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CAN COMPENSATION BE STRATEGIC? A REVIEW OF COMPENSATION MANAGEMENT PRACTICE IN LEADING MULTINATIONAL FIRMS

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ABSTRACT

Compensation is a key element of the employment relationship and, in addition to being the single greatest operating cost for many organizations, it has been advocated by some recently as a tool for enhancing organizational performance and sustained competitiveness. Contemporary approaches to compensation emphasize the importance of aligning employee behaviors to the strategic direction of the organization. Such approaches – broadly labeled strategic compensation, have become widely adopted by organizations. Yet our understanding of the nature of strategic compensation management is limited. Though strategic pay has been the subject of considerable academic and practitioner attention, it is argued that orthodox theories of strategic pay have a number of important shortcomings. Moreover, it is argued that there is much empirical evidence with which to challenge the received wisdom of strategic approaches to compensation. In exploring the use and effectiveness of strategic compensation in leading organizations, the findings of the study that forms the basis for this paper reveal that many organizations experience profound managerial difficulties when attempting to use compensation strategically. As a result, realised compensation practice often reflects neither what was desired strategically nor intended as policy. Often reflecting a poor fit for the organization, negative outcomes of strategic compensation systems include high costs, a greater administrative burden and industrial conflict manifest in a demotivated and disengaged workforce. More significantly still, the *mismanagement* of strategic compensation systems may induce undesirable employee behaviours resulting in unintended consequences that are often discreet and therefore difficult to remedy. In this sense, compensation clearly is important, but not as the value-creating activity purported by exponents of strategic compensation. Rather, it is a business risk that requires careful management and good governance to ensure that it does not diminish or consume more value than it creates. Theoretically, the study highlights a number of limitations of managerialist accounts of strategic compensation, and points instead to the importance of additional powerful, but currently underdeveloped, theory. Contingency and neo-institutional accounts of firm behaviour are seen in light of the empirical data to be particularly relevant and worthy of further research to enable a greater understanding of this important economic and social aspect of organizational behaviour.

Keywords:

Compensation, strategic compensation, risk and performance

CAN COMPENSATION BE STRATEGIC? A REVIEW OF COMPENSATION MANAGEMENT PRACTICE IN LEADING MULTINATIONAL FIRMS

Contemporary approaches to compensation emphasise the importance of aligning employee behaviours to the strategic direction of the organisation, an approach often labelled 'strategic compensation'. Yet our understanding of the nature of strategic compensation management in practice is limited. The research that forms the basis for this paper sought to explore the realities of contemporary compensation management in seven leading companies operating globally in the fast moving consumer goods sector. It has reviewed empirically *what* they are doing in relation to compensation, *how* they are doing it and above all, *why*. To address these issues, the study uses multi-level analysis and multiple methods to gain a rounded picture of contemporary compensation management in context. It is apparent that the organizations comprising the research sample experience profound difficulties when attempting to execute compensation strategies. Is strategic compensation, therefore, mere rhetoric?

This paper explores the theory and practice of strategic compensation. and starts by defining strategic compensation. In the second section, the theory of strategic compensation, which is based on a rationalist approach, is examined and critiqued and concepts of contingency and isomorphism are discussed as alternatives to the hegemony of the rationalist approach in contemporary human resource management (HRM) and compensation theory. In the third section some findings of the author's research are discussed providing an empirical basis for the final section. The paper concludes by suggesting that sights should be lowered: strategic compensation cannot and does not necessarily or automatically provide competitive advantage. Those responsible for determining an organisation's compensation strategy should, therefore, focus on risk management and not on economic value maximisation.

STRATEGIC COMPENSATION: THE BACKGROUND

Unlike traditional forms of remuneration, *strategic compensation* is not purely a cost of hiring the necessary labour as before; nor is it determined in most parts of the private sector by collective bargaining. Instead compensation is positioned within prescriptive literature as a means of aligning a company's unique and inimitable asset – their employees – to the strategic direction of the organisation and, in doing, securing competitive advantage and promoting shareholder value.

As Lawler (one of the greatest proponents of strategic compensation) has said: 'The starting point for any compensation system design process needs to be the strategic agenda of the organisation' (Lawler, 1990, pp.15). Once aligned with this agenda, compensation becomes a powerful means through which firms may attract and retain desired talent, and elicit desired behaviour outcomes in the form of employee motivation, commitment and loyalty, all of which are conducive to positive organisational performance. With a particular focus on performance, strategic compensation incorporates considerable scope for 'at risk' compensation, with employees' compensation potentially being contingent upon one, or a combination of, company performance, team/division performance and individual performance.

The primacy of managerial choice as the determinant of compensation practice is characteristic of strategic compensation. Strategic compensation differs substantially, therefore - conceptually and practically, in a number of important ways from traditional compensation. The emergence to the fore of strategic compensation has redefined the role and perceived contribution of compensation organisationally and economically. No longer merely a 'cost of doing business', when used strategically compensation is a source of economic value added and, along with other human capital measures, the means by which firms can secure sustained competitive advantage (Pfeffer, 1994).

Existing research illustrates that organizations are embracing strategic compensation widely. The Chartered Institute of Personnel and Development (CIPD) reviews compensation arrangements in the UK annually. Their Annual Survey Report 2007, reports that 35 per cent of respondents have a formal compensation strategy, with a further 40 per cent planning to introduce one in 2007. Large organisations are far more likely than smaller ones to have adopted a formal compensation strategy, with 49 per cent of organisations, employing between 1,000 - 4,999 employees, having had one for the past four years or more, and 57 per cent of organisations, employing over 5,000 employees, having had one for the past four years or more (CIPD, 2007). Respondents said that by far the most common goal for strategic compensation is that of supporting the achievement of business goals (84 per cent), closely followed by compensating high performers through performance differentiation (77 per cent) and the recruitment and retention of talent (68 per cent).

These developments are not confined to the UK alone, however. Proprietary consultancy data gathered from a sample of over one hundred Fortune 500 firms, all operating globally, reveal that all of them have had a global compensation strategy in place for four or more years (Mercer Human Resource Consulting, 2004). The main reasons given by respondents for introducing global compensation strategies include supporting global expansion (29 per cent), improved governance structures (17 per cent), cost management (15 per cent), compliance and reporting (12 per cent) and mergers and acquisitions (5 per cent). On a domestic, regional and global level, the survey data indicate that firms are embracing strategic compensation for the achievement of competitive advantage (ibid).

