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PAY POLICY, ORGANIZATION STRATEGY AND STRUCTURE:
A QUESTION OF "FIT"

by

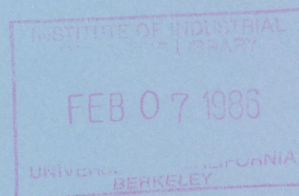
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About the Author

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Abstract

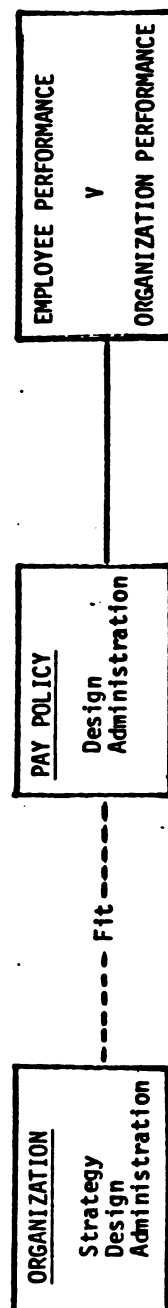
This study investigated policy decisions on middle management pay and their relationships to business strategy. Compensation directors at 208 manufacturing firms answered questions on pay structure, level, mix, incentives and administration, and on firm business strategy. The results suggested that pay decisions reflect seven broader dimensions of policy such as an emphasis on paying for membership or performance. They also supported the notion that pay policy varies systematically with business strategy. For example, firms with a strategy of maintaining market share emphasized centralized pay administration and cost control performance criteria. The results are discussed relative to development of a model of "fit" between pay policy and business strategy.

PAY POLICY AND BUSINESS STRATEGY

The notion that pay policy should be related to or vary with an organization's business strategy is grounded in the research and professional literature on pay. It implies that the better the "fit" between pay policy and organization characteristics such as business strategy, the higher the organization performance. The model in Exhibit 1 shows that the "fit" between policy on the design and administration of pay and overall organization strategy, design and administration influences organization performance.

There are two theoretical reasons offered for the higher organization performance attributable to "fit" relationships between pay policy and these organization characteristics. First, if pay policy is contingent on an organization's business strategy--that is, if it is designed and administered to support business strategies--then appropriate employee behaviors are more likely to be defined and rewarded. By rewarding the appropriate employee behaviors, the organization is sending a clear signal about what is expected. This increases the probability of the desired

Exhibit 1. A Model of Pay Policy, Organization and Performance



performance. (See Lawler, 1981; Ellig, 1982; Milkovich and Newman, 1984.) Second, the notion of "fit" includes congruency between pay policy and the organization's design and administrative style. Such consistency is believed to increase employee perceptions of pay policy equity. Equity perceptions can, in turn, increase employee motivation to perform. (See Lawler, 1971; Salter, 1973; Lorsch and Morse, 1974; Dyer and Theriault, 1976.)

By increasing the chances of desired employee performance in these ways, pay policy appropriately related to organization strategy, design and administration could increase organization performance. If these performance relationships are true, then knowing how to develop pay policy that "fits" a particular organization could be advantageous in the management of human resources.

Unfortunately, these performance assumptions have not been tested. In part, this is due to the fact that a number of pieces needed to test the pay policy model are missing. At minimum, measures of pay policy decisions and some definition of "fit" are needed. Measures of employee and organization performance must also be specified. This study

looks at three aspects of the model in Exhibit 1: (1) pay policy; (2) organization strategy; and (3) the relationship (or "fit") between them. The relationship with performance is left to subsequent studies.

DEVELOPING MEASURES OF PAY POLICY AND "FIT"

This study is organized around two questions: (1) Can an important set of organization pay policy decisions be identified and measured?; and (2) Do pay policy decisions vary systematically across organizations with different business strategies? The first question is related to the pay policy aspects of the model. The second is related to organization strategy and "fit" aspects. The investigation of the first question was meant to develop measures of pay policy. The investigation of the second, was meant to provide an initial description of "fit" that could be developed in subsequent study. In order to investigate each question a search of the pay administration, human resource management and organization behavior literatures is coupled with an empirical examination of pay policy decisions in organizations.

