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# The Diffusion of Human Resource Innovations: The Case of Flexible Benefits Plans

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**Abstract**

The purpose of this paper is to examine the implications of current theories for organizations' decisions about employee benefits. Drawing on organizational and economic theories, we offer alternative explanations for patterns in the adoption and design of flexible benefits plans. An integrated model of firms' flex plan decisions is presented.

This paper examines how current organizational and economic theories explain observed variation in the adoption and design of an innovative employee benefits practice. Specifically, we will offer alternative theoretical explanations of firms' decisions about flexible benefits plans, an increasingly popular type of plan that has been the subject of much debate and interest over the past decade (Meisenheimer & Wiatrowski, 1989). The focus is threefold: first, to generate theoretical explanations of observed patterns in the incidence and design of flex plans; second, to critically analyze the potential power of existing behavioral theories to explain or inform firms' decisions about employee benefits; and third, to develop complete models of these decisions by integrating the relevant axioms of the alternative theories.

### **Flexible Benefits Plans**

The introduction of flexibility into employee benefits by a handful of American firms in the 1970s represented a substantial departure from traditional practice. Whereas managers of traditional benefits plans made decisions about the type and level of benefits employees would receive, employees participating in flexible benefits plans were now allowed to make many of these decisions themselves. The incidence of these innovative plans among American firms was initially quite low, and it was not until the mid 1980s that they began to gain popularity. Survey evidence suggests that the incidence of flex varies across industries, with the highest rate occurring in the service industry (Hewitt, 1992). There is also evidence of considerable variation in the design of flex plans. Plans that simply give employees the opportunity to contribute pre-tax income to a flexible spending account for uncovered medical expenses, as well as those that allow employees to select from among multiple types and levels of benefits, are all considered to be flexible benefits plans.

The merits of flexible benefits plans were espoused over twenty years ago by Lawler (1971), who argued that allowing employees to fashion their own compensation packages heightens their awareness of benefits costs and ensures that they receive the benefits that they want. In this way, he wrote, flex plans increase the perceived value of employees' pay, and hence pay satisfaction. From an expectancy theory perspective, flex plans should therefore reduce turnover and enhance attraction, since they increase the perceived value to employees of working for the organization. This rationale has become even more compelling in recent years. Lawler (1981: 76) points out that the workforce has been changing in a number of ways (e.g., increasing heterogeneity, less acceptance of traditional authority, changing

family structures) that make flex plans attractive to a substantial portion of employees, and suggests that the plans "would seem to be potentially effective in most organizations."

Others have argued that flexible benefits plans can help firms contain health care costs (EBRI, 1991; Hewitt, 1991). Theoretically, cost containment is achieved by moving firms from a defined benefit (in which a certain level of coverage is promised, regardless of cost) to a defined contribution (in which a certain level of benefits expenditures is promised, regardless of the level of coverage the funds can purchase) arrangement. Further, advocates believe that the prices of options can be so structured as to encourage employees to move into more cost-effective health care plans.

It is not clear that employers have relied on the reasoning of Lawler (1971, 1981), or others who have written on the subject, when making decisions about flexible benefits plans. If carried to its logical conclusion, Lawler's pay satisfaction argument implies that any firms whose production costs are tied to their capacity to attract and retain qualified employees would have a strong reason to implement flex. Further, the workforce is becoming increasingly diverse, and the premiums for health insurance plans are escalating at a rate of 20%-25% per year (Woolsey, 1991). Yet twenty years after Lawler first made his argument, only 25%-30% of American firms now offer flex plans (EBRI, 1991).

The high costs of program design and implementation, paternalistic concerns about employees' capacity to make sound decisions, and actuarial concerns about disproportionate participation rates across options have been offered as reasons that many organizations have not implemented flex plans (Bloom & Trahan, 1986). Since some firms are deterred by these potential problems and others are not there must be other factors, factors specific to the organization, driving the decision to implement flexible benefits plans. Such factors may also influence program design.

To identify the factors that can help explain the patterns of decisions organizations have made about flexible benefits plans, we turn to the organizational and economic theories that have implications for the design of employee compensation systems. Many of these theories have been successfully applied in previous studies to explanations of organizations' pay practices. Eisenhardt (1988), for example, found that both the agency and institutional models did a good job of describing variation in the pay policies in effect for salespersons employed at retail stores. Similarly, Pfeffer and Davis-Blake (1987) used the resource dependence perspective to explain variation in the relative wages paid to six administrative jobs common to both private and public universities.

