Compensation, Strategy and Performance:

A Question of Fit?

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Abstract

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This research evaluates the compensation-strategy-performance relationship and focuses on the middle management compensation system. The thesis is organized around two major objectives: (1) to investigate the differences in compensation design and administration characteristics associated with the business strategies of Cost Leader versus Differentiation (Porter, 1980). (2) to analyze whether organization performance is linked to different combinations of business strategy and compensation system.

The study required collecting data on three types of variables including (1) compensation policy design and administration decisions, (2) business strategy and (3) organization performance. These data came from Broderick's (1986) Ph.D dissertation, the COMPUSTAT database (1989) and the Fortune magazine Corporate Reputation surveys (1980-1987).

High-performance cost leader oriented firms were predicted to be different from high-performance differentiator oriented firms in terms of their compensation design and administration characteristics. Research results suggest that there are some compensation

patterns which are associated with either a cost leader or with a differentiation strategic orientation. These patterns, however, are not always similar to what was predicted in the literature. The research results further indicate that cost leader oriented firms have higher organization performance under the following conditions: that is when they (1) de-emphasis internal equity in compensation design, (2) have a lower compensation level than their competitors, (3) have a lower emphasis on incentives, (4) emphasize incentives rewarding growth and innovation, (5) have open communication on compensation issues, (6) encourage participation and (7) have a decentralized but standardized compensation structure. In contrast, differentiator oriented firms have higher organization performance when they (1) emphasize external equity practices, (2) have higher compensation level than competitors, (3) do not emphasize incentives based on performance, (4) do not emphasize open communication on compensation issues, (5) discourage participation and (6) have a centralized but not standardized compensation structure.

To my parents and my sister Nathalie

To my best friends in Montreal

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Introductory Section

In our dramatically changing world, traditional management practices are trying to aim at moving targets. "Responding to environmental turbulences requires new organizational mindsets" as Ulrich and Wiersema put it (1989, p:115). With increasing rates of environmental changes, as well as the diversified nature of most large firms, continuity and durability of organization strategy no longer guarantee success. The management of change remains the challenge of the 1990s. To compete in this and the next decade of transformation requires that executives create and maintain organizational assumptions and practices that help clarify and cope with continual environmental change. Successful management amid such turbulence requires organizational and strategic adjustments. Objectives of these adjustments are to foster better performance, control costs and enhance flexibility. These are all necessary to successfully compete in fierce markets. To build this internal capacity to deal with change, executives need to reevaluate their assumptions and game plans and inaugurate practices to instill strategic and organizational capability.

"Once the most productive nation in the world, the U.S. now lags most of its global competition in productivity growth " explain Cameron, Freeman and Mishra (1991, p:57). They argue that a good share of the blame for this decline rests squarely on white-collar employees and management (top executives as well as middle managers). They illustrate this by highlighting that between 1978 and 1986 the number of production workers in the U.S. declined by 6% while real output rose by 15%. That represents a 21% gain in blue-collar productivity. During the same period, however, U.S. manufacturing firms expanded the number of white-collar non production workers by 21%, representing a 6% decrease in productivity.

Declining white-collar productivity has created a cost structure in many U.S. companies that contributes to limit global price competitiveness and consequently market share growth. As a consequence, top managers as well as middle managers are challenged by the pace and magnitude of this change. Human resources managers are not excepted. They are confronted daily with questions about how to respond to changes in technology, changes in organizational structure, and changes in business strategy to cope with increased competition. Employees themselves have changing values and expectations and increasing demographic diversity. When confronted with the need for rapid and large scale change, human resources managers, like their counterparts in marketing, finance and production, tend to adopt strategies that enable them to manage their work forces effectively in the face of uncertainty. Developing a human resources strategy requires <u>defining</u> the work force performance goals needed to support the organization's overall business strategy and the human resources implications of these goals, diagnosing the organization's internal and external environment to pinpoint human resources strengths and weaknesses relative to these goals, and designing the mix of human resources policies and programs that exploits strengths and downplays or corrects weaknesses. The aim is to shape a work force that is focused on strategic performance goals and capable of achieving them.

Compensation is a critical piece of the overall human resources strategy. Because compensation is both visible and important to employees, a compensation program designed to communicate and reinforce strategic goals increase the probability that employees not only will understand what these goals are but also will achieve them (Milkovitch & Broderick, 1990). Because employees also understand that compensation dollars are important to the organization, the strategic intent of other human resources efforts (such as performance management, recruiting, career development, and the like) are also clearer if their designs are consistent with the compensation program. In short, realization of compensation strategy requires that "the money match(es) the message" as Milkovitch and Broderick put it (1990, p:25).

But why spend the time developing compensation strategy? In the past recent years, many compensation researchers and consultants have been advocating that the design of an effective compensation system demands not only a close articulation between human resources strategies and pay strategies, but also a clear fit between compensation system components and organizational structure and strategy. This is why L.L. Gomez-Mejia and T.M. Welbourne wrote in 1988 that:

> *A number of writers are now arguing that compensation as a field of study is undergoing a transformation from being micro-oriented, bureaucratically based, applied discipline that emphasizes tools and techniques to a broader field focusing on such concepts as "congruency", "fit" and "linkages" that involve close articulation between the pay system and other organizational functions."* (Gomez-Mejia & Welbourne, 1988, p:173).

The compensation system, when properly designed, is a key contributor to the effectiveness of the organization (Lawler, 1990; 1991; Kerr, 1985; Wallace & Fay, 1988). If managers make compensation decisions consistent with the organization's business strategy, responsive to external and internal conditions, and consistent with the overall human resources strategy, then the organization is more likely to be competitive. Basic to Lawler's book (Pay and Organizational Effectiveness, 1981) and to the search for the right compensation system is the belief that how people are paid has a direct impact on organizational effectiveness. How people are paid affects their absenteeism, productivity and the quality of work they do (Lawler, 1971). Few doubt the validity of this belief, but widely divergent views exist about what the most effective system is. Beliefs, myths, opinions and counter-opinions abound in the literature on organizations concerning how much people should be paid and what methods should be used to pay them. Probably no other topic concerned with the management of work organizations is a subject of more debate, controversy and misunderstanding. The reasons for this are not hard to identify. Pay is an important cost item for organizations. There has been little research on how it affects organizational performance and it is a highly emotional issue for many individuals. It is precisely because it is an emotional issue that generally accepted precise answers, based on rigid formulations and data, are so difficult to obtain. This statement is based on belief, not systematic evidence. Few studies link the implementation of compensation strategy with business success. Indeed there are so many factors unrelated to compensation that can influence business strategy success that disentangling the effects of compensation strategy is a difficult task (Milkovitch & Broderick, 1990). Finkelstein and Hambrick confirm this statement asserting that while empirical work has found a link between compensation schemes and strategic choices, the eventual tie to firm performance has not clearly been made (1988). Only recent studies do offer guidelines on the effects of certain decisions, specifically pay-for-performance plans, on firm performance.

For many years both researchers and practitioners have attempted to learn why some organizations achieve higher levels of performance than other organizations. Thompson (1967) and Schendel and Hatten (1972) suggest that the success of an enterprise seldom depends upon a single factor. Rather, it largely stems from the ability of administrators to reach and maintain a viable balance among a combination of different factors (Lenz, 1980). Empirical studies address particular aspects of this broad problem of managing multiple dependencies. Several studies center upon relationships between environment and performance, while others address the influence of strategy and organizational structure and processes upon performance (Lenz, 1980; White & Hammermesh, 1981; White, 1986; Roderick & Hammermesh, 1981; Robinson & Pearce, 1988). This research indicates that success depends upon a contingent relationship between environment and strategy. However, few, if any, empirical studies focus upon the broader issue of the joint influence of compensation policies and strategy upon organizational performance. In part, this is due to the fact that some pieces to test the strategy-compensation-performance relationship were missing. The empirical investigation of this relationship requires appropriate measures for strategy, compensation policies and performance. Hambrick (1980) explains that the lack of a non-situation specific concept of business strategy, that can be operationalized, has impeded the empirical investigation of this relationship at the business level.

Fortunately, the development of generic business strategies along with the validation of the contingent approach to organizations have begun to redress this problem (Miles & Snow, 1978; Porter, 1980; Hambrick, 1983;

Galbraith & Nathanson, 1978). This circumstance, coupled with the delineation of business units within large diversified companies, permits the empirical study of business unit strategy-compensation "fit". This was the purpose of Broderick' s study (1986). She first argued that a set of important pay policy decisions can be identified and measured and then demonstrated that pay policy decisions vary systematically across organizations with different business strategic types, using Miles and Snow's typology (1978).

Thus, strategic groups provide a useful intermediate frame of reference. But, with the recognition of limitations and defects in previous constructs representative of generic strategies (the Miles & Snow's typology for instance), Porter's framework (1980) of generic strategies and competitive dimensions proposes an alternative guide for strategy formulation. This potentially valuable research tool for classifying the strategies of all competitors within an industry has received particular notice among academicians and has been used and validated by practitioners (Dess & Davis, 1980; Pearce & Robinson, 1988). This is why we find it of a great interest to study the "fit" between compensation strategies and Porter's generic strategies of Cost and Differentiation.

The purpose of this study is to investigate the compensation-strategy-performance relationship for middle managers. The literature review gives evidence that compensation policies and reward items vary with the group of employees involved (Carroll, 1987; Lawler, 1971; 1981). Since very few studies have addressed compensation issues for middle management, middle managers are chosen in this research as the group of employees on which the study's investigation of compensation policies would focus. An advantage of this choice is that usually compensation systems for middle managers include a higher number of incentive options than compensation systems for lower level managers or non-management employees. This increases the likelihood of collecting data on a variety of incentives decisions. Another advantage is that the pay of middle managers, as opposed to that of top executives, is less likely to be influenced by the decisions of people from outside the organization. This decreases the chances that data on compensation policies would be considered confidential (Broderick, 1986).

The study is organized around two major objectives. The first objective is to extend Broderick's (1986) study, by using Porter's generic strategies, instead of Miles & Snow's strategic types. The following question will be addressed: **(1)** ***Do the business strategies of cost versus differentiation influence the choices of compensation design and administration characteristics for middle managers?*** The second objective is to go beyond the descriptive focus of the first question and analyze whether organization performance is linked to different combinations of business strategy and compensation system. The cumulative implication of previous research indicates that high performing firms should exhibit different combinations of these two factors than low performing firms with the same generic strategy. Thus, the second question addressed is the following: (2) ***Does the existence of a "fit" between compensation system and business strategy contribute to improve organization performance?***

CHAPTER I

LITERATURE REVIEW

This chapter reviews theory and research in such areas as compensation, organizational design and structure, organization strategy and organization behavior in order to investigate the compensation, strategy and performance relationship. This research is primarily focused on strategic compensation. Though compensation may include both monetary and non-economic rewards, this research focuses primarily on economic rewards. The first section of this chapter presents the compensation literature relevant to our investigation and defines important elements of compensation systems. The second section presents a review of theory and research on how these compensation dimensions might be differentially associated with business strategy choices and introduces our conceptual framework. The third section addresses the major issue of our research, the compensation-strategy-performance relationship. Following this, the hypotheses which will guide this research are presented.

Compensation Literature

The purpose of this section is to review the compensation literature and define important elements of compensation systems. Key dimensions of the design and administration of compensation systems will be derived from the literature.

An Introduction to Compensation

Towards a Definition of Compensation

The idea of compensation is deeply rooted in every culture and society, be it ancient, medieval or modern. Traditionally, the term compensation meant economic or monetary rewards that are often used in work contexts. However, we shall use the term in its broadest possible sense to include all forms of rewards: monetary, payments in kind and non-economic rewards such as praise, recognition, etc. In this broad sense, compensation is one of the most important aspects which affect human relationships. Most of the writings focusing on the use of human resources management to help implement and reinforce organizational goals and strategies have emphasized the special role of the compensation system (Salter, 1973; Galbraith & Nathanson, 1978; Balkin & Gomez-Mejia, 1987; 1990).

Organizations must design compensation systems in order to remove the goal limitations to performance because they can not rely upon the voluntary and spontaneous selection of the behavior which will produce the most effective task performance (Galbraith & Nathanson, 1978). This premise is not based on an assumption that people are lazy or recalcitrant; it simply means that organizations can not rely on a perfect matching of personality and role requirements without devoting additional administrative effort. Galbraith explains that every organization is dependent upon its members to choose to perform those behaviors which will produce the desired effects on its environment. By definition, the more consistently individuals choose the appropriate behaviors for the role related situations with which they are faced, the more effective is their performance. This is why the function of organizational design is to remove as many factors as possible which would limit individuals in making these choices. Galbraith and Nathanson (1978) points out that in order to deal with this problem, organizations have developed devices such as compensation systems. But like the choices among structure attributes, there is no one best compensation system. Similarly, not all individual compensation systems are equally effective.

Unlike small scale business enterprises in traditional societies which compensated their employees through basic wages, modern organizations offer a wide variety of rewards to employees in order to remain competitive. An extensive list of such rewards offered by today's organizations has been compiled by Kanungo and Hartwick (1987). The type and number of reward items in a compensation package of an organization depends upon the organization's needs. In the literature, the reward system may include <u>economic</u> rewards, such as salary, merit pay, incentive pay, bonuses, insurance policies, cost of living increases and the like, and <u>non-</u>

economic rewards, such as personal growth, personal challenge, feedback, autonomy, job enrichment programs, promotion, socialization, career planning, training opportunities (Kanungo & Mendonca, 1990; Lawler, 1971). Another possible way of dealing with rewards could be in making the distinction between extrinsic and intrinsic rewards. This classification has been questioned by several authors. Others have found different additional ways of classifying rewards (Galbraith & Nathanson, 1978; Lawler,1971; Kanungo & Mendonca, 1990)

Economic compensation may be received directly in the form of cash (e.g., wages, merit increases, incentives, cost of living adjustments) or indirectly through benefits and services (e.g., pensions, health insurance, paid time off). Non-economic reward items which do not involve any monetary payments or benefits are, for instance, personal challenge in assignments, feelings of worthwhile accomplishments, personal growth and development. Thus, according to Kanungo and Hatwick (1987) the entire domain of compensation or reward items can be classified into three basic categories: (1) direct cash payments, (2) benefits and (3) non-economic rewards. We can therefore refer to the totality of compensation items as the reward system with two major components: (1) economic compensation system and (2) non-economic reward items.

In this research, we will narrow the focus of the economic issues and use the definition of compensation proposed by Milkovitch and Newman (1990): ***"Compensation refers to all forms of <u>financial</u> returns and tangible services and benefits employees receive as part of an employment relationship".*** This definition excludes other forms of non-economic rewards or returns that employees may receive, such as promotion, verbal recognition for outstanding work behaviors, feelings of accomplishment, and the like. Such factors may be considered as part of an organization's total reward system and are often coordinated with compensation (Milkovitch & Newman, 1990). We have chosen this definition because this research focuses primarily on economic types of rewards, in work relationships, and within an organizational context.

<u>The Forms of Compensation Systems</u>

Programs that distribute compensation to employees can be designed in an unlimited number of ways, and a single employer typically will use more than one program. These compensation delivery programs typically fall into four forms: (1) base salary, (2) merit pay, (3) incentives and (4) employee services and benefits (Milkovitch & Newman, 1990).

<u>Base wage</u> is the basic cash compensation that an employer pays for the work performed. Base wage tends to reflect the value of the work itself and generally ignores differences in contribution attributable to individual employees. Some pay systems set base wage as a function of the skill or education an employee possesses. Periodic adjustments to base wages may be made on the basis of changes in the overall cost of living or inflation, changes in what other employers are paying for the same jobs, or changes in experience/performance/skill of employees. A distinction is often made between salary and wage, with salary referring to pay for those workers who are exempt from regulations of the Fair Labor Standards Act (for U.S. workers), and hence do not receive overtime pay. Managers and professionals usually fit this category. Their pay would be calculated at an annual or monthly rate rather than hourly, because hours worked do not need to be recorded. In contrast, workers who are covered by overtime and reporting provisions of the Fair Labor Standards Act, "non-exempts", usually have their pay calculated at an hourly rate referred as a wage.

Merit pay rewards past work behaviors and accomplishments. It is often given as lump-sum payments or as increments to the base pay. Merit programs are commonly designed to pay different amounts, often at different times, depending on the level of performance. It is important to note that merit pay is defined as a reward. A reward is given for meritorious performance. A return is given in exchange for something of value (Milkovitch & Newman, 1990).

Incentives also tie pay directly to performance. Incentives may be long or short term-oriented, and can be tied to the performance of an individual employee, a team of employees, a total business unit, or even some combination of individual, team and unit. Usually very specific performance standards are used in short-term incentive programs. Long-term incentives are intended to focus employee efforts on longer range results. Managers or professionals are often offered long-term incentives (e.g., stock ownership, bonuses) to focus on long-term organizational objectives such as return on investment, market share, return on net assets and the like. Incentives and merit pay differ. While both may influence performance, incentives do so by offering pay as an inducement. Merit, on the other hand, is a reward that recognizes outstanding past performance (Milkovitch, 1990). Merit pay is typically based on individual performance; incentives may be based on the performance of an individual, team or unit.

Employee services and benefits are the programs that include a wide array of alternative pay forms ranging from time away from work (vacations, jury duty), services (drug counseling, financial planning, cafeteria support), and protection (medical care, life insurance, and pensions). Because the cost of providing these services and benefits has been rising and health care expenditures have been increasing at rates in excess of 16%, they are an increasingly important forms of pay. Many employers now manage benefits as closely as they manage direct compensation.

The pivotal role of compensation in organizations

It is important to recognize that the need for adequate compensation is fundamental to human nature and, therefore, to the human condition. This fact alone should be sufficient to demonstrate the pivotal role of compensation. However, there are other considerations which further emphasize the critical nature of compensation. We can explore these considerations from the vantage point of: (1) society, (2) individuals and (3) organizations.

Compensation in the form of monetary rewards has always been a societal concern, principally because it affects justice, taxes and the health of the economy. Different religions, down the ages, have decreed that the principles of justice should govern compensation. After the industrial revolution, for instance, the concept of a "just" wage was extended to include a "living" wage. The minimum wage legislation provided some safeguards to the non-unionized workers. However, all workers have benefitted considerably from the social security legislation which provides in Canada and in the States, for medicare, unemployment insurance, workmen's compensation and old age pensions. Societal concerns today are also focused on the issue of pay equity for women and minorities. This issue of "equal pay for work of equal value", also known as "comparable worth" is well underlined in the compensation literature (Milkovitch & Newman, 1990; Balkin & Gomez-Mejia, 1987; Lawler, 1981; Wallace & Fay, 1988). Societal concerns about economic compensation arise also because of its effects on taxes and the health of the economy. Compensation to government and municipal employees generally comes from tax revenues. Increases in compensation without a corresponding increase in productivity can, and do, lead to inflationary pressures which could impact adversely on the competitiveness of business and industry.

Secondly, individuals are obviously concerned about compensation. It is their sources of income. For the vast majority of people, monetary compensation is the primary, if not the only, source of income which determines social status and standard of living. The paycheck is a crucial determinant of the individual's socio-economic well-being. Compensation is also considered as being a return on their investment in education and skills development. The paycheck also represents a return on the individual's investment in his/her education and skills training. The time spent in school or in a profession constitutes his/her investment not only of time but also of effort and expenditures. Individuals also expect that their compensation provides adequate and fair feedback on their work contributions. Concerns and expectations about their monetary compensation are inextricably linked to their job satisfaction (Lawler, 1971). Of course, monetary compensation is only one element contributing to job satisfaction. Non-monetary rewards are equally important. Other elements such as satisfaction with co-workers, supervisors, working conditions, job security and the like, play also an important role. Nevertheless, satisfaction with financial compensation has been found to be a major contributor to job satisfaction (Mendonca, 1991).

Finally, from the point of view of organizations, economic compensation is also an obvious concern. Compensation is a major item of expenditure. In manufacturing organizations, for instance, the compensation package constitutes as much as 50% to 60% of the total operating costs. In service organizations and in the government and its agencies, the compensation package can go as high as 80% of total costs. The real concern of successful organizations then is to view its compensation package as an investment in people, its most valuable resource. Organizational concerns about a compensation package that includes both financial and non-financial elements are also expressed in terms of its motivating potential (Lawler, 1981). Motivation theories asserts that a well-designed compensation package can effectively motivate employees towards the organizationally desired behaviors. This is the compensation package, both economic and non-economic, that motivates an employee to perform at varying levels of performance, to grow on the job, accept challenge and responsibility, or to be absent from work (Lawler, 1981). In Canada, for instance, the total costs to the economy due to absenteeism is estimated at between 3 to 7 billion dollars, which is 10 to 11 times the cost of strikes. In brief, society, individuals and organizations demonstrate the pivotal role of compensation.

Designing a Compensation System: The Importance of Employee Motivation

Lawler's (1971; 1981; 1990) research on pay and organizational effectiveness has demonstrated that a properly designed compensation program is an effective response to the concerns presented above and constitutes an important element of the strategies to socialize and manage the human resources. Until recently, organizational concerns about compensation issues arising from the external environment stemmed from the unions. With the advent of the pay equity legislation, alluded to under societal concerns, organizations are now forced to look at compensation programs not in paternalistic terms, but in terms of fairness and equity.

Kanungo and Mendonca (1991) recognize that the real test of the effectiveness of a compensation system is whether it enables the organization to attract and retain employees, to motivate them to high performance in their present job, to induce them to want to prepare themselves to seek and accept additional responsibilities and challenges and to promote commitment and loyalty to the organization. To design a compensation system which will successfully meet these tests, it is essential to understand the motivational dynamics inherent in the reward-behavior relationships.

Employee motivation, therefore, is a critical consideration in the development of the compensation system. It is important to have a fairly clear idea of why and how a reward item motivates the recipient to manifest a certain desired behavior. "Whereas the environment provides the organization's underlying strengths, capabilities and objectives of the foundational structure of the compensation system, the consideration of employee motivation is the raison d'etre of the compensation system, and, accordingly, constitutes the core and integral element of the foundational structure" (Kanungo & Mendonca, 1991).

Theories of motivation provide the essential characteristics which a reward item must possess if it is to be effective in motivating employees towards the desired work behaviors. The content approaches to work motivation which explain human behaviors as an attempt to satisfy a need, proposes that rewards affect work behavior in substantially different ways depending on whether they are intrinsic rewards or extrinsic rewards. The process approaches to work motivation, explain human's behavior and motivation as an individual's attempt to restore equity or reduce the inequity the individual experiences in work situations (Equity Theory) and as an individual's effort to perform only if he/she values the reward item and if it is received as a consequence of his/her behavior (Expectancy Theory). The Porter-Lawler model (1981) suggests that the critical attributes of organizational compensation items are

(1) contingency upon performance, (2) valence (highly desired reward by employees) and (3) saliency (employees must be aware of the existence of the reward and the conditions for earning it (Kanungo & Mendonca, 1991). Thus, if the reward items offered by the organization are seen by the employees in terms of these attributes, then the compensation system will, to the extent of such perceptions, have a significant influence on work motivation.

The Foundations of Compensation Strategy

"Compensation strategy is the repertoire of compensation decisions and pay choices available to management that may, under some conditions, have an impact on the organization's performance and the effective use of its human resources" (Gomez-Mejia & Welbourne, 1987). From this perspective, the degree of success associated with various pay choices depends on those contingencies facing the organization at any given time (Balkin & Mejia, 1987).

The examination of compensation _decisions_ in organizations and compensation _dimensions_ associated with these decisions is necessary to understand the conceptual framework of this study.

An Examination of Compensation Decisions

In the literature, decisions on compensation _structure_, _level_, _mix_, _incentives_ and compensation _administration_ were consistently identified as important to the overall design and administration of an organization's compensation system. In a number of texts (Milkovitch & Newman, 1990; Rock & Berger, 1991; Sibson, 1990), they were the essential elements of an organization's compensation system. Those compensation system design as well as compensation administration elements were considered necessary to the day-to-day operation and maintenance of an organization's compensation system (Lawler, 1981; Ellig, 1982; Henderson & Risher, 1987; Milkovitch & Newman, 1990). They are briefly defined in the following paragraph.

Compensation Structure is defined as the distribution of money rates paid to different jobs in an organization (Broderick, 1986; Milkovitch & Newman, 1990). The actual compensation structure for a group of jobs or employees is determined by a number of compensation decisions. For example, in developing a compensation structure for a group of jobs, the organization must decide the degree of emphasis placed on internal norma relative to external prices.

Compensation Level is defined as the average of the total distribution of these rates (Broderick, 1986; Milkovitch & Newman, 1990). The actual compensation level is determined by a number of compensation decisions. For example, in developing a compensation structure for a group of jobs, an organization must determine the going rate for the jobs in the external labor market.

Compensation Mix refers to the emphasis on a particular form of compensation in the total compensation package offered for a specific group of employees. Typical forms of compensation include base salary, benefits and incentives, that is pay increases related to performance. Organizations that wish to reward employee loyalty and seniority often emphasize base salary and benefits in compensation mix decisions. Organizations wishing to reward employee performance often emphasize incentives (Broderick & Milkovitch, 1990).

The compensation decisions associated with ***incentives*** require that organizations determine how to best communicate to their employees the broad outlines of the performance desired. Broderick (1986) asserts that there are at least three decisions considered. The first involves the time orientation the organization wishes to communicate and reward. By emphasizing long-term incentives, that is pay contingent on performance over a three to five year period, long term objectives are shown to have high priority. Alternatively, an emphasis on short-term incentives, that is pay contingent on a one to two year period of performance, is a signal of the importance of short-term objectives (Ellig, 1982). The second decision reflects the performance emphasis desired. Typically the literature describes choices between entrepreneurial and production (including cost control) performance criteria. The third decision reflects the degree of risk involved in employee attempts to perform as desired.

Compensation administration decisions influence the style in which a compensation system's design is developed and maintained, day to day. The characteristics of an organization's administration are described in the organization behavior literature as: communication, centralization, formalization and standardization (Broderick, 1986; Milkovitch & Newman, 1990). The definition of these characteristics is extended to compensation system administration (Broderick, 1986; Carroll, 1987). Communication decisions can range from an emphasis on open communication of all types of compensation information to relative restriction of information. Compensation centralization decisions determine the level at which employees participate in, and authorize, different types of compensation decisions. Closely related to centralization are decisions that establish the degree to which the implementation of compensation system design is governed by standard operating procedures, work rules and supervision. Examples of formalization in a compensation context might include the degree to which job analysis, evaluation and wage surveys are governed by structured questionnaires, evaluation manuals and established wage survey procedures. Finally, the compensation standardization decisions involve the degree to which compensation is either tailored to a specific organization unit or standardized across all units. For example, in some firms, the same performance criteria can be used for incentives in all units. In other firms, differences in objectives may justify establishing unique performance criteria (Salter, 1973; Broderick & Milkovitch, 1986).

An understanding of those compensation decisions is useful to determine the compensation policy dimensions associated with these elements, which are the focus of this study. In addition, the necessary first step is the identification of compensation policy design and administration decisions, before addressing any issue regarding compensation system and strategy "fit" (Broderick, 1986).

An examination of Compensation dimensions

All compensation decisions presented above involve trade-offs. These trade-offs are related to important compensation system objectives. Broderick (1986) also suggests that compensation decisions might be differentially related to more aggregate compensation policies.

Eighteen different studies have explicitly examined strategic compensation dimensions (Gomez-Mejia, 1987). This literature spans such areas as executive compensation, diversification strategy, product-life cycle, incentive pay and research and development compensation. These articles were categorized by Gomez-Mejia and welbourne (1987) and are presented in **table 1**. The compensation dimensions associated with the compensation decisions of structure, level, mix and administration are described below. Compensation policy dimensions are distinguished from more technical compensation dimensions such as those related to methods of job evaluation or choice of the wage survey to be used in determining compensation level (Lawler, 1981; Milkovitch & Newman, 1984).

Compensation Structure: The choice of a compensation structure involves decisions in the following dimensions: (1)internal versus external equity, (2)job versus skills, (3)performance versus seniority, and (4)hierarchical versus egalitarian.

Internal versus External Equity: The emphasis placed on internal versus external equity in the compensation system depends on whether divisions are autonomous or dependent. If autonomous, they are free to develop their own policies; therefore, internal equity in relation to the entire corporation is not critical, and external equity becomes the main concern. The opposite would be true for dependent divisions. The findings of Balkin & Gomez-Mejia (1987) indicate that "related products" strategy firms emphasize internal equity over external equity. These authors suggest that more "freewheeling" compensation practices that are responsive to varying conditions, contingencies, and individual situations seem to be most effective for single product firms and strategic business units at the mature stage.

Table 1

Strategic Compensation Dimensions Used by Various Authors

Author	Balkin & Gomez Mejia	Balkin & Gomez Mejia	Broderick	Carroll	Gomez Mejia Tosi & Hinkin	Hambrick & Snow	Kerr	Kerr	Lawler	Miles & Snow	Murthy	Pitts	Rappaport	Salscheider	Salter	Steers & Ungson	Stonich	Tichy Fombrun & Devanna	Total Frequency
Year	1987a	1987b	1986	1987	1987	1987	1985	1982	1981	1984	1977	1974	1978	1981	1973	1984	1981	1982	
Type of Paper	Empirical	Empirical	Empirical	Conceptual	Empirical	Conceptual	Empirical	Conceptual	Conceptual & Case Studies	Case Studies	Empirical	Empirical	Conceptual	Case Studies	Case Studies	Conceptual	Conceptual	Case Studies	
STRATEGIC COMPENSATION DIMENSIONS																			
Basis for Pay																			
Job vs. Skills	•		•				•		•										4
Performance vs. Seniority	•		•			•	•		•										5
Individual vs. Group Performance	•			•			•	•	•									•	6
Short vs. Long Term Orientation	•			•	•	•	•	•	•				•	•	•	•	•		12
Risk Aversion vs. Risk Taking	•								•						•				3
Corporate vs. Division Performance			•			•	•	•	•	•		•			•				8
Internal vs. External Equity	•			•		•			•	•	•					•			7
Hierarchical vs. Egalitarian	•					•	•		•	•									5
Qualitative vs. Quantitative Performance Measures			•	•	•	•	•	•	•		•	•	•		•	•	•	•	14
Design Issues																			
Pay Level vs. Market	•	•	•	•					•					•					6
Fixed Pay vs. Incentives	•	•	•	•	•	•	•	•	•	•	•	•		•	•	•		•	16
Frequency of Raises or Bonuses		•		•		•		•					•		•	•	•		8
Intrinsic vs. Extrinsic Rewards						•			•							•			3
Administrative Framework																			
Centralization vs. Decentralization of Pay Policies	•		•			•			•	•					•				6
Open vs. Secret Pay	•		•						•										3
Participation vs. Nonparticipation	•		•						•										3
Bureaucratic vs. Flexible Policies	•		•			•													3

Source: Gomez-Mejia (1987) Compensation Strategy: An Overview and Future steps, Human Resource Planning, vol11 #3

Job versus Skills: Job-based pay is generally used in traditional compensation systems where the company assumes that job value can be determined and that worth is primarily comprised of the contributions of the job (rather than individual incumbents) to the organization. Skill-based pay, on the other hand, tends to be used in non-traditional settings where jobs are fluid, employee exchanges are frequent, and the entire human resources philosophy fosters employee participation and trust. Few companies pay exclusively for individual skills rather than the job itself. These organizations tend to hire professionals such as academics, lawyers and physicians (Lawler, 1981).

Performance versus Seniority: Most authors agree that this decision should be evaluated in terms of organizational goals as well as the firm's ability to measure performance. If a company can accurately measure performance and align rewards accordingly, the compensation system should be perceived as fair by the employees and serve as a powerful reinforcer of desired behavior (Kerr, 1988). If not, the system will be perceived as unfair and become highly disruptive. Unfortunately, failures in pay-for-performance systems are not uncommon. Many firms want to pay for performance, but due to their inability to measure performance, they ultimately pay for seniority (Fombrun, 1989; Gomez-Mejia, 1987).

Hierarchical versus Egalitarian: Whether the compensation system leads to a hierarchical or egalitarian atmosphere tends to be an indirect result of other strategic compensation decisions rather than a goal in and of itself. If a company provides money and various perquisites for moving up the corporate ladder, the traditional hierarchy tends to result. If, instead the firm de-emphasizes the traditional differentials between job grades, allows individuals to increase earnings without moving into management, and minimizes status-related perquisites, an egalitarian atmosphere becomes the norm. Firms that concentrate on harvesting current market share and maintaining existing profit levels tend to reinforce a hierarchical structure. On the other hand, those firms making high investments and undertaking significant financial risks in order to expand market share attempt to foster a more egalitarian style. Milkovitch (1988) suggests that the egalitarian atmosphere allows companies flexibility to deploy the work force into new areas, projects or positions without compensation changes. This could explain why growth firms prefer this style of management.