REVIEW OF THE LITERATURE

IDENTIFICATION OF PAY POLICY DECISIONS

The study's first question involved the identification and measurement of pay policy decisions. In the literature, policy decisions on pay structure and level, mix, incentives and pay administration were consistently identified as important to the overall design and administration of an organization's pay system. These decisions are listed in Exhibit 2 and described below.¹

Pay Structure and Level. Pay structure is defined as the distribution of money rate paid to different jobs in an organization. Pay level is defined as the average of the total distribution of these rates. (See Mahoney, 1979.)

The actual pay structure and level for a group of jobs or employees are determined by a number of pay policy decisions

¹ Pay policy decisions are distinguished from more technical pay decisions such as those on methods of job evaluation or choice of the wage survey to be used in determining pay level (Lawler, 1981; Milkovich and Newman, 1984).

Exhibit 2. A Priori Pay Policies and Decisions Derived from the Literature

	A Priori Pay Policies	A Priori Pay Decisions
Design Factors	1. Internal versus External Equity Emphasis	Job valuation criteria Skill specificity required Skill acquisition policies Pay level competitiveness
	2. Membership versus Performance Emphasis	Percentage of total pay represented by base pay; benefits; incentives.
	3. Performance-Based Pay Increase Guidelines	Performance Time Orientation Performance Evaluation Criteria Amount of Award
Administrative Style Factors	4. Standardization	Degree to which pay structure, level and incentive decisions are the same in all organization units.
	5. Participation	Degree of employee participation in pay plan design and implementation.
	6. Authorization	Degree to which employees at different levels of organization approve pay plan design and implementation decisions.
	7. Formalization of Pay Structure and Level	Degree to which the implementation of pay plan structure and level decisions is explicit (written) and rule bound.
	8. Formalization of Pay Incentives	Degree to which performance based pay increase implementation is explicit (written) and rule bound.
	9. Formal Communication	Number of established channels for communicating pay information. Range of Pay plan information communicated.

For example, in developing a pay structure policy for a group of jobs, the organization must determine their going rate in the external labor market. At the same time, it must decide the emphasis to place on internal norms relative to these external prices. Other decisions involve some specification of the degree of training needed to perform the jobs, and the degree to which the jobs should be filled by current employees or new hires. Before setting a pay level, the organization must decide whether levels equal to, above or below those of its competitors are necessary to attract and retain the employees needed. (See Livernash, 1957; Belcher, 1974; Lawler, 1981; and Milkovich and Newman, 1984.)

Pay Mix. Pay mix refers to the emphasis on a particular form of pay in the total compensation package offered for a specific group of employees. Typical forms of pay include base salary, benefits and incentives (pay increases related to performance). Organizations who wish to reward employee loyalty and seniority often emphasize base salary and benefits in pay mix decisions. Organizations wishing to reward employee performance--particularly very high performance levels--often emphasize incentives. The policy

decision involves a choice between these two emphases (Belcher, 1974).

Pay Incentives. The policy decisions associated with pay incentives require organizations to determine how to best communicate to employees the broad outlines of the performance desired. As Exhibit 2 indicates, 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 (pay contingent on a one to two year period of performance) is a signal of the importance of short term objectives (Ellig, 1982). Typically the literature described choices between entrepreneurial and production (including cost control) performance criteria. (For example see March and Olsen, 1958; Galbraith, 1977.) The combination of criteria used to best communicate the organization's emphasis on a particular type of employee behavior depends on the strategic objectives of the organization (Galbraith, 1977). The third decision

reflects the degree of risk involved in employee attempts to perform as desired. Presumably, more entrepreneurial behaviors are associated with a higher risk of failure. Salter (1973) and Galbraith (1977) suggested that reinforcement of these types of behaviors required high incentive payments.

Pay Administration Decisions. The decisions listed under administration in Exhibit 2 influence the style in which a pay system's design is developed and maintained, day to day. While the pay literature did not describe these decisions in any detail, Lawler (1981) maintained that an organization's pay system should be administered in a style similar to that of its overall administration. The characteristics of an organization's administration were described in the organization behavior literature as: communication, centralization, formalization and standardization (Zey-Ferrell, 1979). The definitions of these characteristics are extended to pay system administration.

Communication decisions can range from an emphasis on open communication of all types of pay information (including

facts on individual salaries) to relative restriction of information. Pay centralization policy determines the level at which employees participate in, and authorize, different types of pay decisions. Decisions can range from an emphasis on the centralization of decision making power in the hands of a select group of top managers to a decentralized dispersal of decision making power throughout all levels of management.

