

The Relationship Between Compensation Systems And Employee Performance: A Literature Review

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ABSTRACT: *Compensation covers everything that an employer offers to an employee in return for their service. Compensation system for employees plays a significant role in various areas of the workplace and can affect employee performance, productivity, turnover rate as well as worker's morale. The main purpose of this paper is to explore the past studies that investigate the relationship between the compensation system and employee performance. This paper is based on secondary sources, which are accumulated from many types of research in the USA, Canada, the UK, Malaysia, Indonesia, European, Nigerian, Japanese, China, Pakistan, and Saudi Arabia. The study uses information that had been accumulated during the review of various literature to address the topic. The outcome of this study will significantly assist the management to enhance their ability to meet the challenges of the current and future competition. The study will also provide several important insights to strengthen the understanding of compensation strategy in developing economies and their impacts on the performance of the employee in the setting in Malaysia. This paper summarizes the latest research on the considerations of compensation system and the influences of compensation system on employee's performance.*

KEYWORDS: *compensation system, employee performance, base pay, bonus and benefits, higher education.*

I. INTRODUCTION

Employees are considered as one of the most important assets in a company; therefore, they should be managed professionally and wisely [1]. Whatever decisions or behaviors displayed by the employees will affect the success or failure of the organization. To ensure the best performance of the employees, organizational leaders should motivate the employees by rewarding them. According to [2], the capability of the employers to attract, maintain and reward talented and competent employees accurately will determine the success or failure of an organization since the employees are the organization's key resources. Moreover, compensation packages offered by the organization will largely ensure that the employees are motivated to work and willing to stay on the job. Compensation is one of the physical needs for employees which in turn will affect their job performance. Job performance can be influenced by many factors either externally or internally. For example, [3] found that pay and performance are directly associated with accomplishing organizational goals, and employees who best achieve their parts of organization goals will be rewarded. This indicates that compensation is a motivator or reinforcement in encouraging the employees to improve their performance and increases their commitment towards the organizational goals [4].

Establishing a fair and adequate compensation that is considered appropriate and meet the requirements is one of the functions in the personnel department; however, they are difficult to be implemented [5]. Moreover, according to [1], if an organization or a company does not manage this function of Human Resources department properly, it will cause negative impacts on their employee performance. The lack of proper compensation systems might lead to low productivity and outcome from the employees since they may no longer receive proper compensation and benefits to motivate them to work harder. Nevertheless, the compensation system which is fair and equal is required and appealing to employees. Reward is one of the elements to improve employee performance but the reward itself must be fair and provided immediately after the desired behavior. [6] also stated that the organization needs to give equal pay to the employees to inspire them to improve. Equity pay is an important issue in an organization because most of the employees will compare their inputs with outcomes. With the effects of economic recession, globalization, increasing policy legislation and rapid technical developments, the establishment and the implementation of efficient and cost-effective compensation and benefits programs become a nightmare to all human resource departments.

Organizations are struggling to come up with a versatile remuneration package that fits all workers while aligning themselves with business goals. If this is not handled well, the organization will lose its market competitiveness and face talent attrition. With a thorough understanding of what all employers are facing and looking at moving forward, the 5th Compensation & Benefits Summit 2017 was held in Kuala Lumpur, Malaysia. The event specifically aims to address the most difficult and complicated issues in managing employee compensation and benefits packages for organizations to design and implement compensation and benefits plans and processes that allow them to manage costs, improve performance, attract, motivate and retain employees. (5th Compensation & Benefits Summit, 2017)

Employee performance is also crucial to establish a good reputation and image of the organization and it also proves the prominent capabilities of the employees within an organization. For employees, compensation is an important issue since pay is perceived to be an indication of their personal and market value to the organization [7]. Many of the companies, however, are overly focused on the profits making that they neglect the establishment of a good reward to their employees. If the employees are not satisfied with the compensation systems provided by the organization, they will reduce their effort in performing their jobs and become less committed to the organizational goals. In fact, [6] claimed that Malaysian higher education institutions have suffered from high labor turnover amongst academic staff for many years. One of the principal causes of high staff turnover is low employee and the key factors underlying the commitment of employees to both particular careers and organizations are pay and promotion policies. Both pay and promotion have been recognized as potential problem issues in Malaysian higher education for many years [6]. Furthermore, some companies offer low pay rates which in turn makes them fail to attract, retain and motivate highly qualified potential employees. Compensation is a highly sensitive issue. It can motivate and also de-motivate employees. The salary increase given to somebody may be beyond one's expectation and can make him happy until he learns a higher increase given to his colleague of the same rank and level of performance. This shows that the compensation system can give success to the company but at the same time it also can be counterproductive if it is not properly administered. Pay must be awarded in accordance with the accomplishments of the company's strategic goals, vision and mission. It must not be tied to the employee's accomplishments alone but should also be based on the company's culture that clearly defines the values that it cherishes.

