SHORT NOTE

Reward allocation decisions of Chinese managers: Influence of employee categorization and allocation context

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The purpose of the present study was to investigate the relationships between employee categorization criteria and Chinese managers' allocation behaviors. Using a vignette approach and a four-factor within-subjects design, the effects of relationship (guanxi), loyalty, and competence, as well as their interactions with allocation context (private *vs* public) were examined. Results showed that subordinates who had a close relationship with the allocator, high loyalty, or high competence were rewarded more. Significant two-way interaction effects indicated that relationship, loyalty and competence interactively affected Chinese managers' reward allocation decisions. In addition, the moderating effects of allocation context on these three criteria were also significant. Limitations of the study and suggestions for further research were discussed.

Key words: allocation context, competence, employee categorization, loyalty, relationship (guanxi), reward allocation.

Introduction

Reward allocation is an important organizational issue, as it affects employees' working attitudes and organizational efficiency (Mahoney, 1978; Freedman & Montanari, 1980). Past research on reward allocation has found that reward allocators are concerned about fairness and make decisions on the basis of recipients' inputs and performance (Carrell & Dittrich, 1978; Kiker & Motowidlo, 1999). In addition, the relationships between allocators and recipients – such as family ties, friendship, social distance, and attitude similarity – also influence reward allocation decisions (Shapiro, 1975; Zhou & Martocchio, 2001).

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In considering how corporate managers efficiently allocate rewards to their subordinates, researchers in the field of leader-member exchange theory have demonstrated that, given time and effort constraints, leaders differentiate subordinates into in-group and out-group members, and reward subordinates differentially (Graen & Cashman, 1975; Cheng, 1995). As the management style of leaders of Chinese organizations differs from that in the West (Redding, 1990; Cheng, 1993, 1995; Westwood, 1997; Yang *et al.*, 2003), some Chinese researchers have studied how Chinese managers categorize their subordinates and allocate rewards. After extensive research on a Chinese family business in Taiwan, Cheng (1995) proposed a cognitive model of employee categorization. This model identifies the key criteria that Chinese managers adopt to categorize their employees and the ways they interact with different types of subordinates. Cheng argued that Chinese corporate managers categorize their subordinates according to three criteria: relationship (*guanxi*), loyalty, and competence. Based on Cheng's model, some researches have investigated the influence of this categorization on managerial behaviors (Hsu *et al.*, 2003), but until now no study has explored the issue of how the categorization is related to reward allocation. The present study investigated the influence of Cheng's three categorization criteria on Chinese managers' reward allocation decisions, and the interaction of these criteria with the allocation context (private *vs* public) for a more comprehensive understanding of Chinese managers' allocation behaviors.

Employee categorization and differential management within Chinese organizations

Several studies have shown that Chinese management style is strongly influenced by Chinese culture (notably Confucianism) and is very different from Western styles of management (Redding, 1990; Whitley, 1992; Cheng, 1995; Cheng & Liu, 1995; Westwood, 1997). Following his long study in Taiwan, Cheng (1995) proposed a cognitive model of Chinese employee categorization, which identified three categorization criteria as below:

Relationship (Guanxi). Given the emphasis on 'relationalism' in Chinese societies (Chen, 1986; Hwang, 1988, 1995; Fei, 1992; Yang K.S., 1993; Yang C.F., 1999). Cheng showed that corporate leaders treat their employees according to the type of relationship (*guanxi*) that exists between them. Leaders tend to offer preferential treatment to those employees related to them by blood or marriage, and to some non-relatives who are social acquaintances (Cheng, 1995).

Loyalty. Research has shown that Chinese corporate leaders demand their employees to show loyalty to them and the organization without reservation. Loyalty is used as an informal control in Chinese organizations (Silin, 1976). According to Cheng (1995), loyalty means that personal obedience to a father figure is of greater significance than loyalty to the organization. Loyal behaviors include a strong sense of responsibility, making sacrifices for the leader, and complete identification with him/her (Cheng & Jiang, 2001).

