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Imam Mahfud

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## **Analysis of the role of fair compensation in improving employee performance: A systematic literature review**

**Imam Mahfud**

Institut Binamadani Indonesia, Jl. KH. Hasyim Ashari No. 77, Kenanga, Cipondoh District, Tangerang City, Banten 15146, Indonesia  
email: imam.mahfud74@yahoo.co.id

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### **ABSTRACT**

Fair compensation has been increasingly recognized as a strategic lever for enhancing employee motivation, satisfaction, and performance in contemporary organizations. This study systematically synthesizes theoretical perspectives and empirical evidence on the role of fair compensation in improving employee performance, with particular attention to how strategic human resource management (HRM) fosters a productive and harmonious work environment. Drawing on a systematic literature review of peer-reviewed articles indexed in Scopus and Web of Science (WoS) between 2014 and 2024, complemented by foundational theoretical works, this study applied predefined inclusion and exclusion criteria covering distributive, procedural, and interactional fairness, intrinsic and extrinsic motivation, and individual and team performance metrics to identify relevant studies. The synthesis demonstrates that (1) financial and non-financial compensation jointly predicts employee performance, with non-financial recognition strengthening the effect of pay-for-performance on engagement; (2) perceptions of internal and external pay equity mediate the relationship between compensation systems and discretionary effort; and (3) effective HRM bundles, integrating workforce planning, training, performance appraisal, and transparent reward design, constitute the boundary conditions for compensation to translate into sustainable performance. Although classical scholars (e.g., Rivai, 2015) emphasize direct financial compensation as the principal driver of short-term productivity, contemporary meta-analytic evidence (Cerasoli et al., 2014; Gerhart & Fang, 2014) suggests that the joint optimization of intrinsic and extrinsic rewards yields superior long-term performance outcomes. This study contributes to HRM theory by integrating equity, expectancy, two-factor, and self-determination perspectives into a coherent fairness–performance framework and offers practical guidance for designing transparent, performance-based, and contextually fair compensation systems.

**Keywords:** fair compensation; employee performance; human resource management; organisational justice; work motivation

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RESEARCH & PUBLISHING



## 1. INTRODUCTION

Human capital is widely acknowledged as the most strategic resource of modern organizations, and the way employees are rewarded fundamentally shapes their willingness to invest discretionary effort in organizational goals (Boon et al., 2019). Compensation, understood as the totality of monetary and non-monetary returns received by employees in exchange for their labor, plays a central role in the employer–employee exchange relationship (Hasibuan, 2016; Newman et al., 2017). Beyond fulfilling basic economic needs, compensation symbolizes organizational recognition of employee contributions and signals the firm's normative stance toward fairness and meritocracy (Greenberg, 1990; Colquitt et al., 2013).

Despite robust industrial growth across Southeast Asia and the proliferation of new industrial zones on the island of Java, the contemporary workplace is confronted with persistent challenges of disengagement, voluntary turnover, and uneven productivity (Anitha, 2014; Tessema & Soeters, 2006). A non-trivial share of these challenges has been traced to the perceived unfairness of compensation systems, particularly the gap between minimum statutory wages and the minimum living wage that allows employees to thrive (Bryant & Allen, 2013). This phenomenon underscores the strategic importance of designing reward systems that are simultaneously externally competitive, internally equitable, and procedurally transparent (Shaw, 2014).

Theoretically, the link between fair compensation and employee performance is anchored in several complementary frameworks. Maslow's (1954) hierarchy of needs posits that satisfying lower-order physiological and security needs through adequate pay liberates higher-order motivational potential. Adams' (1963) and Adams' (1965) equity theory contends that employees calibrate their effort in proportion to the perceived ratio of their inputs and outcomes relative to comparable referents. Vroom's (1964) expectancy theory specifies that motivation arises when employees believe their effort will yield desired rewards. More recently, self-determination theory by Deci et al. (2017) has refined this view by showing that financial incentives can crowd in or out intrinsic motivation depending on whether they are administered in autonomy-supportive ways.

