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The Impact of Incentives on Interfunctional Relationship Quality: Views from a South African Firm

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ABSTRACT *Interfunctional relations and their impact on organizational performance have long been a concern of management and marketing scholars. Similarly, the use of incentives, and how they motivate individuals toward performance, has been a perennial focus of management researchers. Curiously, the effect of incentives on interfunctional relations has not received the same attention in the literature. The research in this paper sought to discover the extent to which the incentives an organization offers its personnel are perceived as being 'fair' by different functional groupings. The results of a study are presented in which the perceptions of a large sales function of the fairness of a series of incentives are compared with those of the rest of the organization. The implications of these findings for the quality of interfunctional relationships are discussed.*

KEY WORDS: Inter-functional relationships, relationship quality, salesforce, incentives, fairness

Interfunctional Relationships: the Importance of Quality

The study of the relationships between various organizational functions has long been of interest to management scholars (e.g. Griffin & Hauser, 1992). Since the 1980s (e.g. Gupta *et al.*, 1986; Ruekert & Walker, 1987), marketing academics in particular have been concerned with the interaction between the marketing function and other organizational units. They have investigated, among other things, the nature of marketing's integration with other departments (Kahn & Mentzer, 1998), and its relationship with areas such as a broad technical function (e.g. Berthon *et al.*, 1998), manufacturing (Griffin & Hauser, 1992), R&D (Gupta *et al.*, 1986); and Human Resources (e.g. Berthon *et al.*, 1996). This interest is not surprising, given that an organization-wide generation- and dissemination of intelligence are seen as cornerstones of marketing orientation (Narver &

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Slater, 1990; Slater & Narver, 1994; Kohli & Jaworski, 1990; Jaworski & Kohli, 1993; Kohli *et al.*, 1993). Marketing orientation, it has been shown in turn, has a significant impact on organizational performance. Just as relationships between buyers and sellers have been an important external focus of marketing scholars (e.g. Morgan & Hunt, 1994), the quality of the relationships between a firm's departments have been a key internal application.

Quality management in business relationships is a very broad, but also very important, domain of interest to scholars and practitioners alike. It is broad because the notion of business relationships covers a very wide playing field, from simple relationships between a firm and its customers, through relationships between a firm and its suppliers, as well as those between the firm and its channel members, to the internal relationships between functional divisions and departments within the firm. It is important because a firm's success or failure depends to a large extent on how well these relationships work; furthermore, it is very complex because these relationships are frequently networked and multifaceted. For example, the relationships between a firm and its suppliers impact on those between the firm and its channel members, and the relationships between functional areas within the firm will ultimately affect the relationships between the firm and its customers. Quality management does not simply imply that quality be good or acceptable. When it comes to relationships, quality management means measurement, for if something cannot be measured it cannot be managed. If relationships are managed they can improve, and it behooves us well to remember Norman Mailer's admonition that relationships that don't get better, get worse.

Incentives lie at the heart of economic behavior (cf. Milgrom & Roberts, 1995), and this has long been recognized and studied by management scholars, especially those in human resource management in general, and sales management in particular (cf. Churchill *et al.*, 1985). If individuals are motivated by the incentives the organization offers in order to enhance their own performance, then it is incumbent upon practitioners and scholars alike to understand the fine effects of the specific kinds of incentives and their interaction with each other on the behavior of individuals. The impact of organizational incentives on the relationships between various functional areas of firms, especially with regard to their quality, has been less well-researched however. Specifically, and simply, what impact do the incentives offered by an organization to its constituents have, not only on their motivation, but also on the nature of their interaction with each other? This is the issue that this article seeks to address.

We proceed as follows: first, we review the literature with specific reference to fairness and incentives. Next, we outline a study conducted in a successful selling organization designed to elicit the perceptions of employees of a range of incentives offered by the firm, specifically with regard to their equity, or fairness. Then we compare the perceptions of members of the sales function to those of the rest of the organization. We discuss the results, identify the limitations of the study, and then consider the implications for managers, and avenues for future research.

