ORGANIZATIONAL CHANGE, INNOVATION AND REWARD SYSTEMS: A LOOK AT THEORY AND PRACTICE

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ORGANIZATIONAL CHANGE, INNOVATION AND REWARD SYSTEMS: A LOOK AT THEORY AND PRACTICE[1]

Today's organizations are faced with a more dynamic, complex, and competitive environment than ever before. In order to cope with this emerging environment, organizations are attempting fundamental changes in what they do and how they function and manage themselves. In short, they are striving to become more innovative, flexible and change-oriented. Empirical evidence, however, indicates that these organizational initiatives often fail to produce long-run, sustainable results, the primary reason for such failure being the lack of congruence between these initiatives and organizational support systems in the organization. One critical support system is the reward system which is the focus of the present study.

The present study consists of four parts. Part I analyses the need for organizations to become more innovative. It also provides an overview of the innovation process and the organizational structural characteristics needed to support and facilitate this process. In Part II, key principles for designing effective reward systems are discussed. These principles are generic in nature and apply to all organizations including those that have chosen innovation strategy to gain a competitive advantage in the market place. Part III discusses specific rewards that would be suited to the needs and contexts of innovative and change-oriented organizations. The potential implementation issues and problems associated with these rewards are also identified. Finally, Part IV presents the experience of four organizations which have indeed implemented these rewards. These organizations are drawn from different industries and are known for their innovative practices and high performance. The policy implications for management resulting from these case studies are also highlighted.

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I. ORGANIZATIONAL CHANGE, INNOVATION, AND SUPPORTIVE STRUCTURAL AND CONTEXTUAL DIMENSIONS

(a) The Business Environment and Organizational Change

The current business environment is characterized by increasing complexity, competitiveness and change. Probably never before in history have organizations had to cope with so many fundamental changes at such an increasing rate of change. As Jensen (1993) notes, "fundamental technological, political, regulatory, and economic forces are radically changing the worldwide competitive environment. We have not seen such a metamorphosis of the economic landscape since the industrial revolution in the nineteenth century. The scope and pace of the changes over the last two decades qualify this period as a modern industrial revolution." As a result of pressures induced by such wider environmental changes, "businesses will undergo more, and more radical, restructuring in the 1990s than at any time since the modern corporate organization first evolved in the 1920s" (Drucker, 1992, p.18). Such restructuring has become an omnipresent feature of the organizational landscape, to the extent that many organizational initiatives have become household terms - downsizing, total quality management, outsourcing, strategic alliances, virtual organizations, and re-engineering to name a few. Apart from the wide, sometimes sensational, coverage of these changes in the popular press, many academics have also become interested in analyzing this phenomenon.

Explaining how and why organizations change - that is, change in how an organization functions, who its members and leaders are, what form it takes, or how it allocates it resources (Huber, Sutcliffe, Miller & Glick, 1993) - has been a central and enduring quest of scholars in management and many other disciplines. As a consequence, organizational change has been examined and analyzed from a variety of perspectives (see Van de Ven & Poole, 1995, for a review).

While some researchers have looked at the antecedent factors (e.g., Child & Kieser, 1981; Meyer, 1982), others have focussed on the process of implementing organizational change (e.g., Kanter, 1984, 1989; Quinn, 1980; Boeker, 1989; Tichy & Ulrich, 1984), and yet others have investigated such changes in the context of environmental threats and opportunities (e.g., Child, 1972; Pfeffer & Salancik, 1978). Despite such varying perspectives, of which the above are just a few, researchers and practitioners seem unanimous in the view that organizational change is pivotal to survival and that one of the most effective strategies in facilitating successful organizational change is through the innovation process (Drucker, 1985, 1992; Kanter, 1984, 1989; Peters & Waterman, 1982; Peters, 1987).

(b) Organizational Innovation

(i) Defining Innovation

A review of the literature on innovation suggests that the most daunting feature is probably not its size, though it is undoubtedly large, but its sheer diversity. The field has been studied by a diverse group of scholars, including social and occupational psychologists, personality theorists, sociologists, organizational behaviourists and management scientists. Such diversity in scholarly investigations has resulted in a mass of literature, in which innovation has been defined and studied from a variety of perspectives.

Definitions of innovation abound in the literature, ranging from highly specific foci to very broad generalizations, some too imprecise to enable operationalization. A few of these definitions are reproduced below.

- "...a complex activity which proceeds from the conceptualization of a new idea to a solution of the problem and then to the actual utilization of economic or social value...innovation is not just the conception of a new idea, nor the invention of a new device, nor the development of a new market. The process is all of those things acting together in an integrated fashion" (Myers & Marquis, 1969, p. 8).

- "...any idea, practice, or material artifact perceived to be new by the relevant unit of adoption" (Zaltman, Duncan & Holbek, 1973, p. 10).

- "...the process of bringing any new problem-solving idea into use. Ideas for reorganizing, cutting costs, putting in new budgeting systems, improving communication or assembling products in teams are also innovations. Innovation is the generation, acceptance, and implementation of new ideas, processes, products or services" (Kanter, 1984, p. 20).

- "the purposeful and organized search for changes, and in the systematic analysis of the opportunities such changes might offer for economic and social innovation" (Drucker, 1985, p. 31).

- "the intentional introduction and application within a role, group or organization of ideas, processes, products or procedures, new to the relevant unit of adoption, designed to significantly benefit the individual, the group, organization or wider society" (West & Farr, 1990, p. 9).

As is obvious from the above definitions, some researchers view innovation more as a process while others as an end result. For purposes of the present study, however, innovation is defined both as a process and a result:

"the complete process of innovation involves a set of activities and sequence of events (both within and outside the organization) that begin with an idea and end with the innovation's reduction to practice. As such, all innovation involves change for an organization. The result of innovation can involve a new product, a new service, a new practice/process and/or a new technology" (IRC, 1996, p. 1).

(ii) Levels of Analysis and Types of Innovation

The innovation literature can be divided into three groups based on whether the level of analysis is individual, group or organizational (Staw, 1984; King, 1990). At the **individual** level, research has focussed on how individuals intentionally introduce new and useful ideas, processes, products, or procedures to the work environment (Farr & Ford, 1990; King, 1990). **Group** innovation can be defined as "the emergence, import, or imposition of new ideas which are pursued towards implementation by the group through inter-personal discussions and successive re-mouldings of the original proposal over time" (Anderson, 1989, as cited by King, 1990, p.82). Group innovation research has focussed on such factors as leadership (Nystrom, 1979; Coopey, 1987) and group cohesiveness (Nystrom, 1979).

Organizational innovation has received considerable theoretical and empirical research attention and a number of useful definitions exist. Damanpour (1990, p.126) defines organizational innovation as "the adoption of an idea or behaviour that is new to the adopting organization...the innovation can be a new system, device, policy, process, program, product or service." Bouwen and Fry (1991, p.37) states that the emphasis of organizational innovation "is on the interactive process among people about new ideas in an organizational context."

Research on organizational innovation has focussed mainly on antecedent and process variables. A wide variety of antecedent variables that facilitate or inhibit organizational innovation can be identified, including, organizational size (Kimberly & Evanisto, 1981; Rogers, 1983; Ettlie & Rubenstein, 1987); structure (Rogers, 1983; Zaltman et al, 1973); resource availability (Rogers, 1983; Dewar & Dutton, 1986); organizational age (Pierce & Delbecq, 1977); and competition (Walton, 1987; Cooper, 1987). In fact, meta-analytic results suggest that organizational innovation is (i) positively associated with functional differentiation, specialization, professionalism, managerial attitude toward change, technical knowledge resources, administrative intensity, slack resources, and external and internal communication; (ii) negatively associated with innovation and centralization; and, (iii) not significantly related with formalization, managerial tenure, and vertical differentiation (Damanpour, 1991).

The organizational innovation process, the focus of this study, involves "...the sequence of activities by which a new element is introduced into a social unit, with the intention of benefiting the unit, some part of it, or the wider society. The element need not be entirely novel or unfamiliar to members of the unit, but it must involve some discernable change or challenge to the status quo" (King, 1992, p.90).