Closely related to centralization are policy decisions that establish the degree to which the implementation of pay system design is governed by standard operating procedures, work rules and supervision. Examples of formalization in a pay 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 pay standardization decisions involve the degree to which pay policies are 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 incentive pay across all units. In other firms, differences in objectives may

justify establishing unique performance criteria (Salter, 1973).

DIMENSIONS OF PAY POLICY DECISIONS

The literature review also suggested that the pay policy decisions listed in Exhibit 2 might be related to more aggregate dimensions of pay policy. For example, the pay administration and industrial relations literatures described pay structure, level, mix and incentive decisions as critical in establishing a framework for an organization's pay system (Doeringer and Piore, 1971; Mahoney, 1979; Lawler, 1981). Pay structure and level decisions establish the shape of the pay distribution for broad classes of work or employees. Mix and incentive decisions establish both the form of pay and linkages between pay and performance. Once the pay framework is established, it is relatively stable and difficult to change.

Pay administration decisions tend to be more process oriented and dynamic. They establish the style of pay system operation--for example, the degree of employee participation in pay decisions, the pay information available and the degree to which incentive guidelines are followed.

The literature suggested that by emphasizing certain choices on these pay policy decisions an organization could communicate a specific policy intent to its employees. For example, pay structure and level decisions emphasizing internal job values, job specific skills, internal promotions and lagging pay levels would tend to focus employee pay comparisons within the organization. An emphasis on market pricing of jobs, general skills, open hiring and leading pay levels would tend to focus employee pay comparisons outside the workplace. Choices on pay mix decisions might be related to an emphasis on membership (base salary and benefits) versus performance (incentives). Likewise, incentive decisions could emphasize entrepreneurial over less risk taking production oriented behaviors. (See descriptions in Livernash, 1957; March and Simon, 1958; Belcher, 1974; and Milkovich and Newman, 1984.) These three design dimensions or factors are listed in Exhibit 2.

There was also evidence in the research literature that the many decisions making up pay administration policy represent distinct (albeit related) dimensions. The work of Lorsch and Allen (1973) and Kerr (1984) suggested that policy

on pay formalization might differ between decisions on pay structure and level and those on pay incentives. Lawler (1981) indicated that policy on pay decentralization might vary with employee level and the pay decision involved. While many levels of employees may participate in a variety of pay decisions the power to authorize decisions may be more restricted. Thus pay centralization might be represented by both participation and authorization dimensions. Pay administration dimensions are listed in Exhibit 2.

PAY POLICY RELATED TO BUSINESS STRATEGY

The second question this study investigated was, "Does pay policy vary systematically across organizations with different business strategies?". The literature review covered research on both strategic types and variance in pay policy.

Strategic Types. While a wide variety of business strategies are feasible, three distinct forms of strategy were consistently identified in the research literature. Each type of business strategy was also associated with a particular type of organization design and administrative style. (See Burns and Stalker, 1961; Chandler, 1962; Lawrence and Lorsch, 1967; and Miles and Snow, 1978.)

Exhibit 3 depicts the three combinations of strategy, design and administration as described by Miles and Snow (1978). The Miles and Snow typology of business strategy was used to review the evidence on pay policy and to classify the organizations in the study's survey because it provided descriptive detail on design and administration.

As Exhibit 3 indicates, Miles and Snow identified three strategic types of organization: Defenders, Prospectors and Analyzers. The Defender has a narrowly defined, stable product market strategy. Its structural design is functional, and its administrative style tends to be centralized, formal and standardized. The Prospector, on the other hand, emphasizes an innovative, dynamic approach to product market definition. Its structural design tends to be divisional or product-based, and its administrative style decentralized, informal and nonstandardized. The Analyzer is characterized by a mixed product market strategy in which some of its product markets are stable and narrowly defined, but others are more dynamic and innovative. Analyzers often have matrix or divisional type structural designs with administrative styles between those of the other types.

