C E Center for Effective Organizations

The Design of Effective Reward Systems

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THE DESIGN OF EFFECTIVE
REWARD SYSTEMS

by

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ABSTRACT

Reviews the effectiveness of a number of different approaches to pay. Considers the role of pay in strategic management and the management of organizational change.

The Design of Effective Reward Systems

Edward E. Lawler III

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Reward systems are one of the most prominent and frequently discussed features of organizations. Indeed, the literature in organizational behavior and personnel management is replete with the examples of their functional as well as their dysfunctional role in organizations (see e.g., Whyte, 1955). All too often, however, a thorough discussion of how they can be a key factor in determining organizational effectiveness is missing.

This chapter will focus on the design choices that are involved in managing a reward system and their relationship to organizational effectiveness rather than on specific pay system technologies. The details of pay system design and management can be obtained from one of a number of sound books on this topic (see e.g., Henderson, 1979, Patten, 1977, and Ellig, 1982). The underlying assumption in this chapter is that, when properly designed, the reward system of an organization can be a key contributor to organizational effectiveness. However, for this to occur careful analysis needs to be made of the role that reward systems can and should play in the strategic plan of the organization.

Objectives of Reward System

The first step in discussing the role of reward systems is to consider what behavioral impact they can have in organizations. That is, we need to first address the outcomes that one can reasonably expect an effective reward system to produce. The research so far on reward systems suggest that potentially they can influence five factors which in turn influence organizational effectiveness.

1. Attraction and Retention - Research on job choice, career choice and turnover clearly shows that the kind and level of rewards an organization offers influences who is attracted to work for an organization and who will continue to work for it (see e.g. Lawler, 1973; Mobley, 1982). Overall, those organizations which give the most rewards tend to attract and retain the most people. This seems to occur because high reward levels lead to high satisfaction, which in turn leads to lower turnover. Apparently this is true because individuals who are presently satisfied with their jobs expect to continue to be satisfied and, as a result, want to stay with the same organization.

The relationship between turnover and organizational effectiveness is not simple. It is often assumed that the lower the turnover rate, the more effective the organization is likely to be. This is a valid generalization because turnover is expensive. Studies that have actually computed the cost of it have found that it can cost an organization five or more times an employee's monthly salary to replace him or her (Macy and Mirvis 1976). However, not all turnover is harmful to organizational effectiveness. Organizations can certainly afford to lose some individuals and, indeed, may profit from losing them, either because they are poor performers or because they are easy to replace. In addition, if replacement costs are low, as they may be in unskilled jobs, it can be more cost effective to keep wages low and suffer with high turnover. Thus, turnover is a matter of rate, who turns over, and replacement cost.

The objective should be to design a reward system that is very effective at retaining the most valuable employees. To do this, a reward system must distribute rewards in a way that will lead the more valuable employees to feel satisfied when they compare their rewards with those received by individuals performing similar jobs in other organizations. The emphasis here is on external comparisons because turnover means leaving an organization for a better situation elsewhere. One way to accomplish this is to reward everyone at a level that is above the reward levels in other organizations. However, this strategy has two drawbacks. In the case of some rewards, such as money, it is very costly. Also, it can cause feelings of intraorganizational inequity because the better performers are likely to feel inequitably treated when they are rewarded at the same level as poor performers in the same organization, even though they are fairly treated in terms of external comparisons. Faced with this situation, the better performers may not quit, but they are likely to be dissatisfied, complain, look for internal transfers, and mistrust the organization.

What then is the best solution? The answer lies in having competitive reward levels and basing rewards on performance. This should encourage the better performers to be satisfied and to stay with the organization. It also should serve to attract achievement-oriented individuals since their like environments in which their performance is rewarded. However, it is important to note that not only must the better performers receive more rewards than poor performers, they must also receive significantly more rewards because they feel they deserve more. Just rewarding them slightly more may do little more than make the better and poorer performers equally dissatisfied.

In summary, managing turnover means managing anticipated satisfaction. This depends on effectively relating rewards to performances, a task that is often difficult. When this cannot be done, all an organization can do is try to reward individuals at an above-average level. In situations where turnover is costly, this should be a cost-effective strategy, even if it involves giving out expensive rewards.

Research has shown that absenteeism and satisfaction are related, although the relationship is not as strong as the one between satisfaction and turnover. When the workplace is pleasant and satisfying, individuals come to work regularly; when it isn't, they don't.

One way to reduce absenteeism is to administer pay in ways that maximize satisfaction. Several studies have also shown that absenteeism can be reduced by tying pay bonuses and other rewards to attendance (Lawler 1981). This approach is costly, but sometimes less costly than absenteeism. It is a particularly useful strategy in situations where both the work content and the working conditions are poor and do not lend themselves to meaningful improvements. In situations where work content or conditions can be improved, such improvements are often the most effective and cost efficient way to deal with absenteeism. Reward system policies are only one of several ways to influence absenteeism, but they are potentially effective if an organization is willing to tie important rewards with coming to work. In many ways this is easier to do than tying rewards to performance, because attendance is more measurable and visible.

2. Motivation of Performance - When certain specifiable conditions exist, reward systems have been demonstrated to motivate performance (Lawler 1971; Vroom 1964). What are those conditions? Important rewards must be perceived to be tied in a timely fashion to effective performance. Organizations get the kind of behavior that leads to the rewards their employees value. This occurs because people have their own needs and mental maps of what the world is like. They use these maps to choose those behaviors that lead to outcomes that satisfy their needs. Therefore they are inherently neither motivated nor unmotivated to perform effectively; performance motivation depends on the situation, how it is perceived, and the needs of people.

The approach that can best help us understand how people develop and act on their mental maps is called expectancy theory (Lawler, 1973). While the theory is complex at first view, it is in fact made up of a series of fairly straightforward observations about behavior. Three concepts serve as the key building blocks of the theory.

A. Performance-Outcome Expectancy. Every behavior has associated with it, in an individual's mind, certain outcomes (rewards or punishments). In other words, individuals believe or expect that if they behave in a certain way, they will get certain things. Examples of expectancies can easily be described. Individuals may have an expectancy that if they produce ten units, they will receive their normal hourly rate, while if they produce fifteen units, they will receive their hourly pay rate plus a bonus. Similarly, individuals may believe that certain levels of performance will lead to approval or disapproval from members of their work group or their supervisor. Each performance level can be seen as leading to a number of different kinds of outcomes, and outcomes can differ in their types.

B. Attractiveness. Each outcome has an attractiveness to a specific individual. Outcomes have different attractivenesses for different individuals. This is true because outcome values result from individual needs and perceptions, which differ because they reflect other factors in an individual's life. For example, some individuals may value an opportunity for promotion or advancement because of their needs for achievement or power, while others may not want to be promoted and leave their current work group because of needs for affiliation with others. Similarly, a fringe benefit, such as a pension plan, may have great value for older workers but little for young employees on their first job.

C. Effort-Performance Expectancy. Each behavior also has associated with it, in an individual's mind, a certain expectancy or probability of success. This expectancy represents the individual's perception of how hard it will be to achieve such behavior and the probability of his or her successful achievement of that behavior. For example, employees may have a strong expectancy (e.g., ninety-ten) that if they put forth the effort, they can produce ten units an hour, but that they only have a fifty-fifty chance of producing fifteen units an hour if they try.

