Strategic Reward Systems: Understanding the Difference between 'Best Fit' and 'Best Practice'

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1.0 Introduction

There are two perspectives that dominate the strategic pay literature. The 'best fit' perspective claims that a firm's reward system should be aligned to support the organisation's business strategy in order to achieve competitive advantage. 'Best practice' advocates claim that there is a bundle of HR policies including the reward system that lead to highly motivated and committed employees who are the key to an organisation's competitive advantage. Although these alternatives are generally described within the literature, there is a lack of clarity about the specific characteristics of either model as applied to reward systems.

This paper attempts to fill that gap. Section two describes how these HR approaches influence pay policy. It will highlight areas of agreement and difference between each approach as well as conflicts within each approach. After outlining the objectives of reward systems advanced by Lawler (1996), the way that advocates of each perspective attempt to achieve each objective is discussed in section three. This shows significant divergence in what each approach suggests that reward system can deliver. Concluding comments are found in section four.

2.0 'Best fit' and 'best practice' applied to reward systems

The terms 'best fit' and 'best practice' are used in strategic human resource management literature and are applied to the specific policy area of reward systems. Each approach attempts to explain the way that HR policies in general and reward policies in particular can lead to greater organisational effectiveness.

Some commentators believe that the development of the best fit model is derived from the Harvard, Michigan and New York models. Sparrow and Hiltrop (1994) claim that these models could be classified as 'matching models' because of their common aim is to match the human resources strategy with that of the corporation. Thorpe and Homan (2000), argue that previous developments in the design of pay systems did not directly relate to the real priorities and problems faced by organisations. Thus, the need to devise pay systems linked to business strategy arose.

The underlying premise of best fit is that a close alignment between organisational strategy and other systems, including reward, can improve organisational effectiveness. Although the idea that pay should be linked strategy is not new, it received impetus in the 1990s with works by Schuster and Zingheim (1992, 1993) and Lawler (1995) discussing the merits of 'new pay'.

Lawler (1995, p. 14) states that all organisational systems must start with business strategy because "…it specifies what the company wants to accomplish, how it wants to behave, and the kinds of performance and performance levels it must demonstrate to be effective." Business strategy, driving individual and organisational behaviours, is the touchstone for the development of the reward strategy.

The contingent nature of the reward system is emphasised by Lawler (1995, p. 14) when he states, "indeed the 'new pay' is not a set of compensation practices at all, but rather a way of thinking about the role of reward systems in a complex organisation…it argues against an assumption that certain best practices must be incorporated into a company's approach to pay." Indeed, he contrasts the reward system for a traditional management style with one that fosters employee involvement. The correct fit for the former includes a reward system that is job-based with merit pay while for the latter it is skill-based with bonuses based on business success.

Schuster and Zingheim (1993, p. 6) also follow a contingent approach but argue that "Merit pay and traditional performance appraisal make it impossible to view employees as key elements of organizational strategy and tactics." They suggest that every element of an organisation's reward system should contribute to expanding employees' line of site "…to include concern about how their organization is performing." (Schuster and Zingheim, 1993, p. 6) Variable or incentive pay, which is not consolidated into base pay, replaces the traditional merit plan.

According to Conway (2003), research examining 'high commitment management' in HRM has its roots in both the configurational and the universal theoretical frameworks. Marchington and Wilkinson (2002, p. 177), claim that "most of the interest over the last decade or so has been in models of 'high commitment' or 'best practice HRM, stimulated initially by the work of a number of US academics, but developed more recently by people in Britain as well." While, for the most part this is a generalist HR debate, writers such as Pfeffer and Huselid applied best practice principles to the field of reward. In doing this they build on the work of Herzberg (1966) and Kohn (1993).

Both approaches believe that HR practices should be complimentary. However, according to Purcell (1999, p. 27***)***, '…what is most notable about the best practice model is there is no discussion on company strategy at all.' The underlying premise of this view is that organisations adopting a set of best practices attract super human resources, talent and competencies. "These superior human resources will, in turn, influence the strategy the organisation adopts and is the source of its competitive advantage." (Milkovich & Newman, 2002, p. 30) Therefore, for this approach, policy *precedes* strategy.

Advocates suggest there are mutually compatible 'bundles' of HR policies that promote high levels of employee motivation and commitment that positively impact on organisational performance. Although there is not unanimous agreement in identifying these practices, the list generally includes: selective hiring, extensive training, employment security, a structure that encourages employee participation and pay policies that lead in relation to industry competitors. (Pfeffer, 1998a; Huselid, 1995)

One obvious point of contradiction is in the area of pay linked to performance appraisal. Pfeffer (1998a, pp. 203-204) criticises merit pay on five grounds:

1. "Subjectivity and capriciousness that reward political skills… rather than performance.
2. An emphasis on the success of the individuals…consequently undermining teamwork.
3. An absence of concern for organizational performance.
4. Encouragement of short-term focus…
5. The tendency of such systems to produce fear in the work place."