Compensation is indeed a complicated issue that challenges human resource professionals as compensation administrators or internal consultants. There is no magic formula that would satisfy all employees in an organization, from the highest to the lowest level positions. Addressing the problem would depend on a lot of variables; industry, the productivity of the bottom line, principles of culture and compensation, competition, and the macroeconomic environment that a business runs [8]. In addition, [9], claimed that strong incentive programs provide good potential for the organization performance only when the incentives that have been promised are met by the employers and employees. However, without a well-defined indicator and a good framework to be practiced, even the most comprehensive program will be jeopardized. Companies must tally their incentive programs to the organizational culture, business model and goals. Rewards programs must be reviewed frequently to ensure that it is still relevant until today. Even the best-meant incentive programs will quickly encounter failure when facing certain obstacles. When a company has not established a consensus rewards programs or it is not properly communicated to employees, the plan is considered incomplete or simply inadequate. Failure can also occur when the company maintains a tradition of constructing reward plans separately for individuals rather than on a team basis. Furthermore, the absence of clear standards and methods that are inconsistent with employee expectations may prompt key talent to leave the company. Some of the top management utilizes a "one program fits all" approach to implement the compensation system in an organization [4]. This will reduce employee's satisfaction and also produce poor performance due to every individual employee have different needs and they pursue different compensation return by their efforts and contributions. As a result, top management has to tailor the compensation systems that are more suitable to the employee's needs in order to motivate the improvement of their performance.

Malaysian government is planning to increase the ratio of Gross Domestic Product (GDP) wages from 33.6% (in the previous year) to 40% in the long term and it will be done gradually since wage increase must be supported by the increase in productivity. This includes total remuneration, in cash or in kind, payable by an enterprise to an employee such as salaries and wages, gratuity, bonus, subsidies and benefits ("Govt planning to push wages...", 2014). Although compensation is the major strategy to attract new employees and motivate existing employees to increase their performance, it is observed that most individuals with higher education qualifications are not satisfied with their jobs and their turnover rate is high. For the organizations to overcome this problem, they need to design a compensation plan in order to retain the employees as well as to attract and motivate them to perform better [10]. Sometimes, a compensation system will occur to be unfair and inappropriate due to different personal perception of the employees and some managers may be biased in gender and race. The managers might give higher compensation to the employees who are the same race or gender with them but give lower compensation to the employees who are different races and gender with them. Unfair

compensation systems can frustrate the employees and some of them might leave the company if it becomes serious. Therefore, organizations must give fair rewards to their employees in order to maintain their performances and remunerate employees' contributions. In the organization perspective, compensation decisions influence the cost of doing business and their ability to sell at a competitive price in the product market. It is an obvious fact that effective implementation of favorable compensation management will not only aid in stabilizing and retaining employees but also help in reducing labor turnover within the organization [11]. Therefore, the objective of this paper is to explore the past studies that investigate the relationship between the compensation system and employee performance.

II. LITERATURE REVIEW

A compensation system is an encouragement design whereby the contribution of employees is returned. An effective compensation system can stimulate employees to work harder, thus increasing productivity and enhancing job performance. Compensation includes the rewards; financial and non-financial, direct and indirect, intrinsic and extrinsic which an organization exchanges for the participation of its employees; both task performance and personal contribution. It is given in the form of wages, salaries and employee benefits like paid vacations, insurance, maternity leave, free traveling facility, retirement benefits, etc. [12]. Compensation is a process of establishing financial value to employees in return for the work they performed. Moreover, compensation can also be used to recruit skilled employees, provide incentives for the performance, reduce the turnover rate by encouraging employees. [13], compensation systems, also known as reward systems and pay systems refer to the scheme by which rewards are distributed to an employee. The typical compensation package can be divided into two basic components; direct pay and indirect pay or benefits. Compensation systems vary across organizations. Compensation schemes and benefits provided to the employees will affect the workers morale and job performance. Well paid employees usually show exceptional performance in terms of their productivities. They also promote ethical practices in their work within an organization [14]. Besides that, well-establish compensation from the organization will be able to arouse new ideas and promote innovation among employees [15, 16].

