

**Interest Alignment Rents and
Competitive Advantage**

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ABSTRACT

Few scholars would deny the importance of employee motivation to explain the variation in performance across firms. Yet, the dominant theories of rent generation and sustainability of competitive advantage have so far focused on aspects of industry structure or of firms' endowment with assets and capabilities as the drivers of sustainable profitability, leaving the influence of variations in degrees of employee motivation either absent or exogenously determined in their arguments. This paper articulates a theory of the conditions under which the superior alignment of the interests of the individual with those of the firm generates economic rents (i.e. advantages over and above the costs necessary to generate them) as well as sustainable competitive advantage (i.e. economic rents resistant to competitive pressures). The resulting argument leverages, links and attempts to integrate the extensive body of knowledge in motivation and incentive alignment theory derived from social psychology and agency theory with the resource-based, knowledge-based and market competition arguments central to current theories of competitive advantage in strategic management. We discuss how intrinsic and extrinsic motivation interact as determinants of interest alignment, show how superior interest alignment can lead to increased organizational effectiveness, and elaborate on the conditions necessary for those advantages to generate rents on the market for human resources. Finally, we identify a set of conditions that lead to a competitive advantage based on superior interest alignment along with the corresponding specific competencies in interest alignment processes required for its sustainability over time in light of competition within a dynamic environment. Our analysis highlights the strategic relevance of motivation and its antecedents as a possible source of economic rents and sustainable competitive advantage.

INTRODUCTION

Employee motivation has long been identified as a key variable to explain variance in firm performance. Researchers from behavioral sciences, in particular from social psychology (Deci, 1971, 1975, 1976; Deci & Ryan, 1985; Dyer & Parker, 1975; Lepper & Greene, 1975) and organizational behavior (Brief & Aldag, 1977; Amabile, 1993, 1997), as well as scholars in different branches of economics, such as industrial organizations (Holmstrom & Milgrom, 1991, 1994; Kreps, 1997; Gibbons, 1998; Lindenberg, 2001) and agency theory (Jensen & Meckling, 1976; Fama & Jensen, 1983) have recognized the importance of motivation as a determinant of individual behavior in business organizations and focused on mechanisms that might influence individual motivation and the alignment of interests between the individual and the organization. While the various approaches often differ substantially with respect to their assumptions regarding determinants of human behavior, their conceptualization of motivation, their methodological treatment of the topic and their conclusions, scholars in all these areas would agree on one point (at least): that individual motivation and interest alignment is a crucial driver of organizational effectiveness.

And yet, despite such agreement, it is striking to note that none of these streams of work has established a clear theoretical link between the determinants of employee motivation and variations in organizational performance. More precisely, the argument leading from individual motivation and interest alignment to the creation of economic rents by the organizations, as well as to the development of sustainable competitive advantage has not been articulated. This is perhaps not surprising, as the generations of economic rents and of sustainable competitive advantage are not a primary focus of these fields – those are normally concepts and problems developed and studied by scholars in the strategic management field. But have strategic management scholars made those linkages in their theoretical work?

Hardly so. The strategic management field, in its search for a theory to explain the generation of economic rents and the creation and sustainability of competitive advantage, has so far focused on advantageous positioning in the product-market space (Porter, 1980, 1985) and on heterogeneity in the endowment with (Penrose, 1959; Wernerfelt, 1984; Barney, 1986b), and development of (Nelson & Winter, 1982; Dierickx & Cool, 1989; Kogut & Zander, 1992), assets and capabilities as antecedents of rent generation and competitive advantage. Factors that influence the motivation to deploy assets and capabilities have been largely left out of the picture or treated as exogenous factors and thus not as part of the set of strategic decision variables of the organization.¹

Our goal in this paper is to draw the attention of strategic management scholars to the role of individual motivation and interest alignment as potential antecedents of the dependent variables absorbing their primary attention, and to identify the conditions under which mechanisms to increase individual motivation can be effective generators of economic rents and sustainable competitive advantage. In other words, this paper attempts to link the existing body of knowledge related to individual motivation and the alignment of interests between individuals and the firm they work for, on one side, with the available theoretical arguments on the generation of economic rents on the market for human resources, on the other. It therefore aims to extend current theories of competitive advantage based on assets and capabilities as determinants of organizational performance to include the motivation to deploy these assets and capabilities in the most appropriate way possible.

We therefore propose a theory that endogenizes interest alignment, defined as the degree to which the members of the organization are motivated to behave in line with organizational goals, as an organizational attribute that influences organizational performance

¹ Two important exceptions can be found in the literature on the performance implications of agency problems, such as in diversification strategy (Amihud and Lev., 1980; Lane et al., 1998) and corporate governance (Cannella & Hambrick, 1993; Finkelstein & Hambrick, 1990 etc.). Although these vast literatures link agency

and its sustainability over and above the factors that have so far been the focus of the dominant theories in the field. To this end, we analyze the influence of interest alignment on rent creation mechanisms on the market for human resources and study different competences specific to the improvement of organizational interest alignment. We then show how this construct is similar in its dynamic nature to, yet different in important characteristics from, the current notions of dynamic capabilities (Teece, Pisano, & Shuen, 1997; Eisenhardt & Martin, 2000; Zollo & Winter, 2002). The development of this theory is founded on an integration of insights on the determinants of extrinsic motivation from agency theory and I/O economics with the determinants of intrinsic motivation studied in social psychology and organizational behavior with the explicit ambition to understand the mechanisms influencing human motivation in organizational contexts in a more comprehensive fashion. This paper is a humble beginning towards the construction of such theory. More, much more, is left for future scholarly work and, even more importantly, for empirical analysis.

The remainder of the paper is structured as follows. We first introduce the concept of interest alignment and develop a model of its antecedents in an organizational context. We then look at the dynamics in the market for human resources to study if and under what circumstances organizational interest alignment can lead to economic rents for the organization. Finally, we compare competitors in their ability to generate such interest alignment rents and identify possible sources of a competitive advantage based on superior interest alignment, as well as conditions that lead to the sustainability of such advantages. In our concluding section we discuss the implications of our analysis for academics and practitioners and outline an agenda for future research in the area.

with performance, they stop short of articulating in more general terms the conditions under which appropriate agency structures develop economic rents and sustainable competitive advantages.

ORGANIZATIONAL INTEREST ALIGNMENT

Extrinsic and Intrinsic Motivation

The concept of “motivation” plays a central role in research concerned with understanding the determinants of individual behavior in organizations and its impact on firm performance (Deci, 1971, 1975; Deci et al., 1985; Lepper et al., 1975; Frey, 1992, 1993). The basic argument is fairly simple: motivation can be linked to a set of underlying goals from the accomplishment of which individuals derive a certain level of utility (Deci, 1976). This then results in a motivation to engage in behavior that is perceived to be useful for individuals to meet their goals. The motivation to behave in a certain way is determined by (1) the degree to which the behavior meets individual goals, and (2) the relevance of each goal to the individual.

While most approaches to understanding the possibilities the organization has to influence individual behavior build upon this basic mechanism, the different fields that have looked at this phenomenon differ substantially with respect to focus, assumptions and conclusions. Historically, economists have focused on extrinsic motivation and studied the influence of incentive systems, monitoring, and control mechanisms without any explicit consideration of the influence of intrinsic motivation and its possible antecedents in their models (Frey & Jegen, 2001; Baker, Gibbons, & Murphy, 1994). Organizational behavior scholars and social psychologists, on the other hand, emphasize the role of intrinsic motivation and tend to consider rewards and extrinsic motivation as either irrelevant or counterproductive (e.g. Deci, 1976; Amabile & Hill, 1994; Deci & Koestner, 1999a, b). The debate among these different views has not been resolved, although recent work has aimed at a more comprehensive treatment of the topics, trying to consider both intrinsic and extrinsic factors as well as their interaction (Frey et al., 2001; Frey & Oberholzer-Gee, 1997; Amabile,

1993). From the perspective of this paper, the most striking observation is that neither these two camps nor strategic management scholars have, to date, explicitly considered the strategic importance of motivation for organizational performance. Consequently, the question of how and under what circumstances organizations can create economic rents from the enhancement of motivation in employees and management, remains surprisingly open despite its intuitive appeal.

Interest Alignment and Organizational Performance

As seminal contributions in agency theory have argued before, (Alchian & Demsetz, 1972; Jensen et al., 1976; Fama et al., 1983) individual goals are not always in line with organizational goals. To illustrate the strategic relevance of this effect, it is helpful to use the concept of “interest alignment” as a measure of the correspondence between individual and organizational goals. Organizational interest alignment can be defined as

“the degree to which the members of the organization are motivated to behave in line with organizational goals.”

Interest alignment is (inversely) related to the magnitude of the agency problem. It is worth noting, however, that our notion of interest alignment is broader than that typically adopted in economic treatments of the problem, as it captures the influence of intrinsic motivation on goal congruence between the individual and the organization in addition to standard extrinsic motivation effects.

Following the standard agency theory rationale, an imperfect degree of organizational interest alignment, i.e. a situation in which individual motivation does not fully support organizational goals, can have a negative influence on organizational performance: the individual chooses a behavior that maximizes the accomplishment of personal goals and in doing so, to the extent that such behavior has a negative influence on the accomplishment of organizational goals, deviates from organizational performance-maximizing behavior.

The mechanism through which interest alignment influences organizational performance is distinctly different from that which has historically played a central role in the resource-based analysis (RBV) of competitive advantage. The RBV has linked rent generation to the endowment of the organization with assets and capabilities that could satisfy a given set of conditions (Lippman & Rumelt, 1982; Rumelt, 1984; Barney, 1986b; Dierickx et al., 1989; Conner, 1991; Peteraf, 1993). The key point, however, is that those conditions guarantee only the “potential” generation of rents, not the actual one. At a high level of abstraction, we can conceptualize organizational performance and rent generation as determined by the positioning of a company in its industry and its interaction with suppliers, customers and competitors (Porter, 1980, 1985) and by the quality organizational resources that are utilized in this interaction. If we then define “potential organizational performance” as “the level of performance that will be achieved through the total set of assets and capabilities available to the organization when they are used to the fullest possible extent” within a given competitive position, then the resource-based argument for the generation of economic rents is applicable only to potential organizational performance. In a sense, assets and capabilities determine what the organization can do within a given competitive environment. The translation of potential into actual performance, however, depends crucially on the willingness of individuals to utilize their skills and the available assets to the full extent. To recognize the importance of motivation as a determinant of actual organizational performance, we model actual organizational performance as a function of both the potential organizational performance and the individual motivation to behave in ways conducive to the realization of that potential, in other words, of the degree of interest alignment (see Figure1). Actual organizational performance will remain below its potential as long as individuals deviate from organizational performance-maximizing behavior as a result of imperfect interest alignment.

