The Relationship Between Strategy, Reward and Organisational Performance: An Empirical Investigation

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Abstract: This study examines the association between reward practices and firm performance based on the type of strategy being used by the firm. Based on a model developed for this study, the paper uses empirical research to determine the relationship between organisational strategy, reward practices and performance. The study identifies different kinds of reward practices that are closely associated with each of the four generic strategies, which are significantly related to higher levels of perceived performance of firms in Saudi Arabia. The study concludes by identifying by identifying limitations and presenting directions for future research.

Key words: Generic strategy %Rewards %Performance %Saudi Arabia

INTRODUCTION

A number of organisational strategies have been identified over the years [1, 2, 3]. Yet, Porter’s generic strategies remain the most commonly supported and identified in academic studies [4, 5] as well as in the literature [6, 7, 8]. A recent empirical study concludes that even Japanese managers are beginning to adopt a more typical Porter styles with greater success [9].

While the efficiency and effectiveness of various business strategies have been examined in a myriad of research, the results have never been consistent. Given the contrary findings on the value of generic strategies, a study by Allen and Helms [10] proposed that reward practices might be associated with stronger organisational performance based on the type of strategy being used by the firm. Their study found that there are clear linkages between a reward system and the efficacy of strategy. The present study is an extension of the study by Allen and Helms [10] and aims to investigate the relationship between strategy, reward and firm performance in Saudi Arabia.

Since the accession of Saudi Arabia as a full member of World Trade Organisation in 2006, the market is transforming rapidly with the entry of global competitors. The Kingdom of Saudi Arabia is the largest country in the Middle East and the 12th largest in the world, measuring approximately 2.2 million square kilometres. It has the largest GDP in the Middle East. It is an oil-based economy having the largest reserves of petroleum in the world (26% of the proved reserves). The Kingdom ranks as the largest exporter of petroleum and plays a leading role in OPEC. However, to lessen the Kingdom’s dependence on oil and increase employment opportunities for the swelling Saudi population, the government has been increasingly supporting private sector growth. The Kingdom has launched a wave of cautious economic reforms aimed at diversifying its oil-based economy.

Given the competitive nature of industries and the growing importance of the linkages between organisational strategy, reward practices and performance this study investigates this potentially important topic. The objective of this study is to empirically explore the potential relationship between generic strategies, a wide range of reward practices and the performance of firms operating in Saudi Arabia.

Theory

Generic Organisational Strategies: Although various type of organisational strategies have been identified over the years, Porter’s generic strategies remain the most commonly supported and identified in key strategic management literature. Porter [3] identified three generic strategies, cost leadership, product differentiation and focus. Porter also suggested that an organisation must make a choice between one of the generic strategies rather than end being “stuck in the middle” to ensure long term profitability [11].
Cost leadership refers to lowering costs and gaining cost advantages resulting from the innovation process, economies of scale and reengineering activities [12]. A cost leadership or low cost strategy is effectively implemented when the business designs, produces and markets comparable products more efficiently compared to its competitors.

Product differentiation involves tailoring a firm’s product and/or service to better fulfil a customer need, thereby allowing the firm to capture a market share with a premium price [10]. This strategy is implemented when the business seeks to provide unique value to customers through product quality, features, or after sales support. A firm that is implementing a differentiation strategy can charge a higher price based on the product characteristics, delivery system and the quality of service. The quality is usually based on the fashion, brand name, or image [12].

A focus strategy enables a firm to obtain a market share by operating in a segment that may be seen as unattractive or overlooked by large competitors. This can arise from a number of factors such as geographical location, buyer characteristics and product specifications [3]. Focus strategy can be successful depending on the industry segment. Segments that have a potential for growth, but are ignored by major competitors can be particularly successful [11]. Market development can be an important focus strategy. Midsized and large firms use focus based strategies, but only in conjunction with differentiation or cost leadership strategies and also focus strategies are usually most effective when a consumer have a distinct preferences [13].

Organisational Performance Measures: In measuring organisational performance, there is a trade of between long-term benefits and short-term gains. As a result, a disagreement on its definition and operationalization is evident [14, 15, 16]. Measuring the performance of a company is therefore seen as being challenging [10]. Firm performance has been defined as the total economic results of the activities undertaken by an organisation [17].