[17] embrace a performance reward, work reward, year-end reward, full attendance reward, proposal reward and merit reward. He proposed these rewards just because of the employee's attention towards work. When organizations planned compensation systems, the managers treated compensation as assess to reward and discipline employees' behavior. In the modern environment, non-management factors, such as employees' values and their consciousness of equity should also be measured. In this way, the compensation strategy of the organizations can draw, keep and arouse talent, while also convention their own demand for market competition and the achievement of strategic goals. [18] proposed the Value theory, and suggested that employee fulfillment does not refer to individual wants, but is linked to individuals' wants, needs or values. If employees are well-paid, have a good quality work environment and endorsement opportunities that meet their work values, employees will be pleased. It also must be watchfully matched with the goals, culture and political reality of the organization. [19] suggested that factors that determine employees' job satisfaction can be alienated into two basic categories: work events and behavior. He indicated that job satisfaction is the relations between these two essentials. Work actions include the work itself, compensation and the working surroundings; behavior includes the actors and others who move in and out of the organization. It can conclude here that compensation is a financial and non-financial remuneration given to the employees for their employments, and a good and fair compensation system can increase the performance quality of an employee. In addition, this paper provides a detailed discussion of important variables in investigating the management of compensation system and how it influences employee performance. It will review the study that had been conducted by previous researchers in compensation and employee job performance field and the comprehensive review of all the related studies will be provided.

2.2 Employee Performance

Employee performance refers to the successful completion of tasks by a certain individual or individuals, as established and measured by a supervisor or organization to pre-defined acceptable standards while efficiently and effectively utilizing available resources within a changing environment [20]. In addition, [21] defined employee performance as the employee activities and behaviors that are relevant to organizational goals that control by employees themselves. This is in line with other researchers like [22], who described employee performance as the job-related activities of an employee in an organization and the excellency of those activities were accomplished. [23], stated that employee performance is the degree of an achievement where an employee needs to reach in order to fulfil the organizational mission in a workplace setting. It is also a process for creating a mutual understanding between employees on what needs to be achieved at an organizations level during a specific time period [24]. Employee performance directly improves the organization

process so that it can be efficient and productive. Employees performance surfaces from the activities and tasks performed by an employee proficiently and effectively. Performance can be measured by managers through different mechanisms [25]. There are numerous factors that impact employee performance such as monetary benefits, training programs, non-monetary benefits, organizational support, organizational support for career development (OSCD), supervisory support and capacity building programs, etc. Employee performance can result in enhancing the profitability of the organization [26]. Additionally, [27], states that the performance of employees is associated with or influenced by job satisfaction and compensation. It also can be influenced by various elements such as skills, abilities and individual traits, desire and environment. Companies are eager to find employees who are high achievers so that they will help the company to achieve its business goal more effectively. [14] claimed that employee performance evaluation is a crucial endowment in an organization. It establishes very important information on the productivity of an employee and the distribution of benefits that included in that endowment. Implementing just and reasonable performance appraisal is vital so that needless prejudice can be avoided and it stimulates the objectivity, productivity, and responsibility of the employees.

2.3 Relationship Between Compensation and Employee Performance

A compensation package is not subjected to monetary form only; it can be given in various forms. This includes flexible benefits, medical care, work-life balance, as well as employee perks. There will be a drastic effect on employee performance and efficiency if a good compensation package is not well-established. Employee productivity is greatly influenced by compensation. Realistic compensation given to the employees ensures higher employee productivity. On the contrary, lower compensation given to employees will result in lower employee productivity [28]. This is parallel to other research findings. According to [29] Muguongo, Muguna, and Muriithi (2015), compensation is one of the forces that motivates workers. Well compensated employees are more encouraged, assured and have a positive feeling towards their job and they are more satisfied with their job. The greater the sense of satisfaction in employees, the more they will be motivated to perform better [30]. A study conducted by [31] identified the relationship between total compensation and employee performance. The objective of the study was to determine the relationship between total compensation and employee performance at Mayfair Insurance Company limited. The study revealed that total compensation has a positive correlation with the employee performance in different ways. On average, there was a positive significant correlation between the total compensation and employee performance factors and the balanced scorecard. It also concluded that different compensation factors have different direct relationships with employee performance. [11] studied the effect of compensation management and employee's performance in the manufacturing sector, a case study of a reputable organization in the food and beverage industry The finding showed the f-statistics of 12.037, which implies that the model is statistically significant. It means that there is a significant relationship between compensation management and employee performance depending on the planning, implementation and control of effective compensation management. The study also suggested that there is an improvement in compensation management between employers and employees in the organization.

