

Anchoring Effect and Salary Negotiation

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Abstract:

The anchoring effect is now frequently used in wage negotiations. This review article aims to discover the potential impact of the anchoring effect in wage negotiations. In the main body, we will analyze the potential impact of anchoring effects in three areas: anchoring strategies in wage negotiations, the impact of anchoring on wage differentials, and mitigating anchoring effects in wage negotiations. After the analysis, we will find that the anchoring effect stealthily has many potential impacts on wage negotiations.

Keywords: anchoring bias; wage negotiations; cognitive bias; wage differentials

1. Introduction

The anchoring effect is a cognitive bias in which initial or “anchoring information” influences subsequent judgments and decisions. Anchoring is found in many types of everyday judgments, such as the pricing of goods, willingness to pay for consumer goods (Ariely, Loewenstein, & Prelec, 2003), and perceptual decisions (Englich & Mussweiler, 2001)). The studies mentioned above suggest that anchoring effects affect various numerical estimates. Given that negotiations are often associated with numerical quantities, anchoring effects are also often present in negotiations. Anchoring may be an essential mechanism in determining the starting wage offer.

The first offer can serve as an anchor for counter offers. The use of anchors has been shown to influence the first offer in a negotiation as well as the outcome.

Anchoring can be an important mechanism for determining the starting wage offer. Most employees need more leverage than elite employees have in wage negotiations, especially in the current job market. For example, employees may be reluctant to initiate a wage offer because they fear the employer will terminate negotiations. After all, the employee's wage demands are too high, or they may be afraid to offer a lower wage expectation. However, if the employee waits for the employer to initiate salary negotiations, the employer can set anchor points in the initial offer.

While research has examined how the initial wage offer affects the negotiation process and the final agreed-upon wage, the potential impact of the anchoring effect in wage negotiations has not been examined. This review article aims to discover the potential impact of the anchoring effect in wage negotiations.

Literature Review

Anchoring bias is caused by inadequate adjustment, as the final judgment is assimilated toward the starting point of the judge's deliberations. (Tversky & Kahneman, 1974) Anchoring and adjustment heuristics, first proposed in their seminal work on judgment under uncertainty, will be the main anchoring effect mentioned in this study.

According to Tversky and Kahneman (1974), anchoring effects are disproportionate influences on decision-makers that bias their judgments toward the initially proposed value. In a classic study by Tversky and Kahneman (1974), participants were asked to estimate the percentage of African countries in the United Nations by turning a wheel of fortune on a scale between 0 and 100 concerning a series of randomly generated numbers. Before making an absolute judgment, participants were asked whether the answer was higher or lower than the reference value provided.

Following Tversky and Kahneman's study, many studies have illustrated the prevalence of the anchoring effect in the human decision-making process. These studies have demonstrated anchoring effects in various domains, including general knowledge and probability estimation. For example, in general knowledge, researchers have studied anchoring effects by asking participants questions such as the freezing point.

Indeed, the use of anchors has been shown to influence the first offer in a negotiation as well as the outcome. For example, Northcraft and Neale (1957) had real estate agents inspect properties and then ask them to estimate the appraised value of the house, and they would list the house's price and purchase price. The authors manipulated the listing price to provide high and low anchors. The listing price influenced each of the real estate agent's

estimates. The agent's listed price for the house could be considered the first offer in a potential negotiation. However, real estate professionals deny using the listing price and cite the property's characteristics to justify their estimates.

Galinsky and Mussweiler's experiment randomly assigned participants to play the role of buyer or seller to negotiate the purchase of a pharmaceutical plant. They found an anchoring effect whereby the purchase price was higher when the seller made the first offer than when the buyer made the first offer. This rationale is consistent with Northcraft and Neale's model of selective accessibility. Goals consistent with the "anchor" are relatively easier to obtain. Huber and Neale (1986) assign negotiators goals that are either easily attainable or difficult to achieve. These negotiators' subgoals were influenced by the difficulty of previously assigned goals in a manner consistent with the anchor. These studies suggest that anchors can influence the types of initial demands negotiators make in negotiations.

