



Faculty of Cognitive Sciences and Human Development

**RELATIONSHIP BETWEEN PAY-FOR-PERFORMANCE
AND DISTRIBUTIVE JUSTICE:
THE MODERATING ROLE OF EMPLOYEE PERFORMANCE APPRAISAL**

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Statement of Originality

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**“RELATIONSHIP BETWEEN PAY-FOR-PERFORMANCE AND
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THE MODERATING ROLE OF EMPLOYEE PERFORMANCE
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TABLE OF CONTENTS

Acknowledgement	iv
Table of Content	v
List of Figures	viii
List of Tables	ix
Abstract	x
<i>Abstrak</i>	xi

CHAPTER 1 INTRODUCTION

1.0	Introduction	1
1.1	Background of Study	1
1.2	Background of Sutera Harbour Resort Kota Kinabalu, Sabah	2
1.3	Problem Statement	4
1.4	Research Objectives	5
1.5	Conceptual Framework	6
	1.5.1 General Theory	6
1.6	Research Hypotheses	7
1.7	Operational Definition of Term	8
1.8	Significance of the Study	9
1.9	Conclusion	11

CHAPTER 2 LITERATURE REVIEW

2.0	Introduction	12
2.1	Pay-For-Performance	12
	2.1.1 Definition of Pay-For-Performance	12
	2.1.2 Elements of Pay-For-Performance	13
	2.1.3 Role of Pay-For-Performance	13
2.2	Distributive Justice	14
	2.2.1 Definition of Distributive Justice	14
	2.2.2 Role of Distributive Justice	14
2.3	Employees' Performance Appraisal	15
	2.3.1 Definition of Employees' Performance Appraisal	15
	2.3.2 Element of Employees' Performance Appraisal	16
	2.3.3 Role of Employees' Performance Appraisal	16
2.4	Relationship between Pay-For-Performance and Distributive Justice	17

2.4.1	Theoretical Evidence Supporting the Relationship between Pay-For-Performance and Distributive Justice	17
2.4.2	Empirical Evidence Supporting the Relationship between Pay-For-Performance and Distributive Justice	18
2.5	Relationship between Employees' Performance Appraisal and Distributive Justice	18
2.5.1	Theoretical Evidence Supporting Relationship between Employee Performance Appraisal and Distributive Justice	18
2.5.2	Empirical Evidence Supporting the Relationship between Employee Performance Appraisal and Distributive Justice	19
2.6	Relationship between Pay-For-Performance, Employees' Performance Appraisal and Distributive Justice	20
2.6.1	Theoretical Evidence Supporting the Relationship between Pay-For-Performance, Distributive Justice and Employee Performance Appraisal	20
2.6.2	Empirical Evidence Supporting the Relationship between Pay-For-Performance, Distributive Justice and Employees' Performance Appraisal	21
2.7	Conclusion	21

CHAPTER 3 RESEARCH METHODOLOGY

3.0	Introduction	22
3.1	Research Design	22
3.2	Data Collection Techniques	
3.2.1	Phase 1: Interview	23
3.2.2	Phase 2: Pilot Study	23
3.2.3	Phase 3: Actual Study	23
3.3	Measures	24
3.4	Research Location, Population and Sample	25
3.5	Data Analysis Techniques	27
3.5.1	Data Screening	27
3.5.2	Validity and Reliability	27
3.6	Pilot Study Result	28
3.7	Pearson Correlation Analysis	28
3.8	Hierarchical Regression Analysis	29
3.9	Conclusion	29

CHAPTER 4 FINDINGS AND DISCUSSION

4.0	Introduction	30
4.1	Participants Characteristics	30
4.2	Data Screening Test Results	32

4.3	Exploratory Factor Analysis	33
4.4	Validity and Reliability Test	34
4.5	Descriptive Statistic and Pearson Correlation Analysis	35
4.6	Testing Moderating Model	37
4.7	Discussion	39
4.8	Conclusion	40

