



The Mediating Effects of Organizational Justice in Determining the Relationship between Performance-Based Pay and Employees' Turnover Intention

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ABSTRACT

This is a study on employees' perception of justice towards performance-based pay and the effect of these perceptions on their turnover intention. This study aims to examine the mediating role played by distributive and procedural justice in linking pay distribution and pay procedure of performance-based pay to employees' turnover intention. A review of past literature in this particular area has prompted the researchers to narrow the gaps in previous studies. Towards that, this study utilized questionnaires which were administered among 50 non-managerial employees currently working in a private company located in Kuching, Sarawak, East Malaysia. Data analysis was done using Statistical Package for Social Sciences (SPSS), Version 20.0. Pearson Correlation and Stepwise Regression were used to examine the relationship between the variables. The outcomes of Stepwise Regression revealed that distributive justice fully mediated the relationship between pay distribution and employees' turnover intention in contrast to procedural justice which did not have a significant impact in the relationship. The findings of this study are useful references for organisation management of the pay system to improve employees' performance.

Keywords: employees' turnover intention; organizational justice; performance-based pay

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INTRODUCTION

In today's business environment, employees' turnover is becoming a serious issue in organizations especially in the field of human resource management, yet it is common in every type and size of organization and at every organizational level (Chan, Yeoh, Lim, & Osman, 2010). Generally, employees' turnover exists when employees resign from their job and they

must be replaced (Samuel & Chipunza, 2009) with the consequences of the performance appraisal exercise having direct or indirect impact on employees' behaviour at the workplace. The performance appraisal process has both positive and negative consequences in determining workers' job commitment, attitudes, ways of thinking, turnover intention and other related aspects in their career path. Performance-based pay has gained attention as a new trend in recent years with the linking of workplace reform and enterprise bargaining (Issac, 2001). Based on Kelly's survey (2013), the rates of performance-based pay recorded in Malaysia was 72% while 67% of the respondents proposed that pay should be linked to productivity. This reflects a widespread recognition of organisations towards individuals who tend to perform well if their interests are aligned to the pay system and many employees clearly believe in their ability to perform their jobs well. They want to be rewarded for their efforts and contributions. According to Salaman, Storey, and Billsberry (2005), performance-based pay system typically involves linking pay to performance which is measured by the achievement and contribution of an individual. This system can create a win-win situation, in which employees gain from the opportunity to perform better thus increasing their earnings while the employers gain benefit from increased productivity and a more engaged workforce (Kelly, 2013).

BACKGROUND OF THE STUDY

In past studies, researchers emphasized the impact of performance-based pay on work outcomes. They advocated that performance-based pay schemes were positively significant to work outcomes such as productivity and quality of work (Lazear, 1996; Lindanauer et al., 2007) and claimed

that performance-based pay can attract and retain the high potential employees as well as motivate them to increase and maintain productivity (Booth & Frank, 1999; Leritz, 2012). They believed that if every employee is rewarded with similar pay rise, then there is a risk of those high performing employees leaving the organization with intent.

On the other hand, numerous studies have also found that performance-based pay systems have limited motivational effect due to the concerns of employees regarding the fairness of the system (Boachie-Mensah & Doghe, 2011; Campbell, Campbell, & Chia, 1998; O'Donnell & O'Brien, 2000; Olusegun, 2012). They argued that performance-based pay underemphasized the effects of attribution biases on performance judgments which affect the effectiveness of the system. These studies showed that biased judgments in performance appraisals can influence the work motivation of employees which in turn significantly affects turnover intention (Olusegun, 2012; Sameul & Chipunza, 2009).

At the same time, some empirical findings revealed that organizational justice in performance appraisal has significant positive outcomes such as increased work motivation, job satisfaction and work commitment. Organizational justice is a significant body of study on work motivation in commitment to an ethical principle of fairness (Gilliland & Chan, 2001; Latham & Pinder, 2005). Choong, Wong, and Tioh (2010) found positive outcomes in increased job satisfaction, organizational commitment and reduced turnover intention in employees who perceived the performance appraisal system as having a high level of fairness in determining their performance outcomes. In short, employees are more contented if they feel they are fairly rewarded for their efforts in the

workplace in consistent with the reward system and policies. Similarly, Aslam, Shumaila, Sadaqat, Bilal, and Intizar (2012) report a positive relationship between organizational justice and overall job satisfaction. According to Choong et al. (2010), employees were more satisfied if they felt they were rewarded fairly for their efforts in work and consistent with the reward system and policies.