However, when discussing specific HR practices that are linked to the creation of firm-specific competitive advantage, Huselid (1995, p. 637) states, “Examples of firm efforts to direct and motivate employee behavior include…performance appraisals that assess individual or work group performance, linking these appraisals tightly with incentive compensation systems…”

Wood (1996) acknowledges the difficulty caused by incorporating performance-related pay (PRP) as part of the high commitment model (HCM) because it can undermine feelings of competence and self-determination. There is also a considerable amount of empirical evidence that cast doubt on its ability to contribute to organisational performance. According to Wood, (1996, p. 55) “There remains, none the less, in a great deal of literature on HCM (and HRM) a reluctance to discard PRP, despite doubts about it…” His research in the UK confirmed this. Wood (1996, p. 64) reported that “…plants which paid the merit pay in the form of a permanent addition to the salary were more likely to have higher scores on the HCM (high commitment management) scale than either those which did not use merit pay or paid it on a different basis.” These are examples of the difficulty described by Boxall and Purcell (2000) where descriptive research clashes with the normative or prescriptive model.

In general, there is striking lack of consistency in reward systems reported by companies using high performance work practices (Huselid, 1995) or high commitment management (Wood, 1996). Although Pfeffer and Velga (1999) clearly advocate that a firm pay high wages in relation to it industry competitors, their list of ‘contingent compensation’ used by organisations runs the gamut from gain sharing to individual incentives.

This brief description of the two approaches indicates that there is one main area of agreement. HR policies should be congruent. Reward systems, as one policy area should interconnect and complement other policies like employee selection, training and performance appraisal. However, there is also a fundamental disagreement. Best fit policies are contingent. They are developed or amended to maintain a ‘line of sight’ with strategy. This means that an organisation’s reward system (and other practices) will be unique and should conceivably change with major adjustments to organisational strategy. Best practice policies are universal. The policy bundle does not change regardless of the organisation’s strategic thrust. This suggests that similar reward systems will prevail across organisations and industries.

However, advocates of either approach are not in complete agreement about the impact on reward systems. Schuster and Zingheim (1993) suggest that employee rewards should always be tied to organisational performance. Lawler’s (1995) approach is truly contingent. His traditional management design option does not include any pay element that varies with organisational performance. Although considered a universal approach, best practice advocates have not identified an agreed bundle HR policies. There is also a striking lack of universality with regard to reward systems. Theoretical discussion and empirical research does not shed light on specific reward elements adopted by organisations with a ‘best practice’ orientation.

3.0 Reward system objectives

Most textbooks and comprehensive articles on reward system begin with a list of generic objectives that should be achieved by an organisation's reward system. (For examples, see Schuler, 1995; Armstrong, 2002; Armstrong and Murlis, 1998; and Thierry 1992)Milkovich and Newman (2002) state that there are probably as many statements of pay objectives as there are employers. They suggest that objectives are important because they can guide the design of the pay system and provide standards for evaluating its effectiveness.

Lawler is one of the best known writers in the field of reward management. His list of objectives is both comprehensive and representative of other writers in this field. Box 1 shows a list of objectives adapted from Lawler's work.

Box 1: Objectives of reward systems
➢ Attract and retain employees; ➢ Motivate performance; ➢ Promote skill and knowledge development; ➢ Contribute to corporate culture; ➢ Reinforce and define structure; and ➢ Determine pay costs
Adapted from Lawler (1996)

Although there is substantial overlap concerning objectives by writers in this area, the way in which the reward system's design contributes to the fulfillment of the objectives is debated. In the following section, methods of achieving these objectives will be discussed from the perspectives of 'best fit' and 'best practice' advocates.

3.1 Attract and Retain Employees

The ability of reward systems to attract and retain employees is of primary concern to most organisations. This is obviously an issue during periods of economic expansion when labour markets are 'tight' and organisations struggle to fill positions and hold on to qualified employees. However, even during recessions, organisations are concerned with finding and securing the efforts of qualified individuals.

Best fit advocates suggest that the composition of the reward package will attract different types of applicants. Lawler (1973, p. 28) states that "for example, organisations that offer a straight base salary with no chance for incentive earnings, typically ends up attracting and retaining very different individuals than one that offers large amounts of incentive pay." Organisations who reward their employees with different performance-related pay incentives are much more likely to attract the more entrepreneurial and problem solving employees than those that just offer a base salary.

It is a basic assumption of the best fit proponents that "good performers tend to seek organisations where performance is recognised and rewarded." (Schuster and Zingheim, 1992, p. 85) Lawler (1996) suggests that a reward system should differentiate between good and poor performers. Not all employee turnover is harmful to organisational performance. A reward system should promote the retention of good performers and facilitate the decision of poor performers to leave.

Best fit advocates emphasise the importance of external competitiveness for attracting and retaining employees. To be effective, a reward system must distribute rewards in a way that will lead the organisation's most valuable employees to feel satisfied when they compare their rewards with those received by individuals performing similar jobs in similar organisations. However, Lawler (1996) adds a caveat when he states that for some organisations, it is more cost effective to keep wages low and accept high turnover, especially if replacement costs are low as with unskilled labour.

