

Employee Responses to Pay Raises

Two recent studies examine employee reactions to pay increases. Research appearing in *Human Resource Management* uses samples in the United States and Finland. This research shows that a pay increase threshold of between 5% and 8% is required to evoke positive employee responses. Similarly, an experiment reported in the *Journal of Economic Psychology* supports these results and shows that small increases can lead to negative employee responses.

Key Takeaways:

- Employees say that 10% is a minimum pay raise that will be meaningful.
- However, pay raises in the 5%-8% pay range evoke positive attitudinal and performance responses among employees.
- Small pay raises appear more likely to evoke feelings of unhappiness (as if it were a punishment) than feelings of appreciation or increased motivation.

In one study, 177 employees at a University medical center in the United States and 495 university employee in Finland were surveyed regarding both their expectations and their responses to changes in their base pay. In the second study, 192 student employees participated in an experiment

designed to examine employee responses to pay raises.

In combination, these two studies provide further evidence that pay raises must be considered carefully. Specifically, employee behaviors are not positively influenced until a specific threshold is reached. In the United States sample, this threshold was about 5% and in a Finish university system, the threshold was about 8%. Further, very small pay raises led to negative employee responses. Additionally, in combination, these two studies also show that there is a diminishing return to the amount of a pay raise, and responses to pay raises are likely to depend on prior pay raise history.

Overall, these suggest that common pay raises, (in the United States, the average annual merit increase is only 4.8% for high performers) may do little in terms of motivating future performance, and smaller pay raises may actually harm employee morale. Not surprisingly, pay cuts of any magnitude evoke negative employee responses.

Sources: Mitra, A., Tenhiälä, A., & Shaw, J. D. (2015) Smallest meaningful pay increases: Field test, constructive replication, and extension. *Human Resource Management*, 55(1): 69–81.
Mitra, A., Jenkins, G. D., Gupta, N., & Shaw, J. D. (2015). The utility of pay raises/cuts: A simulation experimental study. *Journal of Economic Psychology*, 49(C): 150–166.

