Compensation and Culture: A Configurational Fit between Pay System and Culture Types

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For most companies, compensation represents the largest single expenditure, and compensation is recognized as an important mechanism for organizational performance. Pay strategies also have the important role of underpinning and supporting organizational culture, and research suggests that failure to support organizational culture can precipitate a company's failure. Understanding the convergence of these two domains represents an important area of research. We propose that four different culture classifications might each be supported by unique combinations of either an egalitarian or hierarchical pay distribution, in combination with or without pay-for-performance compensation strategies.

INTRODUCTION

Pay is essential to both individual employees and the organization, as it perhaps is the most important reward employees receive and represents one of the biggest costs for an organization (Gupta & Jenkins, 1996). Research also suggests that failure to support organizational culture is a leading cause of organizational failure (Cameron & Quinn, 2006) The intersection of these two important areas of organizational concern is an interesting and worthy focus for research.

The purpose of this paper is to suggest an optimal relationship between organizational culture and compensation practices. The authors propose that specific organizational cultures are supported by appropriate compensation strategies such as a pay dispersion method or pay-for-performance (PFP) incentives. Lawler (1990) suggests that culture is supported and strengthened using appropriate compensation strategies.

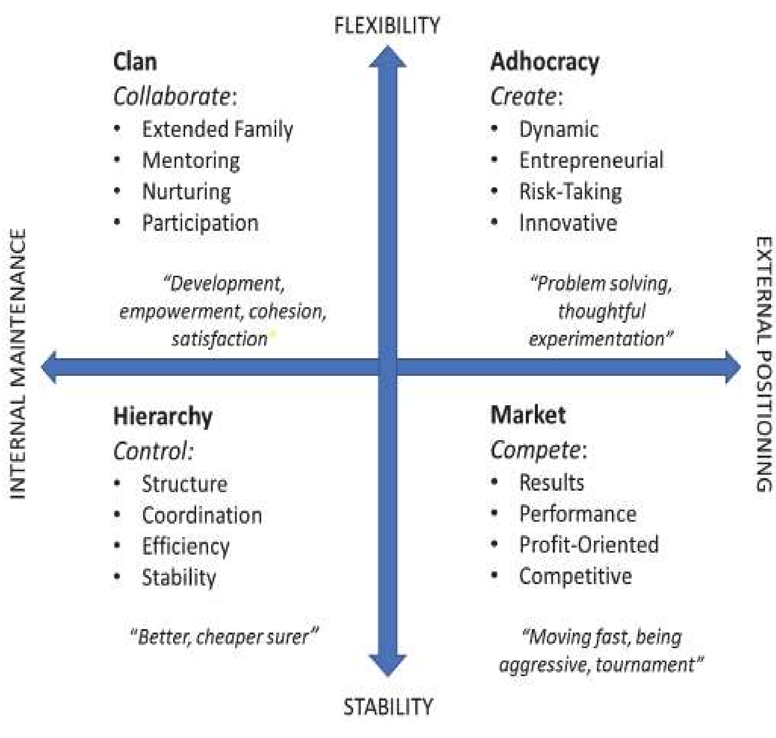
Most firms have developed an organizational culture that is clearly identifiable (Cameron & Quinn, 2006). Organizational culture is an important managerial mechanism that leads to increased employee commitment (Silverthorne, 2004), is a source of motivation (Maithel, Chaubey , & Gupta, 2012), enhances commitment and team work on the part of organizational members (Ghorbanhosseini, 2013), and has a positive relationship with organizational citizenship behavior (Mohanty & Rath, 2012).

Therefore, sustaining appropriate organizational culture is a critical aspect of organizational well- being (Santos, Hayward, & Ramos, 2012).

Organizational Culture

Organizational culture is defined as general behavior patterns, beliefs, and collected and shared values which are considered generally common among organizational members (Cameron & Quinn, 2006). Robbins defined organizational culture as specific ways of running affairs in the organization, or a shared perception of organizational values which is observed by organizational members and reflect common and permanent characteristics that distinguish the organization from other organizations (Robbins, 2010). The competing values framework (CVF) (Quinn & Rohrbaugh, 1981) is a tool for classifying different organization cultures based on the contrasting dimensions of a focus on flexibility or stability, and internal or external focus (Cameron & Quinn, 2006). This framework describes the cultural orientation as well as underlying values of four different culture classifications: Clan, Adhocracy, Hierarchy and Market (See Figure 1).

