

**SUB THEME: HUMAN RESOURCE MANAGEMENT**

**PERFORMANCE BASED PAY MANAGEMENT AS A  
DETERMINANT OF EXTRINSIC AND INTRINSIC JOB  
SATISFACTION**

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**Abstract**

Recent studies about workplace compensation reveal that the ability of management to appropriately implement performance based pay may have a significant impact on job satisfaction. Although this correlation is significant, the role of performance based pay management as an important determinant has been given less attention in workplace compensation research literature. Therefore, this study was undertaken to investigate the correlation between performance based pay management and job satisfaction. Survey questionnaires were employed to collect data from employees at fire and rescue organizations in Malaysia. The outcomes of SmartPLS path model analysis showed two important findings: first, performance based pay management was an important determinant of job satisfaction. Second, specific components of performance based pay management: (1) communication, participation and performance appraisal were important determinants of extrinsic job satisfaction, (2) communication, and performance appraisal were important determinants of intrinsic job satisfaction, and (3) participation was not important determinant of intrinsic job satisfaction in the studied organization. Further, this study provides discussion, implications and conclusion.

**Keywords:** Performance based pay, management, job satisfaction, SmartPLS

**INTRODUCTION**

Pay system is often viewed as an important function of human resource department where human resource managers carry out important duties and responsibilities to plan and implement financial and non-financial rewards to employees who work in different job levels and categories (Ismail, Mohammad Fuad, Aimi, Hasan Al-Banna, Rashidi, 2014; Ismail, Anuar, Haron & Kawangit, 2015; Milkovich et al., 2014). Traditionally, in the early development of organizations, many employers design job based pay as a mean to allocate various rewards based on employees' job structures such as seniority, length of service and work classifications (Ismail et al, 2014; Ismail & Zakaria, 2009; Markova & Ford, 2011). Although this pay system may help organizations to achieve their goals, many scholars view that it is most appropriate for small-medium organizations that operate in domestic, stable and less competition environments (Aaron, Harris, McDowell & Cline, 2014; Baule & Soost, 2016).

Rapidly development and transformation of small-medium organizations to become global organizations have motivated employers to shift their compensation paradigms from a traditional job based pay to performance based pay in order to achieve their strategies and goals. Under this new pay system, employers have allocated extra reward based on employees' performance such as merit, skills, knowledge, competency and/or productivity (Ismail & Zakaria, 2009; Cloutier, Morin & Renaud, 2013; Osterloh, 2014). Many researchers recognize that the implementation of this pay system brings more positive impacts than job based pay because it may strongly attract, motivate and retain high performing employees to improve job efficiency and productivity, as well as maintain and enhance organizational competitiveness in an era of globalization (Ahmad & Scott, 2015; Auh & Menguc, 2013).

A review of the recent literature pertaining to workplace compensation highlights that competent management is an essential factor to enhance the effectiveness of performance based pay in successful organizations. Competent management often emphasize on three management techniques: communication, participation and performance appraisal (Anuar, Ismail & Abdin, 2014; Salim, Roszaide, Ismail & Yusoff, 2015). Surprisingly, extant studies about pay for person reveal that the capability of management to appropriately implement communication, participation and performance appraisal in determining pays based on performance may have a significant impact on employees' outcomes, especially job satisfaction (Appelbaum, Louis, Makarenko, Saluja, Meleshko & Kulbashian, 2013; Khan, Karim & Jan, 2014; Malik, 2013).

Even though the nature of this relationship has been investigated, the role of performance based pay management as an important determinant has not been thoroughly explained in the workplace compensation research literature (Anuar et al., 2014; Ismail et al., 2011; Ismail et al., 2014). Therefore, this situation motivates the researchers to further discover the nature of this relationship. Specifically, this study aims to answer twofold objectives: first, to assess the correlation between performance based pay management and job satisfaction. Second, to assess the correlation between specific components of performance based pay management (i.e., communication, participation and performance appraisal) and job satisfaction.