In what appears to be the closest theoretical contribution to our point, managerial rent theory (Castanias & Helfat, 1991 ; Castanias & Helfat, 2001) submits that the availability of skills with rent generation potential is a necessary, but not sufficient condition for rent generation, and points to the importance of motivation to deploy the skill for the realization of any rent generation potential. However, there is no theoretical treatment of the mechanisms through which motivation can be expected to support the deployment of such skills nor of the costs that this will imply.

--(Figure 1 about here)--

Determinants of Organizational Interest Alignment

Given the importance of interest alignment for actual organizational performance, it is necessary to look more closely at the determinants of individual behavior, in particular to analyze how organizations can influence it. Initially there has been much controversy regarding the accurate conceptualization and definition of motivation (Dyer et al., 1975; Brief et al., 1977; Kanungo & Hartwick, 1987). More recently, Deci's original dichotomy of intrinsic vs. extrinsic motivation (Deci, 1971, 1975) has been refined and more fine-grained categorizations have been proposed (Deci et al., 1985, Deci, Connell, & Ryan, 1989, Lindenberg, 2001). For the purpose of this paper, we consider extrinsic motivation according to Deci's initial conceptualization (Deci, 1975) and distinguish between enjoyment-based "hedonic intrinsic motivation" and obligation-based "normative intrinsic motivation"² (see Table 1).

Hedonic intrinsic motivation is driven by the underlying goal of being engaged in enjoyable (Lindenberg, 2001), self-determined and competence-enhancing (Deci et al., 1985) behavior and is influenced by perceived characteristics of the task and the task context (Van

² This terminology follows Lindenberg's (2001) distinction between a hedonic and a normative frame.

Yperen, 2002; Houkes, Janssen, de Jonge, & Nijhuis, 2001). The impact of hedonic intrinsic motivation depends on the importance the individual attributes to being engaged in enjoyable, self-determined and competence-enhancing behavior (King, Hautaluoma, & Shikiar, 1983).

Normative intrinsic motivation is driven by the underlying goal of engaging in behavior that is compliant with organizational norms and values. Individuals are thus normatively intrinsically motivated to engage in a given behavior, to the extent that this behavior is congruent with organizational norms and values (Allen & Meyer, 1990; Kreps, 1997). The intensity of normative intrinsic motivation depends on the degree to which individuals identify with organizational norms and values.

Extrinsic motivation is driven by the underlying goal of obtaining additional resources (Lindenberg, 2001). These resources come in the form of “extrinsic work rewards” or outcomes (Brief et al., 1977) and can take the form of money, power, recognition etc. The impact of extrinsic motivation depends on the reward system in place, which determines the extrinsic work rewards that the individual obtains as a function of any given behavior, and on the importance of these rewards to the individual.

----(Table 1 about here)--

Organizational Mechanisms to influence Interest Alignment

Collectively, these three factors influence individual motivation and thus determine interest alignment. One has to keep in mind that the three types of motivation differ substantially in the degree to which they can be influenced by organizations to create interest alignment and stimulate individual behavior that maximizes organizational performance. Hedonic intrinsic motivation, for example, is determined by the perceived characteristics of a given task and by the task context. To the extent that required tasks for individuals in an organization are determined by its strategic positioning on the product markets and the consequent

implementation initiatives generated to support those aspirations, organizations might generally have few degrees of freedom to influence hedonic intrinsic motivation.³ Consequently, and for the sake of simplicity of the analysis, we will not consider hedonic intrinsic motivation as a strategic variable in the remainder of this paper.

Regarding the quality of normative intrinsic motivation (i.e. the kind of behavior that can be stimulated), it is worth noting that it will be contingent upon the existing set of organizational norms and values. In other words, normative intrinsic motivation can only be used to stimulate behavior that corresponds to the norms and values of the organization, which have been found to be stable, at least in the short run. However, organizations can influence the intensity of normative intrinsic motivation, i.e. the importance of compliance with organizational norms and values by the individual, as it is a function of individual-organization identification that can be enhanced through socialization regimes (Van Maanen, 1978; Van Maanen & Schein, 1979). One example of this use of socialization would be company-wide events or training sessions targeted at increasing employee-organization identification and the proliferation of organizational norms and values among employees.

Finally, extrinsic motivation can be used to stimulate organizational performance-maximizing behavior with great discretion, as long as the behavior can be pre-specified in the incentive contract of the reward system and rewards can be allocated accurately. Clearly, these contingencies on the completeness of contracts and the complex monitoring of actual behavior have generated entire branches of economic theory (Coase, 1937; Williamson, 1975, 1985, 1989; Alchian et al., 1972; Jensen et al., 1976; Fama et al., 1983; Hart, 1989, 1995). For the purpose of this paper, suffice it to say that the problem implies the joint treatment of the reward design/adaptation problem with the structuring problem. The organizational structure has a fundamental influence on reward mechanisms (extrinsic rewards like power and

³ This is not to deny, however, that important performance improvements on the individual level can be

prestige are the direct consequence of structuring decisions) and has to be considered or adapted in the process of designing reward systems (Melumad & Mookherjee, 1995; Sherman & Smith, 1984). Thus the structure needs to be tailored to organizational goals or strategy in order to make the reward system effective.

Based on this discussion, we can propose a model of organizational interest alignment that considers intrinsic and extrinsic motivation along with their determinants. Organizations can use two strategic variables to stimulate interest alignment: the reward system, as a determinant of extrinsic motivation, and the socialization regimes, as a determinant of employee-organization identification and thus normative intrinsic motivation. The effect of each of these variables, however, is moderated by important organizational contingencies: the degree to which organizational norms and values support a chosen strategy moderates the impact of socialization on interest alignment, and the fit between organizational structure and strategy that influences the effectiveness of the reward system (see Figure 2).

--(Figure 2 about here)--

The interdependence of reward system and socialization regime

The applicability of reward system and socialization regime as strategic variables to influence individual behavior depends on the characteristics of the desired behavior. One can imagine a situation in which the same behavior, e.g. working overtime, can be a result of either extrinsic motivation from higher overtime pay or a consequence of normative intrinsic motivation in the presence of organizational norms that consider occasional (unpaid) overtime an aspect of “good organizational citizenship”. In this sense, rewards and socialization are alternative possibilities to stimulate the same behavior. On the other hand, there may be types of behavior that can be stimulated by one of these factors but not the other. For example, the

achieved through changes in task characteristics.

literature on reward systems has pointed to the fact that cooperative behavior in a teamwork setting where individual contributions to team performance remain unobserved, is difficult to achieve through rewards alone due to the free-riding problem (Gibbons, 1998). However, in the presence of organizational norms and values that favor such cooperative behavior, socialization regimes can be a successful way to increase team performance. On the other hand, we have already seen that normative intrinsic motivation is tied to existing organizational norms and values. This implies that behavior that is not supported by the norms and values cannot be stimulated through socialization regimes. If such behavior is nevertheless desirable, rewards may be a possibility to extrinsically motivate it. These cases show how socialization regime and reward system can be complementary mechanisms to motivate desired behavior. Still, organizations remain limited in their capacity to create perfect interest alignment, as some behavior that would maximize organizational goals cannot be stimulated through either rewards or socialization.

Only recently have researchers in economics and organizational behavior begun to recognize a potential bi-directional interaction effect between reward system and socialization regime and started to look for factors that determine whether interaction effects are positive or negative. While traditionally, social psychologists have focused on the negative impact of rewards on intrinsic motivation (Deci, 1975, 1976; Deci et al., 1999a; Lepper & Greene, 1978), more recent work in this area distinguishes between rewards that are perceived as controlling (and thus have a negative impact on intrinsic motivation) and performance-contingent rewards that are perceived as informative (and thus can have a positive impact on intrinsic motivation) (King et al., 1983; Amabile, 1993). Economists have also begun to move away from their exclusive focus on extrinsic motivation based on rewards and monitoring and controlling activity (Baker et al., 1994) and started to incorporate intrinsic motivation as well as the impact of rewards on intrinsic motivation in their models

(Frey et al., 2001; Frey et al., 1997).

For the purpose of our paper, it is important to emphasize that, in reality, reward system and socialization regime cannot be treated as independent of one another. Rewards can be detrimental to socialization (Deci, 1976; Deci et al., 1999a; Ghoshal & Moran, 1996), but one can also imagine that a “fair” reward system will facilitate the identification of the individual with the organization. Similarly, socialization to norms and values that counter the objective of the reward system can have a negative impact on the efficiency of the reward system, as in cases where a strong norm of equality among co-workers and against “rate busters” renders piece rate systems inefficient. At the same time, socialization and compliance with organizational norms and values can serve as a fix for some of the problems that have been identified in the incentive literature. For example, the internalization of organizational norms and values can suppress behavior aimed at the exploitation of reward systems, mainly by focusing on performance-relevant behavior that the incentive system rewards to the detriment of (equally important) performance-relevant behavior that the incentive system does not capture (Holmstrom et al., 1991, 1994; Gibbons, 1998). Based on the observation that socialization regime and reward system are interrelated, partly alternative and partly complimentary mechanisms, we conclude that reward system and socialization regime need to be considered simultaneously, both in their independent as well as joint effects, in order to study the conditions required for a maximum degree of interest alignment to be realized (see Figure 2).