Additional data from Watson Wyatt Worldwide (2006), a remuneration consultancy, report a trend towards the increasing centralization of compensation management (determination). Fifty-six per cent of multinational firms within their sample, currently without a centralized compensation structure, were planning to implement one over the next two years, compared to 42 per cent in 2004. Two- thirds of multinational firms surveyed (66 per cent) report that they have adopted a globally consistent human resources strategy, including provision for standardized compensation arrangements. Over half of the sample organizations (51 per cent) have a formal or informal global total rewards strategy, with another 20 per cent planning to introduce a strategy within the next 12 to 24 months (ibid).

STRATEGIC COMPENSATION: THE THEORY

Rationalism

As noted, espoused theories of strategic compensation are all predicated on the notion of strategic choice. Choice in the strategic sense involves decision-makers selecting those compensation strategies and systems that are judged to be optimal through rational deliberation. Weber, in his classic treatise on bureaucracy and authority, distinguished between two forms of rationality necessary as preconditions of 'ideal type' bureaucracies (Weber, 1924). *Formative* rationality was achieved when the best means to a given ends, whatever that may be, were chosen. Referring to the ends themselves, *substantive* rationality was achieved when the purpose itself was rational (ibid). In the language of contemporary organisational behaviour, we might equate formative rationality with organisational processes and substantive rationality with strategic purpose. The notion of the ideal type bureaucracy and optimal strategic compensation investments share a lot in common. Both emphasise management exercising rational choice over the ends, and the means through which those ends are achieved as the route to economic maximisation in any given situation. In the context of strategic compensation, rationality might therefore be thought of as (a) the selection of strategic compensation practices which best achieve stated goals (the what) and (b) the selection of processes in support of the achievement of those goals (the how).

The influence of managerial choice on the shape and formation of compensation practice is firmly rooted in the voluntarist tradition of free will and choice free from limitation. Rational actors, or 'classicists', view leadership as the primary moderator of organisational behaviour (Whittington, 1997). Managers choose compensation strategies and dictate a path of action, whilst removed from the process of implementation. The parallel often drawn is that of a general directing the course of battle from atop a hill, but not personally taking up arms in combat. The presumption is that managerial decree equals corporate action. The organisation is in mission, design and performance, because it has been chosen to be so by management (Gerhart and Milkovich, 1990).

Key to the rationalist argument is the assumption that causal conditions preceding choice (for example, deterministic pressures emanating from the environment) are not, of themselves, sufficient to produce that outcome (de Rond and Thietart, 2004). There exists an array of potential choices within any given situation, each with merits and disadvantages and, therefore, more or less attractive as a result. In the language of the rationalist, the process of differentiating between options is one of preference ordering, and it is the ability to discern that which is most preferable, or optimal, and exercise the best choice accordingly, that renders the decision maker as rational. In the context of compensation determination, selecting the optimal means of supporting the achievement of corporate goals is using compensation strategically (Lawler, 1995). The presumption of managerial ability to choose compensation strategies and practices that result in predicted positive outcomes is a core belief of the prescriptive literature on strategic compensation. Simplistically, the manager, as decision maker, reigns supreme.

In a related vein, de Rond and Thietart (2007) note that the libertarian viewpoint on choice and free will is relevant for contemporary strategic management, because it provides a justification for the belief that we have choices available and that we are free to deliberate rationally over our choices. Similarly, the rationalist viewpoint promotes individuals' responsibilities, and accountability for choices made and actions pursued, precisely because of the ability and freedom to choose. However, if the action determined is beyond the control of the individual, then individuals cannot be truly held accountable for the resultant success or failure, and vice versa. This is consistent with the current emphasis placed upon the contribution of leadership and their accountability for corporate performance (Watkins, 2003).

Criticisms

Rationalism as the underpinning basis for compensation strategy is, however, not without criticism, both theoretical and practical. First at a theoretical level, rationalism assumes that decision makers have no information problem, but in practice they have only imperfect knowledge. 'We know only a fraction of the things we need to know' (Simon, 1959). This lack of information about the environment prohibits a decision maker from achieving objectives through optimal means. Secondly, decision makers, due to limited calculative ability, are incapable of anticipating and considering all options to solve a problem. Standard theory, however, assumes that all actors have unlimited cognitive ability to capture, co-ordinate and process information. Thirdly, decision makers are limited in the amount of attention that they are able to marshal for the capturing and processing of information. If one were to assume that decision makers had the computational ability to acquire and process all relevant data, they would be limited to considering the data piecemeal, and not holistically (Forest and Mehier, 2001).

In the face of such limits, decision makers necessarily adopt a 'satisficing' path that permits attainment of needs at some satisfactory (reflexively specified by self) level (Simon, 1957). The fundamental characteristics of the satisficing 'organism', as defined by Simon, include firstly, a limitation on the ability to plan long behaviour sequences. The limitation is imposed by the bounded cognitive ability of the organism as well as the complexity of the environment in which it operates; secondly, the tendency to set aspiration levels for each of the multiple goals that the organism faces; thirdly, a tendency to operate on goals sequentially rather than simultaneously because of the 'bottleneck of short term memory'; and lastly, satisficing rather than optimising search behaviour (ibid). Maximising strategies, like Weber's ideal type bureaucratic scenarios, are inherently problematic to achieve, given cognitive limits.

Another criticism of rationalism centres on the way that decisions are made. Are they made at the start, on a once-and-for-all basis or by evolution? Evolutionists, fundamentally, contest the ability of managers to negotiate the range of competitive pressures through what is called detached calculation. Survival through competitiveness is a constant struggle, in which there will always be winners and losers for reasons other than the 'mere' formulation of sound strategy. Even when the organisation is in a privileged position of advantage over the competition, the process of natural selection still serves to condition the shape, formation and intent of the organisation. It is markets and not managers that choose the prevailing strategies within a particular environment (Whittington, 1997), such as in global markets. Whilst theory has focussed mainly on product market competitive pressure, market fit applies equally to all areas of capital, including innovation, technical capital and, not least, labour. By definition, to survive is to be successful. Competitive pressures within markets naturally weed out weak performers and de-select them as part of the ongoing struggle of survival of the fittest (ibid).