Putting these concepts together, it is possible to make a basic statement about motivation. In general, an individual's motivation to attempt to behave in a certain way is greatest when:

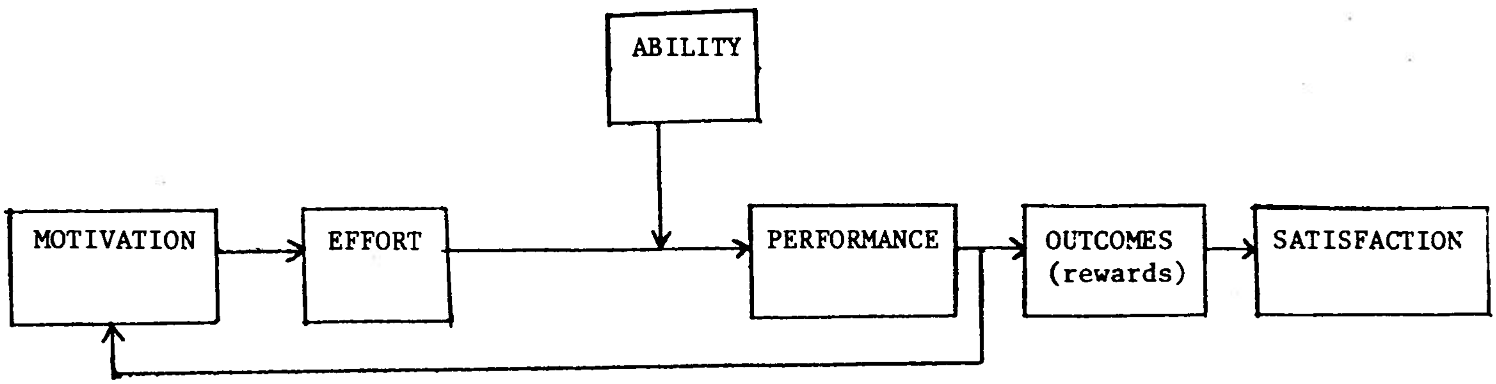
1. The individual believes that the behavior will lead to certain outcomes (performance-outcome expectancy).

2. The individual feels that these outcomes are attractive.

3. The individual believes that performance at a desired level is possible (effort-performance expectancy).

Given a number of alternative levels of behavior (ten, fifteen, or twenty units of production per hour, for example), an individual will choose the level of performance which has the greatest motivational force associated with it, as indicated by a combination of the relevant expectancies, outcomes, and values. In other words, when faced with choices about behavior, an individuals goes thought a process of considering questions such as: "Can I perform at that level if I try?" "If I perform at that level, what will happen?" and "How do I feel about those things that will happen?" The individual then decides to behave in a way that seems to have the best chance of producing positive, desired outcomes.

On the basis of these concepts, it is possible to construct a general model of behavior in organizational settings (see Figure 1). Working from left to right in the model, motivation is seen as the force on an individual to expend effort. Motivation leads to an observed level of effort by the individual. Effort alone, however, is not enough. Performance results from a combination of the effort that an individual puts forth <u>and</u> the level of that individual's ability. Ability, in turn, reflects the individual's skills, training, information, and talents. Effort thus combines with ability to produce a given level of performance. As a result of performance, the individual attains certain outcomes. The model indicates this relationship in a dotted line, reflecting the fact that sometimes people perform but do not get outcomes. As this process of performance-reward occurs, time after time, the actual events serve to provide information that influences an individual's perceptions (particularly expectancies) and thus influences motivation in the future. This is shown in the model by the line connecting the performance outcome link with motivation.



A person's motivation is a function of:

a. Effort-to-performance expectancies
b. Performance-to-outcome expectancies
c. Perceived attractiveness of outcomes

Figure 1.

The Expectancy Theory Model

Outcomes, or rewards, fall into two major categories. First, the individual obtains outcomes from the environment. When individuals perform at a given level, they can receive positive or negative outcomes from supervisors, co-workers, the organization's reward system, or other sources. A second type of outcome occurs purely from the performance of the task itself (e.g., feelings of accomplishment, personal worth, achievement, etc.). In a sense individuals give these rewards to themselves when they feel they are deserved. The environment cannot give them or take them away directly; it can only make them possible.

The model also suggests that satisfaction is best thought of as a result of performance rather than as a cause of it. Strictly speaking, it does influence motivation in some ways. For instance, when it is perceived to come about as a result of performance, it can increase motivation because it strengthens people's beliefs about the consequences of performance. Also, it can lead to a decrease in the importance of certain outcomes, and as a result, decrease the motivation for those performances which are seen to lead to whatever reward becomes less important.

In many ways, the expectancy model is a deceptively simple statement of the conditions that must exist if rewards are to motivate performance. It is deceptive in the sense that it suggests all an organization has to do is actually relate pay and other frequently valued rewards to obtainable levels of performance. Not only is this <u>not</u> the only thing an organization has to do, it is a very difficult task to accomplish.

In order for employees to believe that a performance-based pay relationship exists, the connection between performance and rewards must be visible, and a climate of trust and credibility must exist in the organization. The reason why visibility is necessary should be obvious; the importance of trust may be less so. The belief that performance will lead to rewards is essentially a prediction about the future. For individuals to make this kind of prediction they have to trust the system that is promising them the rewards. Unfortunately, it is not always clear how a climate of trust in the reward system can be established. However, as will be discussed later, research suggests that a high level of openness and the use of participation can contribute to trust in the pay system.

3. Culture - Reward systems are one feature of organizations that contribute to their overall culture or climate. Depending upon how reward systems are developed, administered, and managed, they can cause the culture of an organization to vary quite widely. For example, they can influence the degree to which it is seen as a human resources oriented culture, an entrepreneurial culture, an innovative culture, a competence based culture, and a participative culture.

Reward systems have the ability to shape culture precisely because of their important influence on motivation, satisfaction, and membership. The behaviors they cause to occur become the dominant patterns of behavior in the organization and lead to perceptions and beliefs about what an organization stands for, believes in, and values. As specific reward system design decisions are discussed in this chapter, attention will be focused on their implications for the culture of organizations.

Perhaps the most obvious tie in between pay system practice and culture concerns the practice of performance-based pay. The absence/presence of this policy can have a dramatic impact on the culture of an organization because it so clearly communicates to organization members what the norms are in the organization about performance. Many other features of the reward system also influence culture. For example having relatively high pay levels can produce a culture in which people feel they are an elite group working for a top-flight company, while introducing such innovative pay practices as flexible benefits can produce a culture of innovativeness. Finally, having employees participate in pay decisions can produce a participative culture in which employees are generally involved in business decisions and as a result are committed to the organization and its success.

4. Reinforce and Define Structure - The reward system of an organization can reinforce and define the organization's structure (Lawler, 1981). Often this feature of reward systems is not fully considered in the design of reward systems. As a result, their impact on the structure of an organization is unintentional. This does not mean, however, that the impact of the reward system on structure is usually minimal. Indeed, it can help define the status hierarchy, the degree to which people in technical positions can influence people in line management positions, and it can strongly influence the kind of decision structure which exists. As will be discussed later, the key features here seem to be the degree to which the reward system is hierarchial and the degree to which it allocates rewards on the basis of movements up the hierarchy.

5. Cost - Reward systems are often a significant cost factor. Indeed, the pay system alone may represent over 50% of the

organization's operating cost. Thus, it is important in strategically designing the reward system to focus on how high these costs should be and how they will vary as a function of the organization's ability to pay. For example, a reasonable outcome of a well-designed pay system might be an increased cost when the organization has the money to spend and a decreased cost when the organization does not have the money. An additional objective might be to have lower overall reward system costs than business competitors.

In summary, reward systems in organizations should be looked at from a cost benefit perspective. The cost can be managed and controlled and the benefits planned for. The key is to identify the outcomes needed in order for the organization to be successful and then to design the reward system in a way that these outcomes will in fact be realized.

Relationship to Strategic Planning

Figure 2 presents a way of viewing the relationship between strategic planning and reward systems. It suggests that once the strategic plan is developed the organization needs to focus on the kind of human resources, climate, and behavior that is needed in order to make it effective. The next step is to design reward systems which will motivate the right kind of performance, attract the right kind of people, and create a supportive climate and structure.