## **LITERATURE REVIEW**

Performance based pay management consists of three important dimensions: communication, participation and performance appraisal. First, communication is broadly defined as an employer openly and honestly delivers the information about performance based pay to its employees (Ismail et al., 2014; Milkovich et al., 2014; Salim et al., 2015). Second, participation is generally interpreted as management and employees at different hierarchical levels and categories involving in decision-making, information-processing and/or problem-solving activities related to the design and implementation of performance based reward system (Salim et al., 2015; Shaed, Ishak & Ramli, 2015).. Third, performance appraisal is commonly defined as a cyclical process whereby employers assess employee

performance based on formal appraisal methods and outcomes of this appraisal will be used to allocate rewards based on different levels of employee performance (Ismail, Nur Asilah & Mohamad Rahmad, 2016). While, job satisfaction is mostly defined as individual attitudes toward their working conditions and working environments (Fiorillo & Nappo, 2014; Ismail, Adnan, Awang, Rani & Ismail, 2015; Marasi & Ford, 2016; Joung, Goh, Huftman, Jessica & Surlis, 2015). as well as positive emotional response of employees to their jobs conditions (Bednarska & Szczyt, 2015; Chatzoudes, Chatzoglou & Vraimaki, 2015; Dierendonck, 2015). In the context of workplace compensation, high or low levels of employees' job satisfaction is strongly affected by performance based pay management (Ismail et al., 2014; Jackson, Rossi, Hoover & Johnson, 2012).

Relationship between performance based pay management and employee behavior is consistent with the notion of organizational behaviour theory. For example, Adams' (1963) Equity Theory explains that if an individual views that outcomes that he/she receive equitable with his/her contribution (e.g., effort and/or merit) this may invoke positive actions. Besides that, Lawler's (1971) Discrepancy Theory suggests that if an individual feels that outcomes that he/she receive fulfil his/her expectations (e.g., contribution and/or effort) this may result in positive behaviour. Further, Lazear and Rosen's (1981) Tournament Theory describes that if an individual perceived that if pay differentials are provided based on individual merit this may invoke positive behavior (Han, Ken & Lee, 2015; Milkovich et al., 2014; Pepper & Gore, 2015). The notion of these theories has gained strong support from performance based pay research literature.

For example, several extant studies were conducted using direct effects model to evaluate performance based pay in different organizational settings, such as perceptions of 20,000 employees from electronic component manufacturing organizations of Singapore and China (Malik, 2013), 331 employees of Malaysian private institutions of higher learning (Anuar et al., 2014), 98 Indian business executives in India (Yadav & Rangnekar, 2015), 22,547 employees from 48 European countries (Pacheco & Webber, 2016). These studies reported two important findings: first, the ability of management to appropriately implement performance based pay had enhanced employees' job satisfaction. Second, the ability of management to appropriately practice the specific components of performance based pay i.e., communication, participation and performance appraisal had enhanced employees' extrinsic job satisfaction and intrinsic job satisfaction in the respective organizations (Anuar et al., 2014; Malik, 2013; Pacheco & Webber, 2016; Yadav & Rangnekar, 2015). Thus, it was hypothesized that:

1. H1: There is a positive relationship between performance based pay management and job satisfaction.
2. H2: There is a positive relationship between performance based pay management and extrinsic job satisfaction.
3. H3: There is a positive relationship between performance based pay management and intrinsic job satisfaction.

## RESEARCH METHODOLOGY

A cross-sectional research design was employed because it allows the researchers to integrate the performance based reward literature and the actual survey as main procedure to collect data for this study. This data collection procedure may help the researchers to gather accurate data, decrease bias and increase quality of data being collected (Cresswell, 1998; Sekaran & Bougie, 2010). This study was conducted at Malaysian fire and rescue departments. At the early stage of this study, telephone interview method was conducted involving five officers who had working experience of more than 10 years in the organizations. The information gathered from the interview method helped the researchers to understand the nature and features of performance based pay management, and job satisfaction, as well as the relationship between such variables in the organizations. Next, the information gathered from the participants was used to improve and verify the content and format of the survey questionnaire for an actual research. Further, a back translation technique was employed to translate the survey questionnaires; thus, there are English and Malay versions in order to increase the validity and reliability of research findings (Cresswell, 1998; Sekaran & Bougie, 2010).

