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## COMPENSATION MANAGERS' BELIEFS ABOUT STRATEGIES THAT AFFECT COMPENSATION PROGRAM GOALS

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### Abstract

*A study was conducted to investigate whether individual compensation program goals of recruitment effectiveness, motivational effectiveness, administrative manageability, cost effectiveness, retaining employees and encouraging poor performers to leave were differentially impacted by eleven compensation strategies. It was found that compensation strategies did have differential effects on perceptions of the effectiveness of the compensation goals. While participation in compensation plan design and internal consistency were the most consistent predictors, there was significant variation in the compensation strategies that were predictive across all effectiveness perception variables. Based on these results, compensation managers should carefully consider the organization's strategy and desired employee behaviors before designing compensation programs.*

### Introduction

More than ever before, compensation programs are being challenged to provide a definite and measurable impact on the bottom line results of the company. Many organizations are designing pay programs that de-emphasize individual effort in favor of team, group, or organizational performance. Others are radically altering the traditional conception of base pay by creating broad bands rather than the typically narrow grades. Some organizations are putting less money into base pay programs and more into pay that requires employees to take significant amounts of risk. However, no matter the extent and type of compensation innovations, the ultimate goals of compensation systems are to attract and retain good employees and motivate their performance. Although organizations utilize a variety of different methods to achieve these compensation objectives, there is currently little research that identifies compensation strategy components that are associated with these specific goals of effective compensation programs.

Previous researchers (Balkin & Gomez-Mejia, 1990; Gomez-Mejia, 1992) found that compensation program effectiveness and organizational effectiveness were higher when particular pay strategies were appropriately matched with organizational strategies. Specifically, they found that compensation strategies that

emphasize more flexible, adaptive and incentive-based pay plans were most effective in organizations that focus on a single product or service and are in a growth stage. Mature organizations that are more diversified, focusing on a dominant rather than a single product or service, and that use traditional, job-based, hierarchical and less flexible compensation strategies tend to be most successful. However, the effectiveness of any compensation system hinges on its success in meeting a number of critical objectives. In their 1990 study, Balkin and Gomez-Mejia measured compensation effectiveness through compensation managers' overall ratings of their compensation systems. They did not focus on the specific goals of compensation, that is, to attract, retain and motivate employee performance and behaviors. The study described in this paper investigates the pay strategies that compensation managers perceive as being most associated with achievement of each of the compensation system's primary goals.

Compensation programs have multiple goals, most commonly expressed as attraction, retention and motivation. The decisions to accept a job offer, to remain with or leave the employer and to perform well are controlled to some degree by the compensation program, and there is little reason to believe that simply because a compensation system attracts and retains employees that it also is able to motivate them (Wallace & Fay, 1988). Different pay strategies would theoretically have differential effects on the achievement of each of these multiple goals.

For example, evidence exists that well-designed individual incentives, such as bonuses that are contingent on an employee achieving certain goals, have a positive effect on productivity (Gerhart & Milkovich, 1992). However, pay programs that require a significant percentage of pay to be "at risk," (employees' wages are contingent upon achieving a certain performance level) may be more problematic in recruiting workers, since the guaranteed wage is often lower than at competitor organizations (BNA, 1988; Milkovich & Newman, 1993). Thus, a pay-at-risk strategy may differentially affect two compensation system goals, attraction and motivation.

Further, pay that is equal to or better than that found at competing organizations may greatly affect attraction and retention, but has little effect on motivation once the workers have been hired (Mahoney, 1979). Although research in efficiency wage theory has found that higher pay does seem to increase the number of candidates (Krueger, 1988; Holzer, 1990; Rynes & Barber, 1990), attract and retain more employees (Lawler, 1971) and attract better quality and longer tenured employees (Brown & Medoff, 1989; Holzer, 1990) there is little research to indicate that employees' motivation is affected by pay level during employment.

Additionally, the decision processes involved in the acceptance of a job offer and maintaining organizational membership may rely on different types of information about pay or other factors. Comparisons involving internal equity (the internal value the organization places on jobs, usually established through some type of job evaluation program) are less likely to be made in

the initial job-choice decisions, since the internal hierarchy is not obvious to job candidates. Factors that affect the attractiveness of the organization, such as management practices, quality of supervision or organizational climate may be less known to job candidates, but may make a larger contribution to turnover decisions than characteristics of the compensation system.

In addition to attraction, retention and motivation, compensation systems must also meet secondary objectives which are related to the constraints in which all organizations operate, such as efficiency and equity (Milkovich & Newman, 1993). Compensation systems must have goals of cost-effectiveness and administrative manageability, and include considerations of the organization's ability to pay, compliance with legislation and labor contracts, and effective responses to internal and external labor markets (Hills, Bergmann & Scarpello, 1994). For example, pay secrecy is an administrative strategy that may increase the manageability of the system, in that less information has to be communicated and fewer challenges to fairness may have to be negotiated. However, pay secrecy would also theoretically make it difficult to use the system as an incentive to performance (Wallace & Fay, 1988), since employees may be unaware of the magnitude of potential salary increases available through advancement through their current salary grade or promotions. Similarly, pay levels that are high relative to the market may improve recruitment but have a negative effect on cost effectiveness.