According to Pfeffer (1998a, p. 80), "Although labor markets are far from perfectly efficient, it is nonetheless the case that some relationship exists between what a firm pays and the quality of the workforce it attracts." Best practice advocates place great emphasis on the need to attract and retain the type of employees that will help an organisation to gain and sustain competitive advantage. This is in part achieved through externally competitive pay levels.

However, it is the combination of a number of interrelated policies that ensures that highly qualified people apply and stay with an organisation. Huselid (1995, p. 637) states that 'Recruiting procedures that provide a large pool of qualified applicants, paired with a reliable and valid selection regimen, will have a substantial influence over the quality and type of skills new employees possess.' Pfeffer (1994) discusses the 'symbolic' aspect of the rigorous selection process. The successful candidate feels that s/he is joining an elite organisation with high expectations of performance - a firm where people matter.

'Best practice' advocates positively value low turnover, without Lawler's caveats. Again, this is because other related policies and procedures ensure that the right employees are chosen in the first instance. Unlike Lawler who claims that employment security does not reflect the realities of today's competitive global business, employment security is often mentioned by best practice commentators as being of fundamental importance in attracting and retaining employees (Delery & Doty, 1996; Morgan, 2001) In part, this is because employees are unlikely to make suggestions to increase productivity if they fear it will result in the losing their job.

Pfeffer (1994) claims that although people do work for money, work also adds meaning to their lives. Therefore, organisations with low turnover rates, offer intellectually engaging work, a family friendly environment and the opportunity to work with fun, interesting people in addition to a competitive reward package.

To summarise, advocates of both approaches agree that externally competitive reward packages are important to attracting and retaining qualified employees. However, they differ about which employees are a source of competitive advantage. Best fit focuses on specific high achievers or categories of employees with high replacement costs. These employees need to be satisfied that their reward package equals or exceeds what they will earn in the external market. Best practice, however, believes that there are a number of interrelated policies that attract and tie the individual to the organisation. All employees are carefully chosen and are a source of competitive advantage. They stay with an organisation because of the challenging environment, meaningful work *and* competitive pay package.

3.2 Motivate Performance

Wagner (1990) claims that a primary concern in the design of reward systems is how well the plan will work in motivating employees. However, there are several theories of motivation and no agreement on a 'general theory'. Different theories underpin very different types of reward systems. As we will see, even the same theory can be interpreted in different ways and used to support alternative pay system designs.

Wagner (1990, p. 30), claims that "two of the process theories of motivation are of particular importance in the development of performance pay programs: the Equity and Expectancy theories of motivation." In Adams (1965) model of distributive justice, there are two variables: inputs and outcomes. 'Inputs' refer to factors contributed by individuals to the social exchange. 'Outcomes' are the rewards provided by the organisation in exchange for individual inputs. In order to determine whether equity exists in the exchange relationship, Adams theorised that an individual compared the ratio of his/her outcome to input to the same ratio for significant others. Equity or fairness requires that the ratios are equal. Motivation is particularly affected if the comparison results in 'negative inequity' or the belief that an employee's greater effort is not being recognised by higher rewards. Negative inequity can be internal if the comparator is within the organisation or external if s/he is working in another organisation.

Schwinger (1980) suggests that social norms also intercede into an employee's perception of individual justice. Based on the work of other writers in this field, he identifies three justice principles: "(a) the *"contribution principle"*—allocation proportion to individual's contributions toward the group goals, (b) the *"equality principle"*—equal allocation to all individuals, and (c) the *"need principle"*—allocation according to individual need." (Schwinger, 1980, p. 98)

The belief that payment systems should reflect individual employee contribution is common to all best fit advocates. Lawler (1971) discusses the dissatisfaction that results from negative inequity and the consequences for the organisations. Employees may reduce efforts or seek employment in higher paying jobs in other organisations. As a general rule, Lawler (1996, p. 540-541) observes that "highly diversified companies are pulled more strongly toward an external market orientation, while organizations that are based on a single industry or single technology typically find themselves more comfortable with an internal-equity basis." He states that although both types of inequity present serious implications for the firm, '…the consequences of external equity (e.g., turnover and absenteeism) are the most severe for the organisation and deserve primary consideration.' (Lawler, 1981, p. 37)

This demonstrates the best fit advocates' support for the contribution principle. Employees of an organisation who significantly contribute to its success should be able to compare themselves with significant others both inside and outside of the organisation and be satisfied with their pay. It is a design issue to encourage the development and use of the employee inputs that benefit the organisation.

Porter and Lawler (1968) modified Vroom's (1964) expectancy theory of behaviour. Bartol and Locke (2000, p. 111) state that expectancy theory "…holds that people make choices based on (1) their *expectancy* that their efforts will lead to a certain level of performance, (2) their belief that their performance will lead to valued outcomes (*instrumentality*), and (3) the degree of value they place on those outcomes (*valence*).”