The survey questionnaire consists of four major parts: first, communication had 4 items adapted from performance based pay management literature (Anuar et al., 2014; Singh, 2009; Milkovich et al., 2014). Second, participation had 3 items adapted from performance based pay management literature (Brown, Hyatt & Benson, 2010; Ismail et al., 2011; Milkovich et al., 2014). Third, performance appraisal had 3 items adapted from performance based pay management literature (Ismail et al., 2011; Milkovich et al., 2014). Fourth, extrinsic job satisfaction had 3 items and intrinsic job satisfaction had 3 items adopted from the Warr, Cook and Wall's (1979) job satisfaction scale. All these items were measured using a 7-item scale ranging from "strongly disagree/dissatisfied" (1) to "strongly agree/satisfied" (7). Demographic variables were used as controlling variables because this study emphasizes on employee attitudes.

A purposive sampling technique was utilized to collect 155 survey questionnaires from employees of the studied organizations. This sampling technique was used because the management of the organization had not given the list of registered employees to the researchers and this situation could not allow the researchers to apply a random technique in choosing respondents for this study. The participants gave their consent prior to answering the survey questions, and it was done on a voluntary basis.

The SmartPLS package was used to assess the survey questionnaire data because it may provide latent variable scores, avoid small sample size problems, estimate every complex model with many latent and manifest variables, hassle stringent assumptions about the distribution of variables and error terms, and handle both reflective and formative measurement models (Henseler & Chin, 2010; Ringle, Wende & Will, 2005). The procedure of analysing data is: first, SmartPLS path model was employed to assess the path coefficients for the structural model using the standardized beta ( $\beta$ ) and t statistics. The value of  $R^2$  was used as an indicator of the overall predictive strength of the model. The value of  $R^2$  is

interpreted as follows; 0.19 (weak), 0.33 (moderate) and 0.67 (substantial) (Henseler & Chin, 2010; Chin, 2001). Second, an additional assessment of model fit in PLS analysis was carried out to test predictive relevant using blindfolding ( $Q^2$  statistic). According to Chin (2001), the  $Q^2$  statistic is a jackknife version of the  $R^2$  statistic. It represents a measure of how well observed values are reconstructed by the model and its parameter estimates. A model with  $Q^2$  greater than zero is considered to have predictive relevant. The value of  $Q^2$  is considered as follows: 0.02 (small), 0.15 (medium), and 0.35 (large) (Hair, Hult, Sarstedt & Ringle, 2014).

## RESULTS

The majority of respondents of this study were males (80%), aged from 25 to 34 years old (45%), Malaysia Certificate of Education holders (67%), clerical and support staff (69%), working experiences from 5 to 14 years (38%), monthly salary between Malaysian Ringgit 1000 and 2499 (47%), and married employees (74%).

Table 1 shows the factor loadings and cross loadings for different constructs. The correlation between items and factors had higher loadings than other items in the different concepts; and the loadings of variables were greater than 0.70 in their own constructs in the model, and these values are considered adequate (Henseler & Chin., 2010). Overall, the validity of the measurement model has met the criteria. Meanwhile, the values of composite reliability for all constructs were greater than 0.80, indicating that the instrument used in this study had high internal consistency (Henseler & Chin., 2010; Nunally & Bernstein, 1994).

