#### Sažetak

Tajnost zarada je intrigirajuća, ali i kontroverzna politika u oblasti upravljanja ljudskim resursima o kojoj se malo piše. Tajnost zarada, kao sistematsko uskraćivanje zaposlenima informacija o svim ili nekim aspektima zarada u preduzeću, ima svojih nedostataka i prednosti. Nedostaci su: pogrešna percepcija distribucije zarada, negativna ocena distributivne pravde u preduzeću, pad motivacije, zadovoljstva i produktivnosti zaposlenih, pad njihovog poverenja u preduzeće i lojalnosti, smanjene mogućnosti menadžera da usmeravaju i utiču na ponašanje zaposlenih, izgradnja autoritarne kulture i stila liderstva kao i pogrešne odluke zaposlenih u pogledu izbora posla i karijere. Prednosti tajnosti zarada su: bolja kontrola procesa u organizaciji od strane menadžera, manje konflikata, veća mogućnost diferenciranja dobrih i loših radnika, manja fluktuacija i bolja pozicija menadžmenta u individualnom pregovaranju o zaradama sa zaposlenima. Menadžment svakog preduzeća treba da proceni da li je tajnost zarada dobra ili loša politika u datom preduzeću. Faktori koji utiču na izbor i koje treba uzeti u obzir prilikom odlučivanja za ili protiv tajnosti zarada su: karakteristike radne snage, job design i tehnologija, stepen poverenja između zaposlenih i menadžmenta, organizaciona kultura i stil liderstva i sindikalno organizovanje. Neki kontekstualni faktori deluju podjednako na sva preduzeća: tržište radne snage, nacionalna kultura, tranzicija od socijalističkog ka kapitalističkom institucionalnom obrascu preduzeća.

**Ključne reči:** *zarade, upravljanje ljudskim resursima, menadžment, radna snaga, distributivna pravda*

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## Introduction

Secrecy of pays of employees in companies, banks, public administration, as well as in all other types of organisations is a very interesting and controversial, but also a much neglected issue. Very little is written about it in both domestic and foreign sources [7]. In addition to this, this potentially highly important issue is also very little discussed in practice among managers and employees. It might be said that the attitude that pay secrecy is an issue to be covered by the business policy of the company's management and that there is nothing to be discussed there is tacitly accepted. However, even if this is the case, by neglecting this issue, the problem of depriving the companies' top management of the knowledge on potential advantages and disadvantages of pay secrecy, as well as on the factors that may impact its implementation or revoking, still remains present.

A large number of Serbian companies, as well as other types of institutions and organisations, apply the pay secrecy policy, even though it is not prescribed by any law. Indeed, it is not prohibited, but it is left up to companies to regulate this policy through its collective agreement, work regulations, salary regulations, business policy, or some other document. Thus, for example, the Work Regulations of one of Serbian state agencies states the following: "Employee's salary is a trade secret. Revealing the data regarding the amount of the salary represents a breach of the trade secret" [2, p. 9].

Although it is little known and written about, pay secrecy is highly important. Pay secrecy policy can, as we shall see further in this text, have far-reaching consequences on the employees' motivation and performance, the company's human resources management efficiency, conflicts and climate in the company, but also on the employees' decisions regarding their careers [10]. At social level, pay secrecy can affect labour market efficiency and bring about (sub)optimal decisions by the employees regarding their career choice, and thereby also influence on the efficiency of human resources exploitation at the level of national economy [7]. Finally, pay secrecy issue is, just like any other salary issue, always an interesting

topic for both employees and managers, as well as for the general public.

Having in mind the great importance of pay secrecy, the controversies that surround it, and also the relative lack of research into this issue, there is a clear need to define pay secrecy, to highlight its potential advantages and disadvantages, as well as the factors that promote it and also those that pose an obstacle to pay secrecy implementation. All of this will be presented in the content of this paper.

## What is pay secrecy?

Pay secrecy is simply defined as withholding information from the employees regarding the compensations of all other company's employees [11]. Therefore, it can be said that pay secrecy policy is applied when the management, in a systematic and planned manner, withholds from the employees the information about the distribution of compensations within the company. A common, but not necessarily mandatory dimension of this withholding of information is the prohibition to ask for and disclose to others the information regarding one's own or other employees' salaries, since this is also a way for the employees to obtain the information regarding distribution of compensations inside the company. However, it is very important to understand that pay secrecy is not a "yes or no" situation, but that it must be observed as a continuum [7]. Therefore, it is incorrect to assume that pay secrecy simply exists or does not exist; rather, it can exist to a smaller or larger extent. Thus, an absolute pay secrecy will exist when an employee has no information whatsoever regarding the compensations in the company, save for his/her own compensations. Pay secrecy is non-existent when an employee disposes of absolutely all the information about the compensations of all the company's employees. There are many variants between the two extremes, and they are the very ones most commonly found in practice.

Pay secrecy may be said to exist in several forms, depending on what type of information is withheld [11] [3]. For example, a company may provide to its employees all the information regarding the compensation system

(criteria, salary rates, salary calculation methods and procedures), but deny the information regarding individual amounts of the employees' salaries and incentives. On the other hand, a company may provide different levels of information to the employees regarding different elements of the compensation system. To clarify the concept, we must provide a brief outline of the compensation system and its structure.