Thus, it is clear that different compensation strategies should theoretically affect compensation effectiveness outcomes differentially. Knowing if, when and how these differential effects may occur could be of great benefit to compensation managers responsible for the design of these programs. For example, if an organization's strategy necessitates attraction and retention of highly skilled workers, what compensation strategy mix would maximize these goals? On the other hand, if the organization needs to increase productivity, enhancing motivation through a properly designed compensation system is essential. Knowing the strategies that will maximize the desired compensation effectiveness outcomes would be invaluable. In this study, we propose to begin an investigation into these design issues by asking compensation managers which strategies they believe are most effective for each of the major compensation program goals. The proposition to be addressed in this study is:

***Proposition:*** *Compensation managers' perception of the effectiveness of the individual goals of compensation (recruitment, retention, motivation, etc.) will be differentially predicted by the type of compensation strategy utilized.*

Because there is little previous work that would guide and direct specific predictions, this proposition does not delineate precise relationships between compensation strategies and measures of compensation program goal effectiveness. One of our goals is exploratory; we seek to investigate possible relationships

that can be built upon in future research. The proposition formally investigated is that no one strategy or strategies will predict effectiveness perception measures, but we are also interested in the pattern of relationships that emerges from our findings.

### **Method**

A questionnaire was sent to 1,121 midwestern organizations, taken from two samples. One sample was from a Dun & Bradstreet database (866 organizations of 200 or more on-site employees from five states: Arkansas; Iowa, Kansas, Missouri, Nebraska); the other was a membership directory of a local HR manager's professional organization (The Human Resource Management Association of Greater Kansas City; 255 organizations). The person in charge of the compensation system, who was identified through telephone calls (for the Dun & Bradstreet sample) or through the membership roster (for the HR professional organization), was sent a copy of the survey. The six page questionnaire asked respondents to answer questions regarding their compensation policies as of January 1, 1994 only for non-union employee groups. From the Dun & Bradstreet (D&B) sample, 121 organizations responded, resulting in a response rate of 14%; for the HR managers' group, 52 responded, for a response rate of 20%. The total response rate was 15%. To ensure that the respondents were comparable to non-respondents, analyses of variances were conducted between these groups for the D&B database (comparable data were not available for the HRMA database). There were no significant differences between the D&B respondents and non-respondents in sales or whether they were private or publicly owned. Respondents did tend to be from slightly larger companies (the mean number of employees for respondents was about 225 more than for non-respondents) and to have been in business longer (the mean of number of years in business was about 10 years more for respondents than for non-respondents). These findings are to be expected, since larger, more established companies would not only have more advanced compensation practices but also would have more staff available to complete the survey. For the HRMA database, the only comparative data available on non-respondents was industry sector, and for both samples chi square analysis found no significant differences between respondents and non-respondents in this variable. To ensure that the respondents from the two samples were comparable and could be analyzed together, analyses of variances were conducted that revealed no significant differences in the major variables.

### **Measures**

#### **Compensation Strategy**

Compensation strategy components were measured using Gomez-Mejia's (1992) scale (see Appendix). In Gomez-Mejia's original study, the individual

items used were averaged to form 15 scales, which were then analyzed using principal component analysis. The end result was one factor, with negative loadings indicating an "algorithmic" strategy (using more routinized and mechanistic pay practices) and positive loadings indicating an "experiential" strategy (using more flexible and participative pay practices). We initially replicated this analysis, but one single factor did not emerge. Further analyses of the 15 scales revealed very low reliabilities for our sample, although Gomez-Mejia's work showed acceptable reliabilities (ranging from .74 to .89). Because of these dramatically different results, which indicate that this scale may not be generalizable across populations, we conducted further analyses, using principal component analysis with varimax rotation, to determine how these variables were meaningful in the current data set.

Because our replication of the previous analysis was so significantly different, assumptions based on the earlier work about the constructs the scale measures were not relevant. This led us to choose principal component analysis, since our goal was not to define an underlying causal model among the variables, as factor analysis would do. Principal component analysis linearly summarizes the data into simpler components (Kim & Mueller, 1978), and we believed it would more adequately satisfy our mission of showing that differing compensation strategy choices affect compensation program goals. Also, we wanted to use factor scores, and this method produces exact scores rather than estimates (Hair, Anderson & Tatham, 1987). Further, factor analysis using maximum likelihood extraction was conducted on these data, resulting in substantially the same factor structure. Varimax rotation was used because of its ability to produce more stable results over different sets of data and to simplify the columns, thus making interpretation easier (Hair, Anderson & Tatham, 1987). Again, other rotation methods (quartimax and equimax) did not substantially change the factor structure.

Using principal component analysis, 11 meaningful factors emerged (using the criteria of eigenvalues greater than 1.0), accounting for 61% of the variance. To ascertain the reliability of these factors, or the degree of association between each component and its factor scale (Kim & Mueller, 1978), we conducted separate principal component analyses on the factors that had heavy loadings (greater than .4) on each component, as recommended by Carmines and Zeller (1979). All 11 of these analyses showed that a single phenomenon was being measured by the major variables of each component (they loaded on one factor, which accounted for 40% or more of the variance; Carmines & Zeller, 1979). Using factor scores, we then created 11 variables that represented compensation strategy choices (Table 1). Using factor scores also had the advantage of providing independent variables that were uncorrelated.