Based largely on their content, organizational innovations can be distinguished according to typologies as well. Damanpour (1987, 1990) identifies three main types: technical/technological, ancillary and administrative. Administrative innovations are of particular relevance to this paper[2]. These can be defined as those that occur in the social system of an organization, producing changes in the organization's structure or to its administrative processes (Damanpour, 1987, 1990). These innovations are only indirectly related to the basic work activity of the organization and more immediately related to its management and include, for instance, the implementation of new ways to recruit personnel, allocate resources and structure reward systems.

The present study focuses on administrative innovations as a means of facilitating the organizational innovation and change process. In particular, the focus is on organizational reward systems and how such systems can support or inhibit the organizational innovation process.

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[2] Technical innovations are viewed as those that occur in the technical systems of an organization and are directly related to the primary work activity of the organization. A technical innovation can thus be the implementation of an idea for a new product or service, or the introduction of new elements in an organization's production or service operations. Ancillary innovations "are organization-environment boundary innovations that pertain to programs and services that go beyond the primary functional activities of the organization" (Damanpour, 1990, p.127). For instance, in public libraries, ancillary innovations encompass those that go beyond traditional functions such as collecting books and providing information and include services to the community such as tutorial services and adult education programs (Damanpour, 1987).

However, it is pertinent to first discuss some models of the innovation process so that we can better understand the role of reward systems within the organizational framework.

(iii) Models of the Organizational Innovation Process

Researchers have developed various models, most of which propose the innovation process as a series of stages or sequence of events. Rogers' (1983) model, a leading example, divides the organizational innovation process into five stages: (i) agenda setting - definition of the organizational problem and a search for innovation; (ii) matching - decision to adopt (or not) taken after weighing the benefits and costs of the innovation; (iii) redefining/restructuring - innovation implemented as a "test", with appropriate organizational accommodations made; (iv) clarifying - innovation gradually put into wider organizational use; and, (v) routinization - innovation becomes incorporated into the daily life of the organization. Rogers (1983) refers to the first two stages as the initiation phase and the latter three, the implementation phase. Many other models of the organizational innovation process in the literature, such as Hage and Aiken (1970), Schroeder, Van de Ven, Scudder and Polley, (1989), Zaltman et al, (1973) and Kimberly (1981), display similar characteristics and stages (for a review, see King, 1990). However, these models do not explicitly deal with issues related to organizational structure and functions in their conceptualizations, which are of utmost importance in understanding the totality of the innovation process.

An innovation cannot be sustained without the support of an organization's functional areas such as marketing, R & D, and human resources. As Tushman and Moore (1982, p.xi) state, "the development of an innovation from the idea-generation phase to introduction and commercialization is inherently an interfunctional process." As such, it is essential for researchers to incorporate into their models organizational functions and systems which encourage and sustain organizational innovations. Recognizing this importance, a few researchers have made explicit attempts in incorporating these dimensions into their models and analyses (Nystrom, 1979, 1990; Radhakrishna & Varadarajan, 1991; Vrakking, 1990; Josty, 1990); two such models are pertinent to this paper.

Nystrom (1979, 1990) views organizational innovation as a result of the interaction between strategy and structure, with organizational culture and climate as important intervening variables. He contends that structure leads to stability and continuity, while strategy is necessary to achieve innovative direction and change. In Nystrom's basic model (Figure 1), the pivotal role of strategic leadership is recognized; such leadership influences an organization's innovative direction (the innovative changes the organization wants to achieve) and innovative potential (what the organization can do given its structural and resource restraints).

This model also recognizes the importance of "organizational context" in the innovation process. As Nystrom (1990, p.144) states "in this approach a favourable company culture and climate for achieving successful innovation is viewed as one of the most important resources. This is not explicitly recognized in most of the innovation literature." In this framework, highly innovative organizations are those that both want to achieve change and have the potential to do so, a potential that is enhanced by the organizational context including an appropriate system to reward performance.

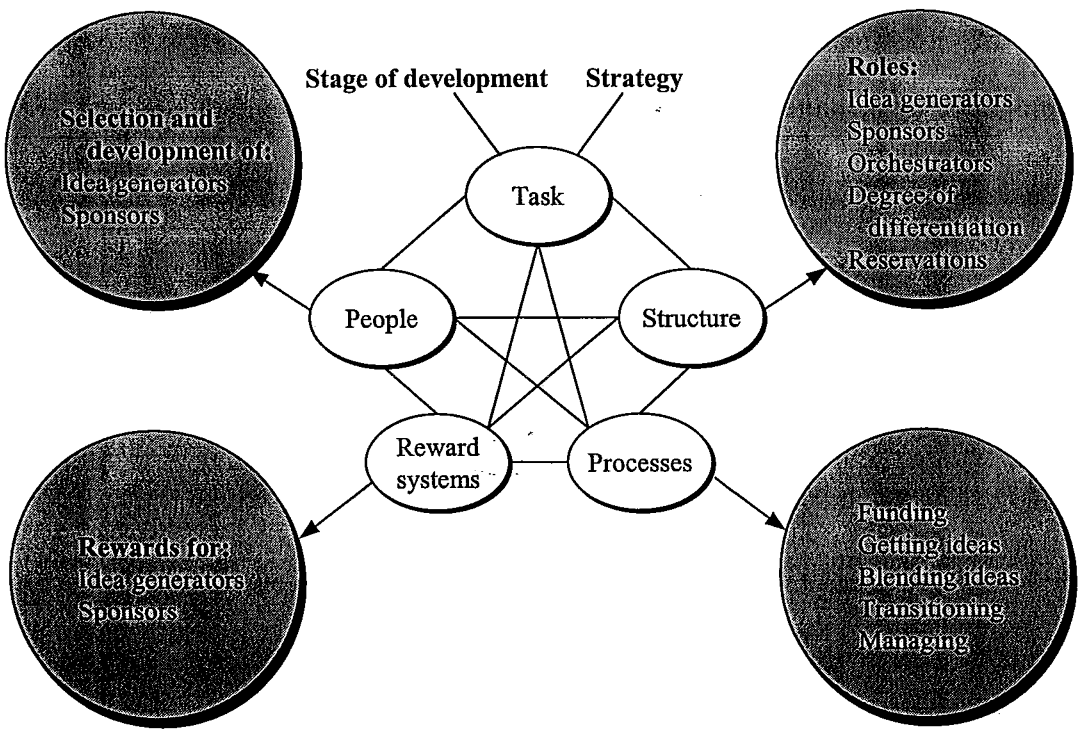
A similar "matching" or "contingency" perspective has been put forward by Galbraith who is well known for his contributions to the field of organizational design. According to his approach (Galbraith, 1986), all organizations include the same basic components i.e., a task, a structure, processes, reward systems, and people, as shown in Figure 2. Each component must fit with each of the other components and with the task. A basic premise of Galbraith's approach is that because the task of an innovative organization is fundamentally different from that of an operating

FIGURES

Figure 1: A Basic Model of Organizational Innovation

Source: Nystrom (1979)

Figure 2: A Model of Innovative Organization



Source: Adapted from Galbraith (1986)

organization, such an organization has to be designed differently. The task of an innovative organization is to create something entirely new and, therefore, is more uncertain and risky, takes place over a longer period of time, and assumes that failure in the early stages may be desirable. An innovative organization's structure, processes, rewards, and people must be combined in such a way as to be consistent with the nature and purpose of its task. For example, its structure should include such roles as idea generators, sponsors, and orchestrators. Similarly, the organizational processes and reward systems must be such that they facilitate, recognize, and reward innovative contributions. Finally, an innovative organization needs to acquire, develop and retain people who are capable of making such contributions.

(c) Organizational Innovation and Supportive Structural Forms

The elements of the "new" organizational structures and management are already taking form and have been studied in the literature (see for example, Peters & Waterman, 1982; Lawler, 1986; Daft, 1995; Ancona, Kochan, Scully, Maanen, & Westney, 1996). There seems to be consensus that new approaches to management must be based upon employee commitment and employee involvement rather than top-down control. In terms of organizational structures and functioning, this means less hierarchy, the making of decisions at lower levels, and a greater emphasis upon employee development (Lawler, 1990).

This new organizational model/approach also needs to include the ability to change rapidly and adapt to new environments. With increasing globalization of competition, it needs to be focussed on the external competition so that organizations can evaluate their relative performance. It also needs to fully utilize its human resources so that it can be more competitive in an increasingly complex business environment (Lawler, 1990).

