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Compensation Design as a Tool for Implementing Foreign Subsidiary Strategy[1]

Abstract

- This study empirically examines the use of compensation at the foreign subsidiary as a tool for implementing subsidiary strategy.
- Theory suggests that the performance objectives upon which incentives for subsidiary managers are based should be aligned with the subsidiary's strategy and that a fit between strategy and compensation design should result in enhanced subsidiary performance.

Key Results

- Subsidiary compensation practices are significantly related to subsidiary strategy. The strategy-compensation fit has moderate performance effects.

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In their efforts to identify organizational structures and processes that facilitate the effective implementation of a multinational corporation's (MNC's) international strategy, international management researchers have examined a variety of macro-level organizational design issues (Egelhoff 1982, 1988, Stopford/Wells 1972). However, it has become apparent that the effective implementation of international strategies requires attention to more than just the structural aspects of organizational design. Researchers have demonstrated the need to focus on subsidiary managers and their role in the implementation of coordinated international strategies (Bartlett/Ghoshal 1989, Hedlund 1986, Hedlund/Rolander 1990). Beginning with Perlmutter's (1969) seminal work, authors have stressed the importance of the international manager's orientation toward doing business internationally. It is generally accepted that one goal of MNC management is to develop in its worldwide managers an orientation or mind-set that is consistent with the international strategy of the firm. (Bartlett/Ghoshal 1989, Kobrin 1994, Murtha/Lenway/Bagozzi 1998). For example, it has been argued that a global strategy necessitates a geocentric managerial orientation (Kobrin 1994). However, little empirical work has been done to examine the role of human resources practices in the development and maintenance of the subsidiary manager's attitude toward the firm and its competitive environment. Several authors have stressed the importance of international human resources management in the implementation of global strategies (Edstrom/Galbraith 1977, Kobrin 1994, Kogut 1985, Rosenzweig/Nohria 1994), however, few authors have empirically examined the role of international human resources management in the effective implementation of international strategies.

One must turn to the strategic management literature to find studies that have demonstrated the importance of various micro-level organizational design issues in the implementation of firm strategy, many of which involve the management of the firm's human resources. In particular, it is becoming increasingly recognized that the compensation and reward system is a key factor in the implementation of an organization's strategy and the accomplishment of its strategic objectives (Galbraith/Kazanjian 1986, Schuler/MacMillan 1984). However, more work must be done to tie compensation and reward systems to the organization's operating objectives and strategies (Balkin/Gomez-Mejia 1987, 1990), for it is recognized that the reward system can be pivotal in terms of the motivation, attraction and retention of human resources (Lawler 1981).

Several studies have examined the relationship between compensation systems and firm strategy in the strategic management literature. A basic assumption underlying much of the research linking managerial reward systems and firm strategy is that compensation, particularly in the form of incentives, can be used to encourage the top management behaviors needed to effectively implement the organization's strategy (Finkelstein/Hambrick 1989). "It is well understood that the basic, underlying objective of an incentive program is to directly influence

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the actions and behavior of those managers covered under that program" (Galbraith/Merrill 1991, p. 353). The notion that, through their decision-making, managers can influence the direction and performance of the firm, has led researchers to examine the link between firm strategy and the reward systems used. Several authors have empirically examined the relationship between firm diversification and reward systems (Balkin/Gomez-Mejia 1990, Gomez-Mejia 1992, Kerr 1985), while others have specifically looked at the determinants and outcomes of CEO compensation (Finkelstein/Hambrick 1989, Zajac 1990).

Increasingly, researchers are advocating a strategic approach to examining compensation systems which calls for a fit between compensation and both corporate and business unit strategy (Balkin/Gomez-Mejia 1987, 1990). It has been recognized that the different business units within a corporation can take on different strategic roles (Gupta/Govindarajan 1984, 1986). It follows that managers at the business unit level may need to be motivated to perform different tasks, and thus be compensated based upon the behaviors desired to implement the strategy of their particular business unit. The compensation literature has followed this line of reasoning, with several studies exploring the role of compensation in the implementation of business unit strategy (Balkin/Gomez-Mejia 1987, 1990).

