
Effect of Performance-Based Pay on Employees' Outcomes

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Abstract - Based on past research that discussed the system of pay within an organization, participation and performance appraisal are two important elements in a performance-based pay. The ability of managers to implement these two important elements may influence job satisfaction and organizational commitment among employees. Hence, this study was carried out to test the connection between performance-based pay against job satisfaction and organizational commitment. Employees at the Department of Fire and Rescue in Selangor and Putrajaya were chosen as the sample in this study. The outcome of the SmartPLS model analysis demonstrates that participation and performance appraisal play an important role as a determinant of an employee's job satisfaction and organizational commitment. Discussion, implication, and conclusion have been provided in this study.

Keywords: Participation; performance appraisal; job satisfaction; organizational commitment

1. Introduction

Compensation can be described as a function of human resources where it covers administration, planning, and managing various types of pay system (i.e., financial and non-financial payment) to pay employees who perform a service or a job in the organization (Milkovich et al., 2014; Henderson, 2009). Well-managed compensation systems may have a positive impact on the efficiency of the organization and the employees' outcomes (Farah, Teng, & Fakhrul, 2014; Adeoye & Fields, 2014). For example, the ability of administrators to appropriately manage the compensation system may enhance commitment and performance among employees who may contribute toward organizational productivity and development (Milgo, Namusonge, & Kanali, 2014; Suifan, 2015). According to many researchers such as Maimunah (2003), Farah et al. (2014), Ajmal, Bashir, Abrar, Khan, and Saqib (2015), the primary objective of a reward system is to attract, retain, motivate, and attach employees to their work.

Traditionally, employers have designed the pay system based on jobs, which is also known as a job-based pay. According to Henderson (2009), difficulty, responsibility, and relative value of work were concerns that helped to determine the employees' pay based on the

job-based pay system. For example, the amount, level, and types of pay were determined by the nature of job, seniority, and length of services toward the organization (Azman et al., 2014; Aimi, Azman, & Fatmawati, 2014). According to Matocchio (2009), skill, knowledge, and efficiency of employees increase when they have worked and serviced within an organization for a long time. Although the implementation of a job-based pay system remains appropriate and applicable, it is insufficient to motivate, attract, and retain high performing employees in order to enhance the performance of an organization (Bergman & Scarpello, 2002; Aimi et al., 2014).

In a global economy, numerous employers have shifted the system of pay from one that is job-based to the performance-based (Lawler, 2000; Azman & Zawani, 2009). According to past literature on pay systems, the performance-based pay can be defined as the decision of pay by employers based on performance, productivity, and skill of employees (Henderson, 2009; Blau & Khan, 2003; Aimi et al., 2014). Within the application of performance-based pay system, the payments of employees are based on their skill and performance and not dependent on the nature of their jobs. The main advantage of implementing this pay system is that it may attract, motivate, and retain high performing employees in order to fulfill organizational goals and lead to sustained organizational competitiveness (Beardwell & Claydon, 2007; Jeyasutharsan & Rajeskar, 2013).

A review of recent literature on compensation systems within organizations has emphasized that managers play two important roles in organizing and carrying out the performance-based pay system, which are participation in the pay system and the performance appraisal (Azman, Aimi, Mohamad, & Razaleigh, 2015; Brown, Hyatt, & Benson, 2010; Fay & Thompson, 2001). Participation in the pay system can be defined as the employer encouraging the employees to participate and question in the decision making, information sharing, and problem solving activities related to the compensation system (Azman, Hock, & Muhammed, 2007; Milkovich et al., 2014; Aimi et al., 2014). Montemayor (1996) reported that allowing employees to participate and question in the decision making and providing them with compensation information might enhance their satisfaction in their jobs and acceptance of the pay decision. A study by Ahmad, Scott, and Solnet (2010) found that the attitude of administrators of employees in a five-star resort hotel in Langkawi that avoided answering employees' questions regarding the pay system, had a negative impact on the employee turnover and caused dissatisfaction in their jobs. Moreover, performance appraisal is often viewed as a continuous process to determine and evaluate the performance of individuals in their responsibilities toward tasks given (Azman et al., 2014; Armstrong, 2014). Therefore, the payment of employees will be determined based on the outcome of this evaluation process (Daft, 2012; Mondy & Mondy, 2014; Noe, Hollenbeck, Gerhart, & Wright, 2014).