Compensation Level: The choice of the compensation level involves decisions regarding the market pay position compared to the external market.

Compensation Level versus Market: Milkovitch & Newman (1990) refer to this dimension of compensation strategy as "competitiveness" which represents the total compensation package in relation to the competition. This makes sense because the entire compensation package is what will attract and retain employees. Unfortunately, researchers seem limited to measuring base pay in relation to the market. Setting compensation rates higher than market will usually enhance a firm's ability to attract and retain employees. Paying greater than market can also create a climate where employees feel part of an elite group. Paying lower than market can be an effective strategy for low-skilled jobs or positions where qualified applicants are readily available. High base pay should be associated with firms that continually search for new products and market opportunities because their employees take more risks, and their tasks are more complex (Carroll, 1987). However, Balkin & Gomez-Mejia (1987) found that growing firms are associated with a lower base salary relative to the market. Their reasoning is that these firms have greater incentives in the compensation mix in order to minimize fixed costs incurred at this stage of growth.

Compensation Mix: The choice of a compensation mix involves decisions in the following areas: (1)fixed pay versus incentives, (2)intrinsic versus extrinsic rewards and (3) bonus versus deferred compensation.

Fixed Pay (Base Salary and Benefits) versus Incentives: Higher risks tend to be associated with opportunities for larger income. Mature firms trying to maintain their present market share generally offer more job security, and that translates into higher base wages and benefits but less incentives (Balkin & Gomez-Mejia, 1987, 1990). Those firms that are aggressively trying to expand their market share (causing employees to incur more personal risks) make use of higher incentives and lower base wages. This enables these firms to minimize fixed compensation components and channel resources into additional growth areas (Balkin & Gomez-Mejia, 1987).

Intrinsic versus Extrinsic Rewards: Lawler (1984; 1990) suggests that a firm can obtain a competitive edge if it combines a good compensation package with intrinsic rewards (e.g., achievement, recognition, etc.) that meet the psychological needs of the employees the firm hopes to attract and retain. Hambrick and Snow (1989) argue that intrinsic rewards are important in organizations that seldom make major adjustments in their technology, structure or methods of operation. This is because there is little glamour associated with this type of business, so recognition and responsability serve as important non-monetary rewards to retain achievement oriented employees.

Bonus versus Deferred compensation: Frequent bonuses and merit pay raises are associated with an emphasis on short-term performance, while deferred compensation is associated with a long-term perspective (Salter, 1973; Rappaport, 1978; Carroll, 1987; Kerr, 1987). There is disagreement as to whether frequent rewards should be utilized by firms with a high need for cost efficiency and stable tasks or by companies with a high need for innovation and unstable tasks. This controversy reflects different views about whether short or long-term goals are most important in each type of firm.

Compensation Incentives: The choice of compensation incentives involves decisions in the following dimensions: (1)individual versus group performance, (2)short versus long-term orientation, (4)risk aversion versus risk taking and (5)quantitative versus qualitative measures of performance.

Individual versus Group Performance: This issue is related to the problem of assessing performance. It has been argued that individual performance should be used as a basis for compensation because it can be a powerful motivator (Carroll, 1987). However, management's inability to accurately measure individual contributions often results in rewards being incongruent with actual performance (Lawler, 1987). Using group performance as a basis for compensation is recommended when corporate goals or the nature of work demands close cooperation in the work force (Carroll, 1987; Gomez-Mejia & Balkin, 1987). It has been suggested that combining group and individual performance criteria can enhance the reinforcement value of a pay for performance system (Tichy, Fombrun & Devanna, 1982). Lawler (1983) suggests using base salary contingent upon individual performance and bonuses dependent on group performance. Or a bonus pool could be established based on group performance and allocated based on individual performance.Lawler's suggestions are based on the presumed advantage of using both group and individual performance measures. Carroll (1987) notes that firms with a strong concern for product and market innovation find it difficult to use individual-based performance measures due to their lack of stable individual output indicators necessary to conduct these evaluations. These firms are better off if they rely on narrowly defined group performance measures to make compensation decisions. Carroll claims that this approach is more likely to foster creativity and cooperation in these types of companies. However, an empirical study by Gomez-Mejia (1987) found that within firms similar to those described by Carroll, compensation managers report that it is important to use both individual and group performance measures as a basis for compensation in order to maximize the motivational impact.

Short versus Long-Term Orientation: Most of the work in this area focuses on top executive compensation, and there are many conflicting views on the subject. Some authors contend that short-term incentives cause managers to consider only the short-term performance of the organization, and this often results in decisions that are inconsistent with long-term objectives (Lawler, 1983; Hambrick & Snow, 1987; Stonich, 1981; Rappaport, 1978). Moving to the opposite extreme, focusing entirely on the long-term picture can mean foregoing the reinforcement value provided by frequent rewards closely tied to desired behaviors. An extensive battery of measures can be used to provide managerial incentives. Included are return on assets, stock price, earnings per share and net profit. New approaches are constantly being introduced to measure and reward long-term performance. However, no single method has been found that is entirely satisfactory. A few case studies discuss alternatives for balancing short-term and long-term goals, but there is little empirical research (Gomez-Mejia & Welbourne, 1987). The time horizon for compensation may also be culture bound. According to Fombrun (1984; 1989), three levels of culture affect each employee's overall orientation toward short-term or long-term performance: societal, industry and corporate cultures. In Canada and the United States, all three of these tend to be much more concerned with short-term performance (Kanungo & Mendonca, 1990), so it will be difficult to reorient managers towards rewards contingent on long-term performance. One of the major challenges when making strategic compensation choices is to develop effective means of leading the change toward a long-term perspective. Unfortunately, boards of directors do not generally consider the performance of a firm's stock (a long-term measure of stockholder welfare) when rewarding top management (Kerr, 1985). Finally, short-term performance is easily quantifiable, and the information needed for measurement is easily obtained. This is not true for measures of long-term performance. Managers are often reluctant to commit to long-term goals because they appear risky and rather nebulous (Carrol, 1987).

Risk Aversion versus Risk Taking: According to Stonich (1981), the Japanese believe that increased job security reduces individual risk and variability of income and so allows employees to make corporate decisions that involve taking risks when needed. Job security permits managers to identify with corporate goals without worrying about the consequences of their business decisions for their personal life and standard of living. There seems to be overall agreement that risk taking is rewarded in high growth companies while risk aversion tends to be reinforced in mature firms that concentrate their efforts on maintaining market share (Gomez-Mejia & Welbourne, 1987).

Quantitative versus Qualitative Measures of Performance: It has been suggested that firms growing through mergers and acquisitions should use objective evaluation measures because they are more accurate indicators of performance for each quasi-autonomous unit, while companies expanding internally through vertical integration should use subjective measures for each unit due to their dependence on corporate headquarters (Kerr, 1985; Pitts, 1977). It is also argued that firms that are trying to be "first movers" in new product and market areas should utilize subjective performance measures to better assess entrepreneurial activities because objective, quantifiable data are not easily found (Kerr, 1982; Carroll, 1987). Firms trying to maintain secure positions in relatively stable product or service areas are said to rely on objective performance measures because quantifiable data is readily available. Objective measures ultimately result in an emphasis on short-term goals. Because of this drawback, Salter (1973) recommended utilizing both types of measures to best serve the corporation's needs.

Compensation Administration: The choice of a compensation administration style involves decisions in the following dimensions: (1)corporate versus division performance, (2)centralized versus decentralized administration, (3)open versus secret compensation, (4)participation versus nonparticipation of employees and (5)bureaucratic versus flexible compensation policies.

Corporate versus Division Performance: When utilizing only division performance as a measuring stick to distribute rewards, a corporation looses synergy and may find itself with less control over its business units than might be desired. Using only corporate performance allows some divisional managers to receive undeserved rewards (Hambrick & Snow, 1897). Rewarding based on corporate performance is more common in firms that have narrow and relatively stable product market domains and that are vertically integrated. The reasoning behind this association is that the headquarter's staff acts as an integrative force and is involved in decisions affecting division performance; therefore performance should be assessed based on the amount of cooperation and synergy obtained across the various units in addition to financial measures of division performance.

In these situations, financial measures are not necessarily representative of only division performance but reflect the contributions of corporate involvement. Therefore, divisional managers should not be exclusively evaluated on division performance because it is not totally within their control. Division performance has been recommended by Kerr (1985) and others as a reward criterion for firms at the start-up phase or those growing through acquisitions. Because firms that grow by acquisition tend to be autonomous and free from corporate controls and influence, measures of division performance are more accurate indicators of the contributions made by managerial and technical staffs. In order to spur growth, an entrepreneurial climate is desired in start-up and growth firms. This can be best accomplished by using division performance as a measure. Another justification for using division performance for these firms is that a corporation is not concerned with transferring employees between headquarters and the division because the product knowledge of employees is unique at each location. Therefore, these types of firms would not acquire the advantages associated with using corporate performance as a measure; they would only incur the disadvantages (Gomez-Mejia & Welbourne, 1987).

Centralized versus Decentralized Administration: Compensation and administration can be tightly controlled by corporate headquarters or can be delegated to various plants, divisions, and other subunits within the firm.

Lawler (1983) asserts that centralized compensation works best when the expertise from headquarters is necessary and when internal equity is emphasized. Decentralized compensation works best when local innovation is beneficial to the organization or when the strategic business units are either in different markets or at different stages in the product life cycle. Miles and Snow (1984) suggest implementing centralized compensation when economies of scale can be realized or when legislative requirements dictate centralization for ease of administration. Centralized compensation is associated with diversified "related products" firms trying to protect their present market share and business units interested in minimizing costs while retaining their position in the market (Carroll, 1987; Balkin & Gomez-Mejia, 1987). Greater control over compensation decisions is consistent with the higher bureaucracy associated with these corporate and business unit types. Single product firms carving out new market niches and undertaking projects with significant financial risks tend to exercise less direct control over compensation decisions. These single-product firms have a more organic management style, with less formal policies and the ability to decentralize decision-making.

Open versus Secret Compensation: Lawler (1983; 1990) suggests that keeping compensation issues secret breeds dependent employees. It also leads to low trust. Open compensation, on the other hand, can encourage communication and involvement, in addition to pressuring management to effectively administer the system. The empirical research conducted by Balkin and Gomez-Mejia (1987) found open compensation systems to be most effective in organizations with compensation policies that emphasize risk-sharing, flexibility, strong "pay for performance" norms, decentralized decisions, employee participation in establishing agreed-upon objectives, and a long-term compensation orientation.

Participation versus Nonparticipation of Employees: Low participation appears to fit the traditional, bureaucratic compensation approach. Participation is associated with non traditional compensation systems and highly knowledgeable workers who are actively involved in other aspects of organizational decision-making (Lawler, 1983; Balkin & Gomez-Mejia, 1987).

Bureaucratic versus Flexible Compensation Policies: Hambrick and Snow (1987) warn that frequent changes to the compensation system can result in a lack of coherent policies leading to a compensation system misaligned with organizational strategy. They suggest that the system should be formalized yet flexible enough to allow for modifications when necessary.

Summary of Dimensions of Compensation Policy Design and Administration: Conceptual Framework

Compensation Policy Dimensions

The dimensions of policy design and administration investigated in this study and the specific compensation policy decisions believed to be associated with them are listed in **table 2** and are supported by compensation researchers (Gomez-Mejia & Welbourne, 1987; Broderick, 1986; Milkovitch & Newman, 1990). These dimensions are differentiated in terms of their policy intent. They summarize in a different manner the most important dimensions presented in the literature.

The first four dimensions deal with compensation design and policy decisions. The first dimension involves compensation structure design decisions and is designated an "internal versus external equity" emphasis. The second covers compensation level and is associated a "meet/lag versus lead" policy. The third covers compensation mix decisions and is called a "membership versus performance" emphasis. The fourth involves the incentives decisions and is named "efficiency versus growth performance" emphasis. The last five dimensions deal with the compensation administration policy decisions. The fifth dimension involves compensation communication decisions and is designated an "open versus restrictive" emphasis. The sixth dimension covers compensation participation and is called a "high versus low" emphasis. The seventh dimension is compensation decentralization and is associated a "high versus low" emphasis. The eighth dimension is compensation structure formalization and is associated a "high versus low" emphasis. Finally, the ninth dimension is called compensation standardization and is associated a "high versus low" emphasis.

Level of Analysis: Compensation for Middle Managers

The literature review gives evidence that compensation policies and reward items vary with the group of employees involved (Milkovitch & Broderick, 1990; Sibson, 1990; Lawler, 1971; 1981). For example, the job valuation criteria chosen will be different for highly professionals, generalists and laborers. Emphasis should be laid upon external equity (external market wages) in valuing professional jobs, while, in contrast, it should be laid upon internal equity (internal norms and work group customs) in valuing the jobs of laborers, and upon both in valuing the job of generalists (Broderick, 1986). Another example would be the timing of pay incentives. Whether it should be short or long term oriented will also depend on the group of employees involved. Another example is that policies on compensation formalization, for instance, might vary with the employee level in the organization and the compensation decision involved (Salter, 1973; Kerr, 1984). Many other examples could be given to illustrate this point. It is therefore important to determine the group of employees on which compensation dimensions will be studied.

Table 2 : Compensation Policy Dimensions

COMPENSATION DESIGN

1/ Compensation structure design
(external vs internal equity emphasis)

2/ Compensation level
(meet/lag vs lead market pay position)

3/ Compensation mix
(membership vs performance)

4/ Compensation incentives
(efficiency vs growth performance objectives)

COMPENSATION ADMINISTRATION

5/Communication
(open vs restrictive)

6/ Participation
(high vs low)

7/ Decentralization
(high vs low)

8/Structure formalization
(high vs low)

9/Standardization
(high vs low)

Why focus on middle managers ? First, the number and influence of middle managers have been increasing in organizations over the past few years. Administration costs associated with middle management positions have expanded in a parallel manner. Second, it is interesting to focus on this group of employees since, while manufacturing firms expanded the number of white collar and management employees (top managers as well as middle managers) during 1978-1986, productivity did not increase. In contrast, manufacturing firms decreased the number of blue collar workers during the same period, but their productivity increased (Cameron, Freeman & Mishra, 1991). Third, most of the empirical studies on strategic compensation is done at the top executive level. Very few studies deal with the compensation systems of middle managers. In addition, effective compensation administration for middle level positions is a particularly difficult and important subject in many firms. Many compensation practices applied to middle level positions were designed for office or factory positions and simply extended upward. Others were designed for management positions and extended downward to middle-level positions. In either case, compensation practices have rarely worked well for middle jobs, primarily because they were not designed for these positions (Sibson, 1990). It is therefore interesting to focus on this employee level.

It is important at this stage to define middle level positions. Sibson (1990) defines middle managers as the ones who translate the company's strategy, expressed in general terms, at the top management level, to operational details. They are neither operational workers nor in the top management group. Middle group employees would include sales persons and professionals, but also a disparate group of supervisory, administrative and technical positions. In 1990 dollars, the supervisory, administration and technical positions would generally include salaried personnel earning between $ 15 000 and $ 50 000 a year (Sibson, 1990). However, there is some ambiguity in the definition of a middle manager since there is no clear distinction between a supervisor and a middle manager from one side, and a middle manager and an executive from the other. A first line manager can be referred to either as a supervisor or as a manager, depending on his/her skill and experience. For example, the head of quality control or of the auditing unit is usually referred to as a manager rather than a supervisor because of the skill level required for that unit. A second level manager, typical of middle management positions, is one where the subordinates of this position have their own subordinates. The definition of middle managers becomes more ambiguous once more approaching the higher levels where, from a certain position and on, the position is classified as an executive position. Therefore, any managerial position that has not been classified as an executive position and is above a supervisory position, is considered to be a middle management one.

Because we are using in our research Broderick's data collected for her Ph.D. dissertation, it is important to give her definition of a middle manager position, since this definition was written on the questionnaires mailed to organizations. According to her, *"The lower limit on the definition of middle managers is the point at which a manager becomes bonus eligible or is offered some form of incentive program. The upper limit on the definition is the point at which executive compensation begins"* (Broderick, 1986).

Advantages of choosing middle managers as the group of employees on which the study's investigation of compensation policies would focus are the following: (1) Usually, compensation systems for middle managers include a higher number of incentive options than compensation systems for lower level managers or non management employees. This increases the likelihood of collecting data on a variety of incentives decisions. (2) The pay of middle managers, as opposed to that of executives, is less likely to be influenced by the decisions of people from outside the organization. This decreases the chances that data on compensation policies would be considered confidential (Broderick, 1986). Therefore, this study will investigate the compensation policy dimensions presented in **table 2** for middle level managers.

In conclusion, we want to underline the role of compensation design and administration in total human resources strategy. Compensation is only part of the policies and programs that organizations use to manage employees. Decisions regarding employment security, development and training, career opportunities, employee assistance programs and organizational design, along with compensation, form patterns of human resources policies (Milkovitch & Newman, 1990). Compensation can act as an instrument of change or simply act as a support of the overall human resources strategy. The implementation of profit-sharing plans, for example, acts to signal competitive environments to encourage employees to identify with corporate performance, and to support corporate values. Alternatively, other human resources initiatives, such as transforming organizational structures, forming work teams and developing other flexible arrangements may act as the change agent in the overall human resources strategy. In such cases, compensation's role may be to support, rather than be on the cusp of human resources strategy (Milkovitch, 1990; Lawler, 1981; 1990). Compensation decisions are part of the pattern of human resources decisions: "They do not operate in a vacuum" (Lawler, 1990). The rush to implement compensation programs, particularly incentive pay, without first examining their role in the total human resources strategy, often results in failure and employee distrust. Hence determining compensation's role in the overall human resources strategy is a strategic decision.

Strategy and Compensation: Conceptual Framework

This section presents the conceptual framework of our research. It proposes first a definition of the concept of strategy and presents a review of the different types of constructs representative of business strategy. It also provides the rationale for using Porter's generic strategies in this study. Second, this section addresses the first question of our research: "*Do the business strategies of cost leader versus differentiation influence the choices of compensation design and administration characteristics for middle managers ?* " It presents a review of the strategy-structure literature before investigating how compensation systems might vary with strategy. Hypotheses about how compensation policies will vary with different strategy choices will be presented in section three of this chapter.

An Introduction to Organization Strategy

In this section, a definition of strategy is proposed and the choice of the business level strategy as our unit of analysis is explained. Porter's generic business strategies are also presented.

Towards a Definition of Strategy

Organizational strategy is one of the broadest and most complex concepts used in studying organizations.

Because the concept of strategy has been evolving rapidly in the business policy literature, it is important to define which concepts of strategy is used and what unit of analysis is studied in this research.

The word "strategy" is derived from the Greek "strategos" -literally, "the art of the general" (Hart, 1967). In early organizational literature, strategy was viewed as a situational art in which the chief executive would craft a comprehensive plan of action that matched environmental opportunities and threats, internal strengths and weaknesses, and managerial values (Hambrick, 1983; Chandler, 1962). In contrast to the Harvard Business School normative approach , Chandler's research was the first to employ strategy as a descriptive concept. In his view, strategy is the key: mechanism used for charting a new direction and its impact on organizational structure and performance is substantial.

> *Strategy refers to the determination of the basic long-term goals and objectives of the enterprise and the adoption of courses of action and the allocation of resources necessary for carrying out these goals (Chandler, 1962 p:13).*

Clearly, this definition of strategy includes elements of both <u>ends</u> (objectives and goals) and <u>means</u> (courses of action and allocation of resources). Today, strategy theorists do not agree about whether the concept should include goals and objectives as well as the means used to achieve them (Hofer & Schendel, 1979).

As the strategy concept received more systematic attention, some of its nuances came to light: (1) the distinction between intended and realized strategy (Mintzberg, 1978); (2) the temporal qualities of strategy (Miller & Friesen, 1980; Mintzberg, 1978) and (3) the relationship between strategy and internal organizational features (Galbraith & Nathanson, 1978; Miles & Snow, 1978; Porter, 1980).

Researchers have, however, reached a general consensus on distinguishing between strategy formulation and strategy implementation. This formulation/implementation dichotomy is useful conceptually, but it implies that strategy is developed consciously and purposefully (Snow & Hambrick, 1980). Although this may be true in many instances, Mintzberg (1978) has described how organizational strategies can emerge unintentionally. Therefore, in order to include both premedidated and emergent strategies in theoretical conceptualizations, Mintzberg as well as Miles and Snow (1978) have suggested that researchers should view strategy as "a pattern in the organization's important decisions and actions". Typically, these decisions will be directed at (1) maintaining the organization's alignment with its environment and (2) managing its major internal interdependencies. Although, since then, strategy has been defined in a variety of ways, we retain Hofer and Schendel's (1979) definition since it is consistent with the needs of contingency theory and with the views of most scholars in the field of strategic management (e.g., Porter, 1980, Schendel & Hofer, 1979). According to this definition:

> *A strategy describes the fundamental characteristics of the match that an organization achieves among its skills and resources and the opportunities and threats in its external environment that enables it to achieve its goals and objectives* (Hofer & Schendel, 1979).

Defining strategy in this manner allows researchers to move beyond the abstract and normative aspects of strategy toward those decisions which actually involve organizational goals and the allocation of resources necessary to achieve goals.

The Different Types of Strategy

Strategies exist at different levels in an organization. They are classified according to the scope of what they are intended to accomplish. Strategic management literature highlights three levels in the hierarchy of strategies: (1) corporate level, (2) business level and (3) functional level. Since functional strategies are narrower in scope than business and corporate strategies and deal with the activities of the functional areas, production, finance, marketing, personnel and the like, the study of strategy in business policy tends to occur either at the corporate or at the business level of analysis (Hofer & Schendel, 1979; Hrebiniak, Joyce & Snow, 1980; Beard & Dess, 1981).

Corporate strategy defines the nature and range of businesses a firm intends to operate. It is conceived in terms of variation in the portfolio of industries in which a firm does business. Hofer and Schendel (1979) define corporate strategy in terms of "variation in the deployment of a firm's resources among the portfolios of industries within which all business firms compete". Corporate level strategy is concerned primarily with answering the question of: "What set of businesses should we be in?" (Hofer & Schendel, 1979 p:27). Consequently, scope and resource deployments among businesses are the primary components of corporate strategy.

At the business level, the key strategic question is "How should we compete in this business?". Hofer and Schendel (1979) define business-level strategy in terms of "variation in firm characteristics relevant to competitive success or failure within a given industry".

> *At the business level, strategy focuses on how to compete in a particular industry or product-market segment. Thus distinctive competences and competitive advantages are usually the most important components of strategy at this level (Hofel & Schendel, 1979 p:27,28).*

Business Level Strategy

The rationale for focusing on the business level of strategy and the alternatives for operationalizing business level strategies in research are presented below.

<u>Why Focus on Business Level Strategy</u> ?

In order to develop an integrative model of compensation, strategy and performance, which is the objective of this research, we must choose a common unit of analysis. The distinction between corporate-level strategy and business-level strategy is of key importance in doing empirical strategy research (Hofer & Schendel, 1979).

For our investigation, we have chosen the <u>business unit</u> of multibusiness firms as our unit of analysis. There are two related reasons for this choice. Most important, there are strong theoretical links and empirical associations between industry, environment, structure and performance. Therefore, a unit of analysis corresponding to distinct industries is needed. As described by Hall (1983), business units within multibusiness firms do correspond to specific and discrete industry environments or markets.

> *The fundamental concept in the identification of strategic business units is to identify the discrete independent product-market segments served by the firm. In essence, the idea is to decentralize on the basis of strategic elements, not on the basis of size or span of control (Hall, 1983 p:18).*

Second, human resources management specialists have often related human resources issues, and hence compensation decisions, to the business unit level of strategy. Even if both the corporate and business levels of strategy influence compensation strategy development, there exists increasing calls for a contingency approach to compensation such that different parts of the organization should employ different compensation procedures and systems in order to more closely conform to actual differences in strategic mission. Differences in strategic mission generally point to the need for different business units to focus differently on long-term considerations relative to short-term concerns, and to differential concerns related to using cost leader versus differentiation strategies, or defender versus prospector strategy (Carroll, 1987). As a consequence, the business level of strategy is chosen for this research, since it is more appropriate to study compensation design and administration characteristics at the middle management level.

Alternatives for Operationalizing Business-Level Strategy in Research:

Over the past several years, numerous models for visualizing business strategies have been proposed. Typically, these models are used in developing normative propositions regarding the appropriate strategy for an organization operating within its chosen environment (i.e. industry). Recently doubt has begun to emerge concerning the underlying assumptions of previous conceptual frameworks and the usefulness of prescriptions based on them. With the recognition of limitations and defects in previous constructs representative of strategies, other researchers have proposed alternative guides for strategy formulation. Alternatives for operationalizing business-level strategy in research are briefly presented here.

Research on business-level strategy has involved basically four different approaches to operationalizing the construct (Hambrick 1980).

(1) First, one view of strategy was to consider it as a situational art that can best be studied through in depth case studies. Strategy, in turn, is characterized textually and no attempt is made to measure strategic behavior. Textual operationalizations of the strategy construct are particularly useful in theory building, but are of limited use in theory testing (Mintzberg, 1977).

(2) Another approach to strategy was to rely on one or a few key variables to portray strategic behaviors. Examples are studies that have viewed market share as the dominant strategic variable, or studies that have focused on a limited number of strategic variables in a single functional area (e.g. marketing). These views of strategy are typically accompanied by relatively reliable measurement of the key variables, since the researcher is drawn to the more quantifiable of those available. Because such research typically involves only one or two key strategic variables, usually on interval scales, these partial operationalization of strategy can be used meaningfully as predictor, mediator or criterion variables. The apparent limitation of such a view of strategy is that it does not capture the breadth of decision areas that constitute strategy.

(3) A third view of strategy was to consider it as a quantifiable interaction of a broad set of variables. Typically, a regression analysis is carried out to determine the effects of the various combinations of variables on organizational performance. These researchers have been able to generate an inventory of potentially important strategic variables and test the relationship of these variables with other constructs, such as organizational performance (Hatten & Schendel, 1979; Lenz, 1978; 1980). Although the multivariate approach to strategy pinpoints interwoven statistical associations, its results are not necessarily generalizable. A multivariate analysis is most useful when strategy is viewed as a predictor construct in a research design.

(4) The fourth and perhaps most recent approach to operationalizing business-level strategy is through strategic typologies, in which each strategic type is viewed as having its own distinct pattern of characteristics. Recently, two notable attempts have been made to empirically establish typologies of business level strategies. One, developed by Miller and Friesen (1977) and the other by Miles and Snow (1978). Miller and Friesen's framework does not distinguish between corporate level and business strategy, but it encompasses elements of both. The authors used Q-typed factor analysis to determine ten strategic types (or "archetypes") based on their quantified assessments of 81 published business cases. The variables

that entered into their analysis included dimensions of strategic content (e.g. product market innovation), and strategic process (e.g. centralization). Each of the ten archetypes (six successful, four unsuccessful) was labeled according to the scores of its member firms on five key factors. For instance, "the impulsive firms" (one of the unsuccessful archetype) had high heterogeneity, high dynamism, low intelligence/rationality, high centralization and high risk-taking temperament. The "stagnant bureaucracies" (another unsuccessful category) had low heterogeneity, low dynamism, low intelligence/rationality, moderate centralization, and low risk-taking temperament. Thus, each of the ten empirically derived archetypes had its own fairly comprehensive strategic profile.

Miles and Snow (1978) originally developed their strategic typology to help explain differences among textbook publishing firms they studied. They later extended, verified, and applied the typology in several other industries. The primary dimension underlying their typology is the organization's rate of product-market change. For example, organizations that really change their products or markets are Defenders. Those that readily and frequently alter their products and markets are Prospectors. Analyzers represent an intermediate category, and Reactors are inconsistent in their approach to product market change. Miles and Snow have enriched their typology beyond a one-dimensional classification scheme by documenting the co-alignment of other dimensions which correlate with the key product-market change variable. For example, Defenders tend to compete primarily on price, delivery or quality; they invest relatively large sums in process engineering; they have relatively mechanistic structures and processes; and they are run primarily under the influence of production and accounting executives. Similarly, organizations in the prospector, analyzer and reactor categories have their own comprehensive profiles.

Using a strategic typology to study linkages with other organizational structure and process dimensions can be problematic. But researchers have tested for the association between the strategic types and other variables that did not constitute the basis for typing in the first place. If strong associations emerge, the typology takes on new richness: the descriptions of some or all of the types can be expanded. Any typology will have limited applicability. For example, the Miles and Snow typology may not apply in some industries and may have serious limitations in others. The primary strength of a typology is that its endeavour to capture both the comprehensiveness and the integrative nature of strategy. Their usefulness in research is still open to question and clearly will vary according to the research question asked and the characteristics of the particular typology applied (Hambrick, 1980).

Any attempt to categorize the complex phenomenon of business strategy into a limited number of strategy types will necessarily involve simplification. It is necessary to concentrate on certain aspects of business strategic posture while ignoring others. For this reason, recently, the normative propositions advanced by Porter (1980) have had a profound impact on the study of strategic management as well as generating intense interest in the popular press (New York Times, January 2, 1981; Fortune, October 5, October 19, November 2, 1981). Porter's generic business strategies do not correspond directly to other strategy types, like the Boston Consulting Group (B.C.G) model or Miles and Snow (1978) approaches. But these conceptions are not necessarily mutually exclusive. For example, pursuing a cost leadership strategy does not necessarily preclude building, maintaining or harvesting the business, or prospecting for a new market area. Business strategy is not unidimensional; these are different aspects of a complex phenomenon. However, as a first step, in studying business strategy-compensation fit relationships it makes sense to proceed by selecting a simple business strategy concept which incorporates a few critical dimensions, yet has strong theoretical underpinnings. Porter's generic business strategies meet these tests. This is why we will choose Porter's framework in our empirical investigation.

Porter's Generic Strategies

For a business in a competitive environment, success and survival depend primarily upon creating a defendable competitive position. Porter identified three potentially successful generic strategy approaches for creating a defensible position and out-performing competitors in a given industry. The first, *overall cost leadership*, which although not neglecting quality, service and other areas, emphasizes low cost relative to competitors. The second strategy, *Differentiation*, requires that the firm create either a product or a service recognized industry-wide as being unique, thus permitting the firm to command higher than average prices. The third is a *focus strategy*, in which the firm concentrates on a particular group of customers, geographic markets or product line segments. This can be either a cost leadership or a differentiation strategy. The strategies of overall cost leadership, differentiation and focus are briefly presented.

Cost leadership requires aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas like R&D, service, sales force, advertising and so on. A great deal of managerial attention to cost control is necessary to achieve these aims. Low cost relative to competitors becomes the theme running through the entire strategy, though quality, service, and other areas can not be ignored. Having a low cost position yields the firm above average returns in its industry despite the presence of strong competitive forces. Its cost position gives the firm a defence against rivalry from competitors because its lower costs mean that it can still earn returns after its competitors have competed away their profits through rivalry. A low cost position protects the firm against all five competitive forces (threat of new entrants, bargaining power of buyers, threat of substitutes, bargaining power of suppliers, rivalry among existing firms), (Porter, 1980).

The second generic strategy is one of differentiating the product or service offering of the firm, creating something that is perceived industry-wide as being unique. Approaches to differentiating can take many forms: design or brand image, technology, features, customer service, dealer network or other dimensions. Ideally, the firm differentiates itself along several dimensions. It should be stressed that the differentiation strategy does not allow the firm to completely ignore costs. Instead, they are not the primary strategic target. Differentiation, if achieved, is a viable strategy for earning above-average returns in an industry because it creates a defensible position for coping with the five competitive forces, albeit in a different way than cost leadership. Differentiation provides insulation against competitive rivalry because of brand loyalty by customers and resulting empirical attention. The notion was implicitly raised by Fouraker and Stopford (1968), who found that organizations with functional structures had difficulty pursuing an international diversification strategy while organizations with product, divisionalized, structures were able to diversify much more easily. Hall and Saias (1980) noted that structure may constrain and even determine strategy in three major ways: (1) structure can determine the introduction and subsequent development of strategic planning in an organization, (2) structure affects managers' perceptions of both internal and external events, and (3) structure can affect the strength, speed, and character of strategic decisions. Their conclusion was that the strategy-structure relationship is complex, iterative and symmetric (Hrebiniak, Joyce & Snow, 1984).