Additional complexities are encountered by multi-unit firms operating in an international context. Given the coordination and control difficulties faced by multinational corporations with business units in geographically and culturally disparate locations, the design of appropriate compensation and reward systems becomes increasingly important. Researchers have proposed that subsidiaries within MNCs can and do have different strategic roles (Gupta/Govindarajan 1991), and that MNCs differentiate the control mechanisms used at the subsidiary level depending on the context or strategy of the subsidiary (Bartlett/Ghoshal 1989, Ghoshal/Nohria 1989, Nohria/Ghoshal 1994). Despite the empirical studies linking corporate and business unit strategy to compensation systems, and those examining the relationship between strategy and macro-level organizational design in MNCs, little work has been done which specifically examines the relationship between a subsidiary's strategy for competing internationally and the compensation systems employed to elicit the managerial behaviors and decisions necessary to implement the subsidiary's international strategy.

The purpose of this study is to examine the relationship between the international competitive strategy of the foreign subsidiary and subsidiary compensation policies. In particular, using a global industry context, this study adopts a principal-agent approach to examine the relationship between foreign subsidiary strategy and subsidiary compensation policies as well as the relationship between compensation policy and performance for different subsidiary strategies.

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Theoretical Background and Hypotheses

Subsidiary Strategy in a Global Industry Context

When competing in a global industry, the firm faces a number of basic strategic alternatives, in particular, the firm must choose whether it will compete globally or whether it can compete in just one or a few national markets (Porter 1980, p. 294). According to Porter (1986), within a global industry, several industry segments can co-exist. Firms within the same industry can compete in globally as well as locally oriented segments. Conditions such as strong national differences and/or high levels of protection can lead to situations where there are global competitors as well as country-centered multinationals and domestic firms all competing in the same industry (Porter 1986, p. 48–49).

A firm that sees itself as competing in a global segment of the industry considers its competitive position in one national market to be affected by its competitive position in other national markets (Ghoshal 1987, Porter 1980, 1986). Porter (1986) argues that, to attain a leading position in a global industry, a global strategy that captures the advantages of the configuration/coordination opportunities present in the industry is necessary. A global strategy is one that defines product design, location and scale of manufacturing facilities, choice of technology, sourcing patterns and competitive strategy on the assumption of a unified and interlinked world market (Porter 1980, Prahalad and Doz 1987). In a global industry segment, superior firm performance can be attained by realizing the benefits that can be reaped by coordinating firm activities on a worldwide basis (Porter 1986).

Alternatively, within a global industry, a firm may compete in a multidomestic segment wherein the firm responds more effectively to local conditions (Porter 1980, Prahalad/Doz 1987). A multidomestic strategy requires the use of location-specific sources of advantage, which can be developed by monitoring and responding to local market conditions. Such subsidiaries generally are more autonomous and self-sufficient than their global counterparts, with less emphasis on integration and coordination at the corporate level.

Implementing International Strategies – The Role of Compensation

Firms competing in global industry segments require different sets of behaviors and decisions on the part of subsidiary managers than do those competing in multidomestic segments. Implementing a global strategy in which the firm seeks to link its competitive position across different country locations requires the firm to integrate its activities on a worldwide basis (Porter 1986, Prahalad/Doz 1987). Only through such integration can the firm effectively achieve the economies of

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scope and scale that are associated with competing in a global industry segment. The successful integration of a MNC's position across national markets that results in superior performance has been shown to be a function of both administrative mechanisms and operational capabilities (Roth/Schweiger/Morrison 1991). One of the mechanisms that authors have increasingly focused on as having a potential influence on the implementation of global strategies is the human resources function. Kobrin (1994) has suggested that a firm's international human resources policies can make a significant contribution to the development of a global organization.

Several researchers have examined the role of different aspects of the human resources function in facilitating the implementation of a global strategy. Transferring managers to different organizational locations has been shown to increase their understanding of the subsidiary's role in the corporate-level strategy (Edstrom/Galbraith 1977). Moving managers across functional areas has been found to be critical to "building a network that connects managers across functions and transferring common values that facilitate implementation of central innovations" (Bartlett/Ghoshal 1989, p. 124). Bartlett and Ghoshal (1989) suggest that other aspects of the human resources function are also important in building a "transnational" organization, including recruiting, selection, training, development and career management. The type of and criteria for managerial rewards have also been proposed as being critical to the successful integration of a global strategy. Hedlund (1986) argues that rewards should be tied to the strategic role of the subsidiary within the MNC. Thus, it can be expected that the design of compensation systems at the foreign subsidiary will, in part, be a function of the strategic role of the subsidiary. The next sections of this paper address the use of incentives and the criteria for incentive rewards in a global industry context.