Expectancy theory underpins best fit thinking because it provides a design framework so that each element of a reward system can be used to the element’s best advantage. Lawler’s (1995) new pay model provides guidance on what behaviours to measure. They must be linked to organisational strategy. However, Lawler (1981, p. 22) emphasises in an earlier work, the importance of the implementation process when he states, “In order for employees to believe that a performance-based pay relationship exists, the connection between performance and rewards must be visible, and a climate of trust and credibility must exist in the organization.” The measurement of performance is a critical characteristic of ‘new pay’. Armstrong (2002) emphasises the need for a robust performance management process. Schuster and Zingheim (1992, p. 210), state “measurement is the core of new variable pay because it provides the justification for sharing performance improvements with employees.”

Although belief in the system and understanding of how it operates contribute to expectancy and instrumentality, best fit authors suggest that the magnitude of the reward will impact on valence. Schuster and Zingheim (1993, p. 7) discuss the negative impact on employee motivation of small rewards when they state that ‘It is disheartening to tell employees they did an excellent job and then award a merit increase that is no more than one percent larger than the raise granted to employees doing a satisfactory job.’ Lawler (1995, p. 16) reinforces this when he states, “To be motivational, the systems must create a clear and achievable line of sight between an employee’s behaviour and the receipt of important amounts of pay.”

Best practice advocates rely on content theories of motivation as the basis of their reward systems. Pfeffer refers to the work of Kohn, who in turn bases his theoretical critique of incentives on the Herzberg’s Two Factor Model. Herzberg (2003, p. 91) found ‘…that the factors involved in producing job satisfaction (and motivation) are distinct form the factors that lead to job dissatisfaction.’ Motivators, the source of job satisfaction, are intrinsic to the job including ‘achievement, recognition for achievement, the work itself, responsibility and growth or advancement.’ (Herzberg, 2003, p. 92) Hygiene factor, including salary, are extrinsic to the job and are a potential source of job dissatisfaction. Herzberg views incentives as no more than the psychological equivalent of a ‘kick in the ass’ that leads to spiralling wages and employees who are looking for the next wage increase.

Kohn and Pfeffer continue where Herzberg left off. They object to incentives on two grounds. First, as explained above, they are theoretically unsound. As an extrinsic motivator pay may alter behaviour, but does “…not alter the attitudes that underlie our behaviors.” (Kohn 1993, p. 55) This means that changed behaviour is unlikely to persist. Second, the impact of incentives is not neutral. The casualties of incentives include de-motivated employees who interpret the absence of a reward as a punishment, quality, collegiality, long-term interests and problem solving behaviour. By choosing incentives, firms are blocking the development of the types of behaviour that lead to competitive advantage. Both Kohn and Pfeffer (1998a, p. 216) support their claims with empirical research that demonstrates that, “Not only are financial incentives not the most important thing to most people, but a substantive body of research has demonstrated both in experimental and field settings, that large external reward actually undermine internal motivation."

Herzberg (2001) answers his own question, 'How do you motivate employees?' with job enrichment rather than changing the method of payment because changes to motivators impact on satisfaction and are more enduring than changes to hygiene factors. Kohn and Pfeffer consider combinations of hygiene factors (other than salary) and intrinsic motivators that create an environment where behaviours that are conducive to competitive advantage can develop. Kohn (1993b, p. 49) believes that excellent behaviour actually comes from the "…three C's…Choice means employees should be able to participate in making decisions about what they do every day. Collaboration denotes the need to structure teams in order to facilitate an exchange of ideas and a climate of support. Content refers to what people are asked to do' and reaffirms Herzberg's view of job enrichment." Pfeffer (1998a, p. 217) discusses the importance of "…creating a fun, challenging and empowered work environment in which individuals are able to use their abilities to do meaningful jobs is likely to be a more certain way to enhance motivation and performance…"

This discussion focuses on incentives as a form of payment that fails to motivate. Kohn and Pfeffer also give some indications of the elements of reward systems will promote desired behaviour. Kohn (1993b, p. 49) states, "…pay people well and fairly then do everything possible to help them forget about money." He is clearly viewing money as a hygiene factor and a potential source of dissatisfaction. Once that is alleviated, the organisation can work on motivators. Kohn was criticised by Lebby (1993) for failing to recognise that in case cases, money can be viewed as a motivator because, it is '…a tacit acknowledge of the outstanding nature of their contribution.' Pfeffer appears to agree with this analysis because he speaks about the important symbolic aspects of pay. He states, '…pay can send a signal about the value the organization places on its people…individuals will look to how well they are paid as a signal of whether or not the organization really values its people.' (Pfeffer, 1998a, p. 218)

Equity is also an issue with 'best practice' advocate Jeffrey Pfeffer, though his interpretation leads to very different advice concerning reward systems. Unlike best fit advocates, Pfeffer does not believe that individuals should receive differential pay based on performance. When speaking of the Toyota Motor Manufacturing plant in the US, he states, "Equal pay promotes feelings of equality and helps strengthen bonds among team members…" (Pfeffer, 1998, p. 220)

Pfeffer (1998a, p. 218) believes that '…If the organization enjoys increased profitability and performance as a result of the efforts of its people, then considerations of equity virtually demand that the entire workforce, not just some senior managers share in the returns through higher pay.' This can be done using a collective reward system like gainsharing, profit sharing or share ownership schemes, without fear of 'free riding' because "The evidence for the effectiveness of various group incentives is compelling, while the empirical evidence for free-riding is sparse." (Pfeffer, 1998a, p. 219) The organisation itself can create an atmosphere where employees don't want to let their company or their colleagues down. Therefore, rather than adjusting outcomes to maintain internal equity, employees are opting to adjust their inputs when positive inequity exists. Although this is not an example of strict adherence to the equality principle, the differentials between employees is far lower than for organisations following a ‘best fit’ pay strategy.