Competence. To achieve organizational goals, high-quality human resources are important. For corporate managers, capable employees are those who are competent in completing their assignments (Kiker & Motowidlo, 1999; Zhou & Martocchio, 2001). Cheng (1995) argued that managers assess their subordinates' competence by observing the quality of their work and performance, gradually forming a judgment of their overall level of competence, and then categorizing them accordingly.

Employee categorization and reward allocation decisions

As Chinese corporate managers categorize their subordinates based on relationship, loyalty, and competence, their interactions with different categories of subordinates vary. When subordinates have a close relationship with superiors, a high degree of loyalty, and the capability to make value-added contributions to the organization, their managers will more likely treat them as insiders. In contrast, subordinates who have distant relationships with their managers, a low degree of loyalty, and low performance will likely be treated as outsiders (Cheng, 1995). Prior research has found that managers provide insiders with a greater number of rewards (Zhou & Martocchio, 2001), as well as more support and tangible care than outsiders (Farh & Cheng, 2000; Hsu *et al.*, 2003).

We posit that the three categorization criteria identified in previous research have a direct influence on Chinese corporate managers' reward allocation decisions. Subordinates perceived as having a close relationship, high loyalty, and good competence will likely be categorized as insiders and allocated more reward by their managers.

H1: Relationship, loyalty, and competence will each have a significant effect on the allocation decisions of Chinese managers. Compared to subordinates with distant relationships, low loyalty, or low competence, Chinese managers will allocate a larger percentage of a reward to subordinates with a close relationship, high loyalty, or high competence.

Given that a well-informed manager should be able to assess an employee's relationship, loyalty and competence simultaneously, these three criteria might have interactive effects on the manager's reward allocation decisions. Cheng (1995) suggested that managers are able to differentiate eight types of subordinates based on these three categorization criteria. In fact, a recent study on Chinese employee categorization showed interactive effects of these three criteria on managerial behaviors (Hsu *et al.*, 2003). For instance, relationship and loyalty interact to affect leaders' positive management behaviors such as information sharing, participation and trust. When considering the competence of relatives and non-relatives, the leader favors family members, despite that they may be less competent than non-family members. Moreover, the interactions of loyalty with competence show a significant effect on sharing, participation, and confidant (*chin-shin*) relationships.

It is necessary to examine the interactions among these three categorization criteria with respect to reward allocation. In particular, when the subordinate is close and loyal to the manager, the dyad can be very intimate, resulting in strong attachment to each other (Hsu *et al.*, 2003). In accordance with the five Chinese virtues (*wu-lun*), high-level people must take care of those who are close and faithful to them (Yang K.S., 1993). Hence, managers are expected to allocate more reward to those subordinates who are close and faithful. In other words, for subordinates who are closer to the allocator, the reward for loyalty is likely to be higher than for subordinates who are more distant from the distributor. The interaction of relationship with loyalty will influence managers' reward allocation decisions.

By the same token, when subordinates are close to the manager and highly competent, they can gain a higher level of trust both affectively and cognitively (McAllister, 1995), and may become the manager's most important assistants (Hsu *et al.*, 2003). In this case, the manager will allocate more reward to this type of subordinate. In contrast, if subordinates are competent, but are distant from the manager, less important tasks might be assigned to them than to those who are competent but are close to the manager. Therefore, if the relationship between a manager and subordinate is distant, competence will not influence the reward

allocation as much as if the relationship is close. Thus, we expect an interaction effect between relationship and competence on managers' reward allocation decisions.

As the degree of loyalty is decided by an individual's own personal will, a loyal and competent subordinate is considered to be an invaluable asset to the manager. Chi and Lin (1994) reported that subordinates' loyalty and instrumental value are two key factors to the formation of a confident relationship. We expect that a subordinate who is loyal and competent will be most rewarded. That is, loyalty will affect reward allocation more strongly when subordinates are highly competent than incompetent. The above reasoning is represented in the following hypotheses:

H2: Relationship, loyalty and competence will interactively affect managers' reward allocation decisions.

H2a: The interaction effect of relationship with loyalty will be significant such that the positive effect of relationship (*guanxi*) on reward allocation is stronger for loyal than for less loyal subordinates.

