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

Renae F. Broderick
Assistant Professor of Human Resources
Graduate School of Management
University of California at Los Angeles
Los Angeles, California 90024

PAY POLICY AND BUSINESS STRATEGY

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

There are two theoretical reasons offered for the higher organization performance attributable to "fit" relationships between pay policy and these organization characteristics. First, if pay policy is contingent on an organization's business strategy -- that is, if it is designed and administered to support business strategies -- then appropriate employee behaviors are more likely to be defined and rewarded. By rewarding the appropriate employee behaviors, the organization is sending a clear signal about what is expected. This increases the probability of the desired performance (see Lawler, 1981; Ellig, 1982; Milkovich and Newman, 1984). Second, the notion of "fit" includes congruency between pay policy and the organization's design and administrative style. Such consistency is believed to increase employee perceptions of pay policy equity. Equity perceptions can, in turn, increase employee motivation to perform (see Lawler, 1971; Salter, 1973; Lorsch and Morse, 1974; Dyer and Theriault, 1976).

---

R. J. Niehaus (ed.), Strategic Human Resource Planning Applications
© Plenum Press, New York 1987
By increasing the chances of desired employee performance in these ways, pay policy appropriately related to organization strategy, design and administration could increase organization performance. If these performance relationships are true, then knowing how to develop pay policy that "fits" a particular organization could be advantageous in the management of human resources.

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

DEVELOPING MEASURES OF PAY POLICY AND "FIT"

This study focuses on the development of pay policy measures and the relationship between these measures and organization strategy. It is organized around two questions: (1) Can be important set of organization pay policies be identified and measured?; and (2) Do pay policies vary systematically across organizations with different business strategies? In order to investigate each question a search of the pay administration, human resource management and organization behavior literatures is coupled with an empirical examination of pay decisions in organizations.

REVIEW OF THE LITERATURE

Identification of Pay Decisions

The study's first question involved the identification and measurement of pay policies. In the literature, decisions on pay structure and level, mix, incentives and pay administration were consistently identified as important to the overall design and administration of an organization's pay system. These decisions are listed in Figure 2 (right hand column) and described below. Pay policy decisions are distinguished from more technical pay decisions such as those on methods of job evaluation or choice of the wage survey to be used in determining pay level (Lawler, 1981; Milkovich and Newman, 1984).

Pay Structure and Level. Pay structure is defined as the distribution of money rates paid to different jobs in an organization. Pay level is defined as the average of the total distribution of these rates (see Mahoney, 1979). The actual pay structure and level for a group of jobs or employees are determined by a number of pay decisions.

For example, in developing a pay structure for a group of jobs, the organization must determine the going rate for the jobs in the external labor market. At the same time, it must decide the emphasis to place on internal norma relative to these external prices (see Livernash, 1957; Belcher, 1974; Lawler, 1981; Milkovich and Newman, 1984). Other decisions are listed under the pay structure and level heading in Figure 2.

Pay Mix. Pay mix refers to the emphasis on a particular form of pay in the total compensation package offered for a specific group of employees. Typical forms of pay include base salary, benefits and incentives (pay increases related to performance). Organization that wish to reward employee loyalty and seniority often emphasize base salary and benefits in pay mix decisions. Organizations wishing to reward employee performance -- particularly very high performance levels -- often emphasize incentives (Belcher, 1974).

Pay Incentives. The pay decisions associated with incentives require that