**Table 1**  
**Factor Loadings for Principal Component Analysis of Gomez-Mejia's Compensation Strategy Variables**

	1	2	3	4	5	6	7	8	9	10	11
<b>Component eigenvalue</b>	5.42	3.43	2.52	1.96	1.74	1.61	1.55	1.42	1.27	1.19	1.16
<b>Percentage of variance accounted for</b>	14.3	8.8	6.6	5.2	4.3	4.2	4.1	3.7	3.3	3.1	3.1
Use a job-based system	-.00	.32	-.00	-.00	-.00	-.00	-.00	-.00	-.59	-.00	-.00
Do not use a skill-based system		-.33			.36		-.36				
Emphasis on job evaluation									-.65		
Rewards based on contributions	.51							.43			
Individual over team emphasis							.72				
Emphasis on long term goals											.61
Seniority not important											.79
Emphasis not on short term goals									-.56		
Pay based on group performance	.69										
Large part of pay is variable	.79										
Employees should be risk takers	.65										
Corporate performance is a pay criterion	.71										
Internal equity is important goal		.74									
Try hard to achieve comparable pay across org.		.83									
Higher priority to internal than external equity		.45									-.31
Large pay differentials based on performance	.30		.43					.39			
Provides perks to top management						.80					



**Table 1**  
**Factor Loadings for Principal Component Analysis of Gomez-Mejia's Compensation Strategy Variables *cont'd***

	1	2	3	4	5	6	7	8	9	10	11
Employees have say in pay policies			.84								
Pay decisions are not autocratic			.71								
Preferred salary position is above market		.30							.66		
Preferred benefit position is above market				.83							

- Components:**
1. Pay based on corporate performance
  2. Internal consistency and equity
  3. Participation in designing compensation programs
  4. Benefits
  5. Disclosure of pay practices a key strategy
  6. Hierarchical rather than egalitarian pay
  7. Base salary not a major component of pay
  8. Pay based on individual performance
  9. Pay not based on the job
  10. Monetary rewards versus psychological rewards emphasized
  11. Long term competitiveness

**Compensation Program Effectiveness**

Respondents were asked to rate the effectiveness of the current pay system for both exempt and nonexempt employees using a four-point scale, from highly effective to highly ineffective. Nine dimensions were measured for both exempt and nonexempt employees, and six factors emerged (see Table 2). Based on these factors, six averaged variables were created: compensation program effectiveness in recruitment ( $\alpha = .89$ ), motivating and retaining top employees ( $\alpha = .89$ ), administrative manageability ( $\alpha = .89$ ), cost effectiveness ( $\alpha = .91$ ), retaining average employees ( $\alpha = .89$ ) and encouraging poor performers to leave ( $\alpha = .90$ ).

**Appropriateness of Effectiveness Measures**

Although we believe these compensation effectiveness measures are appropriate, they have some limitations which should be discussed. The first is that they are self-reported responses from compensation managers, who may have a stake in seeing positive relationships between the programs they have



**Table 2**  
**Factor Loadings for Principal Component Analysis of Compensation Effectiveness Variables**

	1	2	3	4	5	6
<b>Component eigenvalue</b>	6.17	2.48	2.03	1.55	1.31	1.09
<b>Percentage of variance accounted for</b>	34.3	13.8	11.3	8.6	7.3	6.0
Attracting large enough pool of exempt applicants	.85					
Attracting large enough pool of nonexempt applicants	.86					
Attracting highly qualified exempt applicants	.76					
Attracting highly qualified nonexempt applicants	.82					
Motivating top performance in exempt employees			.82			
Motivating top performance in nonexempt employees			.74			
Retaining top exempt employees			.85			
Retaining top nonexempt employees			.77			
Retaining average exempt employees					.93	
Retaining average nonexempt employees					.93	
Encouraging below average exempt employees to leave				.95		
Encouraging below average nonexempt employees to leave				.95		
Being a cost effective compensation system-exempt plan						.86
Being a cost effective compensation system-nonexempt plan						.90
Being administratively manageable-exempt plan		.82				
Being administratively manageable-nonexempt plan		.78				
Being easy to communicate to exempt employees		.86				
Being easy to communicate to nonexempt employees		.80				

- Factor names:**
1. Recruitment effectiveness
  2. Administrative manageability
  3. Motivation effectiveness
  4. Encourage poor performers to leave
  5. Retaining average employees
  6. Cost effectiveness

designed and achievement of compensation objectives. However, the responses from the sample contain ample variance and means that do not reflect an extremely strong positive bias (see Table 3 below, variables 5 through 10). If the respondents had greatly inflated their programs' benefits, there may have been more consistently positive results than were seen.

Second, because many compensation managers ultimately have limited impact on the final compensation programs, they may not feel totally responsible for their outcomes and thus are likely to provide fairly objective responses regarding compensation effectiveness. Top management can dramatically affect budgets, philosophies and programs, and the compensation manager does not have omnipotent power over the final package. Additionally, because of the confidentiality of the survey (questionnaires were returned directly to the researcher's university), there is little motivation for respondents to deliberately bias their responses. Therefore, it is unlikely that the respondents would have greatly overestimated the impact of their programs.