FIGURE 1
CULTURAL FRAMEWORK SUMMARIZING THE FOUR ARCHITYPES



Source: *Diagnosing and Changing Organizational Culture*, (Cameron & Quinn, 2006).

The CVF demonstrates congruence with accepted categorical schemes that organize the way people think, their values and assumptions, and the many ways they process information (Cameron, Quinn, Degraff & Thakor, 2006). The CVF categorizes organizational types in a 2 X 2 matrix that centers on the dimensions of organizational flexibility versus control, and internal maintenance versus external positioning (Cameron, et al., 2006). Some organizations exist in stable environments while others must contend with elevated levels of dynamism. As a consequence, organizations in stable environments tend to be controlling, rigid, highly structured and mechanistic (Burns & Stalker, 1961; Zanzi, 1987), while those in dynamic environments must be less structured, nimbler, flexible and organic (Burns & Stalker, 1961; Courtright, Fairhurst & Rogers, 1989).

Moreover, some organizations tend to be internally focused while others are externally oriented to their environment. The opposing dimension of positioning draws attention to the tendency of an organization to be either centered on internal processes, such as collaboration between organizational members or exercising control over them, versus an external focus on striving to compete or to create products fit for market (Cameron, et al., 2006).

Figure 1 graphically represents the CVF, and each quadrant in the CVF represents a type of culture (Cameron & Quinn, 2006). Specifically, each culture type is characterized by a unique set of shared beliefs, style of leadership, and sets of shared values that act as a bond for members, and varied strategic emphases in pursuit of effectiveness. (Daulatram B., 2003)

Clan Culture

Clan culture, in the upper left quarter of the CVF, represents a culture that is congruent with an internal focus and a flexible, organic organization. Clan culture tends to be collaborative in nature, with a developmental value system. It is considered a family-oriented culture existing in an egalitarian organization. Upper management commonly assumes the role of mentors and coaches. Loyalty and group work are important here. Employee collaboration is a key process and long-term employee development is practiced. Generally, rewards are distributed on an egalitarian, rather than a merit basis, consistent with the collaborative spirit that prevails in the Clan culture (Cameron, et al., 2006).

Adhocracy Culture

Adhocracy culture is in the upper right quarter of the CVF and represents a type of culture that is congruent with an external focus, along with the characteristics of a flexible, organic organization. Adhocracy emerges in companies facing dynamic environments. Employees in this culture commonly are risk takers and the leadership style is entrepreneurial. Adhocracy culture shares the collaborative nature of the Clan culture type, but differs in that the focus now becomes problem-solving, creativity, and developing products that are fit for market. Often this means that new teams form and employees work together to accomplish short term goals. Once the goal is accomplished, the employees are assigned new teams for another task. The work environment can be very flexible, for example, it would not be uncommon for meetings between team members to be held informally in coffee shops. Adhocracy is also considered an egalitarian type of organization, though rewards may be bestowed based on employee creativity and innovation (Cameron, et al., 2006).

Market Culture

Market culture, in the bottom right quarter of the CVF, represents a culture that is congruent with an external focus, and operates in a relatively stable environment. Market culture organizations tend to be competitive and reactive in nature, thriving on rivalry within their industry. This manifests as the company forms exchange relationships with external clients, and jockeys its competitive position with rivals, leading to an external focus. Organizational goals are short-term and oriented toward financial performance, such as market share and profitability. Commonly employees are rewarded for individual performance. Rather than being collaborative, the relationship between employees is generally tournament-based, promoting competition between employees for the purpose of reaching aggressive financial performance goals (Cameron, et al., 2006).

Hierarchy Culture

Hierarchy culture in the bottom left quarter of the CVF, representing a culture that is congruent with an internal focus and tight control over employees. Hierarchy culture tends to be controlling in nature, here the organization tightly guards against process failure. This is a bureaucratically oriented culture, where rules and following formal procedure prevail. Leaders are coordinators, monitors, organizers and enforcers. Stability, predictability, and efficiency are paramount values. Employees tend to be rewarded individually, however in contrast to a Market culture, rewards are commonly based on tenure and loyalty (Cameron, et al., 2006).