INTEREST ALIGNMENT RENTS AND THE MARKET FOR HUMAN RESOURCES

The Cost and Benefits of Interest Alignment

As we have seen, interest alignment is an important determinant of actual organization performance and organizations can actively attempt to increase interest alignment to enhance

performance. Obviously, however, interest alignment cannot be created for free: actions that create an appropriate socialization regime (training, events, collective retreats, workouts etc.) are costly, as is the reward system, primarily due to the employee compensation required but also because the administration of rewards requires a system of monitoring and control. Organizations need to carefully consider the cost and benefits of a change in the determinants of interest alignment in their effort to increase organizational efficiency. This raises the question of whether and under what conditions the advantages of a performance increase through higher interest alignment exceed the cost required for their generation and therefore translates into economic rents for the organization. This question is difficult to answer, as the advantages of increased interest alignment, and likewise the cost required to achieve them, are difficult to assess and quantify in general. One way to gain insight into the conditions under which companies can capture economic rents from increased interest alignment, is to take a look at the market for human resources as an important determinant of the cost of interest alignment.

Competition for Human Resources and Employee Compensation

One important determinant of the cost of interest alignment is the “extrinsic work rewards” necessary to stimulate extrinsic motivation, in other words, the employee compensation.⁴ Competition in the market for human resources has a great influence on the required level of this employee compensation. The market for human resources can be characterized by two alternative conditions: scarcity or oversupply. Obviously, questions of interest alignment and the required rewards to retain and motivate employees are more relevant when human resources are scarce and companies compete for human talent. Consequently we will focus on this case in our analysis. Simply speaking, competition for human resources implies that

compensation levels are bid-up to the point where they match employee productivity⁵ (which can be broadly defined as all benefits from employee activity to the organization). In this case, the employee captures all benefits from his or her work and no rents accrue to the organization. This can be compared to the rents-destroying effects of unlimited price competition in the product market (Barney, 1986b). We thus have established an important link between employee productivity and extrinsic work rewards, mainly that in a case of unlimited competition for scarce human resources, extrinsic work rewards are only equal to employee productivity.

We can apply this insight to the question of whether and when benefits from increased interest alignment lead to economic rents. If we consider that advantages from increased interest alignment are part of overall employee productivity, we can conclude that in the absence of factors that limit competition for human resources, the employee will capture all benefits from interest alignment as extrinsic work rewards and no rents from interest alignment accrue to the organization. Hence we need to focus on mechanisms that soften competition for human resources if we want to identify conditions under which organizations can capture rents from increased interest alignment.

Imperfections in the Market for Human Resources and Related Economic Rents

In order to attract and retain employees,⁶ an organization has to offer a level of compensation that is high enough to make it optimal for an employee to work for this organization rather than for a competitor.⁷ As previous research has pointed out, employees consider several

⁴ We conceptualize employee compensation in a broad way as the aggregate of financial remuneration, recognition, power, perks etc.

⁵ For the time being, we assume that the productivity of a given employee is identical across potential employers.

⁶ In the following, we will focus our discussion on the retention of the existing workforce, assuming that employee turnover is costly for the organization and thus to be avoided. Our rationale, however, applies equally well to the case of recruitment of new/additional employees.

⁷ In the following, we focus on the comparison between our focal organization, who is assumed to be able to make the most attractive offer, and the competitor who makes the second most attractive offer.

factors beyond extrinsic work rewards in their decision to work for a given employer. Most relevant to our discussion are (1) the utility from a fit between individual characteristics and norms and values of either organization (Schneider & Goldstein, 1995), (2) the degree to which socialization regimes have created individual-organization identification (Kogut & Zander, 1996) and (3) the disutility of the required effort from performing the given task in the desired way in either organization.⁸ As we have seen, unlimited competition for scarce human talent that is based exclusively on extrinsic work rewards makes it impossible for the organization to generate economic rents from the employee's activity. There are several mechanisms, however, that limit the competition in the market for human resources and provide a possibility for organizations to generate economic rents.

The first of these mechanisms is linked to heterogeneity in organizational norms and values across competitors. Let us assume that our focal company has a different set of norms and values to those of its competitor and that employees have chosen and have been chosen to work for this organization according to the congruence of their individual characteristics and organizational norms and values ("I-O Fit") (Schneider et al., 1995). According to Schneider's argument, employees "enjoy" (or "derive a positive utility from") being part of an organization dependent on this congruence. Employees consider this utility when they compare their current compensation to job offers from competitors. For example, employees may prefer to work for a not-for-profit organization even if alternative jobs offer higher levels of compensation, if they perceive a strong fit between their individual values and the values of the organization. If an organization has such an advantage in terms of "I-O Fit" vis-à-vis its competitors, the required rewards to keep employees from leaving the organization will be lower than the level of employee productivity and economic rents which therefore accrue to the organization. In other words, differences in norms and values between competitors limit

⁸ For example, the required level of effort to meet employer expectations (and bonus criteria) in a low-

the competition in the market for human resources and make rent generation possible. This mechanism can be compared to the effect of product differentiation in the product market and will be described more formally in the following proposition.

Proposition 1: The greater the heterogeneity among competitors regarding organizational norms and values, the lower the required compensation and the greater the possibility for a company to capture economic rents.

Companies can actively create a similar situation through the use of socialization regimes which increase the identification of the individual with organizational norms and values. A higher level of identification increases the positive utility of the employee's organizational membership. This ex-post effect⁹ reduces the required rewards to keep the employee from leaving the organization and increases the amount of economic rents that can be generated by the organization. In a sense, socialization constitutes a possibility for the organization to actively create a "barrier to exit" for the employee, which limits the competition in the market for human resources and increases the possibilities for rents generation. Professional service firms, which compete heavily for human resources as their key asset, have been reported to heavily use socialization activities as a mechanism to increase employee identification and reduce turnover (Pascale, 1985). To remain in our analogy with the product market, socialization to organizational norms and values corresponds to the creation of "product switching costs" for the consumer, which limit competition and provide a possibility for the producer to extract economic rents. Hence:

Proposition 2: The greater the use of socialization regimes to enhance the identification of individuals with the organization, the lower the required compensation and the greater the possibility for a company to capture economic rents.

An important point to keep in mind, however, is that socialization not only influences

performance organization may be below the corresponding required level of effort in a high-performance company. This needs to be considered when employees compare the compensation offered in either case.

⁹ Socialization creates identification after the employee has joined the organization, whereas I-O Fit exists prior to this.

competition in the market for human resources and thus the required level of employee compensation, but that it also has a direct impact on interest alignment and organizational performance as it influences normative intrinsic motivation. Direction and magnitude of this impact depend on the degree to which organizational norms and values support behavior that maximizes organizational performance. Competitors with different norms and values will consequently differ in the degree to which they can use socialization to create a “barrier to exit” for their employees. If we think, for example, of an organization whose future success crucially depends on the willingness of its workforce to innovate and take risk but which traditionally is endowed with a set of norms and values that favor conservatism and risk-aversion, all socialization activity that reinforces these norms and values among the workforce will have a detrimental effect on organizational performance. Consequently, the organization will have to consider this negative performance impact of socialization when deciding whether it should use socialization and increased identification as a mechanism to fight employee turnover. Competitor who are in the same situation but endowed with norms and values that support innovation and willingness to take risk are at an advantage, as they can use socialization to capture rents in the market for human resources without such negative consequences on organizational performance. Hence, a company with norms and values that do not perfectly support performance-maximizing behavior will be limited in the use of socialization.

Sources of Heterogeneity in Employee Productivity across Firms

So far, we have based our discussion on the assumption of competitors that are identical in terms of the productivity of the focal employee.¹⁰ However, as Castanias and Helfat (Castanias et al., 1991) have pointed out, it is normal to expect employee productivity to

differ across competitors. They illustrate how the existence of firm-specific skills, i.e. skills that translate into productivity only for the focal employer but are worthless for competitors, lead to differences in employee productivity across companies. This can translate into “managerial rents” for the organization (Castanias et al., 1991), as the compensation necessary to match outside offers and retain employees can remain below the firm-specific employee productivity and organizations can capture the difference as economic rents.

We proceed to build upon the insight that differences in the productivity of an employee across competitors can be a source of economic rents for the employer and propose a refinement of Castanias and Helfat’s argument through the explicit consideration of motivational aspects. Castanias and Helfat claim that firm-specific skills are a necessary condition for the creation of managerial rents and acknowledge the importance of employee motivation to deploy the firm-specific skills and realize their rent-generating potential.

There is, however, an alternative scenario that creates such a differential in productivity even in the absence of firm-specific skills and in the presence of generic or industry-specific skills only. Differences in productivity of an employee across competitors can exist whenever one organization is better able to motivate the employee to deploy his or her skills than its competitors. This corresponds to the case where potential employee productivity is identical across competitors but actual employee productivity differs due to differences in interest alignment. Just as in the case of productivity differences due to firm-specific skills, productivity differences due to firm-specific interest alignment translate into economic rents that can be captured by the organization. This specific type of economic rent due to a firm-specific superior level of interest alignment¹¹ shall be referred to as “*interest alignment rent*”.

¹⁰ In the following, we always compare the productivity of one specific employee who is assumed to be working for either our focal organization or the competitor.

¹¹ Antecedents and consequences of heterogeneity in interest alignment across organizations will be discussed in more detail in the following section.

As an illustration of the generation of interest alignment rents, we can look at the case of a start-up company that competes with a number of incumbents and employs a team of engineers with a set of skills that are as valuable to the start-up as the incumbents (i.e. there are no differences in employee productivity across competitors due to firm-specific skills). We further assume the start-up company to have a specific configuration of reward system (e.g. an attractive equity plan in a pre-IPO situation) and socialization regime (e.g. the “start-up effect” that implies a tight-knit community within the organization and a strong level of identification of employees with “their” company) that none of the incumbent competitors could possibly match. Consequently, we can expect the team of engineers to be more highly motivated – and thus more productive (e.g. in terms of innovativeness or creativity) than if it were employed by any of its competitors. This gives the start-up the possibility to generate rents from the engineers’ activity, as it can pay each engineer a compensation comparable to his or her level of productivity when working for a competitor and capture the additional productivity that stems from a degree of interest alignment that can only be created by the start-up as interest alignment rents.¹²

Proposition 3: The greater an organization’s ability to create a degree of interest alignment for the focal employee that cannot be matched by competitors, the higher the amount of “interest alignment rents” that can be generated by the organization.