Third, as in all self-report studies, the possibility of common method variance should be addressed. Common method variance refers to the fact that "because both measures come from the same source, any defect in the source contaminates both measures" (Podsakoff & Organ, 1986, page 533). Common method variance is present when correlations between measures are not due to "true" relationships between the constructs but simply because the same respondents provide the measures for both constructs. One method of investigating whether this condition exists is Harmon's one factor test (Podsakoff & Organ, 1986), which consists of a factor analysis of all relevant variables. If a large degree of common method variance is present, one factor will emerge (Podsakoff & Organ, 1986; Miceli, Jung, Near & Greenberger, 1991). Such an analysis was conducted on the compensation effectiveness perception and strategy variables in this sample. Fourteen factors emerged, with the first factor (which, in cases of common method variance, would account for a majority of the variance) only accounting for 15% of the variance. Thus, common method variance is unlikely to be at issue here.

Fourth, researchers (Balkin & Gomez-Mejia, 1987; Gomez-Mejia, Page & Tornow, 1982) have asserted that management opinions about effectiveness may actually be *more* valid indicators than "objective" data such as profitability, market share and shareholder value, since these measures are subject to a vast number of contaminating variables, including trends in the economy and other environmental factors. Indeed, researchers have argued that the "bottom line" of compensation effectiveness is its value as perceived by its users. Other researchers concur that self-report measures may, in some cases, represent more accurate descriptions than more objective measures (Howard, Maxwell, Weiner, Boynton & Rooney, 1980; Podsakoff & Organ, 1986). In the present study, since we are interested in the technical success of the compensation program, the only people with the breadth and depth of knowledge to adequately evaluate these dimensions are the compensation managers.

Finally, since we were interested in assessing the separate components of a successful pay system, we were limited in the number of objective measures that were available and within the scope of this study. Because of the previously stated arguments, we concluded that the expert opinions of compensation managers would be valid and appropriate for this study. As Podsakoff and Organ argue, "the practical utility of these types of measures makes them virtually indispensable in many research contexts" (page 540) and may be acceptable if adequate controls, such as Harmon's one factor test, are reported for the data. While we believe that further research into these effectiveness constructs, using multiple measures from multiple constituents are essential, for this initial study in our research we believe that they are acceptable.

### **Control Variables**

Four variables were analyzed as control variables, since past research has found relationships with these variables and compensation strategies and effectiveness. These control variables are sales, size of the organization in number of employees (Day, 1995; Gerhart & Milkovich, 1990; Gomez-Mejia, 1992), extent and process of diversification and life cycle stage (Balkin & Gomez-Mejia, 1990; Gomez-Mejia, 1992; Gomez-Mejia & Balkin, 1992). The magnitude of sales was evenly distributed across respondents: 33% reported sales of over \$500 million; 32% reported sales of under \$50 million. The mean number of employees was 1,253.

The measures of diversification and life cycle stage (see Appendix) were taken from the work of Gomez-Mejia and Balkin (Balkin & Gomez-Mejia, 1990; Gomez-Mejia, 1992; Gomez-Mejia & Balkin, 1992) who had used Rumelt's (1974) earlier work on diversification. The four diversification extent categories include: single product/service firm (95% or more of revenues are derived from a single product/service line); dominant product/service firm (may be several products/services but a dominant product/service accounts for 70% to 94% of revenues); related product/service firm (70% or less of revenues are derived from any single product/service); unrelated product/service firm. Most respondents (46%) judged their organizations to be dominant product; similar numbers judged their organizations to be either single product (26%) or related products (29%). Only one respondent judged the organization to be unrelated.

Process of diversification included two categories: organizations that are vertically integrated with a commitment to an existing product/service and that expand primarily in that product/service area; organizations that prefer to expand by acquiring new businesses, even if unrelated to existing product/service lines. Most respondents (77%) believed their organizations were vertically integrated. Twenty-three percent believed that their organizations expanded outside current product/service lines.

Similarly, the life cycle stages of organizations were analyzed. These stages included: start-up (a small company five or fewer years old, run by an

entrepreneur); growth (sales are growing at 20% or more annually, with technology and company structure changing); mature (growth is stable and slow and products/services are familiar to most prospective users); decline (growth is declining). Most respondents (64%) judged their organizations to be mature. Twenty-seven percent believed their organizations were growing. Only 2% saw their organizations as start-up and only 7% saw them as declining.

Data were analyzed using hierarchical regression analysis for equations for each of the six dependent variables. The five control variables were entered in the first step of the equations. In order to determine the unique variance accounted for over and above the control variables, the eleven compensation strategy variables were entered in the second step of the equation.

