COMPENSATION AND REWARD DESIGN

Reward Theory

Lawler · Milkovich & Newman · Gerhart & Rynes

PAPER 01 / 02

A Furtherance reference compendium on the intellectual traditions behind organisational design, leadership, execution, and culture.

IN THIS PAPER

This paper opens the Compensation and Reward Design series in Furtherance's reference library. It covers the mainstream theory of reward – how pay should be designed, and the evidence that it matters. The question it answers: what makes a compensation system strategic, fair and effective, and does pay actually drive performance?

Lawler frames reward as strategic and tied to organisation design; Milkovich and Newman give the comprehensive pay model; Gerhart and Rynes anchor the field in evidence – pay affects both motivation and who joins and stays.

Edward Lawler Strategic Pay, 1990–

Strategic reward · pay and organisation design

CORE THESIS

Reward systems are **strategic** and must **fit the organisation's design and strategy**. Pay shapes motivation, attraction, retention and culture – and in high-involvement organisations, rewarding skills and competencies, not just jobs, aligns pay with capability.

FRAMEWORK

Design choice	Question
Base vs performance pay	How much reward is fixed versus variable?
Job- vs person-based pay	Pay for the role, or for skills and competencies?
Line of sight	Can people connect their effort to the reward?
Fit to organisation	Does the reward system match the design and strategy?

METHODOLOGY

Organisational research linking reward system design to effectiveness.

SIGNIFICANCE AND CRITIQUE

The foundational scholar of strategic reward. The critique: the treatment is broad, spanning many design choices.

Milkovich & Newman Compensation, 1987–

The pay model · the standard reference

CORE THESIS

Compensation is best designed through a systematic **pay model** that balances four policies against clear objectives – efficiency, fairness and compliance. It is the comprehensive architecture of a reward system.

FRAMEWORK

Policy	What it governs
Internal alignment	Pay relationships among jobs (job evaluation, structure)
External competitiveness	Pay level and mix versus the market
Employee contributions	Pay for performance and seniority
Management of the system	Administering, communicating and governing pay

METHODOLOGY
The comprehensive textbook framework of compensation practice.

SIGNIFICANCE AND CRITIQUE
The definitive reference and framework for designing pay. The critique: it is a textbook treatment, broad rather than pointed.

Gerhart & Rynes Compensation: Theory, Evidence, Strategy, 2003

The empirical anchor

CORE THESIS
The rigorous **evidence** shows pay matters – in two distinct ways. Beyond its **incentive** effect on effort, pay has a powerful **sorting** effect: it shapes who is attracted to and retained by the organisation. This challenges the claim that money does not motivate.

FRAMEWORK

Effect of pay	Meaning
Incentive effect	Pay influences how hard and how well people work
Sorting effect	Pay determines who joins, stays and leaves
Pay dispersion	The spread of pay affects cooperation and performance
Evidence base	Empirically, pay matters more than critics allow

METHODOLOGY
A synthesis of empirical research on the effects of pay.

SIGNIFICANCE AND CRITIQUE
The scholarly counterweight to “pay doesn't motivate,” and the evidence base for the field – directly relevant to the critiques in the next paper. The critique: it is academic in register.

Synthesis

Contribution	Focus	Key idea	Register
Lawler	Strategy	Reward fits organisation design	Foundational
Milkovich & Newman	Architecture	The four-policy pay model	Standard reference
Gerhart & Rynes	Evidence	Incentive and sorting effects	Empirical

FOR THE OPERATOR

The mainstream tradition treats reward as a strategic system worth designing well – fitted to organisation design (Lawler), built on a coherent pay model (Milkovich & Newman), and grounded in evidence that pay drives both effort and who joins and stays (Gerhart & Rynes). For the operator: design pay deliberately, align it to strategy, and take seriously that it shapes your workforce, not just their effort. The next paper presents the sharp counter-tradition – that incentives can do real harm.