In summary, there are two scenarios in which heterogeneity in the productivity of an employee across competitors can lead to economic rents for the employer.¹³ If the employee possesses firm specific skills and is motivated to deploy them¹⁴ the organization captures “managerial rents” (Castanias et al., 1991). Alternatively, if the organization is able to create

¹² In actuality, we still need to correct for the cost of the rewards (e.g. equity plan) and any socialization activity (e.g. the “launch party”).

¹³ Using again our metaphor of competition in the product market, we can compare this mechanism of rent generation to the existence of consumer rents, whenever one consumer has individual valuation for a good beyond its market price.

¹⁴ And if this leads to an amount of additional employee productivity that exceeds the cost required to develop the firm-specific skills.

a firm-specific superior degree of interest alignment for an employee¹⁵ (even without firm-specific skills¹⁶), the organization captures “interest alignment rents”.

Returning to our more general discussion of possible conditions under which organizations can generate rents from interest alignment, we can conclude from the previous analysis that compensation-based competition for scarce human resources limits the degree to which organizations can generate rents from increased interest alignment. Rent generation becomes possible only if competition in the market for human resources is reduced due to heterogeneity among competitors with respect to their norms and values (cf. Proposition 1), or by the use of socialization to “lock-in” employees by the focal firm (cf. Proposition 2), the degree to which the productivity of the focal employee varies across potential competitors due to firm-specific skills (Castanias et al., 1991), or the superior ability of the focal firm to align individual with organizational interests (cf. Proposition 3).

So far, we have been primarily concerned with the implications of interest alignment for the generation of economic rents. Consequently, we have focused on one organization and considered competitors only to the extent that they influence the factor cost of human resources. Rent generation is a necessary but insufficient condition for the existence of competitive advantage, however. The next step is to analyze the conditions under which enhanced interest alignment can be a source of competitive advantage and the circumstances that make such an advantage sustainable over time. This requires the comparison of competitors in their ability to generate economic rents from interest alignment.

¹⁵ And if this leads to an amount of additional employee productivity that exceeds the cost required to create the superior level of interest alignment.

¹⁶ The second alternative shows that contrary to Castanias and Helfat, firm-specific skills are not a necessary condition for the appropriation of economic rents from managerial activity by the organization.

SUSTAINABLE COMPETITIVE ADVANTAGE THROUGH INTEREST ALIGNMENT

A Model of Interest Alignment Rents

In order to understand the conditions under which economic rents from interest alignment also lead to sustainable competitive advantage, we first build a comprehensive model of interest alignment rents. Based on this model, we can compare competitors in their ability to generate interest alignment rents and identify conditions for the generation of a competitive advantage and its sustainability. For this comparison, we will make the simplifying assumption that all competitors are identical in their endowment with assets and capabilities (except for the factors related to interest alignment) and that they have furthermore adopted the same positioning in the product market space. Hence all competitors are identical in terms of their potential performance (c.f. Figure 1). Any differences in actual performance¹⁷ will be related to heterogeneity in interest alignment. This way we can focus exclusively on the impact of interest alignment on competitive advantage.

Our model of interest alignment rents (shown in Figure 3) builds upon the previous model of interest alignment, according to which it is a function of reward system and socialization regime as two (interrelated) strategic variables that organizations can use to stimulate interest alignment. The impact of these is moderated by organizational contingencies, which are determined by norms and values, structure and strategy (Figure 2). Interest alignment rents, as the net effect of the performance increase due to a firm-specific superior level of interest alignment over and above the required cost of interest alignment, are determined by the same variables: as we have seen, the chosen level of both reward system and socialization regime directly influences interest alignment as well as interest alignment cost. In addition we have seen that the socialization regime also moderates the required level of rewards, as it influences the competition in the market for human resources. Whenever

competitors differ in one or several of these determinants of interest alignment rents, the company that has adopted the most advantageous configuration of these determinants will earn the most interest alignment rents and therefore enjoy a competitive advantage.

--(Figure 3 about here)--

Possible Sources of Sustainable Competitive Advantage through Interest Alignment

In the following, we look at a series of scenarios, which differ in their assumptions regarding the various components of our model (reward system, socialization regime, organizational structure, norms and values and firm strategy) as homogeneous or heterogeneous, constant or variable. Based on these scenarios, we can highlight different mechanisms for the generation and sustainability of a competitive advantage based on superior interest alignment. The logic of the analysis is to inquire about the conditions for the generation and sustainability of competitive advantage at increasing levels of complexity and dynamism in the model. We start from the simplest possible model, where all but the endowment of reward system and socialization regime is homogeneous across competitors and all variables are stable over time. We then proceed to relax the assumption of homogeneity and stability in all the key variables – one at a time. In each scenario we look for possible sources of competitive advantage related to increased interest alignment rents and try to identify the conditions that provide their sustainability. In the transition to each ensuing scenario, we relax assumptions in a way that the previously identified conditions for sustainable competitive advantages are no longer sufficient and highlight each time an additional mechanism that determines competitive advantage and its sustainability in the new setting. Table 2 summarizes the different steps of the analysis.

--(Table 2 about here)--

¹⁷ Here we consider always net performance differences, i.e. performance increases due to interest alignment

Scenario 1: Heterogeneous but fixed Reward and Socialization Systems

Let us first assume that strategy and internal contingencies (organizational structure and norms and values) are homogeneous and stable across competitors. We furthermore consider reward system and socialization regime as heterogeneous but also constant. If one company has a configuration of reward system and socialization regime that leads to a superior level of interest alignment rents,¹⁸ the company enjoys a competitive advantage based on a Ricardian logic. By design, such a situation meets the “VRIN” criteria for sustainability of a competitive advantage established by the resource-based view as the configuration of reward system and socialization regime is valuable (it leads to rents), rare (none of the competitors has it), inimitable and non-substitutable (all determinants of interest alignment rents are constant for all companies). Consequently, we have identified a first (simplistic) scenario in which a sustainable competitive advantage through interest alignment is possible, based on a superior configuration of reward system and socialization regime (see Figure 4).

--(Figure 4 about here)--

Scenario 2: Adaptable Reward and Socialization Systems

In the second scenario, we relax the assumption of stability in the configuration of reward system and socialization regime and allow for the possibility that all companies can adjust their respective configuration of the determinants of interest alignment. What are the implications of this change in assumptions for the sustainability of the competitive advantage in our previous scenario? The inimitability of interest alignment is still limited by the difficult observability of several determinants of interest alignment (implicit rewards, socialization regime, organizational norms and values) and by the complexity and causal ambiguity of the

less the required cost of interest alignment.

¹⁸ The earlier example of a start-up company that had a configuration of reward system and socialization regime that was unique in its industry, hence its level of interest alignment could not be replicated by competitors, illustrates such a situation.

exact mechanisms through which interest alignment is created. However, to the extent that competitors are able to reach the same level of interest alignment through an autonomous change in their reward system and socialization regime, the competitive advantage will be competed away over time.¹⁹

The ability of a competitor to autonomously reach a higher level of interest alignment then depends on a specific competence in the improvement of the configuration of reward system and socialization regime. In a dynamic setting, companies will be constantly trying to create a (temporal) competitive advantage through interest alignment and will be engaged in a race to identify a more advantageous configuration of reward system and socialization regime. The basis for this competition is their capability to improve interest alignment within a given context: a Schumpeterian rather than a Ricardian condition (see Figure 5). We will see below how we characterize this specific capability in more detail.

--(Figure 5 about here)--

Scenario 3: Heterogeneous but constant Organizational Features

So far, we have looked at scenarios in which competitors are homogeneous with respect to all contingencies for interest alignment, i.e. identical in strategy, structure, organizational norms and values. Consequently, the maximum level of interest alignment rents was the same for all competitors and a competitive advantage existed whenever one company was closer to this common maximum than its peers. At this stage, we introduce heterogeneity of competitors regarding their internal contingencies (structure, and organizational norms and values).²⁰ In this case, a superior capability to improve the configuration of reward system and socialization regime is no long a sufficient condition for a sustainable competitive advantage:

¹⁹ In this case, all competitors will enjoy the same level of interest alignment rents.

²⁰ We only consider cases of heterogeneity that lead to differences in the maximum possible degree of interest alignment rents and exclude the case of competitors that differ in internal contingencies, but still have the same maximum degree of interest alignment rents due to the possible equifinality of the configurations in our model.

if one of the competitors has a structure and a set of norms and values that better support its strategy than the other companies, it also has a higher potential for generating interest alignment rents than its competitors. One common example of such a scenario is the case of Johnson&Johnson, which has been able, over time, to develop a set of norms and values around its basic “credo” that uniquely support the company’s goals. Hence the company can make better use of socialization to stimulate interest alignment and lower the required level of rewards compared to its competitors. If competitors are unable to match the level of interest alignment due to superior consistency among internal organizational features (values, structure, etc.) and reward and socialization systems, a company enjoys a competitive advantage. Even if competitors have a superior competence in the improvement of the configuration of reward system and socialization regime, their organizational contingencies limit the maximum possible level of interest alignment rents, so that they cannot “catch up”. This advantage is, in our current scenario, protected from competitive pressures as competitors have been assumed to be unable to adjust the relevant internal organizational features that determine the maximum possible degree of interest alignment.

Thus, we have identified another case in which a sustainable competitive advantage through interest alignment is possible. This time, sustainability is linked to a superior complementarity of internal contingencies that permit a maximum degree of interest alignment rents exceeding the maximum rents a competitor could generate. The logic of this competitive advantage is of Ricardian nature, similar to the advantage in Scenario 1: the “VRIN”-conditions of the RBV are satisfied by the internal organizational features that lead to a superior degree of interest alignment rents that is protected from imitation or substitution *per definitionem*²¹(see Figure 6).