Incentives

Several studies have empirically linked business unit strategy and compensation (Balkin/Gomez-Mejia 1987, 1990, Galbraith/Merrill 1991), the assumption being that, "if a firm wants to pursue a particular strategy, ... the compensation program needs to include those elements that motivate (the appropriate) behavior" (Galbraith/Merrill 1991, p.354). Agency theory is a useful perspective for examining issues of compensation at the foreign subsidiary. Agency theory is used to model what are known as principal-agent relationships, wherein the principal delegates work and responsibilities to the agent (Eisenhardt 1989, Jensen/Meckling 1976). In the case of the MNC, the headquarters-foreign subsidiary relationship can be viewed as a principal-agent relationship, with subsidiary management acting as the agent, performing work and responsibilities delegated by headquarters (Doz/Prahalad 1991, Nohria/Ghoshal 1994, Roth/O'Donnell 1996). As discussed by Nohria and Ghoshal, "as the principal, the headquarters cannot effectively make

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all the decisions in the MNC since it does not possess and must, therefore, depend on the unique knowledge of the subsidiaries," (1994, p. 492) which act as agents of the headquarters. The "agency problem" exists when the goals of subsidiary managers do not coincide with those of headquarters, resulting in the potential for subsidiary-level decisions that are not in accordance with those desired by headquarters.

As is true of classic principal-agent relationships, the local interests of foreign subsidiaries of the MNC may not always be aligned with those of the parent corporation, creating the kind of control problems for which agency theory is most relevant. The task for MNC headquarters managers is to design organizational control systems that help align the subsidiary manager's goals with the goals headquarters has for that particular subsidiary. By doing so, the associated agency problem would be reduced, resulting in the desired subsidiary-level decisions.

Agency theorists argue that one way of aligning the interests of the principal and the agent is through the use of incentive or outcome-based rewards (Eisenhardt 1989, Fama/Jensen 1983, Jensen/Meckling 1976, Jensen/Murphy 1990). By designing rewards that are contingent upon the achievement of specific outcomes, the principal essentially can realign the goals of the agent so that they are more congruent with those of the principal. There is increasing empirical evidence to suggest that the use of incentive compensation can encourage corporate-level strategic decisions (Agrawal/Mandelker 1987, Galbraith/Merrill 1991). The use of incentives was also found to interact with corporate and business unit strategy in its effect on pay effectiveness (Balkin/Gomez-Mejia 1990). In the case of the MNC, one way of addressing the "agency problem" that is inherent in the headquarters-foreign subsidiary relationship would be to increase the proportion of subsidiary management's pay that is outcome-based or in the form of incentives. The purpose of such outcome-based rewards would be to align the interests and, thus, the decisions of subsidiary management with those desired by headquarters in order to more effectively carry out the strategic role of the subsidiary.

Compensation Determinants

The agency theory perspective advocates the use of outcome-based or incentive compensation in principal-agent relationships that have the potential for a high agency problem, such as in the case of the MNC headquarters and foreign subsidiary. However, the nature of the specific outcomes upon which the incentive compensation is to be based will vary depending upon the nature of the principal-agent relationship and the behaviors or outcomes desired of the agent.

Most of the agency theory literature examining outcome-based executive compensation has looked at CEO incentives where the desired outcome upon which the incentive is determined is some measure of firm performance, usually shareholder wealth (Jensen/Murphy 1990, Zajac 1990, Zajac/Westphal 1994). In the

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case of foreign subsidiary managers, the relevant outcome upon which to base incentive compensation is less clear. It is difficult for a manager of a foreign subsidiary to impact MNC corporate performance or shareholder wealth directly. However, if a subsidiary plays a key role in the coordinated global strategy of the MNC, the relevant performance criterion may, indeed, be some measure of corporate performance. On the other hand, for a subsidiary that plays a more multidomestic strategic role, subsidiary performance may be the more relevant outcome measure upon which to base incentive compensation.