Figure 3 suggests another way in which the reward system needs to be taken into consideration in the area of strategic planning. It suggests that before the strategic plan is developed in an existing organization it is important to assess a number of things including the current reward systems and to determine what kind of behavior, climate and structure they are supportive of. This step is needed so that when

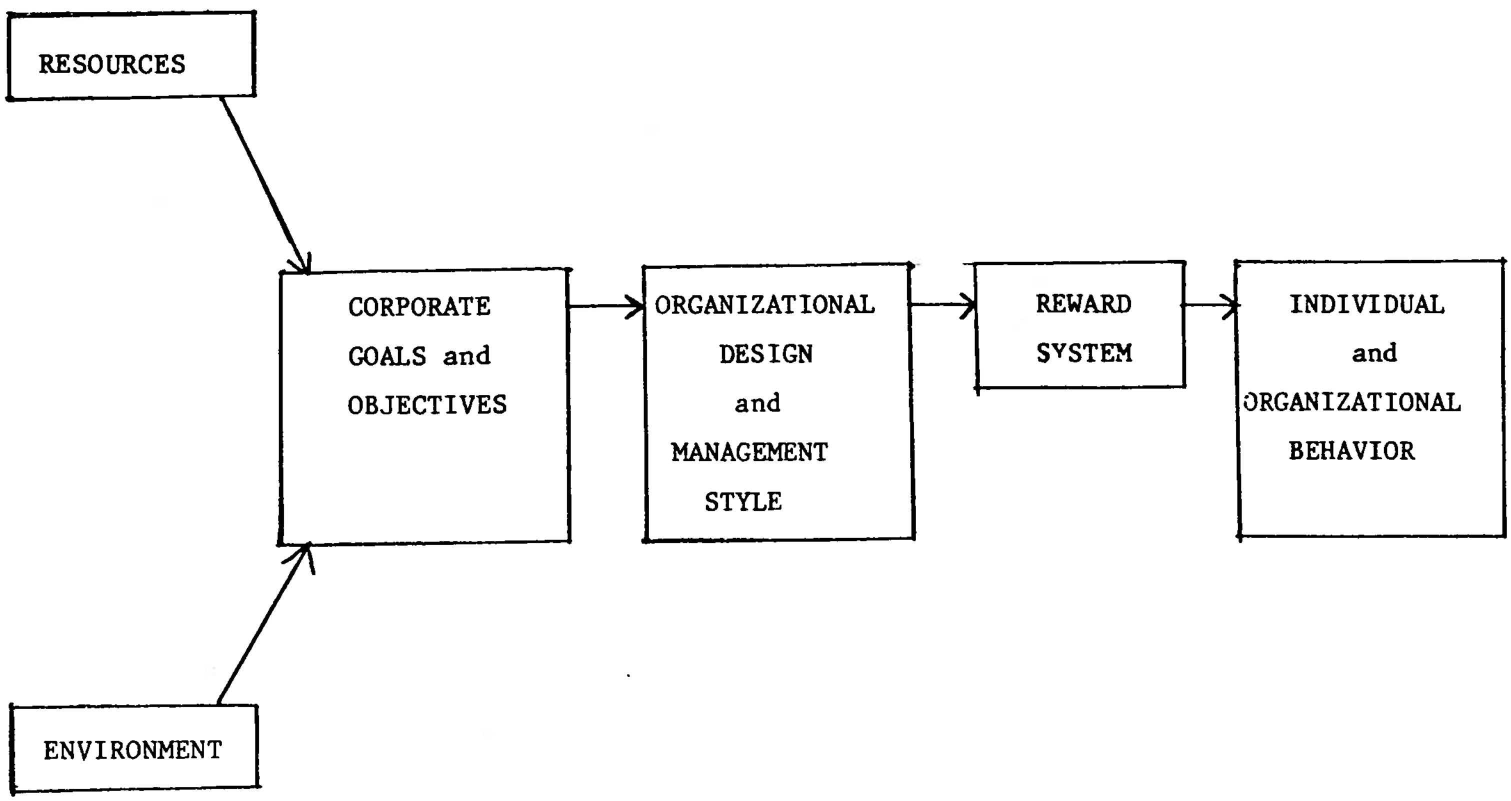

RESOURCES
CORPORATE GOALS and OBJECTIVES
ORGANIZATIONAL DESIGN and MANAGEMENT STYLE
REWARD SYSTEM
INDIVIDUAL and ORGANIZATIONAL BEHAVIOR
ENVIRONMENT

Figure 2.

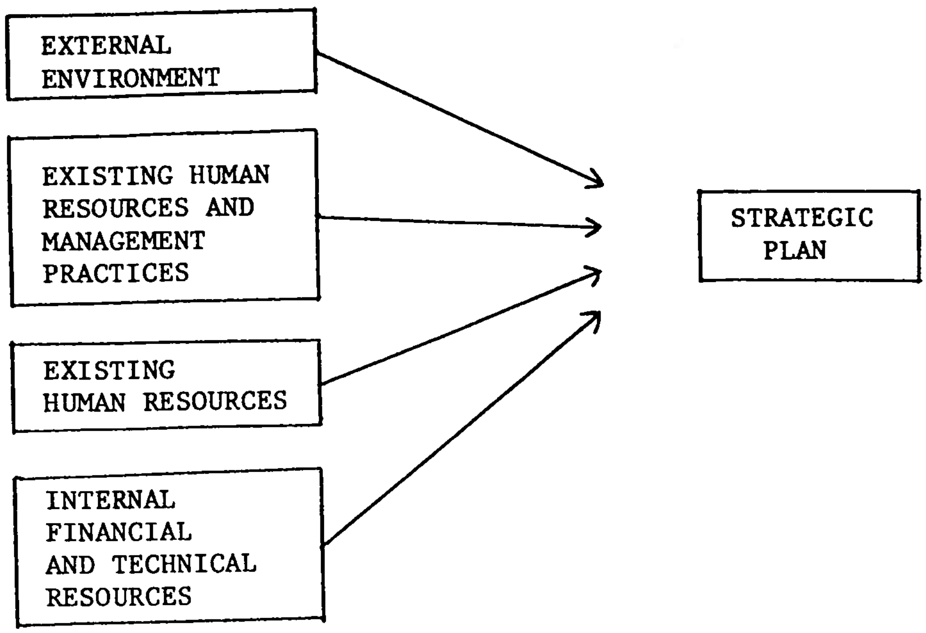

EXTERNAL
ENVIRONMENT
EXISTING HUMAN
RESOURCES AND
MANAGEMENT
PRACTICES
EXISTING
HUMAN RESOURCES
INTERNAL
FINANCIAL
AND TECHNICAL
RESOURCES
STRATEGIC
PLAN

Figure 3.

the strategic plan is developed it is based on a realistic assessment of the current condition of the organization and the changes which are likely to be needed to implement the new strategic plan. This point is particularly pertinent to organizations that are considering going into new lines of business, developing new strategic plans, and acquiring new divisions.

Often, new lines of business require a different behavior and therefore a different reward system. Simply putting the old reward system in place in the new business is often not good enough and indeed can lead to failure in the new business. On the other hand, developing a new reward system for the new business can cause problems in the old business because of the type of comparisons which are made between different parts of the same organization. This is not to say that organizations should avoid venturing into new businesses, it is merely to say that a careful assessment of kinds of reward system changes that are needed should take place before organizations enter into new business sectors.

Design Options

There are almost an infinite number of ways to design and manage reward systems in organizations. This is because there are a host of rewards that can be given and of course a large number of ways that they can be distributed. The focus in the remainder of this chapter will be on the visible extrinsic rewards that an organization controls and that can as a matter of policy and practice be allocated to members on a targeted basis. Included will be pay, promotion, status symbols and perquisites, little attention will be given to such intrinsic rewards as feelings of responsibility, competence, and personal growth and development.

A useful dichotomy in thinking about options in the design of reward systems is the process/content one. All organizational systems have a content or structural dimension as well as a process dimension. The structural or content dimension of a reward system refers to the formal mechanisms, procedures, and practices (e.g. the salary structures, the performance appraisal forms) in short, the nuts and bolts of the system.

The process side refers to the communication and decision process parts of the system. A key issue here involves the degree of openness with respect to information about how the reward system operates and how people are rewarded. A second issue is the degree of participation that is allowed in the design of the reward system and the ongoing administration of it. Many organizations without ever choosing to, administer rewards in a top down secretive way. As will be discussed further, this is not the only way that rewards can be administered.