Compensation Strategies

Pay distribution is defined as an array of compensation levels paid for difference in pay grades, based on work responsibilities, human capital or individual performance within a single organization (Milkovich & Newman, 1996). Bloom (1999) suggest that the two prominent pay distribution types are *egalitarian* and *hierarchal* (See Table 1). The differences can be observed as the degree of change in pay rates of the various pay grades, or job levels, across the organization. This change can be represented graphically as the slope of pay rate as compared to pay grade.

TABLE 1
HIERARCHICAL PAY STRUCTURE AND EGALITARIAN PAY STRUCTURE

	Hierarchical	Egalitarian
Pay Levels	Many	Few
Pay Differential Between Levels	High	Low
Slope of Graph	Rising Steeply	Rising Gently
Supports:	Individual performers Performance Opportunities for promotion Individual Contributions Focus on current job	Teams Equal treatment Cooperation Knowledge sharing Cross training & development

Hierarchical pay distributions have a relatively steep slope that would represent large incremental increases in pay for each advancement in pay grade. Hierarchical distributions place value on the differences in work content, individual skills, and individual contributions to the organization. Hierarchical distributions feature multiple numbers of pay grades that encompass narrower groupings of equivalent positions. Thus, there is a tendency to "narrow band", creating more rather than fewer groups of pay grades allowing for rapid assentation through the ranks for high-performing individuals. Pay is more widely varied among pay grades and less equal across pay levels (Bloom, 1999). Hierarchical distributions might also serve to attract talent and motivate individual performance (Milgrom & Roberts, 1992).

In contrast, egalitarian pay distributions represented on a two dimensional graph have a relatively shallow slope that would represent smaller pay differences between various pay grades. Egalitarian structures have fewer pay grades, grouping more similarly valued positions together, also known as "broad banding". Importantly there are relatively smaller pay differentials between adjacent pay grades and between the highest and lowest paid workers (Milgrom &Roberts, 1992).

In comparison to pay distribution*, compensation strategies* center on the basis by which rewards are allocated. A widely used compensation strategy of note is pay-for- performance (PFP). PFP is defined as a pay strategy where evaluations of individual or group performance have significant influence on the amount of pay increases or bonuses given to each employee (McPhie, 2006). Pay for performance is increasingly a topic of interest for Human Resource managers due to its wide acceptance by corporations

(Gomez-Mejai, Welbourne, & Wiseman, 2000). A survey of 1,861 companies indicated that 61% had implemented variable compensation systems (Hein, 1996).

Configuration Fit Between Culture and Compensation Strategies

For the purposes of this paper, we would like to define the *pay system* as the combination of a pay distribution and compensation strategy that an organization might employ. Research suggests that the pay system represents a particularly effective means of supporting an organization's culture (Kerr & Slocum, 1987). Employees in specific cultures tend to have similar vision, goals and behaviors. Thus, the pay system should reflect these behaviors and set an appropriate relationship between the employees and with management. In the CVF there are four dimensions that describe the behavior and characteristics of each culture, which might further suggest the optimal pay system for each culture.

The dimension of organizational flexibility versus stability suggests that Clan and Adhocracy cultures are more flexible, organic organizations. By their nature organic organizations require more internal collaboration among organizational members than mechanistic organizations, with generally higher levels of interdependence. This suggests use of egalitarian pay dispersion practices might be appropriate. Wide disparities in pay between individuals within a collaborative team might create jealousies that inhibit the willingness of team members to work together. As pay structures become too hierarchical, organizational performance may be adversely influenced because employees will become less cooperative and less inclined toward collaboration. (Brown, Sturman, & Simmering, 2003).

Equity theory (Adams, 1965) and justice theory (Cowherd, Douglas & Levine, 1992) predict that lower-paid employees compare themselves to both similarly as well as higher-paid employees when considering whether their employment contract is fair. As both the Clan and Adhocracy depend, to a greater extent than Hierarchy or Market cultures, on talent development and creativity that thrives on collaboration, they seem naturally more sensitive to turnover relative to other culture types. Research also suggests that turnover rates are higher if employees sense inequity in pay among employee in the same organizational level (Pfeffer & Davis-Blake, 1992). Egalitarian pay structure seems to support the collaborative dynamic of clan and adhocracy culture.