H2b: The interaction effect of relationship with competence will be significant such that the positive effect of relationship (*guanxi*) on reward allocation is stronger for competent than for incompetent subordinates.

H2c: The interaction effect of loyalty with competence will be significant such that the positive effect of loyalty on reward allocation will be stronger for competent than for incompetent subordinates.

Employee categorization, allocation context and reward allocation decisions

Fairness is important in the reward allocation process (Adams, 1965; Leventhal & Michaeles, 1969; Walster *et al.*, 1973) and to retain good employees in the organization, managers must be concerned about fairness and appropriately reward those who deserve it.

Past research has revealed that a confidential pay policy affects individuals' reward allocation behaviors. For example, in a public allocation context, the allocator is more likely to follow social norms and makes decisions based on the subordinate's performance. However, if the organization adopts a confidential pay policy, the reward allocator is less likely to follow the principle of fairness (Freedman & Montanari, 1980). Leung and Bond (1984) found that when social pressure is removed from the allocation context, allocators become more self-serving. It is possible that in public, the allocator tends to give less reward to in-group members than in private. Following Leung and Bond, it is reasonable to predict that the allocation context (private or public) influences the effects of the three employee categorization criteria on reward allocation decisions. That is, the positive effects of relationship, loyalty, and competence on reward allocation are reduced in a public allocation context.

H3: The effects of relationship, loyalty, and competence will be moderated by the reward allocation context. Compared to a public context, the effects of relationship, loyalty, or competence on the reward allocation decision will be greater in a private context.

Method

Participants

Two hundred and eighty-seven managers from 70 companies in Taiwan participated in this study. Males accounted for 64% of the respondents, with 52% from the age group 36–45 years. In terms of educational background, 67% had an undergraduate or graduate education. Regarding seniority, 46% had over 9 years of experience. The proportion of junior, middle, and senior managers was about the same.

Research design and process

The research was conducted in the form of a scenario experiment. Hammond's (1955) policy capturing approach was adopted, in which experimenters present stimulus materials (profiles with various levels) to participants and request them to provide judgment on each of the profiles. In this study, eight employee profiles were designed based on the three criteria: relationship (close *vs* distant), loyalty (high *vs* low), and competence (high *vs* low). Each profile represented a combination of one level of each of the three criteria, and the order of the eight profiles was randomly arranged to minimize any possible ordering effect.

After reading an introduction about each profile, the participants were told to assume themselves as the sales manager of a team of employees. After having achieved their sales goals, the sales manager needed to distribute a bonus to the eight employees. In the profile, it was also stated that the employees put in the same number of work hours. Each participant must decide the percentage of the bonus (the maximum allocation is 100%) given to each employee in a private (each employee does not know the others' share) and in a public (each employee knows the others' share) context. Three items were used to manipulate the three criteria: 'I have a close relationship with the subordinate' (relationship), 'The subordinate is faithful to me' (loyalty), and 'The subordinate has the capability to accomplish assignments' (competence). Participants answered these questions for each of the eight staff on five-point Likert scales. The study used a $2 \times 2 \times 2 \times 2$ complete within-subjects design, with three independent variables (relationship, loyalty, and competence) and a moderator variable (reward allocation context).

Results

Manipulation checks

The *t*-test was used to check the effectiveness of the manipulations. Results showed that the difference between close and distant relationships was significant ($t = 21.07$, $p < 0.01$, $M_{close} = 3.33$, $SD = 0.98$; $M_{distant} = 2.22$, $SD = 0.8$). The difference between high and low loyalty ($t = 30.89$, $p < 0.01$, $M_{high} = 3.69$, $SD = 0.91$; $M_{low} = 2.21$, $SD = 0.79$), and between high and low competence ($t = 47.73$, $p < 0.01$, $M_{high} = 4.41$, $SD = 0.67$; $M_{low} = 2.00$, $SD = 0.72$) was also significant.

Effects of employee categorization and reward allocation decisions

Means and standard deviations are presented in Table 1. With respect to the reward percentage for each employee, results showed a consistent order ($A > E > C > G > B > F > D > H$) under both allocation contexts. The results also indicated that the reward percentage for competent subordinates was higher than the overall mean (12.5%), regardless of the employee's relationship with or loyalty to the allocator. In contrast, the percentage for incompetent subordinates was lower than the overall mean. However, relationship and loyalty did not show such a pattern. The results showed that relationship, loyalty, and competence had distinguishable effects on reward allocation decisions.