From a theoretical perspective, the research findings on organizational justice

among their employees. However, the issue of organizational justice is overlooked and not practiced at times. As a result, the performance-based pay system brings about negative effects of unfairness in pay allocation leading to high turnover rates among employees. As such, this piece of research is essentially another attempt to fill the gap in previous studies conducted in a local context (see Choong et al., 2010) by answering the following questions:

- i. What is the perception of employees

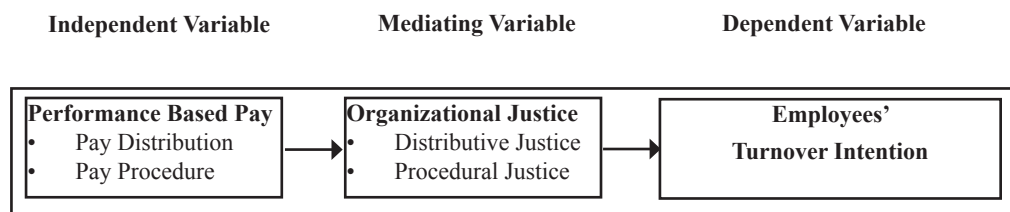


Figure 1.1: Research Conceptual Framework.

Sources: Greenberg & Cropanzano (2001); Salaman et al., (2005); Schneier et al., (1995)

and performance outcomes strongly support theories like organizational justice theory and equity theory. Proponents of organizational justice theory state that employees are able to distinguish the fairness of interactions provided by their supervisors from the fairness of procedures dictated by the organization (Cropanzano & Byrne, 2001). Likewise, the equity theory talks about an individual's perception of equitability and inequity with focus on input and outcome (Al-Zawahreh & Al-Madi, 2012). They claim that an employee tends to compare his job efforts with an outcomes ratio and takes action to correct the inequality he perceives. Greenberg and Cropanzano (2001) exemplify these corrective actions taken by employees when they perceived inequality over time; increased absenteeism and resignation.

Thus, many local organizations are embarking on implementing a performance-based pay system in the hope of gaining value from the positive outcomes

towards performance-based pay in the organization?

- ii. Does the performance-based pay influence the intention of employee to leave the job or organization?
- iii. How do the perceptions of fairness towards performance-based pay affect the employees' turnover intention?

The conceptual framework for this study, as shown in Figure 1.1 is developed based on the review of literature on the three main variables: performance-based pay, organizational justice and employees' turnover intention. Performance-based pay is studied through two important features; pay distribution and pay procedure which have been shown to invoke employees' perceptions of organizational justice in the process. Organizational justice is studied from two perspectives, i.e., distributive justice and procedural justice. Research has shown that employees' perception

of organizational justice in performance-based pay system has significant influence on their turnover intention. This study examines the mediating effect of organizational justice in the relationship between performance-based pay and employees' turnover intention. In specific terms, this study attempts to identify:

- iv. the relationship between pay distribution and employees' turnover intention;
- v. the relationship between pay procedure and employees' turnover intention;
- vi. the mediating effect of distributive justice in the relationship between pay distribution and employees' turnover intention; and
- vii. the mediating effect of procedural justice in the relationship between pay procedure and employees' turnover intention.

To achieve these research objectives, several research hypotheses are stated:

- H_a1: There is a significant relationship between pay distribution and employees' turnover intention.
- H_a2: There is a significant relationship between pay procedure and employees' turnover intention.
- H_a3: Distributive justice significantly mediates the relationship between the pay distribution and employees'

- turnover intention.
- H_a4: Procedural justice significantly mediates the relationship between the pay procedure and employees' turnover intention.

METHODOLOGY

Data collection in this research was conducted using survey research design. Among the reasons for adopting the survey research design are: it allows flexibility in terms of data collection in which data can be collected through various techniques, selection of respondents can be done randomly from a sample and it can be used to evaluate theories (Rusli & Hasbee, 2011). Quantitative research methodology is employed to examine the mediating effect of organizational justice in the relationship between performance-based pay and employees' turnover intention. Thus, the focus of this study is more on structural aspects rather than the complex issues of the process itself (Van Maanen, 1983). Survey questionnaires are used as the instruments to obtain a comparatively large quantity of data to address the research questions and objectives.