Some of the key characteristics of new organizational structural and contextual dimensions include less hierarchy/flatter structures, more flexibility, increased diversity, increased networking capabilities, and a global orientation.

(i) Flatter Organizations

There is general consensus that organizations which are leaner, with relatively few layers of management, are better suited to promote innovative processes and activities, including innovative reward systems. Flat organizational structures, compared to more hierarchical forms, are more conducive to innovation and change because:

1) they can respond more rapidly and are more flexible to changes in their environment;
2) costs saved from a leaner middle management can be used to improve productivity and performance in other areas; and,
3) lower-level employees become more empowered, mainly through better communications with top management.

(ii) More Flexible Structures

Rigid rules and standardized procedures, more suited to bureaucratic organizational structures, generally inhibit organizational innovation and change. The great strength of "going by the rules" has been predictability, control and fairness (Ancona et al, 1996). However, in the emerging "new" organization there is an increased need for flexibility so that the diverse needs of employees, customers, and other stakeholders can be satisfied.

The need for flexible organizational structures and procedures is driven by: (i) intensified competition and the need for more tailored products and services, (ii) an increasingly diverse labour force, with needs that differ across workers, and (iii) an increasingly complex and unpredictable external environment. Thus, a flexible organization, with less rules and standardization, is more conducive to organizational innovation and change.

(iii) Increased Diversity

An organization that values diversity and has a diverse workforce is more likely to be in a better position to generate innovative and creative approaches in developing new and/or improved products and services. As Ancona et al (1996, p.8) emphasize, there is a need for:

> "the new organization to accommodate a diversity of perspectives and approaches, career paths and incentive systems, people and policies within its boundaries and to respond to an increasingly diverse array of external constituencies and stakeholders."

Diverse organizations that take into consideration the growing diversity of the workplace (more women, greater ethnic diversity, more international, etc.) are more synergistic and are thus likely to be better able to create and sustain organizational innovation and change.

(iv) Increased Networking Capabilities

As organizations try to cope with an increasingly complex uncertain environment, there is a need for less emphasis to be placed on clear lines of individual authority and responsibility both internally and externally. To promote innovation and change, there is a growing need for organizations that are based on interdependence across individuals, groups and subunits within the organization and with key elements of its environment. The boundaries of the "new" organization are more permeable than those in the past, allowing for more frequent movement of people and information across them. Thus, there is an emphasis on (i) teams within a department as fundamental units of activity, rather than individual jobs; (ii) cross-functional teams that bridge people and departments across an organization; (iii) creating units for information sharing and cooperation; and, (iv) building external relationships with stakeholders, such as suppliers and traditional competitors - for example, through strategic alliances (Ancona et al, 1996).

(v) Global Orientation

As trade barriers continue to fall, there are few organizations, if any, that are insulated from contacts with organizations outside their home country. As a result, an increasing number of contemporary organizations have networks that stretch across borders. Some of these networks are extensions of the organization into another country (e.g., establishing branches), while others build international links with foreign stakeholders. These "non-traditional" global networks are quite different from those found in organizations a few decades ago and help to put organizations in a "mindset" favourable to new structures and policies.

As Lawler (1990, p.11) emphasizes, the new approach to management and organizational structures, as discussed above,

> "...clearly calls for some new approaches to compensation as well, simply because it calls for a different relationship between people and their work organization...many of the old compensation practices assume a hierarchical organization in which thinking and controlling are separated from doing. Once this assumption is abandoned, not only do managers need to behave differently, but many new pay and reward policies need to be developed."

II. DESIGNING ORGANIZATIONAL REWARD SYSTEMS

The primary purpose of organizational reward systems is to influence employee membership and performance behaviours. The former includes such behaviours as joining the organization, remaining with the organization, and coming to work regularly and punctually. the latter comprises the entire range of behaviours required in the performance of a given job. The specific context of each organization determines the relative importance to be placed on membership and performance behaviours as well as the specific behaviours within each category. Thus, an innovative organization would need to attract and retain a greater proportion of people with creative thinking skills and administrators/managers with skills to understand, support, manage and coordinate the work of such people. An innovative organization would also place greater importance on such employee behaviours as risk-taking, team work, skills development, and self-management.

In order to be effective in influencing behaviour, reward systems should satisfy three key design requirements (Agarwal, 1998). These requirements are derived from established behavioural science theories and research. The first requirement is that appropriate behaviour-reward contingencies be established i.e., rewards should be made contingent upon specific behaviours that are of importance to the organization. Reinforcement theory suggests that a response followed by a reward is more likely to occur in the future. Applied to organizational settings, the theory implies that employees learn to behave in ways that get rewarded and avoid behaviour that does not get rewarded (Lawler, 1981). The basis of learning here is the employee actually experiencing rewards following desired behaviour. Expectancy theory (Lawler, 1973; Vroom, 1995) also emphasizes the importance of behaviour-reward relationships as a key motivational factor but it focuses more on expected rather than experienced rewards. According to this theory, an employee will be motivated to engage in a certain behaviour if he/she perceives that such behaviour will lead to rewards. The perceived link between behaviour and rewards is called instrumentality in expectancy theory and is often referred to as "line of sight" design requirement in the compensation literature (Gerhart, Minkoff & Olsen, 1995). Many organizations foul-up this design requirement because they fall prey to the "folly of rewarding A, while hoping for B" (Kerr, 1995). Some examples of such incongruencies in reward systems are as follows: rewarding employees for attendance but hoping that they will maximize performance; rewarding the best team member but hoping for teamwork and collaboration; paying sales staff on straight commissions while hoping that the senior salespersons will mentor and train the newly hired junior sales staff; and, rewarding and recognizing university professors almost entirely for their research and publications while hoping that they will not neglect their teaching responsibilities.

The second requirement for designing effective reward systems is that employees should perceive their rewards to be equitable, both internally within the organization as well as externally with respect to the labour market. In employment relationship, the employee provides inputs to the organization and in return receives outcomes (rewards) from the organization. According to equity theory (Adams, 1963), the employee judges the fairness of this exchange by comparing the ratio of his/her outcomes to inputs with the ratio of outcomes to inputs of some relevant other person. If the comparison reveals the two ratios to be equal, the employee experiences equity which in turn contributes to his/her job satisfaction. If the comparison shows the ratios to be unequal, the employee will experience inequity which will cause him/her to take corrective action. Two possible corrective actions postulated in equity theory are altering inputs (e.g., lowering performance) and leaving the organization. Research studies show that when individuals perceive underpayment, they do tend to lower their inputs which enables them to raise their outcomes to inputs ratio to attain equity (Mowday, 1987; Greenberg, 1990a; Cowherd & Levine, 1992). The organizational justice literature distinguishes between two separate aspects of equity in rewards: distributive justice and procedural justice. Distributive justice relates to the perceived fairness of the rewards which was addressed by Adams' equity theory discussed above. Procedural justice relates to the perceived fairness of the processes used in the determination of rewards. Studies show that both the distributive and procedural components of justice are important in establishing perceptions of equity of rewards (Greenberg, 1990b; Scarpello & Jones, 1996).

The third requirement for designing effective reward systems is that the rewards provided by the organization should be of value to employees. If they are not, the rewards will not satisfy employees and influence their organizational behaviour. The logic of this design requirement is derived from need theories (Maslow, 1954; Herzberg, 1965) and expectancy theories (Lawler, 1973; Vroom, 1995). These theories argue that individuals engage in behaviours which produce outcomes (rewards) that satisfy their salient needs. Thus, rewards attain their value or attractiveness from their perceived instrumentality to satisfy salient needs. Different needs can be salient for different individuals at the same time and for the same individual over time. Consequently, the value of a given reward can vary from one individual to another and for the same individual over time.