Hierarchy and market culture are more oriented to individual performance rather than collaborative teamwork. This reduced need for collaboration between employees means that promotions featuring large increases in pay for high performance (Market) or for tenure and process adherence, along with more responsibility to control (Hierarchy), are more acceptable. Here hierarchical pay distribution practices seem more appropriate for Market and Hierarchy culture types.

Along the dimension of internal and external focus in the CVC, we suggest that the internally focused Clan culture and Hierarchy culture are best supported by limiting the use of PFP compensation strategy. Hierarchy culture values consistency, efficiency and control (Cameron, et al., 2006), and success in a hierarchy culture has more to do with not failing rather than high performance. Here failure is not an option, and risk taking is not encouraged. So, for highly bureaucratic organizations such as government agencies or nuclear power plants, incentivizing performance seems out of place. For example, the implementation of PFP compensation strategy in the U.K public sector resulted in failure, with negative reactions from employees (Kessler, Heron, & Gagnon, 2006)

Clan and Hierarchy cultures share the trait of avoiding risk (Cameron, et al., 2006). However, the difference in the Clan culture is that employee development is more important than high levels of control. This suggests a longer-term orientation than other cultures, one that does not led itself well to rewards based on short term results. Additionally, the Clan culture depends on its members to be intrinsically motivated. Research suggests that PFP systems are based on short-term goal achievement, and also can have a destructive effect on intrinsic motivation and collaboration (Beer & Cannon, 2004).

In contrast, we suggest that externally focused organizations, such as those using an Adhocracy or Market culture, might benefit from PFP. The nature of Market and Adhocracy culture share the aspects of short-term perspective and being market responsive (Cameron, et al., 2006). In the Market culture, results and performance orientation seem to mesh well with the use of incentives for individuals to perform. "At risk" pay related to goal achievement, while employees compete among each other for rewards, seems a tailor-made situation for PFP compensation strategies. Research suggests that rewards based on incentives increase short term performance (Beer & Cannon, 2004; Kerr & Slocum, 19870.

An Adhocracy culture shares with Market culture, a focus on external market and environmental dynamics, short-term perspective, as well as a risk-taking mentality (Cameron, et al., 2006). In Adhocracy, however, collaboration, innovativeness and an entrepreneurial spirit are more central to the values of the organization. Short-term project objectives move creative teams of employees incrementally forward toward disruptive, market altering products. As market innovation is so important to the Adhocracy, we turned to the literature on innovation for perspective.

Edmonson and Mogelof (2006) discuss the significant role of psychological safety within teams as a fundamental need for innovation and creativity. Psychological safety is a perceived norm within a team that members will respond positively when one team member takes a creative risk. These authors note that the creative process involves risk represented by divergent thinking between team members. Creative team members must eventually come to embrace an idea or concept that originates with one, a few, or many members of the team, upon which the team stakes its future success. Incentivizing risk, both individually and in teams, would seem to be a supportive mechanism. Consequently, PFP compensation strategies, that focus on risk taking individuals or teams, might be an important underpinning to support innovation in the Adhocracy culture.

Propositions

The present authors suggest that the relationship between the dimensions of flexibility versus stability, and the dimension of external versus internal focus might be valuable in determining the most suitable pay system for each of the four cultures in the CVC. For the risk averse, family orientated nature of clan cultures, we suggest that the best pay distribution practice might be the egalitarian structure. In an egalitarian structure the employees are relatively at the same level of compensation avoiding perceptions of injustice and inequity that might undermine collaboration. Moreover, PFP might *not* be appropriate for this culture as a compensation strategy because of the long-term perspective, the interest in personnel development, and the risk adversity of the Clan organization are incompatible with the short-term, risk rewarding focus of a PFP incentive strategy.

Proposition 1: Clan cultures are optimally supported with the use of egalitarian pay distribution and infrequent use of pay-for-performance compensation strategies.

Adhocracy culture is an organic, flexible and risk-taking culture (Cameron & Quinn, 2006). Employees are generally working in teams collaboratively often for creative and innovative purposes. The present authors suggest the optimal pay distribution for this culture might be egalitarian as it supports the culture's emphasis on collaborative activities. As in clan cultures, collaboration requires that employees perceive they are in a roughly equivalent stature with those they collaborate with, and employees should feel that they are of equal stature to their co-workers. As we have suggested, this will decrease between employee-competitiveness and encourage cooperation. However, since the Adhocracy is an also oriented to be innovative, rewarding individuals or teams for risk-taking in creativity encourages innovation that drives the success of the firm.