In this paper, we explore the implications of current organizational and economic theories for explanations of firms' decisions about flexible benefits plans, and assess where they overlap and/or conflict. Further, we identify what, if any, questions each of the theories does not address, and thus the extent to which multiple perspectives may be required to fully explain the phenomenon. In so doing, we hope to develop a clearer understanding of the insights these theories have to offer into how organizations make decisions about employee benefits, where they fall short and need to be developed, and where empirical investigations may be needed to test the efficacy of conflicting models. Thus, by examining current theories in the context of flexible benefits plans, we gain insights not only into the factors that may determine organizations' benefits decisions, but also into the strengths and weaknesses of the theories themselves.

### **Factors that Influence the Incidence and Design of Flexible Benefits Plans: Implications from Theory**

#### **Institutional Theory**

According to the institutional perspective, an organization's decision about an innovative administrative technology such as flexible benefits is influenced less by "efficiency" considerations than by environmental pressures to conform (Meyer & Rowan, 1977; DiMaggio & Powell, 1983; Zucker, 1987). Organizations will adopt an innovation, even if it is technically inefficient, in order to gain legitimacy, resources, and/or stability, and hence to ensure their survival (Meyer & Rowan, 1977). Thus, by following prevailing practice, an organization may enhance its effectiveness, but not necessarily by improving internal, "technical efficiency" (Meyer & Rowan, 1977; DiMaggio & Powell, 1983; Tolbert & Zucker, 1983). The perspective distinguishes between early adopters, who introduce an innovation based on its capacity to improve performance, and late adopters, who are more likely to behave according to prevailing practice (DiMaggio & Powell, 1983; Tolbert & Zucker, 1983). Tolbert and Zucker (1983), for example, found that performance-related factors could more effectively explain early than late adoption of civil service systems by city governments.

**Early adoption.** Organizational conditions in early adopters of flexible benefits plans should, according to the institutional perspective, have been such that the promised outcomes (enhanced benefits/pay satisfaction, cost containment) could be achieved by introducing these plans. It would therefore seem that the earliest adopters of flex would have had employees with a wide range of demographic characteristics, whose needs would be unlikely to be met by

a single benefits package. Flex plans would also be more likely to increase benefits satisfaction among firms whose employees were relatively well-educated if, as Lawler (1981: 219) has argued, increased levels of education in the workforce has led to less tolerance of "decision making based on traditional authority." to contrast, flexible benefits have in the past been viewed with disfavor by unions, suggesting that highly unionized firms would have been unlikely to propose such plans during the early years of implementation (Bloom & Trahan, 1986; EBRI, 1991).

Organizations that could expect to realize substantial cost savings would also have had performance-related reasons for implementing flex plans. Firms with generous benefits packages, including first-dollar medical insurance, for example, could theoretically contain the rising costs of benefits by moving from a defined benefit to a defined contribution arrangement. On the other hand, where the administrative costs of flex plans were high relative to the expected returns, firms would be logically reluctant to adopt them. Large firms, and/or firms with extensive data processing capabilities, for example, might have the capacity to implement and manage flex plans more efficiently than would smaller firms, particularly in the early years of adoption, when software packages simplifying program administration were not yet available (Lawler, 1981).

*Proposition 1: Decisions about implementing flexible benefits plans during the early years of adoption will be a function of organizational factors related to the plans' potential effectiveness (diversity and educational level of the workforce, degree of unionization, level of employer-provided benefits, firm size, data processing capacity).*

*Proposition 2: The explanatory power of performance-related factors will be greater during the early years of adoption than during the later years of adoption.*

Factors that potentially affected the design of initial flex programs would also be related to "efficiency" considerations during the early years of adoption. If the design of these and other HR programs is rationally driven by program objectives, then variation in the type of plan can be explained by variation in objectives. Thus, programs implemented primarily to meet the diverse benefits needs of a heterogeneous work force would be expected to offer multiple options, rather than just a stand-alone spending account. In contrast, programs aimed more at cost-containment should tend to have explicit incentives to reduce consumption of health care. These programs might be less likely to offer flexible spending accounts, since, by allowing employees to pay insurance premiums and uncovered medical expenses with pre-tax dollars, these accounts essentially reduce the cost to workers of medical care and hence their incentive to use it carefully. They will also be more likely to use credit-based systems (in which

employees are allocated a fixed amount of credits with which to buy benefits), since the advantages of opting down to less expensive insurance plans (and having more credits for other benefit options) are more visible (Hewitt, 1989).

