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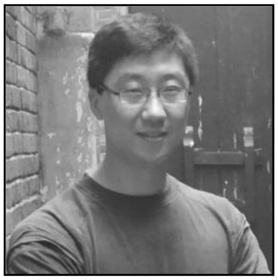
Business and Economic Inequality Forum

Dr. Victor Cui is an Assistant Professor in Business Strategy at the I.H. Asper School of Business. He sat down with BEIF to reflect on the relationship between economic inequality and business.

BEIF: Dr. Cui, how does economic inequality affect business organizations?



This is an intriguing question, which may inspire more questions than answers. For example, if we replace "inequality" in this question with "difference", are we changing anything? Second, what is the level of economic inequality we are more interested in, income differentials among individuals or unbalanced economic development between countries, or others? These are the lenses through which I would like to try to answer this big and important question.

I would like to focus on the individual level. Differences in individuals' wealth may be attributed to the uneven distribution of their innate resources and later effort such as hard working. To this extent, differentiated economic conditions seem inevitable. Regardless, in many societies, people seem to tolerate more "everyone being equally poor" than "someone being richer than me". To the extent that social comparison and ethical evaluation are prevalent in our societies, the pursuit of equality and fairness has never been stopped. Thus, what seems to matter more is not just the issue of economic "difference" but also "inequality".

Equity theory maintains that if individuals perceive themselves to be unequally treated, they are likely to get even. The implication for business organizations is that employees who perceive themselves to be treated unfairly, economically or otherwise, are likely to exhibit more dysfunctional behaviors, such as withdrawing effort from collaboration or absenteeism, and less citizenship behaviors. But it is not always the case, as I will discuss in answering to the next question.

BEIF: Should business organizations try to decrease inequality, and how can they do it?

Differentiated treatment to employees, such as pay dispersion, may be used to create a pay-for-performance system, which will motivate employees to deliver better performance. For example, tournament theory indicates that pay differences across job levels (e.g., between non-managerial and managerial job positions) can motivate lower-ranked employees to work harder and to climb up the ladder. However, the effectiveness of such a pay-for-performance system depends, to a great extent, on organizational context.

My research on compensation and innovation (Yanadori & Cui, 2013) shows that in the R&D context, pay dispersion among employees at the same job levels actually has a negative impact on their innovation performance. This is because innovation demands intensive collaboration to facilitate knowledge sharing and creation. Compensation inequality may de-motivate R&D employees to collaborate because of the perception of unfairness. Also, employees may perceive this compensation design as creating a zero-sum game, fearing that sharing knowledge would erode their relative knowledge advantage and consequently disadvantage themselves in compensation. However, my research also shows that if a firm has a large financial slack, the negative impact of this pay inequality will be mitigated. This is likely because employees may expect the overall compensation budget to increase (that is, a bigger pie to share), and thus their fear of a zero-sum game and their negative reactions to pay differential will be reduced.

Our understanding of economic difference within organizations is still growing. More intriguing questions need to be addressed, for example, what is the difference between pay inequality and inequity[1]? Which one is more detrimental to individual and organizational performance? Examining these questions will help us understand more and be better prepared to examine the important relationship between economic inequality and business organizations that I am trying to shed light on here.

[1] Note from BEIF: Readers interested in the difference between equity and equality as they relate to HRM can find more here: http://link.springer.com/article/10.1007%2Fs10551-012-1435-y