

Impact of Compensation System and Organizational Justice on Employees' Performance with Mediating Role of Organizational Commitment

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Abstract

The organizational performance is outcome of total individual performances. As such improvement in employees' performance is indispensable for improving organizational performance. It has been established in various studies that performance of employees is influenced by organizational justice as well as adequate compensation system. However, mediating role of organizational commitment which ultimately motivate employees to contribute effectively towards organizational goals has not so far been studied. Therefore, this study has been undertaken to determine the impact of organizational justice and compensation system with mediating role of organizational commitment. The present study establishes the impact of independent as well as intervening variables on dependent variables and will be useful for practicing managers to help them formulate HR Policies for improvement in performance of their employees.

Keywords: *Organizational Justice, Organizational Commitment, Employees' Performance, Compensation System.*

Introduction

The term Performance describes the way an employee carries out the assigned tasks that forms his job. Good performance is the outcome of abilities, efforts and directions (Fagbamiye, 2000). Carmeli, Shalom & Weisberg, 2007) pointed out that the task performance is how well an employee performs the task associated with his job and the extent to which he meets the said standards.

The Organization's performance is the outcome of total individual performances (Fagbamiye, 2000). According to Metzler & Renzl (2007), improvement in employee performance is indispensable for improving organizational performance. Therefore, in order to improve organizational performance, individual performances must be focused.

Organizational Justice relates to feeling of employee of being treated fairly in the organization (Schultz & Schultz, 2006 and Ivancevic et al. 2005). It strongly influences employee's attitude and make them demonstrate positive behavior towards organization (Skarlicki & Latham, 1996). Besides it leads to enhance the productivity of the organization (Cropanzano & Ca Randall, 1993).

The Organizational commitment portrays the extent to which the employees of an organization have feeling of belongingness and of being attached to their organization (Vandick, 2004). It depicts of force of employees in and association with their organization and motivate them fully to exploit their capability to achieve the organizational goals (Robbins, 2002).

As defined by Ali Ketabi et al., (2015), compensation referred to a general term which encompasses payroll system, payment system, reward system and implies compensation of employees within organization. Researchers argue that appropriate monetary incentive motivate employees to perform and this leads to increased organizational performance (Entwistle NJ & D.Entwistle, 1970).

Earlier, a number of studies have been carried out to determine the relationship of organizational justice and compensation system with employee performance. However, the mediating role of organizational commitment have not yet been discussed. It is organizational commitment which ultimately motivate employees to contribute effectively towards the achievement of organizational goals. Besides no or little attention have been given to investigate the effects of these variables in the Power Sector of Pakistan which is in a dire need to improve its employee's performance so as to be able to provide adequate services to its customers. As such, this research provides first empirical evidence from Pakistani Power Sector, establishing implications of organizational fairness and reward system on employee performance directly and through mediating role of organizational commitment.

Rabia et. Al. (2015) while studying impact of organizational justice and job security on organizational performance have suggested to incorporate compensation system in further research. Accordingly, this study has been undertaken by incorporating the mediating role of organizational commitment in the Power Sector of Pakistan.

The paper commences with a review of empirical studies that describe and link the independent, mediating and dependent variables. Next, based on the literature review, a conceptual model of causal relationship among the variables have been proposed. Then an outline of the methodology and its findings on the basis of various statistical analysis have been given. The paper culminates with discussions and interpretations of overall results obtained, followed by limitations of this study as well as directions for the future research.

This study will be useful for practicing managers to help them formulate HR Policies keeping in view the impact of appropriate compensation system and organizational fairness to achieve higher level of their employee performance.

Literature Review

This section deals respectively with organizational justice, organizational commitment and employee performance.

Organizational Justice

Organizational Justice is employees' perception of fairness in an organization as to how decisions are made about distribution of results. Studies by Schultz and Schultz (2006), Green Berg and Baron (2003), Muchinsky (2000) and Ivancevic et al. (2005), have all related the Organizational Justice to feelings of employees of being treated fairly in the organization.