*Proposition 3: Among firms that implemented flex plans during the early years of adoption, those that emphasized employee satisfaction as a primary objective will have the widest range of options, all else equal. Those that emphasized cost containment as a primary objective will be the least likely to offer flexible spending accounts and the most likely to use a credit-based system, all else equal.*

*Proposition 4: The strength of the relationships between plan objectives and plan design will be greater during the early than the later years of adoption.*

**Late adoption (mid-1980s to present).** Institutional theory suggests that prevailing normative pressures within a field lead to increasing homogeneity of organizational practices over time (DiMaggio & Powell, 1983; Tolbert & Zucker, 1983). This implies that firms' decisions about flex should be similar within an organizational field. Within a field, organizations' susceptibility to normative pressures to conform tends to vary, and other organizational characteristics are therefore needed to explain decisions about their structures (Zucker, 1987). Organizational uncertainty about goals or technologies, for example, theoretically causes some organizations to imitate the practices of other organizations that are perceived as successful (DiMaggio & Powell, 1983; Zucker, 1987). DiMaggio and Powell (1983) also argue that the professionalization of managerial staff reduces an organization's immunity to the influences of their institutional environments. Firms managed primarily by professionals, who may be heavily influenced by standard-setting academic institutions or professional networks, may tend to adopt the prevailing human resource practices in their field.

*Proposition 5: Within a field in which the portion of firms offering flexible benefits plans is high, those firms that are most susceptible to normative pressures to conform (because of uncertainty, professionalization) will be the most likely to adopt these plans, all else equal.*

*Proposition 6: Within a field in which the portion of firms offering flexible benefits plans is high, the probability that a firm will offer the flex plan feature(s) most commonly offered by other firms in the field will be positively related to their susceptibility to normative pressures to conform, all else equal.*

Institutional theory seems to imply that firms have been implementing flexible benefits plans in ever increasing numbers in recent years not because the plans will enhance firm performance, or efficiency, but simple because "everyone else is doing it." However, this reasoning seems to be based on a somewhat narrow focus on the efficiency of internal, or



technical operations - the performance of "core tasks" (Meyer & Rowan, 1977; DiMaggio & Powell, 1983; Zucker, 1987). Zucker (1987: 445), for example, argues that "efficiency and success do not necessarily covary in institutional theory: Organizational conformity to the institutional environment increases positive evaluation, resource flows, and therefore survival chances, *and reduces efficiency.*" If, on the other hand, efficiency is more broadly viewed in terms of the level of performance relative to the constraints in both the internal and external environments, then it would seem that increasing resource flows and survival chances would *increase efficiency.*

The application of institutional theory to explanations of patterns of organizational behavior is limited because of ambiguities in the definitions of key constructs. For example, the identification of an organization's relevant field, or institutional environment, can be quite difficult. DiMaggio and Powell (1983: 148) define organizational field as "those organizations that, in the aggregate, constitute a recognized area of institutional life: key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products." Perhaps due to the ambiguity of such terms as "key," or "similar," DiMaggio and Powell (1983: 148) argue that "the structure of an organizational field cannot be determined a priori but must be defined on the basis of empirical investigation." This suggests that institutional-based investigations of the determinants of flexible benefits plans cannot be carried out until all relevant organizational fields have been empirically delineated. Further, as Zucker (1987) points out, institutional forces can cut across fields, similar organizations can operate in very different fields, and fields can be differentiated by many factors, thus making it difficult to identify the relevant sources of influence on any particular organization.

The theory is also unclear about how to delineate where rational, efficient behavior ends and mimicry begins. How do we identify the point where an innovation has become institutionalized and firms' decisions about adopting it cease to be rational? Since 1981, when only 17 major U.S. employers offered a flexible benefits plan, almost 1400 more such plans have been implemented (Hewitt, 1992). Is this an indication that the plans have become legitimized, or is the fact that at least 70% of American firms have not implemented them an indication that this is still the early adoption stage?