--(Figure 6 about here)--

Scenario 4a: Environmental Change and Adaptable Firm Strategy

In all previous scenarios, firm strategy has been treated as a stable and homogeneous characteristic for all our competitors. In a dynamic environment, however, companies may be forced to redefine their strategy in response to exogenous changes in the environment (Lawrence & Lorsch, 1967). According to our model of interest alignment rents, this implies a change in the degree of fit between internal organizational contingencies (structure, organizational norms and values) and strategy and thus a change in the maximum possible level of interest alignment as well as in the optimality of the current configuration of reward system and socialization regime relative to this maximum. Hence, changes in firm strategy may lead to the erosion of a competitive advantage based on a superior complementarity of internal contingencies as identified in Scenario 3. We can illustrate this effect by looking at the case of a company that has long been competing in an environment in which differentiation has been the key strategic success factor with competitors who all adopted a differentiation strategy. Let's assume that this company is endowed with norms and values and an organizational structure that support this strategy in a superior way (i.e. better than the organizational contingencies of any of its competitors) and has adopted a configuration of reward and socialization systems that maximizes interest alignment rents given these organizational contingencies. In a situation that corresponds to Scenario 3, this company enjoys a sustainable competitive advantage. If, however, the competitive environment changes in a way that now cost-efficiency becomes the critical success factor, the situation changes drastically. Our focal company (as well as its competitors) is forced to recognize the change in environmental conditions and to react by adopting a cost-efficiency strategy to survive under these new conditions. However, its organizational contingencies are no longer

²¹ This scenario is similar to Barney's observation that organizational culture (of which norms and values are a

in line with this new strategy. In all likelihood, previously “inferior” competitors, whose organizational contingencies did not support a differentiation strategy very well, will now be at an advantage as their organizational contingencies better fit with the new cost-efficiency strategies. At the same time, the original configuration of reward and socialization systems may no longer be optimal to support the new strategy. As, in this scenario, organizational contingencies are constant, the organization can only adjust its configuration of reward and socialization systems to increase interest alignment rents to move towards “its” maximum level of interest alignment rents.²² The competitive disadvantage from an inferior fit between organizational contingencies and the new strategy will be permanent, however, which implies that the maximum level of interest alignment rents of our focal company remains below the maximum possible level for its competitors. Consequently, such an exogenously determined change in strategy will alter the degree to which a company enjoys (and can possibly enjoy) an interest alignment-based competitive advantage.

If we assume that all competitors are subject to the influence of environmental change that causes an exogenous change in strategy, the ability to generate a superior level of interest alignment rents in this scenario depends on two distinct capabilities. First, a company has to be able to accurately assess the implications of such an environmental change. In addition, it needs to be able to appropriately react to the environmental change by adjusting its strategy. Companies with a superior competence in these two areas will then enjoy a competitive advantage vis-à-vis their competitors. Similar to Scenario 2, this dynamic setting sees companies as constantly trying to create a (temporal) competitive advantage through superior interest alignment based on these capabilities in a Schumpeterian fashion (see Figure 7).

--(Figure 7 about here)--

subset) can be a source of competitive advantage, if organizations are endowed with a “valuable” culture that cannot be replicated by competitors (Barney, 1986a).

²² This corresponds to the real-world phenomenon that organizational norms and values tend to be more sticky and difficult to change than firm strategy.

Scenario 4b: Endogenous Adaptation of Organizational Traits

In the previous scenario, a change in strategy led to the erosion of the superior fit between strategy and organizational contingencies identified in Scenario 3 as a condition for sustainable competitive advantage. This fit depends, however, not only on the firm strategy but also on the organizational contingencies themselves. In our last scenario, we therefore relax the assumption of stability of the internal organizational contingencies and assume that companies are, over time, able to change organizational structure as well as norms and values. In this case, companies can use this additional flexibility to increase the degree of complementarity between organizational contingencies and firm strategy and thus their maximum possible level of interest alignment rents. This will give them the possibility to catch up with competitors who were initially endowed with a superior set of organizational contingencies, which leads to the erosion of the competitive advantage that we identified in Scenario 3. If we also consider the possibility of environmental change that was introduced in Scenario 4a and the resulting need to adapt the firm strategy, the possibility to adjust organizational contingencies gives companies additional flexibility to reduce the internal contingency problem and better respond to external contingencies, as internal constraints can be relieved over time. We can think of a case in which a company is forced to adapt its strategy to environmental change but is able to avoid overly harsh consequences on its ability to generate interest alignment rents as the adjustment is made gradually and internal organizational contingencies can be adapted over time to support the strategic change. In our example of a change from a differentiation to a cost-efficiency strategy, a company will be able to better manage the transition if it is able to adapt its organizational structure and eventually also norms and values to support the shift in strategy. A real-world example that shows that such a process is possible, yet time-consuming and costly (not to say “painful”)

for the organization, could be the case of IBM's fundamental transformation over the past three decades from a strategy focused on products to a service orientation.

Again, the generation of interest alignment rents is linked to a specific organizational competence. Crucial in this scenario is the capability of a company to adapt organizational contingencies over time in a way that increases their fit with firm strategy and thus the maximum possible amount of interest alignment rents can be generated. The creation of a (temporal) competitive advantage in this scenario will then be linked to superior levels of this capability vis-à-vis competitors (see Figure 8).

--(Figure 8 about here)--

Sources of Sustainable Competitive Advantage through Interest Alignment

In our different scenarios, we have identified a number of possible sources of competitive advantage linked to a higher level of interest alignment rents as well as the corresponding conditions that are necessary for their sustainability, depending on the assumptions regarding the heterogeneity and adaptability of companies' traits (see Table 3). In essence, however, one can summarize the results of the analysis in the identification of two alternative mechanisms.

The first – illustrated in Scenarios 1 and Scenario 3 – follows a Ricardian logic, as rent generation in these scenarios is linked to an endowment with factors that lead to a superior level of interest alignment rents. Sustainability of this competitive advantage is conditional upon the standard criteria proposed by the resource-based view of the firm, i.e. the source of competitive advantage needs to be valuable, rare, inimitable and non-substitutable (Lippman et al., 1982; Rumelt, 1984; Barney, 1986b; Dierickx et al., 1989; Conner, 1991; Peteraf, 1993). We have illustrated cases in which a sustainable competitive advantage is related to either a superior configuration of socialization regime or reward

system (Scenario 1) or to superiority in the maximum level of interest alignment rents a company can reach given the endowment (fixed but heterogeneous across companies) with other organizational traits (Scenario 3). This second case (Scenario 3) has some level of realism if one considers organizational traits, such as corporate norms and values, to be of a heterogeneous nature across firms but notoriously difficult to change and adapt.

--(Table 3 about here)--

In a sense, this mechanism is similar to rent generation according to the standard resource-based rationale. However, even if superior interest alignment can be considered as a “resource” in the broadest sense of the term (Wernerfelt, 1984), it may be questioned whether such an all-inclusive conceptualization of resources is helpful to refine our understanding of the different mechanisms and factors that lead to economic rents and competitive advantage. After all, interest alignment is an organizational attribute that determines the degree to which individuals in the organization act in a way that promotes organizational goals. As such, it is distinctly different in its influence on actual organizational performance (and rent generation) from the kind of resources that have traditionally received most attention in the RBV as determinants of potential performance (namely tangible and intangible assets). We believe that it is appropriate to conceptualize interest alignment rents that stem from a Ricardian logic as a complement to the rent generation mechanisms that have so far been proposed by proponents of the RBV.

The second mechanism of superior rent generation through interest alignment follows a more dynamic and capability-based logic. We have seen in several scenarios that in a dynamic context any advantages related to an endowment with organizational factors that lead to superior interest alignment will either be eroded away by environmental change (Scenario 4a) or competed away by competitors that, over time, are able to imitate or

substitute the factors that lead to high interest alignment (Scenarios 2 & 4a). In such a situation, (temporary) competitive advantages can only stem from superior capabilities to create (and continuously improve) interest alignment. This mechanism corresponds to the generation of Schumpeterian rents in the product market.

--(Table 4 about here)--

It is interesting, however, to take a closer look at the different characteristics of these capabilities (see Table 4). First of all, it is important to point out that all four capabilities, which we shall call “interest alignment capabilities”, are different from the capabilities typically treated in the capability-based view, as they do not produce products and services or generate resources necessary to that effect, but influence organizational determinants of interest alignment. Furthermore, all interest alignment capabilities are “dynamic” in nature, as they enable companies to react to environmental change (Eisenhardt et al., 2000) or to adjust stable patterns of activity that in turn influence the production of products and services (Zollo et al., 2002). A comparison of the characteristics of these different interest alignment capabilities sheds new light on the construct of “dynamic capabilities” with its different definitions. As illustrated in Table 4, the capabilities to improve the configuration of reward system and socialization regime, adjust firm strategy in response to both external and internal contingencies, and to adapt organizational contingencies over time, all fit the (inward-looking) definition of dynamic capabilities proposed by Zollo (Zollo et al., 2002), as they enable organizations to adjust stable patterns of activity (i.e. process is related to the creation and improvement of interest alignment) that in turn influence the production of products and services. The capability to assess the impact of environmental change on the optimality of competitive strategy and the determinants of interest alignment, on the other hand, better fits the definition proposed by Eisenhardt and Martin (Eisenhardt et al., 2000), as it is more

outward-oriented and enables companies to react to environmental change. This suggests that the existing competing definitions of “dynamic capabilities” should not be seen as redundant. Rather, they simply seem to capture different aspects of this multifaceted construct.

All interest alignment capabilities can only lead to a temporal competitive advantage as long as we assume that companies are able to “learn”, i.e. develop and enhance their interest alignment capabilities over time. This allows competitors with an inferior interest alignment capability to catch up which leads to the erosion of competitive advantage. In all cases, sustainability of the competitive advantage can only be guaranteed by a superior “learning capability” that enables a company to develop the relevant interest alignment capability faster than its competitors (Hamel, 1991).

CONCLUSIONS

Over the past two decades, significant progress has been made in the management field to increase our understanding of factors that determine a firm’s potential to generate economic rents (Lippman et al., 1982; Rumelt, 1984; Barney, 1986b; Dierickx et al., 1989; Conner, 1991; Peteraf, 1993; Kogut et al., 1992, 1996; Conner & Prahalad, 1996; Grant, 1996; Ghoshal et al., 1996; Nahapiet & Ghoshal, 1998; Porter, 1979, 1980, 1985). Among the various factors contributing to rent generation, however, employee motivation and organizational interest alignment have not been formally studied by strategy scholars, in spite of their intuitive relevance. This is surprising not only because of the role motivation plays as a direct antecedent to rent generation, and eventually to competitive advantage, but because of its potential role as moderator, or even enabler, for the impact of the other factors. The usefulness of any given organizational competence or strategic resource, the strength of a certain positioning on the product market, are all fundamentally influenced in their abilities to deliver economic results by the degree to which managers are willing to fully utilize these competencies and resources and exploit those advantageous positions to the benefit of the

organization. It seems that strategic management scholars have somehow taken for granted the existence of motivation, in their theories of sustained firm performance. The “strategic” part of the field has not fully explored the importance of the “management” component.