The design requirements discussed above are relevant to the effective development and administration of all potential rewards that employees can receive from working for organizations. Some behavioural scientists (e.g., Herzberg, 1965; Deci, 1972; Kohn, 1993) distinguish between two kinds of rewards: intrinsic or extrinsic. Intrinsic rewards are the feelings of achievement, self-esteem, and growth experienced by the employee from performing the job itself. The scope for deriving these rewards, therefore, will depend upon job content factors such as the extent to which a given job allows its incumbent variety, challenge, autonomy, and opportunities for development. Extrinsic rewards are external to the job. They include compensation rewards such as base pay, performance pay, and benefits given to the employee in exchange for his/her contributions to the organizations. While a conceptual distinction can be made between intrinsic and extrinsic rewards, these two types of rewards are likely to be closely tied together in real organizational settings. For example, job content factors such as the degree of autonomy, discretion exercised, and level of complexity of tasks will influence intrinsic rewards that the employee can derive from performing his/her job. These very job content factors will also generally have an impact on how much base pay that employee receives. For the same reason, successful job enrichment programs are often accompanied by higher pay to compensate employees for the new skill requirements and higher levels of responsibility entailed in the re-designed jobs. Failure to provide higher pay for enriched jobs can cause feelings of inequity among employees. Thus, integration of intrinsic and extrinsic rewards is very critical for attracting and retaining employees and keeping them motivated in their jobs.

III. REWARD SYSTEMS FOR AN INNOVATIVE ORGANIZATION

Employees typically receive three kinds of compensation rewards from their employing organizations: base pay, benefits, and performance pay. For most employees, base pay constitutes the largest component of their total compensation rewards package. It is given to employees based on time worked and not on any measure of output produced or performance contributions. In the prevailing compensation reward system, the base pay rate that an employee receives depends upon the internal and external value of the job he/she holds in the organization. Internal value of a job is determined through job evaluation which serves to ensure internal equity, and the external value through market pay surveys which helps to maintain external equity and competitiveness of the pay system. Benefits are generally the second largest component of the employee compensation rewards package. While certain benefits are statutorily required, the remaining are negotiated by the employee unions or provided voluntarily by the organization. Benefits are generally given to employees based on how long they have worked for their present employer. Base pay and benefits help the organization to attract and retain employees or, in other words, to influence membership behaviours. The last component of compensation rewards is performance pay which is awarded based on some measure of output produced or performance contributions. For most salaried employees, this is given in the form of merit pay increase which is folded into base pay. Merit pay increases are tied to performance ratings of individual employees but generally bear a weak relationship to the organization's economic performance.

There is one other important feature of traditional compensation reward systems. This relates to the presence of a hierarchical structure of job/pay grades in which the major way for employees to increase their compensation rewards is through promotions. This hierarchical approach to pay rewards employees for upward mobility and reinforces a "linear career orientation" which fits well with traditional top-down, control-oriented management (Lawler, 1986).

In recent years, many experts in the field have begun calling for major changes to the existing reward systems (Lawler, 1990; Schuster & Zingheim, 1992; Wilson, 1994; Flannery, Hofrichter & Platten, 1996). Their common argument is that the existing reward systems do not fit with the context and needs of today's organizations which are faced with a highly dynamic, complex, and internationally competitive environment. In order to cope with such environment, organizations are becoming leaner, flatter, flexible, participative (team-based) and performance-focussed. As discussed earlier, these are also among the key characteristics of innovative organizations. A number of new approaches have been suggested in the literature to better align compensation reward systems with the emerging organizational realities and have begun to be adopted in many contemporary, innovation and change-oriented organizations. A brief discussion of four such approaches is provided below with particular reference to how these approaches are consistent with the logic of the new organizational forms and the principles for effective reward systems.

Skill-Based Pay

This is an alternative method of determining base pay earned by employees. Paying employees on the basis of skills or competencies they possess rather than the job they currently hold in the organization is not a new idea. Historically, the skill-based pay approach has been mostly used for production employees. However, in recent years, organizations have begun applying this approach to professional and management employees as well. the Conference Board of Canada publishes an annual survey of compensation trends and practices based on data collected from a large diversified sample of private and public sector organizations. According to this survey, 7% of the organizations reported using skill-based pay plans in 1990. This figure rose to 10% in 1996 (Lendvay-Zwickl, 1990; Carlyle, 1996).

Skill-based plans can offer many potential advantages to the employer as well as the employee (Lawler, 1992a; O'Neil & Lander, 1993/94). By encouraging employees to acquire more skills, these plans help to develop a workforce that can perform multiple tasks. This provides the employer greater flexibility to rotate employees to cover for absenteeism, overtime, turnover, and fluctuations in produce demand. As a consequence, the employer may be able to maintain leaner staffing levels. Other potential advantages of skill-based pay plans to the employer are better problem solving capability, improved productivity and quality of products/services, and stronger employee commitment. Employees, too, can benefit from these plans. They gain more self-control over their own earnings, develop greater capacity for self-management, and experience more varied and enriched task assignments.

A number of issues should be kept in mind while considering skill-based plans for adoption. The first issue relates to the difficulty of specifying the desired skill or competency sets for managerial and professional employees. These employees perform work which tends to be multidimensional, abstract, non-routine, and often long-cycled. Their work is also mental in nature and, therefore, directly unobservable to a skill analyst. The second issue concerns the non-availability of market data needed to determine competitive pay levels for skill sets. Failure to set such levels can adversely affect the organization's ability to attract and retain employees. The third issue pertains to unsatisfied employee aspirations. Inability to go on learning new skills either because of limited access to training opportunities or because there are simply no more skills to learn can cause employees to become frustrated and dissatisfied. The fourth issue is the cost implications of skill-based pay plans. Under these plans, employees are typically paid for more skills than are used at a point in time. The final issue with skill-based plans is their susceptibility to legal challenges under the pay equity legislation which requires that effort, responsibility and working conditions in addition to skill must be considered in evaluating the fairness of pay differentials between male and female jobs.

Broadbanding

This can be defined as consolidation of existing pay grades into a small number of wide bands. Such consolidation also automatically results in a broad minimum-to-maximum pay spread for each band. Thus, compared to conventional pay structures, broadband structures have fewer bands and broader pay ranges.

Broadbanding is a relatively new concept. It began to be discussed in the literature and implemented in industry only a few years ago. The annual compensation survey conducted by the Conference Board of Canada, which was referred to in the preceding section, started reporting data on broadbanding in 1994. According to this survey, 10% of the organizations used broadbanding in 1994. This percentage rose to 16 in 1995 and remained at this level in 1996.

Broadbanding pay structures are better suited to the needs of flat, flexible and performance-focussed organizations. First, they allow flexibility in moving employees between jobs within a band without formal job title and pay grade changes. Second, broadbanding is a logical complement to flat organizational structures. Such structures place increased emphasis on lateral career moves and skill development, both of which can be supported and rewarded through broadbanding (Winter, 1997). Third, a broader spread between the minimum and maximum pay rates in a band provides for more opportunities to recognize individual difference in performance. However, these benefits can be realized only if certain prerequisite conditions are met. These include the following: investment in employee development activities to facilitate and promote employee mobility between jobs within a band; development and implementation of fair and equitable criteria for managing such mobility; and development and implementation of valid and fair performance appraisal systems for awarding pay increases within a band (Brown, 1996). It is true that broadbanding provides greater flexibility in moving employees between jobs and granting them pay increases. But it is imperative that this flexibility be exercised in a sound, responsible, and equitable manner.

Variable Pay

The traditional approach to performance pay is to grant merit pay increases based on performance ratings. Variable pay is an alternative approach to performance pay. Under this approach, performance pay is awarded as lump-sum payments based on attaining certain pre-defined performance objectives. Unlike merit pay awards, these payments are not folded into base pay and have to be re-earned each year.