Literature Review

At the heart of any perspective on the quality of the relationship between two parties, is trust. Trust can be defined as 'the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action

important to the trustor, irrespective of the ability to monitor or control that other party.' (Mayer *et al.*, 1995). Trust is essentially a mutual perception of integrity on the part of social actors. Trust is in turn predicated on a notion of 'fairness' – it is more likely to survive and grow when the parties to the relationship perceive it to be fair, in other words, free from bias, dishonesty, or injustice. Fairness implies the treating of all sides alike, justly and equitably.

Fairness has been of particular interest to scholars in various management disciplines, particularly with regard to the design and imposition of incentives and incentive procedures. Equity theory (cf. Janssen, 2001; O'Neill & Mone, 1998) and the work of Huseman and his colleagues in particular (Miles *et al.*, 1994; Huseman & Hatfield, 1990; Huseman *et al.*, 1987) in management, seeks to describe a relationship between employees' motivation and their perception of being treated fairly. The theory suggests that employees seek to ascribe values to their inputs and outputs. Obviously, perceptions of fairness are akin to perceptions of equity, and incentives are the fundamental driving force of equity.

Early work on the issues of fairness and incentives utilized experimental designs to examine effects. More than 30 years ago Farr (1976) conducted a factorial laboratory study in which he examined the effects of individual incentives and group incentives. The subjects were 144 college students who worked in three-person groups on a card-sorting task. He found that both individual and group incentives significantly increased task performance. The experimental condition which contained both an individual and group incentive resulted in the highest level of performance, but also resulted in perceptions of the pay system as being unfair. Personal pay satisfaction was not affected by any pay condition. Results also were not in accord with predictions of equity theory concerning both performances and satisfaction. It was concluded that current conceptions of pay inequity may have to be modified to include a distinction between personal pay satisfaction and the perceived fairness of a pay system.

Some years later, also using an experimental design, Dillard & Fisher (1990) investigated the effect of alternative compensation schemes on performance and satisfaction. Using a laboratory study involving 40 subjects, their findings provide insights into the individual and group effects of alternative compensation schemes and the dynamics of changing compensation schemes on productivity and satisfaction. Specifically, a relationship was found between compensation schemes and performance. The effect on performance is independent of the compensation scheme's perceived fairness. Satisfaction is a function of the congruence between the preferred scheme and the implemented scheme.

Obviously, considerable research has been conducted by management scholars on the impact of perceptions of fairness on the success or otherwise of compensation schemes. Greenberg & McCarty (1990) argue that the way information about pay is communicated from supervisors to their subordinates may greatly influence assessments of pay fairness. They point to growing evidence that the appropriate enactment of formal procedures, specifically the provision of a sincere and adequately reasoned explanation, is another aspect of what employees evaluate when judging the fairness of a process. Similarly, Cooper *et al.* (1992) in their consideration of gainsharing identify problems that may limit potential gains in productivity. They explain how contemporary gainsharing plans constitute social dilemmas and provide an opportunity for 'free-riding' and thus lower productivity. They describe two experiments that indicate that fair distribution rules that are participatively developed can ameliorate the social dilemma inherent in gainsharing plans, and offer prescriptions for improving gainsharing plans.

Obviously, there has been considerable attention given to the impact of remuneration on perceptions of fairness. Lowery *et al.* (1996) argue that employees appreciated the opportunity to be judged on merit, the money offered by a performance related pay plan, and the incentive to raise performance. However, they are concerned with the quality of the goals that are set, and especially with a lack of fairness or a perception of favoritism in the allocation of rewards. Their large-scale study encompassed 4788 respondent employees from seven operating companies. The responses indicated that employees appeared to approve of the concept of merit pay, but were concerned about problems with its implementation. Dulebohn & Martocchio (1998) studied employee perceptions of the fairness of work group incentive pay plans in the setting of a non-union chemical production facility of a Fortune 500 company. They investigated the relationships between six antecedent and outcome variables, and studied the indications of procedural and distributive justice and their interaction with two control variables, namely, job classification and organizational tenure.

