Paying Up For Fair Pay: Consumers Prefer Firms With Lower Ceo-To-Worker Pay Ratios

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Forthcoming legislation will require American public companies to disclose the pay ratio of CEO to average employee wage in the coming years. Across three experiments, including one incentive compatible study, we identify when and why consumers purchase behavior is affected by such disclosure.

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EXTENDED ABSTRACT

Starting on January 1, 2017, public companies in the United States will be required to disclose the ratio of the total compensation of the CEO to the average annual compensation of all other employees in their annual reports. We propose that disclosing high pay ratios will have a marked impact on consumer behavior, given that previous research shows that consumers believe pay ratios are far lower than they actually are (Kiatponsan and Norton 2014). In fact, consumers’ ideal ratio of CEO pay to average unskilled worker pay is 4.6 to 1, while their estimated actual ratio of CEO pay to average unskilled worker pay is 10 to 1 (Kiatponsan and Norton 2014). Note that these estimated ratios are far lower than the average pay ratio across US firms, which is estimated to be approximately 331 to 1 (AFL-CIO 2014). Perceived fairness plays a critical role in shaping consumer behavior; generally speaking, individuals prefer equitable to inequitable distributions of outcomes (Adams 1965). Fairness increases individuals’ happiness (Tabibnia, Satpute, and Lieberman 2008) and reduces negative affect (Sanfey et al. 2003). Thus, we hypothesize that the CEO-to-worker pay ratio spurs fairness considerations and that consumers perceive high pay ratios to be less fair than low pay ratios. Perceived wage fairness, in turn, will drive consumers’ purchase intentions and willingness to pay, thus mediating the effect of high (vs. low) CEO-to-worker pay ratios on consumers.

Disclosing pay ratios is not without potential downsides to the firm. It is possible that while disclosing low pay ratios enhances firm perceptions among some consumer segments, it may backfire with others. Political ideology is an important individual-specific factor: for instance, liberal Americans are more likely to support increases in the minimum wage (and therefore lower pay ratios) than conservative Americans (Kaziemko Norton, Saez, and Stantcheva 2015). Given the central role that political ideology plays in consumption (Crockett and Wallendorf 2004; Hirschman 1993) and the fact that different persuasive messages have different appeal to different political affiliations (Kidwell, Farmer, and Hardesty 2013; Winterich, Zhang, and Mittal 2012), it is possible that while low pay ratios may appeal to liberal consumers, they may serve as a deterrent to more conservative consumers.

In this paper, we test the effect of disclosure of pay ratio on product and brand desirability in three experiments.

In Study 1 we tested whether the disclosure of pay ratios can causally affect consumers’ willingness to pay in a controlled, incentive-compatible context. We sold gift cards to two retailers that vary in their real-world pay ratio – Urban Outfitters (with a pay ratio of 15:1) and GAP (with a pay ratio of 456:1; AFL-CIO 2014) – and varied the presence of pay ratios by revealing this information or not. Participants (N = 232, M_age = 35.63, 42% male) completed this online experiment in exchange for $0.50. We used the log of the amount participants bid on the gift card. We also measured perceived wage fairness: participants indicated their perception of wage fairness on a 7-point scale.

We conducted a 2(Ratio Presence: Absent vs. Revealed) by 2(Pay Ratio: High vs. Low) ANOVA on the amount participants bid on the gift card. A linear regression with an interaction between both factors showed that revealing the pay ratio lowers the amount participants bid when the pay ratio was high relative to when the pay ratio was low (β_revealed - low = -0.153, t = -0.833, p = 0.41; β_revealed - high = -0.049, t = -0.272, p = 0.79; β_revealed × low = 0.579, t = 2.230, p < 0.05).

We used moderated mediation to examine whether perceived wage fairness mediated the effect of high and low pay ratio on the amount participants bid on the gift card depending on pay ratio presence. A 5,000-sample bootstrap analysis revealed that the 95% bias-corrected confidence interval for the indirect effect did not exclude zero when no pay ratio was revealed [-0.01, 0.16] but excluded the zero when the pay ratio was revealed [-0.60, -0.48]. The direct effect of the pay ratio (high vs. low) became insignificant [-0.44, 0.26], indicating moderated mediation (Preacher and Hayes 2008).

In Study 2, we tested whether these effects hold across different product categories and price ranges. Within subjects, participants assessed 12 products. The products represented a wide range of categories and prices: listed retail prices for similar products sold online ranged from $3.99 (cereal box) to $499.99 (flat screen television). Between subjects, we once again manipulated pay ratio to be either low or high. We again found a significant main effect on willingness to buy of disclosing a high pay ratio (F(1,149) = 5.43, p = 0.02). Importantly, the interaction between product type and pay ratio was not significant (F(9,141) = 0.66, p = 0.75), indicating that the impact of pay ratio disclosure was not significantly different across product categories.

In Study 3, we tested whether a low pay ratio will alienate certain customer subgroups. Prior research shows that people have varying perceptions of inequality; for instance, Republican voters desire relatively less equal distributions of wealth than their Democratic counterparts (Norton and Ariely 2011). We find that in three of the four subgroups by political affiliation (Democrat, Independent, Other) there were significant differences in willingness to buy between the high-pay-ratio and the low-pay-ratio retailer, with participants more willing to buy in the high-pay-ratio condition (p’s < 0.02). In the Republican subgroup, there was no significant difference in willingness to buy between the high-pay-ratio and the low-pay-ratio retailer (M_lose = 5.36, SD = 1.32 vs. M_win = 5.36, SD = 1.68; t(45) = -0.01, p = 0.99). Thus, a low pay ratio increases positive perceptions of most customers without harming perceptions of other customers.

In sum, our results suggest that pay disclosure can have benefits: firms with low pay ratios stand to garner improved consumer perceptions via disclosure relative to firms with very high ratios.

REFERENCES