The ambitious goal that we have set, not only for this paper but eventually for the field itself, is therefore to look seriously at the significant amount of work being done in applied psychology and microeconomics (by agency theorists in particular) to understand the dynamics of motivation and how they inform the long-term performance of organizations. We attempt to begin this by leveraging on current advances in motivation theory, with the intention to apply standard economic reasoning to the evaluation of (a) the costs attached to interest alignment processes necessary to determine the extent of rent generation, and (b) the relative magnitude of rents generated vis-à-vis competitors, in order to identify the barriers to competitive advantage.

If the overarching goal of this paper is to contribute to the integration of work in social psychology, organizational behavior and agency theory to inform our understanding of the mechanisms underlying the creation of sustainable competitive advantage due to superior interest alignment, on more concrete grounds it tries to connect motivation theory with strategy in three sequential steps. First, it offers a more complete theory linking different motivational mechanisms (working through extrinsic and intrinsic motivation) to interest alignment between the individual and the organization. Whereas these two levers have traditionally been studied as independent determinants of behavior, we base our analysis on recent work that sees them as actually interacting to influence organizational performance through their impact on interest alignment. Additionally, we show how this relationship is moderated by organizational characteristics such as organizational structure, norms and values.

Second, the paper goes beyond the analysis of the “positive side” of interest alignment

and inquires about its cost so that a more complete understanding of rent generation from interest alignment can be developed. To this end, the analysis considers the dynamics in the market for human resources, where managers and employees potentially stand to capture most of the rents from increased interest alignment if the organization does not develop competencies specific to the retention and motivation of the attracted talent.

Third, we apply standard competitive analysis to move from rent generation through interest alignment to the development of sustainable competitive advantage. By comparing firms with respect to their ability to appropriate rents from interest alignment in a number of different scenarios to highlight different sources of competitive advantage, we show that, depending on the assumptions made on the heterogeneity and adaptability of organizational attributes, including motivation mechanisms, firm strategy, structure and cultural values, interest alignment can lead to competitive advantage based on both Ricardian and Schumpeterian mechanisms. Adopting a capability-based view of interest alignment, we have identified four distinct variants of dynamic capabilities relevant to create superior interest alignment rents vis-à-vis competitors. Of particular relevance are the dynamic scenarios analyzed where the sustainability of competitive advantage is only possible to the extent that the focal company can enhance the relevant interest alignment capability faster than the competition. Hence the crucial role of dynamic capabilities – stable patterns of activity aimed at the adaptation and enhancement of operating routines (Zollo et al., 2002) – in the analysis.

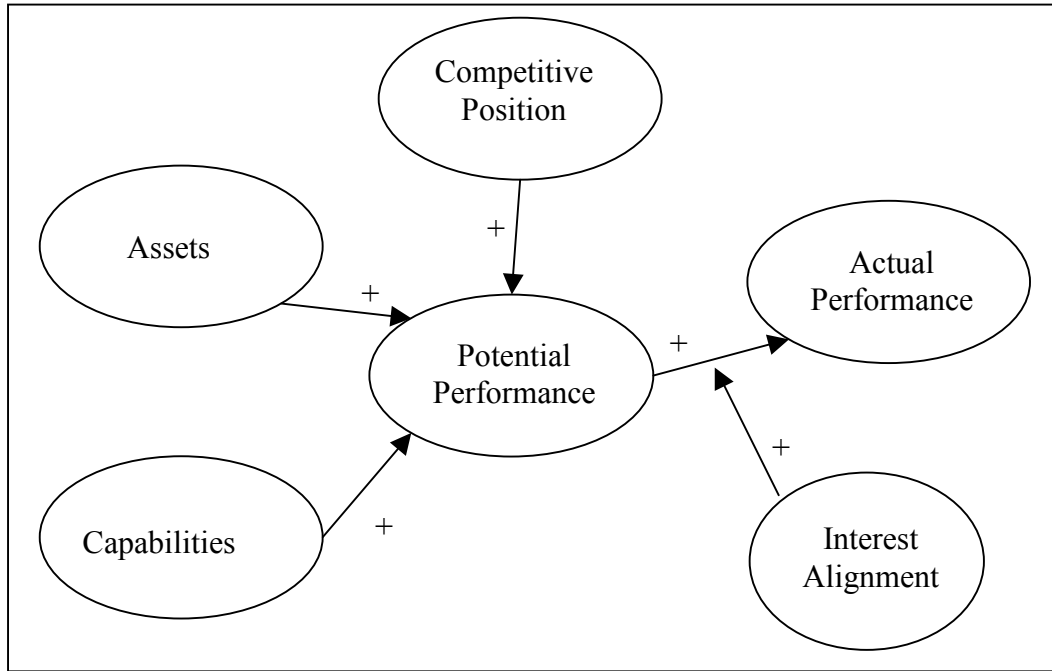
Overall our analysis highlights the strategic importance of interest alignment and its antecedents as factors that can determine the degree to which an organization generates economic rents and is able to create sustainable competitive advantage. If we want to fully understand drivers of actual firm performance beyond the potential defined by its market positioning and endowment with resources and capabilities, it will be crucial to include

motivation and its determinants in our models of competitive advantage.

The development of a comprehensive theory that explains the impact of motivation and interest alignment on competitive advantage is an ambitious target. The present paper represents but a first step towards this goal and suffers from a number of limitations, which in turn indicate avenues for future research. First of all, we excluded hedonic intrinsic motivation from our model of interest alignment. One may think of ways to incorporate it in our analysis, as factors such as socialization, organizational structure, norms and values clearly also have an impact on the perception of a job as joyful, competence enhancing etc.. Furthermore, we currently only consider competitors that are homogeneous with respect to their potential organizational performance (determined by their positioning in the product-market space and their endowment with assets and capabilities) in our analysis. It would be interesting to compare our conclusions with a case in which competitors differ in both strategic positioning, assets, (non-interest alignment) capabilities and interest alignment. One could also start to look at the relevance of interest alignment for different types of (generic) strategies and explore the question of whether its determinants become more or less important when companies compete on the basis of cost-efficiency rather than product differentiation. Finally, we have argued that dynamic capabilities of different kinds play a crucial role in the creation and sustainability of competitive advantage based on interest alignment. It would be important to further refine our understanding of what these stable patterns of learning activity specifically look like and how exactly they develop over time. Whereas the limitations are many, we believe the analysis presented above offers an initial step towards the explicit integration of the “human factor” in the strategic management discourse.