Exhibit 3. Strategic Business Unit Types (Miles & Snow, 1978)

	Defender	Prospector	Analyzer
Product Market Definition	Narrow, stable product market; concerned with continued market penetration and customer service.	Changing product market emphasis; continuous search for new markets, promote reputation for innovation.	Characterized by mixed strategy; has some stable narrowly defined product markets but also some relatively innovative market definitions; tends to follow Prospectors in industry.
Technology	Single core technology with investment in improvements.	Multiple, prototype technologies; invest more in people than machines.	Some single core technologies and some investment in people and prototypical technologies.
Managerial	Tends to be dominated by production, finance types, but is stable.	Tends to change often, but dominated by marketing; R&D types	Dominated by marketing and applied research; relatively stable.
Design/Administration	Functional division of labor, highly formalized, promotion from within, centralized.	Divisional or product centered division of labor; few formal work rules or standards, internal labor market relatively open, decentralized.	Divisionalized or matrix structure; combination of decentralized unstructured work and centralized formalized work activity.
Performance Criteria	Performance standards established and compared to past performance. Standards based on cost savings.	Performance measured on market outcomes compared against key competitors.	Performance measured on a combination of cost efficiency standards and market outcome comparisons.
Organization	American Brands Lincoln Electric	Phillip Morris, USA Hewlett Packard	R.J. Reynolds Texas Instruments

Variance in Pay Policy Dimensions. Exhibit 4 summarizes proposals about how pay policy dimensions might be expected to vary with strategic type. Each of the nine pay design and administration dimensions presented earlier (Exhibit 2) are listed. The pattern of pay decisions associated with the strategic types reflects the Miles and Snow (1983) descriptions of the human resource policies typical of each.

For example, they indicated that the human resource policies of Defenders emphasize job specific skills, retention, promotion from within and production or cost based performance criteria. Pay design compatible with these policies might emphasize internal equity, membership rewards and production based incentives. Prospectors were seen as emphasizing general skills, hiring at all levels of organization and pursuing entrepreneurial performance objectives. A compatible pay design for Prospectors might emphasize external equity, performance rewards and pay incentives based on creative or innovative behavior. The Analyzer, with human resource policies that combine aspects of the other two types, might be expected to have a mixed pay design. (Support for these patterns is also found in Livernash, 1957; Doeringer and Piore, 1971; Galbraith, 1977;

Exhibit 4. A-priori-Derived from Literature

Variance in Pay Policies Across Stratetic Types			
STRATEGIC TYPES			
PAY FACTORS	DEFENDER	PROSPECTOR	ANALZYER
I. PAY DESIGN			
(1) Internal vs. External Equity	Internal	External	Combination
(2) Membership vs. Performance	Membership	Performance	Combination
(3) Performance Based Pay Increases:			
Entrepreneurial vs. Production	Production	Entrepreneurial	Combination
II. ADMINISTRATIVE STYLE			
(4) Communication: #Channels	High	Low	Moderate
Range	Low	High	Moderate
(5) (6) Participation	Low	High	Moderate
Authorization	Low	High	Moderate
(7) (8) Formalization:			
Structure & Level	High	Low	Moderate
Pay Increases	Low	High	Moderate
(9) Standardization	High	Low	Moderate

Lawler, 1981; Salschieder, 1981; Ellig, 1982; Kerr, 1984; and Milkovich and Newman, 1984.)

With regard to pay administration factors, the proposed pattern of variance is an extension of the Miles and Snow (1978) descriptions of each type's administrative style. Defenders are more centralized, formalized and standardized. Therefore, their style of pay system administration might be expected to follow suit. Prospectors are described as having more decentralized, informal and nonstandardized administrative styles. Their style of pay administration might be decentralized, informal and nonstandardized as well. The pay administration of the Analyzers might be expected to represent a middle ground between the other extremes. There was some additional support for these patterns. The work of Salter (1973) and Kerr (1984) suggested a similar pattern of pay standardization and formalization by strategic type. A distinction between the formalization of pay structure and level decisions and that of pay incentive decisions was made in this work. Kerr found that Prospectors had more formal pay incentive procedures than Defenders. This is the opposite of what might be expected given the formalization

characteristic of Defenders. Next, Lawler (1981) suggested that centralization of pay decisions should match the centralization typical of the entire organization. Finally, the number of formal communication channels is expected to be higher, and the detail of pay information communicated lower, for Defenders than for Prospectors. The former are both more centralized and formal.