Studies to measure organisational performance have used a variety of means that include both financial and non-financial measures. Research that employs financial measures include profit [18, 19, 20]; turnover [21]; return on investment [19]; return on capital employed [20]; and inventory turnover [21]. Non-financial measures have included innovativeness [22] and market standing [18, 19]. Apart from financial and non-financial measures, researchers have also used other means to measure performance (for example, national, industry, company and product); Given these differences, comparison of results of financial performance is difficult [23, 14, 21].

All these types of measures carry with them advantages and disadvantages. Financial measures tend to be more concrete but are often limited in scope to financial data. Non-financial measures on the other hand lack concreteness or reproducibility, but often provide the researcher with a richer description of the effectiveness of an organisation and is used more suited to qualitative research design [18, 22].

Reward Practices: Employees in developing nations generally look forward to wage increases on a routine basis. Recent trends from the employers side indicate that firms are looking at developing innovative compensation strategies that can motivate employees to improve the organisation’s performance. A study concluded that rewards must have a positive impact on performance and that verbal appreciation or praise was the most desired form of reward [24]. Individual rewards are still seen as being more important, although there has been an increase in the growth of team based rewards [25].

Many studies have concluded that the reward system should be aligned to motivate employee performance to make it consistent with the organisational strategy. This also leads to creating a supportive culture and structure [26, 27, 28]. Past studies have also reasoned that alignment of the reward system with organisational strategy helps to determine its effectiveness [29]. Studies have concluded that modern-day firms must align their reward system practices with their strategy in order to achieve higher levels of performance at both the individual and organisational level [30].

Generic Strategy and Performance Link: To investigate the linkages between organisational strategy and performance link, Porter’s [3, 31, 32] approach has been widely found to be generalisable across industries.

Pure generic strategies: Past studies have found support for Porter’s [3, 31] original generic strategies [12, 33, 34, 35]. Examining industrial organisation, a study by Allen and Helms, [10] suggested that performance achieved through the single strategy suggested performance was achieved through the adoption of a single strategy.
Another past study also supported two distinct focus strategies including low-cost and differentiation - the first aimed at distinct needs in terms of cost in a narrow target market, while the second targeted at identifying distinct customization requirements in a narrow target market [36].

**Combination Generic Strategies:** There is a growing debate in the literature on the simultaneous adoption of low cost and differentiation strategies (combination strategies). While Porter [31] was of the opinion that differentiation and cost-leadership were mutually exclusive, a number of other studies have shown that is not true [37, 38, 39, 40]. Richardson and Dennis [41] in their research on the UK wine industry concluded combination differentiation approach was best for niche segments. Spanos *et al.* [42], in their study on the Greek manufacturing industry, found that hybrid strategies were preferable to pure strategies. Another study established that lower cost and differentiation are directly connected with profitability establishing the performance link [43].

**Research Model and Hypothesis:** Following the forgoing review of literature, this study proposes a model that establishes the potential relationship between the four generic strategies (i.e., cost leadership, product differentiation, focus-cost and focus-differentiation), reward practices and organisational performance of firms operating in Saudi Arabia. As a result, a conceptual model is developed as shown in Figure 1.

The hypotheses postulated for this study are as follows:

**Hypothesis 1:** For a firm pursuing product differentiation strategy in Saudi Arabia, reward practice will be associated with a higher perceived level of performance.

**Hypothesis 2:** For a firm pursuing cost leadership strategy in Saudi Arabia, specific reward practice will be associated with higher perceived levels of performance.

**Hypothesis 3:** For a firm pursuing on focus product differentiation strategy in Saudi Arabia, specific reward practice will be associated with higher perceived levels of performance.

**Hypothesis 4:** For a firm pursuing on focus-cost leadership strategy in Saudi Arabia, specific reward practice will be associated with higher perceived performance.

**MATERIALS AND METHODS**

**Questionnaire Design and Survey Measures:** Based on the model developed, a survey instrument was specifically developed for this study. The first part of the instrument comprised of questions to gather the demographic information. The second part of the instrument related to the framework of the research as depicted in Figure 1.

All the constructs of the study were measured from items adapted from previous studies. Items used in the measurement of strategy were adapted from Allen *et al.* [44]. Twenty-five questions were developed to operationalise each of the four of Porter’s generic strategies [3, 31]. Respondents were asked to estimate how frequently the various strategic practices are used by their organisation. Responses were captured on a scale ranging from 1 = Never to 7 = Always.

The next section of the instrument comprised of questions to measure reward practice. Respondents were asked to provide information on the various types of reward practices used in their organisation. To measure
reward practices, items were drawn from Allen and Helms [10], Allen and Killmann [45], Lawler et al. [46] and Wellins et al. [47]. Twenty-four items that included both monetary and non-monetary reward practices were used. Again, responses were captured on a scale ranging from 1=Never to 7 = Always.