A variety of variable pay plans are available. They can be distinguished from each other along two dimensions. The first relates to the level (individual, group or organization) at which performance is measured in a variable pay plan. Thus, there are individual plans (e.g., incentive/merit bonus), group plans (e.g., gainsharing), and organization-wide plans (e.g., profit-sharing and stock ownership). Of these, the most popular are the individual incentive plans. The Conference Board of Canada's annual surveys indicate that the percentage of organizations using individual incentive plans increased from 61 in 1990 to 75 in 1996. The percentages increased from 6 to 9 for gainsharing and 22 to 26 for profit sharing over the same period (Lendvay-Zwickl, 1990; Carlyle, 1996). The other dimension on which variable pay plans can differ from each other is the degree of risk borne by the employee, i.e., the amount of base pay put at risk. Here, two types of variable pay plans can be distinguished: add-on vs. pay-at-risk plans (Gherson, 1994). Add-on plans offer rewards on top of base pay for superior performance. No part of base pay is put at risk. Examples of such variable pay plans are merit bonuses, profit-sharing, and stock grants. Pay-at-risk plans put some part of the present base pay, or some or all of the next year's merit pay increase at risk. There is downside risk in that the amount of pay-at-risk is lost if the pre-determined performance target is not met. But there is higher upside earning potential because employees can earn a certain multiple of the amount of pay-at-risk if they attain the performance target. Pay-at-risk plans have always existed for senior executives and sales staff, but now many Canadian organizations are extending their application to other employees as well (Winter, 1997).

Variable pay plans offer many advantages to today's organizations. First, they provide a strong incentive for sustained high performance as performance pay is to be re-earned each year. This ties pay and performance together on an on-going basis. Second, variable pay plans constitute an effective tool for cost control. Because performance pay is not folded into base pay, variable pay plans provide organizations the flexibility to adjust payouts to their ability to pay. Thus, during financially good periods, the organization can share their wealth with employees. But when times are bad, they are not burdened to the same degree with high fixed compensation costs (Greene, 1997). Finally, by tying performance pay to organizational objectives, variable pay plans can serve to align the interests of employees and the organization. Accordingly, these plans can help channel employee effort and behaviour toward what is needed for organizational success.

A number of issues need to be kept in mind in developing and implementing variable pay plans. How well these issues get addressed will have an impact on the success of these plans in achieving their intended goals. The first issue concerns the type of variable pay plan to be used. In making this choice, the organization needs to examine its own business context and requirements. For example, a relevant factor to be considered is the organization's ability to pay. If it is good, an add-on-pay plan can be viable; if not, base pay-at-risk plan may be more appropriate. The second issue relates to the "line of sight" quality of performance objectives used in a variable pay plan. This requires that the objectives must be clearly defined, known to employees, and within their sphere and influence. The final issue pertains to how the relationship between results and rewards is structured in a variable plan. This includes determination of the threshold level of results at which the payouts begin, the size of payout at various levels of results achieved, and the risk to return ratio.

Team Rewards

While organizations are making more use of teams, they are also experiencing a high rate of failure of these teams (A.T. Kearney, Inc., 1994). One key explanation given for this lies in the prevailing compensation systems in organizations. These systems reward and motivate employees based on the relative value of their jobs and their individual performance contributions. They also have a competitive orientation in that employees vie with each other for merit/incentive pay and promotion to higher paying jobs. In some cases, employees do earn bonuses based on group and/or organizational performance measures (e.g., gainsharing and profit-sharing plans). But here, the focus is on much broader work units than on teams as they have come to exist today. Two recent estimates indicate that only between 7 to 10 percent of Canadian organizations surveyed had implemented team-based pay in 1996 (Carlyle, 1996; Winter, 1997).

Some experts suggest that different types of base pay and performance pay systems may be appropriate for different types of teams. For example, Lawler and Cohen (1992) identify three types of work teams: parallel teams, which supplement the regular organizational structure and perform problem-solving and improvement-oriented tasks (e.g., quality circles); project teams, which involve a diverse group of knowledgeable employees who are brought together to conduct specific projects for a defined, typically extended period of time (e.g., new product development team); and work teams, which are self-contained units responsible for producing a product or service (e.g., assembly team). The authors recommend that skill-based pay is suitable for work teams and project teams, with job-based pay a better fit for parallel teams. In addition, a different mix of individual, team, and unit based performance rewards is also recommended. Individual merit pay system for job performance, supplemented by recognition or gainsharing system at the team and unit level rewards, should be used for parallel teams. In contrast, a major emphasis should be placed on team and unit level rewards for project or work teams, with the appropriate balance between these two rewards being determined by interdependence of a given project or work team with other contributors and teams.

Non-financial rewards may also prove effective in teamwork settings. A recent study (Shaw & Schneier, 1995) indicates that only 25% of the organizations surveyed used financial rewards to recognize teams; the remaining used a variety of non-financial rewards such as public recognition of high performing teams and effective team contributors. Teamwork itself can provide intrinsic rewards through enlargement and enrichment of work. Being a member of a well-known, highly prestigious team may be perceived as an additional intrinsical reward.

A number of design issues are involved in developing reward systems to recognize team success and individual team members' contributions to this success. To begin with, it is very important to set team objectives which spell out clearly what is expected from the team. These objectives can then be used to determine team level reward. Sometimes, teams are encouraged to compete against each other for a team level reward. Interdependencies among teams should be considered before implementing such competitive rewards. The other major issue relates to the distribution of team level reward among individual team members. Equal distribution can promote cooperation among team members. But, it can also lead to "social loafing" or "shirking" behaviour on the part of some members (Earley, 1989) which can cause lack of motivation and feelings of inequity among other team members. Differential distribution of rewards can avoid these problems, but it will require the development of a valid and fair procedure to assess member contributions to the team performance.

IV. ORGANIZATIONAL CHANGE, INNOVATION AND REWARD SYSTEMS: FOUR CASE STUDIES[3]

This section provides a detailed account of how four selected organizations have attempted to align their reward systems to their chosen business strategies and contexts. The criteria used in selecting the four companies for this study included: i) they must have implemented organizational change initiatives (so as to examine the effects of organizational change on reward systems); ii) they

[3] The authors acknowledge the research and field work contributions to these case studies made by the following students enrolled in the M.B.A. Program of the Michael G. DeGroote School of Business, McMaster University: K. Henley, M. Jacobson and C. Riddolls.

must be from different industries, with different organizational structures (so as to compare practices across industries and structures); and, iii) they must be "high performance" firms.

After examining the academic and practitioner literature, as well as company documents, it was decided to study Federal Express, Dofasco, Xerox Canada, and Wal-Mart Canada. The following case studies are based on data collected through interviews with key executives from each selected organization.

Federal Express (FedEx)

Background.

Since its inception in 1973, Federal Express has grown from 389 employees servicing a few cities to a company that now employs more than 120,000 people servicing 210 countries; in fact, FedEx is now the world's largest express transportation company. In 1987, FedEx purchased it Canadian licensee, Cansica Inc., and began operations as Federal Express Canada Ltd. In 1990, Federal Express became the first company in the service sector to win the prestigious Malcolm Baldridge National Quality Award for its quality service; analysts equate this award to the Nobel Prize for quality in business (Bowen & Lawler, 1992; AMA, 1991). The company has also fared well financially. In 1983, Federal Express became the only U.S. company in history to top $1 billion in revenues within its first ten years. By 1990, annual revenues climbed to $7 billion and the company commanded 43 percent of the air express market (AMA, 1991). In 1995, FedEx Canada had a workforce of approximately 3,400 employees and sales of $300 million.

Organizational Philosophy, Goals, Strategies and Structure.

The organization's philosophy is summarized in the statement made popular by the company's CEO and Founder Frederick Smith: "when people are placed first, they will provide the highest possible service, and profits will follow." These "People-Service-Profits" goals serve, either singularly or in some combination, as the foundation for almost all quality initiatives, management guidelines, and compensation or recognition programs and strategies within FedEx. As Bowen and Lawler (1992b, p.32) note,

> "Federal Express is a high-involvement, horizontally coordinated organization that encourages employees to use their judgement above and beyond the rulebook...[b]eyond its blue, white, and red planes and uniforms are self-managing work teams, gainsharing plans, and empowered employees seemingly consumed with providing flexible and creative service to customers with varying needs."

Organizational Change and Reward Systems.

In order to maintain a competitive advantage in the face of increasing global competition, Federal Express implemented several new initiatives in the last decade. These initiatives focus more on improvements in its operations rather than large scale restructuring and downsizing. In fact, the company has a "no layoff" policy. Much of the changes implemented so far, involve new technologies that increase the company's efficiency, and its continual focus on customer satisfaction and employee empowerment.

In implementing these changes, Federal Express made a conscious decision to align its reward systems with the new organizational strategies. This has meant an increasing emphasis on a variable-pay system rather than its traditional rewards practices. While the company still uses traditional methods in setting base pay, many of the new reward practices are aimed at improving customer service and financial performance; that is, its P-S-P objectives.