2.4 Elements of Compensation System

The following are the elements of compensation that have been perceived to contribute to employee performance. They include base pay, bonus and benefits, job promotion, the delegation of work, and appreciation and recognition. According to [32], it cannot be denied that the element of monetary benefits motivates employees. But there are Malaysian employees who seek other intrinsic factors as job attractions which tend to contribute more towards the retention of talented workers rather than higher pay.

2.4.1 Relationship between Base Salary and Employee Performance

Base pay refers to the amount of pay that is established for the job and may vary according to the position or skill level in and organization. Furthermore, it can be influenced by external and internal grade of the job or the level of skill required [33]. Based pay is the basic sum of money or hourly rate paid to an employee in compensation for their work efforts or time spent on the job. Base pay is in the form of monetary in nature. It does not include other payments, benefits or expenses allowances. According to [34], The base pay also can be considered as a benchmark for calculating bonuses and benefits. Similarly, [28] also claimed that most companies determined their employees. base pay on employee's job descriptions and positions. Their absence demotivates employees but their presence may not necessarily motivate the employees as it is something that they expect to get it in any way [35].

2.4.2 Relationship between Bonus and Benefits and Employee Performance

Bonuses generally after-the-fact discretionary awards given for accomplishments, behaviors, and/or other related events [2]. Meanwhile, [36] says benefits are all financial rewards except direct payment and it costs money to the firm and employees commonly receive them indirectly. It can be concluded that bonuses and fringe benefits are other forms of compensation rewarded to employees for their good performance in order to motivate them to perform better [31]. These awards and bonuses are used in the recruitment and retention of excellent employees [37]. Valid performance evaluation, bonus and reward systems nurtured employee performance. The consideration of the amount of fringe benefits and bonuses may be varied according to the level of employee performance. These different motivating elements like promotion and bonuses, and suitable payment compensation have a significant connection with higher performance [38]. On the other hand, benefits are a part of an employee involvement strategy. Besides monetary pay offered by the organization, other benefits also complement the salary and influence employee's attitude through this capability of the compensation system [39]. According to [40], benefits alone caused significant improvements in financial performance. But the fact that an organization offers benefits over and above basic reward is a part of engagement activity that promotes higher performance and clearer thinking about what benefits are actually for.

2.4.3 Relationship between Job Promotion and Employee Performance

Promotion is the advancement of an individual from a particular position to a higher rank within the organizational hierarchy. It is almost always come with the increases in responsibility, salary, and organizational benefits [41]. Besides that, promotion in a business organization is a practice for recognizing and rewarding employees. effort and contribution to the organization [42]. Employees that feel promotion decisions are fair are more committed to the organization, show more satisfaction in their work and perform better and more loyal to the organization [43]. According to [44], promotion is a sign of recognition of employee performance. A well-performed employee will have a better chance to be promoted. Thus, promotions are very important for the company because the promotion means the stability of the company and employee morale will be more assured. Contrary to the study conducted by [45], they argued that pay has a significant influence on job satisfaction but the promotion has less influence and partially significant to job satisfaction.

2.4.4 Relationship between Delegation of Work and Employee Performance

Delegation is a process that includes assigning tasks to subordinates, giving responsibility to the subordinates for formal decisions made by the manager, and raising the amount of allowed job-related discretion to subordinates, giving the authority to make decisions without interfering manager's approval [38]. Organizing and managing delegation is the key tasks performed by leaders. Delegation is widely admitted to be an essential element of effective management [46]. Delegation provides lower level employees the opportunity to seek new experience and knowledge since they are responsible for tasks that previously held by their superior. This ensures the improvement in an organization [47]. According to [48], there are many potential benefits from delegation such as enhancing employees learning, building employees skills and knowledge and many more. In addition, manager workload may shift to other priorities with the delegation of work. The study conducted by [46], found that the delegation positively affects employee performance and satisfaction. It also showed that leader delegation leads to higher levels of perceived leader ability and performance.