Table 1 - The Results of Factor Loadings and Cross Loadings for Different Constructs, and Composite Reliability

Construct	No. Of Item	Cross Factor Loading					Composite Reliability
		1	2	3	4	5	
1. Communication	4	0.753 to 0.809					0.859
2. Participation	3		0.782 to 0.867				0.863
3. Performance Appraisal	3			0.706 to 0.859			0.829
4. Extrinsic Job Satisfaction	3				0.801 to 0.869		0.884
5. Intrinsic Job Satisfaction	3					0.753 to 0.812	0.825

Table 2 shows the results of convergent and discriminant validity analyses. All concepts had the values of AVE larger than 0.5, indicating that they met the acceptable

standard of convergent validity (Barclay et al, 1995; Fornell & Larker, 1981). Besides that, all concepts' values of AVE in diagonal were greater than the squared correlation with other concepts in off-diagonal, signifying that all concepts met the acceptable standard of discriminant validity (Henseler & Chin., 2010; Yang, 2009).

Table 2 - The Results of Convergent and Discriminant Validity Analyses

Construct	AVE	1	2	3	4	5
1. Communication	0.604	0.777				
2. Participation	0.677	0.412	0.823			
3. Performance Appraisal	0.619	0.418	0.434	0.787		
4. Extrinsic Job Satisfaction	0.717	0.514	0.438	0.477	0.847	
5. Intrinsic Job Satisfaction	0.611	0.423	0.321	0.464	0.665	0.781

Table 3 shows the results of variance inflation factor and descriptive statistics. The means for all constructs ranged from 4.9419 to 5.2280 signifying that majority of respondents perceived that the levels of communication, participation, performance appraisal and job satisfaction ranged from high (4) to highest level (7) in the organizations. Meanwhile, the values of variance inflation factor for the relationship between the independent variable (i.e., communication, participation and performance appraisal) and the dependent variable (i.e., job satisfaction) were less than 5.0, signifying that the data were not affected by serious collinearity problem (Hair et al., 2014). These results further confirmed that the instrument used in this study has met the acceptable standards of validity and reliability analyses.

Table 3 - The Results of Variance Inflation Factor and Descriptive Statistics

Construct	Mean	Standard Deviation	Variance Inflation Factor	
			4	5
1. Communication	5.1871	.64629	1.317	1.317
2. Participation	4.9419	.64033	1.339	1.339
3. Performance Appraisal	5.1118	.64385	1.347	1.347
4. Extrinsic Job Satisfaction	5.0495	.67505		
5. Intrinsic Job Satisfaction	5.2280	.53012		

Table 4 shows that the inclusion of performance based pay management in the analysis explained 40 percent of the variance in job satisfaction. In terms of predictive strength of this model, it provides a moderate support for the overall model (Hair et al., 2014). Specifically, the results of testing the research hypothesis showed that performance based pay management was significantly correlated with job satisfaction ( $\beta=0.636$ ;

$t=14.253$ ), therefore H1 was supported. This result confirms that performance based pay management is an important determinant of job satisfaction.

Table 4: The Outcomes of Testing H1

Structural Path	Path Coefficient	R <sup>2</sup>
H1: Performance based Pay Management and Job Satisfaction	$\beta=0.636$ ; $t=14.253^*$	0.404

Note: Significant at  $* > 1.96$

As an extension to the testing of the research hypotheses, a test of predictive relevance for the reflective endogenous latent variable was further conducted using Blindfolding procedure. The result of this test show that the value of Q<sup>2</sup> for job satisfaction was 0.207, indicating that it was greater than zero for the reflective endogenous latent variable. This result has predictive relevance. In terms of explanatory power, the Q<sup>2</sup> value for extrinsic job satisfaction was greater than 0.15 (Hair et al., 2014), showing that it had medium predictive relevance.

Table 5 shows that the inclusion of performance based pay management in the analysis explained 38 percent of the variance in extrinsic job satisfaction. In terms of predictive strength of this model, it provides a moderate support for the overall model (Hair et al., 2014). Specifically, the results of testing the research hypothesis showed that communication was significantly correlated with extrinsic job satisfaction ( $\beta=0.328$ ;  $t=4.300$ ), therefore H2a was supported. This result confirms that communication is an important determinant of extrinsic job satisfaction. Second, participation was significantly correlated with extrinsic job satisfaction ( $\beta=0.194$ ;  $t=2.307$ ), therefore H2b was supported. This result confirms that participation is an important determinant of extrinsic job satisfaction. Third, performance appraisal was significantly correlated with extrinsic job satisfaction ( $\beta=0.256$ ;  $t=3.579$ ), therefore H2c was supported. This result confirms that performance appraisal is an important determinant of extrinsic job satisfaction.