CHAPTER 5 SUMMARY, RECOMMENDATIONS AND CONCLUSION

5.0	Introduction	41
5.1	Summary of the Study	41
5.2	Research Implications	43
	5.2.1 Implication to Theory	43
	5.2.2 Implication to Research Methodology	43
	5.2.3 Implication to Practitioners	44
5.3	Limitation of the Study	45
5.4	Recommendations for Future Research	46
5.5	Conclusion	47
	References	48
	APPENDIX 1	53
	APPENDIX 2	59
	APPENDIX 3	60

LIST OF FIGURES

Figure 1.5

Conceptual Framework 6

Figure 5.4

Recommended Conceptual Framework 47

LIST OF TABLES

Table 3.3	
Levels of Likert Scale	25
Table 3.6	
Pilot Test Result	28
Table 4.1	
Respondent Characteristics	31
Table 4.2	
Data Screening Test Results	32
Table 4.3	
Exploratory Factor Analysis	34
Table 4.4	
Goodness of Data	35
Table 4.5	
Correlation Matrix Table	36
Table 4.6	
Results for Hierarchical Regression Analysis with Employees' Participation as the Moderator and Distributive Justice as the Dependent Variable	37

ABSTRACT

RELATIONSHIP BETWEEN PAY-FOR-PERFORMANCE AND DISTRIBUTIVE JUSTICE: THE MODERATING ROLE OF EMPLOYEE PERFORMANCE APPRAISAL

Jacqueline Sikta

This study was conducted to measure the moderating effect of employees' participation as the selected element of employee performance appraisal in the relationship between pay-for-performance and distributive justice. A survey research method was used to gather 129 usable questionnaires from employees who have worked in Sutera Harbour Resort Kota Kinabalu (SHR), Sabah. The outcome of hierarchical regression analysis confirms that relationship between employee participation and pay-for-performance ($\beta = 0.521$, $p = 0.000$) had increased perceived distributive justice. This result confirms that employee participation does act as full moderating variable. Therefore, it is vital for HR practitioner to involve employees in the performance appraisal system as this can influence the employees' perception towards the allocation of pay-for-performance. In addition, the implications of this study to compensation theory and practice, conceptual and methodological limitations and directions for future research are further discussed in this research.

ABSTRAK

PERHUBUNGAN DI ANTARA PAMPASAN BERDASARKAN PRESTASI DAN KEADILAN DISTRIBUTIF. PENILAIAN PRESTASI PEKERJA SEBAGAI PEMBOLEHUBAH PENYEDERHANA.

Jacqueline Sikta

Kajian ini dilaksanakan untuk mengukur peranan persepsi penglibatan pekerja iaitu elemen terpilih dalam penilaian prestasi pekerja sebagai pembolehubah penyederhana di antara gaji berdasarkan prestasi dan keadilan distributif. Kaedah tinjauan telah digunakan bagi mengumpul 129 borang soal selidik daripada pekerja di Sutera Harbour Resort Kota Kinabalu (SHR), Sabah. Keputusan analisis regresi hierarki menunjukkan bahawa interaksi antara gaji berdasarkan prestasi dan penglibatan pekerja ($\beta = 0.521$, $p = 0.000$) mampu meningkatkan persepsi terhadap keadilan distributif. Dapatan kajian ini mengesahkan bahawa penglibatan pekerja bertindak sebagai pembolehubah penyederhana penuh. Oleh itu, adalah amat penting bagi para pegawai Sumber Manusia untuk menekankan penglibatan dari pekerja terutama sekali dalam sistem penilaian prestasi pekerja kerana ini boleh memberi pengaruh ke atas persepsi pekerja tentang pengagihan pampasan berdasarkan prestasi. Turut dibincangkan dalam tulisan ini adalah implikasi kajian terhadap teori pampasan dan amalan, limitasi – limitasi kerangka teori dan metodologi kajian sedia ada serta cadangan kajian lanjut untuk masa akan datang.