More recently, Tekleab *et al.* (2005) have questioned whether it is pay levels or pay raises that matter to fairness and turnover. Their two studies examined the relationship between actual pay and distributive and procedural justice, and the extent to which these perceptions were related to two important pay satisfaction dimensions, pay level and pay raise, and ultimately, impacted turnover. For each study the measures of pay and justice variables were obtained on a cross-sectional basis, while the measure of turnover was necessarily lagged. Results showed that distributive justice mediated the relationship between pay and both pay level satisfaction and pay raise satisfaction. Furthermore, distributive justice was a stronger predictor of pay level satisfaction; whereas procedural justice was a stronger predictor of pay raise satisfaction.

In a marketing and sales context Ramaswami & Singh (2003) examined how salespeople make judgments of merit pay fairness, and the means by which fairness judgments influence the performance and commitment of salespeople. They also used equity and social exchange theories to examine these questions for industrial salespeople in a Fortune 500 firm and provide four key findings. First, of the three dimensions of fairness judgments, they find the interactional fairness dimension to be relatively more important than procedural or distributive fairness in influencing job outcomes of salespeople. Second, supervisory behaviors have significant influence in shaping salespeople's fairness judgments, particularly judgments of distributive and interactional fairness. Third, the results underscore the contrasting mediating role of trust in supervisor and job satisfaction. Although trust in the supervisor is important in reducing salespeople's opportunistic behaviors, the authors find job satisfaction to be important in enhancing their loyalty to the organization. Fourth, salespeople's job performance is influenced directly by extrinsic factors such as fairness of current rewards and potential for rewards.

In a world that is increasingly global, scholars who study incentives and fairness have begun to give attention to international similarities and differences when it comes to perceptions of these phenomena. Recently, Beer & Katz (2003) conducted a survey of the perceptions of a worldwide sample of senior executives on whether incentives work. While their work focused only on incentives at very senior levels in organizations, many of the findings could probably be generalized to the phenomenon in lower settings within firms. They present the results of a survey of 205 executives from different countries to investigate their perceptions of the causes and consequences of using executive incentives. The researchers found evidence that the belief in executive incentives is a social

construction, more prevalent among US managers than among managers from Europe and Asia. The findings suggest that careful efforts to design an incentive system contingent on unit performance may be misguided, and raise questions about the worldwide trend toward the use of more executive incentives. Instead of viewing compensation through motivation, incentive systems may be best evaluated through fairness and justice. This would suggest not so much an interfunctional, but an intra-organizational level of concern for differences in top management versus lower management compensation, and that these should be controlled for. They conclude that the emphasis should be on developing a competitive total compensation package that is perceived to be fair by executives and lower levels.

There have been other international and cross-cultural studies of incentives and fairness. In China, Leung *et al.* (2001) investigated job attitudes and organizational justice in joint venture hotels in China with particular reference to the role of expatriate managers. They surveyed local employees in joint venture hotels in China. They found that perceived interactional justice was predictive of job attitudes, and perceived salary fairness in comparison with expatriate managers explained additional variance in job attitudes. Compared to previous results, local employees now perceived their pay as much more unfair when compared to that of expatriate managers. In addition to perceived justice, perceived managerial practices of expatriate managers and incentives received were also predictive of job attitudes of local employees.

In the United Kingdom, Morris & Fenton-O'Creevy (1996) conducted a case study of top managers' attitudes to their performance related pay. Because little is known about the views of top managers on the effectiveness of such incentives, they polled the attitudes of the top managers within one large financial services organization toward fixed and variable components of their compensation package. The results suggest that the design of effective bonus systems is not just a technical issue: perceptions of market fairness with respect to the compensation package and the clear communication of goals are important in getting senior managers to focus on shareholder interests.

Minkler (2004) studied shirking and motivations in firms with regard to worker attitudes in the USA. A compelling result of this study was that 82.7% of the respondents report that they are very likely to keep an agreement to work hard, even if it was almost impossible for their employer to monitor them. The rank order of motivations found in the study was moral, intrinsic, peer pressure, and only then, positive incentives. However, respondents also reported that fairness considerations were important and that they would be especially likely to keep agreements with honest employers.