This clearly has a bearing on compensation strategy shape and formation.

Processualist theorists also have little confidence in the ability of managers to plan rationally to secure profit maximisation (Whittington, 1997). For processualists, recognition of the complexity of the internal states of organisations is crucial. They reject both rational actor and evolutionary (market forces) accounts as efficiency optimisers, and embrace two radical departures from the received wisdom: the cognitive limitations of rational action, already discussed, and the 'micro-politics' of organisations (Cyert and March, 1963). The micro-political view of the company rejects unitarist notions of companies constituting a single entity, with perfect unity of interest, but views the company and the management structure instead as comprising groups and individuals each with their own interests. As a result, no strategy is ever developed fully in accordance with the aspirations of everyone within the company, but reflects instead a set of joint goals more or less acceptable to all the decision makers. (Whittington, 1997).

From a more practical perspective, and criticisms more closely related to compensation, there is a question of how a decision maker is to know whether his/her decision is optimal. There are currently no generally accepted accounting procedures for measuring human resources (Armstrong, 1995), so there is no yardstick for gauging the success or otherwise of strategic compensation. For instance, (Ferguson and Berger, 1985 pp29) say:

> As tempting as it is to try to establish a balance sheet value for a firm's human assets, such attempts are probably doomed; at this point it is not possible to calculate a figure that is both objective and meaningful.

Similarly Scarpello and Theeke (1989 pp275) say:

> At the theoretical level, human resource accounting is an interesting concept. If human

> resource value could be measured, the knowledge of that value could be used for internal management and external investors' decision making. However, until human resource accounting advocates demonstrate a valid and generalisable means for measuring human resource value in monetary terms, we are compelled to recommend that researchers abandon further consideration of possible benefits from [human resource accounting].

Even if one could measure human resource value, there remain a number of problems with asserting a linkage between human capital and human resource initiatives and organisational performance (Becker and Huselid, 1998; Guest, 1997; Legge, 2001). One problem is the problem of reverse causality. Are companies successful because of the way they manage their people (that is the deployment of human capital / human resource management (HRM) practices), or is it simply the case that successful firms deploy those human resource (HR) practices perceived to be of value?

Furthermore, given that strategic compensation is designed to enhance the organisation's competitive strategy, there are problems with classifications of competitive strategy, as such classifications are not mutually exclusive (Stacey, 1993). Rather, it is apparent that those organisations, primarily competing on the basis of low cost, are also able to compete on the basis of quality: in effect minimising cost whilst maximising quality (Legge, 2001). This reflects, perhaps, some of the conceptual 'fuzziness' of dominant strategic management theories to which, prescriptive literature suggests, HRM strategies, systems, processes and practices, should be aligned (Legge, 1995).

Contingency and isomorphism

Having looked at rationalism and its critiques, we now turn to contingency theory.

Contingency theory does not discount rationality and choice, nor is strategy formation viewed as an entirely determined outcome (Donaldson, 2001). The contextual characteristics of the organisation are treated as independent variables upon which the organisation's structure is dependent (Lawrence and Lorsch, 1997); so contingency theory rejects the purist notion of universality, with clear implications for notions of universal best practices, and redefines rationality as the choice of those strategies that best fit the organisation and its context. In one sense, this is the essence of strategic alignment.

The labour employed by the firm has been identified as a 'first order' variable upon which compensation system choices are contingent (Gerhart and Milkovich, 1990). Other 'variables' such as firm size (Donaldson , 1982), organisational life cycle (Balkin and Gomez-Meija, 1987), and company performance also influence the compensation system shape and formation.

Relatively little work has explored the influence of institutional pressures upon the outcomes of compensation determination. And yet, research on the institutionalisation of organisational forms would suggest that they might have an important impact upon the nature and outcomes of compensation determination (Kessler, 2001). In their seminal paper DiMaggio and Powell (1991, p.189) ask: 'why is there such startling homogeneity of organisational forms and practice?' The answer according to neo-institutionalist theory is isomorphism or conformity and DiMaggio and Powell identify three pressures leading to isomorphism: norms, mimetic behaviour (the desire to emulate the legitimate practice of 'influential others' due to uncertainty) and coercive regulation.

Norms, which also embrace rules, rituals and beliefs, influence organisations and their actors at multiple levels: at the individual level, in terms of informing the values of decision makers; at the firm level, the culture and politics of the organisation; and industry-wide norms at the inter-organisational level (Kessler 2001; Oliver 1997). Whilst an underdeveloped area, extant research highlights the highly influential nature of these determinants, but also reveals that they are often discreet in nature (DiMaggio and Powell, 1991). Measuring the impact and effect of such norms are, for this very reason, problematic (Donaldson, 2001).

As to mimetic processes, compensation specialists reference the experiences and practices of others, often emulating what is considered successful elsewhere, in order to inform choice and mediate risk in the form of failed change. Senior management (non compensation function) within multi-national firms also have a significant input into compensation determination. In terms of external expertise, management consultants and professional bodies stand out in terms of influence. Operating internationally, management consultancy firms offer advice and solutions to domestic and multinational firms on a range of compensation and compensation issues. Despite marketing a tailored approach, the consultancy advice, methodologies and technical solutions are necessarily standardised. This is perhaps inevitable because bespoke development of a solution is time and labour intensive and therefore ultimately less profitable.

A number of factors contribute to the isomorphic outcomes of professionalisation. Firstly, formal education encourages the development of organisational norms and shared rules amongst professionals which thus naturally pervade the organisations in which they are employed. Secondly, developed professional networks typically span organisations and provide a mechanism through which new models, rules and norms are diffused on an inter-organisational basis. The net result of professionalisation is:

> …a pool of almost interchangeable individuals who occupy similar positions across a range of organisations and possess a similarity of orientation and disposition that may override variations in tradition and control that might otherwise shape organisational

behaviour (DiMaggio and Powell 1991, p.175)

The largest professional association for personnel and human resources specialists in the UK with over one hundred and thirty thousand members is the Chartered Institute of Personnel and Development (CIPD). The CIPD provides codes of best practice relating to all aspects of employment management, including remuneration, guidance for practitioners on effective employment management in the form of conferences, seminars and workshops and, perhaps most significantly, an extensive range of taught courses and qualifications. The CIPD is not alone, with organizations such as the World at Work fulfilling a similar function in the US and globally. There are a plethora of other institutions that provide similar services, including consultancies, business schools and government sponsored programmes.