CHAPTER 1

INTRODUCTION

1.0 Introduction

This chapter consists of eight sections. The first section would be background of study which briefly discusses the history and global view of the independent variable and followed by the background of an organization as the target population. The third section contains the problem statement which highlights the theoretical, empirical and practical gap of this study. The research objectives would be in the fourth section of this chapter. The conceptual framework of this study and the general theory which explains the relationships of variables both in the fifth section while hypotheses of the study would be in the sixth section and followed by the seventh section is definition of terms, next eighth section in this chapter would be the significance of this study to the theory, research methodology and practitioner. Finally, the conclusion of this chapter would be in the ninth section.

1.1 Background of Study

Compensation in a global standpoint is commonly renowned as the plan by which rewards and pays are distributed to an employee (Barr, 1998). Compensation

defined as pay, reward, remuneration or wages and salary. It is part of crucial function of human resource management because it deals with employment relationship between employer and employees. According to Brown and Huber (1992), the attitude of employees towards performance rewards affected by perception on fairness of the pay system which include the procedures as well as the outcome of the procedures (i.e. monetary rewards). Therefore if pay systems are properly designed, it will lead perceived distributive justice among employees (Milkovich and Newman, 2005).

Pay-for-performance policy is also known as variable-pay (Milkovich and Newman, 2007) and same context with performance-related-pay is compensation plans that pay employees on the basis of performance measure (Ismail *et. al*, 2007). Pay-for-performance is probably most compatible with expectancy and equity theory. Therefore employee feedback on their reaction to organizational rewards (i.e. monetary and non-monetary) is often use as a primary criterion to assess compensation systems' effectiveness (Dulebohn and Martocchio, 1988). Moreover employees' reaction also used to inform future adjustment on compensation plan development or structure that indicates the hierarchical relationship created among pay rates for employees with different jobs within the organization (Milkovich and Newman, 2008; Wallace and Fay, 1988).

The increasing popularity of pay-for-performance policy can be explained in terms of both motivation and cost control (Wallace and Fay, 1988; Chang and Hahn, 2006). However little is known on the effect of pay-for-performance practice in Malaysia.

1.2 Background of Sutera Harbour Resort

Sutera Harbour Resort (SHR) is a 5-stars hotel which situated in Kota Kinabalu Sabah, Malaysia. This hotel started the business in October 1994 and was launched by the former Prime Minister of Malaysia, Tun Dr. Mahathir Mohamad. (n.a, 2007). Operated by 1696 number of employees, SHR gives a big contribution to the tourism

in Sabah, specifically in Kota Kinabalu. The vision and mission of the company are clearly communicated by superior.

“To be recognized as the most dynamic and profitable market leading hospitality, leisure and lifestyle group in Asia” is the vision of SHR. While the mission of SHR is; *“The Sutera Harbour Group will provide unique and memorable experiences for customer, be the preferred employer and deliver sustainable growth for stakeholders.”*

Other than that, SHR believes on core values as standard of attitude and behavior which aid in attaining mission and vision of company. There are 10 core values on embraced by every practice in the company; *Integrity, Passion and Creativity, Professionalism, Teamwork, Customer Focus, Community Involvement, Ownership and Responsibility, Protect the Environment, Respect and Profitability.*

A unique practice in SHR is in the way the associates greet the customers. SHR preferred to greet in Malay language, for example, *“Selamat pagi. How may I assist you, sir?”* And a remarkable ending of conversation with customer *“Have a great staying with us”* or *“Have a great day.”* This practice had made SHR uniquely different from other hotels in Kota Kinabalu. Based on practical observation which supported by resource of information and details told by experts in SHR, the compensation system which been practiced in the company is set of combination on fixed pay and variable pay. Fixed pay is the basic salary (i.e. base pay, cash pay) while variable pay consist of “service share” as well as reward for great achiever (i.e. Associate of The Month (AOTM) as monetary reward to performed employees of the month). The level of job is characterized into A, B, C and D, E. Hence, the service share only granted to employees in rank and file position that is at level D and E, while managerial groups only based on fixed salary and merit pay.