### **Resource Dependence Theory**

Like the institutional perspective, the resource dependence perspective assumes that organizational actions and decisions are constrained by environmental conditions. Here, agents who control critical resources are assumed to exert influence over the organizations

that are dependent upon them (Pfeffer & Salancik, 1978). Thus, for example, an organization's decisions about employee compensation will be constrained to the extent to which its employees control critical resources such as skills, other employees, or capital assets (Bartol & Martin, 1988). Theoretically, firms will attempt to counteract their dependence on these employees by offering compensation packages which are high relative to their qualifications, thus making them dependent on the organization and increasing their motivation to use resources carefully.

The theory thus implies that firms with a high degree of resource dependency on their employees will be motivated to increase the value of their compensation packages relative to that offered by their competitors in the labor market. It has implications about the relative level of compensation, but the implications about the form of compensation are less clear. It seems unlikely that all employees would view the introduction of flexible benefits plans as again. Enrollment procedures can be confusing and time-consuming. Further, there is some evidence that acceptance of human resource innovations such as flex decreases with tenure (Kossek, 1989). Firms where the average tenure of employees is relatively high, therefore, might actually lower the perceived value of compensation packages by introducing flex. Resource dependence theory can therefore suggest the types of organizations that will be motivated to increase the value of their compensation packages, but not the types that are likely to accomplish this by implementing flex. Moreover, flex plans can theoretically achieve firm objectives other than increasing employee satisfaction. Cost containment, for example, is often a primary objective. Resource dependence theory offers no insights that could help identify those firms that would be likely to implement flex plans for reasons other than increasing the value of employee compensation.

The theory does, however, have implications for the design of flexible benefits plans. Since firms with a high level of dependence on employee resources will want to increase the perceived value of the compensation package, those that offer flex are likely to emphasize benefits satisfaction more than cost containment objectives. Because these firms are seeking to satisfy the benefits preferences of all of their employees, they might want to give employees a choice among several types and levels of benefits. Flexible spending accounts should also be incorporated into these plans, since they provide employees with the valuable opportunity to spend pre-tax dollars on uncovered medical and child care expenses.

Firms with relatively low levels of dependence on employees, on the other hand, are less likely to be concerned with raising the value of their compensation packages relative to

their competitors in the labor market. If these firms implement flexible benefits plans, then, plan design would more likely be driven by efficiency motives such as cost containment. The plans would be less likely to include flexible spending accounts, which theoretically provide incentives to increase medical care consumption (since they effectively lower the price of medical care), or a wide range of options that would be costly to manage.

Factors that are related to firms' dependency on employee resources include task uncertainty, task centrality, ease of observing and monitoring productivity, ease of replacing workers, and the extent to which specialized skills are required to achieve important tasks (Bartol & Martin, 1988). Firms in which the production technology is routine and requires unskilled labor inputs would experience less dependency on their employees than firms with significant research and development components, which depend on less readily observable and controllable creative skills related to product development. Additionally, it may be more difficult, and/or more costly, to monitor employee performance in large than in small firms.

*Proposition 7: Among firms with flexible benefits plans, those that have a high degree of dependence on employee resources will be more likely to offer flexible spending accounts and a full menu of options than will firms where the degree of dependence is low, all else equal.*

The resource dependence perspective also implies that organizations' actions may be subject to the influence of external organizations that control the flow of critical resources (Pfeffer & Salancik, 1978). Government agencies, for example, can impose restrictions on the compensation systems of organizations that have federal contracts. Organizational dependence on external resources can only explain decisions about a particular structure, however, if the organizations controlling these resources have an interest in promoting it. Currently, government funding is not tied to organizations' decisions about flex plans. Unions may control the supply of labor to some organizations, but since in recent years their power has been diminishing and their reaction to flex has been mixed, their explanatory power in this case is questionable (Hewitt, 1989; McCaffery, 1992). Thus, the resource dependence perspective can relate organizations' dependence on employee resources to their decisions about the design of flexible benefits plans, but it cannot explain their decisions about the adoption of these plans, nor can it relate dependence on external resources to these decisions.