Several empirical studies have examined the weight given to various dimensions of performance in the determination of a manager's compensation package. Kerr (1985) found that in performance-based compensation systems, strategic missions were tied to the performance criteria used to determine compensation. Galbraith and Merrill (1991) also found that the weight given to different performance criteria varied across business units with different strategic orientations. The assumption is that managers will make decisions so as to increase their total compensation and that if their compensation is tied to a particular performance criterion, then they will act so as to increase firm performance along the dimension for which they are being compensated. Thus, firm performance should be enhanced if the criteria on which managerial compensation is based are aligned with the firm's strategic objectives. For firms pursuing a global strategy, the strategic objectives are to capture the advantages of the configuration/coordination opportunities present in a unified and homogeneous world or regional market (Porter 1980). To do so, firm activities must be coordinated on a worldwide or regional basis. Thus, the criteria that should be used in determining performance for a firm following a global strategy are corporate and regional performance, as opposed to the performance of the subsidiary or the individual manager. For a firm pursuing a multidomestic strategy, it is more important for each subsidiary to respond to its local market forces rather than to be part of a coordinated corporate strategy. Such subsidiaries contribute to corporate performance by performing well in their autonomous, locally responsive roles. Thus, the performance criterion for managers of subsidiaries with a multidomestic strategy should be subsidiary performance rather than corporate performance.

Based on the above discussion, the following hypotheses are put forth:

Hypothesis 1a: Subsidiaries emphasizing a global strategic role will have a greater percentage of subsidiary manager compensation based on regional and corporate performance than will those subsidiaries emphasizing a multidomestic role.

Hypothesis 1b: Subsidiaries emphasizing a multidomestic strategic role will have a greater percentage of subsidiary manager compensation based on subsidiary performance than will those subsidiaries emphasizing a global role.

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Performance Implications

While the above hypotheses relate the strategic role of the subsidiary to the criteria used in determining subsidiary management compensation, they do not address the performance of the subsidiary. The logic underlying hypotheses 1a and 1b assumes that subsidiary compensation policies are designed based on subsidiary strategy, with the ultimate goal of enhanced performance. While normative agency theory is generally used to predict the appropriate form of compensation (Eisenhardt 1989, Jensen 1983), as a theory of organizational efficiency, its assumption is that the appropriate compensation design will lead to increased efficiency or performance. Thus, the fit between foreign subsidiary strategy and compensation design should be positively related to subsidiary performance. Essentially, by tying the rewards of the subsidiary manager to outcomes that are based on the subsidiary's strategy, headquarters is attempting to modify the behaviors or decisions of the subsidiary manager such that they facilitate the implementation of the subsidiary's designated strategic role. The result should be enhanced subsidiary performance in those areas desired by headquarters. In particular, the performance of subsidiaries with a global strategic role should be improved by rewarding the subsidiary manager for global, or corporate, outcomes, whereas subsidiaries with a multidomestic strategy should perform better when rewards are tied to local, or subsidiary, outcomes. The performance implications of the fit between compensation design and subsidiary strategy will be assessed by testing the following hypotheses:

Hypothesis 2a: For subsidiaries characterized by a global strategic role, the percentage of subsidiary management compensation based on corporate performance will be positively related to performance.

Hypothesis 2b: For subsidiaries characterized by a multidomestic strategic role, the percentage of subsidiary management compensation based on subsidiary performance will be positively related to performance.

Method

Sample and Data Collection

In accordance with the theoretical development of the above hypotheses, foreign subsidiaries in global industries were used as the sampling domain for this study. As previously discussed, firms within global industries can choose to compete in industry segments ranging from local niches to global segments in which customer needs are standardized worldwide (Porter 1980, 1986). Empirical research has verified that global industries consist of firms that compete on both global

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and local levels (Bartlett/Ghoshal 1989, Roth/Morrison 1990, Roth/Schweiger/Morrison 1991). The industries selected for this study were the scientific measuring instruments and medical instruments industries. Both of the targeted industries have been shown to be similar in their level and type of globalization as indicated by Kobrin's (1991) index of transnational integration. Kobrin's index is defined as the proportion of international sales in an industry accounted for by intrafirm trade, which Porter (1986) also has argued is a characteristic of global industries.

All of the international subsidiaries in the United States, Canada, United Kingdom, Germany and Japan whose primary four digit SIC code indicated that they were in one of the two targeted industries were identified through the International Directory of Corporate Affiliations, Dunn and Bradstreet's America's Corporate Families, and the Directory of Foreign Owned Japanese Manufacturers. The final sample consisted of 372 international subsidiaries for which a contact person could be identified. Only majority owned subsidiaries were included in the study. A mail questionnaire was sent to the president or managing director of each of the identified subsidiaries. The president or managing director, the highest ranking manager at the subsidiary, was chosen as the primary respondent because the survey instrument consisted of questions about subsidiary strategy as well as subsidiary compensation policies. The top executive of the subsidiary was considered to be the most knowledgeable individual about both of these topics combined[2]. After two follow-up mailings, 100 responses were received which resulted in a response rate of 26%.