Most often, a compensation in a company consists of direct compensation and indirect compensation [4]. This paper will not take into consideration non-financial rewards that employees in companies receive in addition to their salaries, such as respect, praise, learning and development, and company image, since these are usually not included in the compensation system. We will neither consider indirect compensations (benefits and perquisites) since they are in part mandatory by the law (health and social insurance) and also very noticeable (company car, computers, telephones). Direct compensation is the money that employees receive in exchange for the work they do, and it usually consists of salary (or wage) and incentives. Also, a pay raise due to the increase of the costs of living may also be treated as a form of compensation. Salary is the compensation paid to employees for performing their work and tasks at their workplace, and it depends on the complexity of work, as well as on the working conditions. Salary should be equal for all employees who perform the same type of work, that is, for all who have the same job position, and it must not depend on the employees' performance. Incentive is a compensation which depends on the employees' work results and it is different for each employee. As the basis for incentive, an employee's work results can be determined based on the performance he/she shows at his/her workplace by applying both qualitative and quantitative criteria (pay for performance). If this is difficult or impossible to apply due to the nature of work, education or work experience may be applied as the basis for incentives. The assumption is that more educated, knowledgeable or more skilled employees, as well as the ones with greater experience, will also show better performance (merit increases, pay for knowledge, etc.). Incentives are paid either as permanent rewards (pay rise) or as a one-time compensation (bonus). If incentive pay is

determined directly, based on the work performance, it is most often paid as a one-time compensation (bonus), while if it is determined based on knowledge and experience it is most often paid in the form of a pay raise.

Pay secrecy also differs in respect of whether it includes all the elements of direct or indirect compensation or just some of them [7]. Absolute pay secrecy usually includes withholding the information from employees on both the salaries of other employees in the company, as well as of their incentive payments and other benefits and perquisites. However, it is more frequent that pay secrecy policy includes providing information to employees on how salaries are calculated, but withholding the information on individual amounts of salaries and of all other incentive compensation of all other employees, as well. A more liberal policy of pay secrecy would include disclosing to the employees the information regarding basic salaries of all employees, but withholding the information on their incentive compensation.

Regardless of how it is defined, pay secrecy has its advantages and disadvantages which we will present further in the text. Nevertheless, before moving on to elaborate the said notion, we must emphasise the fact that some pay secrecy effects could be observed both as an advantage and as a disadvantage, depending on the conditions in which the policy is being applied, as well as on the respective point of view. For example, pay secrecy may influence individual negotiations between an employee and employer regarding the amount of salary in the sense that it is an advantage for the employer and, at the same time, a disadvantage for the employee. Bearing this in mind, we will analyse the advantages and the disadvantages of pay secrecy.

### **Disadvantages of pay secrecy**

Disadvantages of pay secrecy are indeed numerous, and any company management must be fully aware of these. If, despite the knowledge of such disadvantages, they chose to apply pay secrecy policy in human resources management, they will at least know what risks they are taking. Pay secrecy policy may cause misconceptions about compensation distribution in the company, a decreased

sense of internal and external equity (or fairness), decreased motivation, decreased capability of the management to influence the employees' behaviour at work, decreased employees' loyalty and trust in the company, and it might also bring about faulty decisions by the employees regarding their career choices [7] and [5].

The employees' perception of distribution of compensations within the company are the first to be sacrificed on the altar of pay secrecy [9]. It has already been proven long ago that withholding compensation information in a company, and even the prohibition to exchange information regarding salaries among employees, will not stop the employees' efforts to identify their respective position in the compensation distribution within the company [18]. The reason for such behaviour is the strong need of the employees for distributive justice, that is, for the feeling that internal equity is accomplished. It is considered that internal equity of the compensation system exists when employees perceive that compensations are fairly distributed, or, in other words, that compensations are adequately allocated according to the value of work that the employees perform in the company, as well as on the basis of the results they achieve [4]. In order to evaluate the fairness of compensation distribution, the employees must be presented with information on compensation. When these pieces of information are withheld from them, the employees strive to find alternative ways to obtain them. The author's extensive experience in the consulting business has shown that there is not a single company in which prohibition of sharing and discussing salary information has stopped the employees from forming some kind of perceptions regarding compensation distribution, and hence also regarding its fairness. Unfortunately, such alternative ways of procuring information on salaries are often unreliable: assumptions, stereotypes, speculations, gossiping, indirect deduction, etc. Due to the lack of accurate information, the erroneous ones are often the basis for creating the employees' perception on compensation distribution in a company. Research conducted in the past have shown that, due to the lack of accurate information on compensations, both managers and employees are inclined to overestimate other employees' salaries, and underestimate their own [16]. This is the main problem

arising from pay secrecy, since the very matter is the cause of nearly all other issues.