EMPIRICAL INVESTIGATION OF PAY POLICIES

PROCEDURE

A survey based on mailed questionnaires was considered the best way to cost effectively sample pay policy in a large number of organizations. The questionnaire included items on pay structure and level, mix, incentives and administration. It also included items on business strategy, organization design and administration. A pilot group of fifteen compensation professionals reviewed the questionnaire. The members of this group represented a variety of industry and geographic backgrounds. They suggested improvements in the questionnaire, identified

compensation directors as the most appropriate respondent group and provided a definition of middle managers. Respondents were asked to focus on middle managers in answering pay policy questions.

TARGET POPULATION AND SAMPLE

One thousand firms in four digit, manufacturing, Standard Industrial Classification (hereafter, SIC) codes were selected as the study's target population. The COMPUSTAT data base (maintained by Investors Management Sciences, Inc.) was used to identify these firms. The four digit SIC codes were considered proxies for a firm's product market. (A firm was assigned to a four digit SIC code based on the product market from which it drew the largest proportion of its revenues.) Only firms with the same SIC code for 1981-1984 were included in the target population. This was done to assure some stability in product market association. In addition, only firms with an average employee population of at least 100 over this same period were considered. It is more likely that organizations of this size would have pay policy covering middle managers.

Respondents for approximately 60 per cent of the firms in the population were identified through the annual membership directory of the American Compensation Association. The remaining 40 per cent were identified in the STANDARD AND POORS DIRECTORY (Vol. III, 1984). The survey response rate was 20 per cent, resulting in a sample of 208 firms. This rate is typical of other studies using questionnaires of similar length (DeBejar, 1983).

As Exhibit 5 demonstrates, the sample was not representative. The sample firms had significantly higher net sales and employment levels than non participating firms. The distribution of firms across the manufacturing SIC codes differed also. The sample firms included more drug manufacturing, petroleum refining and tobacco processing firms. One third of the sample firms were in electronic/electrical and transportation equipment manufacturing.

QUESTIONNAIRE MEASURES

Pay Policy Decisions. The decisions identified in the literature were used to develop measures of pay policy. Pay structure, level and incentive measures were based on five

Exhibit 5. Sample Representativeness

Measures	Nonparticipants (N=797)	Participants (N=208)	Population (N=1000)
<u>NETSALES (in thousands)</u>			
MEAN	1338.76	2544.3	1564.00
STD	5571.57	6787.9	5826.70
<u>NUMBER EMPLOYEES (in thousands)</u>			
MEAN	11.35	20.09	13.00
STD	35.11	44.10	36.97
<u>SIC CODE DISTRIBUTION (%)</u>			
20 Food and Kindred Products	5.6	8.6	6.2
21 Tobacco Manufacturers	0.5	1.0	0.5
22 Textile Mill Products	1.9	--	1.5
23 Apparel and Other Products (Fabr/c)	--	--	--
24 Lumber and Wood Products (exc. Furniture)	1.9	0.5	1.6
25 Furniture and Fixtures	1.1	0.5	1.6
26 Paper and Allied Products	1.7	0.5	1.4
27 Printing, Publishing, and Allied Industries	5.0	2.0	4.4
28 Chemicals and Allied Products	8.9	7.6	8.8
29 Petroleum Refining	3.1	6.1	3.7
30 Rubber and Misc. Plastic Products	2.7	2.5	2.7
31 Leather and Leather Products	2.3	--	1.8
32 Stone, Clay, Glass, Concrete Products	2.7	5.1	3.2
33 Primary Metal Industries	5.7	6.1	5.8
34 Fabricated Metal Products exc. Machines, Transport	8.5	5.1	7.8
35 Machinery except electrical	16.0	20.3	16.8
36 Electrical and Electronic Machinery	15.6	18.3	16.2
37 Transportation Equipment	6.0	11.2	6.9
38 Measuring, Analyzing, Photo, Medical, Optical	6.8	4.1	6.3
39 Miscellaneous Manufacturing	3.9	0.5	3.3

point, anchored scales. For example, a pay level item was phrased as:

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 tends to set pay levels above those of its competitors.