The research instrument is divided into four main sections consisting of: Part A –Demographic Characteristic, Part B, C, and D – items on pay distribution and pay

Table 1: Correlations between Pay Distribution and Employees' Turnover Intention Correlations

		Pay Distribution	Employees' Turnover Intention
	Pearson Correlation	1	-.60**
Pay Distribution	Sig. (2-tailed)		.000
	N	50	50
	Pearson Correlation	-.60**	1
Employees' Turnover Intention	Sig. (2-tailed)	.000	
	N	50	50

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

procedure, organizational justice and employees' turnover intention, respectively. Cronbach's Alpha was used to identify the internal consistency or average correlation of the items in the research instrument, with a value of 0.9 used as a cut-off point.

and data analysis, descriptive and inferential analysis was conducted by using Statistical Package for Social Science (SPSS) Version 20.0.

Table 2: Correlations between Pay Procedure and Employees' Turnover Intention Correlations

		Pay Procedure	Employees' Turnover Intention
Pay Procedure	Pearson Correlation	1	-.59**
	Sig. (2-tailed)		.000
	N	50	50
Employees' Turnover Intention	Pearson Correlation	-.59**	1
	Sig. (2-tailed)	.000	
	N	50	50

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

As stated by Andrew, Pedersen and McEvoy (2011), a high value of Alpha indicates a high correlation between the items in the research questionnaire.

The study was conducted in a private company located in Kuching, Sarawak. The target population consists of 50 non-managerial staff members. Random sampling gives every member of the population an equal chance of being selected (Frerichs, 2008). The minimum sample size is determined by using a formula suggested by Luck, Taylor, and Robin (1987)

RESULTS

Two types of test were used to test the correlations between the two variables as stated in H_{a1} and H_{a2}, and Stepwise Regression to test the mediating effect in the relationship between the two variables in H_{a3} and H_{a4}.

Relationship between pay distribution and employees' turnover intention

Table 1 shows that the value of coefficient

Table 3: Results for Stepwise Regression Analysis with Distributive Justice as the Mediating Variable, Pay Distribution as the Independent Variable and Employees' Turnover Intention as Dependent Variable

Variables	Dependent Variables: Employees' Turnover Intention		
	Step 1	Step 2	Step 3
<u>Independent Variable</u> Pay Procedure	-.60		-.004
<u>Mediating Variable</u> Procedural Justice		-.64	-.64
R Square	.36	.41	.41
Adjusted R Square	.34	.39	.39
R Square Change	.36	.41	.41
F	26.41	32.92	32.92

$r = -.60$ while the value of significant $p = .000$, in which $p < .05$, so it can be considered as moderate relationship between the two variables. This indicates that when the employees are satisfied with the pay distribution in their organization, the lower the rates of turnover intention among the employees or *vice versa*. Therefore, H_{a1} is accepted. It is clear that there is a moderate negative significant relationship between pay distribution and employees' turnover intention.

Relationship between pay procedure and employees' turnover intention

Table 2 shows that the value of coefficient $r = -.59$ while the value of significant $p = .000$, in which $p < .05$. It indicates that when employees are satisfied with the pay procedure in an organization then the lower the rates of turnover intention among employees or *vice versa*. There is a moderate negative significant relationship between pay procedure and employees' turnover intention. Therefore, H_{a2} is accepted.

Mediation roles of distributive justice in the relationship between the pay distribution and employees' turnover intention

The results of stepwise regression were summarized in three (3) steps as shown in Table 3. Step 1 showed that pay distribution, as the independent variable, was found to be a significant predictor of employees' turnover intention ($\beta = -.60, p = .000$). Step 2 showed that distributive justice as the mediating variable was found to be a significant predictor of employees' turnover intention ($\beta = -.64, p = .000$). The inclusion of distributive justice in step 3 revealed that distributive justice was a full mediating variable for the relationship between pay distribution and employees'

turnover intention ($\beta = -.64, p = .000$), while the pay distribution was no longer significant with employees' turnover intention ($\beta = -.004$). The results showed that the strength of the relationship between pay distribution and employees' turnover intention decreased when distributive justice is included in the analysis, an indication of the mediating effect of distributive justice in the relationship. This finding is supported by Baron and Kenny (1986) who claim that if the independent variable is no longer significant when mediating variable is controlled, then the finding supports full mediation. Therefore, H_{a3} is accepted.

Mediation roles of procedural justice in the relationship between the pay procedure and employees' turnover intention

The results of stepwise regression were summarized in three (3) steps as shown in Table 4. Step 1 showed that pay procedure as the independent variable was found to be a significant predictor of employees' turnover intention ($\beta = -.59, p = .000$). Step 2 showed that procedural justice as the mediating variable was found to be a significant predictor of employees' turnover intention ($\beta = -.52, p = .000$). In step 3, the inclusion of procedural justice of the process revealed that procedural justice did not act as a mediating variable for the relationship between pay procedure and employees' turnover intentions ($\beta = -.10, p = .609$). Therefore, H_{a4} is rejected.