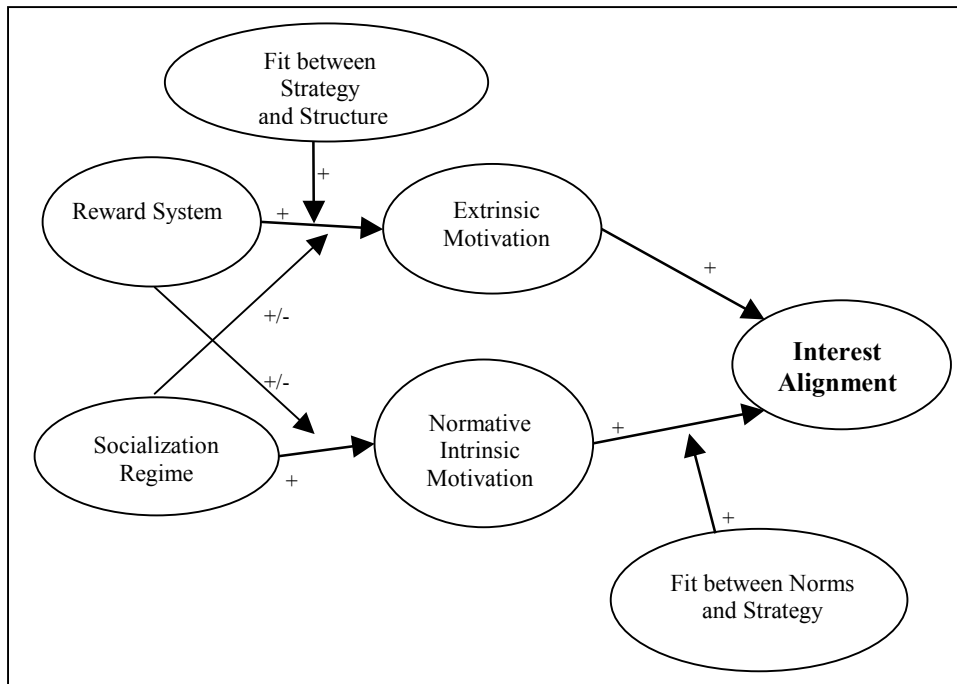
APPENDIX

Figure 1: Interest Alignment as Determinant of Actual Firm Performance



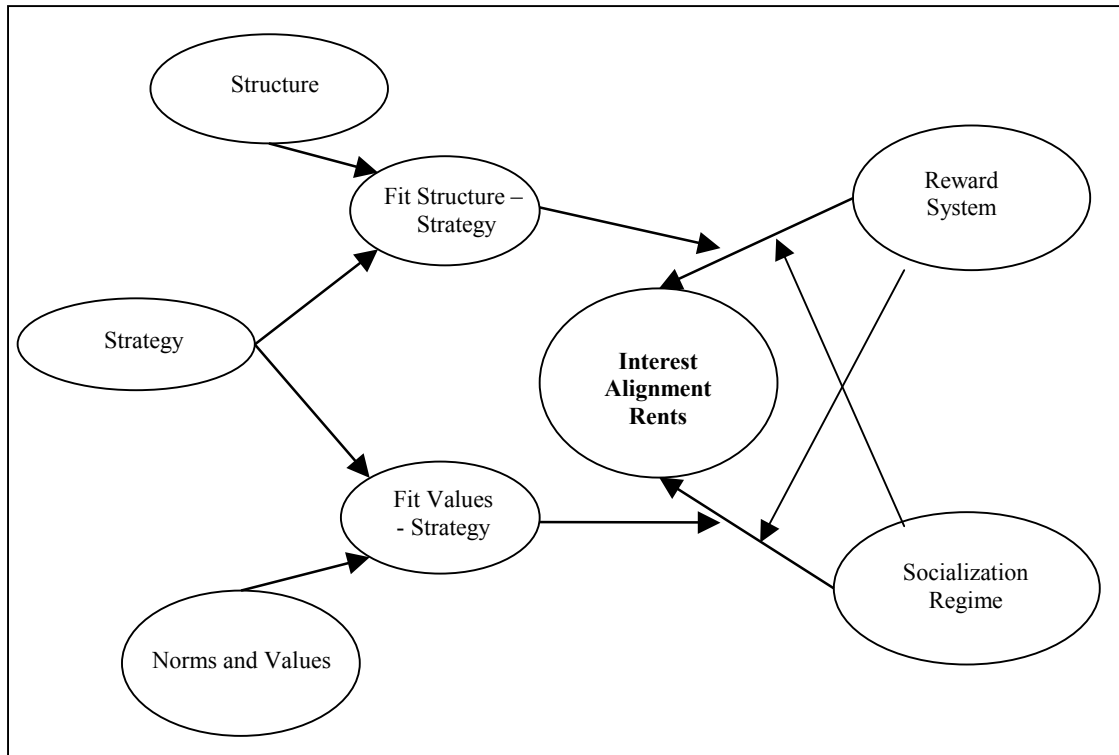
A firm's assets and capabilities and its competitive position determine only potential firm performance. Employee motivation though Interest Alignment has a crucial impact on the degree to which a firm is able to realize this potential and thus on actual firm performance.

Figure 2: Determinants of Organizational Interest Alignment



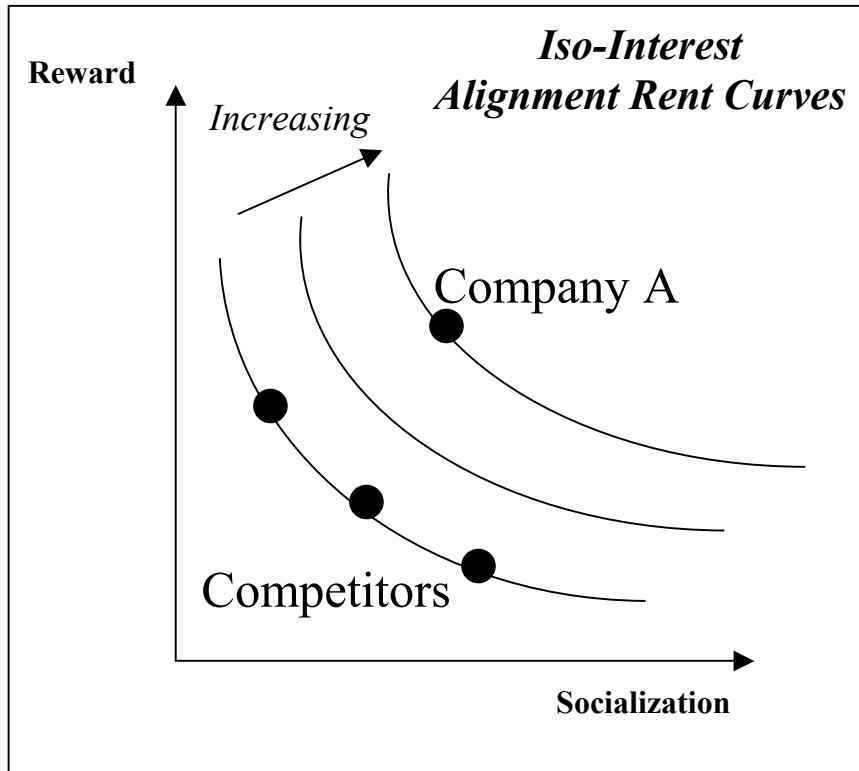
Organizations can influence Interest Alignment through the use of Rewards and Socialization. The impact of these (interrelated) decision variables is moderated by the fit between firm Strategy and internal organizational contingencies (Structure, Norms & Values).

Figure 3: A Model of Interest Alignment Rents



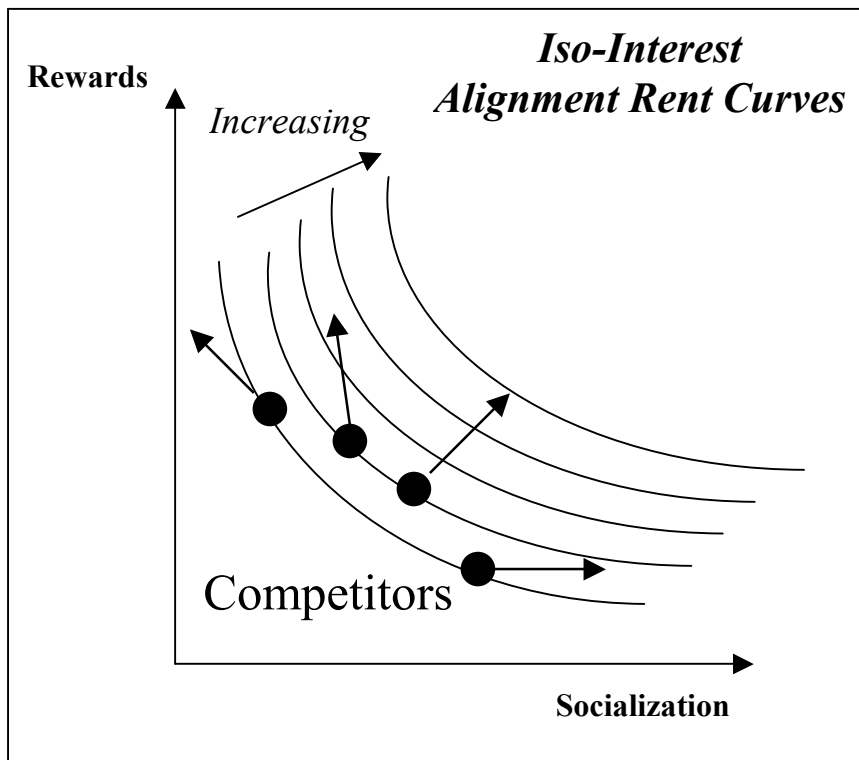
Interest Alignment Rents are determined by the configuration of Reward System and Socialization Regime and the Fit between Firm Strategy, Organizational Structure and Norms & Values

Figure 4: Scenario 1 -- Heterogeneous but fixed Reward and Socialization Systems



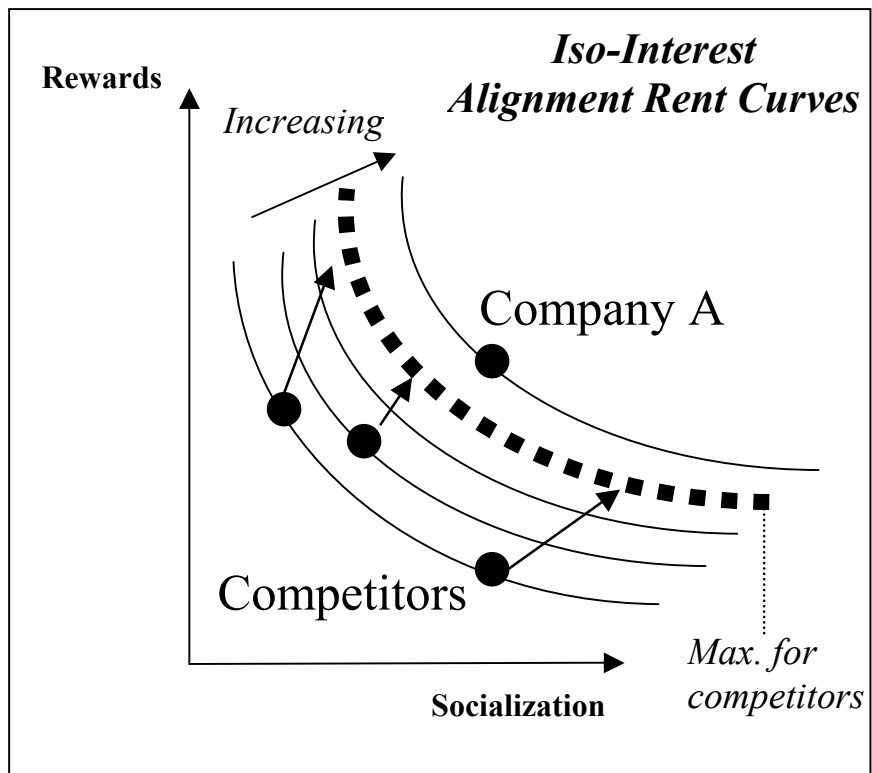
Any configuration of Reward System and Socialization Regime corresponds to a certain level of Interest Alignment Rents. We can imagine Iso-Interest Alignment Curves that connect all those configurations of Reward System and Socialization Regime that lead to the same level of Interest Alignment Rents. If a firm has adopted a configuration of Reward System and Socialization Regime that leads to a higher level of Interest Alignment Rents than all its competitors, this firm enjoys a competitive advantage.

Figure 5: Scenario 2 -- Adaptable Reward and Socialization Systems



If Reward and Socialization System can be adjusted, the firm that can move (fastest) toward a level of higher Interest Alignment Rents enjoys a (temporary) competitive advantage.