1.3 Problem Statement

Past research on pay-for-performance focused solely on classifying the consequences or outcomes of compensation based on individuals, group or team and organizational level (Gerhart and Milkovich, 1990; Milkovich and Newman, 2008). Traditionally, compensation which deal with pay or wages had been practiced differently across employment unit whereby it dealt with several dimension (Gerhart and Milkovich, 1990; Gerhart *et al.*, 1992; Gerhart *et al.*, 1995). According to Gerhart *et al.*, (1995) these dimensions included determinant of points in organizations compensation system which had been proven to have influence on employee attitudes and behavior towards job. Job plays role in determining the form, structure and administration of payment system (Heneman and Schwab, 1979 cited in Milkovich and Newman, 2008). Therefore, the switch to a pay-for-performance policy should be managed as an organizational change (Chang and Hahn, 2006) because it will alter employees' level of job motivation. However little is known whether these plans enhance perception of distributive justice (Cole and Flint, 2003).

Today, in real organizational setting, intense pressure is being placed to identify and implement programs that will prove truly effective in improving employee productivity (Broderick, 1995 cited in Chang and Hahn, 2006). This includes the approaches of pay structure in compensation and benefit management (Milkovich and Newman, 2008). One of particular recent study on variable pay examined the relationship between pay-for-performance and distributive justice (Chang and Hahn, 2006). The study stated that an imperative issue on a need to discover the effectiveness on administration of in pay-for-performance is in aspect of organizational system (i.e. interrelation of performance appraisal and perception of distributive justice). Interestingly, numerous researches on organizational justice show that individuals are satisfied and committed to work once they perceive fairness in the system (Tang and Baldwin, 1996 cited in Tang and Baldwin, 2006).

Unexpectedly, there is very few empirical research overtly studies the moderator of employee performance appraisal on relationship of pay-for-performance and distributive justice (Milkovich and Newman, 2008) on hospitality workers in Malaysia, particularly in East Malaysia. Previous studies on the selected moderator effect had emphasized on fundamental criterion of performance measurements, commitment of managers on the practice, company practice, employee perception and participation during the process (Dipboye and Pontbriand, 1981; Campbell *et al.*, 1998; Chang and Hahn, 2006). Thus in this research, researcher will attempt to extent these past researches by examining the role employee participation in performance appraisal system in relationship between pay-for-performance and distributive justice.

1.4 Research Objectives

a. General

- i. To investigate the relationship between pay-for-performance and perceived distributive justice;
- ii. To investigate the relationship between employees' performance appraisal and perceived distributive justice; and,
- iii. To investigate moderating effect of employees' performance appraisal in the relationship between satisfaction on pay-for-performance and perceived distributive justice.