There is one other important reward system design decision that needs to be considered. Reward systems play important roles in planned organizational change efforts. They can aid or inhibit the installation of changes designed to increase effectiveness. A key design decision concerns how reward system changes will be articulated with other changes. They can, for example, be in either a lag or a lead position with respect to other changes. As will be noted later, the option of not changing them is typically not open because major changes in other important organizational systems almost always require changes in the reward systems if the systems of an organization are to fit each other in an effective manner.

The discussion of design choices will begin by looking at some key structural choices and then turn to a consideration of some key process choices. Finally the issue of pay and organizational change will be considered.

Structural Decisions

Basis for Rewards

Traditionally in organizations such rewards as pay and perquisites are based on the type of jobs that people do. Indeed, with the exception of bonuses and merit salary increases, the standard policy in most organizations is to evaluate the job, not the person, and then to set the reward level. This approach is based on the assumption that job worth can be determined and that the person doing the job is worth only as much to the organization as the job itself is worth. This assumption is in many respects valid since through such techniques as job evaluation programs it is possible to determine what other organizations are paying people to do the same or similar jobs. Among the advantages of this system is that it assures an organization that its compensation costs are not dramatically out of line with those of its competitors and it gives a somewhat objective basis to compensation practices.

An alternative to job based pay which has recently been tried by a number of organizations is to pay individuals for the skills that they possess. In many cases this will not produce dramatically different pay rates than are produced by paying for the nature of the job. After all the skills that people have usually match reasonably well the jobs that they are doing. It can, however, produce some different results in several respects. Often people have more skills than the job uses and in such cases these individuals are paid more than they would be paid under a job based system. In other cases individuals don't have the skills when they first enter a job and do not deserve the kind of pay that goes with the job. In these cases individuals have to earn the right to be paid whatever it is the job related skills are worth.

Perhaps the most important changes that are introduced when skill based or competence based pay is used occur in the kind of climate and motivation it produces in an organization. Instead of people being rewarded for moving up the hierarchy, people are rewarded for increasing their skills and developing themselves. This can create in the organization a climate of concern for personal growth and development and of course it can produce a highly talented work force. It also can decrease the attractiveness of upward mobility and the type of career progression people aspire to. In the case of factories where this system has been used it typically means that many people in the organization can perform multiple tasks and thus the work force is highly knowledgeable and flexible.

In most cases where skills based pay has been tried it tends to produce an interesting mix of positive and negative features as far as the organization is concerned (Lawler, 1981). Typically, it tends to produce somewhat higher pay levels for individuals but this is usually offset by greater work force flexibility. This flexibility often leads to lower staffing levels (fewer indirect and staff people are needed), fewer problems when absenteeism or turnover occur, and indeed it often leads to lower absenteeism and turnover itself because people like the opportunity to utilize and be paid for a wide range of skills. On the other hand, skill based pay can be rather challenging to administer because it is not clear how one goes to the outside marketplace and decides, for example, how much a skill is worth. Skill assessment can also often be difficult to accomplish. There are a number of well developed systems for evaluating jobs and comparing them to the marketplace but there are none which really do this with respect to the skills an individual has.

There are no well established rules to determine which organizational situations fit job based pay and which fit skill or competence based pay. In general, skill based pay seems to fit those organizations that want to have a flexible relatively permanent work force that is oriented toward learning, growth, and development. It also seems to fit particularly well new plant startups and other situations where the greatest need is for skill development. Despite the newness and the potential operational problems with skill based pay, it does seem to be a system that more and more organizations will be using.

<u>Performance Based</u>

Perhaps the key strategic decision that needs to be made in the design of any reward system is whether or not it will be based on performance. Once this decision is made, a number of other features of the reward system tend to fall into place. The major alternative to basing pay on performance is to base it on seniority. Many government agencies, for example, base their rates on the job the person does and then on how long they have been in that job. In Japan, individual pay is also often based on seniority, although individuals may receive bonuses based on corporate performance.

Most business organizations in the United States say that they reward individual performance and they call their pay system and their promotion system merit based. Having a true merit pay or promotion system is often easier said than done, however. Indeed, it has been observed that many organizations would be better off if they didn't try to relate pay and promotion to performance and relied on other bases for motivating performance (Kerr 1975; Goldberg, 1977; Hills, 1979). The logic for this statement stems from the difficulty of specifying what kind of performance is desired and then determining whether and in fact it has been demonstrated. There is ample evidence that a poorly designed and administered reward system can do more harm than good (see e.g., Whyte, 1955, Lawler, 1971). On the other hand, there is evidence that when pay is effectively related to the desired performance, it can help to motivate, attract and retain outstanding performers. Thus, when it is feasible it is usually desirable to relate pay to performance.

There are numerous ways to relate pay to performance and often the most important strategic decision that organizations make is how they do this. The options open to organization are enormous. The kind of pay reward that is given can vary widely and include such things as stock and cash. In addition, the frequency with which rewards are given can vary tremendously from time periods of a few minutes to many years. Performance can be measured at the individual level so that each individual gets a reward based on his or her performance. Rewards also can be given to groups based on the performance of the group and rewards can be given based on the performance of total organizations. This gives the same reward to everyone in an organization. Finally, there are many different kinds of performance which can be rewarded. For example, managers can be rewarded for sales increases, productivity volumes, their ability to develop their subordinates, their cost reduction ideas, and so on.

Rewarding some behaviors and not others has clear implications for performance and thus decisions about what is to be rewarded need to be made carefully and with attention to the overall strategic plan of the business (see, for example, Galbraith and Nathanson, 1978, Salscheider, 1981). Consideration needs to be given to such issues as short vs. long term performance, risk taking vs. risk aversion, division performance vs. total corporate performance, ROI maximization vs. sales growth, and so on. Once the strategic plan has been developed to the point where key performance objectives have been defined, then the reward system needs to be designed to motivate the appropriate performance. Decisions about such issues as whether to use stock options (a long term incentive), for example, should be made only after careful consideration of whether they are supportive of the kind of behavior that is desired (see e.g. Crystal, 1978, Ellig, 1982). At the top management level of large organizations, it is quite likely that the managers of different divisions of businesses should be rewarded for different kinds of performance. Growth businesses call for different rewards systems than do "cash cows" because the managers are expected to produce different results (See Stata and Maidique, 1980 for an example).

It is beyond the scope of this chapter to go into any great detail about the pros and cons of the many approaches to relating pay to performance. Table 1 gives an idea of some of the design features which are possible in a reward system and some of the pluses and minuses associated with them.

First, each plan is evaluated in terms of its effectiveness in creating the perception that pay is tied to performance. In general, this indicates the degree to which the approach ties pay to performance

Table 1
Ratings of Various Pay Incentive Plans*

Employee		Tie Pay to performance	Negative Effects Side	Cooperation	Encourage Acceptance
Salary Reward					
Individual plan	Productivity	4	1	1	4
	Cost effectiveness	3	1	1	4
	Superiors' rating	3	1	1	3
Group plan	Productivity	3	1	2	4
	cost effectiveness	3	1	2	4
	Superiors' rating	2	1	2	3
Organizational plan	Productivity	2	1	3	4
	Cost effectiveness	2	1	2	4
Individual plan	Productivity	5	3	1	2
	Cost effectiveness	4	2	1	2
	Superior's rating	4	2	1	2
Group plan	Productivity	4	1	3	3
	Cost effectiveness	3	1	3	3
	Superiors' rating	3	1	3	3
Organizational plan	Productivity	3	1	3	4
	Cost effectiveness	3	1	3	4
	Profit	2			

* On a scale of 1 to 5, 1 = low and 5 = high

in a way that leads employees to believe that higher pay will follow good performance. Second, each plan is evaluated in terms of whether or not it resulted in the negative side effects that often are produced by performance-based pay plans. These include social ostracism of good performers, defensive behavior, and giving false data about performance. Third, each plan is evaluated in terms of the degree to which it encourages cooperation among employees. Finally, employee acceptance of the plan is rated. The ratings range from 1 to 5; a 5 indicates that the plan is generally high on the factor and a 1 indicates it is low. The ratings were developed based on a review of the literature and on my experience with the different types of plans (see for example, Lawler 1971).