To summarise, each approach suggests different psychological theories of motivation as the appropriate basis of securing employee motivation to create and sustain competitive advantage. The new pay model helps to identify a ‘line of site’ between organisational strategy and employee behaviour needed to promote it. Expectancy theory provides a framework that can be used to ensure that employee effort leads to valued organisational outcomes. Each element of the reward system is considered in light of its potential to promote valued added. Incentives that comprise a large percentage of base pay are considered to be a particularly potent way of motivating employees.

Best practice relies primarily on Herzberg’s Two Factor Model which classifies ‘salary’ as a hygiene factor that can lead to dissatisfaction. Improving motivation requires careful consideration of the work itself and creating an environment where workers can grow, advance and achieve. Individual incentives damage relationships and the organisational capacity that are the ultimate source of competitive advantage. High base pay has symbolic value and reinforces workers’ belief that they are valued by their employer.

Both groups advocate reward systems that are fair but have different views about how this can be achieved. Best fit conforms with the concept of with the contribution principle meaning that individuals are paid according to their contribution to the organisation. In other words, high inputs are matched with high outcomes. Best practice leans toward the equality principle. People doing similar jobs are paid the same to promote collegiality and cooperation. Collective incentives that compensate employees for strong organisational performance are encouraged.

3.3 Promote Skill and Knowledge Development

Marchington and Grugulis (2000, p. 909) observe “There is little doubt that there has been a growing recognition during the last decade of the importance of training and development, and even learning as a source of sustained competitive advantage as employers introduce more skills-specific form of training and experience continuing skills shortages in some areas.” However, there is some debate about if and how skill development and acquisition should be linked to the reward system.

In terms of the best fit perspective, Lawler (1996) puts forward the argument that most pay-for-performance systems reward employees for skill and knowledge development indirectly, by rewarding the performance that results from the skill. He also states that systems that pay the holders of higher-level, more complex jobs also reward skill development when and if it leads to obtaining a higher-level job. However, he suggests that a more direct link is also possible. “Just as reward systems can motivate performance they can motivate skill development. They can do this by tying rewards to skill development.” (Lawler, 1996, p. 531) Schuster and Zingheim (1992, p. 85), state that “new pay encourages the acquisition of skills and knowledge and that horizontal growth is important and employees are rewarded for preparing themselves to perform a wider range of duties and responsibilities that add value to the organisation.”

Payments to workers who improve their human capital by skill acquisition or development may be paid in the form of a bonus or an increase to base pay. Skill-based pay has replaced job-based pay in some organisations. Because the applications are most common in manufacturing setting, workers are likely to be paid an hourly rate. Under this system, "…individuals are paid for the number, kind, and depth of skills that they develop." (Lawler and Ledford, 1987, p. 48) Hourly pay rates increase as additional skills are mastered.

Although numerous difficulties with skills-based pay have been identified (Lawler and Ledford, 1987; Zingheim and Schuster, 2002), it has not diminished Lawler's belief that organisations must reinforce skill development by linking it to the reward system. Lawler (2003, p. 1) discusses the death of the 'loyalty contract' "…because of globalized competition, the rise of technology and increasing demand for knowledge workers with state-of-the-art skills." In order to maintain competitive advantage through employees, organisations "must continuously compete for new talent and focus on retaining their critical existing talent." (Lawler, 2003, p. 2) To create a 'virtuous spiral' of continuously improving performance, "…organizations need to focus on ever-increasing levels of competence and performance, as well as higher rewards." (Lawler, 2003, p. 2)

A commitment to training is a feature of virtually every model of best practice. Pfeffer and Velga (1999, p. 43) confirm their belief in the importance of training when the state, "Training is an essential component of high performance work systems because these systems rely on front-line employee skill and initiative to identify and resolve problems, to initiate changes in work methods, and to take responsibility for quality." Organisational commitment to training continues during economic downturns and even though it is difficult to calculate a return on investment.

The importance of linking training to other HR practices is a common theme in best practice literature. Youndt *et al* (1996, p. 839) state that "at their root, most 'best practice' models focus on enhancing the skill base of employees through comprehensive training but also through other HR activities such as selective staffing and broad development efforts like job rotation and cross utilisation." Morgan (2001), believes that training will produce positive returns only if the trained workers are then permitted to employ their skills. Worker autonomy, self-managed teams and even a high-wage strategy, depend on having employees who not only are empowered to make changes in products and processes, but also have the necessary skills to do so. Pfeffer (1998a) identifies the interrelationship between employment security and other high performance management practices like training. He suggests that it is only worthwhile for organisations to invest in human capital through training if employees remain with the company so it can recoup its investment.