Table 5: The Outcomes of Testing H2 (H2a, H2b and H2c)

Structural Path	Path Coefficient	R <sup>2</sup>
H1: Communication → Extrinsic Job Satisfaction	$\beta=0.328$ ( $t=4.300$ )*	0.377
H2: Participation → Extrinsic Job Satisfaction	$\beta=0.194$ ( $t=2.307$ )*	
H3: Performance Appraisal → Extrinsic Job Satisfaction	$\beta=0.256$ ( $t=3.579$ )*	

Note: Significant at  $* > 1.96$

As an extension to the testing of the research hypotheses, a test of predictive relevance for the reflective endogenous latent variable was further conducted using Blindfolding procedure. The result of this test show that the value of Q<sup>2</sup> for job satisfaction was 0.243, indicating that it was greater than zero for the reflective endogenous latent

variable. This result has predictive relevance. In terms of explanatory power, the  $Q^2$  value for extrinsic job satisfaction was greater than 0.15 (Hair et al., 2014), showing that it had medium predictive relevance.

Table 6 shows that the inclusion of performance based pay management in the analysis explained 29 percent of the variance in intrinsic job satisfaction. In terms of predictive strength of this model, it provides a weak support for the overall model (Hair et al., 2014). Specifically, the results of testing the research hypothesis showed that communication was significantly correlated with intrinsic job satisfaction ( $\beta=0.261$ ;  $t=3.634$ ), therefore H3a was supported. This result confirms that communication is an important determinant of intrinsic job satisfaction. Second, participation was significantly correlated with intrinsic job satisfaction ( $\beta=0.072$ ;  $t=0.923$ ), therefore H3b was supported. This result confirms that participation is an important determinant of intrinsic job satisfaction. Third, performance appraisal was significantly correlated with intrinsic job satisfaction ( $\beta=0.325$ ;  $t=3.698$ ), therefore H3c was supported. This result confirms that performance appraisal is an important determinant of intrinsic job satisfaction.

Table 6: The Outcomes of Testing H3 (H3a, H3b and H3c)

Structural Path	Path Coefficient	R <sup>2</sup>
H1: Communication → Intrinsic Job Satisfaction	$\beta=0.261$ ( $t=3.634$ )*	0.286
H2: Participation → Intrinsic Job Satisfaction	$\beta=0.072$ ( $t=0.923$ )*	
H3: Performance Appraisal → Intrinsic Job Satisfaction	$\beta=0.325$ ( $t=3.698$ )*	

Note: Significant at  $* > 1.96$

As an extension to the testing of the research hypotheses, a test of predictive relevance for the reflective endogenous latent variable was further conducted using Blindfolding procedure. The result of this test show that the value of  $Q^2$  for intrinsic job satisfaction was 0.150, indicating that it was greater than zero for the reflective endogenous latent variable. This result has predictive relevance. In terms of explanatory power, the  $Q^2$  value for intrinsic job satisfaction was equal with 0.15 (Hair et al., 2014), showing that it had medium predictive relevance.

## DISCUSSION AND CONCLUSION

The findings of this study generally show that performance based pay management has been an important determinant of job satisfaction. In particular, specific components of performance based pay: (1) communication, participation and performance appraisal have been important determinants of extrinsic job satisfaction, (2) communication, and performance appraisal have been essential determinants of intrinsic job satisfaction, and (3) participation has not been an important determinant of intrinsic job satisfaction in the studied organizations.