Measures of pay mix reflected the percentage that base salary, benefits and incentives each represented in a middle manager's total pay. Pay centralization measures represented the number of lower level managers who participated in, or authorized, ten different pay decisions (ranging from compensation philosophy to budgets). Communication measures involved the number of formal channels over which seven kinds of pay information were circulated. (These ranged from policy manuals to formal grievance procedures.) Measures of pay formalization involved twenty different items such as, "There are established guidelines on how to conduct wage surveys." (to what extent does this statement represent your pay policy?--(1) very little; (3) moderately; (5) to a great extent). Seventy pay policy decision were measured.

In general, questions were written so that the higher the scale score (5 is high), the more likely that the associated decision would represent a highly developed internal labor market (internal promotion, job specific skills, and so forth) and a centralized, formal and standardized style of pay administration.

Measures of Strategic Type. Questionnaire measures of strategic type were based on the Miles and Snow descriptions of Defenders, Prospectors and Analyzers. There were four measures--one on product market definition; another on the business unit's reputation for product market innovation; a third on the area of expertise or the function from which top management was drawn; and the fourth, on the organization's general structure and administrative style. Each measure was based on a five point, anchored scale. In general, the higher the score (5) on these scales, the more likely the organization was a Defender.

An index of an organization's overall business strategy was developed by adding each firm's scores on the four questionnaire measures of strategic type. These sums were then averaged, and the means and standard deviations were

calculated. Defenders were defined as firms with an average score more than one standard deviation above the mean (greater than 4.23); Prospectors were defined as firms with average scores one standard deviation or more below the mean (less than 2.67); and Analyzers were defined as firms with scores that fell within one standard deviation of the mean (inclusive).

Control Measures. In addition to the measures on pay and strategic type, the survey questionnaire included measures of respondent characteristics and business unit age. The COMPUSTAT data base also included measures of employment size, net sales and other industry characteristics. These measures were used as control variables in sample analysis.

Levels of Analysis. The study survey was designed to compare pay policy decisions across organization strategic types. The Miles and Snow typology was chosen as a measure of strategic type primarily because it allowed this kind of comparison. Theoretically, Defenders, Prospectors and Analyzers can be identified in all product markets. Strategic types might thus be compared without further stratification of the sample by product market. The primary

unit of analysis in this study was organization strategic type. Within strategic type, measures of pay were limited to policy decisions concerning middle management. The middle management group was selected because their pay typically reflects a broader range of policy decisions than that of lower level employees, yet is considered less confidential than executive pay.

ANALYSIS AND RESULTS

SUMMARY PROFILE OF SAMPLE MEASURES

The sample descriptive statistics indicated that the measures of pay policy decisions were normally distributed. Design decisions were slightly skewed toward a higher emphasis on internal equity, membership pay and incentives based on cost control performance criteria. The administration decisions indicated that sample firms tended to centralize pay decision making and standardize pay policies. Their pay administration was only moderately formalized. Overall, there was not a lot of variance in the sample pay measures. Measures of strategic type were also

slightly skewed toward higher scale scores; that is, toward the Defender strategic type.

MEASURES OF PAY POLICY

Measures of pay policy decisions were factor analyzed for the entire sample. The resulting seven factors selected to represent these decisions are presented in Exhibit 6. The factors accounted for 61.1 per cent of the variance in the sample. The first four factors to emerge in the analysis were very like the policy dimensions on participation, authorization, formalization and standardization identified in the literature review (compare Exhibits 2 and 6). The measures of policy decisions most closely related to these factors were those on participation in pay decisions, authorization of pay decisions, the regulation of pay policy and uniformity in the application of pay policy. The factor on external competitiveness covered pay policy measures on pay level decisions (Factor 5 in Exhibit 6). The membership versus performance factor covered decisions on pay mix and the efficiency versus growth factor covered decisions on performance criteria used for incentive awards. (These are Factors 6 and 7 in Exhibit 6.) Some

Exhibit 6 A Seven Factor Model of Pay Policy Decisions: Summary of Factor Analysis Results

Emergent Pay Policy Factors	Factor Scale Description	Variance Explained %	Cumulative %
1. Participation	Level of managers participating in pay plan decisions	18.8	18.8
2. Authorization	Level of managers approving pay plan decisions	12.2	31.0
3. Formalization	Degree to which pay plan design and administration is regulated	7.4	38.4
4. Standardization	Similarity of pay plans across business units	6.5	44.9
5. Degree External Competitiveness	Degree to which unit's pay level leads the competition	6.2	51.2
6. Membership v. Performance	Degree to which pay mix emphasizes membership rewards	5.1	56.3
7. Efficiency v. Growth	Degree to which performance rewards are based on cost criteria	4.8	61.1

pay structure and incentives measures were not related to these factors as had been suggested in the literature.