The first direct consequence of misconceptions about compensation distribution within a company is the negative perception of distributive justice and negative evaluation of internal and external equity guaranteed by the compensation system. Distributive justice has its informational, procedural, and distributive component [7] and [8]. Pay secrecy directly disables achieving informational justice since important information are withheld from the employees. Procedural justice is jeopardised since the employees are obviously denied the right to participate in the compensation distribution process, and thus their impact on making decisions regarding compensations is reduced. Finally, the distributive component is also at risk for two reasons. First, in the absence of reliable information about one's own and other people's salaries, an employee will naturally overestimate the compensations of others and perceive himself/herself more as the inflicted party than as a beneficiary [9]. On the other hand, in the presence of informational and procedural unfairness, the employee naturally believes that distributive injustice must also exist [18]. The employees' reasoning might be the following: If the management is withholding information about the compensation system and if I have no influence whatsoever on the compensation, it must be because this system is unfair to me. Thus, internal equity of the compensation system is jeopardised by the fact that, by not having the correct information, the employees are more prone to believe that the system is unfair (to their detriment) than vice versa. Internal inequity is in addition indirectly correlated with external equity, which refers to comparability between compensation within a company and the compensation for the same or similar work in other companies [4].

The perception of absence of distributive justice, or of internal equity inside the compensation system, has a direct negative impact on the employees' motivation, as well as on their job satisfaction. In order to understand this effect, it is necessary to briefly look back on one of the most important motivation theories – equity theory [1]. According to equity theory, employees' motivation does not depend on the total amount of their earnings as

much as it depends on the relative relationship between the efforts they put in (inputs) and the rewards (outcomes) they receive for it. Hence, employees with low salary may be much more motivated and satisfied than the ones with high salary if the former ones perceive that their input is at a lower level than the salary they receive. On the other hand, someone may have a very high salary, but still be unmotivated because they perceive that the input (efforts, work, time, education, experience) they bring in to the company is substantial and that their salary does not correspond to the said input. What makes matters more interesting is the fact that employees compare not only their own inputs and outcomes, but those of other people, as well. They develop perception of their own input/outcome ratio and compare it to the input/outcome ratios of their co-workers with whom they compare themselves. The result of this comparison is threefold: equity, underpayment or overpayment. The feeling of equity guarantees motivation and it is present when employees perceive that their input/outcome ratios correspond to that of their co-workers. However, underpayment, which implies that employees perceive that they invest the same amount of input in return for a smaller reward, or larger input for the same rewards, leads to decreased motivation. Therefore, the employees who perceive that they are underpaid will try to restore the balance of input/outcome ratio by requiring a greater reward for themselves, and if they do not get it, they will reduce their input to the level they see fit as corresponding to the rewards they receive. The case is similar with the impression of overpayment: even though the employees perceive that they bring less input for the same reward or the same amount of input for a greater reward, they will soon persuade themselves that their input is actually greater than that of their co-workers and hence that a greater reward is also justified. According to equity theory, it is extremely important for the employees' motivation that they develop a realistic perception of their own and of other people's inputs and outcomes (compensation). Pay secrecy represents a direct obstacle to achieving this goal. We are not saying that employees cannot develop a mistaken perception of inputs and rewards when pay secrecy is not applied, but this wrong perception is highly more likely to occur in the event of its application.

Underpayment reflects on motivation in another negative way: it decreases job satisfaction. Job satisfaction is a complex construct, because it emerges from the employees' evaluation of whether their jobs provide them with what is important to them [14]. Many often overlook the fact that what employees expect from their jobs is not just a salary, but also social contact, friendship and acceptance, possibilities to learn and improve themselves, praises and recognitions for the job well done, respect, etc. Therefore, there are several job dimensions whose importance varies depending on the employees' perspective, whereby employees evaluate to what extent their expectations are fulfilled in each of the said dimensions. Absolute job satisfaction is the outcome of the satisfaction with individual job dimensions. When underpaid, the employees will surely not be satisfied with salary as an important job dimension. However, here we would like to point to another job dimension: respect and recognition. Employees have a legitimate need for their work and results to be recognised and appreciated. In this sense, compensation is not just a sum of money that enables the employees to satisfy their basic needs, but it is also a symbol. Compensation symbolises the level of respect and recognition. If employees feel that they are underpaid, even if their compensation is high, they will not be satisfied because the compensation tells them that they are not appreciated, respected, and recognised enough in their company.

Compensation system, like other human resources management systems in a company, serves not only to motivate the employees, but also to manage and steer their behaviour [15]. By designing the compensation system, employees can be incited and motivated not only to perform their work and tasks, but this can also be used to influence the way in which the employees perform the said work and tasks. The compensation system rewards one type of work behaviour, and penalises the other, and thus effectively guarantees that employees will not only complete their tasks at work, but that they will do it the way the company expects them to. Compensation system affects the employees' behaviour in two different ways. First, the compensation system directly guides the employees towards a certain pattern of behaviour by rewarding some and penalizing other forms of behaviour. As rational people, employees

will try to practice the behaviour that the compensation system rewards, and avoid the ones it penalizes or does not reward. If a company's compensation system defines bonuses for the salespeople with the smallest stock, and penalties for the ones with the largest stock of goods, then they will surely pay attention to the stocks of the goods they sell. If this element is absent in the compensation system, then the salespeople will disregard the stock quantity. The other way in which the compensation system influences the employees' behaviour is symbolic. The compensation system always sends the message of what is and what is not appreciated in the company. If the compensation system defines a bonus for regular work attendance (even such companies exist), then the message the employees receive is very clear: discipline is more important than performance. If, however, a bonus is received depending on the initiatives undertaken and innovations introduced, the employees receive a clear message that initiatives, innovativeness, and creativity are what is expected from them and what is appreciated.

