EPoS
Collaborative Research Center Transregio 224

Economic Perspectives on Societal Challenges: Equality of Opportunity, Market Regulation, and Financial Stability - EPoS

UNIVERSITÄT BONN

UNIVERSITÄT MANNHEIM

INTERVIEW

18. January 2024

How companies lose staff due to their wage-setting practices

Interview with Germán Reyes, EPoS Economic Research Center

Bonn, Mannheim, 18.01.2024 – ***Companies tend to set wages at round numbers which leads to clusters of salaries. A possible reason: This simplifies decision-making when it comes to negotiating pay. As a downside, these companies have higher employee turnover, lower growth, and lower survival rates — as Germán Reyes from the EpoS Economic Research Center finds in data from Brazil. His research results are published in the discussion paper "Coarse Wage-Setting and Behavioral Firms".***

Mr Reyes, wage setting practices seem to be far from optimal…
Germán Reyes: Indeed, the analysis of data from over 200 million new hires in Brazil shows exactly that. Employers often set salaries at even, easily remembered figures like $30,000 or €40,000 per year and hourly wages like $10 or €20. Many firms default to these round-numbered salaries, possibly due to simplification in decision-making rather than choosing a nuanced, strategic approach. The consequences in terms of market outcomes can be serious.

Can you specify the negative effects?
Germán Reyes: My analysis suggests that employers engaging in the practice of round-numbered salaries have worse worker-firm matches, leading to higher employee turnover. In the data, new hires in these companies are, on average, 4.1 percentage points more likely to leave the firm. These companies also have a 3.4 percentage points lower growth rate and are 1.1 percentage points more likely to exit the market, possibly because of their worse worker-firm matches.

How common are simplified wage-setting practices in other countries?
Germán Reyes: While the study is based on Brazilian data, the concept of firms opting for round-numbered salaries has been found in other countries like the USA. More generally, this type of "simplified pricing" is relevant in many countries. The extent and specifics will likely vary depending on the local labor market conditions, cultural factors, and wage-setting institutions.

Do your results apply to blue- and white-collar workers?
Germán Reyes: The study's findings are based on both blue- and white-collar workers.
Wage bunching at round numbers seems to be a general firm behavior, not limited to a specific type of job, industry, or occupation. However, the impact and prevalence vary between these groups due to differences in wage negotiation and setting processes, e.g., wage bargaining is more prevalent among white-collar workers.

INTERVIEW

What is your recommendation to HR departments that set salaries?
Germán Reyes: HR departments should consider adopting an informed and nuanced approach to salary setting. To be clear, this is not easy. It requires answering challenging questions: What are all the possible tasks that the new hire is going to perform? How does each of these tasks affect the firm's bottom line? How likely is the prospective employee to accomplish each of these tasks? Yet, without an answer to these questions, it's not possible to know what a worker contributes to the company and, therefore, what their salary should be. Instead of defaulting to round numbers, they may opt to use a data-driven approach, accounting for factors such as employee skill levels and market conditions.

The presented discussion paper is a publication without peer review of the Collaborative Research Center Transregio 224 EPoS. Access the full discussion paper here :
https://www.crctr224.de/research/discussion-papers/archive/dp492

Find the list of all discussion papers of the CRC here: https://www.crctr224.de/research/discussion-papers.

Author
Germán Reyes, Assistant Professor, Department of Economics, Middlebury College and member of EPoS Economic Research Center

The Collaborative Research Center (CRC) Transregio 224 EPoS
Established in 2018, the Collaborative Research Center Transregio 224 EPoS, a cooperation of the universities Bonn and Mannheim, is a long-term research institution funded by the German Research Foundation (Deutsche Forschungsgemeinschaft, DFG). EPoS addresses three key societal challenges: how to promote equality of opportunity; how to regulate markets in light of the internationalization and digitalization of economic activity; and how to safeguard the stability of the financial system.

Press Contact
econNEWSnetwork
Sonja Heer
Telefon + 49 (0) 40 82244284
Sonja.Heer@econ-news.de

Contact
Germán Reyes
IZA – Institute of Labor Economics
german.reyes@briq-institute.org