Surprisingly, recent research pertaining organizational pay system reveals that the ability of managers to properly implement a performance-based pay system may have a significant impact on individual attitudes and behavior especially job satisfaction and organizational commitment (Garib, 2009; Zeeshan et al., 2010; Wainaina et al., 2014; Azman et al., 2015). Based on the organizational behavior perspective, job satisfaction is often viewed as a pleasurable or positive emotional state resulting from the appraisal of one's job or experience (Locke, 1976; Ida & Ali, 2010). According to Oshagemi (2000), employees who are less satisfied with their jobs tend to resign, while satisfied ones tend to remain in their jobs. In addition, organizational commitment is viewed as the relationship that has been built between individuals and the organization shown through loyalty and

readiness of the individual to give something of themselves to the organization for the sake of organizational development (Mowdays et al., 1979; Ida Irdawaty & Ali, 2010). Many scholars such as Hemdi and Nasuridin (2006), Walsh and Taylor (2007), and Lee, Hung, and Chen (2012) have found that organizational commitment may reduce costly behavior such as absenteeism and turnover intention.

Within the organizational pay model literature, many scholars view participation, performance appraisal, job satisfaction, and organizational commitment as distinct but highly interrelated constructs. For instance, the ability of administrators to give an opportunity for employees to actively participate in the pay decision-making and pay their employees based on performance evaluation results, may boost the employees' job satisfaction and organizational commitment (Garib, 2009; Zeeshan et al., 2010; Wainaina et al., 2014; Azman et al., 2015). Although the nature of this relationship is important, the role of administrators on performance-based pay as an important predicting variable is not discussed much in the workplace pay system literature (Aimi et al., 2014). This is because many scholars in past studies have discussed more on the characteristics and internal features of the performance-based pay system, using a simple correlation method to assess employees' reaction toward the type of reward administration system, and have ignored the importance of the administrators' role in the performance-based pay on the employees' outcomes and attitudes (Garib, 2009). Hence, these studies have not provided adequate roles or guidelines to practitioners in understanding the complexity of the performance-based pay, and in formulating tactical plans to enhance the effectiveness of the reward system within organizations (Azman et al., 2014). Hence, it encourages the researchers to explore in depth about the nature of this relationship. This study therefore examines the association between participation and performance appraisal on job satisfaction and organizational commitment.

2. Literature Review

Currently, numerous studies in the area of pay administration have been conducted using the direct effect model based on different samples, such as the perception of 333 middle and top managers from the public sector in Malaysia (Garib, 2009), the perception of 170 employees in telecommunication organizations in Pakistan (Zeeshan, Hina, Nadeem, & Ebtisam, 2010), the perception of 203 employees in public and private universities in Kenya (Wainaina, Iravo, & Waititu, 2014), and the perception of 4 private tertiary educational institutions in Peninsular Malaysia (Azman et al., 2015). The outcomes of these studies show that the ability of managers to encourage employees to actively participate in the reward system and pay their employees based on performance evaluation results may enhance job satisfaction and organizational commitment among employees (Sharan & Garib, 2009; Zeeshan et al., 2010; Wainaina et al., 2014; Azman et al., 2015).

These research literatures support the idea of the equity theory that has been developed by Adam (1963), which states that when employees are paid equitable to their contribution, it has a positive influence on their outcomes (e.g., attitudes and behavior). In addition, individual behavior is influenced by the expectation of what will be achieved in future if they act a certain way. This situation is in line with the notion of the expectancy theory by Vroom (1967). The notions of these theories in the performance-based pay system demonstrate that the capability of managers to properly practice participation and performance appraisal in the reward system may enhance the feeling of fairness in pay

equity and understanding of the value of outcomes among employees. Consequently, it may further increase job satisfaction and organizational commitment among employees. Thus, it can be hypothesized that:

H1: Participation is positively associated with job satisfaction

H2: Performance appraisal is positively associated with job satisfaction

H3: Participation is positively associated with organizational commitment

H4: Performance appraisal is positively associated with organizational commitment