Base Pay. The base pay is determined by a job evaluation (AIKEN - KPMG) plus market surveys. The job evaluation focuses on internal consistency/equity, while the market surveys help to determine pay that is externally competitive.

Performance-based variable pay. In line with the company's emphasis on rewarding employees for performance, several variable pay schemes have been implemented. These include a Management-by-Objective (MBO)/Professional-by-Objective (PBO) incentive system for managers and professionals, a "win-win" incentive system for all permanent salaried and hourly employees, a "star-superstar" incentive system, merit bonuses, and recognition/reward programs for all employees.

In the MBO/PBO system, managers and professionals achieve points based on their performance as measured against stated objectives. Compensation levels, in terms of dollars-per-point, depend on overall company performance as measured against P-S-P goals. For example, for a regional sales manager, the People goal could be an improvement in her leadership (measured by a specific scale); the Service goal might target the completion of four customer-supplier alignments with other departments, and the Profit goal might involve cost saving initiatives. These MBO/PBO goals are established by employees in close consultation with their managers, with all goals focussed on fundamental corporate objectives and strategies.

Permanent salaried non-management and hourly employees also earn incentives based on a "goal-sharing" or "win-win" program. This program has two parts: one for permanent non-management employees and the other for all permanent employees. Under the first, if an individual meets his/her goals (based on performance review score and attendance), and the department meets its productivity and service goals, a permanent full-time employee will receive a quarterly payment of up to $250, or up to $125 if he/she is a permanent part-time employee. The second part of the program depends on whether or not the Canadian Region meets its annual goals. If these goals are met, including an established goal for Outbound Operating Profit, a permanent full-time employee will receive an annual lump sum payment of up to $1,000, and a permanent part-time employee up to $500.

In the "star-superstar" system, each departmental manager identifies the department's top 10 percent of its employees to become "stars" (through a performance appraisal process that uses measurable criteria tied to corporate strategy). Employees selected as "stars" are awarded a bonus, equivalent to 2 percent of semi-annual base earnings. In a similar process, the top 1 percent of employees are selected to be "superstars"; these employees receive a bonus of 5 percent of their semi-annual base earnings. All employees are eligible for an annual merit bonus.

The company's recognition/reward programs also attempt to reinforce organizational objectives and strategies, especially those related to quality and customer satisfaction. While these programs are not substantially different from those found in many large service organizations, FedEx's programs have three notable characteristics (AMA, 1991). Firstly, each division is given autonomy in controlling these programs and granting the awards. Secondly, the company's "Bravo Zulu" awards give individual managers leeway to reward employees for outstanding effort and achievement virtually on the spot. The typical "BZ" award is about $50. For the company as a whole, the use of these awards increased ten-fold from 1985 through 1989 - from 2,774 awards totalling $182,000 to 20,000 awards totalling $1.8 million (AMA, 1991). Finally, in another effort to link rewards to strategy, FedEx offers a prestigious company-wide award - the Golden Falcon - worth 10 shares of stock and a congratulatory phone call or visit from a top executive, to employees based on complimentary reports from customers.

In a case study of this nature, it is difficult to assess with any confidence, the effectiveness of these reward strategies. Federal Express has an annual survey (the Survey-Feedback-Action or SFA) which assesses, in part, employee satisfaction with pay and benefits. While one company executive notes that "employees are thrilled with their pay and benefits", these survey responses are not within the public's domain. Nevertheless, it is obvious that the company has made conscious efforts in trying to align its pay and reward practices with organizational objectives and strategies (Cappelli & Crocker-Hefter, 1996). Thus far, this strategy seems to be helping the organization cope successfully with environmental changes.

Dofasco

Background.

Dofasco started as a small steel foundry in 1912 in Hamilton, Ontario, and became a fully integrated steel producer with the introduction of its first blast furnace in 1951. Dofasco introduced the industry's first basic oxygen process to North America in 1954 and since then has been one of the premier steel making companies in the world. The company currently employs over 7,000 people - 2,000 salaried and 5,000 hourly workers.

Organizational Philosophy, Goals, Strategies and Structures.

Like Federal Express, Dofasco also emphasizes the people aspect of its operations, as is evident in its motto: "Our product is steel. Our strength is people." The company's goals include: i) to provide customers with high quality, flat-rolled steel products; ii) to provide shareholders with the best investment opportunity; and, iii) to enhance employees' career experience and personal development in an open and participative environment.

To achieve these goals, the company emphasizes strategies that focus on product quality, customer service, and employee development. The company still has a traditional, hierarchical organizational structure; however, recent initiatives have resulted in the elimination of several layers, making the company flatter, leaner, and more flexible.

Organizational Change and Reward Systems.

The economic recession of the 1980s, and the increasing globalization of competition in the steel industry, have led to significant changes in Dofasco's operations. As international competitors penetrated the North American market, and local (North American) production increased, prices plummeted, thus giving the advantage to smaller, more efficient mills that were able to produce small batches more cost-effectively.

In response to this changing environment, Dofasco undertook a significant restructuring program, including the reduction of the management bureaucracy from 13 to 5 layers, and the workforce from 13,000 employees to 8,000. Many "non-strategic" assets were also sold. This restructuring process culminated in 1994 and in the following year, the company announced a $200 million expansion of its steel making facilities aimed at improving efficiency.

In addition to the traditional compensation objectives of attraction, retention, and motivation, the company is now consciously making efforts to link pay and performance, and to align pay and rewards strategies with organizational goals and strategies. In the past, the company's compensation system was fairly simple: after conducting its job evaluation process to ensure internal consistency/equity, the company paid slightly better than the industry average. Basic benefits and incentives were also offered (pensions, disability benefits, etc.). However as the company's President and CEO stated, "our old incentive systems were created to measure performance based on factors that aren't appropriate for today's needs. As a result, these systems no longer motivate people to focus on today's priorities" (Dofascõ Newsletter, Sept., 1996, p.2). As such, Dofasco has now added a variable pay scheme and an improved benefits package to the traditional rewards programs.

Base pay. Base pay is determined by a job evaluation (CWS), plus a survey of market rates. The system continues to recognize the importance of knowledge, skills, and responsibilities required to perform the job, as well as ensuring internal equity; the market survey helps to determine pay that is externally competitive. Automatic cost-of-living increases have been eliminated since the company feels that these are not explicitly linked to organizational strategies.

Variable pay. In this new system, a portion of pay is based on employees attaining set goals. For salaried employees, in a process somewhat similar to profit-sharing, a typical employee can earn as much as 10 percent of their earnings once the company, the business unit, and certain health and safety objectives are met; these objectives are evaluated annually. For instance, in 1996, a salaried employee will earn 7.5 percent if the company achieves a set Return on Capital Employed (ROCE), 2.5 percent if business unit goals are met, and 0.5 percent if health and safety targets are satisfied. A similar system is now gradually being implemented for hourly employees. This strategy is a conscious effort to link pay with performance and organizational goals.

Broadbanding. The company has also implemented an hourly employee base salary system that reflects attributes of broadbanding. In this pay-for-applied skills program, each job is subject to a traditional job analysis in which the specific skills required to perform the job are identified, and the job is subsequently included in a job class. A job class is thus composed of a number of specific skills for which employees can become certified. To remain certified for certain skills, employees must log a minimum number of hours within the relevant job class per year. Base pay increases as the number of job class skills for which an employee is certified increases. At this time, promotion is considered, and employees may begin working on the next job class level.

Pensions and Benefits. Improvements in the company's pension and benefits package have also been implemented. These include an improvement in the Supplementary Retirement Income Plan, increased vision care coverage and short-term disability benefits. These compensation changes are aimed at satisfying the organization's goals of increasing employee morale by keeping the rewards package competitive.

Like Federal Express, it is difficult to evaluate the effectiveness of Dofasco's compensation practices based on this case study. This is compounded by the fact that many of the changes in its reward strategies have been recent. An employee survey conducted about two years ago revealed "reasonable satisfaction" with pay and benefits, according to a company executive. In light of the recent reward initiatives the company plans to conduct another survey sometime in the future.