When the compensation system is kept secret, and especially when incentive or variable payments (that is, the portion of compensation which depends on the employees' performance) are not transparent, then the message that such system sends to the employees regarding their desirable behaviour remains blurred and unclear. If the employees are uncertain of the bonus awarding criteria in the company, then they will not have clear guidelines on how they are supposed to do their job and they will not know how they are expected to behave. In doing this, the management fails to take advantage of the opportunity to steer and manage the employees' behaviour by means of the compensation system, especially through incentive payments. If an employee is not sure why he/she received a bonus for one month (or quarter) while not receiving it for some other month (or quarter), then the compensation system has no effect on the behaviour of such employee. Additionally, the effect of following other people's example should not be neglected. If pay secrecy is absent, the employees will be able to see when, why and how much of a bonus their colleague received. In this case, since they also want a bonus, the employees will strive to perform their work in the way that provides such bonus. By openly

rewarding desirable behaviour of one or several employees, the management steers the behaviour of all or most of the other employees. Pay secrecy completely hinders this effect, and leads to confusion and uncertainty regarding the way in which the employees should perform their tasks.

Uncertainty with respect to compensation distribution and expectations regarding performance and behaviour that pay secrecy implies lead to a decrease in the employees' loyalty and trust in the company [6]. If the manner in which rewards are distributed in a company is kept secret, the employees will be uncertain regarding such rewards, and this is no way conducive to creating an ambience of trust. Respect should also be added to the list. Namely, when information about compensations in a company are withheld from the employees and when asking for and revealing the information regarding one's own and about other people's salaries are prohibited, the most logical question to ask oneself is the following: "Why mustn't I know that?" Of course, in such situations any responsible adult would reach to a conclusion that the organisation does not trust him/her. The logical consequence is that the employee starts to distrust the company. In addition to this, absence of trust is the immediate cause of decrease in one's loyalty to the company, which is defined as the employee's expressed willingness to be retained in the company, to invest more effort into the achievement of the company's goals, and to identify oneself with the respective company [13]. Diminished trust and loyalty produce several negative effects: decrease in the employees' motivation, greater workers' fluctuation, higher inclination to opportunistic behaviours, etc.

Another negative impact of pay secrecy is that it contributes to creating of authoritarian and paternalistic organisational culture. As it was mentioned before, pay secrecy sends a message to the employees that there are compensation related issues they are not supposed to know about, and that the management is taking care of everything. By excluding the employees from an important aspect of work within the company such as compensation distribution, and by placing this business aspect exclusively into the hands of the management, the employees are forced into a passive position where they depend on the management's authority. Pay secrecy sends the following

message to the employees: You should not think and you should not know – someone else thinks and knows for you. Authoritarian and paternalistic values in the organisational culture are strengthened through the said actions. This is especially true for national cultures such as Serbian, in which the values of collectivism and authoritarianism prevail at a national level [12]. Authoritarian culture may seem appealing to the management because it produces obedient employees who follow orders without asking any questions. However, we must always bear in mind the other side of the coin. Authoritarian and paternalistic culture is indeed conducive to obedience, but also to passivity and heavy dependence on the authority. The employees who work in an authoritarian and paternalistic culture perceive the organisation as a patriarchal family, its leader as the “*pater familias*” (father of the family), and themselves as family members (children). And just as the father of the family can fix any problem in the eyes of his children, without ever asking his children for their opinion, and just as the children should be obedient and simply let the father take care of their needs, so is the relationship of infantile dependence between the leader and employees established in an authoritarian and paternalistic culture. The consequence is that the employees are passive, with no ideas and initiative, reluctant to make changes and take risks. No smart manager wants such employees. In addition, authoritarian culture usually produces a spin-off effect: the more competent employees are not satisfied because they cannot actualise their potential, and hence they soon leave the organisation in order to create their own in which they will be able to exploit their talents better. The management is then left with mediocre employees who are comfortable with the situation in which no one asks them for their opinions and where they simply follow instructions.

One negative effect of pay secrecy does not relate to the company, but it rather concerns the employees and the economy at large, as well. We are now referring to the negative impact of pay secrecy on individual decisions of the employees regarding their job choices and career planning, as well as to the optimal allocation of the workforce in the labour market [20]. Namely, every employee makes his/her own decisions regarding job choices and

career planning. The employee makes these decisions based on his/her own preferences, but also based on the information about the labour market, company, types of job, etc. One of the important factors which influence the employees’ decision, for example, to change jobs or to move to another company is the compensation. In a situation where salaries are kept secret, the employee will simply not dispose of enough credible information to make these decisions properly. The resulting consequence will be mistaken or suboptimal decisions, observed from the aspect of the employee’s goals and interests. For example, an employee may lack information about compensations in the company and be convinced, contrary to the reality, that the company underestimates him/her and therefore seek job opportunities in another company just to discover that he/she will be even more underappreciated there. However, observed from the perspective of the economy in general, these decisions may lead to suboptimal allocation of the workforce as a labour market resource. Pay secrecy decreases the efficiency of the labour market as workforce allocator, especially in the long-run.