### **Agency Theory**

The agency model of employment contracts is based on the premise that the interests of owners, or principals, will not always be the same as those of the agents, or employees, and

that compensation packages should be designed to motivate employees to act in the best interests of the principal (Ross, 1973; Jensen & Meckling, 1976). Without incentives employees have no reason to act in the best interests of the employer. The problem does not occur when employers have perfect information about employee effort, since they can easily identify and sanction inappropriate effort levels. Obtaining information about employee effort is not always possible, and in this situation employers must introduce incentives for workers to optimize their effort. It is this consideration, according to some theorists, that lead employers to pay "efficiency wages," that is wages that are above the market-clearing rate (Nalbantian, 1987; Stiglitz, 1987). By paying these high wages, employers create an incentive for employees not to shirk and risk losing their high-paying jobs.

Employers are more likely to offer efficient wages in situations where information about employee effort is difficult to obtain. Thus, task uncertainty, ease of monitoring productivity, and firm size will all affect the employer's need to increase the value of the compensation package. Small firms, and/or firms characterized by routine, assembly-line technologies are therefore the least likely to experience principal-agent problems.

The implications of this theory for the incidence of flexible benefits plans are quite similar to those drawn from a resource dependence perspective. Under both scenarios, some employers are induced to offer compensation packages of higher value relative to the market in order to motivate their employees to act on their behalf. As with the resource dependence theory, however, the agency model may be better at explaining decisions about the *level* of compensation than it is at explaining decisions about *form*.

The agency model may be more helpful in explaining decisions about the design of flexible benefits plans. Flex plans that emphasize employee benefits satisfaction as a primary objective should be more prevalent among organizations or industries in which information about employee effort is relatively difficult to obtain. Such firms would be more likely, for the reasons discussed above (under "Resource Dependence Theory") to offer "full flex" plans and flexible spending accounts. Where work effort is relatively easy to monitor, the primary flex plan objective is more likely to be cost containment. These plans would not be likely to include flexible spending accounts, or a wide range of options that are costly to administer.

*Proposition 8: Among firms with flexible benefits plans, those in which information about employee effort is relatively difficult to obtain will be more likely to offer flexible spending accounts and a full menu of options than will other types of firms, all else equal.*

## **The Transaction Cost Approach**

An economic approach to the study of organizations, this perspective assumes that decisions about structures are based primarily on efficiency considerations, and that efficiency is evaluated in terms of transaction costs (Williamson, 1981). Thus, organizations' decisions about structures for managing the employment relationship will be based on the characteristics of their human resource transactions that affect efficient operations. On this issue, Williamson (1981: 564) argues that the salient characteristics of an organization's "human assets" are: "(1) the degree to which they are firm-specific, and (2) the ease with which productivity can be metered." Where individuals' productivity levels are difficult to monitor, efficient governance structures would enhance employee motivation. Further, where critical skills specific to the firm are acquired primarily on the job, employers have a vested interest in protecting the employment relationship, since such skills are not easily replaced. In such firms, internal governance structures will be efficient if they stabilize employment. Benefits that accrue with seniority, for example, would discourage quitting (Williamson, 1981). Alternatively, compensation packages that exceed what employees could obtain elsewhere would also discourage quitting. The perspective therefore offers an explanation for organizations' decisions about the level of overall compensation, but, like the resource dependence and agency models, it is less helpful in explaining decisions about whether or not to include flex as part of the package. Among those firms that have implemented flex plans, however, the perspective may be more helpful in explaining plan design.

Since organizations' decisions about structures is assumed to be driven by efficiency considerations, it follows that the design of flexible benefits plans will be goal-related. Organizations that rely heavily on skills acquired on the job tend to establish structures that protect the continuity of employment, according to this perspective, and it is therefore likely that compensation/benefits satisfaction would be a human resource goal at these firms. If, as we have argued above, flexible benefits plans that offer a wide range of options are most likely to meet the benefits needs of all employees, then when such organizations implement flex plans they are likely to include a full menu of benefits. More so than the resource dependence and agency models, however, the transaction cost perspective implies some upper bounds on this trend. The focus is on economizing, and if administrative costs increase with the number of options, then a threshold may be reached beyond which the costs outweigh the returns. In general, however, organizations that rely on firm-specific skills should tend to offer a wider range of benefits options than those that rely on general skills. Where human assets are

nonspecific, organizations should tend to be less concerned about maintaining the employment relationship and will be more likely to implement flex plans for cost containment purposes.