### **Results**

Means, standard deviations and the correlation matrix for the major variables can be found in Table 3. In the first step, for all six dependent variables, the control variables entered as a block did not account for significant variance (Table 4). In the second step, the proposition was confirmed for five of the six dependent variables (Table 4). As predicted, there was variation in the specific strategy variables that affected each compensation effectiveness goal, and the compensation strategy variables accounted for at least 20% of the variance for the five measures of effectiveness perceptions in recruitment, motivation, administration, cost and encouraging poor performers to leave. No compensation strategy variables were significantly related to the perceived effectiveness of the compensation system in retaining average performers.

Two compensation strategies showed significant relationships with four of the six dependent effectiveness perception measures. Participation in plan design was predictive of effectiveness in recruitment, motivation, cost effectiveness and encouraging poor performers to leave the organization. An emphasis on internal consistency was predictive of effectiveness perception in recruitment, motivation, administration and cost effectiveness. An emphasis on paying for individual performance was predictive of three effectiveness perception measures: motivational effectiveness, cost effectiveness and encouraging poor performers to leave. Contemporary thinking about compensation practices would predict that participation and incentive pay, since they are innovative and nontraditional approaches, would be associated with effectiveness. However, it is surprising that an emphasis on internal consistency, which has been maligned because it has been seen as unsupportive of organizational goals (Lawler, 1990; Schuster & Zingheim, 1992), would so consistently predict effectiveness perceptions. This finding may indicate that internal consistency is, as many compensation analysts have claimed for decades, a critical component of compensation effectiveness, regardless of organizational strategy.

**Table 3**  
**Means, Standard Deviations and Correlation Matrix**

	Mean	SD	1	2	3	4	5	6	7	8	9	10
<b>Control Variables</b>												
1. Sales	2.80	1.49	1.00									
2. Number full-time employees	1248.28	2460.71	.46	1.00								
3. Diversification extent	2.04	.75	.13	.10	1.00							
4. Life cycle stage	2.76	.60	.12	.01	-.17	1.00						
<b>Compensation effectiveness variables</b>												
5. Recruitment effectiveness	3.14	.62	.26	.18	.04	-.01	1.00					
6. Motivational effectiveness	2.84	.60	.16	.12	.08	-.10	.48	1.00				
7. Administrative manageability	3.11	.68	.02	.01	.15	.02	.32	.32	1.00			
8. Cost effectiveness	3.02	.72	.01	-.02	.13	-.06	.26	.46	.41	1.00		
9. Efficacy in retaining avg. performers	3.27	.65	.03	-.00	-.08	.05	.27	.18	.28	.13	1.00	
10. Efficacy in encouraging poor performers to leave	2.20	.91	.00	.04	.06	-.08	.08	.17	.26	.28	-.07	1.00
<b>Pay strategy variables</b>												
11. Participation in design of plan			-.23	-.14	.11	-.07	.24	.22	.07	.28	-.06	.20
12. Pay for corporate performance			.27	.31	.29	-.20	.18	.26	-.01	.23	.11	-.04
13. Pay disclosure			.20	.05	-.10	.08	.23	.08	.12	.01	.00	-.11
14. Competitiveness			.07	-.03	.01	.02	.15	.28	.28	.09	.01	-.01
15. Monetary rewards			-.03	-.04	-.15	.12	.12	.00	.04	-.01	.08	-.09
16. Low emphasis on base pay			-.08	.01	-.03	-.11	-.05	.10	.07	.00	-.02	-.03
17. Pay for individual performance			.10	-.00	-.02	.10	.08	.20	.16	.29	.07	.29
18. Benefits major part of comp.			.07	-.02	-.03	-.01	.23	.16	.03	-.04	.15	-.03
19. Jobs versus skills			.13	.00	.10	.05	.09	.12	.08	.07	.07	-.02
20. Internal consistency			.00	.11	.07	-.13	.30	.31	.35	.28	.16	.11
21. Hierarchical rewards			.26	.07	.02	-.07	-.04	-.04	-.24	-.14	-.03	-.11

Significance of correlations: .30 or above,  $p < .001$ ; .23 to .29,  $p < .01$ ; .17 to .22,  $p < .05$ .

Compensation effectiveness variables are based on a five-point scale, with 5 indicating the highest level of effectiveness. Since the pay strategy variables are factor scores, their means are 0, standard deviations are 1.0 and correlations with each other are .00. Thus these statistics are not included in this table.

**Table 4**  
**Regression Analyses of Organization and Compensation Strategies On Effectiveness Variables**

	Recruitment Effectiveness		Motivation Effectiveness		Administrative Effectiveness		Cost Effectiveness	
	Beta	$\Delta R^2$	Beta	$\Delta R^2$	Beta	$\Delta R^2$	Beta	$\Delta R^2$
<b><u>Step 1: Control Variables</u></b>		<b>.05</b>		<b>.04</b>		<b>.05</b>		<b>.05</b>
Sales	.121	.033	-.094	-.040				
Number full-time employees	.102	.112	.104	.042				
Diversification extent	-.066	.011	.151	.107				
Diversification process	.117	-.094	-.133	-.200*				
Life cycle stage	-.022	-.152	.039	-.068				
<b><u>Step 2: Compensation Strategies</u></b>		<b>.31***</b>		<b>.32***</b>		<b>.32***</b>		<b>.43***</b>
Participation in design of plan	.343***	.201 *	.031	.333***				
Pay for corporate performance	.071	.193 *	-.060	.336**				
Pay disclosure	.189*	.117	.123	.024				
Long term competitiveness	.136	.274**	.261**	.123				
Monetary rewards	.090	-.009	.039	-.093				
Low emphasis on base pay	.015	.139	.041	.103				
Pay for individual performance	.064	.275**	.140	.321***				
Benefits major part of comp.	.256***	.129	.062	-.075				
Skills versus jobs	.076	.076	.088	.048				
Internal consistency	.299***	.253**	.351***	.338***				
Hierarchical rewards	-.000	-.108	-.222*	-.169				
***	p < .001							
**	p < .01							
*	p < .05							
+	p < .10							