A number of trends appear in the ratings. Looking only at the criterion of tying pay to performance, we we see that the individual plans tend to be rated highest; group plans are rated next; and organizational plans are rated lowest. This occurs because in group plans, to some extent, and in organizational plan, to a great extent, an individual's pay is not directly a function of his or her behavior. An individual's pay in these situations is influenced by the behavior of many others. In addition, when some types of performance measures (e.g. profits) are used, pay is influenced by external conditions which employees cannot control.

Bonus plans are generally rated higher than pay raise and salary increase plans. This is due to the fact that with bonus plans it is possible to substantially vary in individual's pay from time period to time period. With salary increase plans, this is very difficult since past raises tend to become an annuity.

Finally, note that approaches that use objective measures of performance are rated higher than those that use subjective measures. In general, objective measures enjoy higher credibility; that is, employees will often accept the validity of an objective measure, such as sales volume or units produced, when they will not accept a superior's rating. When pay is tied to objective measures, therefore, it is usually clearer to employees that pay is determined by performance. Objective measures are also often publicly measurable. When pay is tied to them, the relationship between performance and pay is much more visible than when it is tied to a subjective, nonverifiable measure, such as a supervisor's rating. Overall, the suggestion is that individually-based bonus plans that rely on objective measures produce the strongest perceived connection between pay and performance.

The ratings of the degree to which plans contribute to negative side effects reveal that most plans have little tendency to produce such effects. The notable exceptions here are individual bonus and incentive plans at the nonmanagement level. These plans often lead to situations in which social rejection and ostracism are tied to good performance, and in which employees present false performance data and restrict their production. These side effects are particularly likely to appear where trust is low and subjective productivity standards are used.

In terms of the third criterion - encouraging cooperation - the ratings are generally higher for group and organizational plans than for individual plans. Under group and organizational plans, it is generally to everyone's advantage that an individual work effectively, because all share in the financial fruits of higher performance. This is not true under an individual plan. As a result, good performance is much more likely to be supported and encouraged by others when group and organizational plans are used. If people feel they can benefit from another's good performance, they are much more likely to encourage and help other workers to perform well than if they cannot benefit and may be harmed.

The final criterion--employee acceptance--shows that, as noted earlier, most performance-based pay plans have only moderate acceptance. The least acceptable seems to be individual bonus plans. Their low acceptance, particularly among nonmanagement employees, seems to stem from their tendency to encourage competitive relationships between employees and from the difficulty in administering such plans fairly.

It should be clear that no one performance-based pay plan represents a panacea. It is therefore unlikely that any organization will ever be completely satisfied with the approach it chooses. Furthermore, some of the plans that make the greatest contributions to organizational effectiveness do not make the greatest contributions to quality of work life, and vice versa. Still, the situation is not completely hopeless. When all factors are taken into account, group and organizational bonus plans that are based on objective data, and individual level salary increase plans, rate high.

Many organizations choose to put individual on multiple or combination reward systems. For example, they may put individuals on a salary increase system which rewards them for their individual performance while at the same time giving everybody in the division or plant a bonus based on divisional performance. Some plans measure group or company performance and then divide up the bonus pool generated by the performance of a larger group among individuals based on individual performance. This has the effect of causing individuals to be rewarded for both individual and group performance in the hope that this will cause individuals to perform all needed behaviors (see e.g., Lincoln, 1951; Fox, 1979).

A common error in the design of many pay for performance systems is the tendency to focus on measurable short-term operating results because they are quantifiable and regularly obtained anyway. Many organizations reward their top level managers in particular on the basis of quarterly or annual profitability (Fox, 1979). This can have the obvious dysfunctional consequence of causing managers to be very short-sighted in their behavior and to ignore strategic objectives which are important to the long-term profitability of the organization. A similarly grievous error can be the tendency to depend on completely subjective performance appraisals for the allocation of pay rewards. Considerable evidence exists to show that these performance appraisals are often biased and invalid and instead of contributing to positive motivation and a good work climate that improves superior subordinate relationships they lead to just the opposite (see e.g. DeVries, Morrison, Shellman and Gerlach, 1981; Latham and Wexley, 1981). These are just two of the most common errors that can develop in the administration of performance reward systems. Other common errors include the giving of too small rewards, failure to clearly explain systems, and poor administrative practices.

In summary, the decision of whether or not to relate pay to performance is a crucial one in any organization. The error of automatically assuming that they should be related can be a serious one. Admittedly, the advantages of doing it effectively are significant and can greatly contribute to the organizational effectiveness. What is often overlooked is that doing it poorly can have more negative consequences than positive one. Specifically, if performance is difficult to measure and/or rewards are difficult to distribute based on performance, the effect of the pay for performance system can be the motivation of counter-productive behaviors, law suits charging discrimination, and the creation of a climate of mistrust, low credibility, and managerial incompetence. On the other hand, total abandonment of pay for performance means that the organization gives up a potentially important motivator of performance and as a result may condemn itself to a reduced level of performance. The ideal, of course, is to crease conditions where pay can be effectively related to performance and as a result have it be an important contributor to the effectiveness of the organization.

Market Position

The reward structure of an organization influences behavior partially as a function of how the amount of rewards given compare to what other organizations give. Organizations frequently have well developed policies about how their pay levels should compare with the pay levels in other companies. For example, some companies (e.g. IBM) feel it is important to be a leading payer and they consciously set their pay rates at a level that is higher than that of any of the companies they compete with. Other companies are much less concerned about being in the leadership position with respect to pay and as a result are content to target their pay levels at or below the market for the people they hire. This structural issue in the design of pay systems is a critical one because it can strongly influence the kind of people that are attracted and retained by an organization as well as influencing the turnover rate and the selection ratio. Simply stated, those organizations that adopt a more aggressive stance with respect to the marketplace end up attracting and retaining more individuals. From a business point of view this may pay off for them, particularly if turnover is a costly factor in the organization and if a key part of the business strategy demands attracting and retaining highly talented individuals.

On the other hand, if many of the jobs in the organizations are low-skilled and people are readily available in the labor market to do them, then a corporate strategy of high pay may not be effective. It can increase labor costs and produce a minimum number of benefits. Of course, organizations don't have to be high payers for all the jobs. Indeed, some organizations identify certain key skills that they need and adopt the stance of being a high payer for them and an average or below average payer for other skills. This has some obvious business advantages in terms of allowing organizations to attract the critical skills that it needs to succeed and at the same time to control costs.

Although it is not often recognized, the kind of market position that a company adopts with respect to its reward systems can also have a noticeable impact on organization climate. For example, a policy which calls for above market pay can contribute to the feeling in the organization that it is an elite organizational, that people must be competent to be there and that they are indeed fortunate to be there. A policy which splits certain skill groups into a high pay position and leaves the rest of the organization at a lower pay level can on the other hand contribute to a spirit of elite groups within the organization and cause some divisive social pressures.

Finally, it is interesting to note that some organizations try to be above average in non-cash compensation as a way of competing for the talent they need. They talk in terms of producing an above-average quality of work life and stress not only hygiene factors but interesting and challenging work. This stance potentially can be a very effective one, because it puts organizations in the position of attracting people who value these things and could give them a competitive edge at least with these people.

In summary, the kind of market position that an organization has with respect to its total reward package is crucial in determining the behavior of the members as well as the climate of the organization. It needs to be carefully related to the general business strategy of the organization and, in particular, to the kind of human resources that it calls for and to the organization climate which is called for.

Internal - External Pay Comparison Oriented

Organizations differ in the degree to which they strive toward internal equity in their pay and reward systems. Those organizations that are highly internal equity oriented work very hard to see that individuals doing similar work will be paid the same even though they are in very different parts of the country, and in different businesses. Some corporations (e.g. IBM) set the national pay structure for their organization based on the highest pay that a job receives anywhere in the country. Those organizations that do not stress internal equity typically focus on the external labor market as the key determinant of what somebody should be paid and although this does not necessarily produce different pay for people doing the same job, it may. For example, the same job in different industries, electronics and auto, may be paid quite differently.