Nonresponse bias was examined in two ways. Armstrong and Overton (1977) argue that the responses of late respondents are more like those of nonrespondents than are those of early respondents. In this study, a comparison of the responses from the first and last mailings yielded no significant differences in any of the variables used to test the hypotheses or in any demographic characteristics of the subsidiaries. In a second procedure, secondary data on sales and number of employees were gathered for fifty randomly selected nonresponding subsidiaries. A comparison of the means of these variables indicated no significant differences between responding and nonresponding subsidiaries.

Measures

The measure used to assess *subsidiary strategy* was adapted from a previously used measure of international strategy (Roth/Schweiger/Morrison 1991) and industry position (Roth/Ricks 1994). This measure was designed to capture the strategy of the subsidiary from its structural position within the industry. Respondents were asked to indicate on a scale of 1 to 5, where 1 = "not at all characteristic" and 5 = "extremely characteristic," how characteristic the following seven state-

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ments are of the industry segment in which their subsidiary competes: 1) buyer/customer needs are standardized worldwide, 2) competitors exist that have a presence in all key markets, 3) production technology is standardized and generally available worldwide, 4) competitors market a standardized product worldwide, 5) new product introductions tend to occur in all major international markets simultaneously, 6) production awareness exists worldwide, and 7) competitive actions taken in one country affect other country locations. Responses were averaged across the seven dimensions to arrive at an index for subsidiary strategy, with higher values indicating a more global subsidiary strategic role and lower values indicating a more multidomestic role. The internal reliability of this measure was examined using Cronbach's alpha, which was found to be acceptable at $\alpha = 0.71$.

To assess *compensation design*, respondents were asked to indicate the weight given to each of the following criteria in the determination of compensation for the subsidiary *senior management team*: 1) individual's performance, 2) subsidiary performance, 3) regional performance, and 4) corporate performance, with the total adding up to 100%. Compensation design was assessed at the level of the subsidiary senior management team, for it is the decisions of these subsidiary-level managers that have the most impact on subsidiary performance outcomes. Preliminary and follow-up interviews indicated that the typical subsidiary top management team consisted of the president or managing director and between three and five executives who were heads of functional or product areas, depending on the organization of the subsidiary. As pointed out by previous research, the decisions of these middle- to upper-level managers are important determinants of performance (Guth/MacMillan 1986, Wooldridge/Floyd 1990).

Performance was measured using two self-report measures, an objective financial indicator and a measure assessing performance as compared to the parent corporation's expectations of the subsidiary. Secondary performance measures were not consistently available at the subsidiary level, nor are accounting measures comparable across the five countries sampled. Thus, self-report performance measures were necessary. The first measure, based on objective financial figures, was return on investment (ROI). Respondents were asked to indicate after tax return on total investment for the last fiscal year using a seven-point scale, with higher responses indicating higher ROI.

Although self-reported financial measures of performance have been found to be valid (Venkatraman/Ramanujam 1987), they can be criticized for being unduly influenced by accounting methods. Additionally, measures such as ROI do not take into account differences in the nature of a subsidiary's designated role within the MNC. For example, successful performance for a subsidiary with a primary role of R&D or market development would not necessarily be reflected in an increase in ROI. Thus, the second measure of performance used in this study was designed to overcome some of the limitations of financial measures. Based

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on a previously used measure, (Gupta/Govindarajan 1986), respondents were asked to indicate on a five-point scale (1 = not at all satisfactory, 5 = outstanding) the performance of their subsidiary as compared to their superiors' expectations on each of the following ten dimensions: sales volume, market share, profit, cash flow from operations, return on investment, new product development, market development, cost control, personnel development and political/public affairs. Respondents were then asked to rate the importance of each of the same dimensions in the evaluation of the subsidiary's performance, again using a five-point scale (1 = of little importance, 5 = extremely important). The performance of the subsidiary on each dimension was then weighted by the importance of the dimension to the evaluation of subsidiary performance and the resulting scores for each of the dimensions were summed. Thus, the final scale is a performance figure that reflects the subsidiary's performance on ten dimensions, weighted by the importance of each dimension. This performance measure takes into account the goals of each particular subsidiary by weighting the dimensions according to how important they are in the evaluation of that subsidiary's performance.