The transparency of financial markets also highlights winners and losers. Winners are regularly illustrated as best practice organisations, losers the opposite. Winners therefore become objects for other aspiring organisations to emulate, and institutions such as the CIPD facilitate such a process.

Standard theories of strategic compensation do not recognize the importance of the role of institutions, nor the degree to which choices are informed by institutional forces, both consciously and in ways that are taken for granted by decision makers. The greater the condition of uncertainty under which decisions are made, however, the greater is the likelihood that decision makers are likely to reference practice externally and become by degree, therefore, prone to the isomorphic institutional pressures pervasive within their organisational field. The implication is that compensation system choices are not driven by purely economic interests nor formulated through purely rational means. Institutional pressures are primarily social and political and not economic, which places the reality of compensation determination at odds with that assumed by standard theory. Compensation systems are **selected** for reasons other than for purely economic maximisation.

STRATEGIC COMPENSATION: THE PRACTICE

How well does strategic compensation theory stand up to scrutiny empirically? What are leading organisations doing and most importantly – how well are they doing it? In response to these issues, and using both quantitative and qualitative methods, primary case study based research conducted by the author reveals a portrait of strategic compensation practice in stark contrast with prescribed theory and practice, with important implications for performance, organizations and the people they employ (Trevor, 1997).

The research

Existing research investigating strategic compensation and related HRM practice does so according to assumptions about the causal linkages between practice and performance. The approach adopted here is not to view compensation practice in such 'one-dimensional' terms. Consistent with other multi-level approaches (see Kochan et al. 1986, for example), a *multi-level framework* was created for the exploration of companies' attempts to manage managerial, professional and technical compensation strategically. The first level, the compensation *approach*, reflects the implicit or espoused values, principles and aspirations that underpin compensation practice. The second level, the compensation *design*, reflects the technical content of the intended compensation policy. The third and final level, the compensation *operation*, reflects what is achieved operationally as compensation practice.

These three levels of compensation practice are not mutually exclusive. Nevertheless, it is possible to differentiate between the three levels: between the principles underpinning compensation, expressed in the form of compensation strategies; between the technical design of compensation practice, expressed in the form of policy; and between achieved compensation practice. In being able to differentiate between the three states of the same compensation practice, or system, it is therefore possible to assess any potential disconnection. What is desired (approach), and what is intended (design), may not be reflected in what is achieved in practice (operation). Such a nuance in the management of compensation practice, as an example, is neglected by standard theories of strategic compensation that assume linearity and discount the potential for disconnect between strategic conception and execution (Pfeffer and Sutton, 2000).

Data was gathered from seven case studies operating in the global consumer goods market(s), with extensive operations throughout the world. Combined, the sample case study companies employ currently almost 560,000 staff in a variety of occupations worldwide. Their combined annual sales are $160bn, and compensation spend is the single largest operating cost in nearly all of the case study companies. The seven case study firms all represent market leading, multinational firms competing within the global consumer goods sector. They compete in some, or all, of the major consumer goods markets, including those most common, namely tobacco, food, confectionery, beverages (alcoholic and non-alcoholic), home care products and other non-durable consumables. In addition to their sustained high performance, the firms are also all highly reputable, and referenced frequently as examples of best practice, 'excellent', brand leading firms with the consumer goods sector and more broadly.

All of the firms are very large, the smallest employing over 35,000 employees, and the largest employing at the time of research slightly fewer than 200,000 employees. All are multinational in scope, marketing and selling products in over one hundred countries in all cases, and with manufacturing and distribution facilities in multiple locations throughout the world.

The research was multi-level and multi-national in scope, reviewing compensation practice at industry, organisation, division and team level. Primarily the fieldwork, which was conducted in the period 2004-2006, included quantitative analysis of industry trends in compensation (in the UK and European FMCG labor market) and interviews with relevant stakeholders in the seven case studies described above. Over 150 interviews were conducted with senior managers, human resources directors, remuneration specialists, line managers and employees in nine countries and over 20 business divisions (in total).

Table 1: Summary of key case study company attributes

	Cig Co.	**Choc Co.**	**Booze Co.**	**Home Co.**	**Grocery Co.**	**Candy Co.**	**Food Co.**
Industry	FMCG	FMCG	FMCG	FMCG	FMCG	FMCG	FMCG
Sub-industries	Tobacco	Confectionery & beverages	Alcoholic beverages	Home, health and hygiene	Confectionery food and beverages	Confectionery food and pet care	Home, personal care, food & beverages
Size (no. employees)	98,000	58,442	48,000	56,000	94,000	38,000	206,000
Founded	1902	1824	30+ years	50+ years	1805	1911	1890
Life cycle	Mature	Mature	Mature	Mature	Mature	Mature	Mature
Ownership	Public	Public	Public	Public	Listed subsidiary	Private	Public
Org. structure	Holding Co / country structure	Business unit	Regional structure	Regional structure	Regional structure	Regional structure	Matrix
HQ	UK	UK	UK	USA	USA	USA	UK and Netherlands
Market Strategy	Brand led	Brand led	Brand led	Brand led and supplier	Brand led	Brand led	Brand led and supplier
Scope	Multi-national	Multinational	Multi-national	Multi-national	Multinational	Multinational	Multi-national
No. of facilities	54	48	21	36	95	65	100
Markets	160	135	180	150	155	120	150
Perf.	Market leading	Market leading	Market leading	Market leading	Market leading	Market leading	Market leading

Source: Datamonitor (2005, 2006) and company reports and accounts

Compensation management within seven in-depth case studies

Given their similarity in terms of organisational form and circumstance, as described above, one might expect to see conformity of compensation practice, if contingency theory has purchase. As market leading companies, theory would also presume that they are using compensation strategically in support of their superior performance.