### Advantages of pay secrecy

No company management would implement pay secrecy policy if it did not bring some sort of advantages to the company and its managers. The following advantages are most commonly observed in practice: improved organisational control and less conflict, greater possibilities for differentiation between good and bad workers, ensuring employees’ privacy, and reduced turnover of the employees [7]. Another convenience which occurs in certain companies, especially in small privately-owned businesses, should be added to the list: better position of the employer during salary negotiations with the existing or potential employee.

The less information the employees have, the more easily they are controlled by the management. Withholding information and disclosing only the selected details is one of the main forms of manipulation through which the management can guide the employees to act the way the management wants. When denying to the employees the right to have discussions on certain matters is added to

this set of actions, it is clear that pay secrecy is conducive to more efficient control of both the employees' individual behaviour and interactions between them, and through this it also leads to more efficient control of interpersonal processes in the organisation. After all, in political circles it is a well-known fact that all totalitarian dictatorships strive to limit information (although today, in the Internet era, this is virtually impossible to do) which reach their citizens because it is a tool to keep them subdued [21].

Since compensation distribution is one of the most frequent sources of conflict in an organisation, the secrecy of compensation distribution decreases or completely eliminates conflicts inside the organisation. When employees are not in possession of information on salary and are, in addition, prohibited to give, ask for or discuss them, then there is no room for discussions and conflicts. This, in turn, creates the ambience which the management prefers – a one without conflicts. Conflicts have a wide range of negative aspects, such as disturbing the normal functioning of the company, diverting the attention from the company's to personal goals, supremacy of emotions over reason in the decision-making process, problem personalisation, as well as negative effects to people's mental and physical health [15]. Even though conflicts might result in some positive outcomes, such as initiating changes, the managers aim to avoid conflicts whenever possible. Pay secrecy enables them to achieve this at least when compensation is concerned.

Pay secrecy enables managers to employ compensation to differentiate the good from the bad workers in a simpler and extensive manner. If we assume that the management is willing to reward the best employees through compensation, and especially through incentive payments, the logical obstacle to this is the negative reaction of all those who did not receive a reward (or who even received a penalty). After negative reactions, conflicts between the employees and managers, and also among the employees themselves, are inevitable. When pay secrecy is applied, there is no such reaction, because those who would otherwise respond negatively are not aware of the rewards being received. Consequently, there are no conflicts that would certainly ensue if the pay secrecy policy was not applied. This is why, when pay secrecy is applied, the managers

can safely and without fear from the employees' reaction, reward the desirable behaviour and performance of the best workers. It has been empirically proven that, in the absence of pay secrecy, managers show tendency to narrow the salary spread between the best and the worst employees in order to avoid conflicts [17]. This is especially important in collectivistic and egalitarian cultures such as the Serbian one. Collectivism implies that cohesiveness of the collective (unison, brotherhood) is highly valued, whereas anything that disturbs this cohesiveness is not welcome [12]. Salary differentiation is, by all means, such occurrence. On the other hand, the values upheld by egalitarianism imply equality in distribution of material goods. It is not desirable that an individual stands out in the sense of receiving a higher salary, even though this may be justified by a more outstanding work performance. Therefore, the pressure to uniform compensations is far greater in collectivistic and egalitarian cultures than in individualistic ones (mostly Western, and especially Anglo-Saxon cultures) that promote equal opportunities and not equal rewards. This is the reason why managers in Serbia have greater difficulties than their colleagues in the Western world to differentiate better workers by means of higher salaries, and hence pay secrecy is more valuable to them.

If the positive effects of pay secrecy on distinguishing better workers are greater in collectivistic cultures, its positive effects on privacy are greater in individualistic cultures. Namely, it is often emphasised that pay secrecy enables greater privacy for the employees and better protection of their personal interests [23]. This is certainly true: if no one but the employee knows the amount of this person's salary, their privacy is guaranteed. Positive effects of pay secrecy on privacy protection, however, depend on how much the employees value the said privacy. Privacy is certainly more important in individualistic than in collectivistic cultures. This might be explained by the difference of where the borderline between the private and the public is set in collectivistic, on one hand, and in individualistic cultures, on the other [12]. In individualistic cultures, the sphere of individual's privacy is much larger and includes a substantially wider information spectrum than in collectivistic cultures. In a collectivistic culture it

may well happen that the prevailing assumption is that personal earnings are not a private matter and that pay secrecy makes no sense, at least not as a means of protection of privacy. Pay secrecy in collectivistic culture should, therefore, protect the privacy of information on something that is not private, but public. For the same reason, it is more difficult to implement pay secrecy in collectivistic cultures. A particular challenge is to prohibit asking for and disclosing information on compensation among the employees, as well as discussions on the issue because the employees do not consider this matter private.