Most recently, structure has been viewed as part of the implementation of strategy (Hrebiniak & Joyce, 1984). Thus, strategic decisions are actualized by first developing primary structures (functional, product, matrix and so forth) and then supplementing these with operating structures, goals, incentives and controls. This is the one of the rare frameworks developed thus far that integrates major planning and organizing decisions at multiple levels of strategy and structure. According to contingency theory, Hrebiniak (1984) proposes a logical order among the elements considered in implementing strategy and provide a process and framework for determining the content of implementation activities. According to them, important questions concerning the relative desirability of altering strategy, structure, compensation and control systems (or some combination of these) are addressed based on the nature of the strategic problems encountered and the time available for implementation.

Miles and Snow (1978) have developed a general model of the adaptation process, the adaptive cycle. Consistent with the strategic choice approach to the study of organizations and contingency theory, the model parallels and expands ideas formulated by theorists such as Chandler (1962) and Thompson (1967). Essentially, proponents of the strategic choice perspective argue that organizational behavior is only partially pre-ordained by environmental conditions and that the choices top managers make are the critical determinants of organizational structure and process. The question becomes: how do organizations move trough the cycle and what strategies do organizations employ in solving their entrepreneurial, engineering and administrative problems? By answering that question, Miles and Snow divide organizations in three strategic types, defenders, prospectors and analyzers, presented earlier in this chapter. A fourth type of organizations is the reactor, a form of strategic failure, in that inconsistencies exist among its strategy, technology, structure and process. Each type has its own unique strategy for relating to its chosen market(s), and each has a particular configuration of technology, structure and process that is consistent, that "fits", with its market strategy. These typologies specify relationships among strategy, technology, structure and process to the point where entire organizations can be viewed as integrated wholes in dynamic interaction with their environments.

Any typology is unlikely to encompass every form of organizational behavior - the world of organizations is much too changeable and complex to permit such a claim - nevertheless, Miles and Snow have observed that, when compared to other organizations in their industry, organizations fit predominantly into one of the four categories. Their behaviors are generally predictable given its typological classification.

The concept of fit between strategy and structure is also illustrated by Porter (1980). In his book "Competitive Strategy" (1980), Porter presents the organizational requirements to implement successfully the generic strategies presented above. He primarily focuses on the commonly required skills and resources and on the common organizational requirements associated with each generic strategy.

These requirements are, according to him, necessary to implement successfully both strategies. For instance, the commonly required skills and resources for the <u>overall cost leadership strategy</u> are (1) substained capital investment and access to capital, (2) process engineering skills,

(3) intense supervision of labor, (4) products designed for ease of manufacturing, and (5) low cost distribution systems. This approach requires: (1) tight cost control, (2) frequent detailed control reports, (3) highly structured and formal organization and job design and (4) incentives based on meeting strict quantitative targets.

The commonly required skills and resources for the differentiation strategy are (1) strong marketing abilities, (2) product engineering, (3) creative flair, (4) strong capability in basic research, (5) corporate reputation for quality or technological leadership, (6) long tradition in the industry or unique combination of skills drawn from other businesses, and (7) strong cooperation from channels. This approach requires: (1) strong coordination between functional areas (e.g., R&D, product development and marketing), (2) subjective performance measurement and qualitative long-term evaluation criteria and (3) amenities to attract highly skilled labor, scientists or professionals.

No explicit requirements are made regarding overall compensation policies for each generic strategy. **Table 3** summarizes the proposed differences in compensation policies across Porter's generic strategies. Some logical differences in compensation policy decisions can be inferred directly from Porter's framework.

Porter did not discuss compensation policy decisions associated with the three generic strategies. He did however present the commonly required skills and resources and common organizational requirements of each strategy. This permits inferences about the compensation policy decisions likely to be associated with each generic strategy. In fact, the proposed differences in compensation policies across Porter's generic strategies are inferred from several sources. They are derived first from Porter's statements (1980). Also the development of contingent framework in organizational design (i.e. Contingency Theory) suggests that the administration policies of all organization systems should be consistent with those characteristics of its overall administration. Thus, this logic is applied here to extend descriptions of overall administration policies to the compensation policies level. Table 3 indicates that there might be a particular set of policy alternatives associated with the cost and differentiation strategies.

TABLE 3

Logical Differences in Organizational Requirements and Compensation Across Generic Strategies

COST LEADERSHIP STRATEGY

Commonly Required Skills & Resources	Common Organizational Requirements	Inferred Compensation Policies
Substained capital investment and access to capital Process engineering skills Intense supervision of labor	Tight cost control. Frequent, detailed control reports. Structured organization and responsibilities	Cost emphasis High formalization and standardization Efficiency related performance objectives Incentives based on meeting quantitative targets Quantitative and short run evaluation criteria

DIFFERENTIATION STRATEGY

Commonly Required Skills & Resources	Common Organizational Requirements	Inferred Compensation Policies
Strong marketing abilities Product engineering skills. Creative flair. Strong capability in basic research Corporate reputation for quality or technological leadership. Long tradition in the industry or unique combination of skills drawn from other businesses Strong cooperation from channels	Strong coordination among functions in R&D, product development and marketing. Amenities to attract highly skilled labor, scientists or creative people.	Open communication Reward for performance. Growth-related performance objectives. External equity. Lead market pay position Qualitative and long term evaluation criteria

In brief, inferred compensation policies for cost leader organizations are: cost emphasis, efficiency-related performance objectives, incentives based on meeting quantitative targets, quantitative, short-term evaluation criteria and high formalization and standardization. In contrast, inferred compensation policies for differentiating organizations are: external equity emphasis, reward for performance, growth related performance objectives, qualitative and long-term evaluation criteria, lead market pay position and open communication.

As a conclusion, the internal structure and process, when designed to "fit" the strategy, are key contributors to the effectiveness of the organization. Compensation systems are part of the organization structure and process. Their design is a critical issue that managers have to face when designing internal structure and process within the organization, in accordance with strategy. Next section presents the compensation-strategy relationship.

Strategic Compensation: A Question of "fit" between strategy and compensation

The notion that compensation policies are strategic, thereby affecting the mission of the organization, has considerable currency (Milkovitch, 1988). While some may write it off as another fad, a less cynical view is that a strategic perspective on compensation is part of a growing recognition that macro-organizational issues are an important part of the study of human resources management.

According to Milkovitch (1988), the importance of a strategic perspective on compensation rests on three fundamental tenets. The first is that compensation policies and practices differ widely across organizations and across employee groups within organizations. The second tenet is that the decisions managers and employees make, help shape these differences. Indeed, a strategic perspective implies the anticipation of environmental pressures and assesses whether these pressures require changes in compensation systems. Perhaps most fundamental of all tenets on which a strategic perspective on compensation is based is the belief that fitting compensation systems to environmental and organizational conditions makes a difference; that making compensation policies and practices contingent on organizational and environmental conditions (strategy) has some desired effects on employee behaviors and the performance of organizations (Ehrenberg & Milkovitch, 1987). This section explains what it means to be strategic. Next section will explain what factors are affected by strategic compensation.

Milkovitch (1988) offers the following definition of strategic compensation:

> *A strategic perspective on compensation focuses on the patterns of compensation decisions that are critical to the performance of the organization. Such decisions, in all likelihood, vary by employee groups within organizations (Milkovitch, 1988).*

Given this definition, the major research tasks are then to (1) identify the compensation decisions and employee groups that are strategic, (2) develop measures or descriptions of these decisions, (3) extract any basic combination or patterns of decisions that may be related to a variety of organizations and environmental conditions, and finally (4) determine if compensation strategies affect workforce behaviors which in turn affect the implementation of an organization strategy.

Issues of variation, interrelation and fit are well developed in the strategy literature. It contains many analyses of congruence between strategy and other organizational variables (Miller & Friesen, 1984; Miles & Snow, 1978; Miller, 1986; Hambrick, 1983, 1984). This body of research suggests that coherent or matching strategy types are more effective. The concept of fit is based on the notion that strategies are decomposable, consisting of elements (e.g., technology) that are interesting for their individual importance as well as their role in overall strategic plan (Venkatraman, 1986). If the various elements are not integrated or congruent with the overall strategy, the organization has an unclear, or missing, strategic direction leading to suboptimal or even dysfunctional outcomes (Lawler, 1987). In other words, because strategy elements should be mutually determined by a firm, the interrelationship implies that an important normative test for a firm's strategy is internal consistency (Porter, 1980; Galbraith & Schendel, 1983). A growing number of writers are advocating a strategic approach to the compensation system based on such notions as "congruency", "fit", "linkages", which call for a close articulation between compensation and business unit missions (Carroll. 1987; Lawler, 1981; Balkin & Gomez-Mejia, 1987). In a futuristic environmental scanning of major compensation trends, Hay Management Consultants (1986) concluded that linking compensation systems to organizational strategies will be the major challenge as we move into the 21st century. The underlying assumption is that, when properly designed, the compensation system of an organization can be a key contributor to the accomplishment of its strategic objectives. However, careful analysis needs to be made of the role that compensation can and should play in the strategic plan of the firm. Unless compensation strategies reinforce the organization's overall strategy, the return on compensation dollars will be less than optimal and even negative in some cases if compensation policies induce behaviors that run counter to a firm's strategic objectives (Lawler, 1981).

The most voluminous literature that specifically addresses strategic concerns in compensation can be found in the executive compensation area (Salter, 1973). Closely related to the work on executive compensation are some studies that examined the relationship between strategy and rewards for middle managers. Based on expectancy theory, the evidence was provided that middle managers are not motivated to implement strategies that conflict with their own self-interest. Napier and Smith (1987) report that highly diversified firms offer larger bonuses to their middle managers when compared to less diversified companies. Some additional research has examined compensation strategy in terms of specific industries and employee groups. For example, Balkin and Gomez-Mejia (1987) found that the effectiveness of compensation incentives for scientists and engineers was related to the growth stage of the product life cycle and inversely related to company size. All things considered, however, surprisingly little empirical investigation has been conducted that could serve as a guide in designing compensation systems that are alined with business unit strategies. As a consequence, there is definitively a need for this research.

According to Carroll (1987), choices of compensation policies are certainly influenced by the choice of a business strategy. Carroll argues that the Miles and Snow typology seems to have the clearest implications for compensation system differences. Defender and prospector firms have exactly opposite orientations, with the former emphasizing cost controls and the latter innovation. In addition, the structures are likely to be different, with the defender firm having a mechanistic structure and the prospector firm a rather organic structure. Since different types of structures and differences in the stability of tasks influence what types of incentives systems can or cannot be used, these strategies lead to differences in the types of compensation systems that are appropriate. Carroll (1987) describes how some compensation system characteristics might vary in the prospector firm versus the defender firms. This is based on the fact that the prospector and defender firms differ not only in the relative emphasis they place on cost efficiency versus innovation, but also in structural characteristics and task-stability as well. Performance measures will be quantitative for the defender and qualitative for the prospector. The frequency of performance as well as the frequency of incentives will be higher in the defender firm because objective data are available and such firms tend to have a short term orientation. The size of the bonus given to managers and the amount of differentiation should be higher in the prospector firm because there are higher risks and greater difficulty in making good in unstable markets. However there should be at least moderate-size bonuses and differentiation in the defender firm because differences in performance do exist, and they must be rewarded with noticeable bonuses if motivation is to be encouraged. Also incentive plans are appropriate in the defender organization but not in the prospector organization because stable individual output measures are not likely to exist in the latter. Group bonus systems are most appropriate for the prospector firm because only group performance can be measured and also because creativity is fostered by encouraging intra-group cooperation and good information flows among individuals. There should be some emphasis on long-run performance in both defender and prospector firms, with more emphasis required in the latter. In addition, high pay is probably especially needed in the prospector firms because there is more risk in employment in such firms and the tasks for managers are more complex than in the more stable and established product firms. Finally, deferred compensation alternatives might be more valuable in the prospector firms since often in such firms there is a high turnover of managers and often they leave with much valuable knowledge badly needed in the firm. Most gainsharing plans for workers would not seem appropriate for the prospector firm, because for their effective use, they require a stable performance standard and also allow only moderate work process changes. As a conclusion, Carroll provides us with a view of what should be the compensation characteristics and differences in emphasis in the defender or the prospector firm, given differences in goals, structures and task stability. Business strategy does really influence the choice of compensation policies. **Table 4** summarizes these results.

Table 4

Managerial and worker compensation system differences in defender versus prospector firms

COMPENSATION SYSTEM CHARACTERISTICS	DEFENDER FIRM	PROSPECTOR FIRM
Performance Measures Used	Quantitative	Qualitative
Frequency of Performance Measurement	Very Frequent	Less Frequent
Size of Bonus Payments	Moderate	High
Amount of Merit Differentiation	Moderate	High
Degree of Use of Individual Bonus Plans	High	None
Degree of Use of Group or Organizational Bonus Plans	Moderate	High
Degree of Emphasis on Long-Run Performance in the Compensation System	Moderate	High
Degree of Emphasis on Short-Run Performance in the Compensation System	High	Moderate
Internal Pay Equity	High	High
Pay Level as Compared to Market	Moderate	High
Use of Deferred Compensation to Encourage Employment Stability	Moderate	High
Use of Gainsharing Plans (Scanlon, etc.)	High	Low
Degree of Use of Guaranteed Compensation for Key Operatives, Managers, and Professionals	Moderate	High

Source: Carroll (1987), Business Strategies and Compensation Systems, in New Perspectives on Compensation, Balkin and Gomez-Mejia eds.

The results of Carroll's (1987) research are interesting since they can be derived and applied to the

Porter (1980) strategies of cost leadership and differentiation. In analyzing the proximities between the typology of Miles and Snow and Porter's generic strategies, Segev (1989) demonstrated that similarities exist between the cost leader (Porter) and the defender (Miles & Snow), and the differentiator (Porter) and the prospector (Miles & Snow). Cost leaders and defenders are in the short-run low-risk strategies, while the prospector and the differentiator incorporate high-risk level in the short-run. Therefore, even if some differences remain between the Porter's strategies of differentiation and cost and the Miles and Snow's strategic types of propector and defender, Segev concludes that his research will enable researchers to relate previous findings in the context of one typology to the framework of the second typology. As a consequence, it is possible to derive from Broderick's study (1986) and Carroll's research (1987) some proposed differences in compensation policies across Porter's generic strategies.

We suggest that organizations with a cost leadership strategy are most likely to have a compensation design policy emphasizing internal equity, with a meet/lag market pay position, membership and efficiency performance objectives and compensation administration policies reflecting restricted communication, centralization in decision making, high formalization and standardization. Organizations with a differentiation strategy are most likely to have a compensation design policy emphasizing external equity, a lead market pay position, performance, efficiency performance objectives and compensation administration policies reflecting open communication, decentralization in decision making, low formalization and low standardization. **Table 5** summarizes these proposed differences in compensation policies across Porter's generic strategies.

So far each reward system design feature has been treated as an independent factor. This was done for exposition of the concepts but it fails to emphasize the importance of overall reward system congruence. Compensation system design features are not stand-alone items (Lawler, 1984). There is considerable evidence that they affect each other and, as such, need to be supportive of the same types of behavior, reflect the same overall managerial philosophy, and be generated by the same business strategy.

TABLE 5

Proposed Differences in Compensation Policies across Porter's Generic Strategies

COMPENSATION POLICIES	***BUSINESS STRATEGIES***	
	COST LEADERSHIP	DIFFERENTIATION
DESIGN		
Compensation Structure		
1.Equity emphasis (external vs internal)	Internal (specific skills)	External (general skills)
Compensation Level		
2.Market position (meet/lag vs lead)	Meet or lag	Lead
Compensation Mix		
3.Mix (membership vs performance)	Membership	Performance
Compensation Incentives		
4.Incentives (efficiency vs growth performance)	Efficiency	Growth
ADMINISTRATION		
5.Communication (restrictive vs open)	Restrictive	Open
6.Participation (high vs low)	Low (intense supervision)	High (cooperation)
7.Decentralization (low vs high)	Low	High
8.Formalization (structure & level) (high vs low)	High	Low
9.Standardization (high vs low)	High	Low

The importance of congruence is not limited to just the compensation system in an organization. The compensation system needs to fit the other features of the organization in order that total human resources management system congruence exists. This means that the compensation system needs to fit such things as the way jobs are designed, the leadership style of the supervisors, the types of career tracks and the like. Overall, the design of an effective compensation system demands not only a close articulation between the business strategy and the compensation system, but also a clear fit between the compensation system and the other design features of the organization. Lawler (1984) suggests that the key strategic decisions about the compensation system need to be made in an interactive fashion in which tentative compensation system design decisions are driven by the business strategy and then are tested against how other features of the organization are being designed. The key, of course, is to ultimately come up with an integrated human resource management strategy that is consistent in the way it encourages people to behave, that attracts the kind of people that can support the business strategy, and that encourages them to behave appropriately (Lawler, 1984).

Lawler (1990) even considers the use of compensation systems as a change agent in organizations. Compensation policies can affect organization climate and therefore induce organization change. According to him, compensation is a common language shared by all, and because of this, it is a medium through which an organization can communicate with all its employees. Thus, compensation practices can influence the whole climate of the organization. They can be a direct indication to employees of a change in management thinking or management style. All too often organizations expect dramatic changes in behavior because of an announced reorganization, when in fact the compensation system is communicating to individuals that change is undesirable. Failing to change or adapt first the compensation system prevents organizations from implementing the new structure and objectives. The reason is that individuals are still driven by the compensation system that measures them on traditional measures and rewards them according to what they accomplish on those familiar measures. For example, individuals who are asked to reorganize and reduce their staff may not be motivated to do this, if the pay rate for their job depends on the number of subordinates that they have and the amount of budget they control. Therefore, the right "fit" between organization strategy and compensation system may be found in targeting the compensation system to the kind of organizational structure and practices that are desirable from a strategic point of view.

Compensation, Strategy and Performance

This section focuses on the compensation, strategy and performance relationship and addresses the second objective of our research: "Does the existence of a "fit" between compensation system and business strategy contribute to improve organization performance ?". It presents first an introduction to the impact of the "fit" on performance and a review of the different ways of defining and measuring organization performance in research. Following this, the model and hypotheses which will guide this research are presented, with relevant literature support.

The Impact of Fit on Organization Performance

There is currently a convergence of attention and concern among managers and management scholars across basic issues of organization success and performance or failure. Whether attention is focused on the very survival of organizations in aging industries, the pursuit of excellence in mature industries or the preparation of organizations for the rapidly approaching challenges of the 21st century, the concern of performance is real and highly motivated.

Clearly, neither organizational high performance nor low performance has an easy explanation. For many years both researchers and practitioners have attempted to learn why some organizations achieve higher levels of performance than other organizations. Thompson (1967) and Schendel and Hatten (1972) suggest that the success of an enterprise seldom depends on a single factor; rather, it largely stems from the ability of administrators to reach and maintain a viable balance among a combination of different factors. Nevertheless it is becoming increasingly evident that a simple, though profound, core concept is at the heart of many organization and management research findings as well as many of the proposed remedies for industrial and organizational renewal. The concept is that of "fit" among an organization's strategy, structure and management processes, such as compensation systems. Successful organizations achieve strategic fit with their market environment and support their strategies with appropriately designed structures and management processes. Less successful organizations typically exhibit poor fit externally and/or internally (Miles & Snow, 1984).

Miles and Snow (1984) argue that "minimal fit" among strategy, structure and process, such as compensation systems, is essential to all organizations operating in competitive environments. If a misfit occurs for a prolonged period, the result is usually failure. "Tight fit", both internally and externally, is associated with excellence. Tight fit is the underlying causal dynamic producing sustained, excellent performance and a strong corporate culture. "Early fit", the discovery and articulation of a new pattern of strategy, structure and process, frequently results in performance records which in sporting circles would merit Hall of Fame status (Miles & Snow, 1984). According to these authors, the invention or early application of a new organization form may provide a more powerful competitive advantage than a market or technological breakthrough. "Fragile fit" involves vulnerability to both shifting external conditions and to inadvertent internal unraveling. Even Hall of Fame organizations may become victims of deteriorating fit (Miles & Snow, 1984).

The relationships between the strategic compensation policies a firm pursues and the firm's economic performance is a central issue in human resources management. Yet, while a variety of theories exist about the effects of various strategic compensation policies, surprisingly little evidence exists on the extent to which strategic compensation policies vary across firms and, more importantly, on the effects of pursuing alternative compensation strategies that match strategy. Business policy research suggests that coherent or matching strategy types, that is organizations where strategy fits organization variables, including formal organizational structure, technology, human resources practices and compensation systems, are predictive of future firm's performance (Hambrick, 1983).

Carroll (1987) even argues that there have been increasing calls for a contingency approach to compensation such that different parts of the organization should employ different compensation procedures and systems in order to more closely conform to actual differences in performance emphases and measurements and to differences in strategic mission. Carroll's arguments for using a contingency perspective in the compensation system to support the strategic objectives and plans of the organization are linked with the success of the organization. Everyone now agrees that organizations face a far more competitive environment than was the case a few years ago and that gaining strategic advantage by linking compensation to strategy is a requirement for an organization's effectiveness and success, and even survival. Unfortunately, hard evidence of the beneficial effects on organization performance of using a more strategic, contingency perspective for compensation is lacking at present.

This is why, the purpose of this research is to learn whether performance varies in accordance with a firm's overall combination of strategy and compensation. The cumulative implications of previous research indicate that high performing firms should exhibit different combinations of environment, strategy and organization structure and process than low performing firms (Lenz, 1980). For instance, high performing firms should have a "fit" between strategy and compensation (Lawler, 1990; Broderick, 1986; Milkovitch, 1988;).

However, eventhough the contingency theory school has done much work on the strategy-structure relationship, there is no certainty that "fit" is actually optimal for organization's success. In fact, Evans (1986) and Green (1987) suggest that pursuing fit may lead to a rigid and inflexible system. If this is the case, naive concepts of "fit" need to be carefully reexamined and new, more complex paradigms may have to be developed. Milkovitch (1988) offers an alternate way of thinking about fit. Rather than alluding to fit as something static, he suggests that obtaining a state of fit is much like "shooting at a moving target". This implies that although fit is desired, the strategies that are appropriate today might easily become incongruent tomorrow. A major problem is that once a compensation system is in place, employees develop a set of expectations that makes change difficult and potentially disruptive. Management should be reluctant to make strategic compensation decisions that could be ideal under present conditions but may become obsolete in the near future.

In order to understand the impact of the "fit' on organization performance, a review of the different ways of operationalizing organization performance in research is necessary. This is the objective of the next part.

Measuring and Defining Performance in Research

Once the compensation system and strategy fit is focused on, the next issue is how to measure firm performance. The empirical investigation of the strategy/compensation/performance relationship requires appropriate measures of performance. Organization performance (Lenz, 1980) and organization effectiveness (Cameron, 1991) are but two of the labels under which aspects of strategic performance have been researched. Despite these attempts there is little agreement on how strategic performance should be defined and measured. Three major frameworks frequently used to conceptualize performance were examined in the literature: (1) The goal approach (Etzioni, 1964) seeks a definition based upon explicit goals or goals which can be implied from the behavior of organizational members. (2) The systems resources approach provides a framework to assess performance in terms of the key internal and external factors upon which the organization depends for survival. (3) The constituency approach views the organization as existing to benefit numerous "constituencies", both internal and external to the organization, with organization performance assessment focused on fulfillment of constituent needs (Thompson, 1967). Therefore, regardless of the framework chosen to conceptualize organization performance, it is apparent that performance is a complex and multidimensional phenomenon.

Today, organization performance refers to the achievement of an enterprise with respect to some criteria (Lenz, 1980). We will define performance in this study according to the definition provided by Hrebiniak, Joyce and Snow (1989). They view performance as "a multidimensional outcome of organizational behavior". They argue that organizations develop strategies and structures to achieve various goals: "Performance refers to the degree of fulfillment of these purposes." As a variable, performance is difficult to define and measure and its relation to environment, strategy and structure components, such as compensation systems, is not well understood. Four major factors contribute to the problem of predicting and explaining organization performance: (1) level of analysis, (2) referent and perspective, (3) time frames and (4) measures (Hrebiniak, 1978; Cameron, 1986; Venkatraman & Grant, 1986).

First, performance has not been consistently defined by researchers using the strategy-structure performance framework. Discrepancy occurs between the definitions of economists and those of strategy analysts. Traditionally, industrial economists have examined performance at the level of the total economy. At this level, the most important aspects of performance include production and allocative efficiency, technical efficiency and progress, full employment and an equitable distribution of income. Strategists on the other hand usually are concerned with performance at the firm or business-unit level. Performance at this level is defined as growth, profitability, leadership and so forth. Therefore, one must be careful to specify the level at which performance is being analyzed before attempting to link it to strategy and compensation system. In this research, performance is being primarily analyzed at the business-unit level.

Second, performance referents vary according to the different perspectives of an organization's stakeholders. For example, stockholders might equate high performance with the creation of shareholders' value (Rappaport, 1978); managers and employees might see performance as growth or job security; customers may regard quality and service as key indicators, and so forth. Because organizations have many stakeholders, we will measure performance in this study in a way that accounts for these important referents. This is especially crucial to the generalizability of performance findings.

Third, the literature is unclear about the appropriate time frames to use when defining and measuring performance. There is virtually no systematic evidence, for instance, on how performance lags strategy and compensation system "fit". This makes it difficult to relate a performance measure to strategy and compensation measures. Does a strategic decision made now impact performance one year or two, or more years later? It was studied when and how performance "leads" strategy, that is how long it takes before performance stimulates consideration of strategic change and how organizations respond to crisis situations. No systematic results came out from these studies (Schendel & Hatten, 1972; Bourgeois, 1980)

Finally, once defined, performance must be assessed. Measures of performance must be identified that are both accurate and consistent over time. Performance measures frequently used by economists, such as return on equity, stock price earning ratio, price-cost margins, and so on, tend to be relatively accurate and consistent (controlling for accounting differences across firms, industry and time) especially when compared to softer measures such as a firm's ability to innovate, be socially responsible and so forth (Hrebiniak, Joyce & Snow). However, there is a substantial disagreement concerning the measurement of performance. Any organization's performance can be assessed from several different levels and perspectives, at different times, using different indicators. Some authors have even suggested that the performance construct be abandoned altogether. It can be argued, however, that without a performance referent, managers cannot objectively or consistently evaluate the quality of their strategic decisions. Conventional measures of strategic performance used in research are quantitative measures such as return on investment (ROI), return on sales (ROS), return on equity (ROE), return on total capital (ROTC), growth in revenues, cash flow/investment, market share, cost relative to competitors, variations in ROI, and so on. According to Woo and Willard (1983) profitability measured by ROI and ROS, relat.ve market position, change in profitability and cash flow and growth in sales and market share are the best measures of performance.

However, measures of performance rooted in financial accounting, such as the ones described above, have come in for a lot of criticisms (McGuire & Schneeweiss, 1983). The problems that have been cited with this approach are (1) scope for accounting manipulation, (2) undervaluation of assets, (3) distortions due to depreciation policies, inventory valuation and treatment of certain revenue and expenditure items, (4) differences in methods of consolidating accounts and (5) differences due to lack of standardization in international accounting conventions. This is why Chakravarthy (1986) demonstrate the inadequacy of traditional measures of performance that are only based on a firm's profitability for measuring its strategic performance. This author gives an empirical evidence that conventional measures of performance, whether they be measures of profitability like ROS, ROE, ROTC or financial market measures, are unsatisfactory discriminants of excellence. He proposes alternative perspectives on measuring strategic performance that goes beyond accounting measures of performance. He argues that the rudimentary surveys done by Fortune magazine, the Fortune survey of corporate reputation points to the need to look beyond performance measures that address only the concerns of stockholders. In these surveys, each firm's reputation is ranked on such key attributes as financial soundness, quality of management, long-term investment value, quality of products, ability to attract, develop and keep talented people, community and environmental responsibility. These measures of performance account for the different perspectives of stockholders, customers, employees and community. Therefore, this study will use both financial accounting and non-financial measures of performance.

Despite these problems of definition and measurement, however, it is widely believed that performance should be an integral part of studies of the relationship between compensation and strategy, and not only a control variable, as it used to be in many studies. Next section presents our model and hypotheses to be tested.

A Model of Compensation, Strategy and Performance: Hypotheses to be tested

This section presents our model of compensation, strategy and performance and the hypotheses that will guide this research. Table 5 presented earlier in this chapter suggested that organizations with a cost leadership strategy are most likely to have a compensation design policy emphasizing internal equity, with a meet/lag market pay position, membership and efficiency performance objectives and compensation administration policies reflecting restricted communication, centralization in decision making, high formalization and stanoardization. Organizations with a differentiation strategy are most likely to have a compensation design policy emphasizing external equity, a lead market pay position, performance, efficiency performance objectives and compensation administration policies reflecting open communication, decentralization in decision making, low formalization and low standardization. This section provides with the rationale and literature support for why cost leaders and differentiators will improve their organization performance if they adopt matching compensation profiles.

HYPOTHESIS 1: ***Organizations following an overall cost leadership strategy will emphasize internal equity in compensation system design; Organizations following a differentiation strategy will emphasize external equity in compensation design.***

HYPOTHESIS 2: ***(1)If organizations with a cost leadership strategy emphasize internal equity, overall organizational performance, as measured by profitability, efficiency, solvability, a better use of corporate assets and ability to keep talented people, will be higher; (2)If organizations with a differentiation strategy emphasize external equity, overall organization performance, as measured by profitability, efficiency, value as a long-term investment, innovation rate, quality of products and ability to attract new talented people, will be higher.***

Decisions on internal structures determine the distribution of base pay to different jobs or skills. Internal equity, also called internal consistency in the literature, refers to comparisons among jobs and skill levels inside a single organization. The focus is on comparing jobs and skills in terms of their relative contributions to the organization's objectives (Milkovitch, 1986, 1990). In some other cases, the distribution of base pay is determined by market pricing, through matching competitors' compensation structures reported in the market. A number of articles written by compensation specialists described difference in compensation design decisions and in emphasis on internal versus external equity in designing the compensation structure that should be found in organizations with different business strategies (Cook, 1973; Salscheider, 1981; Smith, 1982; Miles & Snow, 1978; Milkovitch, 1990; Carroll, 1987; Muczyk, 1987). Muczyk (1987), for instance, suggested that the companies pursuing a cost reduction strategy should design their compensation system with an emphasis on internal consistencies and bureaucratic orientations. The compensation mix that Muczyk (1987) suggested to be adequate for firms with a cost reduction strategy is the same as the one described by Kerr (1984) for mechanistic organizations; that is emphasizing base benefits, high job security, internal equity, restricted communication and formalization. Broderick (1986) focused on the Miles and Snow strategic typologies and related compensation policies. She proposed differences in the compensation structure and level decisions associated with an internal vs external equity dimensions of compensation policy. She found that Defenders will emphasize internal equity and tend to meet or lag the market. Prospectors will emphasize external equity and tend to lead the market. Analyzers will emphasize a combination of the two. Carroll (1987) confirmed that defenders which have a high need for cost efficiency, need to highly emphasize internal pay equity while prospectors, which have a high need for innovation, should emphasize external pay equity. Kerr (1984) found a similar pattern of differences in reward systems across organizations.

Based on Segev's (1989) results which demonstrate that it is possible to relate findings in the context of the Miles and Snow typology to the Porter's framework, we can infer from both Broderick (1986) and Carroll (1987)'s findings that cost leaders will emphasize internal equity and differentiators will emphasize external equity in their compensation design. Organizations with a cost strategy (cost leaders) will emphasize internal equity in their compensation decisions with the intent of limiting unfavorable employee comparisons with their compensation within the organization itself. Internal equity would involve an employee's comparison between the rewards for his/her job and the rewards for other jobs within the organization. They want to avoid comparisons in the external labor market, which would put pressure on them to lead the external labor market average rate to keep talented people within the organization. This emphasis on internal equity is consistent with their tight cost control policy of minimizing wage and salary costs. In addition, in order to minimize turnover costs, they might also emphasize promotion from within and the need for job specific skills and experience (internal equity emphasis). This will help to predict labor costs and production volumes (Milkovitch, 1990; Broderick, 1986; Muczyk, 1987; Carroll, 1987). Minimizing wage and salary costs and turnover costs will therefore contribute to maximize overall organization's profitability, since a low cost position will help the firm to have above average returns, despite the presence of strong competitive forces (Porter, 1980). Job valuation criteria, skill requirements and skill acquisition approaches are indicators of an organization's compensation structure (Lawler, 1991). Each of these elements are investigated here to make clear the relationship between an internal versus an external equity focus for a particular strategy and improvements in organization performance.