We do indeed see very similar profiles of compensation practice across all of the sample firms. All organisations subscribe to strategic compensation philosophically, espousing the role of compensation as being the attraction, retention and motivation of valued talent and, most significantly, the means by which desirable employee behaviours might be induced. Moreover, they all deploy very similar compensation practices to achieve those ends. For instance, all seven firms deploy multiple forms of incentive system on a broad basis (multiple occupations and at multiple levels throughout the organisations), using one or more schemes at any one time depending upon the role and level of the employee. Incentives are determined primarily by individual performance, but moderated in all cases by overall company performance depending on employee role and level.

Equity ownership at a discounted rate is also a key element in the form of all employee share ownership programmes, options (on a restricted basis) and stock purchase plans (SPP). Six of the seven also offer a comprehensive range of flexible benefits, or 'cafeteria benefits', emphasising flexibility and personal choice in individuals' benefits, with the anomalous firm planning to introduce a similar scheme at the time of research. Yearly referencing of internal compensation structures against roles' external relativity – the external labour market – is the primary determinant of compensation levels, and all three firms have dedicated compensation professions that reside in all cases within headquarters operations. Interestingly, all of the case firms make extensive use of specialist management and compensation consultants when formulating compensation strategies, using the same firms of consultants and even the same individual consultants in a significant number of cases.

Using the multi-level framework described in the previous section reveals a more nuanced and more complex portrait of compensation determination, however. At the level of approach, the portrait of compensation practice of the seven case companies is strikingly similar. However, as table 2 illustrates, *how* those same compensation systems are *managed* differs from company to company, with implications for their perceived effectiveness and the compensation outcomes experienced as a result. Not only are they managed differently, but some of the case study companies manage their compensation systems more effectively than others.

In the case of *Cig Co.*, compensation is determined and managed locally within the overall guiding framework of the corporate compensation strategy (the articulated approach to compensation). The result is the deployment of compensation systems that reinforce performance expectations, throughout the firm, with the additional perceived benefit of binding the fragmented organization to the over-arching corporate identity and culture. Whilst a significant proportion of management and white collar employee compensation is placed at risk, performance based compensation systems are not viewed as incentives, but as rewards. Bonuses are determined post hoc and not according to a predetermined performance quantum or formula. Incentives are also, typically, bundled with above-market, median base compensation, generous benefits and complementary non-financial rewards. These include, for example, career opportunities, training and development and a positive work environment.

INSERT TABLE 2 ABOUT HERE

Choc Co. bears a close resemblance to *Cig Co.* Variable compensation systems are, again, managed as rewards and are complemented by generous base compensation, benefits and non-financial rewards. Compensation is viewed as a means of binding, culturally, the multiple subsidiary businesses that comprise the group organization overall. Given its history of growth through acquisition, this is considered an especially important outcome of compensation by senior management. In the case of both companies, the locus of compensation determination and the responsibility for effective management is devolved to line management. The role of the dedicated central reward function is to provide support and technical assistance to the line and to uphold the clearly articulated corporate approach to compensation – the compensation strategy.

Discretion over compensation choices and responsibility for execution is purposefully devolved to line management reflecting a corporately held view that compensation is best managed in the local context. The result is locally determined compensation systems representing multiple variations on the same theme – the articulated compensation approach. compensation for *Cig Co.* and *Choc Co.* is a core element of the overall employee proposition. In the hands of line management, it is not used as the strategic lever envisaged by proponents of strategic compensation, nor is it used as a means of corporate control. compensation is used to support the achievement of local business objectives and not to drive them. There is a recognition that compensation is something that, if mismanaged, can lead to negative outcomes in the form of conflict, and the associated organizational implications, and is therefore best managed almost as a matter of governance. More than getting it right strategically, the emphasis, within the three firms, is on not getting it wrong.

Booze Co. shares a similar philosophy about devolving primary responsibility for compensation determination to line management. However, unlike *Cig Co.* and *Choc Co.*, *Booze Co.* fails to articulate and disseminate clearly the corporate approach to compensation.

The approach to compensation adopted by *Booze Co.* senior management neither guides the determination of compensation locally, nor does it communicate to the organization what senior management value in terms of performance expectations, values and behaviors. The central compensation function provides merely the mandate that end markets (business units) are required to incorporate compensation at risk as part of employees' total compensation, and provides basic minimum standards to which line management must comply when determining compensation. Such standards include equal opportunities, for example. Whilst compensation is locally determined, however, business unit performance targets (a measure of performance upon which performance compensation is typically contingent) are centrally determined and do not, it is felt, represent practicable and achievable targets in the context of end market operations. As such, compensation systems reinforce behaviours that are in some case misaligned with local markets and result in conflict, dissatisfaction, disengagement and employee disenfranchisement.

Compensation within *Candy Co.* and *Home Co.* is determined centrally at the regional level (Western Europe) for example, within the overall framework of the corporately determined compensation approach. Both firms have their headquarters in the USA, but the design and operation of the compensation approach are managed differently. At *Candy Co.*, the emphasis remains on selecting compensation systems which are in the interests of ensuring good governance and the best possible 'deal' for both employee and employer, consistent with their stated corporate value of mutuality and the paternalistic ethos that continues to pervade the firm, despite recent poor performance against competitors. *Home Co.*, on the other hand, desires conformity of the local organization to central planning, rules and checks in the interests of standardization and corporate control. Compensation policy within *Candy Co.* is viewed by line management as operationally limiting, as a result of insufficient flexibility built in for the 'best fit' management of compensation locally. compensation policies are disseminated regionally within *Home Co.* to business units in the form of a mandate, which is felt to constrain local leaders in attempting to manage their employees as they would otherwise wish. Even at a regional level, the tension between centrally determined policy, and decentralized compensation execution, is a manifest challenge organizationally.

In the case of both companies, however, compensation is intended to be, in principle, a measure that reinforces a broader employment proposition. Compensation is intended to promote a sense of 'team' and corporate belonging and not the achievement specifically of corporate objectives. The performance based element of employees' total cash compensation is, therefore, aligned to regional performance measures. However, the degree to which individual employees or teams are able to influence regional organizational performance is a perennial issue, with the frequent complaint being the limited line of sight between employees' individual contributions and the overall success of the firm. Arguably, as they are managed, the compensation systems are of limited value and, by aligning employee compensation to regional performance, potentially demotivating.