3. Methodology of Study

3.1. Research Design

For the purpose of increasing the data quality, and to achieve accurate and lesser bias, the researchers have chosen a cross-sectional research design. According to Sekaran and Bougie (2013), using a cross-sectional research design allows the researchers to combine the literature of performance-based pay, a pilot study, and the real survey as a procedure for data collection. The Department of Fire and Rescue in Selangor and Putrajaya have been chosen as the area of study. Researchers had drafted the questionnaire survey at the beginning of this study and the content and format of the questionnaire have been improved via discussing and interviewing 10 employees from the administration division in the studied organization. The technique of purposive sampling was used by the researchers to select the employees and they were selected based on their working experience and knowledge in the area of pay system management. For the sake of valid and reliable research findings, the survey questionnaires were translated into the Malay language using a technique of back translation (Cresswell, 2008; Sekaran & Bougie, 2013).

3.2. Measures

The survey questionnaires were divided into three parts, including performance-based pay that consists of participation and performance appraisal, job satisfaction, and organizational commitment. Participation had 5 items that was measured by items such as opportunity in discussing pay based on performance, opportunity in asking about the level of pay, and involvement in the recognition program. Meanwhile, performance appraisal was measured by 6 items such as award given to high performing employees, determine the suitable pay level, determine a higher increment in pay, given a better promotion, chance to get training, and given recognition. The entire dimensions used to measure participation and performance appraisal were adapted from the performance-based pay literature (Pettijohn, Pettijohn, & d'Amico, 2001; Milkovich & Newman, 2009; Azman et al., 2014; Greenberg, 2003). Secondly, job satisfaction was measured using 7 items such as satisfaction with freedom to choose the method of working, recognition based on performance, supervisor, responsibility that was given, chance to use skill, varies in task, and job security. These dimensions were adapted from past literature (Azman et al., 2014; Farah et al., 2014; Oriarewo, Agbim & Owutuamor, 2013; Warr, Cook & Wall, 1979). Lastly, organizational commitment consists of 7 items and the dimensions include feeling a part of the organization, loyalty toward the organization, and in line with the organization's mission (Mowday et al., 1979). These items will be graded using a 7-item scale and these scales range from "very strongly disagree/dissatisfied" (1) to "very strongly agree/satisfied" (7). This study focused on employee attitudes and behavior, therefore

demographic variables such as gender, age, race, status, salary, and position were used as a controlling variable.

3.3. Sample

A total of 300 survey questionnaires were distributed to employees who worked in the fire and rescue department. The list of registered employees was not given to the researchers and this condition did not allow the researchers to use the random sampling technique. Therefore, the researchers used a convenient sampling technique to distribute the questionnaires in the studied organization. Out of the total number of questionnaires, 100 were returned to the researchers as usable questionnaires. The figure exceeded the minimum sample of 30 participants as required by the probability sampling technique, showing that it may be analyzed using inferential statistics (Sekaran & Bougie, 2013). The survey questionnaires were fulfilled by participants based on their consent on a voluntary basis.

4.4. Data Analysis

The SmartPLS version 13.0 was utilized to measure the validity and reliability of the questionnaires' data and further to test the research hypotheses. This statistical package was chosen by the researchers because it may help in problems dealing with a small sample size, deliver latent variable scores, handle formative and reflective measurement models, and manifest variables and error terms (Henseler et al., 2009). The standardized beta and *t* statistics were employed to measure a structural model and the value of R² was used to indicate the strength of the model. The value of R² was considered weak when the value is 0.19, moderate when the value is 0.33, and substantial when the value is 0.67 (Chin, 1998; Henseler et al., 2009; Rozila, 2013).

4. Result

4.1. Characteristics of Respondent

Table 1 shows that out of the number of respondents, 68.4% of them are males, with ages between 25 and 35 years old (53.1%), SPM/MCE holders (49%), clerical and supporting staff (60.2%), employees who have worked from 5 to 14 years (53.1%), permanent basis (100%), monthly household expenses of RM1000-RM2499 (38.8%), and gross monthly salary of RM1000-RM2499 (45.9%).