The seven practices of successful organisations as outlined by Pfeffer (1998a) do not suggest that there should be a links between pay and training. Wood (1996, p. 60) reported that "Skills-related increments existed for any category of worker in only 5 per cent of plant, and thus skill-based pay was of little significance in the sample." Although this suggests a concurrence between model and practice, it probably reflects the difficulties organisations have experienced in implementing skill-based pay systems.

To summarise, advocates of best fit and best practice are committed to training. However, best fit advocates suggest that the acquisition of skills that add value to the organisation should be recognised through the payment system while best practice advocates do not link the two practices. In the absence of a 'loyalty contract' best fit advocates see an organisational commitment to training and rewarding 'up-skilled' employees as an important way to attract and retain employees who need to enhance their personal skill set. Best fit proponents believe that organisations can only realise a return on investment if they commit themselves to a long-term relationship with their employees.

3.4 Contribute to Corporate Culture

Drennan (1992, p. 3) describes culture as "'how things are done around here.' It is what is typical of the organization, the habits, the prevailing attitudes, the grown-up pattern of accepted and expected behaviour." Peters and Waterman (1982), Kanter (1983) and others identified corporate culture as a factor that impedes or facilitates organisational change.

Armstrong (1999) argues that the reward strategy provides an opportunity to reinforce the organisation's values and beliefs in such areas as performance, quality, teamwork and innovation. Going a step further, Lawler (1996, p. 531) suggests that pay systems can help to change culture when he states, "The behaviours they evoke become the dominant patterns of behaviour in the organisation and lead to perceptions about what it stands for, believes in and values." Lawler observes that reward systems can be adapted to any type of culture. He states, "Depending on how they are developed, administered and managed, reward systems can help create and maintain a human-resources oriented, entrepreneurial, innovative, competence-based, bureaucratic, or participative culture." (Lawler, 1996, p. 531)

Lawler, throughout his work discusses the importance of reward system congruence with management style and other organisational systems. In particular he points to the importance of two process issues: communication and decision-making. Lawler (1996, p. 543) notes that "Organizations differ widely in how much information they communicate about their reward systems." The two extremes are organisations that are completely secretive and those who are completely transparent about pay philosophy, policies and wages paid to individual employees. Although neither extreme is right or wrong, the different processes support different management styles and organisational cultures.

Decision-making in relation to reward systems can also be thought in terms of a continuum. Lawler (1981, p. 50) states, "…decisions need to be made about how big the pie will be, what procedure will be used to divide it up, and what size piece each person will get. None or all of these decision can be made on a participative basis." Milkovich and Newman (1999) support this contingency approach. In making decisions about reward system administration, they suggest that organisations have to answer the following questions: "How open and transparent should the bases for pay decisions be to all employees? Who should be involved in designing and managing the system?" (Milkovich and Newman, 1999, p. 28) Again, the amount that decision-making is devolved depends on management style. Lawler (1995, p. 16) states, "…a company's approach to developing, administering and managing reward systems can cause its culture to vary widely from that of another organisation."

No surprisingly, the reward design options available to organisations with an autocratic management style, secretive communications and top-down decision-making differ from the participative management style with open communications and devolved decision-making. For example, Lawler (1981) notes that open communications and strong group processes are necessary for the successful design and implementation of gainsharing and skill-based pay schemes. They are likely to fail spectacularly in an organisation run using an autocratic style.

Lawler (1995, p. 14), states that "perhaps the most obvious connection between reward systems and culture, concerns the practice of performance-based pay." A policy of linking pay and performance implies a performance-orientated culture. Not alone do reward systems impact the performance culture of an organization, but Lawler (1995), states they can also shape culture precisely because of their important influence on motivation, satisfaction and membership.

The management approach of choice of best practice advocates has been labelled "…high commitment, high performance, high involvement and so forth." (Pfeffer, 1998, p. 65) Although the names vary, the underlying idea is the same. The optimum management approach for organisational effectiveness is universal rather than contingent. A culture of mutual commitment is congruent with this management system.

Story (1992) claims that a tight definition of the 'high commitment' approach would appear to give greater weight to pay's ability to influence employee attitudes and more specifically, its potential to generate organisational commitment. Pfeffer, however suggests that compensation arrangements affect commitment in conjunction with other HR policies. For example, the practice of employment security demonstrates management's commitment to the employee and invites reciprocity. Information sharing "…on such things as financial performance, strategy and operational measures conveys to the organization's people that they are trusted." (Pfeffer, 1998a, p. 93) Complete transparency concerning salaries inspires trust in the reward system. Self-managed teams "…are largely successful in having all of the people in the firm feel accountable and responsible for the operation and success of the enterprise." (Pfeffer, 1998, p. 75) Morgan (2001) adds to this debate and states that long-term commitment can be achieved through more rigorous recruitment and selection and greater investment by firms in training and developing their work force. These are combined with an externally competitive reward system that emphasises group and collective contingent compensation linked to organisational performance over individual incentives. The combined practices help organisations to attain and maintain the culture of mutual commitment.