Xerox Canada

Background

Xerox Corporation established its first Canadian office in 1953. Since then it has grown from 118 people to over 5100 country wide. They are a leading supplier of document-based solutions for business problems, providing equipment, supplies and devices that facilitate the six basic phases in the life cycle of a document: create, link, archive, process, distribute and output. Its range of products include xerographic and digital copiers and duplicators, electronic printers and publishing systems, electronic typing systems, facsimile equipment and industry standard networks. The company also provides software services, customer education, professional consulting services in document management and training and consulting support in quality management.

In 1972, Xerox Canada ceased being a part of U.S. operations and became a member of the international group within Xerox Corporation. In June of 1984, the company issued shares to the public and today it is 15% publicly owned.

Organizational Philosophy Goals, Strategies and Structures

Xerox Canada operates primarily as a marketing organization, with one third of its workforce employed in a sales capacity. Xerox Canada's objective is to be the preferred vendor in its major business: Business Products and Systems. Their fundamental strategy for attaining this goal is achieving satisfaction for the company's three major stake holders, namely its customers, its employees, and its shareholders.

"Leadership Through Quality" is the cornerstone of Xerox's corporate culture, which focuses on three key areas: (1) a dedication to understanding customer requirements; (2) a work culture and ethic in which every employee assumes responsibility for quality improvement; and (3) a management style that encourages employees to reach their maximum potential.

Xerox Canada has four main goals: (1) Customer Satisfaction; (2) Employee Satisfaction; (3) Return on Assets; and (4) Market Share. To achieve these goals, the company emphasize certain principles and organizational structures:

1. Customers define their business. They must continue to identify and define critical market segments and fully understand customers problems, requirements and needs.

2. Success depends upon the involvement and empowerment of trained and highly motivated people. The company aims to become the benchmark for employee motivation and satisfaction.

3. Quality is "on the line by the line". Line management is responsible for leading quality improvement.

4. Management develops, articulates and deploys clear direction and objectives.

5. Strategic quality challenges are identified and met.

6. Business is managed and improved by using facts. The company aims to enhance the quality tools through a more rigorous application of management by fact.

Organizational Change and Reward Systems

Xerox's historical structure was traditional; it was designed for function rather than performance. The management system was very rigid, hierarchical and centralized. It tended to create and reinforce functional "silos" throughout the organization. This structure was not optimal for the provision of high levels of customer satisfaction, but since there was little competition, customers and suppliers had no choice but to accept Xerox's delays and mistakes.

Increased global competition has forced Xerox to become more efficient and customer focussed. The late 1980's and early 1990's brought about large scale layoffs and a re-organization at Xerox Canada. The company effectively delayered its organization, minimizing bureaucracy by moving to just four layers[4]. The goal was to create a customer-engaged and efficient organization.

The operational re-engineering of the 1980's emphasized quality and efficiency in manufacturing. The 1990's required a focus on customer satisfaction, which necessitated a change in management philosophy and organizational structure. Xerox Canada undertook a change to move

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[4] The first level is composed of all employees in sales, service and administration who work directly with clients. The second level consists of area or district managers; the third of vice-presidents; and the fourth is the President and CEO.

from its traditional "command and control", functionally-organized structure to a much more cross-functional, inter-disciplinary, and participative organization, where team-orientation and self-managed work-groups would become commonplace.

The company believes that operating with fewer layers of management will result in a more empowered and cost-effective environment that will contribute to customer satisfaction.

Xerox's objectives for its compensation system are (1) to keep it simple (according to the principle that with complicated reward systems, employees cannot understand what behaviours and practices are rewarded and hence are demotivated); (2) to align compensation with the organizational system and strategy; and (3) to drive productivity. The goal of this system is to attract and retain the right employees, as well as to motivate employees to perform to the best of their ability. Specifically, productivity and customer satisfaction are the behaviours Xerox has designed its compensation to reinforce.

Xerox's Canada recently re-engineered its compensation system to support its strategic change from a centrally-run organization to a decentralized, division-focussed approach. The divisions, or customer business units, are organized geographically to meet the needs of the different regions across Canada. The company is now organized with a matrix structure, decentralized as much as possible into the customer business units. Functions such as human resources, finance, and the legal department are centralized at head office. While human resource policies are formulated at the corporate level to ensure consistency and compliance with legal status, there is some customization at the regional level. Line managers administer the compensation system, with assistance from a Human Resources Operations Manager located in each customer business unit, following corporate guidelines.

Over the past two to three years, Xerox has also developed a more integrated approach to customer service and support. Previously, different objectives and targets were set for each employee group. As a result, there was very little alignment or synergy among the activities and behaviours of the sales force, customer service representatives, and administrative staff. Processes were sub-optimized the misalignment negatively impacted customer satisfaction, organizational performance, and employee morale. The integration of objectives and targets across the employee groups has improved on these goals through increased proximity to customers and an emphasis on teamwork. A change in the compensation system was necessary to drive the team-focussed approach, and further refinements were needed to ensure consistency across divisions.

Under the old compensation system, employees were compensated for individual performance, but only the sales force had a variable component (e.g., every sales rep had targets they individually had to meet, and they were compensated for meeting those targets). *Variable pay* is now a part of everyone's compensation, and is structured through a variety of incentive programs. Sales and service representatives, and even administrative staff, receive bonuses for achieving or exceeding their objectives, and gainsharing opportunities, in the form of stock options linked to business unit performance, are provided for senior executives who do not have specific targets. Gainsharing for vice presidents, directors, and district managers was incorporated into their compensation package in addition to the bonus plan in existence under the old.

In addition to the individual component, the compensation system has incorporated variable pay that is linked to team and customer business unit performance for all employee groups. Employee receive the maximum payout if targets are achieved in all three performance measurements areas, individual, team, and customer business unit. General targets are set at head office, and then adapted for each region and communicated to employees via their direct line manager.

To encourage the team-focus at levels of the organization, *manager compensation* is now linked to the performance of the sales and customer service representatives and the administrative staff who report to each manager. Senior managers are linked to the team effort through variable pay tied to overall company performance. The desired end-state is to compensate everyone based on the performance of the unit, with a high percentage of compensation 'at risk'.

The *base pay* component of the compensation package is determined though a traditional job analysis that is conducted for all jobs expect for those at the senior management level. Employees are subsequently classified by pay grade in a traditional pay structure. Company policy is to pay at the median of market rates.

Compensation at Xerox is directly linked to organizational goals. Specifically, Xerox recognizes and compensates all employees for actions and behaviours that support the company's quality policies and goals. In addition to the team-focussed variable pay discussed above, sales representatives are also compensated based on profit growth and customer retention (which is factored into their customer satisfaction rating). Customer satisfaction ratings are also determined through customer service staff. The emphasis is on continual improvement; compensation is based on year-over-year growth in profit and customer satisfaction. The formal performance evaluation is conducted annually by the line managers. There is no formal peer or customer participation in the evaluation, but customer and co-worker complaints and compliments are indirectly factored in, as are the customer survey results mentioned above. Compensation information about individuals is considered highly confidential and is not shared openly.

Managers are also recognized for implementing quality improvement processes. They are expected to promote employees who model 'Leadership Through Quality' behaviours, and to concentrate on team recognition through events such as Teamwork Day, which is held annually in every region in Canada. Managerial rating systems were changed to reward behaviour and style as well as performance.

Xerox evaluates its compensation system annually. Xerox considers each employee's compensation to be highly confidential and does not publicize in any way how exactly each group of employees is being compensated.

Wal-Mart Canada

<u>Background</u>

In 1962, Sam Walton opened the first Wal-Mart store in Bentonville, Arkansas. Since then, the company has grown to become America's première discount retailer. Wal-mart recently entered the Canadian market through the purchase of 122 non-unionized Woolco stores from Woolworth Inc. All stores were renovated under the Wal-Mart name in March, 1994. Currently, Wal-Mart Canada employs approximately 21,000 people, 40 percent of who are full-time. Company operations are divided into three regions across Canada (Central, Western and Eastern), with human resource policies devised at head office and administered at store level.

The corporate structure is described as an inverted bureaucracy, with "servant leaders" providing the needed support for front-line associates. Wal-Mart Canada recently adopted its parent company's coaching policy, whereby store and department managers are responsible for coaching associates for personal and company success.