From the companies' perspective, one positive effect of withholding the information on compensation is the decrease in the turnover of employees. Namely, when the information on compensation system are withheld from the employees, their motivation and tendency to leave the company are reduced. In the absence of information regarding distribution of compensation inside the company, and often even outside the company, the employees often find themselves in a state of uncertainty. It has been proven that the absence of information on compensation in a company is often accompanied by a lack of information on compensation outside the company, that is, in other companies in which an employee could perhaps seek new employment. This situation of uncertainty discourages the employees to make decisions which involve risk, and switching the company and/or the job is certainly one of such decisions. When an employee is uncertain regarding the compensation distribution, his fear and insecurity grow and this certainly does not contribute to his/her desire to leave the company. Although this consequence of pay secrecy is negative for the employees, because they are individually denied the opportunities to make optimal decisions regarding their career choices, it is certainly positive for the company. The reason for this is that high turnover of employees is negative for the company in many respects [15]. High workforce turnover creates additional cost to the company which arise from the need to recruit and select new employees. Also, as a rule, the newly employed workers are less productive, at least during the period of socialisation and learning the new work, and there are also additional training expenses for the newly employed. The risk of making mistakes in the selection

of new employees, and also the issue of whether they will successfully blend in with the organisation's culture or not, are also observed as negative consequences of workforce turnover. Also, a problem in its own right can be the loss of specific knowledge or skills that an employee who is leaving the organisation possesses, but that no one else in the organisation can offer. For all the above mentioned reasons, it suits the company's management if the employees show as little as possible tendencies to leave the organisation and, as we have seen, pay secrecy contributes to this purpose.

Finally, a positive effect of pay secrecy, again for the company but not for its employees, is the strengthening of the management's position in negotiating with individual employees regarding their salary and working conditions. This effect of pay secrecy may be exploited only in the absence of collective negotiations between the employer and the employees (trade union), which is most often the case in small private companies. If pay secrecy is applied, the employer (owner or manager) can take full liberty to use his/her negotiating skills to reduce the level of the employee's compensation to the smallest possible amount. A possible outcome in this situation could be that a person A and a person B do exactly the same job in the company and receive very different compensations for their work, depending on how skilled they were while negotiating with the employer during their job interviews. In the absence of pay secrecy, the person earning less money will be highly unsatisfied, so he/she would complain or resign. This is why it is very important for the employers to withhold information about other employees' compensation packages, but also to prevent discussions on compensation among the employees of the company.

### **Factors relevant to pay secrecy: pros and cons**

Since pay secrecy produces both negative and positive effects, the decision on the application of pay secrecy depends on whether the pay secrecy advantages in a specific company prevail over the disadvantages or vice versa. The company management should evaluate the importance of all the negative and also of all the positive effects of pay secrecy in the process of deciding about its

pros and cons. The decision should be based upon the prevalence of either positive or negative consequences. The present situation in a company and the company-specific factors shall determine the importance of both negative and positive effects of pay secrecy. This practically means that evaluating the pros and cons of pay secrecy depends on the situation in which a company finds itself or, more precisely, it depends on the specifics of the situation factors for the given company. Therefore, in order to make the proper decision regarding pay secrecy, besides being aware of pay secrecy effects, the management should know which situation factors are relevant to the selection of pay secrecy policy. We will now list just a few obvious ones. These factors mainly emphasise the importance of some positive and negative effects of pay secrecy, and thereby play a determining role in the choice regarding pay secrecy.

The first factor to be considered is certainly the set of qualities of a company's workforce, such as their qualifications or level of education [7]. This factor highly correlates with job aspects and job design, and properties of the company's technology. When all other factors are equal, the companies in which highly educated experts constitute the majority or a very significant percentage of the employees may implement the pay secrecy policy, because of the fact that the human resources character neutralises to a large extent some key negative effects of pay secrecy. The reasons for this are numerous, but we will mention three main ones: nature of motivation, control mechanism, and labour costs. Highly educated experts (professionals) who perform, with a high degree of autonomy, non-repetitive and creative jobs and tasks at job positions that are not highly specialised, and who use sophisticated technology are mostly intrinsically motivated. Therefore, they are driven by the motivators categorised as higher-level needs in Maslow's hierarchy: self-actualisation, development, learning, status, and non-material needs [19]. Since salary does not play such a significant role in their motivation, pay secrecy will not have a negative effect on their perception of distributive justice, motivation, and loyalty and trust in the organisation. Similarly, human resources specifics, job and tasks' design, as well as technology also decrease the negative effects of pay secrecy on possibilities for controlling the employees.

It is not possible to control professionals only by means of compensation; hence pay secrecy, which reduces the possibilities to control the employees' behaviour, is not something to be considered vital. Managers may exert influence on the professionals by granting them autonomy at work, providing them possibilities for further learning and advancement, accepting initiatives, and also by praising – in other words, they *can* influence the professionals by means of salary, but only to a certain extent. In this case, implementation of pay secrecy will not decrease the capability of the management to control the work and behaviour of the employed professionals. Finally, the process of recruitment, selection, training, and development of a professional requires a considerable amount of time and it is extremely expensive. It takes years to create a good professor, lawyer, or company consultant, and hence the company cannot afford to let them leave the company so easily. Since pay secrecy decreases turnover of employees, it is reasonable to introduce it in this type of companies. It is quite the opposite in the companies in which the majority of employees are low-skilled workers who perform simple, repetitive tasks at highly specialised job positions by using simple technology. For this type of employees, salary is a highly important motivator, and all the negative effects that pay secrecy has on motivation are extremely noticeable here. The most efficient way for the managers to control such workforce is precisely by means of compensation, and therefore pay secrecy is a poor solution in this case. Finally, since the cost of recruiting and training of low-skilled workers are not very high, the company can afford even a high level of workforce turnover, which also creates the basis for pay secrecy.