While the move towards researching incentives and fairness on an international and cross-cultural basis is encouraging, it is obvious that more work needs to be done in this area. The current work seeks to do this in a setting hitherto not researched extensively: South Africa. This nation is seen by many observers as representing a microcosm of major global trends: cultural, ethnic, economic and technological diversity and change, culminating in disparate and fast changing market needs and tastes (Adam, 1995; Gefen *et al.*, 2005). Such an environment could pose a unique challenge to business, as it may yield non-linear rates of change of degree of technological, market and competitive turbulence.

The Research Setting and Project

The setting for the research was a small-to-medium size marketer of a range of financial services, which had over a two-year period designed and implemented a range of

incentives for its sales force, and also for other members of the firm. As part of a larger study concerning various aspects of corporate life, all members of the organization were required to complete items gauging the perceived fairness of their work situation and especially the range of performance incentives that had been instituted. These 13 items were taken from the work of Beltrami & Evans (1988). They were scored on a 7-point Likert-type scale ranging from 1 = I strongly disagree through 7 = I strongly agree. The items are shown in Table 1. In a way, our method here follows that recommended by Churchill (1979), which would be recognized by researchers as a classic approach to the construction of an instrument and a survey research project.

The questionnaires were delivered through the internal mail system in hard copy to each individual, with a signed letter from the CEO explaining the purpose of the study, and requesting their cooperation. This letter particularly emphasized the employees' anonymity, and that their participation was entirely voluntary. It stressed that if everyone's views were heard in the survey, they could be taken note of, and hopefully responded to. While anonymity and the fact that the data gathered would be used for statistical and overall company evaluation employees only were assured, the questionnaires were numbered so that reminders could be sent (by the researchers only, and not identifiable by company officials) to those who were tardy in replying. Replies were required to be placed in sealed envelopes in a sealed box prepared especially for the purpose. By the cutoff date, 141 usable responses had been received from the firm's 174 employees, representing an effective response rate of 81.03%. Of the non-respondents, 23 were either on

Table 1. Factor analysis of the 11-item inequity fairness scale

Item	Factor 1: Fairness	Factor 2: Benefits	Factor 3: Procedures
1. I have sufficient opportunities for advancement within XXX CORPORATION	0.581426	-0.111638	0.327548
2. Compared to my colleagues I am rewarded fairly	0.626195	-0.367343	0.039666
3. In general the performance appraisal system works well	0.720915	-0.321306	0.176323
4. People who perform their jobs well get rewarded for it	0.581412	-0.517511	-0.076106
5. The salary structures across the XXX CORPORATION divisions/departments are fair	0.871774	-0.118445	0.109396
6. Promotion at XXX CORPORATION is based on ability/merit	0.769258	-0.293011	0.018939
7. XXX CORPORATION offers benefits that are motivational to employees (leave/medical/pension)	0.452499	-0.552484	0.059677
8. The way benefits are distributed among staff is fair	0.374556	-0.677571	-0.027115
9. People are more loyal to XXX CORPORATION because of the incentive system	0.154793	-0.813543	0.199263
10. The targets set for the incentives are achievable and motivate people to try harder	0.341066	-0.686387	0.382704
11. In my opinion the Annual National Sales Conference is core to the success of XXX CORPORATION	0.160811	-0.810762	0.107630
12. I have sufficient opportunities for advancement within XXX CORPORATION	0.001710	0.002094	0.863075
13. Compared to my colleagues I am rewarded fairly	0.209669	-0.283027	0.539354

vacation or ill at the time of the survey, and 10 were discarded either because they were incomplete or had been spoiled. As already stated, the firm is sales intensive, with a large sales force relative to its overall size. Sixty-three responses were received from members of the sales force (abbreviated as S in our subsequent analysis), and 78 from other members of the organization (referred to as A in our subsequent analysis). The latter represented a mix of operations, administrative and other functional areas of the firm.

The Results

The coefficient alpha (Cronbach, 1951) for the 13-item scale measuring perceptions of incentive fairness scale was 0.89, which exceeds the generally accepted commercial cutoff of 0.7 (Nunnally & Bernstein, 1994). It can thus be inferred that the scale is one that possesses internal consistency. The items, which are shown in Table 1, were then subjected to a principal components factor analysis, with varimax rotation, using the eigenvalues greater than one cut-off rule. The rotated factor pattern is also shown in Table 1. Three factors, explaining 62.6% of the variance were obtained. Factor 1 clearly has to do with the perceived fairness of the incentives in the organization, and this was labeled 'Fairness'. Factor 2 clearly has to do with the benefits received by staff, and this was labeled, 'Benefits'. Factor 3 seems to have to do with the way in which incentives are administered in the organization, and this was named 'Procedures'.