Organizational fairness strongly influences employees' attitude and behavior. As and when they feel fairly treated, they are seen demonstrating positive attitude towards the organization (Skarlicki & Latham, 1996). Studies are focusing on how the organizational fairness lead to a motivated and committed human resource. Some studies have concluded that Organizational Justice leads to enhance the productivity of the

organizations (Cropanzano & C.A. Randall, 1993). According to some researchers, Organizational Justice has limitless monetary and non-monetary benefits for organizations (Cropanzano & Byrne, 2001).

Organizational Justice is playing significant role. A large number of theoretical and empirical studies have been published on it by different researchers. Perceiving justice in organizations lead to a number of favorable individual and organizational outcomes stemming from positive attitudes and behaviors (Aryee, Budhwar & Chen, 2002).

A study held that Organizational Justice is positively related to employees' work attitude. If treated fairly, they will work in their organization for a longer period of time. All kinds of organizational justices viz. distributive, procedural or interactional lead to increase trust level and commitment of employees. The organizations which deal its employees with fairness proved successful in the long run. Nowadays, the organizations are fully aware of the importance of employees as they are its backbone and living assets. The satisfied and committed employees have greater productivity in the organization (Muhammad Jawad, 2012).

Different studies have proposed various dimensions of Organizational Justice. For example, Gordon (1993), suggests 7 dimensions of the Organizational Justice. Aamodt (2007), has determined three facets of Organizational Justice; distributive justice is the perceived fairness on decisions taken, procedural justice on means of reaching decisions and interactional justice in interpersonal treatment.

According to the theory of Organizational Justice, unfair treatment with the employees would result in decrease of their sense of belonging to Organizational Commitment. On the other hand, if the perceptions of justice are fostered, it would result in accepting more duties and responsibilities and consequently enhancing their Organizational Commitment (Qafuri & Reno Safaderani, 2009).

Equity Theory provides basis to ascertain the relationship between distributive injustice and employees' performance (Austin & Walster, 1974). Procedural justice models focused on its influence on attitudes and quality of work life (Lind & Tyler, 1988). The models ignore its concerns when the objective is communal harmony. On the other hand, distributive justice ignores its concerns when the goals are efficiency and output. (Lind & Tyler, 1988). It means, procedural justice enhances performance effecting attitudes, e.g. it may lead to alter attitudes towards the organization causing negative effects on performance (Brockner & Wiesenfeld, 1996; Greenberg, 1987).

A number of studies have made Social Exchange Theory, a basis to suggest links of perceived procedural justice with employees' performance (Cropanzano & Prehar, 1999; Masterson et al., 2000). This theory views an organization, a place for reciprocal and long-term collective dealings with its employees (Cropanzano & Prehar, 1999). Justice is taken as an input to the exchange relationship either from organization or the reporting officer (Masterson et al., 2000; Settoon, Bennett, & Liden, 1996). Accordingly, under the Social Exchange Theory, the employees' performance is viewed associated to the levels of organization as well as supervisor (Settoon et al., 1996; Wayne et al., 1997). As such, as long as it is effected by the organizational level of exchange, it falls under procedural justice and as far as it is effected by the supervisor level of exchange, it falls under interactional justice.

Organizational Commitment

The term Organizational Commitment portrays the extent to which the employees of an organization have feelings of belongingness and of being attached to their organizations (Meyer, Kam, Goldenberg & Bremner, 2013; van Dick, 2004). It is also viewed as a psychological connection that employees have with the organization, embodying a strong identification with and a desire to contribute to the fulfillment of organizational objectives (Meyer & Allen 1997). According to Allen and Meyer (1990), the Organizational Commitment comprises affective, continuance and normative commitments.

While conducting a study to look at the relationship of job satisfaction with Organizational Commitment, it has been found that besides employee's growth opportunities and HR development program, the Organizational Commitment has a strong impact on Organizational Performance (L.T. Yew, 2008).