2.4.5 Relationship between Appreciation and Recognition and Employee Performance

[49] defined appreciation and recognition as the general acknowledgement or validation of a given occurrence or performance. Appreciation is important in employee work life. Employees respond to appreciation expressed through recognition of their good work because it confirms that the company valued their work [31]. Recognition and appreciation are two important tools in promoting employers. and employees. motivation and organizational success [50]. The impact of employees. perception of their professional skill recognition and appreciation on their emotions will help them to show motivational behavior at work and consequently, increases their performance and productivity [51]. Moreover, it is important to understand that recognition is not the same as appreciation. Recognition focuses primarily on external behavior and specifically, employee performance [52]. Employee recognition is getting more crucial and gaining more attention as motivational strategies [53]. Conversely, appreciation has the most positive effect on workplace culture when both coworkers and supervisors offer it [54]. When employee feel appreciated by their supervisor and colleagues, their job satisfaction increases [52]. When empowering individuals, a leader needs to demonstrate the appreciation in ways that will maximize the impact of every individual in the organization [55].

III. CONCLUSION

In this paper the impact of compensation system on employee's performance was considered and prioritized. And this paper shed lights on the importance of employee for any organization. Variables which are taken in this article are employee's performance which is the depended variable and job security, salary and job promotion are independent variables. Researchers always have made efforts to identify the employee issues in organizations. organizational productivity can't be increased without employee performance .one way of improving the organizational productivity and employee performance is to improve the salary and providing employees job security and others factors which are involved in increasing the productivity of employee and organizations like working environment, and other motivational tools. We are agreed with past researchers that employee's commitment with the organization can be only made possible by giving them what they demand, but in ethical and legal manners. Variable that we have discussed in this research study are if addressed properly then there will be less turn over in the organization. Employee's honesty with their works can only be possible through soft approach; in this regard efforts should be made in helping work life balance.

Finally, the discussion in this paper shows that more the relation of employer with employee and the relation with the employees are managed effectively, and then the organization will certainly grow. Organization in private sector becomes more effective because they use human resource management in better way, but in public sectors personnel management is implemented, which don't work for the beneficial of employees. Organizations must make sure that there is friendly and positive relationship between employers and employees in the organization. Management creates good and friendly working conditions that will aid employee's performance. Organizations should ensure the provision of good welfare packages that will encourage and promote employee's performance. It is the desire of every organization to constantly increase productivity, thereby necessitating the need to motivate employees through comprehensive compensation policies and friendly working conditions. The need to retain effective and qualified work force is a necessity for a functional organization, thereby necessitating the need to provide good working conditions and effective working packages that will aid in retaining effective work force. Employees are the most important resource of any given organization and it is not only right but also legally and morally correct to pay workers fairly. Commensurate to their performance, experience and qualifications, employees should be well compensated. (Direct financial, indirect financial or non-financial). This will enhance job satisfaction and consequently productivity and profitability are archived. Fairness should be in terms of in relation to what job one is doing as well as their level of skill and education. Equity relates to what one gets compared to colleagues in similar roles either within the same company or those doing similar jobs in other organizations in the same sector. Vital information pertaining to compensation issues should be timely and clear.

Working environments should be suitable for the kind of job performed. In general, all working spaces should be clean, comfortable and harm free. So managers can put some offers for employees in terms of their performance such increasing wages, salaries, bonuses, tips and commissions. Such direct financial compensations increase employees' satisfaction and motivate them to work better Indirect financial compensation can be very effective and be used to increase the employees' productivity at workplace, hence managers should seriously consider them. Companies can offer a defined benefit plan, which promises to pay a certain amount of retirement benefits to an employee upon the employee's retirement. Another example of indirect financial compensation which can be effective in increasing employees' job satisfaction is defined contribution plan. It stipulates that the company will contribute a certain amount of money each year to the employee's individual retirement account. Finally, non-financial compensation can be another effective strategy to increase employees' motivation and satisfaction at the workplace. Flextime allows employees to work hours outside of the standard 9 to 5-time frame. This can be a huge benefit to parents who need to take their kids to daytime appointments. It also is beneficial to employees who work best in the early mornings or late evenings, and others who might need time to attend to personal matters without having to take sick days. Another example is telecommuting options. Letting employees telecommute from home every now and then goes a long way toward restoring their peace of mind. Thanks to the internet and technological advances in corporate communications, employees can still handle their duties even if they don't travel further than from their bedroom to their home office. In addition, employee perks is another example of non-financial compensation which can be considered in making employees satisfied. Offers such as health club memberships, onsite gyms and regular health screenings, also providing employee cafeterias with low-cost or free meals, and babysitting services to relieve some parental burdens. Companies recognize that a healthy workforce is mor productive and takes fewer sick days.

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