The second critical factor that might influence the decision on pay secrecy implementation is the trust that employees have in the company and its owner(s) and/or management. If the employees' trust in the company (that is, its management or the owner) is very high, if there are no tensions and conflicts between the management and employees, and if majority of the employees are loyal to the company, then pay secrecy may be implemented without negative effects on motivation, employee satisfaction, and productivity. But if the employees' trust in the company is low, if tensions and conflicts between the management

and employees are frequent, and if the employees are not loyal to the company, then all the negative effects of pay secrecy will be even more prominent. This is why such companies are advised not to implement pay secrecy. In such a company, pay secrecy would be yet another reason for conflicts between the employees and the managers/owners. The company's history and track record certainly have a great impact on the level of the employees' trust in the company. If a company's management has made some unfair moves in the past (from the employees' perspective), if there have been recent lay-offs, if salaries are not paid regularly and on time, it is only natural that the employees cannot have much trust in the company. Major organisational changes also contribute to the lack of trust, since they are always accompanied by conflicts and clash of power where some individuals and groups win while other lose. The employees' trust in the company and its management often depends on the leader's and/or owner's personality. If the leader is a person of high integrity, consistency and charisma, the employees may develop trust and loyalty not so much to the company, but rather to the leader. In such case, pay secrecy is easier to implement, since the employees believe that their leader would not deceive them.

As we have already explained earlier, pay secrecy is conducive to the establishment of authoritarian culture and paternalistic leadership. But the opposite influence is also present: authoritarian organisational culture and benevolent authoritarian leadership style strengthen the tendencies to implement or strengthen pay secrecy. Pay secrecy is compatible with authoritarian cultural values and management style. Authoritarian leader is far more inclined to implement pay secrecy than the leader with democratic or participative management style. In authoritarian culture, even the employees observe pay secrecy as something natural and compatible with authoritarian leadership style. On the other hand, if the values of employees' participation in decision-making, autonomy, and people development prevail in a company, and if the leader practices participative leadership style where employees are included in decision-making and are allowed to have autonomy in their work, then pay secrecy is not recommended. In this case, pay secrecy

would cause a great resistance in the employees, and its negative effects would come to the fore. Democratic culture and leadership in which an individual is treated as an autonomous personality cannot be developed if the information on compensation are at the same time concealed from the employees.

Trade unions of employees within a company may also be the factor that would influence the management's decision about the pros and cons of pay secrecy. If there is a trade union (or several of them) in a company, if it is strong and well organised, the possibilities for pay secrecy implementation are significantly decreased. The assumption is that trade unions genuinely represent and protect the workers' interests. If this is indeed the case, trade unions will actively oppose pay secrecy, and their power and influence in the company would determine whether or not the management will benefit from entering into a conflict with the trade union on the issue of pay secrecy.

Besides the factors that are company-specific and which determine whether or not the management of a certain company should implement pay secrecy, there are also other factors that are equally relevant to pay secrecy in all the companies in a given economy. These contextual factors may also work in favour of or against pay secrecy.

Labour market is certainly an important factor that impacts pay secrecy in Serbian companies. The following applies as a general rule: the higher degree of unemployment, the wider the opportunities to implement pay secrecy. To put it more simply, in an environment where unemployment rate is high, the employees have less room to manoeuvre when it comes to switching jobs and companies, and hence their resistance to pay secrecy is weaker. The employees' motivation and their productivity will not be reduced due to pay secrecy because they are aware that if they lose their current job, it will not at any rate be easy to find another one. Since the unemployment rate is very high in Serbia, it is clear that our companies favour pay secrecy as a tool to influence the labour market. This might not apply to all industries, all types of companies, and all profiles of employees in companies. For example, labour market will not have a positive impact with respect to pay secrecy in the companies doing business in the sector of information

and communication technologies, but this applies only to IT professionals.

National culture, with its values, may act in favour of or against pay secrecy in all the companies in the country. As far as Serbia and influence of our national culture are concerned, this may be described as controversial. Namely, Serbian national culture is marked with a high power distance (authoritarianism), high uncertainty avoidance, collectivism, and the so-called “feminine values” [12]. A high degree of authoritarianism in our national culture is the root-cause of a large number of our companies developing authoritarian organisational culture, as well as the authoritarian leadership style. People in Serbia prefer to have a strong leader who will solve all their problems instead of them. This works highly in favour of pay secrecy. Expressed uncertainty avoidance means that people in Serbia do not like changes, uncertainty, risk, ambiguity, and diversity [12]. Since pay secrecy introduces some degree of uncertainty, it is clear that this cultural value inhibits pay secrecy. The increase in uncertainty caused by pay secrecy would be faced with a tough resistance of the employees and emphasise negative effects of pay secrecy. Collectivism has a similar impact on pay secrecy. Namely, in collectivist cultures, the cohesion of the group (unison) is very important, and pay secrecy greatly jeopardises it. Collectivism is also often accompanied by egalitarianism, that is, by striving to make all the members of the collective equal in their earnings as much as possible and to erase all the differences between them. This in turn also advises against pay secrecy because it causes doubts in differentiation between the members of the collective. Finally, the presence of feminine values in a national culture means that people hold in high regard the social relations and harmony between people and nature more than they appreciate result, success, and material gains [12]. In such culture, pay secrecy is less problematic for the employees, since other values are more important to them than material ones. In summary, authoritarianism and femininity in Serbian national culture work in favour of pay secrecy, while uncertainty avoidance and collectivism inhibit pay secrecy in Serbian companies.