According to a study, if employees are paid and given incentives on performance basis, their satisfaction level will be enhanced ultimately resulting in increased Organizational Commitment (Mosadeghrad & Ferlic, 2008). According to Osa and Amos (2014), one way of achieving Organizational Commitment is through developing organizational trust and motivation. In such a situation, the employees believe that organizational actions are in their benefit. Mistrust appears when information is withheld and resources are allocated in a vague manner.

According to, Newstrom (2007), Organizational Commitment relates to feeling pride in identification with the organization. Luthans (2008), termed it as strong desire of an employee to be identified as a member of the organization and a firm belief in accepting its values. Luthans (2008), pointed out three facets of Organizational Commitment. Firstly, affective commitment, an outcome of emotional attachment of employees to their organizations. Secondly, normative commitment, coming from the desire of employees to enjoy benefits and comforts in the organization. Thirdly, rational commitment, relates to commitment based on the fear of employees for losses in case of discontinuance of their jobs in the organization.

Organizational Commitment is a vital connection and it causes many positive outcomes (Chughtai & Zafar, 2006) and keep them together even when there are problems or difficulties (Allen & Meyer, 1990; Meyer & Allen, 1997). It depicts the force of employees in and association with his organization. According to Robbins, 2002, motivate employees to utilize their capabilities to achieve the organizational goals. It is a stabilizing force that shapes an employees' behavior (Herscovitch & Mayer 2001). According to Nawab and Bhatti (2011), compensation has positive and significant impact on Organizational Commitment. Paik (2007), suggests that there is positive relationship between compensation system and effective commitment. Anvari et al., (2011), also suggest a positive relationship between compensation strategies and affective commitment. Gungor (2011) pointed out that financial reward is positively and significantly related to employees' performance.

Javed et al., (2010) showed that compensation significantly effects organizational performance. Robbins and Judge (2007), described Organizational Commitment as a state of affair in which employees remain steadily in line with organizational objectives and desire to remain employed in their organization. Smith (1993) stated that commitment is a dynamic and constructive orientation to organizations. Khan et al., (2011) examined relationship of organizational commitment with an employee's performance and found a positive and significant relationship between them. According to Rod et al., (2010), employees' performance is significantly affected by Organizational Commitment. An employee's performance is considered as his output with respect to his place in the organization (Gibson et al., 1994).

Somersl and Birnbaum (1998), suggested a positive relationship between Organizational Commitment and employees' effectiveness. Several other studies have found a positive association and relationship between Organizational Commitment and employees' performance (Suliman & Lles, 2002). Meyer et al., (1989), pointed out that organizational commitment is positively associated with employees' performance. Suliman and Lles (2002), found that all the facets of Organizational Commitment were positively correlated with employees' performance.

Compensation System

As defined by Ali Ketabi et al., (2015), compensation refers to a general term which encompasses payroll system, payment system, reward system and implies compensation of employees within the organization.

For employees, financial remuneration is more relevant and crucial issue. Specially in developing nations, money is regarded as an effective motivational factor and a catalyst for building committed workforce. For

attainment of optimum organizational performance there is a need to inspire and motivate the employees through a rewarding compensation system.

The employees after having given their inputs in the form of time, efforts, energy and labor in helping organization accomplish its targets rightly expect adequate compensation to satisfy their personal, social and growth needs (Adeniji & Osibanjo, 2012).

Researchers argue that appropriate monetary incentives motivate employees to perform and this lead to increase in organizational performance (Entwistle N.J & D. Entwistle, 1970).

Recent studies suggest that the most effective way to enhance motivational as well as job satisfaction level of employees is to fix their pays and perks in line with the organizational productivity (Coughlan A.T & R.M. Schmidt, 1985).