Food Co. shares a similar compensation approach to *Cig Co.* and *Choc Co.*, but differs at the design stage by emphasizing the alignment of compensation to the corporate organization over the local organization, in an effort to achieve levels of corporate fit. As such, the compensation design takes the form of practice prescription and formal policy, informing the design and management of compensation at the business unit/country level of the firm. However, acknowledging 'one size does not fit all', scope for local discretion is built in, allowing for some adaptation by local management to local business needs, thus resulting in compensation systems that are aligned to both corporate and local performance targets.

The result is a globally consistent compensation system, emphasizing line of sight to both corporate and local targets, that leads both performance and behaviors by placing a greater degree of employee compensation at risk in comparison to the other two cases described above.

However, *Food Co.* fails, arguably, to support the process of local adaptation – and therefore the effective management of their compensation systems – by not providing support on processual activities such as performance management, communication and other related areas of HR intervention. The linkage between performance management and compensation systems is often not clearly understood, serving to undermine the much sought after 'line of sight' between individuals' performance and their compensation. Moreover, contrary to what is intended, compensation continues to be treated as a stand alone element, and not integrated with performance management and development for example, with the result that the employment offering often appears piecemeal when viewed from the perspective of the employee.

Grocery Co. differs by mandating compensation systems corporately that constrain local management when attempting to best manage their employees. By aligning compensation systems to corporately determined targets, and placing significant levels of employee compensation at risk, the findings suggest that the compensation systems used direct employee interests and behaviors in ways contrary to the interests of their business unit operations. Moreover, the structure and management style of the firm is such that the negative aspects of the compensation systems used are not communicated upwards, compounding the gap between the rhetoric of the approach, the intended design and the achieved operation. Not only does compensation represent an obstacle to company performance and value creation, but it also poses a risk, threatening to destroy value, unbeknownst to compensation decision makers located centrally and operating corporately.

In terms of compensation outcomes, some firms clearly experience better outcomes than others. In the case of both *Cig Co.* and *Choc Co.*, representative opinion of line management and the compensation function would contend, experience positive outcomes that are organizationally beneficial and directly (but not solely) attributable to the compensation systems they deploy. These outcomes include, principally, compensation acting as a symbolic communicator of what is important to the organization's leadership and reinforcing a culture of positive behaviors. What it is not, however, is an instrument, tool or lever through which the leadership are able to direct the company's human capital. The findings indicate that it is those case study companies that do attempt to use compensation in this way that experience the greatest degree of compensation system ineffectiveness. Compensation system ineffectiveness is manifest in the degree of 'gap' between what is desired strategically and intended as policy, and what is achieved as compensation practice operationally. Clearly, there is a strong relationship between the form and effectiveness of compensation systems realized operationally, and the locus of determination. The greater the degree of centralized compensation system determination, the greater the likelihood of a disconnection between the compensation approach, design and operation it seems.

Overall however, the findings indicate that in all of the case study companies, the strategic compensation systems used operationally do not yield fully the benefits promised by advocates of strategic compensation. Compensation remains an important component of the ability of the firm to attract and retain desired labor. Compensation is also a powerful communication tool which symbolically conveys the performance and behavioral expectations of senior management to employees. Variable compensation, tied to company performance, also provides the means of transferring the costs and associated risks of poor corporate performance on to employees, and thereby serving to reduce wages as a fixed cost and barrier to enhanced profitability. Such a benefit of introducing variable compensation is, however, rarely publicized.

In attempting to use compensation to achieve such outcomes, and if managed improperly, as illustrated above, a number of negative outcomes may result, ultimately diminishing company performance and destroying value in place of creating it. In practice, the experience of the case study companies would suggest that attempting to use compensation strategically carries with it a number of risks, not least the possibility that the strategic compensation systems deployed achieve precisely the opposite of what they are supposed to.

Discussion

What can we observe from analysis and comparison of the seven case studies? Firstly, all seven organisations, which are very similar when assessed using criteria such as industry, size, age, life cycle, all share at first sight very similar profiles of compensation practice, but deeper analysis highlights profound differences. For example, the role of compensation in *Grocery Co*. might be characterised as corporate control. In *Cig Co.* this is less so, and might be characterized as an attempt to *lead* the overall organisation corporately in a defined strategic direction. The emphasis in *Choc Co.* is fostering and sustaining a commitment based culture orientated around the local organisation, but operating under the umbrella values of the group organisation overall.

Secondly, and perhaps most significantly, what is intended is not what is always achieved in practice. A simple observation conceptually but of grave significance practically, is the existence of a disconnection – or *gap* – between the three levels of the compensation determination process. All classical conceptions of strategic management assume that intent translates directly into action (Wright and Nishii 2004; Whittington 1997). The findings illustrate clearly, however, the pervasiveness of a gap between compensation strategy, policy and execution in each of the case study companies – albeit to a greater or lesser degree per case. The implication is that, irrespective of strategic desire or the saliency of the design, ineffectual execution results in ineffectual compensation practice which then impacts negatively upon the compensation outcomes experienced as a result. Whilst mainstream studies continue to investigate the nature of the linear relationship between practice and performance, such studies are moot if 'realised' compensation practice differs from the 'espoused' (Mintzberg 1978). The neglect of the gap between strategy and execution is therefore a critical weakness of strategic theories of compensation.

This distinction between intended and actual practice is largely omitted from strategic management literature. Very little of the research underpinning standard theories of strategic compensation recognize that 'not all intended HR practices are actually implemented and, those that are, may often be implemented in ways that differ from the initial intention' (Wright and Nishii, 2004), and the findings clearly lend support to this. Despite rational planning at the design stage, selected compensation systems are rarely perfectly applied or enacted by those charged with implementation – typically line management – for a variety of reasons. In the language of Gerhart and Rynes (2003), functional compensation strategies are neither successfully implemented nor executed.

