Video Transcript: "Equity Theory"
https://youtu.be/uQutP57MTGg

SPEAKER_1: Fairness, or what people perceive to be fair, is also a critical issue in organizations. Let's take a look at equity theory.

Equity theory says that people will be motivated at work when they perceive that they are being treated fairly. Equity theory stresses the importance of perceptions. So, regardless of the actual level of rewards people receive, they must also perceive that, relative to others, they are being treated fairly.

The basic components of equity theory are inputs, outcomes, and referents. Inputs are the contributions employees make to the organization. They include education and training, intelligence, experience, effort, number of hours worked, and ability. Outcomes are what employees receive in exchange for their contributions to the organization. They include pay, fringe benefits, status symbols, and job titles, as well as assignments. And, because perceptions of equity depend on comparisons, referents are the other people with whom people compare themselves to determine if they have been treated fairly.

According to equity theory, employees compare their outcomes (the rewards they receive from the organization) with their inputs (their contributions to the organization).

This comparison of outcomes with inputs is called the outcome/input (O/I) ratio. After an internal comparison in which they compare their outcomes with their inputs, employees then make an external comparison in which they compare their O/I ratio with the O/I ratio of a referent.

Inequity can take on two forms, under-reward and over-reward. Under-reward occurs when a referent O/I ratio is better than your O/I ratio. In other words, you're getting fewer outcomes relative to your inputs than the referent you compare yourself with is getting. When people perceive that they've been under-rewarded, they tend to experience anger and frustration, and that tends to happen a lot.

By contrast, over-reward occurs when a referent O/I ratio is worse than your O/I ratio. In this case you're getting more outcomes relative to your inputs than the referent is. In theory, when people perceive that they've been over-rewarded, they experience guilt. But, not surprisingly, people have a very high tolerance for over-reward. It takes a tremendous amount of overpayment before people decide that their pay or benefits are more than they deserve.

So what happens when people perceive that they've been treated inequitably at work? In the case of under-reward, this usually translates into frustration or anger, or with over-reward the reaction is guilt. These reactions lead to tension and a strong need to take action to restore equity in some way. People who perceive that they've been under-rewarded may try to restore equity by decreasing or withholding their inputs. That is, their effort. Increasing outcomes is another way people try to restore equity. This might include asking for a raise or pointing out the inequity to the boss, hoping that he or she takes care of it.

Another method of restoring equity is to rationalize or distort inputs or outcomes instead of decreasing inputs or increasing outcomes. Employees restore equity by making mental or emotional adjustments in their O/I ratios or the O/I ratios of their referent. Changing the referent is another way to restore equity. In this case people compare themselves with someone other than the referent they had been using for previous O/I ratio comparisons.

What practical steps can managers take to use equity theory to motivate employees? They can start by looking for and correcting major inequities. Among other things, equity theory makes us aware that an employee's sense of fairness is based on subjective perceptions. Second, managers can reduce employees' inputs. Increasing outcomes is often the first and only strategies that company use to restore equity. Yet reducing employee inputs is just as viable a strategy. Finally, managers should make sure decision-making processes are fair.

Equity theory focuses on distributive justice, the perceived degree to which outcomes and rewards are fairly distributed or allocated. However, procedural justice, the perceived fairness of the procedures used to make reward allocation decisions, is just as important. Procedural justice matters because even when employees are unhappy with their outcomes (that is, low pay), they’re much less likely to be unhappy with company management if they believe that the procedures used to allocate outcomes were fair.