The Compensation System remains a critical issue for organizations as it is a sizeable investment in paying to the employees. Similarly fostering organizational commitment in employees through compensation system is crucial for having valuable human capital efficiency in productivity necessary for organizational success. From the above, it is evident that compensation system as well as employees' performance are related to each other. Besides, unless an appropriate compensation system is employed, true potential of employees cannot be fully utilized (Parker & Wright, 2001).

Compensation systems and employee performance

It is widely believed that a strong relationship exists between compensation system and employee's performance (Lawler, 2003). Furthermore, an appropriate compensation system will contribute effectively towards better performance, increased efficiency, and the settlement of organizational problems (Lawler, 2003). Employment is characterized as an exchange relationship. Employees gave to the organizations their labor and in return receive pay and fringe benefits (Rynes, Colbert, & Brown, 2002). Organizations may make use of compensation system for enhancing the performance of employees by paying more to those who have a good record of performance. This motivates the other staff to take care of their performance so as to get higher pay.

Employees Performance

Organizational Performance is referred as an organization's ability to acquire and utilize economic resources as expeditiously as possible for accomplishment of organizational goals (Griffin, 2006).

Organizational Performance is a ratio of actual outputs of the organization to its intended outputs. As contained in, Mukolwe Eunice (2014), organizational performance may be measured taking into account profitability, productivity, service delivery, customer satisfaction, market share and sales. It is affected by a multiplicity of individual, managerial, technical and environmental factors. Individual incompatibilities among the employees and in their groups may have adverse effects on work output resulting in decreased organizational performance.

The organizational performance is the outcome of total individual performances. The term performance describes the way an employee carries out the assigned tasks that forms his job. Good performance is the outcome of abilities, efforts and direction (Fagbamiye, 2000).

Performance management of employees is an integral part of HR strategy of any organization (Meyer & Kirsten, 2005). Task performance relates to the proficiency in performing core technical activities by the employees, Boyazis, (2002). Carmeli, Shalom & Weisberg, 2007, pointed out that task performance is how well an employee performs the tasks associated with his job and the extent to which he meets the set

standards. According to Nowell and Dopson (2000), the committed and satisfied employees exhibit effective performance.

It is widely believed that efficiency is improved when pay and perks are determined on the basis of performance. Studies have found a positive relationship between pay based on performance and the actual performance (Huselid, 1995; Dotty, 1996; Goelm, 2008). Lawler, (1985) suggests that the factors namely the difference between expected reward and that actually received, disparity in payment made to different employees for the same job, and non-monitory reward affect the employees' performance.

Conceptual Framework

Based on the findings in the literature review, the following conceptual framework has been proposed for studying the impact of independent variables (Organizational Justice & Compensation System), dependent variable (Employees' Performance) and mediator (Organizational Commitment).

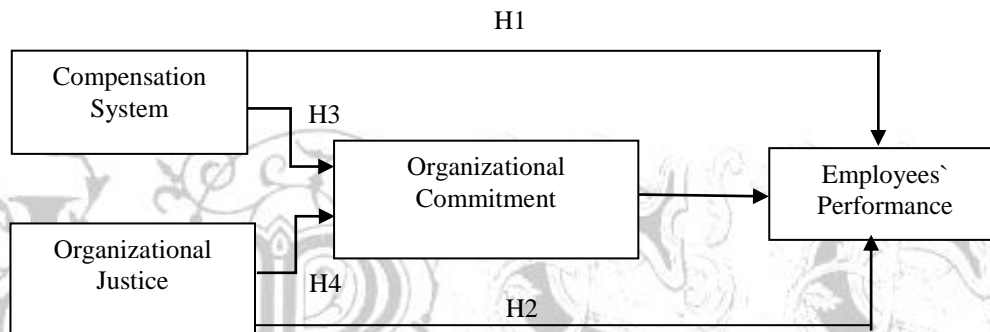


Fig 1: Relationship of Independent, Dependent and Mediating Variables

Therefore, in order to study relationship of independent variables (Compensation System and Organizational Justice) with dependent variable (Employees' Performance) with mediating effect of Organizational commitment has been proposed in Fig 1.