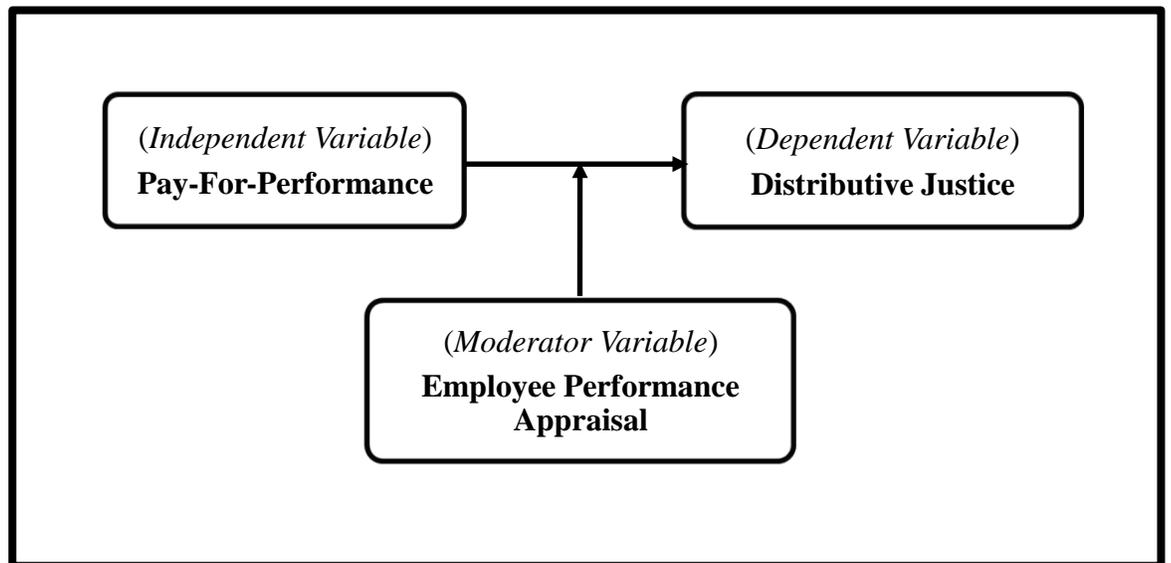
b. Specific

- i. To investigate the relationship between employees' participation in performance appraisal system and perceive distributive justice; and,
- ii. To investigate moderating effect of employees' participation in employees' performance appraisal system towards relationship between pay-for-performance and perceived distributive justice in allocating salary.

1.5 Conceptual Framework

Figure 1.5 show the conceptual framework which is been developed based on pay-for-performance literature. This framework highlights that effect of the independent variable e.g., pay-for-performance is indirectly influenced by the moderating variable e.g., employee performance appraisal, on the dependent variable e.g., distributive justice.

Figure 1.5: Organizational performance as moderator in the relationship between variable-pay-level and perceived income distributive.



(Source adapted and modified from Chang and Hahn (2006) *Does pay-for-performance enhance perceived distributive justice for collectivistic employees? Personnel Review*, 35 4, 397-412)

1.5.1 General Theory

Equity Theory

Equity theory stated that employees tend to do comparison on their output to others (Adams, 1965). Thus, when they perceive that the level of pay they received is practically almost the same on what they deserved to receive, relatively, they will feel satisfied with their pay. Those employees who perceive

that they were paid less than they deserved were relatively dissatisfied with their pay (Sweeney, 1990). According to Henderson (2000) employees often evaluate level of pay satisfaction based on two factors: (1) comparison between received salary and expected salary (2) comparison between received salary and salary that received by other employees in the organization. In addition, equity theory is also applicable in performance appraisal.

Employees wished that they were treated fairly by their supervisor. The feeling of inequity arose in performance appraisal when supervisors have potential to act bias in their evaluation (Tang and Baldwin, 2006). Equity issue is an important concept in work setting. As for employees, perception of inequity has been linked to a variety of important behaviors, including dissatisfaction with rewards, lowered effort on the job and willingness to leave the organization (Mowday, 1987; Sweeney, 1993).

1.6 Research Hypothesis

Direct effect hypothesis

- H1: There is a significant relationship between pay-for-performance and perceived distributive justice.
- H2: There is a significant relationship on employees' participation in performance appraisal system and perceive distributive justice.

Indirect effect hypothesis

- H3: Interaction between pay-for-performance and perceived distributive justice will positively moderate by employees' participation.

1.7 Operational Definitions of Term

Researcher will only explain the operational definition of important terms. The conceptual definition will be discussed in Chapter Two (2).

1.7.1 Pay-for-performance

It refers to pay plan to be assigned employees based on procedure which related to performance as a measurement. In this study pay-for-performance there are two components involved; pay level and the pay administration for pay-for-performance.

1.7.2 Distributive Justice

It refers to perceived fairness on procedures and/or total variable pay received as well as in perceived fairness on procedures and/or on employee performance appraisal system.

1.7.3 Employee Performance Appraisal

It refers to rating system on employees' and their performance with employee participation on pay-for-performance.

1.7.4 Employee Participation

Employees participate in giving feedback to the result of performance appraisal.

1.8 Significance of the Study

This research will contribute to three parties, which are:

1.8.1 Significance to Theories

The existing theory of organization justice; both procedural and distributive justice correlated with fairness (Sweeney and McFarlin, 1993; Tang and Baldwin, 1996). From previous studies, procedural justice have always link with the organizational procedures in practices (Sweeney and McFarlin, 1993; Ismail *et al.*, 2007) while distributive justice place employees perception on fairness of distribution of resources (Korsgaard and Roberson, 1995). Most of this theory overlooked the important aspects that able to explain the effect of proper implementation on employee performance appraisal as a moderator in the pay-for-performance.