4.2. Validity and Reliability of the Instrument

Table 2 demonstrates the validity and reliability result of the constructs. Items for each construct have fulfilled the requirement standards of validity and reliability analyses because their values have exceeded 0.701 (Fornel & Larcker, 1981; Gefen & Straub, 2005). Due to the value of the composite reliability that is greater than 0.8, it can be said that the measurement used in this study has high internal consistency (Chua, 2006; Henseler et al., 2009).

Table 3 shows the results of the convergent and discriminant validity analysis. For convergent validity, the value of the average variance extracted (AVE) should be more

than 0.50 (Azman et al., 2013; Mitra et al., 2011; Fornell & Larcker, 1981). Table 1 shows that all values of the AVE are greater than 0.50, thus this convergent validity result is acceptable. For discriminant validity, the value of the square root of the AVE value or also known as the in-diagonal should be greater than the value of the off-diagonal figures (Fornell & Larcker, 1981; Henseler et al., 2009). For this result, the test for discriminant validity is valid since the value of the in-diagonal figure is always higher than the off-diagonal ones.

Table 1: Profile of Respondent (n= 98)

Variable	Category	n	%	Variable	Category	n	%
Gender	Male	67	68.4	Type of Service	Permanent	98	100
	Female	31	31.6		Contract basis	0	0
Age	< 25 years	8	8.2	Education	LCE/SRP	2	2.0
	25 - 35years	52	53.1		MCE/SPM	48	49.0
	35 - 44 years	26	26.5		HSC/STPM	14	14.3
	45- 54 years	11	11.2		Diploma	18	18.4
	55 +	1	1.0		Degree	16	16.3
Variable			Category		n	%	
Length of Service			Less than 5 years		20	20.4	
			5-14 years		52	53.1	
			15-24 years		16	16.3	
			25 years and above		10	10.2	
Gross Monthly Salary			Less than RM1000		4	4.1	
			RM1000 to RM2499		45	45.9	
			RM2500 to RM3999		33	33.7	
			RM4000 to RM5499		9	9.2	
			RM5500 to RM6999		7	7.1	
Monthly Household Expenses			Less than RM1000		18	19.4	
			RM1000 to RM2499		38	38.8	
			RM2500 to RM3999		31	31.6	
			RM4000 to RM5499		9	9.2	
			RM5500 to RM6999		1	1.0	
Position			Professional & Management Group		30	30.6	
			Supervisory Group		7	7.1	
			Technical Staff		1	1.0	
			Clerical and Supporting Staff		59	60.2	
			Other		1	1.0	

Note:

SPM/MCE: Sijil Pelajaran Malaysia/ Malaysia Certificate of Education

STPM/HSC: Sijil Tinggi Pelajaran Malaysia/ Higher School Certificate

PMR/SRP/LCE: Penilaian Menengah Rendah/Sijil Rendah Pelajaran/Lower School Certificate

RM: Malaysian Ringgit

Table 2: The result of factor loadings and cross loadings for different constructs

Constructs	Items	Participation	Performance Appraisal	Job Satisfaction	Organizational Commitment	Composite Reliability
Participation	5	0.713-0.901				0.920
Performance Appraisal	6		0.863-0.952			0.965
Job Satisfaction	7			0.742-0.906		0.948
Organizational Commitment	7				0.749-0.893	0.944

Table 3: The Result of Convergent and Discriminant Validity Analysis

Variable	AVE	Participation	Performance Appraisal	Job Satisfaction	Organizational Commitment
Participation	0.699	0.836			
Performance Appraisal	0.822	0.658	0.907		
Job Satisfaction	0.724	0.579	0.614	0.851	
Organizational Commitment	0.707	0.666	0.643	0.842	0.841

Table 4 shows the results of the construct analysis. Means for all variables were from 4.5 and 5.0, showing that the levels of participation, performance appraisal, job satisfaction, and organizational commitment were high. In addition, the data was also free from serious collinearity problem based on the value of the variance inflation factor (VIF) between the independent variables (i.e, participation and performance appraisal) and the dependent variables (organizational commitment and job satisfaction) at less than 0.50 (Hair, 2014; Azman et al., 2014). Hence, these outcomes of analysis confirm that the constructs used in this study are valid and reliable.