Transition of the Serbian economy from the socialist to the capitalist model represents an element

of the context in which Serbian companies do business and which stimulates them to implement pay secrecy. Institutional theory of organisation and change defines the concept of institutional pattern [22]. It is a set of mutually consistent practices, rules, and structures that show how processes should be performed in certain social and business circles. In the modern market economy, institutional pattern of the organisation shows how a company should be structured and how it should function. It is interesting that institutional pattern is being created in a process that is not necessarily objective, and that this process does not necessarily have to be rational or economically efficient. It may even, and it often does contain rationalised myths [22]. However, companies must implement it in order to prove their legitimacy to society. Great changes occur in the society, economy or organisations within them when the institutional pattern of society, economy or organisations is changed. Therefore, transition may be understood as the process of institutional changes in which the existing institutional patterns (socialist society, economy, or company) are replaced by other, capitalist patterns. It is a feature of the socialist pattern of a company that the society has external control over the processes within the company. This form of control was formally conducted by the Social Bookkeeping Service. In such a pattern, compensation of all the employees in a company were public. In the institutional pattern of capitalist companies there is no external control of companies' procedures (hence the Social Bookkeeping Service was dismissed in Serbia at the beginning of the transition process), and compensation is kept secret. It is possible that this is just a myth, but nevertheless it is something that the managers and employees in Serbian companies believe in and something that they strive to adapt to. Just as they have adopted board of directors instead of workers' councils, managers instead of directors, human resources department instead of personnel department, Serbian companies are also adopting pay secrecy. So, if a company (and its management) wants to prove that it is legitimate, modern and a true capitalist company, then it must implement pay secrecy. This is the factor that steers all the companies in Serbia towards pay secrecy.

## Conclusion

Pay secrecy is a very interesting and controversial element of human resources management in modern companies. Defined as withholding the information from the employees on different compensation aspects in the company to a smaller or larger extent, pay secrecy is applied in a great number of companies, both throughout the world and in Serbia. Pay secrecy offers advantages and disadvantages to both the employees and also to the company and its owners and managers. Therefore, the following questions are rightfully asked: Does pay secrecy pay off? Do advantages of pay secrecy surpass its disadvantages and under what circumstances? In which situation should a company choose pay secrecy and when should the company avoid it? This paper represents an attempt to answer these questions.

Disadvantages of pay secrecy are numerous. The main negative effect of pay secrecy is the misconception of compensation distribution in the company, which gives rise to negative evaluation of distributive justice, decrease in employees' motivation and job satisfaction, diminution of the employees' trust in the organisation and its management, and decline in loyalty. Also, pay secrecy deprives the management of a very important tool for controlling and guiding the employees' behaviour, which in turn become less efficient. Pay secrecy brings about the feeling of underappreciation and uncertainty in employees. It also contributes to creating an authoritarian organisational culture and leadership style. Finally, pay secrecy jeopardises the employees' capacity to make rational decisions regarding their job and career choices.

Pay secrecy also has its advantages. It enables the management to exert a higher degree of control over the organisational processes, and it also causes less conflict. Moreover, pay secrecy enables managers to differentiate, to a larger extent, the employees showing good from those displaying bad performances, and this is especially true in collectivist cultures such as Serbian. Also, pay secrecy decreases the turnover of employees, which is a very positive effect for a company. Finally, pay secrecy provides the management or company owners with a more favourable position in negotiations with potential employees regarding the conditions of their employment.

The factors that impact the pros or cons in making the decision on pay secrecy can be company-specific, but also contextual factors that produce equal effect on all the companies in the Serbian economy. Among the company-specific factors, the most prominent are the following: workforce characteristics, job design and technology used, organisational culture and leadership style, the degree of the employees' trust and loyalty to the company which is determined by the history of interpersonal relationships, and power and the level of organisation of trade unions. Pay secrecy will be a good solution when the workforce is highly educated and/or performs complex and creative tasks by using sophisticated technology, when autocratic culture and leadership style are applied in organisations, when the degree of the employees' trust in and loyalty to the company are high and when there is no history of conflicts between the employees and management, when there were no recent dismissals and layoffs, etc. Finally, pay secrecy is a good solution when trade unions are weak, disorganised or non-existent. In the event when the workforce is low-skilled and/or performs simple, routine tasks by applying simple technology, when autocratic culture and leadership style are not applied in organisation, and when the degree of the employees' trust in and loyalty to the company are low, while trade unions are strong, then pay secrecy is not a good solution.

Contextual factors that equally influence the decisions of all companies on whether to accept or refuse to apply pay secrecy are the following: labour market, national culture and transition from socialist to capitalist institutional patterns of management. Labour market, as well as moving away from socialist and accepting institutional patterns of capitalist companies, act simultaneously in the favour of pay secrecy implementation. National culture has a controversial impact, since authoritarian and feminine values have a positive impact, while collectivism and uncertainty avoidance have a negative impact on pay secrecy.

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