To summarise, both approaches view culture as important to organisational effectiveness and believe that reward systems have some part to play in defining and reinforcing organisational culture. However, the reward system is centrally important to best fit advocates and plays a supporting role for best practice. Both approaches emphasise the importance of congruence. For best fit, this means that reward systems must align with the management approach and the organisational processes. Together, these components define and support culture. For best practice, the key is to develop a particular culture: the culture of commitment. To do this, an organisation adopts a set of key interrelated practices including its reward system that formally and informally encourage organisational commitment.

3.5 Reinforce and Define Structure

Burnes (2000) believes that in the 1960s, a definable contingency approach to management emerged challenging the 'one best way' advocated by followers of the Classical and Human Relations Approaches. He states that the Contingency Theory "…substituted the view that the structure and operation of an organisation is dependent ('contingent') on the situational variables it faces—the main ones being environment, technology and size." (Burnes, 2000, p. 73) This debate is reopened by best fit and best practice commentators who agree that the reward system should reinforce the structure of an organisation. However, they disagree on what that structure should be.

Best fit advocates continue to argue that an organisation's structure is contingent on situational variables and a reward system can have a significant impact on reinforcing and defining the organisation's structure. Lawler (1996, p. 532) states that the "…key issues here seem to be the degree to which the reward system is hierarchical and the degree to which it allocates rewards on the basis of movements up the hierarchy." Milkovich and Newman (1999, p. 65) explain the difference between egalitarian and hierarchical structures when they observe, "Egalitarian structures have few level and smaller differential between adjacent levels and between the highest and lowest paid workers."

According to best fit proponents, either structure can be viewed as fair depending on reward system administration and employee values. However, each is thought to promote different types of behaviour. Hierarchical organisations tend to concentrate on individual performance rather than group performance and there are opportunities for promotion that attract higher wages. Top management makes important decisions on pay and other organisational issues. Status differences are reinforced through large pay differentials and perquisites.

Egalitarian organisations often have team-based work units, less promotional opportunities and promote cooperation between workers. For best fit advocates, this does not eliminate the argument for variable pay but changes the entity that receives the payment. Schuster and Zingheim (1993, p. 3) point out that "…if team performance is essential, compensation must be focused at the team level, since it would make little sense to have a pay system focused only on individual results." Decisions concerning pay and other organisation matters are devolved. Status differences are minimised.

Best practice advocates argue that a particular structure should be adopted by organisations seeking competitive advantage. According to Pfeffer, (1998a, p. 74) "Organizing people into self-managed teams is a critical component of virtually all high performance management systems." Self-managed teams substitute peer-based control for hierarchical control of work. This facilitates the removal of layers of the hierarchy and permits employees to pool their ideas in order to produce better or more creative solutions to work problems. Decentralised decision-making moves control to the front-line.

Pfeffer (1994) believes that compressed pay should be used to increase the sense of community and a common fate that such organizations seek as a source of competitive success. The fundamental premise of best practice work systems is that organisations perform at a higher level if they are able to tap into ideas, skill and efforts of all their people. This will not happen if status differentials exist. Boxall & Purcell (2003, p. 62) add that "although people should be paid well, huge variations in their pay should be avoided to encourage teamwork."

To summarise, congruence between organisational structure and reward systems is important for both perspectives. Reward systems are designed to reinforce structure. This provides considerably more scope for variation for best fit than best practice. However, best fit proponents argue that an appropriate organizational structure depends on a number of situational variables. The two ends of the spectrum are hierarchical (many-layered) and egalitarian (flat) organizations. Best practice proponents argue that there is one best organizational structure: self-managed teams operating in flat structures.

3.6 Determine Pay Costs

Although labour intensity varies across industries and services, labour costs are a significant percentage of operating costs for most organizations. Because of this, best fit proponents argue that "…the system designer must focus on how high these costs should be and how they will vary with the organization's ability to pay." (Lawler, 1995, p. 16)

Schuster and Zingheim (1993) suggest that there is a critical flaw in reward systems that rely primarily on base pay as the primary form of reward because increases lead to a permanent escalation of operating costs that is generally disconnected from organisational outcomes like sales turnover and profit. They point to "Many employees who received merit increases for doing a good job on tasks and duties lost their job shortly after…" (Schuster and Zingheim, 1993, p. 6) This occurred because it became increasingly untenable for organisations to pass on escalating labour costs.

They argue that reward systems need to be more flexible. One aspect of this flexibility is the payment of incentives that are not consolidated into base pay and are linked to organisational performance. Schuster and Zingheim (1992, p. 151) state that "when the organisation does not do well, variable pay rewards will be small or nonexistent." A portion of labour costs will expand and contract with revenues. This has the effect of sharing the risk with employees. Another aspect of flexibility is that "The messages of variable pay can be changed based on the situation, and can focus on key priorities and be redirected to new areas of importance an opportunity as necessary." (Schuster and Zingheim, 1993, p. 8) This suggests that organisations can frequently change their incentives to motivate value-added behaviours.