Because this research used a four-factor complete within-subjects design, general linear model (GLM) with repeated measures was used to test the hypotheses. The correlation results show that three demographic variables, including education, position, and seniority was significantly related to the reward percentage ($p < 0.01$). However, these three variables were analyzed as between-subject variables rather than covariates because they significantly interacted with the independent variables, which mean that the assumption of within-regression coefficients was violated (Wildt & Olli, 1978). The results showed that the main effects of relationship, loyalty, and competence were all significant. (Table 2, relationship: $F_{1,273} = 59.73$, $p < 0.001$, $\eta^2 = 0.18$; loyalty: $F_{1,273} = 169.44$, $p < 0.001$, $\eta^2 = 0.38$; competence: $F_{1,273} = 322.31$, $p < 0.001$, $\eta^2 = 0.54$). It appears that allocators accorded a higher percentage to subordinates with a close relationship, high loyalty, and high competence. H1 was fully supported.

The two-way interactions were also significant, and the patterns of these interactions were as predicted (Figure 1). First, regarding the interaction effect between relationship and loyalty ($F_{1,273} = 7.89$, $p < 0.001$, $\eta^2 = 0.03$), results showed that the allocator's reward decisions varied according to the distance of the relationship with the subordinate and the degree of the subordinate's loyalty. The influence of loyalty on the reward allocation was stronger if the relationship was close, meaning that the difference in reward allocation between the 'close' and 'high loyalty' condition ($M = 15.97$) and the 'close' and 'low loyalty' conditions ($M = 10.78$) was larger than the difference between the 'distant' and 'high loyalty' condition ($M = 13.63$) and the 'distant' and 'low loyalty' condition ($M = 9.62$). H2a was supported.

The interaction between relationship and competence was significant ($F_{1,273} = 32.40$, $p < 0.001$, $\eta^2 = 0.11$), suggesting that the effect of competence on reward allocation varied according to the relationship between subordinates and allocators. The difference in the reward percentage between the 'close' and 'high' condition ($M = 19.12$) and the 'close' and 'low' condition ($M = 7.63$) was larger than the difference between the 'distant' and 'high' condition ($M = 16.60$) and the 'distant' and 'low' condition ($M = 6.66$). This result showed that the additive effect of competence on reward allocation was stronger when the relationship was closer. H2b was supported.

Finally, the interaction between loyalty and competence was also significant, $F_{1,273} = 66.94$, $p < 0.001$, $\eta^2 = 0.20$. The influence of loyalty on the reward percentage varied according to competence. When the subordinate was loyal and competent, the percentage of the reward allocated was greater, suggesting that the effect of competence was stronger when loyalty was high. The difference in the reward percentage between the 'high loyalty' and 'high competence' condition and the 'high loyalty' and 'low competence' condition (12.54) was larger than the difference between the 'low loyalty' and 'high competence' condition and the 'low loyalty' and 'low competence' condition (8.90). H2c was supported.

Table 1 Means and standard deviations of employee categorization criteria and allocation context

Criteria		Relationship close				Relationship distant			
		High loyalty		Low loyalty		High loyalty		Low loyalty	
Context		Excellent competence *A*	Poor competence *B*	Excellent competence *C*	Poor competence *D*	Excellent competence *E*	Poor competence *F*	Excellent competence *G*	Poor competence *H*
Public	*M*	21.97	8.96	15.02	6.82	18.74	8.49	14.14	5.86
	SD	(7.98)	(3.64)	(3.58)	(4.05)	(5.35)	(3.68)	(3.58)	(3.94)
Private	*M*	24.23	8.72	15.27	6.02	19.34	7.95	14.16	4.33
	SD	(9.38)	(3.93)	(4.04)	(4.03)	(5.54)	(3.75)	(3.92)	(3.74)

Sample size of each cell is 287.

