What’s My Employee Worth? The Effects of Salary Benchmarking

Abstract

While U.S. legislation prohibits employers from sharing information about their employees' compensation with each other, companies are still allowed to acquire and utilize more aggregated data provided by third parties. Most medium and large firms report using this type of data to set salaries, a practice that is known as salary benchmarking. Despite their widespread use across occupations, there is no evidence on the effects of salary benchmarking. We provide a model that explains why firms are interested in salary benchmarking and makes predictions regarding the effects of the tool. Next, we measure the actual effects of these tools using administrative data from one of the leading providers of salary benchmarks. The evidence suggests that salary benchmarking has a significant effect on pay setting and in a manner that is consistent with the theoretical predictions. Our findings have implications for the study of labor markets and for ongoing policy debates.

This paper is joint work with Zoë Cullen (Harvard Business School) and Shengwu Li (Harvard University).

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