Table 4  
Regression Analyses of Organization and Compensation Strategies On Effectiveness Variables *cont'd*

	Effectiveness in Retaining Average Performers		Effectiveness in Encouraging Poor Performers to Leave	
	Beta	$\Delta R^2$	Beta	$\Delta R^2$
<b><u>Step 1: Control Variables</u></b>		<b>.01</b>		<b>.03</b>
Sales	-.035		-.035	
Number full-time employees	.080		.053	
Diversification extent	.004		.172+	
Diversification process	.051		-.068	
Life cycle stage	.089		.015	
<b><u>Step 2: Compensation Strategies</u></b>		<b>.14</b>		<b>.20*</b>
Participation in design of plan	-.059		.275**	
Pay for corporate performance	.205+		-.090	
Pay disclosure	.031		-.095	
Long term competitiveness	-.055		.107	
Monetary rewards	.086		-.123	
Low emphasis on base pay	-.100		.065	
Pay for individual performance	.080		.283***	
Benefits major part of comp.	.195+		.013	
Skills versus jobs	.118		-.063	
Internal consistency	.180+		.115	
Hierarchical rewards	-.077		-.113	
***	p < .001			
**	p < .01			
*	p < .05			
+	p < .10			

### **Discussion**

Our proposition, that compensation strategies will differentially affect the objectives of an effective compensation system, was supported. However, some of the relationships suggested in the introductory section of this paper were not supported. For example, we suggested that internal consistency may be positively related to retention but not related to recruitment, since those outside the organization would not understand the internal pay structure. Our findings were opposite this prediction. While we did not find relationships between internal consistency and retention, we found that it was predictive of recruitment effectiveness perceptions. We also suggested that pay secrecy would positively affect administrative effectiveness because it requires less salary communication, but secrecy would negatively affect motivation, since employees would be unaware of potential pay increases. We did not find these relationships. We also believed that pay at risk would be positively associated with motivation effectiveness, which these data supported; basing pay on both corporate and individual performance was positively related to motivation effectiveness. However, we had suggested that paying for performance would be negatively associated with recruitment effectiveness, which was not found in these data.

### **Predictors of Recruitment Effectiveness**

Compensation systems are in part designed to attract acceptable candidates to the organization. Most frequently this is conceptualized as offering a package of pay and benefits, along with appropriate working conditions and other psychological accouterments that will be appealing to the appropriate type and quality of candidate. We found that four compensation strategies were significantly related to perceptions of recruitment effectiveness. First, as would be anticipated, was an emphasis on benefits. Since the value of benefits as a recruitment device has increased dramatically over the last few years (ACA, 1993), this finding is not surprising. Of some interest is that an emphasis on benefits did not predict any other effectiveness perception variables. Second, participation in pay program design was predictive of recruitment effectiveness, perhaps indicating that active employee input produces pay programs that are more attractive, not only to current incumbents, but also to job candidates. Third, the relationship between pay disclosure and recruitment may indicate that the more pay information job candidates are able to gather, the more they are apt to perceive that the organization offers adequate financial incentives and is open with key job information. Finally, an emphasis on internal consistency was predictive of perceived recruitment effectiveness. While it is doubtful that external candidates are aware of the level of internal equity present in the organization, it may be that an emphasis on internal equity is positively correlated with pay level. Recent authors have claimed that traditional point-factor job evaluation programs, which are found in pay programs emphasizing internal equity, are



more likely to pay over the market (Lawler, 1990; Schuster & Zingheim, 1992) and thus may be more attractive to recruits. Alternatively, if internal consistency is coupled with pay disclosure, this may communicate to candidates that the organization has an organized and equitable pay structure that rewards appropriately for skills and abilities that the organization values.

### **Motivational Effectiveness**

Four compensation strategies were predictive of perceived motivational effectiveness. Participation in design of pay programs, an emphasis on long-term competitiveness and paying for individual performance were associated with pay programs that were seen as motivational. These findings reflect current professional thinking regarding compensation programs and their ability to elicit appropriate employee behaviors (Lawler, 1990). Individual incentives, when designed properly, have been found to be motivational (Gerhart & Milkovich, 1992), and participation in plan development encourages acceptance and understanding of the plan (Crepanzano & Folger, 1989; Milkovich & Newman, 1993), which may result in increased motivation.