The final section of the instrument was designed to capture information on firm’s performance. As for the items, past studies of this nature have used scale measurements using five items [10] Dess and Robinson [48]. For the present study, we used a five point, Likert-type scale on five key objective performance indicators total revenue growth, total asset growth, net income growth, market share growth and overall performance. This process of selection was employed to ensure generalisability of the findings, as the study covered a broad range of industries. A pre-test of the instrument was undertaken conducted on employees of three firms, in order to ensure clarity and validity of the survey instrument. Some minor changes were made to produce a final version.

**Data Collection:** The target respondents were individual employees in the position of middle to senior level employment. Respondents were asked to select their organisation as a point of reference. If the organisation under study had multiple divisions or subsidiaries, respondents were asked to base their answers on the specific division or subsidiary in which they worked. To ensure that the respondents chosen were competent to answer the questions, a screening question was included. Only those respondents who had at least six months employment at the firm were asked to proceed to complete the questionnaire.

Primary data collection poses numerous challenges to researchers in Saudi Arabia [49]. Although the society is moving towards modernization, there is still a general apathy to unsolicited surveys. Waves of reminders and call-backs are necessary and were undertaken. Further, due to a preference for formality, research assistants were engaged to make personal visits and to distribute/administer the survey questionnaire to respondents who had consented to participate.

Due to the lack of the lack of complete and reliable sampling frames from which to draw probability samples, most empirical studies have relied on convenience samples in the Saudi environment. Convenience sampling was also used for the present study. Research assistants under the direct supervision of the researchers visited the targeted industrial cities, soliciting the participation of senior employees. Those who voluntarily agreed to participate were provided with the questionnaire. One thousand questionnaires were distributed in this manner. All these efforts yielded 167 completed and usable questionnaires, for a response rate of 17 per cent, which compares well with response rates from other studies in Saudi Arabia.

**Study Findings and Implications**

**Survey Profile:** Of the 167 respondents, the average years of work experience was 5, the time employed ranged from six months to 22 years with a standard deviation of 6.23 years. In terms of position, 21 percent held professional or technical positions in their organisation, 43 percent were in middle management, 10 percent were front-line managers and 26 percent were senior managers. 37 percent were service organisations, 46 percent were manufacturing and 17 percent were in the government/non-profit sector.

**Reliability Analysis**

**Firm Performance Scale:** The Cronbach Alpha for the firm performance scale was computed to be 0.95. This compares favourably to previous research using this scale to measure firm performance [45].

**Strategy Scales:** Measures for the strategy items were based on Porter’s [3, 31] framework of four generic organisational strategies. Of the total of items, 11 corresponded to product differentiation, 5 each to focus cost leadership and focus product differentiation and 3 to cost leadership. The means, standard deviations and psychometric properties of the measures are provided in Table 1.

**Reward Scales:** As mentioned earlier, 24 reward practice items were identified for this study. The correlation list comprising these items has some strong correlations between many of the variables. This makes a conceptual sense, as an organisation employing a particular type of reward practice is likely to use another similar reward practice. For example, an organisation that places an emphasis on teamwork is likely to use such related reward practices as work group incentives, employee stock ownership, profit sharing and gain sharing [10]. Table 2 shows the descriptive statistics and correlations of the items.
RESULTS AND DISCUSSION

To help control for possible multi-collinearity, a stepwise variation of multiple regressions was used to test the hypotheses. This stepwise procedure permits the elimination of variables that become statistically non-significant. Organisations that scored above the mean on each of the four strategy scales were included in a regression equation along with the reward practices as independent variables and firm performance as the dependent variable. This technique has also been previously employed in a number of similar studies, for example Allen et al. [9]. Based on this technique, regression analysis results revealed that seven of the originally 24 reward practices were associated with significantly higher levels of performance for the different types of strategies. Seventeen insignificant reward practices were discarded by the step-wise regression as not adding significant explanatory power regarding the variance in firm performance. The regression results for the four hypotheses are summarized in Table 3.