There are a number of advantages and disadvantages to the strategy of focusing on internal pay comparisons and paying all people in the similar jobs the same regardless of where they are in the organization. It can make the transfer of people from one location to another easier since there won't be any pay differences to contend with. In addition, it can produce an organizational climate of homogeneity and the feeling that all work for the same company and are all treated well or fairly. It also can reduce or eliminate the tendency of people to want to move to a higher paying division or location and the tendency for rivalry and dissatisfaction to develop within the organization because of poor internal pay comparisons.

On the other hand, a focus on interal equity can be very expensive particularly if the organization is diversified and as usually happens, pay rates across the corporation get set at the highest level that the market demands anywhere in the corporation (Salscheider, 1981). The disadvantage of this is obvious. It causes organizations to pay a lot more money than is necessary in order to attract and retain good people. Indeed, in some situations it can get so severe that organizations become non-competitive in certain businesses and industries and find that they have to limit themselves to those businesses where their pay structures make their labor costs competitive. Overly high labor costs have, for example, often have made it difficult for auto and oil and gas companies to compete in new business areas.

In summary, the difference between focusing on external equity and internal equity is a crucial one in the design of pay systems. It can determine the cost structure as well as the climate and behavior of organizations. The general rule is that highly diversified companies find themselves pulled more strongly toward an external market orientation while organizations that are single industry or single technology based typically find themselves more comfortable with an internal equity emphasis.

Centralized/Decentralized Reward Strategy

Closely related to the issue of internal versus external equity is the issue of a centralized versus decentralized reward system strategy. Those organizations that adopt a centralized strategy typically assign to corporate staff groups the responsibility for seeing that such things as pay practices are similar throughout the organization. They typically develop standard pay grades and pay ranges, standardized job evaluation systems, and perhaps standardized promotion systems. In decentralized organizations, policy and practice in the area of pay and promotion and other important reward areas is left to local option. Sometimes the corporations have broad guidelines or principles that they wish to stand for but the day to day administration and design of the system is left up to the local entity.

The advantages of a centralized structure rest primarily in the expertise that can be accumulated at the central level and the degree of homogeneity which is produced in the organization. This homogeneity can lead to a clear image of the corporate climate, feelings of internal equity, and the belief that the organization stands for something. It also eases the job of communicating and understanding what is going on in different parts of the organization. The decentralized strategy allows for local innovation and of course closely fitting the practices to the particular business.

Just as is true with many other critical choices, there is no right choice between a centralized and decentralized approach to reward system design and administration. Overall, the decentralized system tends to make the most sense when the organization is involved in businesses that face different markets and perhaps are at different points in their maturity (Greiner, 1972; Galbraith and Nathanson, 1978). It allows those unique practices to surface which can give a competitive advantage to one part of the business but may prove to be a real hindrance or handicap to another. For example, such perquisites as cars are often standard operating procedure in one business while they are not in another. Similarly, extensive bonuses may be needed to attract one group of people, e.g., oil exploration engineers, while it makes little sense in attracting other groups, e.g., research scientists. Overall then, an organization needs to carefully look at its mix of businesses and the degree it wants to stand for a certain set of principles or policies across all its operating divisions and then decide whether a centralized or decentralized reward strategy is likely to be most effective.

Degree of Hierarchy

Closely related to the issue of job based versus competence based pay is the strategic decision concerning the hierarchial nature of the reward systems in an organization. Often no formal decision is ever made to have relatively hierarchial or relatively egalitarian approach to rewards in an organization. A hierarchial approach simply happens because it is so consistent with the general way organizations are run.

Hierarchial systems usually pay people greater amounts of money as they move higher up the organization ladder, and give people greater perquisites and symbols of office as they move up. The effect of this approach is to strongly reinforce the traditional hierarchial power relationships in the organization and to create a climate of different status and power levels. In steeply hierarchial reward systems the reward system may have more levels in it than the formal organization chart and as a result create additional status differences in the organization.

The alternative to a hierarchial system is one in which differences in rewards and perquisites that are based only on hierarchial level are dramatically downplayed. For example, in those large corporations (e.g., Digital Equipment Corporation) that adopt a egalitarian stance to rewards, such things as private parking spaces, executive restrooms, special entrances etc. are eliminated. People from all levels in the organization eat together, work together, and travel together. Further, individuals can be relatively highly paid by working their way up a technical ladder and do not have to go into a management ladder in order to gain high levels of pay. This less hierarchial approach to pay and other rewards produces a quite different climate in an organization than does the hierarchial one. It tends to encourage decision making by expertise rather than by hierarchical position and it draws fewer status differences in the organization.

As with all reward system strategic choices there is no right or wrong answer as to how hierarchial a system should be. In general, a steeply hierarchial system makes the most sense when an organization needs relatively rigid bureaucratic behavior, strong top down authority and a strong motivation for people to move up the organizational hierarchy. A more egalitarian approach fits with more participative management style, and the desire to retain technical specialists and experts in non-management roles or lower level management roles. It is not surprising, therefore, that many of the organizations which have emphasized egalitarian perquisites are in high technology and knowledge based industries.

Reward Mix

The kind of rewards that organizations give to individuals can vary widely. The money, for example, that is given can come in many forms varying all the way from stock through medical insurance. Organizations can choose to reward people almost exclusively with cash, downplaying fringe benefits, perquisites, and status symbols. The major advantage of paying in cash is that the value of cash in the eyes of the recipient is universally high. When the cash is translated into fringe benefits, perquisites, or other trappings of office it may lose its value for some people and as a result be a poor investment (see e.g., Nealey, 1963; Lawler, 1971). On the other hand, certain benefits can best be obtained through mass purchase and therefore many individuals want the organization to buy in them. In addition, certain status symbols or perquisites may be valued by some individuals beyond their actual dollar cost to the organization and thus represent good buys. Finally, as was mentioned earlier, there often are some climate and organizational structure reasons for paying people in the form of perquisites and status symbols.

One interesting development in the area of compensation is the flexible or cafeteria style benefit program (see e.g. Fragner, 1975;

Lawler, 1981). Here, individuals are allowed to make up their own reward package so that it is sure to fit their needs and desires. The theory is that this will lead to organizations getting the best value for their money because they will give people only those things that they desire. It also has the advantage of treating individuals as mature adults rather than as dependent people who need their welfare looked after in a structured way. At the moment this approach has been tried in only a few organizations. The results so far have been favorable, thus there is reason to believe that others may be adopting it in the near future because it can offer a strategic cost benefit advantage in attracting and retaining certain types of employees.

Overall, the choice of what form or rewards to give individuals needs to be driven by a clear feeling of what type of climate the organization wishes to have. For example, the idea of a flexible compensation package is highly congruent with a participative open organization climate that treats individuals as mature adults and wants to attract talented mature people. A highly status symbol non-cash oriented approach may on the other hand appeal to people who are very status oriented, who value position power and need a high level of visible reinforcement for their position. This would seem to fit best in a relatively bureaucratic organization that relies on position power and authority in order to carry out its actions.

Process Issues and Reward Administration

A number of process issues exist with respect to reward system design and administration. In some respects process issues come up more often than do structure and content issues because organizations are constantly having to make reward system management, implementation, and communication decisions while structures tend to be relatively firmly fixed in place. Rather than discussing specific process issues here the focus will be on broad process themes that can be used to characterize the way reward systems are designed and administered.

Communication Policy

Organizations differ widely in how much information they communicate about their reward systems. At one extreme some organizations are extremely secretive, particularly in the area of pay. They forbid people from talking about their individual rewards, give minimal information to individuals about how rewards are decided upon and allocated, and have no publicly disseminated policies about such things as market position, the approach to gathering market data, and potential increases and rewards for individuals. At the other extreme, some organizations are so open that everyone's pay is a matter of public record as is the overall organization pay philosophy (many new high involvement plants operate this way; see e.g., Lawler, 1978; Walton, 1980). In addition, all promotions are subject to open job postings and in some instances peer groups discuss the eligibility of people for promotion.