The implications of the gap between compensation strategy and execution are all too real. Contrary to espoused compensation theory and the prescriptions of strategic compensation proponents, the experience of strategic compensation in practice, when observed through the lens of multiple dimensions, reveals a highly complex process of compensation determination where the outcomes are far from certain a priori. Indeed, in the case of Grocery Co., and in all of the cases albeit to varying degrees, a great many unintended consequences are encountered as a result of the strategic compensation systems deployed in the hope (and expectation) of positive performance outcomes. As a result of these unintended consequences, similar firms using the same compensation practices do very different things operationally and experience very different outcomes.

Third, compensation may not fulfil the stated strategic objectives of motivating managerial, professional and technical employees to work harder. *Grocery Co.*, represents a cautionary tale for those attempting to use strategic compensation systems. The desired outcomes of a high performance work culture, an organisation aligned to mission and goals and desirable behaviours and productivity are, if they are present in Alpha, not the result of the strategic compensation. Rather the organisation, which is of course market leading, is successful in spite of compensation, not because of it.

Arguably, more than merely ineffectual, the compensation systems used are positively damaging and are quite the opposite of what was desired (approach) or intended (design). Indeed, there are numerous examples in *Grocery Co.* of conflict arising from poorly managed strategic compensation practices, conflict that is overt and manifest, and therefore apparent to management, but also conflict that is discreet and therefore much more difficult to remedy. Such discreet conflict takes the form of employee demotivation, disengagement and disenfranchisement, resulting in poor performance, employee attrition and behaviours that consume or destroy value.

Moreover, the centralised and standardised ethnocentric nature of the enforced compensation design – which in many divisions is a poor fit for the local organisation – creates a great deal of work for local line management who are necessarily required to adapt (or subvert in extreme cases) the imposed system to avoid the inevitable conflict. Implementing such poorly aligned systems is not only problematic, but extremely time consuming, and therefore a burden, and distracts from the strategic goals in hand.

Fourth, analysis of the case studies provides renewed support for contingency. At the organisational level contingency predictions are borne out by empirical observations of the compensation practices of the case organisations. However, the same contingency effect at sub-levels of the case study organizations encourages divergence which is observed particularly at the level of operation. In short, the influence of contingency is a key factor shaping compensation practice at all levels of the organisation and at each stage of the determination process.

Finally, in addition to the importance of contingency, this research provides strong support for the salience of isomorphism. Isomorphism or conformity as a result of social and political pressures is observed especially at the level of approach. The seven competing organisations draw on the same pool of managerial employees, who move often interchangeably from one employer to another and, as noted above, all use the same advisors, and thus inevitably according to neo-institutionalist theory, adopt essentially the same compensation practices.

In summary, the findings suggest that attempting to use strategic compensation systems, such as incentive compensation, results often in unintended consequences and negative outcomes that destroy value and do not create it. The case study company findings overall are littered with examples of strategic compensation systems producing outcomes precisely the opposite of what was desired strategically, including employee de-motivation and disengagement, misdirected behaviours and conflict. In process terms, strategic compensation systems place significant demands on managerial time and effort operationally, particularly when managers have to reconcile the negative tensions that arise as a by-product. Strategic compensation can, therefore, represent a significant organisational risk if managed improperly and a far cry from the value-added means of securing competitive advantage envisaged by strategic compensation proponents.

CONCLUSIONS

The main implication of the findings from this research is that theory is out of step with reality and may represent a largely unattainable ideal in practice. It would be overly pessimistic and wrong, however, to conclude that compensation cannot be strategic in any sense because of the managerial limitations identified. Choice may be limited, but managers are still able to exercise a *degree* of choice. Thus, it is argued here that a revision and not an abandonment of strategic compensation is required.

Clearly, attempting to use compensation strategically is not as straightforward as prescriptive commentary, or advocates of strategic compensation, suggest. A key implication of the research is that standard theory has established an ideal with little practical grounding that is, as a result, inherently challenging to achieve operationally. Moreover, practitioners not only cannot avoid achieving only limited success, but also run the risk of incurring negative outcomes as an unintended consequence of attempting to use compensation strategically.

Despite the difficulties encountered by all, some case study companies clearly experience better outcomes than others – in large part because of their approach to the use and management of strategic compensation systems. In the light of the findings, firms should approach the prescriptions of strategic compensation advocates with caution and adopt more modest expectations of the desired compensation outcomes. Thus the findings of this study challenge many key aspects of standard theory and provide the basis for a grounded reorientation of standard theory to reflect more clearly the reality of strategic compensation in practice.

A revision to theory would necessarily have to incorporate sensitivity to the managerial aspects of compensation practice and the importance of effective management of compensation systems to compensation system effectiveness, an issue overlooked by existing commentary. The current focus on the practice and performance linkage to the neglect of the gap between strategy and execution is one such area requiring revision. If sensitive to such issues, a revised approach to strategic compensation would necessarily be less ambitious in terms of promised outcomes.

Whilst challenging a compelling and enduring corpus of literature, this view is consistent with some of the most recent commentary on strategic compensation. Armstrong and Brown (2006), formerly two of the most vocal advocates of strategic compensation having produced over nine practitioner orientated books between them alone, reflect on developments to strategic in the United Kingdom and call for a 'new realism'. They say:

> When mostly North American concepts of strategic HRM and rewards first entered into management thinking and practice in the UK we were some of their most fervent advocates, writing and advising individual employers on the benefits of aligning their reward systems so as to drive business performance. We helped articulate strategic plans and visions, and to design the compensation and compensation changes that would secure better alignment and performance..... Some 20 years later, we are a little older and a little wiser as a result of these experiences. We remain passionate proponents of a strategic approach to reward management..... but in conducting this work *we have seen some of the risks* and opportunities ..... at times *there has been an over-ambition and optimism in terms of what could and couldn't be achieved by*

changing compensation and reward arrangements.....' (Armstrong and Brown, 2006, p.1 – emphasis added).

In principle, strategic compensation remains a laudable ambition. Companies continue to aspire to use compensation strategically and, despite the challenges encountered, show little sign of deviating from their current trajectories nor adopting alternative approaches – indeed, alternative approaches are not obvious, such is the pervasiveness of the strategic approach. Can firms move beyond the orthodoxy of strategic compensation? Any change to the prevailing status quo would necessarily have to be incremental, given the inertia of company practice, the taken for granted associations developed in the minds of decision makers and the norming effects of a labour market where so-called strategic compensation interventions are not simply commonplace, but benchmarks to which both firms and employees attach great value. Nevertheless, the findings presented in this paper prompt a call for a fresh perspective that better reflects the reality of strategic compensation.