Job valuation criteria: The selection of internal norms and work customs to value jobs is viewed as a policy focus on internal equity (Milkovitch, 1990; Broderick, 1986; Milkovitch & Broderick, 1986). This focus is believed to increase employee acceptance of the compensation offered for their jobs, and hence enhance employee retention and motivation (Belcher, 1974; Lawler, 1981; 1991; Milkovitch & Newman, 1984). This, in turn, improves performance on the job, which contributes to improve overall organization's profitability and efficiency ratios. It enables to better use human resources and keep talented people. The logic behind this belief is based on the notion that employees would assess the equity or fairness of the compensation offered by the organization. Such assessments would positively or negatively influence the organization's ability to attract, retain and motivate its workforce (Lawler, 1981; Milkovitch, 1990). Since the ability to attract, retain and motivate employees is considered a basic compensation objective, these equity assessments are important. A focus on both internal work customs and norms and a promotion from within (acquiring specific skills) would likely support internal equity comparisons, which, as said, will contribute to improve performance for firms with a cost leader strategy.

Skill requirements: However, training for more job or specific skills might be more cost effectively acquired within the organization with a cost leadership strategy.

Following the above logic, the compensation literature suggests that a decision on specific versus general skills would influence compensation structure and level. An organization with more specific skill requirements, such as cost leaders, might be able to hire people with little training. It might be expected to offer a lower average pay rate, and to depend on customs and norms to value jobs (cost leadership). Lower wage costs will contribute to increase organization performance ratios.

Skill acquisition approaches: Decisions on skill acquisitions is also believed to influence compensation structure and level. Certainly they would be related to decisions on job valuation and skill requirements. A decision to promote from within would be most consistent with specific skill requirements and job valuation based on organization norms and work customs. The compensation literature suggests that this pattern of compensation policy decisions would allow the organization to trade compensation for training dollars and increase employee retention. This, in turn, might improve organization profitability by decreasing salary and training costs (low input/output). This will increase financial performance. It will also lead to low quality products (not highly trained people) (Belcher, 1974; Lawler, 1981; 1991; Milkovitch & Newman, 1984; Nash & Carroll, 1975; Henderson, 1982). In brief, an internal equity emphasis, with promotion from within and requirements for job specific skills and experience, is consistent with a cost strategy of maintaining market share and controlling production costs (Porter 1980).

In contrast, organizations with a differentiation strategy (differentiators) will try to encourage compensation comparisons in the external labor market. External equity would involve an employee's comparison between the rewards for his/her job within the organization and the rewards for similar jobs in the external labor market. Differentiators want to attract from the external labor market highly skilled labor scientists or creative and talented people with general problem-solving skills, who will contribute to improve R & D activities, product development and innovation. To do so, they will have to implement a compensation level policy that lead the market. This, is consistent with their commonly required skills and resources described by Porter (1980) of strong marketing abilities and strong capability in basic research. Differentiators will tend to hire from the external labor market at all levels and emphasize the importance of general problem solving skills. This is consistent again with the differentiator's needs to attract people capable of solving general problems involved in establishing and launching a new product. As a consequence, overall organization growth will be accelerated. Job valuation criteria, skill requirements and skill acquisitions are also investigated here for the differentiation strategy case.

<u>Job valuation criteria</u>: The external equity focus is considered more appropriate for organizations with general skills requirements which can easily be matched in the external labor market (Belcher, 1974; Lawler, 1981; 1991; Milkovitch & Newman, 1984). This is believed to increase employee acceptance of the pay offered for their jobs (Equity Theory) and hence increase performance on the job. Employing more skilled and talented people will maximize organization's profitability and efficiency at the business level. It is also responsible for improving products quality and innovation rate (key success factors for differentiators) since people will be trained and rewarded for that purpose.

<u>Skill requirements</u>: Training for more general problem solving or mechanical skills could probably be acquired most cost effectively outside the organization (Those are the skill requirements for Differentiators). However, an organization with more general skills requirements (such as differentiators) might be expected to offer a high average pay rate, and to price jobs in the market in order to attract such skills (Belcher, 1974; Lawler, 1981;1991; Milkovitch & Newman, 1984; Nash & Carroll, 1975; Henderson, 1982). This in turn might lead to less cost efficiency (high input/output), but higher innovativeness and higher products quality (highly trained people) and higher ability to attract new talented people.

<u>Skills acquisition</u>: A decision to hire at all levels would be most consistent with general skill requirements and job valuation based on market prices. This pattern of policy decisions would allow the organization to trade training for compensation dollars and increase its ability to attract skills in the labor market. Thus, a focus on external equity in designing the pay structure will enable differentiators to improve performance. As a conclusion, we hypothesize that cost leaders will improve their performance by emphasizing internal equity in their compensation design and that differentiators will improve their performance by emphasizing external equity.

HYPOTHESIS 3: ***Organizations following an overall cost leadership strategy will have compensation level policies that meet or lag the market; Organizations following a differentiation strategy will have compensation level policies that lead the market.***

HYPOTHESIS 4: ***(1)If organizations with a cost leadership strategy have compensation level policies that <u>meet or lag</u> the market, organizational performance, as measured by profitability, efficiency, solvability and ability to keep talented people, will be higher; (2)If organizations with a differentiation strategy have compensation level policies that <u>lead</u> the market, organization performance, as measured by profitability, efficiency, innovation rate, quality of products and ability to attract new talented people, will be higher.***

Descriptions of the compensation level policies involve assessments of both the organization's ability to pay a particular average rate and its need to compete with other organizations in attracting certain types of skills. External competitiveness refers to how an employer positions its compensation relative to what competitors are paying.

For instance, how much do other employees pay accountants, and how much do the organization wish to pay accountants in compari.. to what other employers would pay them? As stated earlier in the literature review, organizations may set their compensation levels higher than their competitors, hoping to attract the best applicants. In the literature, the policy regarding external competitiveness has a twofold effect on objectives: (1) to ensure that the pay rates are sufficient to attract and retain employees (i.e if employees do not perceive their compensation as equitable in comparison to what other organizations are offering for similar work, they are more likely to leave) and (2) to control labor costs so that the organization's prices of products and services can remain competitive. So external competitiveness directly affects both the efficiency and equity objectives. The compensation literature considers selection of a market pay position to be related to other policy decisions on compensation structure and the type of strategy followed. For example, the literature says that a leading compensation level would offer the organization a market advantage in attracting needed skills (Lawler, 1991; Milkovitch & Newman, 1984; Broderick, 1986). Wage surveys would be carried out to determine the compensation levels offered by competitors for particular skills. Cost leaders and differentiators could then decide whether to set its average compensation rates above (LEAD), below (LAG) or about equal (MEET) to those offered by its competitors.

An organization with a cost leadership strategy, which has a strong need to control costs and focus on internal equity will not try to lead the market. It will, to the contrary, either meet or lag the market. The rationale for this suggestion is that cost leader's primary objectives are to control for labor costs, so that the organization's prices of products and services can remain competitive. Attracting best skilled researchers is not their primary objective. Broderick (1986)'s results suggest that defenders will have a compensation policy that either meet or lag the market. Carroll (1987) confirms these results by arguing that defenders' emphasis on pay level as compared to market will be very moderate. As suggested by Segev (1989), it is possible to extrapolate these results to Porter's (1980) framework. Therefore, there is some basis to argue that cost leaders should either lag or meet the market in the design of their compensation policies (Segev, 1989; Muczyk, 1987; Kerr, 1987). A decision to meet or lag competitors' pay position is assumed to decrease the level of skills available to the organization. This is consistent with the cost leader's policy decisions emphasizing job valuation based on organization norms and work customs, specific skill requirements and promotion from within. Cost leaders are presumed more likely to develop necessary skills internally. A Compensation level that meets or lags market competition is considered consistent with an internal equity focus. If reward comparisons are focused internally, it is not necessary to provide leading market pay levels to retain employees (Belcher, 1974; Nash & Carroll, 1975; Mahoney, 1979; Milkovitch, 1990; Lawler, 1986; 1990). If they only meet or even lag market competition, they will be able to minimize their salary costs, hence maximizing overall organization's profitability. This available cash flow would be useful to develop internally process engineering and specific skills.

In contrast, if a Differentiator takes the decision to lead the market, it would thus be consistent with differentiator's policy decisions of emphasizing job valuation based on market prices, general skill requirements and hiring at all levels. Presumably, organizations with this pattern would depend on the market for needed skills. Compensation levels that lead market competition are consistent with the external equity focus. They increase the likelihood of attracting the needed skills and retain talented people (Belcher, 1974; Lawler, 1981;1991; Milkovitch & Newman, 1984). Those talented people will contribute to R & D innovation and product development. This, in turn, will improve organization's growth and performance.

Broderick's (1986) results confirm this hypothesis if we consider Segev's study (1987) that suggests that differentiator patterns are very similar to prospector patterns. As a matter of fact, she found that prospectors are more likely to lead the market. Carroll (1987)confirmed this hypothesis by asserting that prospectors, which have a higher need for innovation than differentiators, will emphasize a lead market pay position in their compensation policies in order to ensure that the compensation rates are sufficient to attract and retain the best researchers and knowledgeable employees with general problem solving skills. First, satisfaction with compensation level will increase motivation and hence organization effectiveness (Lawler, 1971; 1981; 1990). Second, highly skilled employees and talented researchers with general problem-solving skills will contribute to accelerate organization growth by developing intensively R & D activities, product development and innovation. Therefore, we hypothesize that cost leaders will increase their performance by emphasizing a meet/lag market pay position, and differentiators by leading the market.

HYPOTHESIS 5: ***Organizations following an overall cost leadership strategy will tend to reward for membership and seniority (with base salary and benefits) rather than for performance (with merit pay and incentives based on performance objectives); Organizations following a differentiation strategy will tend to reward for performance rather than membership and seniority.***

HYPOTHESIS 6: ***(1)If organizations with a cost leadership strategy emphasize compensation for membership, organizational performance, as measured by profitability, cost efficiency, solvability and ability to retain talented people, will be higher; (2)If organizations with a differentiation strategy emphasize compensation for performance, organization performance, as measured by profitability, efficiency, innovation rate, quality of products and ability to attract new talented people, will be higher.***

The primary decision that the compensation literature associated with compensation mix is a choice between paying for employee membership and seniority or performance (Kerr, 1984; Lawler, 1981; Broderick, 1986; Milkovitch, 1990). This involves selecting the appropriate form of compensation to emphasize. Belcher (1974) classified employee contributions to an organization into two broad categories: (1) membership and (2) performance. Rewards accrued to an employee simply by virtue of joining and remaining in a organization are associated with membership. A compensation mix emphasis on base salary, benefits and seniority related increases is viewed as an appropriate means of communicating the importance of membership to employees and the importance of retention and internal skill development. A compensation mix emphasis on incentives is viewed as an appropriate means of communicating the importance of employee performance (Broderick, 1986; Lawler, 1991).

Organizations with a cost leader strategy will emphasize compensation for membership in their compensation decisions with the intent of maintaining a loyal specialized workforce and limiting turnover. Paying for membership and seniority is consistent with promoting from within and providing internal training and development. These are necessary organizational requirements consistent with cost leader's needs to succeed in maintaining its market share and its vigorous pursuit of cost reductions from experience. Cost leaders will tend to use such compensation elements as base salary, benefits, pay increases based on seniority or change in the cost of living to motivate their employees. The rationale supporting this hypothesis is that an organization with specific skill requirements, as it is the case for cost leaders, would have invested money in training employees, and as a result, would be extra-interested in retaining them. A focus on internal equity could foster retention by decreasing external comparisons that might lead to dissatisfaction with compensation packages. It could also increase employee's sense of job security. It could also avoid much of the internal conflict and dissatisfaction due to incentives based on performance (Lawler 1981, 1991). These increases in satisfaction and job security will tend to increase employee motivation and hence performance on the job. This, associated with retention of people trained internally, will contribute to cost reduction from experienced employees and maximization of organizational efficiency.

A number of other compensation specialists have described the compensation emphasis on performance versus membership consistent with a specific product market strategy (Cook, 1973; Salscheider, 1981; Ellig, 1982; Smith, 1982). Broderick (1986) and Carroll (1987), both using the Miles and Snow typology, suggest that defenders will have an emphasis on pay for membership. Thus, as it is possible to apply the findings in the context of the Miles and Snow (1978) typology to the Porter's (1980) framework (Segev, 1989), cost leaders will also improve their organizational performance by rewarding their employees for membership and seniority.

In contrast, organizations with a differentiation strategy will emphasize compensation for performance in their compensation decisions since they are concerned with their employees' abilities to directly contribute to product market growth and innovation. They will tend to use incentives as a compensation element to instill product and market development. This, in turn, will contribute to attracting talented people from the external labor market and motivate them to acquire the required general skills needed for R & D activities and innovation. The compensation literature does not directly states that a compensation mix emphasis on performance is most consistent with external equity focus. However, if a differentiator had a compensation mix emphasis on membership, questions about the fairness of performance measurement could lead to turnover and other forms of employee dissatisfaction. This would damage internal development and innovation. As a consequence, if employees are focused on external comparisons, with a compensation for performance system, such problems might be less severe. Compensation for performance will enhance R & D activities, innovation and product development. It will increase employee's feelings of job security, fairness, equitable distribution of rewards and hence satisfaction with pay. This, will contribute to increased performance on the job, reduce turnover and hence improve overall organization performance. Improved quality of products will also lead to higher margins. Broderick's (1986) results also suggested that prospectors, who also emphasize innovation and product development, will have an emphasis on pay for performance. Using Segev's (1989) results, it is possible to assert that differentiators will improve their organization performance by rewarding their employees for performance. Therefore, we hypothesize that cost leaders will increase their organization performance by rewarding for membership and seniority and differentiators by rewarding for performance.

HYPOTHESIS 7: ***Organizations following an overall cost leadership strategy will have efficiency-related performance objectives; Organizations following a differentiation strategy will have growth-related performance objectives.***

HYPOTHESIS 8: ***(1)If organizations with a cost leadership strategy emphasize efficiency-related performance objectives, organization performance, as measured by profitability, cost effectiveness, financial soundness, solvability and value as long term investment, will be higher; (2)If organizations with a differentiation strategy emphasize growth-related performance objectives, organization performance, as measured by profitability, innovation rate, quality of products and ability to attract new talented people, will be higher.***

Incentives policy decisions can also be related to employee pay equity perceptions. The compensation literature stresses that if incentives are to be viewed as equitable, they must be based on performance measures that employees considered fair. This means that the organization must determine clearly the general types of employee behavior required to meet its performance objectives (Lawler, 1990). Efficiency-objectives would typically require regulated and well defined types of behaviors such as reducing overtime, accident and absenteeism rates or increasing quality control standards and staying within budget (Broderick, 1986). This would be consistent with cost strategy and will contribute to maximize organization's profitability and effectiveness through budget and cost control. Growth-oriented behaviors would have targets such as a given percent growth in market share. The specific behaviors required to effect such growth might well be unknown.

Organizations with a cost strategy will emphasize efficiency-related performance objectives in compensation decisions (e.g. achieving quantifiable quota of production, reducing absenteism rates, increasing quality control standards, staying within budget). The literature suggests that efficiency is often associated with incentives, based on cost control or production-related performance criteria and low incentive payments (Milkovitch, 1990; Lawler, 1990; Muczyk, 1987; Broderick, 1986). Efficiency-related performance objectives are consistent with cost leader's organizational requirements of tight cost control and incentives based on meeting strict quantitative targets. That type of organizations wants employee performance focused on cost control, efficient production to maintain market share and profit margins and cost minimization in areas like R & D, service, sales force, advertizing and the like. This will then contribute to higher organization performance. Broderick (1986) using the Miles and Snow's strategic types suggested that defenders would presumably want to reinforce cost control or production related employee behaviors, and then emphasize efficiency related performance objectives. Using Segev's (1989) results, it is possible to predict that cost leaders will behave in the same way.

In contrast, organizations with a differentiation strategy will emphasize more growth-related performance objectives (e.g., growth in market share, number of new products created per year). This is consistent with their requirements of product market growth and innovation. That type of organizations wants employee performance focused on innovations in product or market research and development of marketing and product engineering skills and resources. Differentiators do not allow the firm to ignore costs, but rather they are not the primary target. Growth related performance objectives will contribute to corporate reputation for quality or technological leadership, one of their commonly required skills and resources. Broderick (1986), using the Miles and Snow's strategic types, suggested that prospectors would probably want to reinforce innovative kinds of employee behaviors and then emphasize growth-related performance objectives. Using Segev's (1989) conclusions, we can infer that differentiators will behave in the same way. If employee performance is focused on innovation in product and market research, and quality of products, organization growth and performance will be accelerated. Therefore, we hypothesize that cost leaders will increase their organization performance, if they have efficiency-related performance objectives in their compensation policies and differentiators, if they have growth-related performance objectives.

Decisions on compensation administration were cited in the literature review to be strategic and important to the organization, since they can influence managers' sense of ownership and employees' views of the fairness of their compensation. Both ownership and fairness are thought in the literature to be achieved through communication, decentralization and participation (Milkovitch, 1990; Lawler, 1990, Broderick, 1986). These are the purpose of the remaining hypotheses.

HYPOTHESIS 9: ***Organizations following an overall cost leadership strategy will have formal communication channels, but will use them to circulate only limited information on compensation policies; Organizations following a differentiation strategy will have an open communication and will use their communication channels to circulate a broad range of information on compensation policies.***

HYPOTHESIS 10: (1)If organizations with a cost leadership strategy circulate only limited compensation information, organization performance, as measured by profitability, efficiency and financial soundness, will be higher; (2)If organizations with a differentiation strategy circulate a broad range of information on compensation policies, organization performance, as measured by efficiency, profitability, innovation rate, quality of products and ability to attract new talented people, will be higher.

The compensation literature suggests two types of decisions related to communication policies: (1) decisions on the types of information and (2) decisions on the methods used to circulate that information. Organizations have the choice between choosing to give employees only very limited information about compensation policies or choosing to present detailed information. The decisions associated with how to circulate compensation information involve choices among different methods or channels of communication (such as policy manuals, formal meetings, employee attitude surveys, formal compensation grievance procedures, and the like), (Belcher, Lawler, Milkovitch & Newman, 1984; Henderson, 1982). In the compensation literature, communication decisions are considered to have an important influence on employee acceptance of the fairness or equity of compensation system operation (Lawler, 1971; 1990). Compensation systems in which information of all types is circulated through a number of different channels are associated with high levels of employee trust (Milkovitch, 1990). More restrictive communication channels are associated with employee speculations about the rewards received by workers above and below them in the hierarchy. These speculations usually lead to distortion and dissatisfaction. As a consequence, this decreases employee motivation to work, and contributes to decreases in overall organization performance and quality of products (Lawler, 1990). This is why an organization with a differentiation's strategy should choose to circulate a broad range of information, so that it can reduce speculations, distortions and dissatisfaction. They will be more open to employee questions and will circulate a large range of information on compensation. They will exercise little control over the information available to employees. This is consistent with their needs of innovation, creative flair capability in research as well as strong coordination among functions in R & D, product development and marketing. Information channels are the basis for effective coordination. In addition, such open communication might contribute to encourage employee comparisons with the external labor market (which is one of their objectives). This will lead to better individual performance on the job and, as a consequence, to better organization performance. A differentiator does not need many communication channels, since it is supposed to have a strong cooperation and informal communication. In addition, open communication will contribute to better coordination and cooperation among departments and better organization effectiveness. It will also encourage employee comparisons with the external labor market and since the firm is leading the market, talented people will be attracted, thus cooperating to the overall organization's success. Broderick (1986) and Carroll (1987) supported these proposed differences since they suggested that prospectors will more likely pursue an open communication policy on compensation issues. According to Segev's (1989) results, we can infer that differentiators will behave in the same way.

Unfortunately, open communication is also felt to be a potential source of dissatisfaction (Lawler, 1981). Direct comparisons among co-workers can lead to disagreements about the value of individual contributions . Moreover, such open communication can also mean less control over the compensation system operations. This in turn, can lead to less motivation and less job performance, hence diminishing the overall organization performance. In that situation, limited information and discretionary procedures would increase the organization performance (or limit the decrease). This could be the strategy followed by cost leaders. Organizations with a cost strategy will have many formal communication channels but will use them to circulate only limited information on compensation. The fact that they will tend to carefully control the amount and type of information which flows through communication channels to employees is consistent with their requirements of tight cost control and efficiency. This is also consistent with their need to retain employees and to promote the internal development necessary to the overall cost leadership strategy. For example, by giving too much information on compensation policies, they might encourage employee comparisons with the external labor market (which is not one of their objectives). This will enable them to control compensation systems and related costs. In addition, this strategy would be consistent with the overall organization administration policy with close supervision and restricted communication. In addition, too much information on compensation policies might encourage employee comparisons with the external labor market and could induce them to quit the firm for another one that pays better, making the overall organization performance suffer. Broderick (1986) and Carroll (1987), using the Miles and Snow typology, suggested that defenders will more likely limit and regulate information on compensation issues. According to Segev's (1989) conclusions, we can infer that cost leaders will behave in the same way. Therefore, we hypothesize that cost leaders will increase their organization performance if they restrict, regulate and limit information on compensation issues and differentiators, if they pursue an open communication policy regarding compensation issues.

HYPOTHESIS 11: ***Organizations following an overall cost leadership strategy will not encourage employee participation in compensation decision making; Organizations following a differentiation strategy will encourage such participation.***

HYPOTHESIS 12: ***(1)If organizations with a cost leadership strategy do not encourage employee participation in compensation decision making, organization performance, as measured by profitability, efficiency (cost control) and a better use of corporate assets, will be higher; (2)If organizations with a differentiation strategy encourage such participation, organization performance, as measured by profitability, efficiency, innovation rate, quality of products and ability to attract new talented people, will be higher.***

HYPOTHESIS 13: ***Organizations following an overall cost leadership strategy will restrict authority to approve compensation policy decisions to high-level managers;***

Organizations following a differentiation strategy will allow relatively lower level of managers to be involved in approving compensation decisions.

HYPOTHESIS 14: ***(1)If organizations with a cost leadership strategy restrict authority to approve compensation policy decisions to high levels, organization performance, as measured by profitability, efficiency (time and cost control), will be higher; (2)If organizations with a differentiation strategy allow relatively lower level managers to be in involved in approving compensation decisions, organization performance, as measured by profitability, efficiency, innovation rate, quality of products, quality of management and ability to attract new talented people, will be higher***

These four hypotheses are related to the centralization characteristic of compensation systems. There are two types of centralization decisions described in the compensation literature. The first involves the degree of employee participation in compensation decision making (hypotheses 11 and 12). The second involves the extent to which lower levels of management are authorized to approve such decisions (hypothesis 13 and 14). In general a policy discouraging participation would probably be associated with one restricting decision-making authority. Together they may represent a centralized administration system. On the other hand, a policy associated with high levels of participation and broad decision-making authority would be considered as a decentralized system. Lawler (1990,1981) indicates that the degree to which compensation decisions are centralized or decentralized can influence employee acceptance of the compensation system, and therefore increase or decrease their performance at work, consequently affecting the overall organization performance.

The literature says that centralized compensation administration systems are generally less acceptable to employees than decentralized systems. This is why differentiators should adopt a rather decentralized system. Organizations with a differentiation strategy will encourage employee participation in compensation decision making and will allow relatively low level employees to approve compensation decisions, with the intent to encourage strong cooperation from channels and strong coordination among functions in R&D, marketing, product development. This, is consistent with their organization requirements and needs to enable people to develop new approaches to problems. Authority to make decisions would have to be widely distributed since decisions have to be taken quickly and at different levels of the organization. Time is to differentiators what cash is to cost Leaders. In addition, people with general skills and broad aptitudes may be less accepting of a very centralized system and more likely to turnover. Employee participation in compensation issues will be better accepted among employees and would contribute to keep talented people and motivate them. Motivated and talented people will contribute to improve overall organization's performance. Broderick (1986) suggested that prospectors will encourage employee participation in compensation decision making and will not restrict authority to high level employees. These patterns of centralization are also supported by Lawrence & Lorsch (1966). According to

Segev's results, we can infer that cost leaders will also encourage employee participation in compensation decision-making and will allow relatively low level employees to approve compensation decisions.

However employees might be more willing to accept centralized compensation administration if the organization's overall administration is centralized. Such consistency might appeal to an employee's sense of equity or fairness (Lawler,1990). Organizations with a cost strategy will discourage employee participation in compensation decision making and restrict authority to approve compensation decisions to high level managers with the intent to encourage intense supervision labor and implement a structured organization with centralized responsabilities. This is consistent with the cost leader's product maintenance strategy which requires requiring aggressive construction of efficient scale facilities, cost minimization, overhead control and centralization of administration processes. This can be explained by cost leaders having developed programs in compensation, as well as other areas, that lead to the maintenance of market share. So, first, discussing those programs might be time and money consuming. Second, employees in such organizations have very specific skills. It might then be possible that only top managers have these general problem solving skills to make decisions on compensation design and administration policies. In addition, centralized systems offer more control over the compensation system, increasing cost effectiveness, organization's efficiency.Restricting decision making to a few people might also make coordination easier. This is the type of strategy a cost leader should adopt to increase its overall organization performance. Broderick (1986) suggested that defenders will discourage employee participation and will restrict authority to high level employees to approve compensation decisions. According to Segev's (1989) results, we can infer that cost leaders will behave in the same way. Therefore, we hypothesize that cost leaders will increase their organization performance if they discourage employee participation in compensation decision making and differentiators, if they encourage such a participation.

HYPOTHESIS 15: ***Organizations following an overall cost leadership strategy will have highly formalized rules and procedures regulating the implementation of compensation <u>structure, level and mix policies</u>; Organizations following a differentiation strategy will have less of these formalized procedures.***

HYPOTHESIS 16: ***(1)If organizations with a cost leadership strategy have highly formalized rules and procedures regulating the implementation of <u>compensation structures, level and mix policies</u>, organization performance, as measured by profitability, efficiency (cost control) and a better use of corporate assets, will be higher; (2)If organizations with a differentiation strategy have less of these formalized procedures, organization performance, as measured by profitability, efficiency, innovation rate, quality of products and ability to attract new talented people, will be higher.***

These two hypotheses are related to the formalization dimensions of compensation systems, that is the degree to which compensation system design and administration is dictated by rules and procedures (e.g. written job analysis, evaluation manuals, trained analysts, supervision by a compensation committee). In the literature, formalization decisions are associated with the implementation of policy on compensation structure, level and mix and with the implementation of policy on incentives. Both required choices about the degree to which such implementation should be governed by written rules and procedures. Milkovitch and Newman (1984) explained that there might be few instructions or operating procedures for carrying out job analysis, writing job descriptions or doing job evaluation and wage surveys. On the other hand, in some organizations, these activities might be regulated by extensive procedures, done by specialists and reviewed by committees.

Organizations with a cost leader strategy will have formalized rules and procedures regulating the implementation of compensation system (structure, level and mix) in the intent to support their product strategy. This is consistent with their organization requirements of cost control. They want to keep control over the way in which decisions are taken and implemented and in which work is done. They need frequent, detailed reports within a structured organization with centralized responsabilities (Porter, 1980). As a consequence, formalized rules and procedures regulating the implementation of compensation policies might be necessary, since rewards regulate work behaviors. Tight cost control and overhead control will tend to maximize overall organization's profitability. This low cost position will yield the firm to have above average returns, despite the presence of strong competitive forces. Lawler (1990) suggests that the formalization of an organization's compensation system should be similar to the formalization characteristics of its overall administration. The rationale is that, again, such consistency would lead to higher employee acceptance of the compensation system. As a consequence, a cost leader should have a rather formalized structure and a differentiator a rather non-formalized structure. Higher formalization would also be expected to offer the organization greater control over compensation system operation. Again, the cost leader would maximize its organization performance, through control cost and increased individual performance, in implementing a formalized compensation structure and mix. However Salter (1973) noted that organizations with more maintenance oriented product market strategies such as cost leaders might use a more subjective flexible process in implementing incentives, even if these incentives are supposed to meet strict quantitative targets. This is consistent with an emphasis on membership in compensation mix (Salter, 1973). Incentives processes are mostly developed and standardized in compensation for performance strategies.

In contrast, organizations with a differentiation strategy will have very few rules regulating the implementation of compensation system (mix, structure and level) in the intent to have more flexibility. This is consistent with the fact that, neither the problems encountered in pursuing a growth strategy, nor the employees hired in these types of firms were amenable to specific rules and procedures (Broderick, 1986). It is consistent with a differentiator's organizational requirements of less formalization, strong cooperation and an environment that promotes creative flair, R & D activities and quick problem solving skills acquisition (Porter, 1980). An abundance or written rules and work procedures will impede R & D activities and innovation. As a consequence, organization performance would suffer. However Salter (1973) noted that organizations with growth oriented strategies, such as a differentiator strategy, should use a more formal and regulated process to implement incentives and bonuses, even if these incentives are supposed to be measured subjectively with more qualitative targets. Employees in these types of firms are more likely to be motivated by the challenge of obtaining a particular incentive. For these reasons, Salter explains that "defining precisely the rules of the game" and making a formal, objective statement about *how* a particular incentive can be won (and not about on *which* criteria) is more acceptable. This will increase performance on the job and products quality. The latter will enable higher product margins. Both will contribute to higher overall organization performance. Therefore, we hypothesize that cost leaders will increase their organization performance if they have highly formalized rules and procedures regulating the implementation of compensation structure, level and mix policies and differentiators if they do the opposite.

HYPOTHESIS 17: ***Organizations following an overall cost leadership strategy will have standard uniform compensation policies throughout the organization; Organizations following a differentiation strategy will have compensation policies tailored to the needs of individual business units.***

HYPOTHESIS 18: ***(1)If organizations with a cost leadership strategy have standard uniform compensation policies throughout the organization, organization performance, as measured by profitability, efficiency, a better use of corporate assets and ability to keep talented people, will be higher; (2) If organizations with a differentiation strategy have pay policies tailored to the needs of individual units, organization performance, as measured by profitability, efficiency, innovation rate, quality of products and ability to attract new talented people, will be higher.***

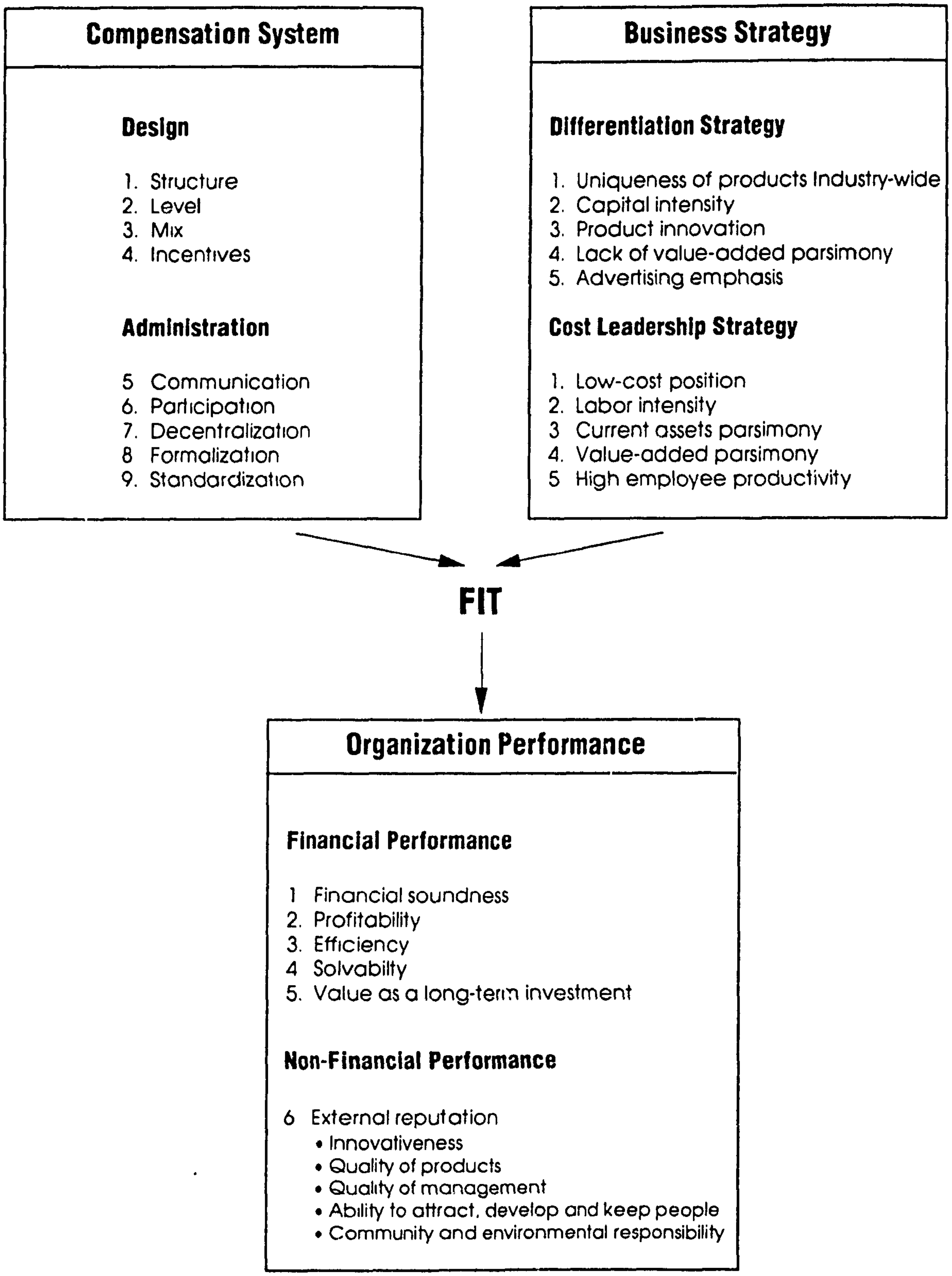
The compensation literature indicates that decisions on compensation structure, level, mix and incentives can vary with organization unit covered. An organization can have uniform policies across divisions, or it can tailor policies to the unique needs of each unit. Compensation standardization decisions involved this choice. Highly standardized compensation administration would involve uniform policy application. Decisions to standardize or tailor compensation policies across units involve tradeoffs between coordination and employee acceptance of the compensation system.