In order to test whether there are differences in perceptions between the sales force (S) and the members of the other functional areas within the organization (grouped as 'Division A' variable in the analysis), we conducted a series of three ANOVA (analysis of variance) procedures, using the three factors, Fairness, Benefits and Procedures as criteria.

In Table 2, the results of the ANOVA for Fairness are presented. As can be seen in Table 2, the ANOVA results in a small but significant R^2 of 0.08 ($F = 12.85$; $p < 0.05$), which suggests that there are differences in the levels of perceptions of Fairness between the sales function and other employees in the firm. On average, members of the sales force rated the 'fairness' of incentives as 4.49 on a seven-point scale, while other members of the organization only rated this as 3.65. This can also be observed from the means diamonds plot in the table, which enables a visual comparison of the mean and standard error of the mean for each sample group. The line across each diamond represents the group mean. The height of each diamond represents the 95% confidence interval for each group, and the diamond width represents the group sample size.

The results of the ANOVA for Benefits are presented in Table 3. Here the ANOVA results in a small R^2 of 0.025 ($F = 3.67$; $p < 0.058$), which is not significant at $p < 0.05$, but is meaningful because if the significance level were adjusted to 0.1 this would then be important. On average, members of the sales force rated the 'benefits' as 4.93 on a seven-point scale, while other members of the organization only rated this as 4.51. Thus, while members of the sales force perceived the benefits offered to be slightly better than members of other functions, the difference is not significant.

Finally, the results of the ANOVA for Procedures are presented in Table 4. Here the ANOVA results in a small but significant R^2 of 0.044 ($F = 6.35$; $p < 0.05$). On average, members of the sales force rated the 'procedures' as 5.12 on a seven-point scale, while other members of the organization only rated this as 4.55. Members of the sales force perceived the procedures employed to be significantly better than members of other functions.

Table 2. One-way analysis of fairness by organizational function

Discussion

From this small study in a single organization, it is evident that there are small but significant differences in the perceptions of the fairness of incentives provided by an organization between members of the sales force, and other functions within it. While there seem to be no differences between the two groups with regard to the benefits offered, there are differences between the perceived fairness of benefits and the procedures used to administer these. Quite simply, members of the sales force in the organization perceive the benefits offered to be fairer, and better administered than do other members of the organization. These findings add to the knowledge already gathered by researchers in other parts of the world, and discussed in our literature review. In particular, this research contributes to our understanding of these issues in a South African context.

Obviously a small study such as this has some significant and obvious limitations. Most obviously, it is risky to draw encompassing conclusions from results taken from one, relatively small, organization. The situation might be considerably different in other organizations, and a more conclusive study would have to incorporate a range of different organizations across a range of products and services, and of different structures and sizes. Secondly, there may be a number of other factors behind the use of incentives and benefits in organizations that have not been considered here. Thirdly, the use of a survey might

Table 3. One-way analysis of benefits by organizational function

One-way Anova
Summary of Fit

Rsquare	0.025722
Adj Rsquare	0.018712
Root Mean Square Error	1.31239
Mean of Response	4.701305
Observations (or Sum Wgts)	141

Analysis of Variance

Source	DF	Sum of Squares	Mean Square	F Ratio	Prob > F
DivisionA	1	6.32055	6.32055	3.6697	0.0575
Error	139	239.40898	1.72237		
C. Total	140	245.72953			

Means for Oneway Anova

Level	Number	Mean	Std Error	Lower 95%	Upper 95%
A	78	4.51103	0.14860	4.2172	4.8048
S	63	4.93689	0.16535	4.6100	5.2638

Std Error uses a pooled estimate of error variance

give an overall picture, but we are unable to provide the richness and context ‘behind’ the perceptions without conducting in-depth interviews or focus groups with members of both functional groupings.