The difference between an open and a closed communication policy i the area of rewards is enormous. Like all the other choices that must be made in structuring a reward system there is no clear right or wrong approach. Rather it is a matter of picking a position on the continuum from open to secret that is supportive of the overall climate and types of behavior that are needed for organizational effectiveness. An open system tends to encourage people to ask questions, share data, and ultimately be involved in decisions. On the other hand a secret system tends to put people in a more dependent position to keep power concentrated at the top and to allow an organization to keep its options open with respect to commitments to individuals. Some negative side effects of secret systems are the existence of considerable perceptual distortion about the actual rewards that other people get and creation of a low trust environment in which people have trouble understanding the relationship between pay and performance (see e.g., Lawler, 1971; Steele, 1975). Thus, a structurally sound pay system may end up being rather ineffective because it is misperceived if strong secrecy policies are kept in place.

Open systems put considerable pressure on organizations to do an effective job of administering rewards. Thus, if such difficult to defend policies as merit pay are to be implemented considerable time and effort needs to be invested in pay administration. If they are done poorly strong pressures usually develop to eliminate the policies and pay everyone the same (see e.g., Burroughs, 1982). Ironically therefore if an organization wants to spend little time administrating rewards but still wants to base merit pay secrecy may be the best policy although secrecy in turn may limit the effectiveness of the merit pay plan.

Decision Making Practices

Closely related to the issue of communication is the issue of decision making. Open communication makes possible the involvement of a wide range of people in the decision-making process concerning compensation. Further, if individuals are to be actively involved in decisions concerning reward systems they need to have information about policy and actual practice.

In discussing the type of decision-making processes that are used in organizations with respect to reward systems, it is important to distinguish between decisions concerning the design of reward systems and decisions concerning the ongoing administration of reward systems. It is possible to have different decision-making styles with respect to each of these two types of decisions. Traditionally, of course, organizations have made both design and ongoing administration decisions in a top down manner.

Systems typically have been designed by top management with the aid of staff support and administered by strict reliance on the chain of command. The assumption has been that this provides the proper checks and balances in the system and in addition locates decision-making where the expertise rests. In many cases this is a valid assumption and certainly fits well with an organizational management style that emphasizes hierarchy, bureaucracy, and control through the use of extrinsic rewards. It does not fit, however, with an organization that believes in more open communication, higher levels of involvement on the part of people, and control through individual commitment to policies. It also doesn't fit when expertise is broadly spread throughout the organization. This is often true in organizations that rely heavily on knowledge worker or that spend a great deal of effort training their people to become expert in technical functions.

There have been some reports in the research literature of organizations experimenting with having employees involved in the design of pay systems (Lawler, 1981, reviews these). For example, employees have been involved in designing their own bonus system in some instances and the results have been generally favorable. When employees are involved it seems to lead to them raising important issues and providing expertise which is not normally available to the designers of the system. And perhaps more importantly, once the system is designed the acceptance level of it and the understanding of it tends to be very high. This often leads to a rapid start-up of the system and to a commitment to see it survive long-term. In other cases systems have been designed by line managers rather than by staff support people because of the feeling that they are the ones that need to support it, maintain it, and be committed to it. In the absence of significant design input from line people it often is unrealistic to expect them to have the same level of commitment to the pay system as the staff people have.

There also has been some experimentation with having peer groups and low level supervisory people handle the day-to-day decision-making about who should receive pay increases and how jobs should be evaluated and placed in pay structures. The most visible examples of this are in the new participative plants which use skill based pay (see e.g., Walton, 1980). In these plants, typically the work group reviews the performance of the individual and decides whether he or she has acquired the new skills. Interestingly, what evidence there is suggests that this has gone very well. In many respects this is not surprising since the peers often have the best information about performance and thus are in a good position to make a performance assessment. The problem in traditional organizations is that they lack the motivation to give valid feedback and to respond responsibly, thus their expertise is of no use. In more participative open systems this motivational problem seems to be less severe and as a result involvement in decision-making seems to be more effective. There also have been isolated instances of executives assessing each other on a peer group reward system and practices (e.g., in Graphic Controls Corporation). Again, there is evidence that this can work effectively when combined in a history of open and effective communication. Deciding on rewards is clearly not an easy task for groups to do and thus be taken on only when there is comfort with the confrontation skills of the group and trust in their ability to talk openly and directly about each other's performance.

Overall, there is evidence that some participative approaches to reward system design and administration can be effective. The key seems to be articulating the practices in the area of reward systems with the general management style of the organization. In more participative settings there is good reason to believe that participative approaches to reward systems can be effective because of their congruence with the overall style and because the skills in norms to make them effective are already in place. In more traditional organizations the typical top down approach to reward system design administration probably remains the best. From a strategic point of view the decision then about how much participation and reward system design and administration must rest upon whether a participative high involvement type organization is best in order to accomplish the strategic objectives of the business. If so, then participation in pay decisions and reward system decisions should be considered.

Rewards Systems and Organizational Change

In many major organizational changes it is difficult to change all the systems in an organization that need to be changed simultaneously. Thus what typically occurs is one or one set of changes leads to another set of changes. Reward systems change may either be a lead change or a lag change in the overall change process.

Reward as a Lead

There are a number of examples of pay being a lead change. Perhaps the most highly discussed of these is the use of the Scanlon plan or other forms of gain sharing to improve plant productivity (Moore and Ross, 1978; Lawler, 1981). In these situations the initial change effort is focused on the development and installation of a gain sharing plan that pays bonuses based on improvements in productivity. In the case of the Scanlon Plan emphasis is also placed on building participative problem solving groups into the organization but the clear emphasis is on the gain sharing formula and the financial benefits of improved productivity. The participative management structure is put in for the purpose of supporting and making possible productivity improvement which in turn will result in gains to be shared. Not surprisingly, once gain sharing starts and inhibitors to productivity are identified, the result is other changes. Typical of these are improvements in the organization structures, the design of jobs and work, and additional training programs. Often these are dealt with rather swiftly and effectively because the gain sharing plan itself provides a strong motivation to deal with them.

There are a number of other reward system changes that can key broader organizational change efforts. For example, the introduction of skill based pay can potentially key a broad movement to participation because among other things it provides people with the skills and knowledge they need to participate. The movement to a more flexible fringe benefit program can lead to an organization being seen as more innovative in the area of human resource management. In this sense it can help change the organization climate.

In a somewhat different vein a dramatic change in the pay for performance system can be very effective in altering the kind of strategic directions that an organization takes. For example, installing bonus systems which pay off on previously unmeasured or unfocused upon performance indicators can dramatically shift the directions of an organization. Similarly, installing a long term bonus plan for executives can cause them to change their time horizons and their decision making practices in important ways.

Rewards as a Lag

In the majority of major organization change efforts pay ends up not as a lead factor but as a lag factor. This certainly is true in most change efforts that involve movement toward participative management. The initial thrust often is in team building, job redesign, quality circles, or some other area. It is only after these other practices have been put in place for awhile that the organization tends to deal with the reward system changes which are needed to support these new practices. Often, there is surprise that these other important changes lead to a need for revision in the reward system. The connectedness nature of organizations makes it almost inevitable that when major changes are made in an organization's strategic direction or management style and practices, changes will also have to be made in the reward system.

New participative plants represent an interesting example of where participative reward systems changes are put in at the same time as are other participative practices (Lawler, 1981). Indeed, one reason for their success probably is their ability to start with all their systems operating in a participative manner.

Rewards as a Motivator of Change

Finally, it is important to consider the use of rewards systems in producing organizational change. Major organizational changes are often difficult to accomplish. The forces of equilibrium tend to work to cancel out many changes. To the extent that changing one component of an organizational system reduces its congruence with other components, energy will develop to limit, encapsulate, or reverse the change. In addition, to the extent that management needs to give time and attention to directing a change, dealing with resistance, and coping with the problems created by change, it may become diverted from other ongoing management tasks.