(These are described in the discussion section.)

Pay scales were then developed from the seven factors that emerged in sample analysis. Each of the pay scales might be interpreted as follows: High scores on participation (1) and authorization (2) scales indicate that lower level managers are involved in discussing and approving a variety of pay decisions; high formalization scores (scale 3) indicate that the business unit's pay structure and level decisions are made and implemented in a regulated fashion; and high standardization scores (scale 4) suggest that pay policy is uniform across divisions or departments. High scores on the external competitiveness (scale 5) imply that the pay level policy of the firm is closer to leading than lagging its competitor's pay levels; and high scores on the membership versus performance scale (6) suggest an emphasis on membership rewards (base salary and benefits) in pay mix decisions. Finally, a high score on the efficiency versus growth performance scale (7) indicates a concern with growth oriented performance criteria.

ANALYSIS OF PAY POLICY VARIANCE BY STRATEGIC TYPE

The next step in the analysis was to classify each of the sample firms as a Defender, Prospector or Analyzer. The firms were placed according to their scores on the overall index of business strategy. The pay scales described above were then compared across the three groups of firms. The results of descriptive comparisons are presented in Exhibit 7.

The pattern of pay scale differences across Defenders, Prospectors and Analyzers was very like the pattern suggested in the literature review (compare Exhibit 4 and 7). Defenders, for example, had lower scores on efficiency versus growth performance scales. This suggests a concern with cost based performance criteria. Prospectors, on the other hand, had higher scores on this scale. This suggests a concern with growth oriented performance criteria. Analyzers scores fell mid-scale. These descriptive statistics suggested some support for the patterns of policy variance derived from the literature.

The significance of mean differences in these scales across types was also analyzed. The results suggest that

Exhibit 7 **Variance in Pay Policies for Defenders, Analyzers and Prospectors**

	<u>Defenders (N=35)</u>				<u>Analyzers (N=136)</u>				<u>Prospectors (N=37)</u>			
	Mean	Std.	Range		Mean	Std.	Range		Mean	Std.	Range	
<u>Pay Policy Scales</u>												
(1) Participation	56.1	29.3	109.8		60.4	22.1	118.9		63.9	26.3	108.3	
(2) Authorization	57.8	21.6	118.3		53.9	16.2	88.4		59.3	15.7	53.1	
(3) Formalization	5.7	1.3	5.2		5.2	1.4	6.9		5.1	1.5	5.7	
(4) Standardization	5.8	1.7	5.7		5.9	1.4	6.1		5.6	1.1	4.1	
(5) External Competitiveness	.94	.20	.87		.93	.23	1.2		1.1	.24	.87	
(6) Membership vs. Performance	2.95	.28	1.1		2.95	.34	2.1		2.97	.51	2.8	
(7) Efficiency vs. Growth	1.3	.59	1.4		1.7	.61	2.7		1.9	.76	2.7	
<hr/>												
Business Strategy	4.2	.26	1		3.3	.33	1		2.2	.41	1.5	
Business Age	51.7	36.4	96		53.3	29.2	94		44.8	31.2	97	
Net Sales ^a	4989	12259	59922		2070	4490	28070		1944	5667	34350	
Number of Employees ^a	17.9	34.2	187.9		21.9	44.6	366.9		23.9	62.0	364.6	

^aNumbers in thousands

when viewed as a composite of all seven pay scales, policy did differ across strategic types. (These comparisons were done using multivariate analysis of variance [MANOVA] techniques.) However, when analyzed individually, the means of only three scales differed significantly by type. (These comparisons were done using one-way analysis of variance techniques, controlling for the firm's level of employment.) These were the participation (1); authorization (2); and efficiency versus growth performance (7) scales. Overall, these results suggest that while differences in pay policies do exist among strategic types, the differences are not always significant.