Organizations with a cost strategy will have a standard or uniform compensation system throughout the business unit, since high standardization will contribute to better control and coordination of the compensation system. A standardized compensation system is also consistent with their product maintenance strategy and low cost position. There is no need to differentiate compensation policies across units, which permits cost minimization. In addition, a standardized compensation system also contributes to an intense supervision of labor and helps in persuading people to transfer across units. Standardization is consistent with an internal equity emphasis and promotion. It is also easier to get employees to accept the importance of performance objectives that are compatible with the goals of cost controls of the entire organization. This low cost position will permit the organization to have above average returns despite the fierce competition. Broderick (1986) and Carroll (1987) suggested that defenders will have standard uniform compensation policies throughout the organization. Therefore, according to Segev's (1986) results, we can infer that cost leaders will do the same.

Such standardization might however weaken the perceived links between rewards and performance in cases where the objectives of the unit are truly different from those of the entire organization. In such cases, employees might feel that standard policies do not reflect the unit's unique characteristics. As a result, they would be less likely to consider the compensation system acceptable and thus, motivation will be lowered, which affects the overall organization performance. Thus, organizations with a differentiation strategy will have compensation policies tailored to the needs of individual units, since a low standardization would mean higher employee acceptance of compensation policies tailored to each unit's needs. Differentiators are less concerned with internal mobility; they are more concerned with compensation policies that motivate performance, R & D and innovation in each unit. This is why they might require compensation policies which are tailored to the specific goals of each unit, and the specific objectives of each product line. Broderick (1986) and Carroll (1987) suggested that prospectors will have compensation policies tailored to the needs of individual units. Using Segev's (1986) results, we can infer that differentiators will do the same. Therefore, we hypothesize that cost leaders will increase their organization performance, if they have a standard uniform compensation policies throughout the organization, and differentiators, if they have compensation policies tailored to the needs of individual units.

Figure 2 presents a model of compensation, strategy and performance. This model summarizes the hypotheses presented in this section and will guide the method section presented next.

Figure 2
A Model of Compensation, Strategy and Performance



CHAPTER II

M E T H O D

Methodological Approach: Overview

This study is designed to (1) describe and (2) evaluate the impact of the joint influence of compensation and strategy on organization performance. The choice of a comparative, multi-organizational analysis versus a single or small sample case study as a methodological approach is based on two main reasons: First, as the literature review indicates, much of our knowledge is built on research conducted with one organization or a small sample of organizations. We lack the more systematic information from larger scale, multi-organizational samples. Second, this choice is influenced by the availability of Broderick's (1986) dissertation and data set. This data set was created in 1984 for her Ph.D. dissertation on "Pay Policy and Business Strategy : Toward a Measure of Fit". For this purpose, she gathered data on compensation policies for middle managers and business strategy decisions on a sample of U.S. manufacturing firms.

The study design required collecting data on three types of variables: (1) compensation policy decisions, (2) business strategy and (3) organization performance. These data came from three sources. The first source of data was Broderick's data set with information from U.S manufacturing firms on the compensation design and administration dimensions presented in the literature review. The second source of data was the COMPUSTAT database. Data were extracted from this database in order to measure business strategy and organization performance. The third source of data was the Fortune magazine Corporate Reputation surveys (1980-1987) which is used to measure non-financial organizational performance.

Site, Sample, Data Collection

The three main sources of data are presented in this section and each data set is described.

Description of Broderick's Study Design

In order to empirically investigate the compensation-strategy-performance relationship, compensation policy decisions and procedures at the middle management level had to be translated into measures on which data could be collected. Broderick (1986) did this by developing scaled, anchored items for each of the compensation design and administration decisions for middle managers identified in chapter I. Additionally, these measures had to be developed in a form that can be used across a number of organizations. Broderick used simple Likert scales in her questionnaire. Most of the scales used allowed for the rating on one of five anchored scale values. It is important to point out that the written descriptions accompanying each scale value were taken from the literature and that the accuracy and clarity of these descriptions were verified by a group of compensation professionals, from consulting firms and a variety of business organizations in the banking, utilities, electronics, pharmaceuticals, oil refining and cigarette manufacturing sectors. The items developed became part of a questionnaire mailed to compensation managers at a number of manufacturing firms. This questionnaire is presented in Appendix I.

Target population and sampling strategy

Broderick used the COMPUSTAT (Investors Management Sciences, Incorporated) database to select firms. She selected manufacturing organizations with the four digit SIC codes 2001-3999 for 1980-1983, with no foreign ownership and with an average employment of 100 or more. Other firms were eliminated. This sampling strategy was used since it provided a sample with enough business units for the study's empirical analysis. There were 1,024 firms in the manufacturing SIC codes alone. Second, this sampling strategy helped in defining the target population more narrowly. This usually reduces uncontrolled variance that might influence the analysis of compensation policies.

The other refinements were made in order to assure some stability in the database measures of the business unit (SIC code), net sales and employment. Firms not associated with the same four digit, manufacturing SIC code over the period 1980-1983 were eliminated. This sampling strategy was supported by Hambrick (1983) who indicated that firms in the same product market for at least four years had some stable association with it. The 4-digit SIC code unit can be considered as an appropriate measure of the industrial environment within which a given firm competes. This unit of analysis has been used frequently by policy and industrial economics researchers and is supported by Porter (1980).

In addition, firms with an average employment of less than 100 for 1980 to 1982 were eliminated. The lower limit of 100 was applied because it was felt that business units with at least this number of employees would be more likely to have specific compensation policies for middle managers. The resulting target population was a total of 1,000 firms.

A group of compensation professionals from consulting firms and a variety of business organizations identified the appropriate respondent for the target organizations,i.e., the highest-level compensation person in each organization. In most cases, it was the Compensation Manager or Director. In smaller firms, it was the Director of Human Resources or Industrial Relations. The list of such respondents was generated from the annual membership directory of the American Compensation Association (ACA) and the Standard and Poors Register (vol. III, 1984).

The questionnaire on compensation systems for middle managers was sent to the target population of the 1,000 firms, in June 1984. These mailings were first class. There was a return-pre-addressed envelope included. Respondents were assured of the confidentiality of their responses. The response rate was 203 out of 1,000 firms or approximately 20%. Only 199 firms were complete enough to be used in the analysis. A 20% return rate limits the generalizability, but this response rate is comparable to those in other organizational-level studies with surveys of similar length and complexity (DeBejar, 1983).

The COMPUSTAT Database

In order to empirically investigate the compensation-strategy fit, business strategy had to be translated into measures on which data could be collected. It was not possible to gather questionnaire measures of strategy from these companies. Instead, financial data were extracted from the COMPUSTAT database (Standard & Poors COMPUSTAT Services, Inc.) for the period of 1983-1985. This database contains the financial statements of some 10,000 firms for each year in finance, retail, manufacturing, agriculture, services. Some of the figures extracted from the COMPUSTAT database were also used to measure financial performance of organizations. Financial ratios were computed for each organization. Data on all firms (N=1,024) in the relevant two-digit industrial groupings were also obtained in order to standardize the various financial indices on the basis of industrial group averages.

The Fortune Magazine Corporate Reputation Surveys

While COMPUSTAT provided quantitative financial performance data, it was desirable to use more qualitative non-financial performance indices. Mailing a second questionnaire to the same sample of companies was time consuming, uncertain (companies may not answer this time and this could result in reducing the sample size), and quite questionable given that it would require respondents to try and reflect back on the firm in the performance in the 1984 context. As a consequence, data on organizational performance were collected through other sources. The Fortune magazine corporate reputation surveys complement the COMPUSTAT database by offering data on financial as well as non-financial performance measures for large U.S manufacturing firms. The Fortune magazine offers corporate reputations surveys, which gathered data on eight key attributes of reputation, such as reputation for (1) quality of products, (2) quality of management, (3) innovativeness, (4) ability to attract and develop talented people, (5) financial soundness, (6) use of corporate assets, (7) long-term investment value, and (8) community and environmental responsibility. This permits to measure organization performance with financial and non-financial criteria (Dess & Robinson, 1984). Surveys covered about 300 companies in 32 industry groups. They polled more than 8,000 high executives, outside directors and financial analysts, who were asked to rate those companies in their own industry on eight key attributes of reputation. Unfortunately, the Fortune survey only assesses the largest ten firms in each industry category. This means that analyses with these indices will involve a subset of the 199 firms with questionnaire data.

Measures

The model developed in this study and diagrammed in detail in figure 2, chapter I (page 129), identifies several key dimensions. The first set of key dimensions concerns the measurement of compensation policiy decisions. Our model identifies two key types: (1) the compensation system design (compensation structure, level, mix and incentives) and (2) its administration (compensation communication, centralization, formalization and standardization). Ten variables measure the compensation system for middle managers within each organization for the calendar year 1984.

The second set of key dimensions concerns the measurement of business strategy. The model identifies seven variables useful in differentiating strategic orientation: (1) Lack of assets parsimony, (2) Lack of value added parsimony, (3) Lack of current assets parsimony, (4) Product innovation, (5) Lack of cost parsimony, (6) Advertising emphasis, and (7) Employee productivity. The first variable is a strategic position variable; the last six variables are strategic choice variables (Hambrick, 1983). All those variables were measured for the 1983-1985 period and two-digit SIC industry group means and standard deviations for the larger population of firms (n=1024) allowed standardization of all strategy measures.

The third set of key dimensions concerns <u>organization performance</u>. The model identifies two key dimensions: (1) financial performance measures and (2) non-financial measures. Financial measures include measures on: (1) financial soundness, (2) profitability, (3) efficiency, (4) solvability and (5) value as long term investment. Non-financial variables measure the external reputation of the firm related to innovativeness, quality of products, quality of management, ability to attract, develop and keep talented people, and community and environmental responsability. COMPUSTAT performance measures were gathered for the years 1983 to 1985 and standardized for industry group norms. The Fortune reputation survey provided the data for several of these companies.

Compensation Construct Operationalization

Table 2 presented in chapter one, section one (page 43), summarizes the compensation policy dimensions which are measured. Measures on compensation policy decisions come from Broderick's (1986) data set. Conceptually, there is a distinction between policy decisions on compensation system design and compensation system administration. Exploratory principal components analysis was used to establish many of the final scales described below. In general, items retained had loadings of 0.5 or higher on a single factor and off-factor loadings of less than 0.3.

Compensation Design Dimensions

Compensation policy design decisions include those on compensation structure, level, mix and incentives. Exploratory factor analysis identified scales generally related to the following constructs.

(1) Compensation structure: This construct involves the extent to which there is an external versus internal equity emphasis in compensation system design. Exploratory factor analysis yielded no specific scale related to this construct. This is why the internal versus external equity emphasis was operationalized with one item in part I-A, 1, (a,b,c) on page 289 of Broderick questionnaire (see appendix I).

(2) Compensation level: This construct involves the extent to which there is a meet/lag versus lead market pay position. Exploratory factor analysis yielded one scale related to this construct. Compensation level was operationalized with items part I-B, 3 and 4 on page 290 of Broderick questionnaire (see appendix I).

(3) Compensation mix: This construct involves the extent to which compensation mix rewards for membership versus performance. Exploratory factor analysis yielded two scales related to this construct. (a) The proportion of compensation forms was operationalized with one item in part II-A, 1 and (b) the compensation increase guidelines was operationalized with one item in part II-B, 3 on page 291 of Broderick questionnaire (see appendix I).

(4) <u>Compensation incentives</u>: This construct involves the extent to which incentives are based on efficiency versus growth performance objectives. Exploratory factor analysis yielded one scale related to this construct. Compensation incentives was operationalized with one item in part II, B, 6, c on page 293 of Broderick questionnaire (see appendix I).

<u>Compensation Administration Dimensions</u>

Compensation administration decisions include those on compensation communication, participation, decentralization, formalization and standardization.

(5) <u>Communication</u>: This construct involves the extent to which communication on compensation policies is open versus restrictive. Exploratory factor analysis yielded one scale related to this construct. Communication was operationalized with seven items in part III, C, 3 (a to g) on page 296 of Broderick questionnaire (see appendix I).

(6) <u>Participation</u>: This construct involves the extent to which employee participation in compensation decision making is high versus low. Exploratory factor analysis yielded two scales related to this construct. (a) Participation on compensation decisions related to job analysis and job evaluation methods, wage survey results and pay increase guidelines was operationalized with 10 items in part III, A, (a to j) on page 293 of Broderick questionnaire and (b) participation in the development of incentive plans was operationalized with one item in part II, B, 6, a (see appendix I).

(7) Decentralization: This construct involves the extent to which authority to approve compensation policiy decisions is restricted to high level managers versus lower level of management. Exploratory factor analysis yielded three scales related to this construct. (a) Decentralization on compensation decisions regarding job analysis, job evaluation and performance evaluation criteria was operationalized with six items in part III, A, (b,c,d,e,i) on page 293 of Broderick questionnaire; (b) decentralization on compensation decisions related to budget plan and increase guidelines was operationalized with three items in part III, A, (a,h,j); and (c) decentralization on compensation decisions related to market wage surveys was operationalized with two items in part III, A, (f,g) (see appendix I).

(8) Structure/level/mix formalization: This construct involves the extent to which the implementation of compensation structure, level and mix is formalized. Exploratory factor analysis yielded four scales related to this construct. (a) Formalization of procedures related to job descriptions and evaluation was operationalized with five items in part III, B, (f,g,h,i,n) on page 295 of Broderick questionnaire; (b) formalization on job analysis procedures was operationalized with two items in part III, B, (a,b); (c) formalization of procedures related to performance appraisal was operationalized with two items in part III, B, (p,q); and (d) formalization of procedures related to market wage surveys was operationalized with two items in part III, B, (m,o) (see appendix I).

(9) Standardization: This construct involves the extent to which compensation policies are standardized throughout the organization (i.e.,uniform versus tailored to each individual unit's needs). Exploratory factor analysis yielded two scales related to this construct. (a) Standardization of compensation structure and compensation level policies was operationalized with one item in part I, B, 6; (b) standardization of incentive plans was operationalized with two items in part II, B, 6, (b,d) on page 293 of Broderick questionnaire (see appendix I).

These measures of compensation policy decisions were developed using simple Likert scales. Most of these scales allowed for the rating of the organization on one of five anchored scale values. Each scale required the survey respondent to indicate the extent to which the middle-management compensation system in the business unit is characterized by each particular compensation construct to the organization.

Strategy Construct Operationalization

Measuring strategy involved the evaluation of the seven corporate-level financial indicators from the COMPUSTAT database. Principal components analysis was used in determining the scaled measures of strategy. Prior to this analysis, all ratios were standardized within two-digit SIC codes. The following financial indices were included in the initial factor analysis.

(1) Lack of assets parsimony: This construct indicates the lack of assets parsimony of the business and is measured by three ratios:

(1) gross book value of plant & equipment/revenues
(2) net book value of plant & equipment/revenues
(3) total net investment/revenues

(2) Lack of value added parsimony: This construct involves the extent to which the value added of the product is high versus low. It is measured by the following ratio:

(4) Value added=
(revenues - cost of good sold - rental expense)/revenues

(3) Lack of current assets parsimony: This construct indicates a lack of current assets parsimony. It is measured by three ratios:

(5)inventory/revenues

(4) Product innovation: This construct indicates the extent to which innovativeness is an important strategic objective. It is measured by the following ratio:

(6) R&D expenses/revenues

(5) Lack of cost parsimony: This construct indicates the importance (high versus low) of costs within the business unit. It is measured by two ratios:

(7)Cost parsimony=Total costs/revenues
(8)Administration parsimony=Administrative costs/revenues

(6) Advertising emphasis: This variable measures the importance of advertising expenses. It is measured by the following ratio:

(9)advertising expense/revenues

(7) Employee productivity: This construct indicates the extent to which employees are highly versus poorly productive. It is measured by the two following ratios:

(10)value added/number of employees (I)
(11)revenues/number of employees (II)

The literature review (Porter, 1980; Hambrick, 1980; Robinson & Pearce, 1988; Dess & Davis, 1984) indicates that a cost leader oriented firm will emphasize current assets parsimony, a rather low product innovation and low R&D expenses, a low value added, low prices and low costs, low marketing and promotion expenses, but a high employee productivity. In contrast, a differentiator oriented firm will not emphasize current assets parsimony, but will have high product innovation, high value added, rather high prices and high costs, high marketing and promotion expenses, and a rather low employee productivity. The literature does not suggest anything regarding organizations that might have both strategies or none of these two strategic patterns.

The results of the Principal Components Analysis of COMPUSTAT strategy indices using the varimax rotation indicate that lack of administrative costs parsimony, measured by administrative costs/revenues, lack of value added parsimony, measured by (revenues - cost of good sold - rental expense)/revenues, product innovation, measured by R&D expense/revenues, lack of current assets parsimony, measured by inventory/revenues, and advertising emphasis, measured by advertizing expense/revenues load on a single factor which is close to the differentiator construct. Lack of cost parsimony, measured by total costs/revenues (negative loading), employee productivity (I), measured by value added/number of employees, and employee productivity (II), measured by revenues/number of employees load on a single factor which is close to the cost leader construct. **Table 6** presents the factor loadings related to differentiators and cost leaders. In this table a blank indicates that the coefficient was less than .30. It should be noted that a third factor was related to capital intensity items. Those items were excluded from the final analysis presented in table 6. Differentiation construct was defined by the average of the five items that loaded on factor one (see table 6). Cost leadership construct was defined by the average of the three items that loaded on factor two. Additional analysis of the differentiator and cost leader scales indicated that **21%** of the sample firms clearly had a cost leader oriented strategy (above the mean on the cost leadership score and below the mean on the differentiation score) and **24%** clearly had a differentiator oriented strategy (above the mean on the differentiation score and below the mean on the cost leadership score). Thirty nine percent of the sample firms had no well defined strategic pattern (below the mean on both scales) while 16% seemed to follow both strategic orientations (above the mean for both scales), emphasizing both a low cost position vis a vis their competitors and product innovation, as well as differentiation by uniqueness of products industry-wide. It has to be noted that less than 50% of the sample firms were clearly following one of the two strategic orientations.

TABLE 6

Principal Components Analysis of COMPUSTAT Strategy Indices

	Factor 1 Differentiators	Factor 2 Cost Leaders
1. Lack of administrative costs parsimony	.913	
2. Lack of value added parsimony	.879	
3. Product innovation	.759	
4. Lack of current assets parsimony	.586	
5. Advertizing emphasis	.476	
6. Lack of costs parsimony		-.672
7. Employee productivity (I)		.807
8. Employee productivity (II)		.635

Performance Construct Operationalization

Measures of organization performance came from the Fortune magazine's surveys and the COMPUSTAT database. They were gathered for a period of three years (1983-1985) in order to generate averages which represent more typical performance characteristics. These averages were standardized within two-digit SIC codes. Corporate reputations are based on organizational external reputation for excellence assessed by industry experts (Friedman, 1986). All non-financial measures came from surveys of corporate reputations conducted annually by Fortune magazine.

Financial performance measures

(1) Financial soundness: This construct indicates the extent to which the organization has financial soundness. It is measured by the following ratio:

(1) ***Current ratio***=current assets/current liabilities

(2) Profitability: This variable measures the extent to which the organization is profitable. It is measured by six ratios:

(2) ***Gross margin*** = gross profit/revenues
(3) ***Net profit margin*** =
((Earnings before interest & tax)-taxes)/revenues
(4) ***Return on assets (ROA)*** =
((Earnings before interest & tax)-taxes)/total assets
(5) ***Return on investment (ROI)*** =
((Earnings before interest & tax)-taxes)/Invested capital
(Invested capital = Long term debt + shareholders' equity)
(6) ***Earnings per share (EPS)*** =
net income (or net profit)/number of common shares

(3) Efficiency: This construct indicates the extent to which the organization is efficient. It is measured by two ratios:

(7)***Inventory turnover*** = Cost of good sold/average inventory
(8) ***Average collection period*** =
(Accounts receivable x 360)/net sales

(4) Solvability: This construct indicates the extent to which the organization's solvability regarding long-term debt is high versus low. It is measured by one ratio:

(9) ***Times interest earned*** =
((Earnings before interest & tax)-taxes)/interest charges

(5) Value as long term investment: This construct indicates the extent to which the organization is considered by investors to have a low versus high value as a long term investment. It is measured PER:

(10) ***Price earning ratio (PER)*** = Stock Price/EPS

Non-financial performance: External reputations

The principal components analysis of the eight Fortune reputation indices produced one factor indicating that the firm's external corporate reputation is measured by a single construct, labeled "reputation". These sub-dimensions are: (1) Innovativeness, measuring the extent to which the organization is little versus highly innovative in product development; (2) Quality of products, measuring the extent to which the organization produces quality products; (3) Quality of management, measuring the extent to which the organization has a reputation for having high quality of management; (4) Ability to attract, develop and keep people, measuring the extent to which the organization is able to attract, develop and keep people; (5) Community and environmental responsibility, measuring the extent to which the organization has a reputation for having community and environmental responsabilities; (6) Financial soundness, measuring the extent to which the organization has a reputation for financial soundness; (7) Assets parsimony, measuring the extent to which the organization is little versus highly parsimonious regarding the use of corporate assets and (8) value as long-term investment, measuring the extent to which the organization is considered by investors to have a low versus high value as a long-term investment. The average three-year rating across these dimensions were computed to indicate the overall external reputation of the firm. A high score indicates a positive external reputation on these eight dimensions. A low score indicates relatively negative external reputation.

Therefore, the first step of analysis was finalizing the scales used to measure all constructs. This involved correlational and reliability analyses. This was used to supplement the principal components analyses and evaluate the psychometric characteristics of each scale and to assess hypotheses with regression techniques. **Table 7** presents the psychometric information for the three types of scales, compensation, strategy and performance. The first column in this table lists the scales used to measure compensation, strategy and performance. The next three columns present descriptive statistics for each scale (i.e., means, standard deviations and frequencies). The last column indicates the Crombach alpha reliability coefficient for each scale.

In addition, the information on compensation systems for middle managers suggested a general tendency for sample firms to have design characteristics focused on internal equity, membership compensation and short-term, efficiency-oriented performance incentives. The information on compensation administration characteristics suggested a focus on moderate levels of centralization, formalization and standardization (Broderick, 1986).

TABLE 7
Descriptive Statistics

Variables	Mean	Std Dev	N	Alpha Reliability
Compensation				
Internal Equity Emphasis	3.43	0.97	199	-
Internal promotion Orientation	3.35	0.78	199	-
External Equity Emphasis	3.57	0.81	199	-
Compensation Level	3.30	0.65	199	.63
Compensation Mix:Incentives-Based	24.96	7.76	199	.72
Incentives:Performance-Based	91.99	15.09	199	.82
Incentives:Innovation/Risk/Growth	2.45	0.96	152	.73
Communication Breadth	1.41	0.81	199	.89
Participation:Compensation Structure	19.26	7.29	199	.89
Participation:Incentive Plans	1.94	1.06	156	.64
Decentralization:Job Evaluation Decisions	17.09	6.21	199	.83
Decentralization:Increases Decisions	17.73	6.07	199	.76
Decentralization: Market Rate Decisions	14.65	6.57	199	.80
Formalization:Job Evaluation	3.10	1.03	199	.79
Formalization:Job Analysis	6.25	3.02	199	.94
Formalization:Performance Appraisal	2.86	1.02	198	.64
Formalization:Market Rate analysis	3.04	1.07	199	.56
Standardization:Incentive Plans	3.50	1.00	151	.70
Standardization:Compensation Structure	1.47	0.69	199	-
Strategy (standardized)				
Cost Leaders	0.06	0.54	106	.84
Differentiators	-0.03	0.58	107	.93
Performance (standardized)				
Current Ratio	0.04	1.01	107	.91
Quick Ratio	0.05	1.02	107	.91
Acid Ratio	0.17	3.08	107	.88
Gross Margin	0.19	0.49	107	.74
Net Margin	0.13	0.49	107	.90
ROI	0.18	0.51	107	.84
ROA	0.24	0.55	107	.84
EPS	0.28	0.77	104	.87
PER	0.33	1.04	107	.93
Inventory Turnover	0.02	0.91	107	.92
Average Collection Period	-0.21	0.75	107	.97
Long-term Debt Ratio	-0.27	0.57	107	.64
Times Interest Earned	0.08	0.56	105	.86
Long-term Debt/Investment	-0.26	0.57	107	.87
External Reputation	6.50	0.86	40	.99

CHAPTER III

EMPIRICAL RESULTS

The results of this study are presented in this section. The presentation of results is organized around the two main objectives of this study: (1) describing differences in compensation design and administration decisions which are related to the business strategies of cost leadership and differentiation, and (2) evaluating the joint influence of compensation and strategy on organization performance. The first section presents the correlation analysis of the relationship between compensation system design and administration characteristics and the two strategic orientations of cost leaders and differentiators. Additionally, some selected partial correlation analyses were performed in which net income, net sales, number of employees and capital intensity were used to control for size. In general, the pattern of results observed with the zero-order correlations did not change substantially and these results will not be presented. The second section presents the results of moderated regressions that were used to assess the impact of the interaction or fit between the compensation system characteristics and strategic orientation on organizational performance.

Investigation of Differences in Compensation Systems related to Strategic Orientations: Correlation Results

The empirical investigation of the first objective of this study required several steps. After finalizing compensation scales, it was necessary to differentiate cost leader oriented firms from differentiator oriented firms, using factor and reliability analyses. Results of these analyses were presented in Chapter II. Finally, the scaled compensation factors were compared across the two strategic dimensions of cost leaders and differentiators. Compensation scales were correlated with strategic orientations. Correlations between compensation scales and strategic types are presented in **table 8**.

The results suggest that the correlation pattern of compensation scale differences and differentiator and cost leader orientations are not exactly like the pattern suggested in the literature review. Some compensation scales were found significantly related to one of the two strategic orientations, even though they were not expected to be. Some others were found not significantly related to cost leadership or differentiation strategy although they were expected to be positively related to one of the strategic orientations.

TABLE 8
Correlations between Compensation Scales and Strategic Dimensions

Compensation	Strategic Orientation: Cost Leaders	Strategic Orientation: Differentiators
Internal Equity Emphasis	0.0218	-0.0366
Internal Promotion Orientation	0.2194*	0.0699
External Equity Emphasis	-0.0807	0.1248
Compensation Level	0.3219**	0.2153*
Compensation Mix:Incentives-Based	0.2892**	0.0695
Incentives:Performance-Based	-0.0332	-0.0139
Incentives:Innovation/Risk/Growth	-0.0576	-0.1186
Communication Breadth	-0.1201	0.1855*
Participation:Compensation structure	-0.1206	0.1531*
Participation:Incentive Plans	0.0151	-0.1145
Decentralization:Job Evaluation Decisions	-0.1514	0.0514
Decentralization:Increases Decisions	-0.1658*	-0.0228
Decentralization:Market Rate Decisions	-0.0335	0.1300
Formalization:Job Evaluation	-0.1512	-0.0271
Formalization:Job Analysis	-0.0277	-0.0189
Formalization:Performance Appraisal	0.0772	0.0326
Formalization:Market Rate Analysis	0.0067	0.0035
Standardization:Incentive Plans	0.0531	-0.1449
Standardization:Compensation Structure	0.1706*	0.0648

* Signif. LE .05 ** Signif. LE .01

The results suggest that cost leaders have a tendency to develop (1) an internal promotion orientation, (2) a high compensation level, (3) a compensation mix which emphasizes incentives, (4) a decentralized compensation system for increase decisions and (5) a rather standardized compensation structure. In addition, results suggest that differentiators have a tendency to develop (1) a high compensation level, (2) open communication regarding compensation policy decisions, (3) participation in the design and administration of the compensation structure, and (4) decentralization of market rate decisions.

Some compensation scales were not significantly related to either of the two strategic orientations, although they were expected to be. These scales are: (1) internal equity emphasis, (2) external equity emphasis, (3) incentives: performance-based, (4) incentives: innovation/risk/growth, (5) participation: incentive plans, (6) decentralization: job evaluation decisions, (7) decentralization: market rate decisions, (8) formalization: job evaluation, (9) formalization: job analysis, (10) formalization: performance appraisal, (11) formalization: market rate analysis, and (12) standardization: incentive plans.

The compensation scale of <u>internal promotion orientation</u> was found significantly related to cost leader orientation at the .05 level. This indicates that cost leaders in the sample rely on the internal promotion and development of employees in order to fill middle management positions. This result is related to hypothesis #1, which suggests that organizations that follow an overall cost leadership strategy will emphasize internal equity in compensation system design, while organizations following a differentiation strategy will emphasize external equity. Internal promotion orientation was described in the literature in chapter I as related to internal equity practices. As a consequence, this result partly supports hypothesis #1. In contrast, there is no significant correlation between external equity emphasis and differentiation orientation Differentiators are not found in the sample to have any external versus internal equity emphasis. The fact that the compensation scale of <u>external equity emphasis</u> was not found significant for cost leaders is consistent with hypothesis #1 since cost leaders were expected in the literature to emphasize internal equity in their compensation system design. Identically, the fact that the compensation scale of <u>internal equity emphasis</u> was not found significant for differentiators is consistent again with hypothesis #1 since differentiators were expected in the literature to emphasize external equity.

The compensation scale of <u>compensation level</u>, which indicates the tendency of an organization to have an overall wage rate that leads the market rate, was found significantly related to the cost leader orientation at the .01 level and to the differentiation orientation at the .05 level. This indicates that both cost leaders and differentiators in the sample tend to have a compensation level that exceeds the compensation levels of their competitors. These results are related to hypothesis #3, which suggests that organizations following an overall cost leadership strategy will have compensation level policies that meet or lag the market, while organizations following a differentiation strategy will have compensation level policies that lead the market. These results partly support hypothesis #3, since differentiators are found to have compensation levels above the market rate. In contrast, these results do not support, and even diametrically counter, hypothesis #3 for cost leaders since cost leaders are found to have compensation levels above the market rate. They were expected to meet or lag their competitors. These results might be partly biased by the lack of sample representativeness. Firms in this sample were larger in terms of sales, net income and employee number than the U.S manufacturing firm population as a whole. Another possible explanation is that the more firms define a business strategy, either a strategy of cost leadership or a strategy of differentiation, the more they will tend to develop lead compensation level policies to attract people and reward them according to the strategic objectives of the organization that were set. Organizations which do not have clear and well defined strategic objectives do not focus on attracting the best people with a lead compensation policy. Perhaps not having a defined strategy makes it too difficult to develop a clear consensus on what types of employees are worth the extra-cost associated with a lead strategy.

The compensation scale of compensation mix was found significantly related to cost leader orientation at the .01 level, but not significantly related to differentiation orientation. This result indicates that cost leaders in the sample have a compensation mix that emphasizes incentives. These results are related to hypothesis #5 which proposes that organizations following an overall cost leadership strategy will reward membership and seniority with base salary and benefits rather than for performance with merit pay and incentives based on performance objectives, while organizations following a differentiation strategy will reward performance rather than membership and seniority. These results contradict hypothesis #5 since results for cost leaders are diametrically opposed to what was expected. A possible explanation could be that cost leaders use incentives based on performance and efficiency in order to reduce costs and, thereby, maximize the profits of the organization. Results with the differentiation orientation are not significant.

The compensation scale of breadth of communication was found significantly related to differentiation orientation at the .05 level and not significantly related to cost leader orientation. This indicates that differentiators in the sample use their formal communication channels to circulate a broad range of information on compensation policies and practices. It also indicates that there is no such clear pattern for cost leaders. These results are related to hypothesis #9, which suggests that organizations following an overall cost leadership strategy will have formal communication channels, but will use them to circulate only limited information on compensation policies, while organizations following a differentiation strategy will have an open communication policy and will use their formal communication channels to circulate a broad range of information on compensation policies. Results support hypothesis #9 for differentiators, but not for cost leaders.