After considering possible factors related to anchor values, human factors may also contribute to susceptibility to the anchoring effect. However, an exception to this rule is judgmental anchoring. Bodenhausen et al. (2000) and English and Soder (2009) found that compared to participants in a neutral or happy mood, participants in a sad mood were more susceptible to the heuristic bias of anchoring than participants in a sad mood. From an attitude change perspective, sadness causes people to engage in more effortful processing, in which they interpret information through the elaboration of existing knowledge and determine whether the claim is acceptable or unacceptable (Blankenship et al., 2008). The concept of elaboration in contemporary attitude change theory is very similar to the confirmatory hypothesis testing mechanism in anchoring (Wegener et al., 2010). Following the trend of argumentation suggested by the selective accessibility mechanism, sad emotions induce judges to engage in more thorough information processing (English and Soder, 2009), thereby activating a confirmatory search for anchoring consistent information. This suggests that happy emotions may lead to judgments not strongly influenced by anchoring.

Subjects' knowledge provided the anchor. This was supported by Chapman and Johnson, who noted that those with a high degree of certainty about the answer produced smaller anchoring effects. Wilson et al. (1996) found that knowledgeable individuals were less influenced by the anchor provided. However, previous studies have provided empirical evidence that expert participants' decisions in the judgment domain also show an anchoring effect. For example, automotive experts (car mechanics

and car dealers) with all the necessary information valued cars based on the provided anchors (Mussweiler et al., 2000), real estate brokers' pricing estimates were biased towards anchor values (Northcraft), and experienced legal professionals, who have higher certainty ratings than laypersons, in their perceived decisions significantly influenced by uncorrelated anchors (English and Mussweiler.) These results imply that expertise does not significantly reduce assimilation bias in decisions affecting inexperienced amateurs.

In conclusion, because of the relevance of anchoring effects to pay negotiations, employer sentiment and employer knowledge of employees may influence the strength of anchoring effects in pay negotiations.

Anchoring Strategies in Salary Negotiations

During the 2009 baseball offseason, Scott Boras, the agent for baseball free agent Manny Ramirez, reportedly told the team that his client wanted a four-year, \$100 million contract (Schmidt, 2009). This extreme contract demand could anchor teams to raise an appropriate counteroffer. Making an extreme initial offer or demand may be effective in negotiations because it can serve as an anchor for a counteroffer (Galinsky, Leonardelli, Okhuysen, & Mussweiler, 2005; Galinsky & Mussweiler, 2001; Magee, Galinsky, & Gruenfeld, 2007; Ritov, 1996) When Manny Ramirez signed a two-year, \$45 million contract with the Los Angeles Dodgers, it was assumed that the Los Angeles Dodgers were the only team actively pursuing the player (Witz, 2009).

In Thorsteinson's experiment, participants made a salary offer like a candidate after receiving a relevant and plausible anchor. They found significantly higher wage offers in the high anchor condition than in the control group (low wage offer).

Bazerman (2006) speculated that a job seeker's current wage might be an anchor for potential employers in deciding what they should offer the job seeker. Alternatively, a job seeker's wage expectation could also serve as an anchor point (Major et al., 1984), asking participants to review the credentials of a fictitious job seeker who provided his or her wage expectation. Participants recommended higher wages to those job seekers who provided higher wage expectations because they perceived themselves as more valuable than those who provided lower wage expectations.

In the experiment of negotiating with candidates, HR directors were told that they could not offer more than a \$20,000 bonus and that the company would prefer to pay \$5,000. The candidate had heard of situations in the

consulting industry where \$30,000 bonuses were offered. The candidate suggests that if he or she cannot get a bonus of at least \$30,000, he or she will withdraw from negotiations. The candidate receives a well over \$5,000 bonus, although less than \$30,000.

Potential advantages and disadvantages of each strategy

1. Setting a high initial offer will lead to a higher salary offer. However, this strategy is not without risk because if it is too extreme to be a trustworthy anchor, the other party may choose to end the negotiation, believing that the first party is unwilling to negotiate seriously (Lewicki, Barry, & Saunders, 2010).
2. The benefit of providing reasons for salary expectations is that communicating initial salary expectations serves, in part, as a strategic self-presentation in which the individual attempts to convince the employer that he or she is a particularly valuable employee or bargainer. Thus, what a person expects to be paid provides the organization with information about what that person believes he or she is “worth.” The downside is that some employers have specific goals, such as a design firm that is short of a qualified employee to meet a need, but does not need that employee to be overly competent as an individual and would prefer to hire a qualified employee at a low salary expectation. In this case, it would not meet the employer's needs if the employee continues to demonstrate his or her exceptional value and offers high salary expectations.
3. The advantage of using industry benchmarks is that you can prepare ahead of time and have a reason to prevent wages from being pushed by the employer to the minimum wage the company is willing to pay. The disadvantage is that similar to setting a high initial offer, the industry benchmark is higher than the minimum wage the company is willing to pay, and the employer may choose to end negotiations.