Managerial Implications and Avenues for Future Research

Nevertheless we believe that there are significant implications for managers to be drawn from these results, if not for managers in general, then at least for those in the organization studied. There is a danger that where other members of the organization perceived the sales force to be better and more fairly treated that a resentment might be built up against them. The relationship quality between sales force and other members of the organization might suffer. In simple terms this could result in degradation in the support from the rest of the organization on which any effective sales force relies. The overall performance of the firm will suffer as a result. Management might want to take steps to overcome this, either by making changes to the fairness and administration of the incentives system, or by communicating more effectively to members of the organization, both those in the sales force and those in other functions. Other functions should be informed not only of the need to incentivize a sales force if it is to perform effectively, but

Table 4. One-way analysis of procedures by organizational function

also of how the incentives work. The sales force should be reminded that they rely on other members of the organization to perform their selling tasks effectively, and that it is incumbent upon them to work at building and maintaining high quality relationships not only with their external customers, but with others in the firm.

Some years ago, Heskett and his colleagues (Heskett *et al.*, 1994) alerted us to the virtues and perils of the Service-Profit chain. According to service-profit chain logic, a firm's performance begins with the workforce, and how satisfied employees are. Obviously in the context of relationship quality management, this depends to a large extent on the quality of the relationships between different functional areas within the firm – such as in this case, the quality of relationships between the salesforce and the rest of the organization. If employees are satisfied, the logic follows, this impacts on customer satisfaction (in our current terminology, on the quality of the relationship between the customer and the firm). Customer satisfaction is critical, because satisfied customers are more loyal, and loyal customers are more profitable, which affects the firm's financial returns in a positive manner. Profitable firms are in turn able to invest further in the quality of relationships between themselves and their employees – and so the chain moves on. The findings in the current research alert us to the potential problems that can arise when there are differences in perceptions of fairness between one functional

area and others, in this case between the sales function and other functions in the firm. According to service-profit chain logic, there is a danger that this imbalance can in turn eventually affect the firm's quality of relationships with its customers in a negative manner.

One potential solution to this problem would be for the firm to investigate the possibility of using internal marketing approaches to level the playing fields between the sales function and other functions. Internal marketing has received some attention in the literature in recent years. Pitt & Foreman (1999) argue that it is not a general panacea, but from a transaction cost perspective, is only really appropriate in organizations with high goal congruence under conditions of high performance ambiguity. Fortuitously in the firm in question, these conditions exist, and the firm is what Pitt and Foreman would describe as a 'relational hierarchy', so internal marketing approaches can be used to address the problems. First, there is high goal congruence, in that all the functions within the firm want it to succeed and generally want to pull in the same direction. However, there is also high performance ambiguity, which means that no one really knows whether other parties are performing at their maximum potential. For example, the sales force is uncertain about whether other functions are really doing their best to support it, and other functions are never certain whether salespeople are performing to their best ability or just coasting.

Internal marketing approaches could be used to better communicate the nature of one party's roles and tasks to others. It could also be used to facilitate interactivity between the sales function and others, so that mutual problems and opportunities can be shared and understood. Other functions can be made to understand and appreciate better why salespeople might need different types of motivation and incentives, while at the same time, the salesforce can be made to recognize and value better the necessity of roles performed by other functions, and why they depend on these.

A number of opportunities exist for future research. First, it would be worthwhile to conduct similar studies across a wide range of organizations and situations. Second, it would be insightful to conduct causal studies, in which perceptions of incentive fairness were tied to other constructs of importance, such as perceptions of relationship quality, and the like. Third, at a more advanced level, it would be important to consider the impact of incentive fairness perceptions and interfunctional relationship quality on micro-level performance levels (i.e. functional performance) as well as on macro-level performance (organizational performance). Finally, while survey type research such as this does allow researchers to generalize to an extent, it does not provide the context and richness that qualitative studies can. There is probably much to be learned from focus group discussions and in-depth interviews with members of different functions in organizations with regard to their perceptions, not only of the fairness of incentives, but also of the factors that would influence the quality of the relationships that they have with other functions.

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