DISCUSSION AND CONCLUSION

THE TWO BASIC QUESTIONS INVESTIGATED

The first question this study investigated was, "Can a set of important organization pay policy decisions be identified and measured?". The literature provided a list of pay policy decisions and suggested that they might be related to more aggregate policy dimensions of pay system

design and administration. Measures of these policy decisions were developed and used in a survey of middle management pay policy in 208 manufacturing firms. These measures were factor analyzed and the emergent factors compared to the policy dimensions suggested in the literature. The comparisons were favorable, and the factors, once scaled can be used as measures of pay policy dimensions. These measures are an improvement over those previously available. They are based on an integrated search of the pay literature, and represent a broader range of policy decisions than has been studied to date. They were quantified, and based on a large sample of firms. This will make their replication easier.

There were some intriguing issues surrounding these measures, however. Pay structure, many incentive, and communication decisions were not clearly related to any of the factors that emerged in analysis. In the case of pay communication and incentive decisions this could be attributed to problems with the questionnaire measures. Despite pilot testing, the survey responses to these items were confused and sometimes inconsistent. Since the

questions designed to measure pay communication and incentive decisions were based on the available literature, this suggests that a more qualitative investigation may be needed. The emphasis should be on how organizations do define these decisions and the range of alternatives covered.

In the case of pay structure decisions the problem is not so clear. The survey respondents did not appear to be confused regarding the pay structure items. And the items covered the domain of decisions discussed in the literature. Indeed these were the decisions considered crucial to an organization's internal or external pay equity orientation. While the results are specific to this sample, it is possible that some unidentified pay structure decisions need to be included in the measurement of this construct. Again, more in-depth case study may be called for.

The second question this study investigated was, "Do pay policy dimensions vary systematically with differences in business strategy?". Simple comparisons of pay scale means across Defenders, Analyzers and Prospectors supported the notion that pay policy does indeed vary with strategic type (see Exhibit 7). The patterns of variance observed were

similar to those proposed in the literature review. Moreover, when differences in the joint distribution of all seven pay scales were tested across strategic types, the results were significant.

When individual pay scales were compared across strategic types, however, only the participation, authorization and cost versus growth performance scales were significantly different. The most straightforward interpretation of these findings is that, in this sample, pay policy for middle managers did vary across strategic type. However, the only significant variation was related to differences in the degree to which pay decisions are centralized in these organizations. While the other scales did vary as the literature would suggest, that literature was based on case studies and speculation. Also, the case studies were not always specific to a particular employee group's pay.

There are several other possible interpretations. The results may be due to error in the measurement of either pay policy decisions or strategic type. The questionnaire measures used in this study were new. Case studies were suggested to improve pay measures. Sample firms could also

be retyped using another measure of business strategy. Pay policy variance could then be reanalyzed to see if the pattern across types remains the same. Further, the full range of policy variation may not be observed in a sample restricted to manufacturing firms. A more heterogeneous sample may be required.

CONCLUSION

This study set out to identify and develop measures of important pay policy decisions and to investigate variance in these decisions across organizations with different types of business strategy. Both these objectives were met. The measures of pay policy decisions developed were an improvement over those previously available in the literature, although they need to be replicated. The results also provided some empirical support for the notion that pay policy varies with business strategy. The overall pattern of variance identified here may provide a step toward a descriptive measure of "fit" between pay policy and business strategy.

Finally, from a theory building perspective, the study's findings offer some food for thought. Earlier in this paper

the importance of pay policy "fit" was related to the concepts of congruency and contingency. Pay policy that is congruent or consistent with organization design and administration is believed to enhance employee perceptions of pay equity and thus, their motivation to perform. One measure of pay policy congruency would be the strength and the direction of the association between detailed measures of organization strategy, design and administration and similar measures of pay policy. The pay factors identified in this study provide a foundation for the development of such measures.

Pay policy that is contingent on business strategy is believed to improve the link between pay and employee behaviors needed to support that strategy. One way of measuring pay policy contingency would be to identify profiles of policy decisions that are associated with different types of business strategies. This study's empirical support for the specific patterns of pay policy proposed in the literature suggests that such measures are feasible.

Measures of pay policy congruency and contingency are important to the development of the notion of pay policy "fit". They are required to test the question of more practical interest--"Does pay policy that "fits" business strategy improve organization performance?". The results of the present study represent a necessary first step in examining the implications of pay policy "fit" for organization performance.

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