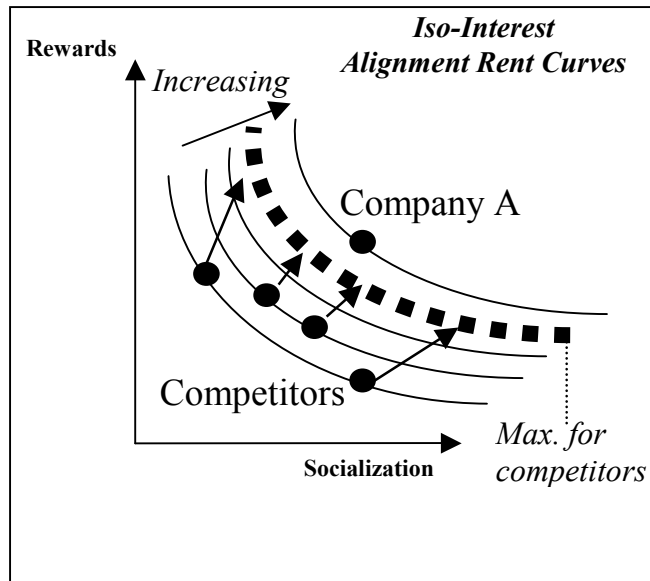
Figure 6: Scenario 3 -- Heterogeneous but constant Organizational Features



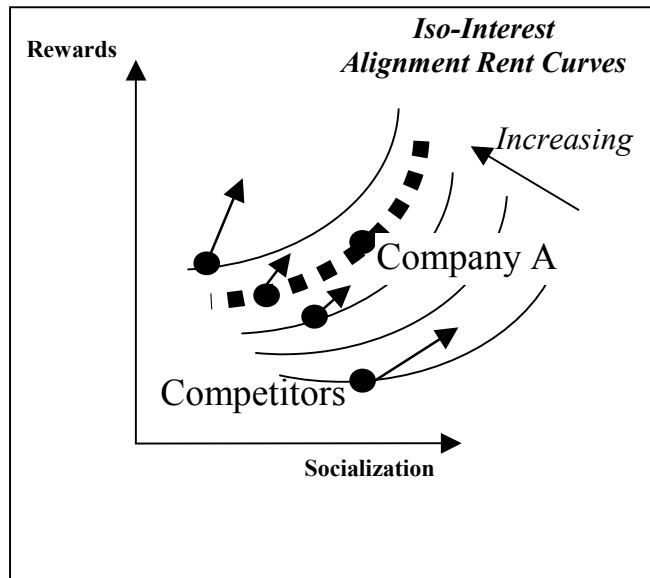
The fit between organizational contingencies (Structure, Norms & Values) and firm Strategy determines the maximum level of Interest Alignment Rents a firm can reach. A company with a superior fit and the corresponding configuration of Rewards and Socialization Regime has a competitive advantage, as competitors are restricted in their ability to “catch up”.

Figure 7: Scenario 4a – Environmental Change and Adaptable Firm Strategy

If initially a company enjoys a competitive advantage due to a superior fit between its strategy and organizational contingencies (Structure, Norms & Values) ...



... Environmental change that forces an adjustment of firm strategy can reduce the suitability of organizational contingencies and the optimality of the configurations of Rewards and Socialization Regime (changing the shape of the Iso-Interest Alignment Curves)...



... Companies then compete on the basis of their ability to assess the impact of environmental change and adjust Strategy (as well as Rewards and Socialization Regime) accordingly to create or maintain a competitive advantage.

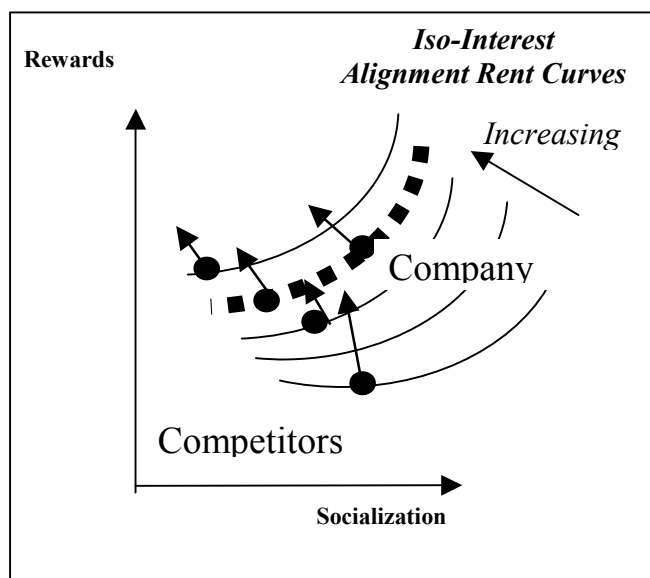
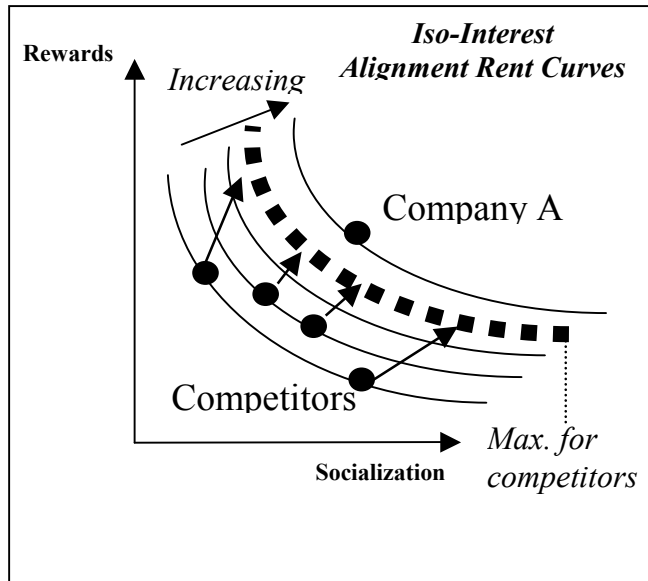


Figure 8: Scenario 4b – Endogenous Adaptation of Organizational Traits

Previously competitors were restricted in their ability to catch up to a company with a superior level of Interest Alignment Rents, as an inferior fit between firm Strategy and organizational contingencies (Structure, Norms & Values) limited the maximum level of Interest Alignment Rents they could generate...



...The ability to adjust organizational contingencies to increase their fit with firm strategy removes this barrier to higher Interest Alignment Rents. Companies then compete on the basis of a better (faster) ability to adjust organizational contingencies to their strategy.

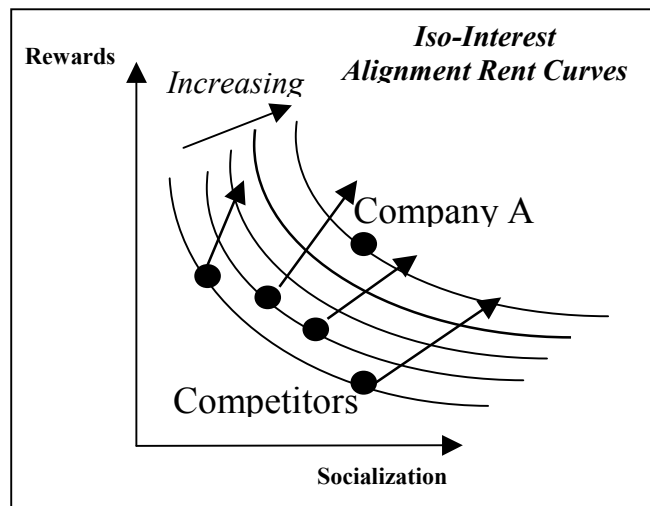


Table 1: Drivers of Motivation

Motivation Type	Underlying Goal	Relevant Characteristics of the Behavior	Moderator
Hedonic Intrinsic Motivation	Engaging in enjoyable, self-determined and competency-enhancing activity	(Perceived) Characteristics of the task and the task context	Utility derived from being engaged in enjoyable, self-determined and competency-enhancing activity
Normative Intrinsic Motivation	Compliance with organizational Norms & Values	Congruence of behavior with organizational Norms & Values	Identification of the individual with the organization, i.e. importance of compliance with organizational Norms & Values to the individual
Extrinsic motivation	Extrinsic Work Rewards	Extrinsic Work Rewards for a given behavior according to the Reward System	Utility derived from Extrinsic Work Rewards

Table 2: Characteristics of Determinants of Interest Alignment in different Scenarios

Scenario	Homogeneous stable Factors	Heterogeneous stable Factors	Variable Factors
1	Structure, Norms & Values, Firm Strategy	Reward System, Socialization Regime	-
2	Structure, Norms & Values, Firm Strategy	-	Reward System, Socialization Regime
3	Firm Strategy	Structure, Norms & Values	Reward System, Socialization Regime
4a	-	Structure, Norms & Values	Reward System, Socialization Regime, Firm Strategy
4b	-	Firm Strategy	Reward System, Socialization Regime, Structure, Norms & Values

Table 3: Conditions for Competitive Advantage and its Sustainability

	Homogeneous stable Factors	Heterogeneous stable Factors	Variable Factors	Source of CA	Condition for Sustainability	Rent Generation
1	Structure, Norms & Values, Firm Strategy	Reward System, Socialization Regime	-	Superior Configuration of Reward System and Socialization Regime	Unimitability and Non-Substitutability of superior configuration of RS and SR	Ricardian
2	Structure, Norms & Values, Firm Strategy	-	Reward System, Socialization Regime	Capability to better/faster improve the configuration of reward system and socialization regime	Superior learning capability to enhance ability to improve the configuration of RS and SR	Schumpeterian
3	Firm Strategy	Structure, Norms & Values	Reward System, Socialization Regime	Superior fit between Structure, Norms & Values and Firm Strategy	Unimitability and Non-Substitutability of superior fit between Structure, Norms & Values and Strategy	Ricardian
4a	-	Structure, Norms & Values	Reward System, Socialization Regime, Firm Strategy	Capability to assess the impact of environmental change and adjust firm strategy	Superior learning capability to enhance ability to assess the impact of environmental change and adjust firm strategy	Schumpeterian
4b	-	Firm Strategy	Reward System, Socialization Regime, Structure, Norms & Values	Capability to adapt Structure and Norms & Values	Superior learning capability to enhance ability to adapt Structure and Norms & Values	Schumpeterian

Table 4: Interest Alignment Capabilities

Competence	Dynamic Nature	Matching Definition of DC
Improving the configuration of reward system and socialization regime	Adjust stable patterns of activity that in turn influence the production of products and services	Zollo et al., 2002
Assessing the impact of environmental change on the optimality of competitive strategy and the determinants of interest alignment	React to environmental change	Eisenhardt et al., 2000
Adjusting firm strategy in response to both external and internal contingencies	Adjust stable patterns of activity that in turn influence the production of products and services	Zollo et al., 2002
Adapting organizational contingencies over time	Adjust stable patterns of activity that in turn influence the production of products and services	Zollo et al., 2002

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