The compensation scale of <u>participation in the design of the compensation structure</u> was found significantly related to differentiation orientation at the .05 level, and not significantly related to cost leader orientation. This indicates that differentiators in the sample are encouraging participation in compensation system related decision-making and that cost leaders do not have any clear pattern regarding this matter. These results are related to hypothesis #11, which suggests that organizations following an overall cost leadership strategy will not encourage employee participation in compensation decision-making, while organizations following a differentiation strategy will encourage such participation. The results support hypothesis #11 for differentiators, but not for cost leaders.

The compensation scale of decentralization regarding increase decisions was found to be negatively related to cost leaders at the .05 level and not significantly related to differentiators. This indicates that cost leaders in the sample do not decentralize compensation decision-making related to increase budget plans. Differentiators do not have any clear pattern regarding decentralization of decision-making in compensation policy design and administration. These results are related to hypothesis #13 which suggests that organizations following an overall cost leadership strategy will restrict authority to approve compensation policy decisions to high-level managers, while organizations following a differentiation strategy will allow relatively lower-level of managers to be involved in approving compensation decisions. The scale of decentralization:market rate decisions was found to be positively related to differentiators at the .05 level when controlling for size (net income, net sales and number of employees) and capital intensity. This indicates that differentiators in the sample decentralize market rate decisions, when controlling for size. Results support hypothesis #13 for cost leaders, but not entirely for differentiators. The scales of decentralization of job evaluation decisions was not significantly related to either of the two strategic orientations.

The compensation scale of standardization of the compensation structure was found significantly related to cost leader orientation at the .05 level and not significantly related to differentiation orientation. This indicates that cost leaders in the sample tend to have a rather standardized compensation structure for middle managers, which is part of a corporate-wide plan implemented in each business unit without major adjustments for each unit. It also indicates that differentiators in the sample do not have any clear pattern regarding the standardization of compensation structure. These results are related to hypothesis #17 which suggests that organizations following an overall cost leadership strategy will have standard uniform compensation policies throughout the organization, while organizations following a differentiation strategy will have compensation policies tailored to the needs of individual business units. The results support hypothesis #17 for cost leaders, but not for differentiators.

Finally, the compensation scales of <u>incentives: innovation/risk/growth</u> and <u>incentives: performance-based</u> as well as all the <u>formalization</u> scales were not found significantly related to cost leader and differentiator orientations. This indicates first that cost leaders and differentiators in the sample do not have any clear pattern regarding their tendency to reward for efficiency-related performance objectives versus growth-related performance objectives. Therefore, hypothesis #7, which suggests that organizations following a cost leadership strategy will have efficiency-related performance objectives, while organizations following a differentiation strategy will have growth-related performance objectives, is not supported. Second, it indicates that cost leaders and differentiators in the sample do not have any clear pattern regarding the degree to which their compensation structure is formalized. No pattern was observed for the formalization of job evaluation procedures, job analysis procedures, performance appraisal procedures and market rate analysis procedures. Therefore, hypothesis #15 which suggests that organizations following a cost leadership strategy will have highly formalized rules and procedures regulating the implementation of compensation structure, level and mix policies, while organizations following a differentiation strategy will have less of these formalized procedures, is not supported.

In summary, hypotheses 1, 3, 9, 11, 13, 17 received partial support, hypotheses 5, 7, 15 were not supported. Correlational results suggest that while some differences in compensation design and administration characteristics do exist among strategic types, the differences are not always significant. In brief, these results indicate that cost leader oriented firms in the sample have a tendency to rely on the internal promotion and development of employees in order to fill middle management positions. They also have a compensation level that, in general, exceeds the compensation levels of their competitors,i.e., a <u>lead</u> compensation level policy. In addition, they have a tendency to develop a compensation mix which emphasizes incentives and to adopt decentralized decision-making processes regarding increase decisions. They also implement a standardized compensation structure for middle managers, which is part of a corporate-wide plan implemented in each business unit without major adjustments for each unit. Results also indicate that differentiator oriented firms in the sample have a tendency to have a compensation level that exceeds the average compensation level of their competitors. They also have an open communication regarding compensation design and administration decisions, and use their formal communication channels to circulate a broad range of information on compensation policies. In addition, differentiators in the sample tend to allow lower-level managers to participate in the design and administration of their compensation structure. The partial correlation analysis which controlled for size did not produce any substantial change in this pattern of results. One difference was that the compensation scale of decentralization in market rate decisions for differentiators. The zero-order correlation coefficient associated with this scale was .13 without controlling for size and increased to .23 (significant at the .05 level) when controlling for number of employees, for net income and for net sales. It increased to .19 when controlling for capital intensity. Next part presents the results of the moderated regressions on performance.

Investigation of the Impact of Compensation and Strategy on Performance: Results of Moderated Regressions

The empirical investigation of the second objective of this study, the evaluation of the joint influence of compensation and strategy on organizational performance, required the use of moderated regression techniques. The 10 performance variables were separately regressed on the nine compensation variables and the two strategic orientations: 180 regression analyses were obtained. A .12 significance level was arbitrarily selected for this investigation. As a consequence, only supportive and contradictory results which obtained a .12 level of significance are presented in this section. Given the large number of results, results which exceed the .12 level are not presented, but are discussed if relevant to this research.

Moderated regression results are presented in tables 9.1 to 9.9. The focus of moderated regressions is on analyzing interaction effects in the context of multiple regression analyses. The first step of the procedure evaluated the main effect of the independent variables of strategy and compensation. In the second step, the cross-product term (e.g., compensation*strategy) is entered and the interaction effect is assessed. A significant cross-product term indicates that the relationship between the compensation variable and performance index varies across the range of the strategy measure (e.g., compensation has a stronger relationship to performance at higher levels of the strategy measure, etc.).

In each table, the first column lists the compensation scales. The second column presents the performance criterion variables, which are gross margin, net margin, return on investment (ROI), return on assets (ROA), price earning ratio (PER), earnings per share (EPS), inventory turnover, current ratio and times-interest earned. The next five columns present statistical information for each indicated strategy, compensation and performance combination. The "R^2" column is the explained variance with all variables entered. The change in explained variance associated with entering of the cross-product term (noted as R^2) is presented in the next column. The sign and value of the unstandardized regression coefficient of that cross-product term (e.g., compensation*strategy) is noted as "+/-b_3". The significance of the cross-product term (noted as "Signif. b_3") and the overall significance of the full regression equation (noted as "Overall Signif.") are presented in the last two columns. This format is used for tables 9.1 to 9.9. For each related hypothesis, selected supportive and contradictory results are presented.

In addition to the moderated regressions described above, supplemental analyses which control organization size (net income, net sales and number of employees) and capital intensity were conducted. This involved entering the control variables on the first step and then repeating the two-step moderated regression process described above. In general, the pattern presented below was verified in that supplemental analysis, and those results will not be formally presented, but will be discussed if relevant.

Hypothesis #2 argues that if organizations with a cost leadership strategy emphasize internal equity in compensation system design, the overall organizational performance will be higher; while, if organizations with a differentiation strategy emphasize external equity, overall organizational performance will be higher. Table 9.1 presents supportive and contradictory results for cost leaders and differentiators related to this hypothesis.

TABLE 9.1
Moderated Regression Analysis: Hypothesis 2

Compensation Scale	Performance	R^2	R^2	+/-b_3	Signif b_3	Overall Signif
Differentiator Orientation						
Internal Equity	Current Ratio	.045	.030	-.337	.021	.206
Internal equity	Invent. Turn.	.466	.016	-.228	.095	.000
External equity	ROI	.069	.030	+.193	.077	.072
External equity	Tim.Interest	.042	.032	+.214	.075	.236
Internal Promotion	Current Ratio	.049	.029	-.377	.084	.176
Cost Leader Orientation						
Internal Equity	Gross Margin	.446	.124	-.322	.000	.000
Internal Equity	Net Margin	.122	.052	-.209	.019	.005
Internal Equity	ROA	.119	.052	-.239	.019	.006
External Equity	EPS	.153	.065	-.767	.008	.001
External Equity	PER	.126	.065	-1.04	.008	.004
Internal Promotion	Current Ratio	.484	.069	+.526	.001	.000
Internal Promotion	Gross Margin	.466	.122	-.350	.000	.000
Internal Promotion	Net Margin	.114	.039	-.200	.042	.008
Internal Promotion	ROI	.042	.033	-.197	.070	.244
Internal Promotion	ROA	.108	.058	-.278	.014	.011
Internal Promotion	EPS	.119	.061	-.400	.011	.006
Internal Promotion	PER	.103	.069	-.570	.008	.014
Internal Promotion	Invent. Turn.	.066	.055	-.448	.019	.082
Internal Promotion	Tim.Interest	.253	.028	-.172	.098	.000

Results of the regression concerning cost leaders for the compensation scale of <u>external equity emphasis</u> had negative coefficients. This indicates that for cost leader oriented firms, the more they put emphasis on external equity practices in designing the compensation structure and level, the lower their organizational performance, as measured by EPS and PER. These results are highly significant and support hypothesis #2 for cost leaders, given that it was predicted that cost leader oriented firms will not emphasize external equity but internal equity, if they are to have higher organizational performance. However, results of the moderated regression for the scale <u>internal equity</u> also had negative coefficients. This indicates that for cost leader oriented firms, the more they put emphasis on internal equity practices in designing the compensation structure and level, the lower their organizational performance, as measured by gross margin, net margin and ROA. These results contradict hypothesis #2 for cost leaders since it was predicted that for cost leader oriented firms, developing internal equity practices would increase organization performance. In addition, results of the regressions for the compensation scale <u>internal promotion orientation</u> have negative coefficients, except in one case. This indicates that for cost leader oriented firms, the more they rely on the internal promotion and development of employees in filling middle management positions, the lower their organizational performance, as measured by gross margin, net margin, ROI, ROA, EPS, PER, inventory turnover and times-interest earned. Only current ratio loaded positively. Overall, these results contradict hypothesis #2, since it was predicted that cost leader oriented firms will develop internal equity practices and, as a consequence, will rely on internal promotion and development of employees, if they are to have higher organizational performance. Therefore, hypothesis #2 is not supported for cost leaders.

Results of the regression concerning differentiators for the compensation scale <u>internal equity</u> produced negative regression coefficients. This indicates that, for differentiation oriented firms, the more they put emphasis on internal equity practices in designing the compensation structure, the lower their organizational performance, as measured by such variables as inventory turnover and current ratio. These results support hypothesis #2 for differentiators since it was predicted that differentiation oriented firms should not emphasize internal equity but external equity, if they want to improve their organizational performance. Similar results were obtained with the internal promotion orientation scale. Results of the regression for <u>external equity emphasis</u> produced positive coefficients. This indicates that for differentiation oriented firms, the more they put emphasis on external equity practices in designing the compensation structure, the higher their organizational performance, as measured by such variables as ROI and times-interest earned. Thus, these results generally support hypothesis #2 for differentiators. However, it should be noted that the significance level of these results missed the .05 level, but were under .10.

Hypothesis #4 argues that if organizations with a cost leadership strategy have compensation level policies that meet or lag the market, organizational performance will be higher; while, if organizations with a differentiation strategy have compensation level policies that lead the market, organizational performance will be higher. Table 9.2 presents supportive as well as contradictory results for this hypothesis.

TABLE 9.2
Moderated Regression Analysis: Hypothesis 4

Compensation Scale	Performance	R^2	R^2	+/-b_3	Signif b_3	Overall Signif
Differentiator Orientation						
Comp. Level	Invent. Turn.	.477	.029	+.462	.021	.000
Cost Leader Orientation						
Comp. Level	Current Ratio	.529	.115	+.999	.000	.000
Comp. Level	Gross Margin	.367	.045	-.314	.010	.000
Comp. Level	ROI	.061	.050	-.351	.026	.106
Comp. Level	ROA	.100	.047	-.366	.027	.016
Comp. Level	EPS	.088	.043	-.495	.034	.029
Comp. Level	PER	.111	.031	-.565	.068	.010
Comp. Level	Invent. Turn.	.071	.039	-.558	.046	.068

The coefficients for the cross-product term in the moderated regression analysis of cost leaders and compensation level were significantly negative in a number of cases. The results current ratio which has a positive coefficient is the exception to the pattern. Overall, this indicates that, for cost leader oriented firms, the higher their compensation level compared to their competitors, the lower is their organizational performance, as measured by such variables as gross margin, net margin, ROI, ROA, EPS, PER and inventory turnover. These results support hypothesis #4 for cost leaders, since it was predicted that cost leader oriented firms should not have compensation level policies that lead the market, but rather they should lag or meet the market, in order to have higher performance.

Results of the regression concerning differentiators and compensation level were less definitive. Only one significant interaction was found. This indicates that, for differentiation oriented firms, the higher their compensation level compared to their competitors, the higher their organizational performance, as measured by such variables as inventory turnover. Therefore, hypothesis #4 is marginally supported for differentiators. Much stronger support was seen for the hypothesized interaction between cost leaders and compensation level. Additional analysis with control for size (net income, net sales and number of employees) and capital intensity confirmed these results.

Hypothesis #6 argues that if organizations following a cost leadership strategy tend to reward for membership and seniority rather than for performance, organizational performance will be higher; while, if organizations with a differentiation strategy tend to reward for performance, rather than membership and seniority, organizational performance will be higher. Table 9.3 presents supportive and contradictory results related to this hypothesis.

TABLE 9.3
Moderated Regression Analysis: Hypothesis 6

Compensation Scale	Performance	R^2	R^2	+/-b_3	Signif b_3	Overall Signif
Differentiator Orientation						
Incentives:Perf-based	Invent. Turn.	.477	.029	-.019	.021	.000
Cost Leader Orientation						
Incentives:Perf-based	Gross Margin	.441	.099	-.022	.000	.000
Incentives:Perf-based	EPS	.074	.045	+.024	.033	.057
Incentives:Perf-based	PER	.041	.038	+.030	.052	.254
Incentives:Perf-based	Tim.Interest	.312	.069	-.022	.002	.000
Comp. Mix:Inc-based	Current Ratio	.475	.058	+.037	.001	.000
Comp. Mix:Inc-based	Gross Margin	.478	.157	-.030	.000	.000
Comp. Mix:Inc-based	Net Margin	.125	.055	-.018	.016	.005
Comp. Mix:Inc-based	ROA	.108	.057	-.021	.015	.011
Comp. Mix:Inc-based	EPS	.102	.028	-.021	.086	.015
Comp. Mix:Inc-based	PER	.085	.031	-.029	.072	.034
Comp. Mix:Inc-based	Invent. Turn.	.032	.028	-.025	.085	.367
Comp. Mix:Inc-based	Tim.Interest	.267	.035	-.017	.033	.000

Results of the regression for cost leaders with the compensation scale incentives: performance-based are mixed. Increases in performance-based incentives were found to be related to decreases in gross margin and times-interest earned. This indicates that for cost leader oriented firms, the more they have incentives based on performance rather than membership and seniority, the lower their organizational performance. These results support hypothesis #6 for cost leaders, since it was suggested that cost leader oriented firms should reward membership and seniority with base salary and benefits rather than emphasize merit pay and performance incentives. However, results were also found positively significant with current ratio and gross margin. This indicates that for cost leader oriented firms, the more they have incentives based on performance, the higher their organizational performance, as measured by such variables as EPS and PER. These results contradict hypothesis #6. No conclusion can hence be drawn from these results. The interaction term coefficients for the second scale, compensation mix:incentives-based, were, with one exception, negative for cost leaders. This indicates that for cost leader oriented firms, the higher the proportion of incentives in the compensation mix, the lower their organizational performance, as measured by such variables as gross margin, net margin, ROA, EPS, PER, inventory turnover and times-interest earned. These results support hypothesis #6 for cost leaders, since cost leader oriented firms were predicted to reward for membership rather than performance, if they are to have higher organizational performance.

Results of the moderated regression concerning differentiators and the scale incentives:performance-based were negative. This indicates that for differentiator oriented firms, the more they have incentives based on performance rather than on membership and seniority, the lower their organizational performance, as measured by such variables as inventory turnover. These results contradict hypothesis #6, since it was predicted exactly the opposite. The scale compensation mix:incentives-based was not found significant with any of the performance variables. As a consequence, hypothesis #6 is not supported for differentiators, but received partial support for cost leaders. Supplemental analysis with control for size (net sales, net income and number of employees) and capital intensity confirmed these results.

Hypothesis #8 argues that if organizations with a cost leadership strategy emphasize efficiency-related performance objectives, organizational performance will be higher; while, if organizations with a differentiation strategy emphasize growth-related performance objectives, organizational performance will be higher. Table 9.4 presents the results for this hypothesis.

TABLE 9.4
Moderated Regression Analysis: Hypothesis 8

Compensation Scale	Performance	R^2	R^2	+/-b_3	Signif b_3	Overall Signif
Differentiator Orientation						
Incentives:Innovation	Gross Margin	.467	.097	+.307	.007	.005
Incentives:Innovation	Current Ratio	.527	.137	+.317	.011	.000
Incentives:Innovation	Invent. Turn	.071	.067	-.297	.009	.000
Cost Leader Orientation						
Incentives:Innovation	Gross Margin	.487	.141	+.406	.000	.000
Incentives:Innovation	Net Margin	.254	.131	+.373	.000	.000
Incentives:Innovation	ROA	.157	.070	+.315	.013	.004
Incentives:Innovation	Tim.Interest	.335	.064	+.338	.008	.000

Results of the regression concerning cost leaders for the compensation scale incentives: growth/ risk/ innovation produced positive interactions with four performance indices. This indicates that for cost leader oriented firms, the more incentives are based on rewarding growth, innovation and risk, the higher their organizational performance, as measured by such variables as gross margin, net margin, ROA and times-interest earned. These results contradict hypothesis #8 for cost leaders since exactly the opposite was expected. Cost leaders were expected to have efficiency-related performance objectives rather than growth-related performance objectives.

Results of the regression for differentiators for the compensation scale incentives:growth/risk/innovation found both positive and negative interaction coefficients. Positive coefficients are with current ratio and gross margin. This indicates that for differentiator oriented firms, the more incentives are based on rewarding growth, innovation and risk, the higher their organizational performance, as measured by current ratio and gross margin. These results support hypothesis #8 for cost leaders. However, Inventory turnover had negative coefficients, which indicates that for differentiation oriented firms, the more incentives are rewarding growth, innovation and risk, the lower their organizational performance, as measured by inventory turnover. Results for differentiators do not indicate any clear pattern. As a consequence, results do not support hypothesis #8 for either strategic orientations. Additional analysis with control for size (net sales, net income and number of employees) and capital intensity supported these results.

Hypothesis #10 argues that if organizations with a cost leadership strategy do not have an open communication on compensation policies and use their formal communication channels to circulate only limited information on compensation policies, organizational performance will be higher; while, if organizations with a differentiation strategy have an open communication on compensation policies and use their communication channels to circulate a broad range of information on compensation policies, organizational performance will be higher. Table 9.5 presents supportive and contradictory results for this hypothesis.

TABLE 9.5
Moderated Regression Analysis: Hypothesis 10

Compensation Scale	Performance	R^2	R^2	$+/-b_3$	Signif b_3	Overall Signif
Differentiator Orientation						
Communication Breadth	Gross Margin	.077	.027	-.218	.096	.047
Communication Breadth	Net Margin	.161	.026	-.218	.084	.000
Communication Breadth	Tim.Interest	.035	.025	-.242	.115	.322
Cost Leader Orientation						
Communication Breadth	Current Ratio	.476	.061	-.884	.001	.000
Communication Breadth	ROI	.050	.042	+.392	.042	.170
Communication Breadth	ROA	.113	.057	+.490	.014	.009
Communication Breadth	EPS	.161	.088	+.851	.002	.001
Communication Breadth	PER	.200	.061	+.961	.008	.000

Results of the regression concerning cost leaders for the compensation scale communication breadth were positive coefficients, except for one performance variable (current ratio). This indicates that for cost leader oriented firms, the more they have an open communication policy and use their formal communication channels to circulate a broad range of information on compensation policies, the higher their organizational performance, as measured by such variables as ROA, ROI, FPS and PER. These results contradict hypothesis #10 for cost leaders since exactly the opposite was suggested. Only the results with the current ratio performance index went in the predicted direction. Thus, hypothesis #10 was not generally supported.

Results of the regression with the differentiator scale and communication breadth provided negative interaction coefficients. This indicates that for differentiator oriented firms, the more they have an open communication policy and use their formal communication channels to circulate a broad range of information on compensation policies, the lower their organizational performance, as measured by such variables as gross margin, net margin and times-interest earned. These results contradict hypothesis #10 for differentiators. While each of these results did not achieve the .05 level of significance, they nevertheless do not support hypothesis #10. Similar results were obtained with some additional analysis with control for size (net income, net sales and number of employees) and capital intensity.

Hypothesis #12 argues that if organizations following a cost leadership strategy do not encourage employee participation in compensation decision making, organizational performance will be higher; while, if organizations with a differentiation strategy encourage such participation, organizational performance will be higher. Table 9.6 presents supportive and contradictory results for this hypothesis.

TABLE 9.6
Moderated Regression Analysis: Hypothesis 12

Compensation Scale	Performance	R^2	R^2	$+/-b_3$	Signif b_3	Overall Signif
Differentiator Orientation						
Participation:Struture	Net Margin	.187	.039	-.020	.032	.000
Participation:Struture	ROI	.078	.054	-.025	.019	.046
Participation:Struture	ROA	.082	.045	-.024	.030	.036
Cost Leader Orientation						
Participation:Structure	Gross Margin	.377	.049	+.037	.007	.000
Participation:Structure	Net Margin	.292	.180	+.072	.000	.000
Participation:Structure	ROI	.152	.117	+.062	.000	.001
Participation:Structure	ROA	.236	.157	+.076	.000	.000
Participation:Structure	EPS	.094	.031	+.048	.070	.022
Participation:Structure	PER	.113	.046	+.078	.027	.008
Participation:Incent.	Current Ratio	.526	.026	-.301	.043	.000
Participation:Incent.	Invent. Turn.	.062	.046	+.378	.054	.168

Results of the regression concerning cost leaders for the compensation scale <u>participation:compensation structure</u> were all significantly positive coefficients. This indicates that for cost leader oriented firms, the more they encourage participation in compensation decision-making, the higher their organizational performance, on a number of indices (e.g., ROA, EPS, PER). This contradicts hypothesis #12 for cost leaders. Results of the regression concerning cost leaders for the compensation scale <u>participation:incentives</u> suggest no clear pattern, since one interaction is positive (inventory turnover) and the other is negative (current ratio). Therefore, hypothesis #12 is not supported. Similar results were obtained for cost leaders with supplemental analysis with control for size (net sales, net income and number of employees) and capital intensity.

Results of the regression concerning differentiation for the compensation scale <u>participation:compensation structure</u> produced negative interaction terms. This indicates that for differentiator oriented firms, the more they encourage participation in compensation decision-making, the lower their organizational performance, as measured by net margin, ROI and ROA. These results contradict hypothesis #12 for differentiators. There is no significant results for the compensation scale <u>participation: incentives</u>. As a result, hypothesis #12 is not supported. Results with additional analysis with control for size (net income, net sales and number of employees) and capital intensity do not support hypothesis #12 either.

Hypothesis #14 argues that if organizations following a cost leadership strategy restrict authority to approve compensation policy decisions to high-level managers, organizational performance will be higher; while, if organizations with a differentiation strategy allow relatively lower-level managers to approve compensation policy decisions, organizational performance will be higher. Table 9.7 presents supportive and contradictory results for this hypothesis.

TABLE 9.7
Moderated Regression Analysis: Hypothesis 14

Compensation Scale	Performance	R^2	R^2	$+/-b_3$	Signif b_3	Overall Signif
Differentiator Orientation						
Decentralizat.:Job.Ev	Current Ratio	.072	.045	-.056	.023	.000
Decentralizat.:Job.Ev	Net margin	.171	.024	-.023	.064	.000
Decentralizat.:Job.Ev	Invent. Turn.	.476	.023	-.043	.021	.000
Cost Leader Orientation						
Decentralizat.:Job.Ev	Current Ratio	.596	.171	-.181	.000	.000
Decentralizat.:Job.Ev	EPS	.169	.066	+.091	.007	.001
Decentralizat.:Job.Ev	PER	.163	.053	+.109	.015	.001
Decentralizat.:Job.Ev	Invent. Turn.	.036	.032	+.075	.074	.306
Decentralizat.:Incr.Dec.	Current Ratio	.433	.018	-.074	.085	.000
Decentralizat.:Incr.Dec.	ROI	.041	.032	+.053	.077	.255
Decentralizat.:Incr.Dec.	EPS	.126	.065	+.114	.009	.004
Decentralizat.:Incr.Dec.	PER	.174	.094	+.185	.001	.000

Results of the regression concerning cost leaders for the compensation scale decentralization: job evaluation decisions produced positive interaction effects, except for one performance variable (current ratio). This indicates that for cost leader oriented firms, the more they allow relatively lower-level managers to be involved in approving job evaluation decisions, the higher their organizational performance, as measured by EPS, PER and inventory turnover. This contradicts hypothesis #14 for cost leaders. Results of the regression concerning cost leaders for the compensation scale decentralization:increase decisions followed the same pattern. This indicates that for cost leader oriented firms, the more they allow relatively lower-level managers to be involved in approving increase decisions, the higher their organizational performance, as measured by ROI, EPS and PER. This contradicts also hypothesis #14 for cost leaders. The compensation scale decentralization:market rate decisions was not found significant with any of the performance variables even though it was expected to be negatively significant for cost leaders. Therefore, hypothesis #14 is not supported for cost leaders. All these results for cost leaders are confirmed with the results obtained with supplemental analysis with control for size.

Results of the regression concerning differentiators for the compensation scale decentralization: job evaluation decisions produced negative interaction coefficients. This indicates that for differentiator oriented firms, the more they allow relatively lower-level managers to approve job evaluation decisions, the lower their organizational performance, as measured by current ratio, net margin and inventory turnover. This contradicts hypothesis #14 for differentiators since it was predicted to be run in the opposite direction. Additional analysis with control for size (net sales, net income and number of employees) and capital intensity supported these results. The compensation scales <u>decentralization: increase decisions</u> and <u>decentralization: market rate decisions</u> were not found significant with none of the performance variables although they were expected to be both positively significant for differentiators. However, regression results with control for size (net income, net sales and number of employees) and capital intensity for these two scales produced negative interaction coefficients, indicating that for differentiators, the more they allow relatively lower-level managers to be involved in approving increase and market rate decisions, the lower their organizational performance. These results are diametrically opposed to hypothesis #14. Therefore, hypothesis #14 is not supported for either cost leaders or differentiators and any conclusions which can be drawn from the results are diametrically opposed to what was expected from the literature.

Hypothesis #16 argues that if organizations following a cost leadership strategy have highly formalized rules and procedures regulating the implementation of compensation structure, level and mix policies, organizational performance will be higher; while, if organizations with a differentiation strategy have very little of these formalized procedures, organizational performance will be higher. Table 9.8 presents supportive and contradictory results for this hypothesis.

TABLE 9.8
Moderated Regression Analysis: Hypothesis 16

Compensation Scale	Performance	R^2	R^2	+/-b_3	Signif b_3	Overall Signif
Differentiator Orientation						
Formalization: Job. Ev.	Invent. Turn.	.463	.018	+.205	.071	.000
Cost Leader Orientation						
Formalization:Job.Ev	Current Ratio	.484	.070	-.642	.001	.000
Formalization:Job.Ev	Gross Margin	.355	.029	-.208	.039	.000
Formalization:Job.Ev	EPS	.094	.065	+.499	.009	.022
Formalization:Job.Ev	PER	.034	.033	+.482	.070	.328
Formalization:Job.Anal.	Tim.Interest	.273	.030	+.073	.047	.000
Formalization:Perf.Apprl	Current Ratio	.451	.020	+.206	.064	.000
Formalization:Perf.Apprl	Gross Margin	.466	.134	-.267	.000	.000
Formalization:Perf.Apprl	Net Margin	.165	.088	-.217	.002	.001
Formalization:Perf.Apprl	ROA	.101	.043	-.172	.035	.016
Formalization:Perf.Apprl	Tim.Interest	.278	.041	-.173	.022	.000
Formalization:Mark.Anal.	Current Ratio	.438	.017	+.189	.086	.000
Formalization:Mark.Anal.	Gross Margin	.443	.108	-.235	.000	.000
Formalization:Mark.Anal.	Net Margin	.121	.045	-.153	.028	.006
Formalization:Mark.Anal.	Tim.Interest	.346	.089	-.249	.001	.000

Results of the regression concerning cost leaders for the compensation scale formalization:job evaluation produced mixed results. Two interactions were positive (EPS and PER), while two were negative (current ratio and gross margin). The single significant interaction term with formalization: job analysis was positive. This indicates that for cost leader oriented firms, the more they have formalized rules and procedures regulating job analysis policies, the higher their organizational performance, as measured by times-interest earned. This weakly supports hypothesis #14. The interaction terms with formalization:performance appraisal for cost leaders were negative, except for one performance variable (current ratio). This indicates that for cost leader oriented firms, the more they have formalized rules and procedures regulating performance appraisal policies, the lower their organizational performance, as measured by gross margin, net margin, ROA and times-interest earned. This contradicts also hypothesis #14 for cost leaders. Finally, the results of the compensation scale formalization:market rate analysis with coat leaders confirm previous results since interaction terms were negative with gross margin, net margin and times-interest earned. The only exception was the results with current ratio. Overall, this indicates that for cost leader oriented firms, the more they have formalized rules and procedures for pay-related human resources systems, the lower their organizational performance. Nine out of 11 significant interaction were in this direction. Therefore, hypothesis #14 is not supported for cost leaders. Additional analysis with control for size (net income, net sales and number of employees) and capital intensity supported these results.

Results of the regression concerning differentiators for the formalization scale were not significant in any direction. The only interaction which reached the minimal .12 significance level was with formalization: job evaluation. This interaction suggests that for differentiator oriented firms, the more they have formalized rules and procedures regulating job evaluation policies, the higher their organizational performance, as measured by inventory turnover. This contradicts hypothesis #16 for differentiators. Additional analysis with control for size (net income, net sales and employee number) and capital intensity produced negative coefficients with the compensation scale of formalization: performance appraisal, indicating that for differentiators, the more they have formalized rules and procedures regulating performance appraisal policies, the lower their organizational performance. This supports hypothesis #14 for differentiators since the latter were expected to have less formalized procedures than cost leaders. However, The compensation scales formalization:job analysis, and formalization: market rate analysis did not have significant results with none of the performance variables although they were expected to be negatively significant for differentiators. Therefore, hypothesis #16 is not strongly supported for either cost leaders, or for differentiators. The weight of the evidence was for cost leaders and results suggested that less formalization is beneficial to the organization. This is diametrically opposed to what was expected from the literature.

Hypothesis #18 argues that if organizations with a cost leadership strategy have standard uniform compensation policies throughout the organization, organizational performance will be higher; while, if organizations with a differentiation strategy have compensation policies tailored to the needs of individual units, organizational performance will be higher. Table 9.9 presents supportive and contradictory results for this hypothesis.

TABLE 9.9
Moderated Regression Analysis: Hypothesis 18

Compensation Scale	Performance	R^2	R^2	+/-b_3	Signif b_3	Overall Signif
Differentiator Orientation						
Standardization:Incent.	PER	.036	.036	+.359	.096	.420
Standardization:Incent.	Invent. Turn.	.478	.033	-.328	.032	.000
Standardization:Incent.	Current Ratio	.055	.037	+.344	.083	.214
Standardization:Incent.	Gross Margin	.072	.029	+.150	.120	.116
Standardization:Incent.	Invent. Turn.	.490	.037	-.317	.019	.000
Standardization:Struct.	Invent. Turn.	.464	.016	+.282	.086	.000
Cost Leader Orientation						
Standardization:Incent.	Gros Margin	.534	.190	-.348	.000	.000
Standardization:Incent.	Net Margin	.267	.117	-.260	.001	.000
Standardization:Incent.	Tim.Interest	.414	.140	-.370	.000	.000
Standardization:Struct	EPS	.142	.071	-.726	.006	.002
Standardization:Struct	PER	.143	.091	-1.11	.002	.002

Results of the regression concerning cost leaders for the compensation scale standardization: compensation structure produced negative coefficients. Since the compensation scale of standardization is reversed, this indicates that for cost leader oriented firms, the less they have a standardized uniform compensation system, the lower their organizational performance, as measured by such variables as EPS and PER. In other words, cost leaders should have a standardized uniform compensation system throughout the organization, in order to improve their organizational performance. These results support hypothesis #18 for cost leaders. Results of the regression for the scale standardization:incentives were negative. This indicates that for cost leader oriented firms, the more they have standardized uniform procedures regulating the implementation of incentive plans, the lower their organizational performance, as measured by gross margin, net margin and times-interest earned. This directly contradicts hypothesis #18. Therefore, hypothesis #18 is supported for cost leaders for compensation policies regarding the implementation of the compensation structure, level and mix, but is not supported for policies related to incentives plans. Similar results were obtained with additional analysis with control for size (net income, net sales and number of employees) and capital intensity.