Analysis

To test all of the hypotheses, the sample was first divided into two groups based on the measure of subsidiary strategy. Based on a median split on the subsidiary strategy variable, the subsidiaries were grouped into those characterized by a global strategy (high values on subsidiary strategy) and those characterized by a multidomestic strategy (low values on subsidiary strategy). *Hypotheses 1a* and *1b* were tested by performing a test of mean differences between the two groups on the percentage of compensation based on regional/corporate performance (*Hypothesis 1a*) and the percentage of compensation based on subsidiary performance (*Hypothesis 1b*). To ensure that there were no influences on the use of incentive compensation due to nationality, an analysis of variance was performed on the data. Results of the ANOVA indicated that there were no nationality differences in the use of incentives based on regional/corporate or subsidiary performance. *Hypotheses 2a* and *2b* were tested using correlation analysis.

Results

Table 1 provides the summary statistics and correlations for all variables using the entire sample. Table 2 shows the results of the t-tests of mean differences used to test *Hypotheses 1a* and *1b*. As indicted in Table 2, there is moderate support for *Hypothesis 1a*, as subsidiaries characterized by a global strategic role have a

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Table 1. Descriptive Statistics and Correlations

Variables	Means	s.d.	1	2	3	4	5	6
1. Subsidiary strategy	3.21	0.63						
Compensation Design – Weight given to:								
2. Individual performance	57.64	29.32	0.03					
3. Subsidiary performance	32.59	28.65	−0.11	−0.83***				
4. Regional performance	2.89	10.45	0.16	−0.18+	−0.15			
5. Corporate performance	4.61	7.61	−0.01	−0.07	−0.17+	−0.05		
6. ROI	3.43	2.10	0.10	−0.06	0.00	−0.05	0.30***	
7. Multidimensional performance	126.00	31.37	0.24*	0.00	−0.03	−0.07	0.10	0.53***

+$p<0.10$
*$p<0.05$
**$p<0.01$
***$p<0.001$

Table 2. Results of Tests of Mean Differences

	% Compensation Based on Regional/Corporate Performance	% Compensation Based on Subsidiary Performance
Global Strategy Group	9.31	27.91
Multidomestic Strategy Group	4.85+	39.88*

+$p<0.10$
*$p<0.05$
**$p<0.01$
***$p<0.001$

greater percentage of subsidiary manager compensation determined by corporate/regional performance than do subsidiaries characterized by a multidomestic strategic role ($p<0.10$). As Table 2 also shows, subsidiaries characterized by a multidomestic strategic role have a significantly greater percentage of subsidiary manager compensation based on subsidiary performance than do those characterized by a global strategic role ($p<0.05$). Thus, *Hypothesis 1b* is supported.

Table 3 indicates the correlations between compensation design and the two performance measures for the two groups of subsidiaries. *Hypothesis 2a* is not supported as, for the multidomestic group, the correlations between the percentage of subsidiary management compensation determined by subsidiary performance and the two measures of subsidiary performance are not significant. It should be noted that the correlation for the objective ROI performance measure is in the hypothesized direction while the correlation for the multidimensional performance measure is very small and in the opposite direction. The results are

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Table 3. Results of Correlations Testing Performance Implications

	ROI Performance	Multidimensional Performance
Multidomestic Strategy Group:		
% Compensation Based on Subsidiary Performance	0.165[a]	–0.054
Global Strategy Group:		
% Compensation Based on Corporate Performance	0.296*	–0.064

[a] Entries indicate the correlation between the performance and compensation variables for the specified group.
+p<0.10
*p<0.05
**p<0.01
***p<0.001

mixed for *Hypothesis 2b*, the test of performance implications for the global strategy group. The correlation between performance and the percentage of subsidiary management compensation determined by corporate performance is significant and in the hypothesized direction for the ROI performance measure ($p<0.05$), but the result for the multidimensional performance measure is not significant.

Discussion and Implications

The purpose of this study was to better understand the link between foreign subsidiary strategy and subsidiary compensation practices. Additionally, the performance implications of the fit between subsidiary strategy and compensation were examined. The results indicate that the compensation of subsidiary managers is, indeed, related to the competitive strategy being pursued by the subsidiary. As expected, more weight is given to corporate/regional performance in the design of subsidiary management reward systems for subsidiaries characterized by a global strategy than for those characterized by a multidomestic strategy. Similarly, in the determination of executive compensation, multidomestic subsidiaries emphasize performance at the subsidiary level more than do global subsidiaries. The strategic role of the foreign subsidiary seems to influence the design of the reward system, although the cross-sectional nature of this study precludes any causal inferences.