DISCUSSION

From the findings of the study, H_{a1} , H_{a2} , and H_{a3} were accepted, whereas H_{a4} was rejected. For H_{a1} , the results showed that there was a significant relationship between pay distribution and employees' turnover intention in the organization under study, but it was a negative relation-

Table 4: Results of Stepwise Regression Analysis with Procedural Justice as the Mediating Variable, Pay Procedure as the Independent Variable and Employees' Turnover Intention as Dependent Variable

Variables	Dependent Variables: Employees' Turnover Intention		
	Step 1	Step 2	Step 3
<u>Independent Variable</u> Pay Procedure	-.59		-.59
<u>Mediating Variable</u> Procedural Justice		-.52	-.10
<i>R</i> Square	.35	.27	.35
Adjusted <i>R</i> Square	.34	.25	.34
<i>R</i> Square Change	.35	.27	.35
<i>F</i>	25.93	17.33	25.93

ship. It reflects that when employees are satisfied with the pay distribution of the organization, such as, when pay is aligned with qualifications, the amount of reward is allocated equally based on work performance and others, it will reduce the intention of employees to leave the organization and *vice versa*. According to Faulk (2002), pay is an imperative reward or outcome that allows employees to achieve other rewards. In addition, it can be a motivational tool for performance as well as attracting and retaining the best employees (Carragher, 2011). Past studies for example, Carragher (2011) have shown that voluntary turnover intention among employees is significantly related to pay satisfaction. Furthermore, past researchers found that voluntary turnover intention among employees has a significant relationship with the outcome of pay satisfaction (William, McDanniel, & Nguyen, 2006).

In addition, the results of Pearson Product-Moment Correlation revealed that H_a2 is supported, in which the procedure of pay allocation has reached the level of significance on employees' turnover intention in the organization. The correlation showed that there was a negative relationship between both variables, which means the higher the satisfaction of employees towards the pay procedure, the lower the

rates of turnover intention among the employees. The perception of employees on how the organization administers the pay system, such as, how the salary increment is determined, the employees being well-informed about the pay procedure, allowing employees to make suggestions in the process and others play significant roles in the organisation under study.

The results from stepwise regression revealed that H_a3 is accepted, in which distributive justice mediates the relationship between the pay distribution and employees' turnover intention in the organization. If employees perceive justice in pay distribution as fair, then pay satisfaction and job satisfaction will be higher, and intent to leave the organization will be reduced and *vice versa*. In previous studies, the researchers found that distributive justice related to pay, benefits, and rewards were significantly linked to job satisfaction and turnover intentions (Harr & Spell, 2009). On the other hand, the results of stepwise regression showed that H_a4 is rejected, in which procedural justice does not act as a mediator in the relationship between pay procedure and employees' turnover intention in the organization. It is supported by Leventhal, Karuza and Fry (1980) in which distributive justice judgments were found to be more influential

than procedural justice judgments in overall fairness perceptions. In addition, Folger and Konovsky (1989) advocated that distributive justice is a better predictor of pay satisfaction than procedural justice perceptions and more discrepancy in satisfaction with pay than did procedural justice.

CONCLUSION

In conclusion, performance-based pay was found to be significant with employees' turnover intention. In addition, distributive justice was found to be a full mediator in the relationship between pay distribution and employees' turnover intention, while procedural justice did not act as a mediator in the relationship between pay procedure and employees' turnover intention. This study has contributed to the body of knowledge regarding this particular field, *albeit* in a small way due to the limitations of the study. Nonetheless, it helps to illuminate the point that employees' perceptions of organizational justice is an important factor in performance-based pay system. It enhances our understanding that employees' perception of justice in distributing the performance-based pay may induce positive outcomes and attitude in employees. Besides, it also contributes to the knowledge base of HR practitioners in general. In a previous study conducted, the mediating effect of organizational justice in the relationship between performance-based pay and turnover intention was not clearly defined. Thus this study gives further insights and understanding of the influence of organizational justice and the need to give it due consideration when designing a compensation system. A well-designed compensation system will positively influence employees' perceptions of fairness practised in the performance appraisal process, thus increasing its effectiveness through motivating

employees to optimise their performance leading to increased work productivity and thereby ultimately accomplishing organizational goals.

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