It is interesting that an emphasis on internal consistency was also predictive of motivational effectiveness. This may refute the current philosophy that complicated point-factor job evaluation programs, typically used to establish internal equity, support the status and thus detract from the accomplishment of key organizational goals (Emerson, 1991; Lawler, 1990; Schuster & Zingheim, 1992). Indeed, these results indicate that internal consistency may assist the compensation system in motivating employees toward goal accomplishment.

### **Administrative Manageability**

Emphases on long term competitiveness, internal consistency and egalitarian rather than hierarchical pay were found to be predictive of administrative manageability. These predictors indicate that emphasizing both competitiveness and internal equity are associated with a more easily managed compensation program, facts with which most compensation managers would probably concur. Less emphasis on hierarchical relationships, especially in perquisites and status-related pay and benefit components, was associated with a pay system that is easier to administer, perhaps through fewer grade levels or otherwise simpler programs.

### **Effectiveness in Retaining Average Performers**

No compensation strategy variables were predictive of this measure. However, the lack of associations with the main effects of compensation strategies may be because the variable itself is not seen as a critical goal of compensation programs. While retaining employees who "meet expectations" is theoretically an important compensation goal, it may not be one that is very prominent in the minds of compensation managers or is actively promoted.

**Encouraging Poor Performers to Leave**

Participation in plan design and individually based incentive plans were predictive of encouraging poor performers to leave the organization. The latter finding supports commonly held beliefs that incentive pay will not be attractive to poor performers, since they are unable to reap the same rewards as others while continuing to shirk or perform poorly (Gerhart & Milkovich, 1992; Lawler, 1990), and will thus be more likely to leave. Participation in design of the compensation program may create a program that maximizes perceived fairness and equity based on performance inputs, which sends a message to those who do not perform as well as others that their behavior will not be well rewarded.

**Recommendations for Compensation Managers**

Although further research is needed, some suggestions should be considered regarding the development of compensation programs in specific organizations based on this study. First, different compensation objectives were seen to be supported by different compensation strategies, and a careful analysis of the intent and purpose of compensation in the context of the entire organization's strategic plan should be done to ensure that pay strategies match the objectives for which the program is being designed. For example, does the organizational strategy demand that highly skilled employees be recruited from a competitive labor market? If so, those compensation strategies that affect recruitment should be examined to ensure that they are designed adequately. For example, is the benefits package competitive for the segment of the labor force the organization wishes to attract? Would employee participation in pay plan design produce a compensation package that would be attractive to job candidates? Alternatively, if the organization is geared toward improving productivity and cost-cutting, compensation strategists may carefully evaluate whether the program includes those strategy choices that seem to positively predict motivation and cost effectiveness. Can employees participate in plan design? Is the compensation program internally equitable? Does the organization pay for performance, both at the corporate and individual level? Ensuring that these compensation strategies are utilized may assist in accomplishing the organization's goals of improving productivity and reducing costs.

Two strategies, participation in plan design and internal consistency, were associated with four key compensation goals, and thus may prove to be critical compensation strategies across a number of programs. While there has been much recent negative opinion about establishing internal equity, the respondents surveyed in this study believe that it is associated with a significant number of desirable outcomes. Indeed, since the basic psychological makeup of human beings will probably not change dramatically, we may assume that basic equity judgments will continue to be made. Thus, compensation strategies should take internal equity into consideration.

Our results also indicate that participation in pay program design may be critical to many facets of compensation effectiveness. Thus, compensation managers may want to carefully consider to what degree and extent employees can become involved in this process. While probably not contributing to administrative effectiveness (as indeed our results indicate), establishing compensation programs based on employee input may be worth the time and trouble since they may enhance other important goals of the compensation program.

Compensation managers should consider those compensation strategies that showed limited relationships with effectiveness: an emphasis on benefits and pay disclosure. The extremely high cost of benefits in today's organizations is well known and should be carefully considered in light of these results. If benefits serve primarily a recruiting function, then the benefits package needs to be designed so that it obtains maximum recruitment impact. While a competitive benefits package may have a dramatic effect on other non-compensation issues, such as a sense of security or organizational commitment, it may not produce broad positive compensation effects.

Similarly, pay disclosure was related only to recruitment effectiveness perceptions. Since pay disclosure involves increased communication, potential challenges to fairness and associated complaints and grievances, compensation managers should carefully consider whether a policy emphasizing secrecy or disclosure is appropriate. Once information about a compensation program is disclosed, it will always be disclosed. Especially if disclosure does not result in added motivation or retention, it may be more prudent to lean towards a policy of non-disclosure.

Finally, compensation managers should also take note of those compensation strategies that were not useful in predicting compensation effectiveness. For example, an emphasis on monetary over psychological rewards, low emphasis on base pay and an emphasis on skills versus jobs were not associated with any of the effectiveness measures in this study. These compensation managers place greater value on other strategies as the real drivers of compensation effectiveness.

### **Recommendations for Further Research**

In interpreting these results, it must be kept in mind that our sample was not representative of all US firms. First, our analyses showed that these firms tended to be somewhat larger and older than the nonrespondents. They also reported themselves as being mainly dominant product/service and vertically integrated. Additionally, they are Midwestern firms, often accused of being more conservative in outlook and practices than the rest of the country. Whether these results would generalize to a broader population is not known.