Table 2 Results of repeated measures general linear model (GLM) involving relationship, loyalty, competence and allocation context

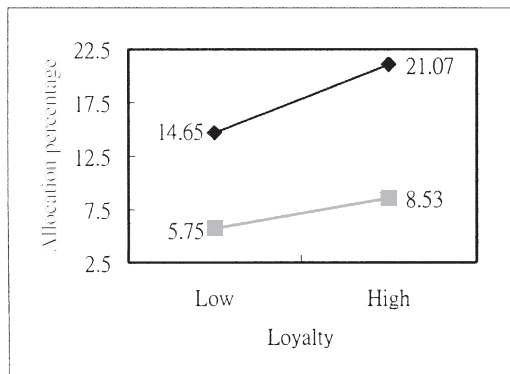|	Reward allocation	
Variable	F	η^2
Relationship (A)	59.73**	0.18
Loyalty (B)	169.44**	0.38
Competence (C)	322.31**	0.54
A × B	7.89**	0.03
A × C	32.40**	0.11
B × C	66.94**	0.20
Allocation context (private/public) (D)	0.41	0.00
A × D	4.17*	0.02
B × D	10.52**	0.04
C × D	41.40**	0.13

*$p < 0.05$; **$p < 0.001$.

Figure 1 Interactive effect of loyalty and competence on reward allocation. ◆, Excellent; ■, poor

Employee categorization, allocation context and reward allocation decisions

We now examined the effects of allocation context (private or public) on reward decisions. Results showed that allocation context (private/public) significantly moderated the effects of relationship, loyalty, and competence (relationship × context: ($F_{1,273} = 4.17$, $p < 0.05$, $\eta^2 = 0.015$; loyalty × context: $F_{1,273} = 10.515$, $p < 0.001$, $\eta^2 = 0.037$; competence × context: $F_{1,273} = 41.40$, $p < 0.001$, $\eta^2 = 0.13$; Figure 2). These results suggest that in different allocation contexts, allocators used different ways to allocate rewards depending on the level of relationship, loyalty and competence.

In the private context, the difference between close and distant relationships was larger than in the public context (difference in private = 2.12; difference in public = 1.38). Similarly,
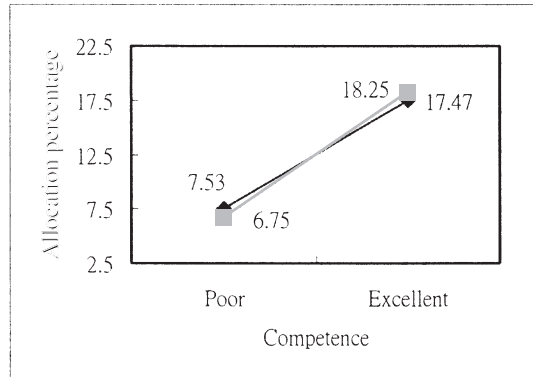
Figure 2 Interaction of competence and allocation context on reward allocation.
◆, Public; ■, private

subordinates with high loyalty were allocated a higher percentage of the reward in the private than in public context (difference in private = 5.12; difference in public = 4.10). As for competence, the difference between the competent and incompetent subordinates was larger in private than in public (difference in private = 11.50; difference in public = 9.94). H3 was fully supported.

Discussion

The present study investigated the relationships between employee categorization and reward allocation decisions among Chinese managers with a vignette approach. In general, the results supported Cheng's proposition that managers treat subordinates according to their relationship, loyalty, and competence. Despite subordinates having worked the same number of hours, managers allocated a higher percentage of the reward to those subordinates with whom they had a closer relationship and who were loyal and competent. These results support the argument that corporate managers do care more about their in-group subordinates.

The results also revealed that among the three categorization criteria, the effect of competence on reward allocation was significant and consistent. No matter whether the subordinate was close or distant, of high or low loyalty, as long as the employee was competent, the reward allocated was higher than the overall mean. The effect size of competence was also the highest among the three criteria. This finding is consistent with Zhou and Martocchio's (2001) research and confirms that competence is the most important criterion in Chinese managers' reward allocation decisions.