Lawler (1996) discusses various combinations of incentives that may suit particular organisations. However, he is less enthusiastic about recommending performance-related pay for all organisations. He states, “Specifically, if performance is difficult to measure and/or rewards are difficult to distribute on the basis of performance, a pay-for-performance system can motivate counterproductive behaviours, invite lawsuits… and create a climate of mistrust…” (Lawler, 1996, p. 539) He adds, however, that organisations should work towards conditions where pay and performance can be effectively linked.

The reliance of best practice advocates on a lead policy for base pay relative to industry competitors has already been mentioned. However, the impact on organisational competitiveness has not been discussed. Pfeffer (1998b) argues that people confuse labour rates and labour costs. He defines a labour rate as, “…total salary divided by time worked. But labor costs take productivity into account.” (Pfeffer, 1998b, p. 111) Therefore an organisation with high levels of productivity can pay higher rates and remain externally competitive.

High pay, along with other practices that promote low turnover has also been discussed but not its impact on productivity. Pfeffer (1998a) reports that organisations that downsize often report decreased productivity. There are many possible reasons including poor employee morale, impact on the quality of the product or service and ruptured relationships with customers. Pfeffer (1998a, p. 179) argues that this impacts on current and future economic performance when he states, “Tenure not only affect customer satisfaction and economic performance, it also affects the ability to accomplish the work place transformation that can help customer service and workplace productivity.” Huselid’s empirical research (1995) supports the connection between low turnover and improved short-term economic performance.

Pfeffer (1998b) also contests the popular view that labour costs are the largest operating cost though he agrees that is the easiest cost to vary. Attempting to increase profitability by reducing labour costs as a short-term measure is “a slippery way to compete and perhaps the least sustainable competitive advantage there is.” (Pfeffer, 1998b, p. 110) Tapping into the knowledge and experience of employees is a surer way to improve quality and productivity.

As mentioned earlier, Pfeffer also advocates the use of collective incentives like gainsharing, profit sharing and share ownership schemes to reward employees during periods of strong organisational performance. For best practice advocates, this appears to be form of ‘success sharing’ rather than an effort to positively vary payroll costs with economic performance.

To summarise, there is really no point of comparison between best fit and best practice advocates on this objective but there are many points of contrast. Best fit commentators view employees as a cost and attempt to vary that cost with economic performance through the use of incentives that are not consolidated into base pay. Best practice commentators, combining high base pay with other practices to ensure low turnover, view a committed workforce as an organisation’s most important asset. While best fit advocates see variable labour costs as the best way of ensuring future organisational competitiveness, best practice advocates see it as contrary to an organisation's long-term prospects. Neither approach state a definitive position on the percentage of wages that should be variable. However, if varying wages seriously impacts operating expenses, best fit advocates must be recommending that incentives comprise a considerable proportion of an employee's total pay package. This portion of pay is 'at risk' in the sense that payment depends on organisational performance. Best practice advocates are interested in sharing success. This suggests that external competitiveness is achieved through base pay and group-based incentives are an 'add on'.

Conclusion

The scope of this paper is very limited. It considers strategic human resource management approaches in terms of the guidance that they offer for reward practices. There are difficulties in the sense that different writers from each perspective have different opinions about what constitutes 'best fit' or 'best practice'. In spite of this, there are a few areas of agreement and as well as several points of disagreement.

In the most general sense, both approaches view HR as having an important role in supporting organisational strategy and objectives. Both approaches agree that reward practices should be consistent with other HR practices. There is a shared view that an externally competitive reward system has an important role in attracting appropriate candidates and retaining employees. Both see rewards as a way of reinforcing organisational culture and structure.

However, there are many important differences. At the most general level, best fit is a contingency approach while best practice is a universal approach. For best fit, organisational strategy comes first and all organisation systems and practices, including reward, follow. Just as organisational strategy is unique to the organisation, so is the reward system that will reinforce that strategy. For best fit, a prescriptive set of practices, including reward, precede strategy but provide the human resources needed to fulfil the organisation's objectives, whatever they are.

At a more specific level, best fit advocates exhibit great confidence in the ability of the reward system to motivate specific individual behaviours. They support this view with Expectancy Theory, a theory of motivation that suggests that people with act in particular ways if they believe that their performance will lead to valued rewards. They suggest the use of variable incentives that are not consolidated into base pay to promote particular behaviours that are important to achieving organisational objectives. Incentives also provide financial flexibility because they are tied to an organisation's ability to pay. Best fit proponents see rewards as the stick and the carrot. Since pay varies with performance, poor performers 'vote with their feet'. Excellent performers are attracted to the large pay differentials that reward their performance.

A common theme that runs through best practice literature in relation to pay is, "…first, do no harm." (Pfeffer, 1998a, p. 196) Best practice advocates have very little confidence in pay as a motivator, partly because of their reliance on Herzberg's Two Factor Model. The best that pay can do is to prevent dissatisfaction and provide symbolic recognition that employees are valued. They see the ability of pay to influence particular behaviours as a minefield filled with the potential to destroy the relationships and trust that are the basis of organisational commitment. This leads them to promote a reward system that does not differentiate with compressed pay bands, equal pay for all team members and collective incentives.

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