**Hypothesis 1:** From the analysis of the present study, product differentiation strategy results in four reward practice being associated with higher level of firm performance. These were gain sharing, group celebrations, customer satisfaction monitoring and compensated time.
It is obvious that the use of both financial as well as non-financial incentives motivate employees to achieve a differentiated product or service. Individually, the option of providing benefits to employees enhances employees’ awareness of firm goals and provides personal growth and development opportunities. The option of gain sharing when institutionalized within the firm provides a newly made structure and process for sustaining firm development. Secondly, a product differentiation strategy also hinges on the equalization of reward among group members thereby eliminating the need for comparison. It is revealed that firm performance is a direct result of reward system that enhance teamwork and discourage competition among employees [10]. There is also an association between compensated times to product differentiation strategy. This suggests that firms would be better off giving an employee time off time for hard work or innovativeness at work. All these four reward practices lead to high level of firm performance. Firms pursuing product differentiation strategy pursued emphasis on customizing products to meet customer needs. Individual incentives or rewards based on sales growth thereby will be particularly effective [10].

**Hypothesis 2:** The cost leadership strategy included four reward practices that lead to significant firm performance. These reward practices include quantitative performance measures, group celebration, customer satisfaction monitoring and developmental based performance. Financial rewards to employees to minimize or eliminate costs would be more important for organisations pursuing cost leadership strategy. Customer satisfaction monitoring is also supported in service quality literature [50, 51]. Also with competitiveness growing in many industries, quantitative performance measures for rewarding of employees are more suited to cost reduction emphasis.

**Hypothesis 3:** The significant reward practice concerning focused product differentiation strategy includes, customer satisfaction monitoring, development based performance appraisal, gain sharing quantitative performance measures. Customer-monitoring system would encourage product or service differentiation in a micro segment. When firms pursuing this strategy employ customer satisfaction monitoring system, more autonomy should be for employee empowerment. This will ensure that the firms product and services would be sufficiently differentiated from those of their competitors [42].

Developmental based performance appraisal allows the employee to gain the skills necessary in the future to allow them to differentiate their product and services to niche customer [10]. It is also important for a firm focusing on product differentiation to have measurement of quantitative performance, because by using this a firm can measure and know accurately their performance in the market. Gain sharing reward practices are also associated with focus differentiation strategy, as gain sharing involving payment of lump-sum bonus is seen as a productivity measure, as opposed to profit-sharing which is a profitability measure [52].

**Hypothesis 4:** The fourth hypothesis relates to the generic strategy of focused cost leadership. In focus cost leaderships we found four reward practices to be supportive, these are profit sharing, quantitative performance measures, developmental based performance appraisal system and compensated time. The practice of reward sharing finds support in another recent study [44]. Allen and Helms [44] concluded that in order to increase their performance, it is important for firms pursuing focused cost leadership strategy to develop a system of profit sharing amongst employees. Such direct or indirect payment can enhance the successful perusal of focus cost leadership.
Quantitative performance measures and developmental based performance appraisal systems as reward practices, as discussed earlier, are in agreement with the other focus strategy, focus-differentiation strategy. The final reward practice supporting a focused cost leadership strategy deals with the issue of compensation time. As stated earlier, firms would be better off giving an employee time off for hard work or innovativeness at work. This would help firms to lower costs.

CONCLUSIONS

This exploratory research was undertaken to identify reward practices that are closely associated with generic strategies. As for product differentiation strategy, analysis reveals that four reward practice are associated with higher level of firm performance. These practices include gain sharing, group celebrations, customer satisfaction monitoring and compensated time. Consistent with past studies, cost leadership strategy included four reward practices that lead to significant firm performance. These reward practices were quantitative performance measures, group celebration, customer satisfaction monitoring and developmental based performance.

Noteworthy reward practice relating to focused product differentiation strategy includes, customer satisfaction monitoring, development based performance appraisal, gain sharing quantitative performance measures. Four reward practices found support to the strategy of focused cost leadership. These reward practices were profit sharing, quantitative performance measures, developmental based performance appraisal system and compensated time.

Although Porter’s [31] generic strategies have been widely accepted, this study links specific strategic practices to reward practices by firms operating in Saudi Arabia. Findings of this study provide a clearer understanding the reward practices linked with each generic strategy. The study provides clearer guidance for top management and strategic planners in improving organisational performance.

Like any other study of its kind, this study also suffers from some limitations. The limited sample size is one among them. More empirical work with larger samples from across the Kingdom is needed to generalize findings. The results of the study must, therefore, be treated with caution.

This study also lays down several worthwhile directions for further work on this topic. One area is to examine the trends over time. It is also suggested that studies be conducted in future to test whether or not these different reward practices actually moderate the performance of organisations. Qualitative research design in the form of case studies could also be undertaken to provide rich insights into employee perspectives of strategy and reward practices.

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