*Proposition 9: Among firms with flexible benefits plans, those that rely heavily on skills acquired on the job will be more likely to offer a full menu of options and flexible spending accounts than will firms that rely on nonspecific skills, all else equal.*

The explanatory power of this model depends on the extent to which firms' human assets can be identified as either firm-specific or general. It seems likely, however, that a good number of firms will have a mixture of both. Custodial staff, typists, freight loaders and the like, who do not require firm-specific training, may work in the same firm with accountants, managers, and executives, who cannot perform their jobs effectively without specific knowledge of organizational operations. Thus, it may be difficult to classify firms into distinct categories that can be used to explain variation in their decisions about compensation structures. The theory would perhaps have more explanatory power if other factors that could potentially affect the costs of human asset transactions were considered. The resource dependence perspective suggests, for example, that the ease of replacing certain employees affects the costs to the organization of losing them.

### **An Integrated Approach to Explaining Firms' Decisions about Flexible Benefits**

While explanations of organizations' decisions about flexible benefits plans can be derived from a number of different organizational and economic theories, there is considerable overlap and conflict. The implications of the resource dependence, agency and transaction cost models are quite similar. All suggest that organizational performance can depend on motivating important employee behaviors, and, while they are not in complete agreement on the indicators of the extent of this constraint, all suggest that the ease of monitoring work effort is important. On the other hand, the various theories disagree on the extent to which organizations' decisions are influenced by external versus internal conditions. The institutional perspective focuses on normative pressures in the external environment. In contrast, the resource dependence, agency and transaction cost perspectives all assume that internal conditions affecting contingencies in employment relationships (such as the nature of the task, skill requirements, ease of monitoring productivity) determine how an organization will structure its compensation package. The resource dependence perspective also considers the influence of external forces (such as labor market conditions affecting the ease of replacing workers),

since an organization may depend on resources controlled by other individuals or organizations.

Assumptions about the determinants of organizations' decisions about practices such as flexible benefits vary widely across models. There seem to be two conflicting themes: the decisions are rationally related to the requirements of the work environment; or organizations base their decisions on what others are doing, regardless of the effects on firm performance. Consistent with the first theme, the resource dependence, agency and transaction cost perspectives all imply that organizations can improve productivity by adopting practices that will motivate employees' work behaviors. Explanations of firms' decisions about flexible benefits plans thus require an examination of the factors related to the extent of organizational reliance on, and control over, these important behaviors. In contrast, the institutional perspective implies that organizations are less concerned with improving technical efficiency than with reaching an accommodation with their environments. This theory suggests that an organization's "field," as well as factors related to pressures to conform and organizations' immunities to these pressures, can help explain decisions about flex plans.

None of the theories seem to offer a complete explanation of firms' decisions about flexible benefits plans. Application of the institutional model may be difficult because an organization's "field" is not easily identified, and because the criteria are unclear for determining when institutional forces begin to exert more influence than rational, performance-related considerations. The resource dependence, agency, and transaction cost perspectives seem to be more helpful in explaining the design than the incidence of flex plans, and each seems to focus narrowly on a few aspects of the employment relationship.

The conflicts, overlaps and limitations inherent in current organizational and economic theories as applied to benefits issues are substantial. This may not be unique to benefits issues. There is a growing recognition that no single theory is capable of explaining organizational phenomena and that full explanations can only be derived by considering the views of diverse theoretical perspectives (Abrahamson, 1991; Hall, 1991). Accordingly, we propose a model for explaining firms' decisions about flexible benefits plans that integrate the axioms of the theories discussed above.