One quite unexpected finding concerning subsidiary compensation design is the relatively small weight given to corporate and regional performance as criteria for subsidiary manager compensation, regardless of the strategic role of the

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subsidiary. As reflected in Table 1, the average weights given by the entire sample to corporate and regional performance were 2.9 and 4.6 percent, respectively. Even for those subsidiaries pursuing a global strategy, only 4.1 and 5.1 percent of compensation was based on regional and corporate performance. Theoretically, corporate performance should play a much larger role in the determination of subsidiary management compensation, particularly for those subsidiaries pursuing a strategy that necessitates a high level of coordination and integration across multiple units within the MNC. The low percentage weight given to corporate performance indicates either that MNC managers are unaware of the potential benefits of such a compensation design, or that such compensation practices are difficult to implement. Comments we received from respondents on an open-ended question indicated that the latter is true. Several managers indicated that they were attempting to link compensation to MNC performance, but that they were encountering difficulties in the implementation of such practices.

The results of the hypothesis tests linking subsidiary strategy and compensation design to performance are less clear. The only relationship that was significant as hypothesized was that between ROI and the percentage of compensation based on corporate performance for the global strategy group. It should be noted that the use of corporate performance as a compensation criterion is also positively related to performance for the multidomestic group, a relationship that was not hypothesized in this study. It appears that the use of corporate performance as a compensation criterion is positively related to performance regardless of the strategy pursued by the subsidiary. However, we must again note the low weight attached to corporate performance by all subsidiaries. A post-hoc examination of the distribution of the data on the performance criteria used for subsidiary compensation showed that nearly half of the responding subsidiaries did not use corporate or regional performance at all in the determination of subsidiary top management compensation, although those that did so had higher levels of performance as measured by both ROI and the multidimensional performance measure.

Together, the results of this study and these post-hoc analyses show that there are some firms that are using "state of the art" compensation policies, or those that the literature suggests are appropriate for international subsidiaries in these two highly global industries. The results of the tests for performance implications of the fit between subsidiary strategy and compensation, although mixed, suggest that the use of some of the theoretically derived compensation practices seem to be positively related to performance. Unfortunately, few firms appear to be using such compensation programs. Previous research, both in agency theory (Eisenhardt 1989, Jensen/Murphy 1990) and in international management (Roth/Schweiger/Morrison 1991) suggest that there are institutional forces both internal and external to the firm that may account for the lack of use of such performance-based compensation strategies. Jensen and Murphy (1990) argued that third parties or political forces outside the firm, such as public opinion and societal norms,

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constrain the use of performance related compensation, resulting in less than optimal compensation design. Roth and colleagues (1991) suggested that forces internal to the firm, such as administrative heritage, also play a role in the design and implementation of international strategy. It is these external and internal forces that institutional theorists argue have profound impacts on organizational design (DiMaggio/Powell 1983, Meyer/Rowan 1977). Additionally, several managers in the present study indicated that the compensation practices at their firms had "been the same for decades," indicating the difficulty encountered in changing or implementing new compensation policies. Institutional theory also addresses the forces that act against changes in organizational structure and processes. Given the changing nature of competition in global industries, future studies should incorporate these institutional effects into studies of foreign subsidiary compensation design.

The present study suggests some additional avenues for future research. This study examined the use of financial incentives in the form of monetary compensation. Previous research has indicated that some non-monetary incentives, such as promotions and other career related rewards, may be important motivators for foreign subsidiary managers (Bartlett/Ghoshal 1989). The use and effects of these and other types of non-monetary rewards need to be better understood. The results of this study also indicate that further research into international compensation and reward systems and their relationship to global strategies should begin with some in-depth, qualitative case analyses, particularly of firms that do seem to be fitting their reward systems with their global competitive strategy. The data and respondent comments indicate that firms are just beginning to align their compensation programs with their worldwide strategies, and that there seem to be performance implications that need to be better understood. It is hoped that one contribution of this study will be that it furthers research into the important relationships between international competitive strategy, compensation and reward systems, and firm performance.

Notes

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2 To check for common method and single respondent biases and to assess the reliability and validity of the measures, the same data were collected from the headquarters V.P of international operations and the human resources manager. The responses of the subsidiary manager were significantly correlated with the other two respondents and will be used in the analysis in this study.

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