A fresh perspective

What might a fresh perspective look like? Whilst having concluded that even leading companies struggle to manage strategic compensation effectively with the result that compensation is often non-strategic operationally, the research does not in any way contest the continued importance of compensation. The findings suggest that an alternative approach to the use of compensation systems *in support* of strategy is required: one that acknowledges the relative limits on the ability of companies to manage compensation strategically by the terms of standard theory and incorporates provision for a redefined contribution that would better serve the aim of securing competitive advantage.

The use of compensation was not always thought of, or practised, in strategic terms.

For example, as discussed previously, compensation within post-war Britain was determined primarily as a result of collective bargaining conducted at multiple levels – occupational, industry and multi-employer. Such centralised compensation determination served to take wages out of competition between employers. Management was neither free, in principle, nor empowered, in practice, to determine compensation unilaterally for the achievement of purely managerial ends. Compensation represented a 'cost of doing business' or, more particularly, the cost of hiring the labour necessary to do business.

The philosophy underpinning the employment relationship differed too, emphasising the pluralism of interest between employer and employee. Bargaining arrangements were focused predominately on the avoidance of conflict through negotiation. The risks of not reaching a mutually acceptable settlement included strikes and other forms of well publicised industrial action. Whilst not expressed in such terms, industrial action, in its various forms, represented a significant business risk. Compensation was not, itself, used to secure competitive advantage, but was considered to be a critical risk that required careful management to avoid the crippling effects of industrial conflict. The value-added outcomes of compensation are hard to define and equally difficult to measure, but the negative consequences of 'getting compensation wrong' are all too obvious.

In trying to move beyond the dominant logic of strategic compensation, do we perhaps need to reflect on what compensation was – traditional compensation? The research illustrates that many of the features of old compensation continue in practice to pervade the operational management of compensation, strategic or otherwise. Despite the underlying ideology of strategic compensation being one of unitarism, the management of compensation operationally continues to be characterised by pluralist relations between employer and employee, and by pluralism within the management structure itself. Given these, and other challenges involved, our definition of what constitutes strategic compensation might be re-scaled to reflect more clearly the reality of compensation in practice. The strategic contribution of compensation should not be to maximise value, given the constraints on the ability of companies to do so, but to minimise the inherent risks associated with compensation, whether used strategically or not. Indeed, what is maximisation in compensation determination? In practice, compensation professionals are not 'strategic partners', but risk managers, and continue to fulfil a great number of the tasks and activities characteristic of old compensation, such as conflict resolution. Effective compensation management, in practice, is effective risk management and attempts to manage it on any other basis are inherently, and inevitably, problematic. Future research on compensation might profit greatly by developing further the risk thesis proposed above.

It is recognised that such a revision will not prove popular with large sections of the compensation profession, remuneration and management consultants, academics, and others with a vested interest in the success of strategic compensation conceptually and prescriptively. They will find it overly negative – pessimistic perhaps – and may challenge the conclusions drawn from the findings by citing numerous counter examples and stories of success. The methods used here, necessary to gain the insights presented as findings, may also be criticised on those same grounds that relegate qualitative studies of compensation to a secondary position in terms of importance to dominant positivist studies – namely reflexivity, lack of the ability to generalise and other such acknowledged limitations. The research upon which this paper is based, however, was not conducted with the aim of reforming the opinion of the faithful, but to put forward an alternative perspective garnered as a result of grounded experience. It is hoped that, ultimately, the findings and conclusions presented here will resonate most with those for whom attempts to use strategic compensation systems prove the most problematic – a frustrated and often much maligned compensation function and long suffering line management.

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Table 1: Case study company compensation practice and outcomes at the levels of approach, design and operation

Level	*Stage*	*Description*	***Cig Co.***	***Choc Co.***	***Booze Co.***	***Home Co.***	***Grocery Co.***	***Candy Co.***	***Food Co.***
Approach	*Context*	*Aligned to*	Mission and values	Mission and values	Mission and values	Mission and values	Mission and values	Mission and values	Mission and values
	Variation	*Aspiration*	High performance work culture	High performance work culture	Employer of choice	High performance work culture	High performance work culture	Employer of choice	High performance work culture
	Selection	*Content*	Total rewards model	Total rewards model	Total rewards model	Total rewards model	Total rewards model	Talent model	Total rewards model
		Form	Guiding framework	Guiding framework	Implicit	Code of practice	Implicit	Code of practice	Guiding framework
	Retention	*Perceived impact*	Symbolic	Symbolic	Ambiguous	Symbolic	Ambiguous	Symbolic	Symbolic
Design	*Context*	*Aligned to*	Local organization	Local organization	Local organization	Regional organization	Corporation	Regional organization	Corporation
	Variation	*Aspiration*	Local fit	Local fit	Local fit	Conformity	Conformity	Good governance	Corporate fit
	Selection	*Content*	Guidance on good practice	Guidance on good practice	Mandate	Precise planning, rules and checks	Precise planning, rules and checks	Precise planning, rules and checks	Practice prescription
		Form	Minimum standards	Minimum standards	Minimum standards	Mandate	Mandate	Formal policy	Formal policy
	Retention	*Perceived impact*	Guiding	Guiding	Mandate	Limiting	Constraining	Limiting	Limiting
Operation	*Context*	*Aligned to*	Local targets	Local targets	Centrally determined targets	Centrally determined targets	Centrally determined targets	Regional and / or product	Corporate and local targets
	Variation	*Aspiration*	Autonomy	Autonomy	Autonomy	Enforced scheme	Enforced scheme	Compliance	Enforced scheme
	Selection	*Content*	Post hoc reward	Post hoc reward	Directional	(some) line of sight	Directional	(some) line of sight	(some) line of sight
		Form	Reinforcing	Reinforcing	Misleading	Reinforcing	Misleading	Reinforcing	Reinforcing
	Retention	*Perceived impact*	Culturally reinforcing	Culturally reinforcing	Neutral Demotivating	Neutral Demotivating	Risk	Neutral Demotivating	Neutral Demotivating