Management is therefore faced with two key tasks if change is to be brought about. The first task is motivating change, or overcoming the natural resistance to change that emerges and getting individuals motivated to behave in ways that are consistent with the immediate change goals and still consistent with long-range corporate strategy. The second major task is managing change. We can think of many organizational changes in terms of transitions (Beckhard and Harris, 1977). The organization exists in a current state (C). An image has been developed of a future state of the organization (F). The period between A & B can be thought of as the transition period (T). The question is how to manage the transition.

The transition state frequently is overlooked. People become fixated with the future state and assume that all that is needed is to design the best possible future. They think of change as simply a mechanical or procedural detail. The problems created by the lack of concern for the transition state are compounded by the inherent uniqueness of it. In most situations, the management systems and structures developed to manage either C or F are simply not appropriate or adequate for the management of T. They are steady state management systems, designed to run organizations already in place rather than transitional management systems. This suggests the need for temporary reward systems that are designed to operate during the transition period. One reason many change efforts are resisted by individuals is that they are often perceived to be a threat to their pay level. Particularly when the present system is highly standardized and tied to objective measures, such as the number of subordinates, the vagaries of a reorganization or other type of change may lead people to resist the change because of its unclear and potentially negative impact on their pay rate. There is no magical formula for overcoming this resistance, but two approaches can help.

1. Until the change period is complete, there should be a floor put under individual pay rates. That is, no one should have to fear losing pay during the change process. This point is critical where major reorganizations are planned because, in order for the change to go well, some people might have to give up some subordinates and responsibilities. As a result, if the job were reevaluated, it might be evaluated lower. If this problem is likely to be severe the organization may want to assure individuals that their pay will not be cut, even after the change is in place.

2. Assign a group of key individuals the responsibility for the development of an approach to compensation that will fit the new

organization. The charge is to develop a corporate rewards philosophy that includes the following:

a. The goals of the pay system
b. How the pay system will fit the new organizational structure
c. The fit between the management style of the organization and the process used to administer the pay system
d. How the pay system will be managed once it is developed.

The purpose of assigning this task to a group of key individuals is four-fold. First, the creation of a pay philosophy is a necessity if the new organization is going to have an effective pay system. More and more evidence is accumulating that without some sort of widely subscribed-to philosophy in a corporation, pay administration ends up being haphazard and a source of internal conflict. A philosophy cannot answer all the problems associated with rewards, but it can at least provide a touchstone against which new practices, policies, and decisions can be tested. Second, it will give the key individuals a chance to influence how they will be paid in the future and it can very dramatically reduce their fears about what their pay will look like after the restructuring is complete. In essence, they are being offered a chance to develop a reward approach that will fit the new organization that they will be a part of. A big potential unknown in the new organization thus becomes a factor that is under their control and becomes a much less fearful and potentially threatening factor about the reorganized structure. Third, it can assure that serious attention will be given to how the pay system will have to change to fit other changes. This can prevent "surprise" pay system problems from occurring once the other changes have been implemented. Fourth, it can aid institutionalization by helping to assure that an acceptable and appropriate pay system will exist to support and reinforce the new state when it is obtained. More about this point later.

Putting a floor under existing salaries is important in reducing resistance, but it does nothing to encourage good implementation of change. The reward system can be used to encourage and support successful implementation of the reorganization as well. In most reorganizations, financial rewards are not used to motivate a speedy and successful implementation process. This is an unfortunate oversight. If careful thought is given to rewards and the process of change, often pay can be used to help assure that changes, which are keyed to other systems, are implemented effectively. Specifically, the following points are relevant:

1. In many change efforts, the key question is how to get people to act in ways that are consistent with an effective transition. The organization needs to make it clear that the jobs and associated rewards given to managers after the transition will be dependent upon their contribution to an effective transition process.

2. At some organizational levels, the transition situation may call for the use of one-time bonuses and payments. In most cases, it makes sense for these to be paid on a group basis rather than on an individual basis. There may be a few instances where individuals have particular goals to accomplish that are individual in nature, but, in most cases, one-time financial payments should be based at the group level and tied to transition periods.

3. It is important that transition goals be set with respect to both the rate at which change is introduced and the process that is used

to introduce it. Both should be as explicit and quantitatively precise as possible. They are a critical ingredient in the effective motivation of change and should be tied directly to the reception of the one-time payments just mentioned. The goals should include specific dates, what should be accomplished by these dates, and measures of the process that was used in implementing change. These process measures are harder to define than are implementation events, such as having a new unit operating or having people relocated, but they be measured. Typical of the measures that can be used here are people's understanding of the new system, the degree to which it was explained to them, the level of turnover among people that the organization wished to retain, signs of stress among people involved in the transition, and the willingness of managers to give up people to other parts of the organization where they can make a greater contribution.

The best way to summarize this discussion is to say that the transition process can be managed and that rewards, goals, and performance measures are critical tools in managing this process. They can be used to assure that a rapid implementation of the change strategy takes place and that it does so in a way that minimizes the dysfunctional consequences for both the organization and the people who work within it.

Reward System Congruence

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

Table 2 illustrates one effort to define congruent sets of reward system practices (Lawler, 1977). Here the effort is to show how two different management philosophies call for two very different reward system practices. The two management philosophies portrayed here are a traditional bureaucratic management style and a participative employee involvement strategy. As can be seen from the table, every reward system practices needs to be different in these two cases. The reward system practices which go with traditional bureaucratic models tend to be more secretive, more top down and oriented toward producing regularity in behavior. On the other hand, the participative practices encourage self-development, openness, employee involvement in reward system allocation decisions and ultimately more innovation and commitment to the organization.

Greiner (1972) and Galbraith and Nathanson (1978) have pointed out that reward system practices need to be congruent with the maturity of the organization and the market in which the business operates. For example, rapidly developing businesses need to stress skill development, attraction, high potential individuals and incentives tied to business growth, while declining businesses need to reward expense reduction and to have a formalized job evaluation system that closely tracks the market.

The importance of congruence is not limited to just the reward system in an organization. The reward system needs to fit the other features of the organization in order that total human resource management system congruence exists. This means that the reward system

Table 2

Appropriate Reward System Practices

Reward System	Traditional or Theory X	Participative or Theory Y
Fringe benefits	Vary according to organizational level	Cafeteria - same for all levels
Promotion	All decisions made by top management	Open posting for all jobs; peer group involvement in decision process
Status symbols	A great many carefully allocated on the basis of job position	Few present, low emphasis on organization level
Pay		
Type of system	Hourly and salary	All salary
Base rate	Based on job performed; high enough to attract job applicants	Based on skills; high enough to provide security and attract applicants
Incentive plan	Piece rate	Group and organization-wide bonus, lump sum increase
Communication policy	Very restricted distribution of information	Individual rates, salary survey data, all other information made public
Decision-making locus	Top management	Close to location of person whose pay is being set

needs to fit such things as the way jobs are designed, the leadership style of the supervisors, and the types of career tracks which are available in the organization, to mention just a few. Unless this kind of fit exists the organization will be replete with conflicts and to a degree the reward system practices will potentially be cancelled out by the practices in other areas. To mention just one example, an organization can have a very well developed performance appraisal system but in the absence of well designed jobs and effective supervisory behavior it will be ineffective. Performance appraisal demands interpersonally competent supervisory behavior and jobs that allow for good performance measure (see DeVries et al., 1981).

Conclusion

Overall the design of an effective reward system demands not only a close articulation between the business strategy of an organization and the reward system, but also a clear fit between the reward system and the other design features of the organization. The implication of this for reward system design is that not only is there no one right set of practices for reward systems, it is impossible to design an effective reward system in the absence of knowing how other design features of the organization are arrayed. This suggests that the key strategic decisions about the reward system need to be made in an interactive fashion in which tentative reward system design decisions are driven by the business strategy and then are tested against how other features of the organization are being designed. The key, of course, is to ultimately come up with an integrated human resource management strategy that is consistent in the way it encourages people to behave, that attracts the kind of people that can support the business strategy, and that encourages them to behave appropriately.

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