Results of the regression concerning differentiators for the compensation scale standardization:compensation structure produced positive coefficients, with one variable only. This indicates that for differentiator oriented firms, the more they have a compensation system tailored to the needs of individual units, the higher their organizational performance, as measured by such variables as inventory turnover. These results weakly support hypothesis #18 and must be interpreted with caution since they did not reach the .05 level of significance. Results of the scale standardization:incentive plans produced both negative and positive coefficients. However, if one focuses only on the significant interaction terms, which are both negative, this suggests that for differentiator oriented firms, the more they have a compensation system tailored to the needs of individual units, the lower their organizational performance, which contradicts the hypothesis. As a conclusion, hypothesis #18 received partial support, since it was supported for cost leaders and differentiators for the standardization of the compensation structure, but not supported for the standardization of the implementation of incentive plans.

The results of the moderated regressions on external reputation of the firm were not significant at all except for one compensation scale, decentralization for increase decisions, which had a significant positive interaction term for cost leaders. This indicates that, for cost leader oriented firms, the more the organization has decentralized decision-making policies regarding increase decisions, the higher their external reputation for excellence. This contradicts hypothesis #14. All other interactions of strategy and compensation were found to not have any impact on the reputation of the firm. Supplemental analysis with control for size (net income, net sales and number of employees) and capital intensity did not produce any significant interaction effects with the scale of reputation.

In brief, the results of this investigation suggest that cost leader oriented firms have higher organizational performance when they (1) de-emphasis internal equity in compensation design and internal promotion orientation; (2) have a lower compensation level than their competitors; (3) have a lower emphasis on incentives compared to base salary and benefits in the compensation mix; (4) emphasize incentives rewarding growth, innovation and risk (growth-related objectives); (5) have open communication of compensation design issues and use those formal communication channels to circulate a broad range of information; (6) encourage participation in compensation decision-making regarding the implementation of the compensation structure; (7) allow lower-level managers to be involved in approving job evaluation and increase decisions; (8) develop formalized rules and procedures regulating job analysis policies, but have low formalization of performance appraisal and market rate analysis procedures; and (10) present a standardized uniform compensation structure throughout the organization, but have incentive plans tailored to the needs of each business unit.

Results also indicate that differentiator oriented firms have higher organizational performance when they (1) emphasize external equity practices in designing the compensation structure; (2) have higher compensation level than competitors; (3) do not emphasize incentives based on performance; (4) do not emphasize open communications on compensation issues; (5) discourage participation in compensation decision-making; (6) centralize job evaluation decisions; (7) develop formalized rules and procedures regulating job evaluation policies; and (8) tailor their compensation policies to the needs of each individual unit (low standardization).

As a conclusion, regression results showed partial support for the research model of compensation, strategy and performance identified in figure 2 in chapter I. There is an overall pattern suggesting that compensation and strategy combinations do influence organization performance. However, in a number of cases, the results did not strongly support this complete model anticipated in the hypotheses. Table 10 presents a summary of results with hypotheses supported as well as not supported.

TABLE 10
Summary of Results

HYPOTHESIS #	SUPPORT FOR CL/DIFF *	RESULTS
1	Partially supported for CL Partially supported for DIFF	PARTIAL SUPPORT
2	Not supported for CL Supported for DIFF	PARTIAL SUPPORT
3	Not supported for CL Supported for DIFF	PARTIAL SUPPORT
4	Supported for CL Supported for DIFF	SUPPORT
5	Not supported for CL Not supported for DIFF	NO SUPPORT
6	Supported for CL Not supported for DIFF	PARTIAL SUPPORT
7	Not supported for CL Not supported for DIFF	NO SUPPORT
8	Not supported for CL Not supported for DIFF	NO SUPPORT
9	Not supported for CL Supported for DIFF	PARTIAL SUPPORT
10	Not supported for CL Not supported for DIFF	NO SUPPORT
11	Not supported for CL Supported for DIFF	PARTIAL SUPPORT
12	Not supported for CL Not supported for DIFF	NO SUPPORT
13	Supported for CL Not supported for DIFF	PARTIAL SUPPORT
14	Not supported for CL Not supported for DIFF	NO SUPPORT
15	Not supported for CL Not supported for DIFF	NO SUPPORT
16	Not supported for CL Not supported for DIFF	NO SUPPORT
17	Supported for CL Not supported for DIFF	PARTIAL SUPPORT
18	Supported for CL & DIFF for compensation structure Not supported for CL & DIFF for incentive plans	PARTIAL SUPPORT

* CL= Cost Leaders, DIFF= Differentiators

CHAPTER IV

DISCUSSION AND IMPLICATIONS FOR FUTURE RESEARCH

The results of this study are discussed in this chapter. Implications for practice, limitations and methodological issues as well as theoretical implications are presented.

Summary of Research Results

As presented in chapter III, results of this research are not always similar to what was expected in the literature. Cost leader oriented firms in the sample show some compensation design and administration characteristics similar to those suggested in the literature review: For instance, they rely on internal promotion and development of employees, as part of their internal equity practices and develop a standardized compensation structure for middle managers. In contrast, cost leader oriented firms in the sample show some compensation design and administration characteristics different from what was expected: For instance, they do not have a meet/lag compensation level policy (rather they lead tne market), they develop a compensation mix which emphasizes incentives and they adopt decentralized decision-making processes regarding increase decisions. The research results further suggest that cost leader oriented firms increase their organizational performance when they modify some of their compensation design and administration characteristics. For instance, it was suggested that, in order to improve organizational performance cost leaders should (1) lower their compensation level as compared to their competitors, (2) develop formalized rules and procedures regulating job analysis policies but lower formalization of performance appraisal and market rate analysis procedures and (3) present a standardized uniform compensation structure throughout the organization, but have incentive plans tailored to the needs of each business unit. These recommendations are consistent with the literature review and hypotheses. However, research results also suggest that, for cost leaders, increasing organizational performance, is associated with (4) de-emphasizing internal equity in compensation design and internal promotion orientation, (5) having a lower emphasis on incentives compared to base salary and benefits in the compensation mix, (6) emphasizing incentives rewarding growth, innovation and risk (growth-related objectives), (7) having open communication of compensation design issues and using those formal communication channels to circulate a broad range of information, (8) encouraging participation in compensation decision-making regarding the implementation of the compensation structure, and (9) allowing lower-level managers to be involved in approving job evaluation and increase decisions. These last six results are not consistent with the literature review and hypotheses.

In addition, differentiator oriented firms in the sample show some compensation design and administration characteristics similar to those anticipated in the literature review: For instance, they tend to have a lead compensation level policy, have more open communication regarding compensation design and administration characteristics, use their formal communication channels to circulate a broad range of information on compensation policies, and allow lower-level managers to participate in the design and administration of their compensation structure. However, they do not have any clear pattern regarding external versus internal equity emphasis, incentives plans, formalization and standardization. The research results further demonstrated that differentiator oriented firms increase their organizational performance when they modify some of their compensation design and administration characteristics: For instance, it was found that differentiator oriented firms should (1) emphasize external equity practices in designing the compensation structure, (2) tailor their compensation policies to the needs of each individual unit (low standardization) and (3) maintain their high compensation level as compared to their competitors. These recommendations are consistent with the literature review and hypotheses. However, research results also indicate that increases in organizational performance of differentiator oriented firms are associated with (4) de-emphasizing incentives based on performance in their compensation mix, (5) de-emphasizing open communication on compensation issues, (6) discouraging participation in compensation decision-making, (7) centralizing job evaluation decisions and (8) developing formalized rules and procedures regulating job evaluation policies. These recommendations diametrically counter the research hypotheses and are not supported by the literature. These results, if true, lead to some implications for practice regarding the compensation design and administration.

However, these results are somewhat different from those obtained in Broderick's study (1986). She suggested that a strategic orientation of a defender was associated with higher scores regarding the compensation administration characteristics (e.g,. centralization, participation, formalization and standardization). In contrast, the prospector strategic orientation was associated with lower scores on those scales. Therefore, prospectors (Miles & Snow) and differentiators (Porter) have some similarities in their compensation patterns regarding administration characteristics, while cost leaders (Porter) and defenders (Miles & Snow) show more differences in their compensation administration pattern. In addition, some similarities exist between cost leaders and prospectors (in compensation level policies and performance orientation), but not between cost leaders and defenders. These similarities and disimilarities are consistent with Segev's results (1989). In his systematic comparative analysis and synthesis of Miles and

Snow (1978) and Porter (1980) strategic typologies, Segev revealed some differences between the cost leader and defender strategies. Similarly, the present study reveals some differences in the compensation system of cost leaders and defenders. In contrast, segev's study comparison of the evaluated profiles of differentiators with the profile of prospector revealed no major differences. This is consistent with the results of this study, since similarities were found in the compensation design and administration patterns between differentiators and prospectors.

Compensation Practices and Performance: Implications for Practice

Results of this study suggested that firms following a cost leadership or a differentiation strategic orientation have higher performance when they adopt compensation design and administration characteristics which match with their business strategy. These results should be of interest to compensation specialists, human resources managers and business managers since they suggest guidelines and recommendations for developing an effective compensation system that maximizes organizational performance.

Cost Leader Oriented Firms

If an organization is following a cost leadership strategic orientation (i.e. emphasizing a low cost position, labor intensity, current assets parsimony, value-added parsimony and high employee productivity) an effective compensation system that maximizes organizational performance should (1) de-emphasize internal equity practices and internal promotion orientation, (2) have a "lag" compensation level policy, (3) de-emphasize incentives compared to base salary and benefits, but (4) focus what incentives they have on rewarding growth, innovation and risk and (5) have a generally standardized uniform compensation structure throughout the organization, but have incentive plans tailored to the needs of each unit. Recommendations concerning communication breadth, participation of lower-level managers in compensation decisions, decentralization of compensation decision-making and formalization of rules and procedures regulating compensation administration decisions are more speculative.

Therefore, cost leader oriented firms should follow a <u>middle-of-the road policy with respect to internal versus external equity practices</u> in compensation system design. Research results indicated that they should de-emphasize internal equity practices and internal promotion orientation, in order to reach higher performance levels. Thus, while increases in cost leadership orientation are generally associated with increases in internal promotion orientation, following that general pattern evident in the correlational analysis is associated with lower organizational performance. However, regression results also indicated that, for cost leaders, increases in an external equity focus is also negatively related to organizational performance. These results are puzzling and, perhaps, suggest that cost leader oriented firms should not adopt extreme policies regarding equity practices. This means that cost leaders should determine the distribution of base pay to different jobs and skills by referring to comparisons among jobs and skills levels inside the organization in terms of their relative contributions to the organization's objectives as well as utilizing market pricing, through matching competitors' structures reported in the market. Some emphasis on internal equity is consistent with their tight control policy of minimizing wage and salary costs. By limiting employee comparisons with their compensation within the organization itself, they avoid comparisons with external labor market and do not have to lead the market to keep talented people within the organization. On the other side, some emphasis on external equity will enable them to attract skilled labor scientists and the best managers from the external labor market, who will run the organization effectively and competitively. Thus, a middle-of-the-road policy for equity practices seems to be more appropriate for cost leaders.

Second, cost leader oriented firms should adopt a <u>lag or meet compensation level position</u> relative to their competitors, i.e. should lag or meet labor market average rates. This recommendation is the reverse of the general correlational pattern observed in the sample firms. This suggests that cost leader oriented firms could improve their organizational performance by adopting a meet or lag compensation level policy. By meeting or lagging market competition, cost leaders will be able to minimize their salary costs, hence maximizing organization's overall profitability. This available cash flow will be, for instance, useful to internally develop process engineering and specific skills.

Third, cost leader oriented firms should limit the proportion of incentives in their compensation mix. They should provide rewards for membership and seniority with high base salary and benefits. Results indicated that cost leader oriented firms have lower performance when they include a high proportion of incentives in the compensation mix of middle managers. However, incentives should not be totally neglected. This recommendation is the reverse of the general pattern observed in the sample population in which focus on incentives and cost leadership strategy was positively correlated. Therefore, cost leader oriented firms could improve their organizational performance by lowering the proportion of incentives in the compensation mix of middle managers and emphasizing base salary and benefits. Further research should focus on the ideal proportion of incentives versus base salary and benefits for cost leaders. A compensation mix emphasizing base salary and benefits is viewed as an appropriate means of communicating the importance of membership and seniority to employees and the importance of retention and internal skill development. By choosing to pay employees for membership and seniority, cost leaders will maintain a loyal specialized work force, increase employee's sense of job security and limit turnover. Because cost leaders have specific skills requirements, and therefore will have invested money in training employees internally, cost leaders are extra-interested in retaining their employees. By rewarding for membership, cost leaders will minimize their costs and hence maximize their organizational performance. In addition, by de-emphasizing incentives based on performance, they avoid much of the internal conflict and dissatisfaction due to internal competition. All of this, will contribute to cost reduction from experienced employees and maximization of organization efficiency.

Fourth, cost leader oriented firms should have incentives rewarding growth, innovation and risk. Results indicated that cost leader oriented firms will lower their performance when they reward only for efficiency-related objectives. Although cost leaders were predicted to have efficiency-related objectives (e.g., achieving quantifiable quota of production, reducing absenteeism rates, increasing quality control standards, staying within budget, etc.), it is now recommended that cost leaders develop growth-oriented objectives, such as growth in market share. Although, cost leaders were expected to have incentives based on cost control or production-related performance criteria with strict quantitative targets, it seems that once they are performing well, that is they are maximizing their organizational performance by minimizing costs, any compensation mix which will encourage growth and innovation will lead to improving organizational performance. This will enable them to compete in a fierce competition and still increase their market share. It is therefore recommended that cost leaders use incentives based on growth-oriented behaviors only once the organization is already minimizing its production and overhead costs.

Fifth, cost leader oriented firms should have a <u>standardized uniform compensation policies</u> regarding the implementation of the compensation structure, throughout the organization, except for the regulation and implementation of incentive plans. That should be tailored to the needs of each business unit. A highly standardized system will contribute to better control and coordination of the compensation system and is also consistent with the cost leader product maintenance strategy and low cost position. In addition, cost leaders have no need to differentiate compensation policies across units, which permits cost minimization. A standardized compensation system also contributes to an impersonal control of labor, and facilitates the transfer of people across units. It is also easier to get employees to accept the importance of performance objectives that are compatible with the goals of cost controls of the entire organization. This low cost position will permit the organization to have above average returns despite the fierce competition.

Finally, further research should be conducted on the recommendations regarding the breadth of communication, the degree of decentralization of compensation decisions, the participation of lower-level managers in decision-making and the formalization of compensation rules and procedures for cost leader oriented firms, due to a lack of agreement between these research results and past theory and research. Results indicated that cost leader oriented firms should (1) develop an open communication policy on compensation issues, (2) decentralize decision-making for job evaluation and increase decisions and (3) have formalized rules and procedures regulating performance appraisal and market rate analyses. These implied recommendations should be evaluated with further research.

Perhaps, if cost leader oriented firms have an open communication on compensation policies, it will reduce employee speculations and hence distortions and dissatisfactions associated usually with restrictive communication. These speculations usually lead to decreasing employee motivation to work and contribute to decreasing overall organizational performance and quality of products. An open communication will also have an important influence on employee acceptance and fairness of the compensation system. However, open communication can also be a source of dissatisfaction, since direct comparisons among co-workers can lead to disagreements about the value of individual contributions. Such open communication can also mean less control on compensation issues and employee comparisons with the external labor market, which may lead cost leaders to lessen their control of compensation system and related costs. As a consequence, future research should confirm if cost leaders should emphasize or de-emphasize open communication in their compensation system.

Second, a compensation system with decentralized decision-making for job evaluation and increase decisions will allow cost leaders to encourage cooperation and coordination among departments. Employee participation in compensation issues will be better accepted among employees and will contribute to keep talented people and motivate them. Motivated and talented people will, in turn, contribute to improving organization performance. However, employees might be more willing to accept centralized compensation administration if the organization's overall administration is centralized. Such consistency might appeal to an employee's sense of equity or fairness. Organizations with a cost strategy will discourage employee participation in compensation decision-making and restrict authority to approve compensation decisions to high level managers with the intent to encourage intense supervision of labor and implement a structured organization with centralized responsibilities. This is consistent with the cost leader's product maintenance strategy, requiring aggressive construction of efficient scale facilities, cost minimization, overhead control and centralization of administration processes. As a consequence, future research should address the possibility that cost leaders should develop decentralized or centralized compensation systems.

Finally, a compensation system with formalized rules and procedures regulating job analysis policies, but with little formalized rules regulating performance appraisal and market rate analysis decisions, might allow cost leaders to improve their organizational performance. Since cost leaders should emphasize membership and seniority, job analysis policies may have more importance for a cost leader than performance appraisal or market rate analysis procedures. As a consequence, formalization will offer to cost leaders greater control over this key compensation system operation. In contrast, a high formalization is not required for performance appraisal and market rate analysis policies. However, these recommendations are speculative and require further investigation.

Differentiation Oriented Firms

If an organization is following a differentiation strategic orientation (i.e., emphasizing uniqueness of products industry-wide, product innovation, lack of value-added parsimony, and advertising), an effective compensation system that maximizes organizational performance should (1) emphasize external equity practices, (2) have compensation level higher than competitors, (3) follow a middle-of-the-road policy for the compensation mix with respect to membership versus performance emphasis and (4) be tailored to the needs of each individual unit. Recommendations concerning communication breadth, participation of lower-level managers in compensation decisions, decentralization of compensation decision-making and formalization of rules and procedures regulating compensation decisions are more speculative. Many of the results have direct implications for compensation specialists and human resources managers of that type of organizations. They provide them with recommendations for developing an effective compensation system within a differentiator oriented organization (i.e., one emphasizes uniqueness of products industry-wide, versus considering costs as their primary target).

First, differentiators should emphasize external equity practices in designing the compensation structure for middle managers. Research results indicated that differentiators can reach higher levels of performance by emphasizing more external equity practices. This means that differentiators should determine the distribution of base pay to different jobs and skills by market pricing, i.e., through analysis of competitors' structures. Differentiators need to encourage compensation comparisons in the external labor market, in order to attract highly skilled, creative and talented people with general problem-solving skills, who will contribute to improving R&D activities, product development and innovation. Differentiators need to attract people capable of solving general problems involved in establishing and launching a new product. As a consequence, overall organization growth may be accelerated.

Second, differentiators should have <u>higher compensation levels</u> than competitors: they should "lead" the market. Results indicated that differentiator oriented firms improve their organizational performance when they have higher compensation level than their competitors. This recommendation supports this research's hypotheses and is identical to the general pattern observed in the sample firms. By leading the external labor market, differentiators set their compensation levels higher than their competitors, hoping to attract the best applicants. Presumably, organizations with this pattern would depend on the market for needed skills. Compensation levels that lead market competition are consistent with the external equity focus. They increase the likelihood of attracting the needed skills and retain talented people. Those talented people, again, should contribute to R&D, innovation and product development. This, in turn, should improve organizational growth and performance.

Third, differentiators should follow a <u>middle-of-the-road policy for the compensation mix with respect to membership versus performance emphasis</u>: They should not emphasize only incentives based on performance. Enough room should be left in the compensation mix for base salary and benefits. A compensation mix emphasizing both incentives based on performance and base salary and benefits in an equitable fashion, is viewed as an appropriate means of communicating, on one hand, the importance of membership and seniority and, on the other hand, the importance of employee's performance in the organization. Results indicated that differentiator oriented firms could improve their organizational performance when they have, in addition to base salary and benefits, incentives based on performance. Differentiators should not only reward for membership and seniority, but also for performance. Future research should indicate in which proportions. Differentiators should emphasize compensation for performance in their compensation decisions since they are concerned with their employees' abilities to directly contribute to product market growth and innovation. They will tend to use incentives as a compensation element to instill product and market development. This, in turn, will contribute to attracting talented people from the external labor market and motivate them to acquire the required general skills needed for R&D activities and innovation. However, performance-based incentives do not contribute to maintaining a loyal work force and augmenting turnover rates. In addition, a compensation mix based only on incentives will contribute to internal conflicts and dissatisfaction due to internal competition. This is why, differentiators should limit the proportion of incentives in the compensation mix and follow a middle-of-the-road policy regarding membership versus performance emphasis.

Fourth, differentiators should tailor their compensation policies to the needs of each individual units. Results indicated that differentiator oriented firms can reach higher levels of performance when they do not have a standardized compensation system, but, to the contrary, when they tailor their compensation policies to the needs of each individual business unit. This recommendation supports this research's hypotheses and follows the general pattern observed in the sample firms. Since the objectives of the units are truly different from each other, employees might feel that standard policies do not reflect their unit's unique characteristics. As a result, they would be less likely to consider the compensation system acceptable and motivation will be lowered, affecting the overall organizational performance. Thus, organizations with a differentiation strategy should have compensation policies tailored to the needs of individual units, since a low standardization would mean higher employee acceptance of compensation policies tailored to each unit's needs. Differentiators are more concerned with compensation policies that motivate performance, R&D and innovation in each unit. This is why they require compensation policies tailored to the specific goals of each unit and in adequation with each product line.

Finally, further research should be conducted regarding the breadth of communication of compensation issues, participation of lower-level managers in the design of the compensation system, formalization and centralization of compensation regulations and procedures, particularly those regulating job evaluation policies, for differentiator oriented firms. There is a lack of consistency between these results and prior theory and research. data analysis presented in this study indicates that differentiator oriented firms reach higher levels of performance when they (1) do not have an open communication, (2) do not encourage participation in compensation decision-making, (3) do not decentralize job evaluation decisions and (4) have formalized rules and procedures regulating job evaluation policies. These results directly contradict the hypotheses and past research. The same contradictory results were found with the same four scales for cost leaders and differentiators. Therefore, future research is required in these domains.

As a conclusion, these guidelines are particularly pertinent to organizations that are considering going into new lines of business, developing new strategic plans, acquiring new divisions or even downsizing. Once the strategic plan is developed, according to the organization's changing environment, the organization needs to focus on the kind of human resources, climate and behavior that is needed in order to make it effective. The next step is to design a compensation system that motivates and rewards the right kind of performance, attracts the right kind of people and creates a supportive climate and structure. Designing an adequate compensation system that "fits" the business strategy is a key for success in tomorrow's international competition, where adapting and responding to environmental turbulences with new organizational systems will guarantee success and performance. Furthermore, in some cases, before the strategic plan is developed, it is important to assess the current compensation system and to determine the kind of behavior, climate and structure of which they are supportive. This step is needed so that when the strategic plan is developed, it is based on a realistic assessment of the current condition of the organization and the changes likely to be needed to implement the new strategic plan. Lawler (1984) points out that "a careful assessment of compensation design and administration characteristics changes that are needed should take place before organizations move into new strategic areas". This suggests that the key strategic decisions about compensation systems need to be made in an interactive fashion in which tentative compensation system decisions are driven by the business strategy and then are tested against how other features of the organization are being designed. "The key, of course, to compensation specialists and human resources managers is to ultimately come up with an integrated human resources management strategy that is consistent in the way it encourages people to behave, that attracts the kind of people that can support the business strategy and that encourages them to behave appropriately "(Lawler, 1984, p:147). Therefore, if the results of this study are true and can be generalized, each compensation design and administration characteristics should be chosen carefully according to the strategic orientation and related objectives. Moreover, in this study, more significant results are obtained with the compensation administration characteristics for cost leaders as well as differentiators, even though they are the opposite of what was expected in the past literature. This suggests a stronger compensation pattern for compensation process variables (administration variables), though most of the emphasis has been placed on content variables (compensation design variables) in the past literature. Therefore, some uncertainty remains around compensation administration issues.

Methodological Issues and Research Limitations

Limitations and methodological issues are mostly related to lack of generalizability and imperfections in the measurement of constructs.

First, results of this research might be biased and weakly generalizable since they could be sample specific. The sample did deviate somewhat from the whole U.S manufacturing firm population in that they have higher average sales, higher average employment and more heterogeneity in both of these measures. The distribution of sample firms across all manufacturing SIC codes also differed from the distributions of the other two groups. Sample firms also tended to be more heavily represented in food and kindred products, petroleum refining, stone, clay, glass and concrete products and transportation equipment. In addition, since the COMPUSTAT database was developed for investment, one would expect more small, growth oriented firms in product markets that were less mature. There were only a few firms in product markets related to steel, rubber or paper manufacturing, for instance. The sample was also too homogeneous to demonstrate differences on all the compensation scales. Perhaps, a sample including firms in retail, service and finance, as well as manufacturing, would display more compensation policy variations.

External validity could be improved by replicating this study on a sample representative of some other population, so that results would be more generalizable. This means that future research would require a larger sample of firms more representative of the U.S firms population in terms of size, industrial distribution and strategic orientation. Firms in the sample should have average sales, net income and employment identical to the U.S. firms population and should be representative of the different industry groups. Since the COMPUSTAT database may include more small growth-oriented firms in product markets that are less mature, future research may take this into account and select more mature firms to keep the proportion of small growth-oriented firms versus larger bureaucratic and mature firms identical to that of the U.S. firms population. Future research could also replicate this study with a proportion of cost leaders and differentiators in the sample identical to that in the target population prior to sampling. Therefore, results would be more generalizable. It should be noted however, that most of the research in this area is done with small convenient samples. These have even more questionable external validity than this study.

Second, the newness of Broderick's compensation design and administration variables limit the interpretation of the empirical results. Reliability measures were calculated for each of the compensation scale identified in the analysis. However, confidence in these measures would require replications, and in some cases, changes and improvements in the measures. Some limitations of the research design come also from Broderick's questionnaire. The latter was long and complex and there was some evidence that respondents did not consistently answer questions on compensation mix and incentives and that they felt the questions on compensation communication did not cover enough alternatives. The degree to which these things influenced the study's results could not be estimated. Additionally, the scales of (1) compensation level, (2) participation: incentive plans, (3) formalization: performance appraisal and (4) formalization: market rate analysis did not reach the alpha .70 level of reliability. The first paragraph of the discussion section highlighted the need for adjusting formalization and decentralization scales and for investigating the ideal proportion of incentives versus base salary and benefits in the compensation mix. Some compensation scales were also measured by single items such as equity practices in designing the compensation structure and the degree of standardization of the compensation structure. Reliability could hence be improved by adding multiple items for those two scales. The compensation variables identified in this study represent the range of compensation characteristics commonly discussed in the literature. Results of this study indicate, however, the need for future analysis of formalization and centralization procedures in compensation system design. Future research should differentiate formalization procedures as well as centralization procedures and test for differences with strategic orientations. The distinction should be made amongst formalization of job evaluation and job analysis procedures, performance appraisal procedures and market rate analysis procedures. Distinction should also be made amongst decentralization of job evaluation decisions, increase decisions and market rate decisions. It is also possible that important compensation design and administration characteristics were omitted. Replication with case studies will be appropriate. Case studies might focus on creative compensation systems that are not now widely used in anticipation of the possible spread of such practices over time. Of special interest would be case studies of firms whose management take a strong ethical stance against the receipt of clearly extravagant rewards.

Third, the construct of strategy was measured by indices from the COMPUSTAT database. Since these measures of strategy are far from being perfect, before any conclusion can be drawn about the need for compensation differences associated with a strategic orientation, strategy should be measured in a different way and those results should be contrasted with the COMPUSTAT indices. This would improve construct validity of these measures. In short, further analysis of the validity of this procedure must be conducted. Using COMPUSTAT measures, however, does avoid common method bias so prevalent in this literature. Also, it would be of interest to (1) use another database to measure the construct of strategy and (2) use another strategic typology of business strategy. Broderick used Miles and Snow (1978). Porter 's generic strategies were investigated here. Miller and Friesen's framework (1977) or Segev's synthesis of two business-level strategic typologies (1989) could be investigated.

Fourth, another important limitation concerns the levels of analysis. There was some overlap of business and corporate levels of strategy in measuring the constructs of strategy and performance. Although additional analyses were performed with control for size, further research is needed which truly reduces the strategy and performance measures to clearly the firm level of analysis.

Finally, the proposed pattern of relationships between compensation, strategy and performance was based on contingency theory. However, contingency theory research has not been systematically applied to compensation. Before researchers can take full advantage of a survey's strengths in amassing large amounts of data at low cost to investigate the contingency relationship between compensation, strategy and performance, they must continue to specify the key factors affecting this relationship. Clinical studies should be appropriate to sort out key relationships among strategy, compensation systems, human resources practices and other organizational characteristics. This can only come about by observing organizations at close hand through inspection of personnel records and interviewing relevant managers and human resources specialists.

As a conclusion, although this research design had some limitations, the use of independent sources of data, Broderick's data set, COMPUSTAT database and Fortune magazine corporate surveys, is the major strength of the study's research design since it avoids common method bias. In addition, it should be noted that the compensation scales covered a broad range of practices usually developed in compensation systems. Moreover, many performance indices were used to measure organization performance so that it takes into account the interests of shareholders as well as employees, managers and customers. Last but not least, the study design used a multi-firm sample on a large scale which is unusual in this line of research. Finkelstein and Hambrick (1988), as well as Milkovitch and Broderick (1990) asserted that while empirical work had found a link between compensation schemes and strategic choices, the eventual tie to firm performance had not clearly been made. No systematic study had ever been conducted.

Theoretical Implications for Future Research

First, the two strategic orientations of cost leadership and differentiation (Porter, 1980) represented the domain of organization strategy. As was pointed out earlier, the Porter's generic strategies had received strong support from academicians and practitioners. However, the empirical research on business strategy is not so advanced that any measure of strategic orientation could be said to adequately represent the domain of an organization strategy concept. Segev (1989) demonstrated that a combination of the Porter typology with the Miles and Snow typology forms a new typology that is coherent. This synthesized combination can be displayed conveniently against the dimensions of consistency and proactiveness. It incorporates the relevant components lacking in the Porter's typology and at the same time provides with some information missing from the Miles and Snow's typology. The synthesis of the two typologies compensate for differences. Therefore, richness can be obtained by using this synthesized typology. This study on compensation, strategy and performance could hence be replicated using Segev's synthesized typology (1989), as a measure of strategy. In addition, this research focused on compensation practices for middle managers for the strategic orientations of cost leadership and differentiation. The strategy, compensation and performance relationship has been demonstrated only for the "pure" strategies. Further analysis should be conducted on compensation system differences for organizations following both strategic orientations or those following no specific strategic pattern. such investigation might enrich the compensation, strategy and performance model presented in this study.

Second, the past literature as well as the hypotheses did not make any clear distinction between formalization of job analysis, performance appraisal and market rate analysis procedures. However, scale analysis revealed that these were somewhat independent dimensions. Future research should differentiate and explore differences in types of formalization.

Third, even if the compensation scales covered a broad range of compensation practices, in this study, each compensation system design feature has been treated as an independent factor. This was done primarily for exposition of the concepts but it fails to emphasize the importance of overall compensation system congruence. There is considerable evidence in the literature that they affect each other and, as such, need to be supportive of the same strategic objectives, same types of behavior, reflect the same overall management philosophy and be generated by the same business strategy. Further analysis should be conducted on the importance of congruence within the compensation system. Congruence should not be limited to compensation and strategy but should go beyond it and include external and organizational elements such as environmental uncertainty, size, product life cycle, etc.

Finally, the compensation system needs to fit the other features of the organization in order that total human resources management system congruence exists, but also the other design features of the organization. Much has been said about integrated human resources practices, but few studies empirically investigated the integration of compensation systems with other human resources functions. Compensation is a critical piece of the overall resources strategy but an organization might hinder its organizational performance by only developing compensation practices aligned with its strategy. Human resources management policies, such as selection policies, training and development procedures, performance appraisal practices, human resource planning, recruiting procedures, etc. should be similarly strategically focused. An organization might also hinder its performance if compensation, one human resources characteristics, does not fit the organizational characteristics, such as leadership style, division of labor, distribution of power, information and decision processes, planning and control, resources allocation systems, information systems, integrating roles and departments, etc. Internal structure and process designs congruence, which will perpetuate and support strategy, is the key to more effective organizations. The fit between the internal organization of an enterprise and its strategy is central to strategic management. It starts by matching compensation systems to strategy, but this is only one step. Effectively implementing strategy requires total commitment and supporting organizational arrangements at all levels and functions of the organization.