In the context of this study, management has implemented performance based pay according to the policies and rules as established by their stakeholders. Majority of the respondents perceived that the levels of performance based pay management, communication, participation, performance appraisal, extrinsic job satisfaction and intrinsic job satisfaction are high. This situation generally explains that management of performance based pay may enhance job satisfaction. Specifically, implementation of communication, participation and performance appraisal may enhance extrinsic job satisfaction, as well as implementation of communication, and performance appraisal may enhance intrinsic job satisfaction. Conversely, implementation of participation may not lead to higher intrinsic job satisfaction in the organizations.

This study provides three important implications: theoretical contribution, robustness of research methodology, and practical contribution. In terms of theoretical contribution, the findings of this study confirm that performance based pay management has been an effective determinant of job satisfaction. While, specific components of performance based pay that are communication, (1) participation and performance appraisal have been essential determinants of extrinsic job satisfaction, and (2) communication and performance appraisal have been effective determinants of intrinsic job satisfaction in the organizations. This result also has supported and broadened studies by Malik (2013), Anuar et al. (2014), Yadav and Rangnekar (2015), and Pacheco and Webber (2016).

On the contrary, participation has not been an important determinant of intrinsic job satisfaction in the organizations. A thorough review of the interview outcomes shows that this result may be affected by external factors: first, the majority respondents have different personal and service backgrounds and these differences may create different values and judgments among respondents about the importance of participation style in managing performance based pay. Second, as a uniformed organization, the organizations use tall structures, centralized decision making, strict standard operating procedures and high power distance in the interaction among different ranks and positions. This organizational situation may decrease the freedom of employees to implement participative decision making in performing daily job. These factors may lead to reduced effectiveness of participation style in managing performance based pay models of the organizations.

In regard to the robustness of research methodology, the survey questionnaire used in this study satisfactorily met the criteria of validity and reliability analyses. This situation could lead to accurate and reliable research findings.

With respect to the practical contribution, the findings of this study can be used as guidelines by practitioners to improve the management of performance based pay in their organizations. This intention may be achieved if management focuses on the following matters: first, monetary and non-monetary payments for high performers should be adjusted according to the current national cost of living and organizational expectations in order to motivate high performers support their organizations' goals. Second, leaders' mentor and coach should be encouraged to upgrade the capability of middle and junior managers in handling and solving employees' complaints and demands. Third, cooperation between

organization and university in education and training should be held in helping employees to upgrade their new competencies and career prospects. Finally, succession plan should be well-designed and implemented at top and middle management levels in order to determine talented and competent managers are hired to fulfil important and higher positions in organizations. If these suggestions are given more attention, this may stimulate employees to accept and appreciate the performance based pay goals.

This study has several limitations. First, a cross-sectional research design used in this study may not capture causal connections between the variables of interest. Second, the outcomes of SmartPLS path model analysis did not measure the relationship between specific indicators for the independent variable and dependent variable. Third, the sample of this study is limited to uniformed employees at one defence and security organizational sector. Fourth, this study only measures a direct relationship between the independent variable and the dependent variable without examining the interference of other factors such as respondent characteristics in this transaction. Finally, this study uses a non-probability sampling technique to collect survey questionnaires from respondents and this may expose to the response biases. If these limitations are strongly considered, a better finding may be exposed for future research.

This study provides several suggestions that may be used to improve future research in this field: first, several organizational and personal characteristics should be further discovered, whereby this may show meaningful perspectives in understanding how individual similarities and differences affect the implementation of performance based pay by the organizations. Second, other research designs (e.g., longitudinal studies) should be utilized to collect the data and describe the patterns of change and the direction and magnitude of causal relationships amongst variables of interest. Third, to fully understand the effect of performance based pay on employee outcomes, more varied organizations need to be involved. Fourth, a larger sample size should be collected in order to better characterize the studied population. Finally, other specific elements of employee outcomes such as job performance, turnover, motivation and ethics need to be considered as important outcomes of performance based pay. The importance of these issues needs to be further discovered in future research.

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