Impact of Anchoring on wage differentials

Studies of business executives have shown that women are less likely than men to use bargaining in upward impact attempts (Lauterbach & Weiner. 1996). Other research in a broader population suggests that women are less likely than men to initiate negotiations (Babcock, Gelfand, Small, & Stayn, 2006; Babcock & Laschever, 2003). Women have greater anxiety about negotiation than men and are less likely than men to perceive situations as negotiable Babcock et al. (2006).

The reluctance of women to initiate negotiations compared to men may be an important and under-explored

explanation for the asymmetric distribution of resources within organizations, such as compensation. Women may forgo such opportunities because they need more negotiation training and practice to help them overcome their nervousness and learn how to act like men when negotiation opportunities arise. But what if women's relative nervousness about initiating negotiations has less to do with their ability to negotiate than with the treatment they receive when they try to negotiate? Gender-specific approaches to “solving women's problems” often fail to consider the social context of gender, in which women's bargaining power is limited.

Mitigating the Anchoring Effect in Salary Negotiations

The practical application of anchoring has recently received considerable attention in business. For example, during negotiations, the initial offer can serve as an anchor to absorb the final judgment powder (Galinsky and Mucsweler, 2001). Based on the persistence of the anchoring effect, the initial offer can significantly impact the negotiation outcome over time. However, Galinsky and Mucsweler (2001) found a technique that eliminates the strong influence of the anchoring effect.

They found that considering that the opponents' most are not supposed to be the lower value of the negotiated agreement, the opponent's reservation price or own goal can eliminate the effect of the first offer. These are only beneficial if negotiators are aware of the effects of the anchor value and, therefore, may compensate for the assumed effects. However, negotiators may be subliminally influenced by the anchor value and assimilate their judgment to the initial reference. Furthermore, pricing policies, or more specifically, reference prices, have been used by retailers as a marketing practice to influence consumers' purchase decisions based on the concept of anchoring. The reference price is the anchor value consumers provide to judge the offer.

Some argue that multiple anchors reduce or eliminate the anchoring effect (Wilson et al., 1996). The results of this study suggest that an unreliable anchor can influence wage recommendations even if there is a relevant anchor. Whyte and Sebenius (1997) hypothesized that an irrelevant anchor might have a greater impact on the final presentation. The current results suggest that the two spreads' presentation order does not affect wage recommendations. The order of anchors may become a more important factor if they are presented with some time interval.

These results suggest that one strategy for maximizing one's starting salary is to initiate wage negotiations with a

joke about an extremely high salary. Job seekers may lack information about the appropriate wage for the job. Rather than waiting for the employer to broach the subject, job seekers should start negotiations by making an extreme request jokingly. Given the benefits of making the first offer in a negotiation, this tactic may be an effective means for job seekers to increase their starting salary. To combat this tactic, organizations may want to ensure that the position has an established salary paradigm to reduce the impact of unreliable anchors in salary negotiations. Anchoring effects may be particularly likely to occur in compensation negotiations involving positions that lack three clear pay paradigms (e.g., the top position in the organization). They may also be more applicable in contract work situations, where the employer may be unfamiliar with the costs, and the price is usually negotiated between the employer and the contractor (e.g., consulting work). Given the impact of even prohibitively high anchor points, organizations may want to ensure that pay ranges are clearly defined to avoid the undue impact of prohibitively high anchor points.

Conclusion

The anchoring effect has been studied for more than 50 years, starting with its introduction by Tversky and Kahneman in the 1970s, and it has proven to be very powerful. It can be demonstrated across a wide range of decision-making tasks, compensation negotiations, and psychological and environmental factors. Understanding and managing the anchoring effect plays a key role in compensation negotiations. The research mentioned in the article has implications for employees, employers, and policymakers that cannot be ignored. I suggest that future research be built on exploring potential ways to mitigate anchoring effects in pay negotiations to further our understanding of anchoring effects in pay negotiations.

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