Organizational Philosophy, Goals, Strategies and Structures

Wal-Mart's corporate philosophy is based on its belief in the value of people - customers and associates alike. Wal-Mart operates through three basic guiding principles: (i) customer value and service; (ii) partnership with associates; and, (iii) community involvement. Associates are encouraged to take personal ownership of their individual assignments and their store's financial performance. Sam Walton began insisting that information and profits be shared with employees in the 1950s, practices that exist to this day. In fact, the organization's leadership began "applying such concepts as a flat organization, empowerment, and gainsharing long before anyone gave them those names" (Saporito, 1992, p.101).

Teamwork, cost minimization, and "the fun of merchandizing" are emphasized at daily planning meetings. Managers and front-line associates are challenged to improve financial results and are often compared with peer stores. Wal-Mart stores compete against each other for the "Store of the Year" Award, and friendly rivalries between department managers often result in sales contests with funny "prizes" for the loser such as riding a tricycle around the store. Wal-Mart's culture actively encourages risk-taking and accepts that some good efforts fail. Associates are not penalized for innovations that do not work - as long as the same mistake is not made a second time. To meet cost containment goals, associates regularly make suggestions for cutting costs.

Organizational Change and Reward Systems

When Wal-Mart first entered the Canadian market in 1994, it tried to superimpose its American mid-west "folksy" culture to its new stores. The company quickly encountered some problems. For instance, Wal-Mart had retained many of the existing Woolco employees, who were unfamiliar with empowerment and the driving focus on customer service. To complicate matters further, Wal-Mart wanted to get the stores "up and running" as soon as the renovations were completed, without changing any of the compensation or other management systems from the old Woolco system. Wal-Mart associates were paid the minimum wage (which is a practice at other Canadian discount stores), with no reward structure to recognize customer service, and with benefit plans that become more comprehensive with seniority and one's position in the administrative hierarchy. This benefit program violated Wal-Mart's philosophy of equality of its employees.

There was no well-defined transition plan for migration from the old culture and systems to the new, so severe misalignment between goals and behaviours resulted. This misalignment was evident in the lower than expected customer satisfaction results, particularly when compared to the results of Greenfield store openings in the U.S., which had been highly successful. In Canada the measurement and reward systems continued to reinforce the old culture and behaviours, while management continued to exhort unsupported 'customer focus' and 'empowerment' efforts. By mid-1995, it became clear the changes were not successfully managed, and Wal-Mart's Canadian head office realized that something needed to be done to remedy declining employee and customer satisfaction results. Wal-Mart Canada subsequently embarked on a revision of its compensation and measurement systems. By the summer of 1996, Wal-Mart Canada's compensation system became more in line with that used in the U.S.

It is virtually impossible to discuss compensation at Wal-Mart in isolation. The compensation strategy is part of an overall Wal-Mart philosophy. It supports, and is supported by, a whole cultural system, which provide the system with context and relevance.

In Sam Walton's words, the compensation system at Wal-Mart follows from its philosophy that "the more you share profits with your associates- whether it's in salaries or incentives or bonuses or stock discounts - the more profit will accrue to the company."(Saporito, 1992, p.103)

Profit-sharing for all employees was implemented in 1971 (in the U.S.) in an effort to increase customer satisfaction through increased employee satisfaction. Sam Walton insisted that if you treat your associates as partners, they will treat you in turn as a partner. (More information will be shared, more commitment will be engendered, and together you will perform above and beyond customer expectations, as well as your own.) Partners (associates) at Wal-Mart are not motivated through money and ownership alone, although these are very important sources of motivation. Further motivation is provided through the setting high goals, encouraging competition and friendly rivalry, and keeping score. None of these motivating factors will work on their own; they must be used in combination.

When designing the new compensation system, Wal-Mart Canada formed a committee of management and non-management associates in an effort to achieve buy-in and to determine how the compensation system needed to be customized to the Canadian environment. The People Department, as Wal-Mart calls Human Resources, wrote a brief compensation manual for managers describing basic compensation decisions and procedures (e.g., merit increases, lateral moves, etc.) which was distributed to managers during a compensation seminar at the beginning of 1996. Managers are expected to explain the new policies to associates on a one-to-one basis.

The new compensation system very much resembles that employed in the U.S. Associates are paid slightly above the market rate, which is minimum wage in the retail sector. All full-time associates are now provided with the same health care and benefit coverage, from the shelf-stocker to the CEO. After one full year of service plus another 1000 hours with the company (made retroactive to Wal-Mart's Canadian entry) all employees are eligible for profit-sharing based on the Canadian results. In addition to the annual Christmas bonus Wal-Mart gives out to all employees based on years of service with the company, the company has instituted a gainsharing 'stakeholder' program to combat the high industry turnover and encourage associate commitment to the organization. If the individual store meets its annual goals, and if the overall company meets its goals, the associates benefit through stock ownership payouts. This gives associates the 'big picture' of how their performance contributes to everyone's success, and motivates them to make a difference.

Associates can also earn Wal-Mart stock through Great Job Awards. If an associate makes a suggestion or improvement that lowers costs or improves customer service, he/she gets a Great Job Button to wear on his /her uniform. Once four Great Job buttons are collected, they can be traded in for one Wal-Mart stock. When associates receive a number of compliments from customers for superior service, they are eligible to receive the Customer's Choice award for the month, which entitles the winner to store coupons as well as store-wide recognition and celebration.

Store managers are also evaluated on store performance, and on how well the store has interacted with its community. Managers also receive annual bonuses tied to their store's performance. Other associates are not yet covered under the bonus plan, but Wal-Mart is looking into how this could be extended.

Wal-Mart still uses a traditional job analysis and job structure to determine *base pay.* Performance appraisals for all associates are conducted by the assistant store manager on an annual basis. Employee compensation, in terms of merit increases, is based strictly on performance: excellent customer service translates into annual base rate increases.

Wal-Mart Canada believes that its associates are happier with the new system. It is considered to be successful because customer satisfaction ratings have increased. Grass root surveys measures employee satisfaction in terms of compensation and support across Canada, and solicits suggestions for improvement. These results are complied at head office, and all the revisions are implemented at the same time in one comprehensive program.

Implications for Management

An analysis of theory, the "new pay" practices in general, and recent reward initiatives at Federal Express, Dofasco, Xerox Canada and Wal-Mart Canada reveals several implications for management:

1. It is important that reward strategies be aligned with organizational strategy.

As previous research (e.g., Gomez-Mejia & Balkin, 1992; Lawler, 1992b), and these case studies suggest, it is important that an organization's functional strategies, including compensation, be aligned to organizational strategies so as to foster innovation and change. As such, managers should make a conscious effort in making such alignments; FedEx and Dofasco have made proactive efforts in this regard.

2. Compensation systems should be designed to satisfy unique organizational objectives and strategies.

There is no "one best way" to design a successful compensation system. As the case studies demonstrate, different pay strategies can be used to support organizational change initiatives. This contingency approach takes into consideration differing starting points, constraints, resources, and goals across organizations.

3. <u>It is important to link pay with performance</u>.

Not only must organizations link pay to performance, but such performance standards must be measurable, attainable, communicated effectively, and set with employee involvement. In the variable pay systems at FedEx and Dofasco, these requirements are, to a large extent, met and this contributes to innovation and change.

4. <u>Change must be supported by top management</u>.

In both cases, the company's CEO and top management not only supported changes in the compensation practices but they also participated in the initiatives. That is, top managers also made their pay packages subject to the "new pay" practices, including variable pay.

5. <u>There must be a continuous evaluation of the effectiveness of new pay and reward strategies.</u>

Organizational restructuring is a dynamic process and the various functional strategies, including those involving the reward systems, must be continuously audited, monitored and evaluated. That is, organizations must ensure that the reward strategies keep up with, if not drive, the rate of innovation and change.

As this paper suggests, reward systems can, and should be designed to encourage creativity and innovation and sustain organizational change in today's business environment. It should be emphasized, however, that while it is important to keep abreast with "new pay" practices, it is crucial to remember that what works best for one organization may not work at all for another. The ultimate choice of the best compensation strategy in changing workplaces rests, in the final analysis, on its fit with other human resources activities and its fit with organizational strategy.

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