The major limitation of this study is its use of compensation manager ratings of compensation effectiveness. Further research should attempt to measure the pay effectiveness dimensions from multiple constituencies and, if possible, objective sources. For example, recruiters should be surveyed regarding

the effectiveness of the compensation program. The relationship of compensation strategies to cost effectiveness could be examined through analyzing actual payroll and costs of activities associated with compensation. Administrative effectiveness could be ascertained through information obtained from line managers who must administer the program on a day-to-day basis. Further formulation and definition of these constructs are needed and future research should focus on these. There also may be other compensation effectiveness dimensions that would be of interest, such as ability of the system to withstand legal challenges or support labor-management relationships. Further, dimensions could be expanded to include sub-dimensions. For example, recruitment effectiveness could focus on ease of recruiting specific job types, such as R&D positions, clerical positions, etc.

Finally, the compensation strategy measures used in this study were those used previously by other researchers, but we found dramatically different statistical results in our sample. Future research should compare and contrast this scale with others to ascertain its validity and reliability, and/or to develop another more useful and generalizable measure of compensation strategies.

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## Appendix A

### **Compensation Strategy Scale (Balkin & Gomez, 1990; Gomez-Mejia & Balkin, 1992)**

"The following questions ask about the general philosophy and policies of your overall pay system's characteristics. Please indicate your level of agreement using this scale:" (*Scale used: 1 = strongly agree to 5 = strongly disagree*)

1. We use a job-based pay system. That is, factors within the job are key determinants of the amount of pay received by incumbents.
2. We have a skill-based pay system. That is, individuals are rewarded in part on their mastery of job skills.
3. The job is a more important factor than an incumbent's ability or performance in the determination of pay rates in this organization. Heavy emphasis is placed on job evaluation procedures to determine pay levels.
4. We have a strong commitment to distribute rewards based upon contributions to the organization.
5. Individual performance is emphasized as a basis for pay rather than group or team performance.
6. Our pay system has a futuristic orientation. It focuses employees' attention on long-term (two or more years) goals.
7. The employee's seniority does not enter into pay decisions.

8. The pay system in this organization rewards employees for short-term accomplishments during a fixed time period (such as annual or semiannual performance reviews).
9. In this organization, a portion of an employee's earnings is contingent on group or organization performance goals being achieved.
10. We designed our compensation system so that a substantial portion of our compensation costs is variable pay in the form of incentives, bonuses or related rewards.
11. We believe that employees should be risk takers with some of their pay.
12. Corporate performance is used as a criterion for pay decisions and aggregate incentive programs (e.g. gainsharing, profit sharing) for employees.
13. Internal pay equity is an important goal of our pay system.
14. We try hard to achieve comparable pay relationships across different parts of the organization.
15. We give a higher priority to internal pay equity than to external market factors.
16. There is a large pay spread between low performers and high performers in a given job.
17. Our compensation system reflects a low degree of hierarchy in that we try to give a minimum of perks (reserved parking spots, first-class air travel, etc.) to top executives.
18. The base salary is an important part of the total compensation package.
19. The base salary is high relative to other forms of pay (such as bonuses or other incentives) that an employee may receive in this organization.
20. Benefits are an important part of the total pay package.
21. The employee benefits package is very generous compared to what organizations similar to us offer.
22. We offer special pay packages and privileges as status symbols to the higher echelons in the organization.
23. Pay incentives such as a bonus or profit sharing are an important part of the compensation strategy in this organization.
24. Pay incentives are designed to provide a significant amount of an employee's total earnings in this organization.
25. Bonuses are provided often; the frequency of bonuses is viewed at least as important as their magnitude.
26. This organization tries hard to meet the psychological needs of employees by offering intrinsic rewards through such means as job enrichment and quality of work programs. Monetary rewards are underemphasized.
27. While intrinsic aspects of the job are not ignored, this organization clearly uses monetary rewards as a crucial part of its human resource strategy.
28. We try to make our pay system as egalitarian as possible; in other words, there are very few special rewards available to any "elite" groups of employees.
29. Pay policy is applied uniformly across all organizational units.
30. The personnel staff in each business unit has freedom to develop its own compensation programs (if your company has only one business unit, please leave this item blank). (*Since the majority of respondents left this item blank, it was omitted from the analyses.*)
31. There is a minimum of interference from corporate management with respect to pay decisions made by line managers.

32. We keep pay information secret from employees.
33. We have formal policies that discourage employees from divulging their pay to co-workers.
34. Our organization does not openly disclose the administrative procedures on how pay levels and pay raises are established.
35. Employees' feelings and preferences for various pay forms (e.g. bonus v. profit sharing) are taken very seriously by top management.
36. Many different kinds of employees (individual contributors, managers, personnel staff, executives) have a say in pay policies.
37. Pay decisions in this organization are made on an autocratic basis. We tend to "follow the book" very closely. Very few employees have any input to pay decisions.
38. Over most of our jobs, the preferred position of our organization's salary levels with respect to competitors is: (*Responses were: substantially above the market; somewhat above the market; generally equal to the market; somewhat below the market; substantially below the market*)
39. The preferred position of our organization's benefits level with respect to competitors is: (*Responses were same as for number 38.*)