Table 4: Collinearity and descriptive statistics

Variable	Mean	Standard Deviation	Variance Inflation factor (VIF)			
			1	2	3	4
1. Participation	4.5	.91			1.762	1.762
2. Performance Appraisal	4.9	.86			1.762	1.762
3. Job Satisfaction	5.0	.78				
4. Organizational Commitment	5.0	.73				

4.4. Hypotheses 1 and 2 Testing Result

The quality of model prediction is shown by the value of r^2 as demonstrated in Figure 1. Based on the value of R2, the independent variables (i.e., participation and performance appraisal) explain 43% of the variance in job satisfaction. The result of the SmartPLS path analysis highlights two important findings: first, participation is positively and significantly associated with job satisfaction ($\beta= 0. 31$; $t= 2.25$) and this result confirms H_1 . Second, performance appraisal is positively and significantly associated with job satisfaction ($\beta= 0.41$; $t= 2.95$), therefore, H_2 is accepted. This hypothesis testing result confirms that job satisfaction can be predicted by the implementation of performance-based pay within an organization.

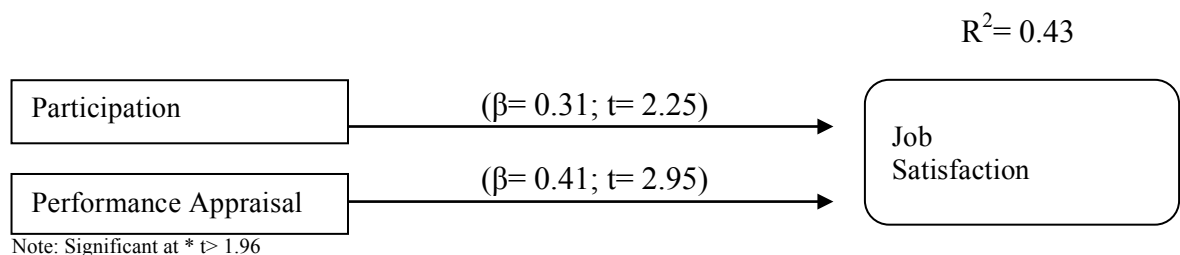


Figure 1. Outcomes of testing Hypotheses 1 and 2

From the result of the hypotheses testing, a test of predictive relevance as suggested by Stone-Geisser's test was carried out based on the formula: $q^2 = Q^2 \text{ included} - Q^2 \text{ excluded} / 1 - Q^2 \text{ included} = 0.292$. If Q^2 has a value of more than zero for a certain reflective endogenous latent variable, it can be confirmed that the path model's predictive relevance is acceptable for these particular constructs. Therefore, the outcome of the Stone-Geisser's test is acceptable since the value of Q^2 is greater than zero (Hair et al., 2014).

4.4. Hypotheses 3 and 4 Testing Result

The quality of model prediction is shown by the value of r^2 as demonstrated in Figure 2. Based on the value of R^2 , the independent variables (i.e., participation and performance appraisal) explain 52% of the variance in organizational commitment. The result of the SmartPLS path analyses discloses two important outcomes: first, participation is positively and significantly associated with organizational commitment ($\beta = 0.43$; $t = 3.85$), and this result confirms H_3 . Second, performance appraisal is positively and significantly associated with organizational commitment ($\beta = 0.36$; $t = 2.84$), therefore H_4 is accepted. This hypothesis testing result confirms that organizational commitment can be predicted by the implementation of a performance-based pay within an organization.