Methodology

This section deals with developing / adopting measures of variables under study, research design, data collection methods and sample design / size.

Data Collection Method

The research objectives of the present study necessitate the use of primary data for analysis and drawing results regarding impact of compensation system and organizational justice on employees' performance mediated by organizational commitment. The primary data has been collected through trusted method of questionnaire which consist of two parts. Part A, requires demographic and personal information including gender, marital status, age, education and total work experience. The Part B relates to independent variables of the study that is compensation system and organizational justice; dependent variable that is employees' performance and mediating variable organizational commitment. Part B is specifically designed to analyze how compensation system and organizational justice impact the employees' performance in an organization with organizational commitment as a mediator.

Measures

For this study, a questionnaire has been designed containing 23 items adopted to measure the independent, mediating and dependent variable as detailed below: -

- a) Thesis on "Effects of Leadership Behaviour on Employees Performance in Guinness Ghana Breweries Limited by Veronica Cellatia Tandoh, 2011"
- b) Thesis on "The Unique Factor Affecting Employees Performance in Non-profit Organizations by Charity Tinofirei, 2011"
- c) "Justice as Mediator of the Relationship between Method of Monitoring Organizational Citizenship Behaviour by Brian P. Niehoff, Robert H. Morrman, 1993"
- d) Commitment to Organizational and Occupational Extension and Test of Three Component Conceptualization by Jhon P. Meyer, Natalie J. Allen and Catherine A. Smith, 1993"

Likert's Scale (Summated Rating Scale)

In this study, a Five Point Likert's Scale has been used in Part B. It includes the statements that show either a favorable or unfavorable approach towards the objects of interest (Cooper et al., 2008). The respondents were to answer from 1 strongly disagree to 5 strongly agree for each statement in order to obtain information regarding the impacts of Compensation System and Organizational Justice on Employee's Performance with Organizational Commitment as a mediator in Power Sector of Pakistan.

Sampling Design

For this research, the primary data was collected through questionnaire from various categories of employees of Multan Electric Power Supply Company Limited (MEPCO) spreading over area of 13 administrative districts of Southern Punjab.

Sample Size

For this study, a sample size of 236 was taken keeping in view various statistical and non-statistical considerations including the total population size and number of items in questionnaire that is 23.

Reliability & Validity

The reliability of multi item construct were accessed using coefficient (Cronbach's) Alpha. Overall values of Cronbach's Alpha were 8.4. Values of Coefficient Alpha for individual constructs above 0.7 were considered to represent acceptable reliability.

Data Analysis and Results

This section relates to discussions, interpretation of data and the results by applying statistical tools:

Correlation Analysis

Table No. 1 elaborates Correlation Coefficient and p-values. It reveals that variables are significantly correlated at 0.01 level of significance.

Table 1: Correlations

	Compensation System	Organizational Justice	Employees' Performance
Pearson Correlation	1	.287**	.467**
Sig. (2-tailed)		.000	.000
N	232	232	232
Pearson Correlation	.287**	1	.554**
Sig. (2-tailed)	.000		.000
N	232	232	232
Pearson Correlation	.467**	.554**	1
Sig. (2-tailed)	.000	.000	
N	232	232	232

** . Correlation is significant at the 0.01 level (2-tailed).

Regression Analysis

Impact of Compensation System on Employees' Performance

The regression analysis shows that compensation system positively and significantly determines the employee's performance. The calculated value of Coefficient slope is .467. Value of t is 8.00, and its p value is .000. The value of adjusted R² is 0.214, showing that the compensation system demonstrates 21.4% impact on employees' performance. The F-Statistics established the significant value.

Impact of Compensation System on Employees' Performance with Organizational Commitment as Mediator

The results show that value of constant variable which is compensation system decreases. Beta values decrease from 0.435 to 0.414 and the p value is greater than 5. Therefore, partial mediation exists between them.