Proposition 2: Adhocracy cultures are optimally supported with the use of egalitarian pay distribution and frequent use of pay-for-performance compensation strategies.

Hierarchy culture is a rigidly controlling, process-based culture (Cameron and Quinn, 2006). Employees succeed in this culture when they are fully aware of the company's policies and comply with them. In this type of culture there is a reduced need for teamwork and collaboration. Here communication between employees and higher management follow guidelines, hierarchy, and administrative rule. We suggest that these cultural dynamics call for a hierarchical pay system. This pay structure meshes well with rewarding those who follow administrative procedure. Moreover, with no great need for collaboration, it is much less critical for individuals to feel as though they have equity with coworkers. Due to the necessity to follow procedure in the hierarchy culture, risk-taking is discouraged, therefore we further suggest that organizations with Hierarchy culture limit the use of PFP.

Proposition 3: Hierarchy cultures are optimally supported with the use of hierarchical pay distribution and infrequent use of pay-for-performance compensation strategies

A Market culture is a stable and externally oriented culture with a strong competitive bent (Cameron and Quinn, 2006). Within this culture there is generally minimal collaboration between the employees and communication is generally top down rather than lateral, which is consistent with a more mechanistic organizational structure (Courtright et al., 1989). Consequently, much of superiors' interactions with subordinates consist of negotiating performance goal agreements and evaluating requests for resource allocation (Kerr & Slocum, 1987). We suggest a hierarchy pay distribution system for the Market culture, which supports risk-taking and individual effort meeting performance objectives. Additionally, due to the short-term performance orientation of the market culture, and considering that organizational members are focused tightly on performance objectives we propose that PFP compensation strategies might be suitable for Market cultures in order to incentivize and reward employees who reach those short-term performance objectives.

Proposition 4: Market cultures are optimally supported with the use of hierarchical pay distribution and frequent use of pay-for-performance compensation strategies.

Conclusions and Implications for Practitioners

Organizational culture is an important aspect that human resource managers should understand in their own organization as they consider implementation of appropriate pay and reward systems. Knowing the nature of the organizational culture, we suggest a manager can establish a complimentary compensation system that will support that culture.

Effectively the compensation system sends a "message" to employees as to what is "valued" in an organization (Lawler, 1990). For example, in a Market culture, independence and risk taking is valued, thus it seems reasonable to suggest that a pay system that rewards employees by promoting individuals to higher levels in the organization, as well as performance-related incentives, acknowledges and supports those values. To do otherwise sends a conflicting and contradictory message to employees that the organization is not authentically embracing those underlying values that a culture contains. Aside from confusion, there is the potential for breaches of procedural justice (Colquitt, Greenberg, Zapata-Phelan, 2005; Thibault and Walker, 1975), which strike a perception of fairness in the organization. This might lead to lower productivity levels among employees as well as higher turnover.

Equity theory (Colquitt et al., 2005; Adams, 1965) suggests that workers compare their efforts against company compensation they receive versus the efforts and compensation of like others. In clan and adhocracy cultures we value collaboration and parity between workers, thus there is more of a perception of equality between workers. In this situation if we have significant differences in compensation between workers, the perception of inequity may be more common.

Procedural justice and equity are crucial factors for employee performance and commitment (Adams, 1965; Colquitt et al., 2005). Managers should therefore be aware as to how their compensation systems can best support the culture of the organization because an incompatible compensation system could create perceptions of injustice.

The present paper proposes best pay practice for each of four organizational cultures depicted in the Competing Values framework (Cameron, et al., 2006), which is an important and well recognized model for understanding organizational culture. By suggesting the appropriate pay system for each unique culture, managers within that culture can better "walk the walk" to support the underlying values they espouse.

At the macro level, future studies might empirically test organizational performance and turnover of companies that have the suggested combination of pay structure and PFP against companies that do not. This would depend on developing accurate surveys that help the researchers determine the culture of different organizations. At the micro level, subjects might be manipulated into mindsets that establish the values of specific cultures and examine perceptions of fairness and commitment, which might be predictive of turnover potential.

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