### **The Model**

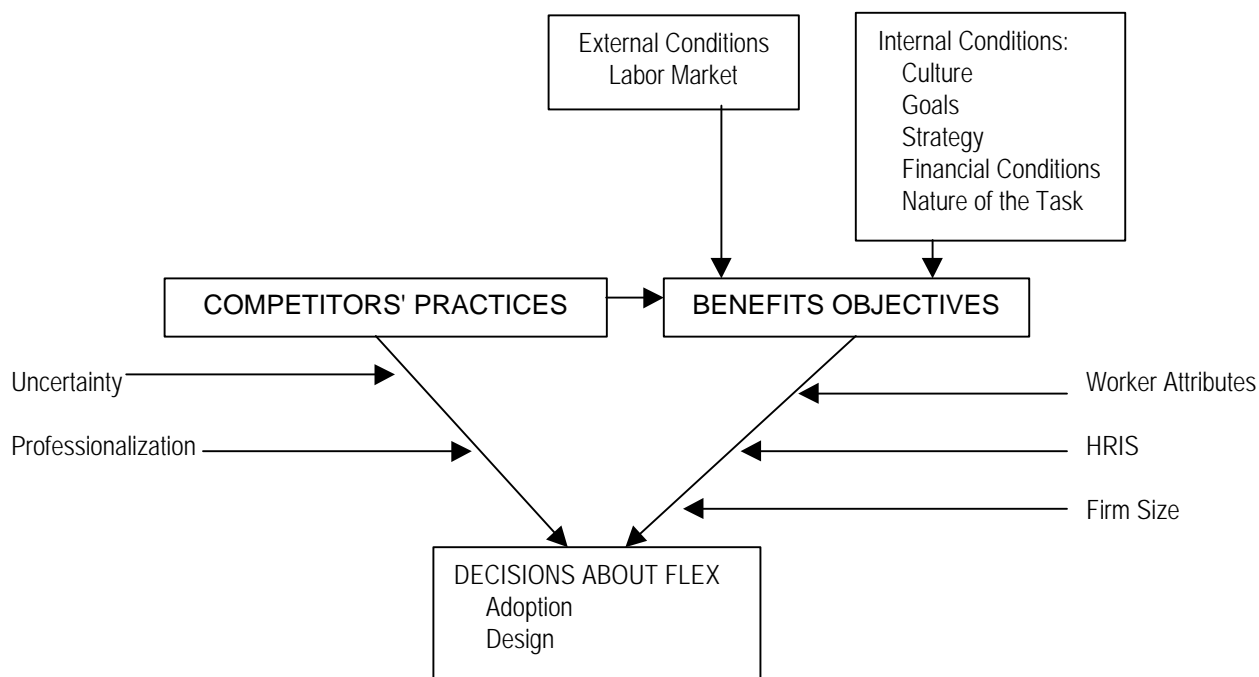
We begin with the premise that organizational decisions are constrained by multiple forces in the internal and external environments. Further, we assume that the implications of each of the perspectives for firms' decisions about flexible benefits plans are valid and should

be incorporated into the explanatory model. One difficulty in achieving this is the apparent fundamental difference in the assumptions underlying the institutional and other perspectives regarding the "rationality" of organizational decision-making. However, as Eisenhardt (1988) points out, the theories may offer complementary explanations of structures. This is because "efficiency" theories such as agency theory yield "several patterns of structures and processes [that] are equally viable" and the institutional model may be required to help explain which one is selected by the organization (Eisenhardt, 1988: 505). Further, as we noted earlier, organizations' tendency to mimic the prevailing practices in their field may also be viewed as a rational response to external constraints if, as the institutional theorists suggest, such conformity can help them gain the legitimacy and resources necessary to their survival (Meyer and Rowan, 1977). Hence, while the model assumes that "technical" efficiency does not drive organizational decision-making, it also acknowledges that other, equally legitimate, goals do.

Figure 1 depicts a proposed model of firms' decisions about flexible benefits plans. As the model indicates, there are two primary factors that are posited to have a direct effect on these decisions: the firm's benefits objectives and prevailing benefits practices among the firm's competitors. The inclusion of competitors' benefits practices is clearly implied by the institutional model, which suggests that organizational structures will tend to conform to prevailing practice in the field. We include benefits objectives for a number of reasons: first, the institutional model implies that where normative pressures to conform are weak, decisions about organizational structures will be related to factors associated with their potential effectiveness (at, in this case, achieving the promised outcomes of benefits satisfaction and/or cost containment). Second, Lawler (1971; 1981) has effectively argued that meeting compensation satisfaction objectives is a powerful rationale for implementing flex. Finally, firms have consistently pointed to objectives such as satisfaction and cost containment when they have been asked to explain their decisions about flex (EBRI, 1991; Hewitt, 1991).