Impact of Organizational Justice on Employees' Performance

Organizational Justice positively and significantly determines the employees' performance. Values of Coefficient slope is .554 and of t is 10.084. While, p value is .000. The adjusted R² is .304, showing that Organizational Justice demonstrates 30.4% impact on Employees' Performance.

Impact of Organizational Justice on Employees' Performance with Organizational Commitment as Mediator

The value of constant variable that is organizational justice decreases. Beta value decreases from 0.348 to 0.242 and the p value is greater than 5. Therefore, partial mediation exists between them.

Summary of the Findings

The regression results show that compensation system positively and significantly determines the employees' performance. Adjusted R² is 0.214 which shows that compensation determines 21.4% of employees' performance. Therefore, these results approved hypotheses. The results of regression show that organizational justice positively and significantly determines the employees' performance. Moreover, the adjusted R² is 0.304 which shows that organizational justice determines 30.4% of the employees' performance.

The regression results show that value of constant variable (compensation system) decreased. Beta values decreased from 0.435 to 0.414 and the P value was greater than 5. Therefore, partial mediation exists between them.

The regression results show that the value of constant variable (organizational justice) decreased. Beta values decreased from 0.348 to 0.242 and the P value was greater than 5. Therefore, partial mediation exists between them.

The results of the study showing positive effects of compensation system and organizational justice, suggest that organizations can greatly enhance the performance of employees by introducing appropriate compensation policies and ensuring justice in the organizations.

These findings empirically confirmed the strategic human resource perspective which states that human resource provides competitive advantage to the organizations by improving the employees' performance (Huselid et al., 1997).

The study connects the compensation system and organizational justice with the organizational commitment. According to this, appropriate compensation and justice among the employees improve the level of employees' commitment. It develops sense of ownership as well as enhances level of satisfaction in the employees which lead to motivate the employees to make consistent efforts in accomplishment of tasks and in achieving the organizational goals.

The findings proved the mediation of organizational commitment in compensation system / organizational justice and employees' performance. This makes the link between the practice of adequate compensation system / organizational justice and employees' performance more clear. According to mediation of organizational commitment, appropriate compensation system and organizational justice firstly enhances the level of organizational commitment and then the employees having developed adequate level of organizational commitment demonstrate high level of performance.

Conclusion and Recommendations

This sections deals with the Conclusions drawn on the basis of findings and results of data analysis, besides highlighting research limitations & suggesting directions for future research.

Conclusion

The review of studies by Park, Y.S et al., (2007); Anvari et al., (2011) and Gungor (2011) found positive and significant relationship between compensation received and effective commitment, organizational commitment and employees' performance and financial reward and employees' performance.

This study examined the impact of compensation system and organizational justice on employees' performance. The results show that both positively and significantly determine the employees' performance.

This study also examined the mediating role of organizational commitment between the independent variables (compensation system and organizational justice) and employees' performance. The results show that mediating role of organizational commitment is significant. Therefore, the present study is in consistence with and validate the above referred studies.

Recommendations

Based on the result of the study, the following recommendations are made:

- a) In order to achieve organizational goals through optimal performance of employees, an organization must offer adequate compensation.
- b) Organizations must ensure fairness and equitable treatment to all employees in order to have committed manpower.
- c) A satisfied, committed and motivated human resource may contribute effectively through its high performance towards organizational efficiency and profitability. Adequate compensation system and exemplary fairness are effective tools for maintaining efficient and productive human resource.

Limitations and Future Research

The following are the limitations of this study which may open venues for future research:

- a) Due to limited resources and time constraints, only one power distribution company was taken as target population for this study. The power sector in Pakistan comprises of government owned entities and dozens of independent power producers. Therefore, researchers may take one company from each province, all the government owned power companies including generation companies, or the whole power sector of Pakistan as target population.
- b) The scope of study can be further broadened by incorporating more variables.
- c) The mediating effect of only one variable has been studied. Further results can be obtained by substituting the mediating variables and introducing moderating variables.

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