The main concern in this study is not on examining such employees' attitudes or behaviors (i.e. intention to stay, organizational commitment and work motivation) towards organizational system, but rather the perception of distributive justice. Therefore in this study, researcher aim is to explanation on theories (i.e. equity theory and distributive justice) in enhancing the perception among employees to the total meaning of fairness. This is crucial because the attitude of employees towards affected by perception on fairness (Brown and Huber, 1992; McShane and Von Glinow, 2006). This study enables to extent knowledge regarding the significance of distributive justice theory in the realm of employee pay plan (Cole and Flint, 2003).

1.8.2 Significance to Research Methodology

The significance to research methodology is in the integration of steps in qualitative with conducting interview the experts, will increase the ability of minimizing the errors in data collection and analysis. This will help researcher to define clearly the situation or condition in the population and/or organization as a whole. In past study, it only used the quantitative method with 5-point Likert-type as the instrument to collect the data (Chang and Hahn, 2006). Hence, in this study, researcher will rank the survey questionnaire using 7-point Likert-type. This method gives a much more reliable and valid data for the study. Plus by conducting interview, pilot study and followed by actual study, researcher can determine the suitability of questionnaire for the target participant.

Besides that, factor analysis will be used as a method to determine validity by reducing a large set of variables to a smaller set of basic variables in survey questionnaire (Vaus, 1991). In the main part of extracting and varimax the factors, a minimum standard of validity and reliability of instrument can be accomplished. Hence, it will lead to a more accurate results and outcomes for the finding of study.

1.8.3 Significance to Human Resource Practitioners

Practically, this study hopes the information can be used for organizational development, knowing that organizational justice is an imperative issue which not only involves employees but also employers and all associates. Therefore, understanding and highlighting the gap in perception of distributive justice in pay-for-performance and performance appraisal can be classified as Human Resource Development (HRD) need for holistic development. Both employer and employees have to set up their mutual goal

which will enable to satisfy individuals and an organization, as this is the main point of total fairness. Hence, the results of this study able to:

- (1) Improved the content and method of the training program for pay administration and rating system;
- (2) Develop skills of raters and ratees (i.e. employee performance appraisal); and,
- (3) Designing and administrating effective pay system and effective performance appraisal system.

Besides that, this study will give the practitioner a chance to realize the important of satisfaction and perception of distributive justice on fixed and/or variable pay, in particular, to retain potential, talented and competent employee. The realization might aid in formulating strategy to increase return of investment not only based on capital equity but also in human capital instead.

1.9 Conclusion

In general, this chapter had discussed about the background of study, the problem statement, the objectives of the study, the conceptual framework and general theory, the research hypothesis, the operational definition of terms, and the significance of the study. This study conducted mainly to investigate the role of employee participation in employee performance appraisal in the relationship between pay-for-performance and distributive justice. The outcomes from this study will indicate whether it supports the finding of the previous studies. In addition, the conceptual framework in this study shows that pay-for-performance directly impact distributive justice. Employee participation in performance appraisal had a direct relationship with distributive justice concurrently it moderates pay-for-performance and distributive justice relationship. In the next chapter, the conceptual definition of terms, theoretical and empirical evidence will be discussed more in order to the relationship.

CHAPTER 2

LITERATURE REVIEW

2.0 Introduction

This chapter has seven main sections. The first section will defined the conceptual terms of pay-for-performance. The second section explains the conceptual term of distributive justice and followed by the third section of defining employees' performance appraisal with employees' participation as the element on it. The fourth, fifth and sixth sections will be discussing the theoretical and empirical evidence that supported the relationships. Lastly, the seventh section is the conclusion.

2.1 Pay-For-Performance

2.1.1 Definition of Pay-For-Performance

According to Milkovich and Newman (2008), pay-for-performance refers to a movement toward pay away from entitlement that varies with some measure of individual, group or organization. The concept of pay-for-performance is described as the processes of allocates money to the employees based on performance of individual, team or organization as a whole (Milkovich and Newman, 2008). Chang and Hahn (2004) stated that pay-for-