Figure 1: Organizations' Decisions About the Adoption and Design of Flexible Benefits Plans



The strength and direction of the effects of these factors will depend on a number of factors: The institutional model suggests that a firm's susceptibility to normative pressures to conform to prevailing benefits practices will vary according to the level of uncertainty (about technology and goals) and the professionalization of management staff. Further, we suggested earlier that the effect of benefits objectives on decisions about flex will depend on such factors as the education, preferences, and demographic diversity of the workforce. Where benefits satisfaction is the objective, for example, flex plans will be most effective if the workforce is diverse and well-educated. Similarly, cost containment objectives are less likely to be achieved by the adoption of flex among small firms, and/or firms with a limited information system.

Decisions about flex plans are also affected, indirectly, by factors that affect the firm's benefits objectives. These include external conditions, such as labor market conditions, which affect the ease of replacing workers (resource dependence model); and internal conditions, such as the nature of the task, which affects the ease of monitoring productivity and skill requirements (resource dependence, agency, and transaction cost models). Obviously, benefits objectives will also be determined by the firm's culture, strategy, goals, and financial conditions. Finally, competitors' practices are also expected to affect these objectives.

## **Conclusions**

The model described above represents an initial attempt at integrating the implications of current theories for firms' decisions about benefits plans. Empirical tests of this model will provide information about its capacity to explain such decisions. By conducting such research in the context of flexible benefits plans, knowledge is also gained about a proliferating, but inadequately studied, human resource practice.

It should be noted that many of the explanatory variables implied by the theories we have discussed may be endogenous in models of organizational structures, and caution is therefore required when estimating these models. The institutional model, for example, implies that workforce diversity is a determinant of early decisions to implement flex plans. However, it may also be true that the presence of flex plans is a causal factor influencing the diversity of the workers who seek employment at an organization. Similarly, the resource dependence, agency and transaction cost models all suggest that inadequate information about work effort will cause organizations to increase the value of their compensation packages. At the same time, the level of overall compensation may influence employees' willingness to share information about their work effort. Thus, decisions about flex plans are affected by the extent of information asymmetry, which is in turn affected by the presence of flex plans. Empirically sound tests of these models may therefore require the estimation of simultaneous equations.

Flexible benefits plans provide a good context for testing the explanatory power of the theories discussed in this paper. Hypotheses about the determinants of these plans can be derived, although not necessarily distinguished, from all of the models. Further, as the diversity of the workforce and the costs of health insurance have increased, interest in flexible benefits plans has increased considerably, and it therefore seems likely that decisions about the plans have been made by a substantial portion of American firms (Meisenheimer & Wiatrowski, 1989).

There are nevertheless some potential barriers to studying the determinants of flexible benefits plans. First, the data requirements will be extensive, since numerous variables are implied by the theories and a large sample size may be required to obtain the variance necessary for efficient model estimation. Moreover, tests of hypotheses regarding organizations' decisions to implement a flex plan will require data from both adopters and non-adopters. Secondly, obtaining this data may prove difficult, since some of it may be considered proprietary, and not all of it will be documented in existing information systems.

There are a number of potential sources for the data needed to study flexible benefits plans. The primary source of information, of course, is the organizations that are making the decisions being examined. Alternatively, federal agencies, such as the Bureau of Labor Statistics and the Pension and Welfare Benefit Administration, maintain data on organizations' benefits practices. Surveys are also conducted by consulting firms, who in addition may have consolidated data bases covering their benefits consulting clients. While we recognize that much of this information is privileged and proprietary, and these organizations may therefore be reluctant to release it, there is ample reason to believe that the economic and demographic conditions in recent years have generated considerable interest in developing knowledge of benefits practices such as flex plans.

Employee benefits have been inadequately researched in the field of human resource management, and there are clearly other phenomena besides flex plans that merit attention. The theories discussed in this paper can also be applied to other innovations in benefits practice, for example managed care, dependent care, employee assistance programs, etc. Organizations' decisions about the level of benefits to provide their employees may also be explained using these theories. The resource dependence, agency, and transaction cost perspectives, for example, all have implications for decisions about levels of compensation. The need for research on these and other benefits issues is substantial.

We have demonstrated that organizational and economic theories have implications for benefits design issues. It is not yet clear how well these theories can actually help explain or inform organizations' decisions about benefits. We suggest that their capacity to explain these decisions can be empirically tested in the context of flexible benefits plans. Results of these investigations may help move toward the development of a multi-theory of benefits.

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