Although the LMX theory and Cheng's employee categorization model both suggest some criteria that leaders use for employee categorization, they do not provide any insight about the interactions among those criteria. This study sought to fill this gap and found that the three criteria did interact with each other to affect reward allocation decisions. In addition, the results confirmed the significance of allocation context for the effects of the three categorization criteria. Compared to the private context, the tendency of the managers to favor in-group subordinates decreased in the public context. Correspondingly, the effects of relationship, loyalty, and competence on reward allocation were reduced. In contrast, when

the allocation context was private, and the concern of fairness and the pressure of social evaluation were minimized, managers allocated more reward to insiders (those of close relationship, high loyalty, or high competence).

The present results make two contributions to organizational behavior research. First, prior research has never examined the interactions between relationship, loyalty and competence on reward allocation, and the present study is a pioneer in this line of enquiry. Second, some researchers have claimed that allocation context is a very important issue for reward allocation (Mikula, 1980), but very few studies have examined its effects. This research represents the first attempt to examine the joint effects of allocation context and categorization criteria on reward allocation decisions in Chinese culture.

In spite of the fact that all participants in this study were from Taiwan, many researchers may agree that Chinese enterprises in China, Hong Kong, and South-East Asia have similar cultural roots and managerial characteristics, such as relationship orientation, paternalistic leadership, personalism, and role obligations (Redding, 1990; Chen, 1996). These similarities suggest that the present findings may be applicable to these cultural contexts as well, which is an interesting topic for further investigation.

The present results also suggest other issues for further investigation. An obvious question is that when managers categorize their employees and treat them differentially, what effect does it have within the organization? Does it affect organizational justice and team cohesion? In addition, future research could compare the influence of the categorization criteria derived from Cheng's model with the standards proposed by leader-member exchange theory, which may provide a more complete understanding of reward allocation behaviors of managers.

Finally, there are some limitations in this research. First, although this research found that managers focused more on competence when allocating rewards, this result could have been produced by contextualizing the study in a sales department, which is likely to be very performance oriented. Second, some may argue that relationship might affect participants' interpretation of loyalty. That is, a close relationship plus high loyalty seems more like real loyalty, whereas it is hard to imagine that a distant relationship may involve a high degree of loyalty. Perhaps, relationship and loyalty cannot be decomposed mechanically as in the case of the present study. Finally, the demand characteristic as a result of the within-subject design might pose a threat to the validity of the results. The four-factor within-subjects design might have sensitized the participants to the research hypotheses and led them to provide responses that they thought were appropriate.

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Appendix

Sales Rep. A is closely related to you and you are very familiar with each other. He has strong competency in his work and can always fulfil your assignments ahead of time. He also follows your orders fully and is willing to work for you even at the expense of his personal interests.

Sales Rep. B is close to you and you are very familiar with each other. He also follows your orders fully and is willing to work for you even at the expense of his personal interests. His competency in his work, however, is less satisfactory, and he always fails to fulfil your assignments on time.

Sales Rep. C is close to you and you are very familiar with each other. He has a strong competency in his work and can always fulfil your assignments ahead of time. He is, however, quite subjective and does not follow your orders. He is less willing to work for you at the expense of his personal interests.

Sales Rep. D is close to you and you are very familiar with each other. He is, however, quite subjective and does not follow your orders, much less work for you at the expense of his personal interests. In addition, he is less competent in his work and always fails to carry out your assignments on time.

Sales Rep. E does not have a close relationship with you and does not know you very well. He has a very high competency in his work and can always fulfil your assignments ahead of time. He also follows your orders fully and is willing to work for you even at the expense of his personal interests.

Sales Rep. F does not have a close relationship with you and does not know you very well. He is less competent in his work and always fails to fulfil your assignments on time. However, he follows your orders fully and will work for you at the expense of his personal interests.

Sales Rep. G does not have a close relationship with you and does not know you very well. He is quite subjective and does not follow your orders, much less work for you at the expense of his personal interests. He is, however, quite competent in his work and fulfils your assignments ahead of time.

Sales Rep. H does not have a close relationship with you and does not know you very well. He is quite subjective and does not follow your orders, much less work for you at the expense of his personal interests. He is less competent in his work and never fulfils your assignments on time.