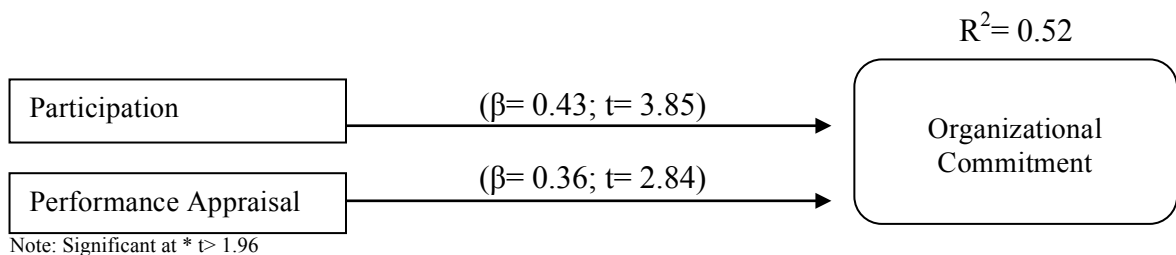


Figure 3. Outcomes of testing Hypotheses 3 and 4

From the result of the hypotheses testing, a test of predictive relevance as suggested by Stone-Geisser's test was carried out based on the formula: $q^2 = Q^2 \text{ included} - Q^2 \text{ excluded} / 1 - Q^2 \text{ included} = 0.292$. If Q^2 had a value of more than zero for a certain reflective endogenous latent variable, it can be confirmed that the path model's predictive relevance is acceptable for these particular constructs. Therefore, the outcome of the Stone-Geisser's test is acceptable since the value of Q^2 is greater than zero (Hair et al., 2014).

5. Conclusion and Discussion

The majority of the participants considered the level of participation and performance appraisal in the reward system to be high. This situation suggests that the implementation of participation in the reward system and determining the level or amount of pay toward employees based on performance by administrators may increase the level of job satisfaction and organizational commitment among employees. This study has provided implications toward the theory, methodology of research, and for practitioners. In terms of a theoretical contribution, the findings of this study have shown that giving the opportunity to employees to participate in the reward decision making and to determine their pay based on performance appraisal system may enhance job satisfaction and organizational commitment. These results are also in line with past literature that were

mostly conducted and published overseas (Garib, 2009; Zeeshan et al., 2010; Wainaina et al., 2014; Azman et al., 2015). Meanwhile, in terms of robustness of the research methodology, the survey questionnaires used in this study have fulfilled the standard of requirement for reliability and validity tests in order to generate accuracy in the research outcomes. In terms of practical contribution, the findings of this study may be used to improve the design and administration of performance-based pay in organizations.

In order to achieve this purpose, managers should pay attention to several important aspects such as the payments of employees should be reviewed to ensure their allocations are based on the current national cost of living. In addition, the administrators should be prepared with the latest knowledge in the area of pay system management because it may contribute to designing and upgrading the pay system and fulfilling the employees' needs. Next, employees that put in more effort and contribution in organizations should be rewarded with additional pay because it may attract employees and create a competitive environment among employees for the sake of organizational development. If organizations seriously consider and positively adopt these suggestions, it may lead to enhanced employee attitudes and behavior.

This study was conducted with the purpose of testing the conceptual framework developed according to the performance-based pay research literature. The instruments used in this study have met the acceptable requirements of the validity and reliability analyses. The outcomes of the SmartPLS path model analysis confirmed that there is a positive and significant relationship between performance-based pay (i.e., participation and performance appraisal) and job satisfaction and organizational commitment, hence H1, H2, H3, and H4 are accepted.

The results also support and broaden the performance-based pay literatures that were mostly published overseas. This study further suggests that the implementation of participation and performance appraisal in the pay system would contribute toward enhancing a positive attitude and behavior among employees. As a result, motivated and hard working employees may support organizational strategies and goals in order to survive in the era of global economic turbulence.

This study has identified several limitations. First, this study only tested two features of the performance-based pay in the hypothesized model using a direct effects method. Second, the survey data were collected only at one time during the study using a non-probability sampling technique in one department. Third, this study only tested the direct effect model in a relationship between the independent and dependent variables regardless of the effect of inclusion moderating or mediating variables. Lastly, other performance-based pay outcomes such as motivation, trust, and performance that may also have a significant effect on organizations and employees were not discussed in this study.

This study may be strengthened if future studies consider the following aspects: first, data should be collected from more than one department because it may have similar or different results. Second, other dependent variables such as, performance and loyalty are found to be important outcomes and these variables should be highlighted in future research. Thirdly, other features of performance-based pay such as communication and pay allocation can be tested to measure whether these other two features have a significant impact on employee outcomes.

Disclosure Statement

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