CONCLUSION

In conclusion, the results of this study suggest some support for a contingency notion of "fit" between compensation and strategy since some compensation patterns were found associated with a cost leadership and a differentiation strategic orientation and higher performance. This research showed empirically that the compensation-strategy-performance paradigm has relevance at the business level. However, these compensation patterns were not always similar to what was predicted in the literature. If further analysis confirms the results of this study, compensation specialists and human resources managers will be provided with guidelines and recommendations for developing and adapting an effective compensation system that maximizes organizational performance.

However, we can question the validity of these findings for the future, since just as the nature of the work force is changing (more heterogeneity, less acceptance of traditional authority, desire for more participation, more self and money-oriented, higher education level, change in family structure, change in the role of leisure, etc.), the nature of organizations is changing as well in some important ways (growing number of service organizations, decline of rate of productivity, increased organization size and diversity despite the development of downsizing practices, etc.), in their efforts to adjust to external environment changes. As a consequence, the reed for new approaches to compensation design and administration remains and will never go away. As society and people change, so must organizations; as organizations change, so must their compensation systems. This means that there will always be a need for new compensation systems and that today's effective compensation system for an organization can quickly become tomorrow's ineffective one. What constitutes an effective compensation system is therefore a moving target and more likely to be a process than an end state. Static guidelines to design an effective compensation system might not be valid in the longer run.

A key objective of future research would, therefore, be to investigate the role of compensation systems as agents of change in organizations. Since a compensation system is a common language shared by all members in the organization, and because of this it is a medium through which an organization can communicate with all its employees, compensation policies can affect and influence the whole climate of the organization and therefore induce organizational change. Compensation design and administration characteristics can be a direct indication to employees of a change in management thinking or management style and strategic orientation. Lawler (1984) explains that all too often organizations expect dramatic changes in behavior because of a re-organization, when, in fact, the compensation system is communicating to individuals that change is undesirable. Failing to change or adapt first the compensation system can prevent organizations from implementing new structures and objectives. The reason is that individuals are still driven by the compensation system that measures and evaluates them on traditional measures and rewards them according to what they accomplish on those familiar measures. For example, individuals who are asked to re-organize and reduce their staff may not be motivated to do this, if the compensation package for their job depends on the number of subordinates that they have and the size of budget they control.

Therefore, the right "fit" between business strategy and compensation system may be found in targeting the compensation system first to the kind of organizational structure and practices that are desirable from a strategic point of view. Rather than suggesting static guidelines in the development of an effective compensation system to compensation specialists and human resources managers, future research should focus on the influence of compensation systems on the effectiveness of organizational change efforts.

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APPENDIX I

Broderick's (1986) Survey Questionnaire

A SURVEY OF COMPENSATION POLICY DECISIONS

This questionnaire is part of a research project being carried out at Cornell University. It explores the relationships between compensation policies and a firm's project market strategy and administrative structure. Each question asks compensation managers to judge the degree to which the compensation plan for middle level managers reflects one or more policy alternatives.

The value of this research depends on the participation of people such as you. We would appreciate your cooperation in answering each question based on your information and experience. Your answers will be used for research purposes only, and kept strictly confidential. The absolute anonymity of participating business units and individual respondents is guaranteed. Only aggregate responses will be used in any material made public.

Please return the completed questionnaire in the enclosed, prepaid, addressed envelope. It would be helpful if you could complete and return it within three weeks. If you have questions, please contact:

Renae Broderick
Cornell University
(607) 257-3758 (home)
(607) 256-6535 (office)

George T. Milkovich
Cornell University
(607) 256-4470 (office)

Thank you in advance for your cooperation. We hope you find the questionnaire thought-provoking. If you would like a summary of the research results, please check the box below.

[ ] Please send me a summary report of this study.

INSTRUCTIONS

1. Two types of questions are asked: (a) checklist, and (b) rating scales.

   (a) Checklist--place a check in the appropriate box.

   [ ] [ ] [✓] [ ]

   (b) Rating scales--circle the appropriate number on the scale.

Very little				To a great extent
1	2	3	4	5

   Select the answer that most accurately reflects your business unit's middle management compensation plan. Some of the questions may not coincide exactly with your plan, but please try to select the most representative alternatives. Answering all the questions is important for the study. However, if you think none of the alternatives offered for a particular question is representative of your plan, please use the Comments section to briefly state why.

2. Three concepts--Middle Management, Compensation Plan, and Compensation Policies--are critical in this study. The questions you will answer pertain to these three concepts. We are defining them as:

   Middle Management - the group of business unit managers who are bonus eligible up to, but not including, the executive level. This is a general description of the middle management group. In most units, the compensation plan for middle managers is different than the plan for executive management. In some business units middle managers may not be bonus eligible, but their compensation plan distinguishes them from lower level management through some form of increased incentive potential. In other units the compensation plans of lower and middle management may be identical except for differences in grades.

   Compensation Plan - typically consists of specific pay levels, pay structures, pay mix, and pay increase guidelines relevant to particular employee groups, or, in some cases, the entire work force. Plan components are defined later in the questionnaire.

   Compensation Policies - serve to regulate or guide the design and administration of the compensation plan--specifically, the types of pay level, pay structure, pay mix, and pay increase guidelines established. Policy decisions also establish the style of compensation plan administration. Policy decisions are not implementation decisions. For example, setting a particular pay level policy requires consideration of organization, product and labor market factors. However, implementing a particular pay level policy involves the application of appropriate compensation techniques--wage surveys, ranges, and projection formulas. Although policy setting and implementation are related, the questions below pertain more to policy alternatives.

3. Some of the upcoming questions imply that decisions about compensation are relatively unstable. Obviously, they are not. We have adopted a rule of thumb, "no significant policy and plan changes in three years." If your unit is an exception to this three-year rule, please answer the questions for the most recently implemented decisions. Then note the year of implementation in the Comments section.

PART I: COMPENSATION POLICIES--PAY STRUCTURE AND PAY LEVEL

A. Pay Structure

Pay structure refers to the hierarchy of jobs and to salaries paid for those jobs. Decisions here involve the determination of a job's value relative to other jobs in the business unit.

1. Listed below are questions about decisions related to pay structure. Circle the number that represents the most accurate description of your unit's decisions. (Circle only one number per question.)

   a. To what extent does your business unit emphasize internal job-to-job comparisons in determining the relative value of each middle management job?

1	2	3	4	5
Very little; in this unit the value of a job is determined primarily by comparisons with competition in the external market.		Moderately; this unit tends to use internal job-to-job comparisons and competitive, external market comparisons to about the same extent.		To a great extent; internal job-to-job comparisons are the primary means of determining relative job values.

   b. How important is the external market competitiveness of middle manager jobs to your unit?

1	2	3	4	5
Not very important; our internal values and culture are more important.		Moderately important; external competiveness is about equally as important as our internal culture and values.		Very important; it is critical that this unit's determination of job values enables it to compete for talent in the external market. Competitiveness is more important than internal job relationships.

   c. To what extent does your unit rely on the internal promotion and development of employees in order to fill middle management jobs?

1	2	3	4	5
Very little; this unit relies heavily on its ability to acquire talent from the external market in order to fill important jobs.		Moderately; the unit does promote and develop people internally, but brings in people from the external market to about the same extent.		To a great extent; internal promotion and development are the principal means of filling important jobs in this unit.

4. In deciding how to allocate pay, how important to your unit are people with a generalizable set of skills?

1	2	3	4	5
Not very important; the unit favors "specialists"; that is, people who have acquired knowledge, experience and skills specific to critical functions in the unit.		Moderately important; the unit does not favor either "specialists" or "generalists." They are each considered about equal in value to the unit.		Very important; the unit favors "generalists"; that is, people with a breadth of knowledge, experience and skill.

2. The number of salary grades in this unit's middle management pay structure is roughly (please check one):

[ ] 1 to 5
[ ] 6 to 10
[ ] 11 to 15
[ ] each job has its own unique grade
[ ] other, please specify ______________________

B. Pay Level

Establishing a pay level for a job group involves setting the midpoints and the upper a lower limits of the salary distribution for the jobs covered. This usually requires co sideration of the unit's desired pay position relative to product and labor market comp tion. Actual pay rates for each job are then established using the midpoints and limit guidelines. The average of the actual rates paid is the definition of pay level used b

3. Does the pay level (actual average rate paid) for your unit tend to exceed the pay levels (actual) of your competitors?

1	2	3	4	5
Seldom; this unit tends to set pay levels below those of its competitors; the unit compensates employees in other ways.		Sometimes; but more often, the unit simply tries to meet competitors' pay levels.		Usually; the unit te to set pay levels ab those of its competi

4. Which percentile below best represents the unit's actual pay level relative to mark rates? (Circle the appropriate portion of the line.)

0 —— 25 —— 50 —— 75 —— 100%
(Midpoint)

5. This unit reviews its pay level policy (whether to lead, meet, or lag the market): (Please check one.)

[ ] annually
[ ] every 2 years
[ ] every 3 to 5 years
[ ] every 6 or more years
[ ] other, please specify ______________________

6. The pay structure and pay level policies for this unit's middle management compensat plan are (please check one):

[ ] part of a corporate-wide plan implemented in each business unit without major adjustments for each unit.

[ ] developed specifically for the unit; it is not necessarily similar to plans used in other business units in the corporation.

[ ] in part, similar to plans used in other units throughout the corporation, and, in part, specifically tailored to this unit.

[ ] other, please specify: ______________________

Comments: Please feel free to respond to, comment upon, or criticize the preceding ques on the back of page 2.

PART II: COMPENSATION POLICIES--PAY MIX AND PAY INCREASE GUIDELINES

A. Pay Mix

There are a number of forms in which pay can be distributed to employees. Typically, these include: base salary, merit pay, long and short term incentives, benefits, and employee services. In this questionnaire merit pay and short and long term incentives are all considered forms of incentives. Employee services are not considered.

The term pay mix refers to the proportion each pay form represents in an individual's pay package. Mix can vary from one compensation plan to another. In one plan salary may represent 50% of the pay package; benefits, 35%; and incentives, 15%; in another plan the distribution might be 40%, 35%, and 25%.

1. Estimate the typical distribution to salary, benefits, and incentives in the compensation plan for your unit's middle managers over the last three years.

Base salary ____%

Benefits ____%

Incentives ____%

100 %

2. Over the same time period, how has your unit's pay mix compared to the pay mix of your market competitors? Please check the matrix cell below that best represents your unit's position relative to competitors.

	High	Competitive	Low	Comparison not known
Our Base Salary is				
Our Benefits are				
Our Incentives are				

B. Pay Increase Guidelines

Pay increase guidelines serve to guide managers when they are making pay increase decisions for subordinates. Guidelines can apply to any increases that employees receive. Such increases may include cost-of-living adjustments (COLA), seniority and merit increases, short and long term incentive awards, and promotional increases. Promotional increases are not considered here. Please focus on within-grade increases in answering the items below.

3. This unit's pay increases for middle managers are roughly based on:

Seniority ____%

COLA ____%

Performance (merit, incentives) ____%

100 % (excluding promotions)

4. In this questionnaire, short term incentives refer to either cash or stock awards based on 1 to 2 year performance criteria. Merit increases are considered a form of short term incentive. Long term incentives also refer to cash or stock awards, but are based on 3-5 year performance objectives. Consider your unit's plan for middle managers, and rank the boxes below according to the relative emphasis the plan places on short term incentives, long term incentives, and other factors.

(1 = high, 3 = low)

[ ] short term incentives

[ ] long term incentives

[ ] other, please specify ____________________

5. Placing pay "at risk" refers to the notion that some percentage of the pay a pers[on] would "normally" receive is held back. Under this type of guideline base salarie[s] would typically be low relative to the market. However, strong performance would [bring] incentive payments that place total pay well above "normal" rates.

a. What percentage of your middle managers' salaries are placed at risk?

[ ] none

[ ] 1-10%

[ ] 11-20%

[ ] other, please specify ____________________

b. How much above market or "normal" rates might outstanding performers receive?

[ ] equal market rates

[ ] 1-10%

[ ] 11-20%

[ ] other, please specify ____________________

6. Below are other questions about incentive plans. Each question can be applied to short and long term incentives. Please respond for both types of incentives by ci[rcling] the number that represents the most accurate description of your unit's decisions.

a. To what extent is the unit's personnel involved in the development of your incentive plans?

Short Term

1 2 3 4 5

Long Term

1 2 3 4 5

1	2	3	4	5
Very little; the incentive plans are primarily developed by corporate headquarters.		Moderately; corporate headquarters and the unit share responsibility for plan development.		To a great ex[tent]; the unit is r[espon]sible for the [devel]opment of its incentive pla[ns].

b. To what extent do incentive plans tend to be similar across business units?

Short Term

1 2 3 4 5

Long Term

1 2 3 4 5

1	2	3	4	5
Very little; the plan is tailored to the incentive needs of the unit.		Moderately; although the plan takes unit needs into consideration, it assumes some incentive needs are constant across units.		To a great ext[ent]; incentive pla[ns] [tend] to be very sim[ilar] across all uni[ts], reflecting cor[por]ate, rather th[an] unit, goals.

c. How important are new ideas, growth, and risk taking as criteria for incentive plan rewards for middle managers in your unit?

Short term

1	2	3	4	5

Long term

1	2	3	4	5
Not very important: operating efficiency, cost control, and profit tend to be the primary criteria for incentive rewards in this unit.		Moderately: the unit uses some weighted combination that tends toward an equal emphasis on both cost/profit and growth/innovation type objectives as criteria for rewards.		Very important: the generation of new ideas with practical applications, the creative definition of markets, and increases in market share are the primary criteria for incentive rewards in this unit.

d. To what extent are your unit's incentive payouts based on measures of corporate performance?

Short term

1	2	3	4	5

Long term

1	2	3	4	5
Very little: the incentive payments are based on measures of divisional or unit performance and the unit's contributions to corporate performance.		Moderately: the incentive payouts are based on both corporate and unit performance, and the weight given each is about the same.		To a great extent: the incentive payouts are based on measures of total corporate performance.

Comments: Please feel free to respond to, comment upon, or criticize the preceding statements on the back of page 5.

PART III: COMPENSATION POLICIES--PAY ADMINISTRATION

A. The Centralization of Pay Administration

The centralization of pay administration involves both the degree to which various levels within the organization participate in compensation decision making and the kinds of compensation decisions considered at each level.

This questionnaire considers several levels of management, types of participation, and kinds of compensation decisions. The management levels have each been assigned a number, as follows:

1 - Compensation manager within the business unit
2 - Middle managers within the business unit
3 - Executive or top management within the business unit
4 - Executive or top management outside the business unit (for example, executives--including compensation executives--at corporate headquarters).

Two types of participation are considered:

Input solicited - input to decision making is solicited.

Approval required - a signoff of some form is required to authorize the decision.

Please complete the following table of decisions by circling the number of the management levels that you perceive to be participating in pay decisions.

For example, if you feel that policy decisions require approval from only the top manager, but that input is solicited from both the compensation and middle managers, you would complete the table row as follows:

	Input Solicited				Approval Required			
a. compensation policy	1	2	3	4	1	2	3	4
	compensation manager	middle manager					executive manager within unit	

Compensation Decisions	Type of Participation: Input Solicited				Approval Required			
a. compensation policy	1	2	3	4	1	2	3	4
b. job analysis methods used	1	2	3	4	1	2	3	4
c. job analysis results	1	2	3	4	1	2	3	4
d. job evaluation methods used	1	2	3	4	1	2	3	4
e. job evaluation results	1	2	3	4	1	2	3	4
f. market wage survey methods used	1	2	3	4	1	2	3	4
g. wage survey results	1	2	3	4	1	2	3	4
h. pay increase guidelines	1	2	3	4	1	2	3	4
i. performance evaluation criteria	1	2	3	4	1	2	3	4
j. development of compensation plan budget for next period	1	2	3	4	1	2	3	4

B. The Formalization of Pay Administration

The formalization of pay administration refers to the degree to which rules and procedures have been established to govern decisions. It also refers to the degree to which these rules and procedures are observed. The statements below are meant to tap degrees of formalization. Please circle the number that best reflects the degree to which your business unit matches each statement. (Circle one number per scale.)

	Very Little		Moderately		To a great extent
a. There are standardized questionnaires for collecting job analysis data.	1	2	3	4	5
b. Standardized questionnaires must be completed when a job is analyzed.	1	2	3	4	5
c. There are no structured formats for collecting job analysis data.	1	2	3	4	5

B. The Formalization of Pay Administration (continued)

(Circle one number per scale.)

	Very little		Moderately		To a great extent
d. There are periodic training sessions for job analysts.	1	2	3	4	5
e. There are few rules or procedures on how to write job descriptions.	1	2	3	4	5
f. Job descriptions are done according to established rules and formats.	1	2	3	4	5
g. Job descriptions are current. The unit requires that they reflect the job currently being done.	1	2	3	4	5
h. There are written manuals for how to do job evaluations.	1	2	3	4	5
i. Job evaluations must be done by the manual.	1	2	3	4	5
j. There are no periodic training sessions for job evaluators.	1	2	3	4	5
k. The unit has permanent committees which meet regularly to discuss changes in job analysis or job evaluation methods.	1	2	3	4	5
l. The results of job analysis and evaluation are not subject to any periodic scrutiny by a permanent committee.	1	2	3	4	5
m. There are established guidelines on how to conduct market wage surveys.	1	2	3	4	5
n. There are only loosely defined "rules of thumb" for how to set pay levels relative to the market.	1	2	3	4	5
o. Wage surveys are always done in the same way.	1	2	3	4	5
p. Performance evaluation is based on quantitative criteria.	1	2	3	4	5
q. Managers who do performance evaluation are trained in an effort to standardize appraisals.	1	2	3	4	5
r. There are written pay increase guidelines.	1	2	3	4	5
s. Managers who grant pay increases have a good deal of discretion over increase administration.	1	2	3	4	5
t. Bonus formulas are established in the period prior to actual performance evaluation.	1	2	3	4	5
u. Bonus formulas are not always followed completely. Managers can consider circumstances contributing to lower than expected performance.	1	2	3	4	5

C. Communication and Pay Administration

An important aspect of pay administration is deciding the degree to which information about pay will be communicated. There are a number of ways to measure communication. This questionnaire considers only the degree to which formal channels of communication about pay exist.

C. Communication and Pay Administration (continued)

The formal channels of communication about pay that we have considered include:

1 - manuals or brochures

2 - ad hoc meetings to answer questions or provide training

3 - "speak-up" sessions where issues are aired informally

4 - employee attitude surveys

5 - formal grievance channels

6 - no channel of communication as defined above

Information can be communicated about any or all of the compensation areas listed in the table below.

Please complete this table by circling the number of each channel typically found in your unit. If you circle (6), please indicate in the Comments section what, if any, other types of pay communication your unit uses.

For example, if your unit has manuals or brochures and "speak-up" sessions on job evaluation methods, you would complete the table row as follows:

	Types of Communication					
c. Job evaluation	1	2	3	4	5	6
	manuals or brochures		speak-up sessions			

3. Compensation Decisions	Types of Communication Channels					
a. compensation policies	1	2	3	4	5	6
b. job analysis	1	2	3	4	5	6
c. job evaluation	1	2	3	4	5	6
d. market wage surveys	1	2	3	4	5	6
e. pay increase guidelines	1	2	3	4	5	6
f. salary ranges	1	2	3	4	5	6
g. individual salaries	1	2	3	4	5	6

Comments: Please feel free to respond to, comment upon, or criticize the preceding statements on the back of page 8.

IV. BUSINESS UNIT AND RESPONDENT DATA

This information is required for appropriate tabulation, aggregation and analysis of the compensation data. Be assured your answers will be treated confidentially.

A. Business Unit

1. Name of your business unit ______________________________

2. Nature of the business (please describe briefly) ______________________________

____

____

3. How old is your business unit? ______________________________

4. Approximately how many employees are in your business unit? ______________
What proportion of these employees are in middle management? ______________ %

5. Below are some general descriptions of strategy and administrative structure which are typical of business units in a particular industry. It is unlikely that any of the alternatives offered will exactly describe your unit. However, please circle the one degree that you feel most closely resembles your unit over the last three years. If you feel very strongly that none of the alternatives are relevant, please note why on the last page of the survey.

a. To what extent does your unit tend to stick with one product line or closely related group of product lines?

1	2	3	4	5
Very little; the unit has continuously tried to locate new product market opportunities. A high proportion of resources is devoted to research and marketing for new product development.		This unit is devoted to a particular product line or related product lines, but also tries to devote a moderate proportion of resources to new and not necessarily related lines.		To a great extent; this unit has been committed to one product line or a closely related group of product lines. Resources are devoted to improvements in production efficiency, quality control, and customer service.

b. To what extent does your unit have an industry reputation as a product innovator?

1	2	3	4	5
Very little; the unit's image is based on a stable association with a specific product and market. It has a reputation for good pricing, quality, and customer service.		Moderately; the unit has a limited reputation for moving quickly to develop new products after they have shown promise. However, it is also associated with a stable product and market base.		To a great extent; the unit has the reputation of being the "first to market." It is associated with new product and market development.

c. To what extent do top level managers in your unit tend to come from production and finance areas (either inside or outside the unit)?

1	2	3	4	5
Very little; top level managers tend to come from marketing and R&D areas.		Moderately; there are some top level managers from production and finance, but marketing and R&D are also represented.		To a great extent; most of the unit's top level managers have had considerable finance or production experience.

A. Business Unit (continued)

4. To what extent is the overall administrative structure of your unit based on a functional (marketing, production, finance, etc.) division of work and labor?

1	2	3	4	5
Very little; the unit tends to be divided according to product lines.		Moderately; there is both functional and product line organization.		To a great extent; t unit is organized ac cording to functions

6. There are many ways to describe a business unit's product market strategies. Three typical strategies are:

Invest (I) - commit additional resources in order to increase a unit's market growth

Evaluate (E) - maintain resource commitment, but continue to monitor unit performance and potential market changes

Disinvest (D) - decrease resource commitment while reaping the benefits of past investment.

The choice of one strategy over another will depend on the unit's assessment of product market attractiveness (high, medium, low), and its own business strengt (high, medium, low). Product market attractiveness can be influenced by many things, but the bottom line is the unit's assessment of the revenue potential of its particular product or product lines in that market. Business strengths include such things as current market position, financing ability, goal orientation, and types of management systems currently operating.

The matrix below summarizes some typical strategic choices depending upon a unit's assessment of market attractiveness and its own business strengths. (The cell letters represent strategic choices; the vertical axis, product market attractiveness; and the horizontal axis, business strengths.) Please consider your unit's business strengths and market attractiveness relative to your product(s). Then circle the cell letter that best represents your unit's position on the matrix axes. (Some guidelines to product market and business strength characteristics associated with each strategy are provided below.)

Product Market Attractiveness

	Low	Medium	High
High	E	I	I
Medium	D	E	I
Low	D	D	E

Business Strengths

Guidelines

I = Invest, Emerging, Growth

- Strong Revenue, Market Share Potent
- Cash Scarcity
- Individual Decision Makers
- Entrepreneurial Managers
- Long Term Orientation
- Invest for Future

E = Evaluate, Manage Selectively:

- Revenue Potential Unclear
- Control Expenses
- Formalizing Management Systems
- Intermediate to Short Term Orientat

D = Disinvest, Harvest

- Revenue Potential Weak
- Control Expenses
- Formalized Management Systems
- Short Term Orientation

B. Respondent

1. What is your title? ______

2. What is your level in the business unit? (Check one)

[ ] Executive or top management

[ ] Middle management

[ ] Lower or first level management

[ ] Other, please specify ______

3. Briefly describe your compensation-related reponsibilities.

4. How long have you been in this business unit? ______

5. How long have you been in your current position? ______

6. How many years of compensation experience have you had? ______

Thank for your cooperation.

* * * * *

ADDITIONAL COMMENTS

APPENDIX II

Intercorrelation Matrix of Compensation, Strategy and Performance Scales

Intercorrelation Matrix Among Compensation, Strategy and Performance (I)

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1)	Participation: Compensation Structure	1								
(2)	Decentralization:Job Evaluation Decisi	.4433**	1							
(3)	Decentralization:Increases decisions	.4408**	.5925**	1						
(4)	Decentralization:Market Rate Decisions	.2923**	.5138**	.4233**	1					
(5)	Formalization:Job Evaluation	-0.0279	0.1123	0.051	-0.0381	1				
(6)	Formalization:Job Analysis	0.0703	0.0934	-0.0212	-0.0231	.3879**	1			
(7)	Formalization:Performance Appraisal	-0.0556	0.0996	-0.0006	-0.0105	.3424**	.2916**	1		
(8)	Formalization:Market Rate Analysis	0.0011	0.0766	0.0566	0.0567	.3077**	.1737*	.2962**	1	
(9)	Standardization:Incentive Plans	-0.0293	-0.0021	-0.0368	0.103	0.0396	-0.0592	0.1198	0.0754	1
(10)	Incentives:Innovation/Risk/Growth	0.0397	.1881*	0.1113	-0.0146	-0.1043	-0.0285	0.0188	0.0216	-0.0224
(11)	Participation:Incentive Plans	0.0782	0.0409	0.1194	-0.1142	-0.034	-0.0508	-0.0208	-0.1003	-.3016**
(12)	Compensation Level	-0.0172	0.108	-0.0467	-0.0606	0.1265	-0.001	0.0806	.1946**	-0.1148
(13)	Communication Breadth	.2021**	0.1329	0.0337	.1571*	.2157**	0.1187	.2257**	.2227**	0.0036
(14)	Compensation Mix:Incentives-Based	-0.0206	-0.0793	-0.1207	-0.07	-0.033	-0.0024	-0.017	-0.0047	0.0316
(15)	Standardization:Compensation Structure	-0.009	-0.1376	0.064	-0.1187	-0.1	0.0294	-0.0798	-.2343**	-.3029**
(16)	Internal equity Emphasis	0.0553	0.1006	0.0126	-0.0665	.4206**	.1846**	.2318**	0.0339	0.0541
(17)	External Equity Emphasis	0.033	-0.0342	-0.0041	-0.0341	-0.0446	0.0351	0.1024	0.0407	-0.1039
(18)	Internal Promotion Orientation	0.08	0.0033	0.0017	-0.0098	0.1031	0.0862	0.1376	0.0913	0.0268
(19)	Incentives:Performance-Based	0.0427	0.1205	0.1365	.1788*	.2801**	0.1013	0.0869	.3039**	0.0314
(20)	Cost Leadership Strategy	-0.1206	-0.1514	-0.1658	-0.0335	-0.1512	-0.0277	0.0772	0.0067	0.0531
(21)	Differentiation Strategy	0.1531	0.0514	-0.0228	0.13	-0.0271	-0.0189	0.0326	0.0035	-0.1449
(22)	External Reputation	0.1456	0.2112	0.0851	-0.1143	0.1216	0.0138	-0.2788	0.2582	-0.04
(23)	Gross Margin	-0.0026	-0.0198	0.0344	-0.0327	-0.1068	-0.1301	0.1051	-0.088	-0.0628
(24)	Net Margin	0.1713	0.087	0.1085	0.0635	-0.075	-0.0827	-0.0023	-0.0911	-0.1324
(25)	Return on Investment	0.1541	0.1096	-0.0051	0.024	-0.0198	-0.0648	0.0542	-0.0722	-0.0646
(26)	Return on Assets	0.1426	0.1316	0.0803	0.0725	-0.0193	-0.0966	0.0589	-0.0667	-0.0767
(27)	Earnings per Share	0.1728	.2539**	0.1641	0.0979	0.031	-0.0987	0.1214	0.051	0.0793
(28)	Price Earnings Ratio	.2605**	.2994**	.2552**	0.1122	0.0336	-0.0645	0.1084	0.0504	-0.0009
(29)	Inventory Turnover	-0.0606	-0.0471	-0.0829	-0.1323	-0.046	-0.0973	0.0238	-0.0679	0.1175
(30)	Times Interest Earned	-0.0037	0.0251	-0.0453	-0.0281	-0.0723	0.1115	0.1071	-0.1567	-0.058

Intercorrelation Matrix Among Compensation, Strategy and Performance (II)

		(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
(1)	Participation: Compensation Structure										
(2)	Decentralization:Job Evaluation Decisions										
(3)	Decentralization:Increases decisions										
(4)	Decentralization:Market Rate Decisions										
(5)	Formalization:Job Evaluation										
(6)	Formalization:Job Analysis										
(7)	Formalization:Performance Appraisal										
(8)	Formalization:Market Rate Analysis										
(9)	Standardization:Incentive Plans										
(10)	Incentives:Innovation/Risk/Growth	1									
(11)	Participation:Incentive Plans	.1765*	1								
(12)	Compensation Level	0.0161	0.0357	1							
(13)	Communication Breadth	0.0601	0.0878	.2240**	1						
(14)	Compensation Mix:Incentives-Based	-0.0231	-0.0897	-0.0531	-0.0571	1					
(15)	Standardization:Compensation Structure	-0.1438	.2761**	0.0762	-0.1062	0.054	1				
(16)	Internal equity Emphasis	0.0442	0.0026	0.0592	0.114	0.0625	0.0138	1			
(17)	External Equity Emphasis	.2100**	0.0737	-0.0788	0.047	-0.007	0.0795	-0.1055	1		
(18)	Internal Promotion Orientation	0.0695	-0.0414	.2060**	0.0635	-0.01	-0.0308	0.1158	-0.0043	1	
(19)	Incentives:Performance-Based	0.0192	-0.0881	-0.0479	0.1043	-0.0337	-0.0536	0.0405	.1433*	0.0322	1
(20)	Cost Leadership Strategy	-0.0576	0.0151	.3219**	-0.1201	.2892**	0.1706	0.0218	-0.0807	.2194*	-0.0332
(21)	Differentiation Strategy	-0.1186	-0.1145	.2153*	0.1855	0.0695	0.0648	-0.0366	0.1248	0.0699	-0.0139
(22)	External Reputation	0.2991	-0.2975	.3309*	0.1394	-0.0784	-0.3019	0.3043	-.4021*	-0.1249	0.2566
(23)	Gross Margin	0.0601	-0.1096	0.169	-0.0706	0.1655	0.0189	0.1083	-0.1226	-0.0179	-0.1897
(24)	Net Margin	-0.0024	-0.0552	.1957*	0.0401	0.1561	-0.0801	0.1137	-0.1611	-0.0458	-0.0561
(25)	Return on Investment	0.0724	0.0061	0.0832	-0.0143	0.1017	-0.1403	0.1476	-0.1734	0.0096	0.0386
(26)	Return on Assets	0.0415	0.0074	0.1591	0.0559	0.1279	-0.129	0.1523	-.2472*	-0.002	-0.0525
(27)	Earnings per Share	0.0898	-0.011	0.1657	0.1815	-0.1507	-0.1878	.2599**	-.2600**	0.1711	-0.0623
(28)	Price Earnings Ratio	0.1434	0.0362	.2521**	.3533**	-.2014*	-.2215*	.3025**	-.2298*	0.1458	-0.0596
(29)	Inventory Turnover	0.1549	0.1045	-0.1133	-.2048*	-0.003	-0.0559	0.0642	-0.0056	0.1221	0.0247
(30)	Times Interest Earned	0.0353	0.0273	0.1314	-0.0692	0.1359	0.0811	0.0954	-0.0722	0.1008	-0.1421

Intercorrelation Matrix Among Compensation, Strategy and Performance (III)

		(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)	(30)
(20)	Cost Leadership Strategy	1										
(21)	Differentiation Strategy	-0.0095	1									
(22)	External Reputation	.3992*	0.2397	1								
(23)	Gross Margin	.5430**	.1965*	.6890**	1							
(24)	Net Margin	.2493**	.3676**	.5008**	.6908**	1						
(25)	Return on Investment	0.0895	0.0217	.3857*	.3636**	.6107**	1					
(26)	Return on Assets	.2201*	0.1567	.5426**	.5878**	.8104**	.8373**	1				
(27)	Earnings per Share	0.1449	-0.0808	0.3581	.3021**	.2671**	.4511**	.4877**	1			
(28)	Price Earnings Ratio	-0.0066	0.0708	.5079**	.2426*	.3208**	.4133**	.4566**	.8703**	1		
(29)	Inventory Turnover	0.0655	-.6576**	-0.0932	-0.1027	-.2538**	0.0413	-0.0707	0.0955	-0.0196	1	
(30)	Times Interest Earned	.4779**	-0.0691	0.1466	.5066**	.3770**	.3039**	.3962**	0.1265	0.1249	.2159*	1