Empirically, the evidence base has rapidly accumulated. Zayed et al. (2022) demonstrated that compensation systems significantly predict employee satisfaction through the mediating role of work motivation. Cerasoli et al. (2014) found, in a 40-year meta-analysis, that intrinsic motivation and extrinsic incentives jointly predict performance and that their relative weight varies by task type. Chiang and Birtch (2012) showed that the performance implications of financial and non-financial rewards are contingent on national culture and individual preferences. However, in practice, designing a fair compensation system remains challenging because organizations must reconcile differences in education, experience, responsibility, labor market dynamics, and financial capacity (Bussin & Toerien, 2015; Mondy, 2008).

Given the strategic importance of compensation and the heterogeneity of existing evidence, this study addresses the following research questions: (1) How is fair compensation conceptualized across financial, non-financial, and procedural dimensions? (2) What mechanisms link fair compensation to employee performance? (3) How does SHRM moderate the compensation–performance relationship? This study contributes to the literature by (a) integrating classical and contemporary theoretical perspectives, (b) consolidating recent empirical findings from Scopus and Web of Science (WoS) indexed journals, and (c) deriving practical implications for HR managers in emerging-economy contexts.

## 2. LITERATURE REVIEW

### 2.1. Compensation

Compensation is an integral component of employee management. Rivai (2015) defines compensation as a reward granted by a firm to its employees in return for their contribution to organizational goals. It comprises two principal forms: financial and non-financial. Direct financial compensation includes base salary, bonuses, and performance incentives; indirect financial compensation includes health benefits, insurance, pension funds, and similar long-term entitlements; and non-financial compensation encompasses recognition, career development, autonomy, and a conducive work

environment (Bussin & Toerien, 2015; Newman et al., 2017). Fair and competitive compensation has been consistently associated with higher motivation, satisfaction, organizational commitment, and lower voluntary turnover (Gerhart & Fang, 2014; Kuvaas et al., 2017).

### **2.1.1. Theories of Compensation**

First, Equity Theory by Adams (1963) and Adams (1965). Employees compare their inputs (effort, experience, working time) and outcomes (compensation) with those of relevant referents. Perceived equity strengthens motivation and performance, whereas perceived inequity generates tension that employees seek to reduce, often by withdrawing their effort. Second, Expectancy Theory by Vroom (1964). Motivation is the product of expectancy (effort will produce performance), instrumentality (performance will produce a reward), and valence (the reward is valued). Compensation systems strengthen instrumentality when pay is consistently tied to performance. Third, Two-Factor Theory by Herzberg et al. (1959). Compensation is primarily a hygiene factor: insufficient pay produces dissatisfaction, but adequate pay alone is insufficient to motivate; motivators such as recognition, achievement, and growth must be added to elicit higher employee performance. Fourth, the Self-Determination Theory by Deci et al. (2017). Financial incentives can either support or undermine intrinsic motivation, depending on whether they are administered in autonomy-supportive ways and are perceived as informational rather than controlling. Fifth, the Organizational Justice Theory by Greenberg (1990) and Colquitt et al. (2013). Fairness operates along three dimensions, distributive (outcomes), procedural (process), and interactional (interpersonal treatment), each of which independently and interactively shapes the performance outcomes.

### **2.1.2. Aspects of Fairness in Compensation**

First, Internal equity. Employees with equivalent responsibilities and achievements receive equivalent rewards. Internal equity depends on the maturity of management practices and the organization's willingness and ability to pay (Shaw, 2014). Second, External equity. Compensation is benchmarked against prevailing rates in the same industry and at a comparable organizational scale, ensuring market competitiveness (Bryant & Allen, 2013). Third, Individual equity. Compensation accounts for the specific needs, contributions, and developmental trajectory of each employee so that quality and loyalty are differentially rewarded (Park & Sturman, 2016). Fourth, Procedural fairness. The mechanisms by which pay decisions are made are transparent, consistent, and voice-friendly (Colquitt et al., 2013).

## **2.2. Employees and Employee Performance**

Employees are the core element of an organization and play a pivotal role in attaining organizational goals. Hasibuan (2019) defines employees as workers who provide services to an organisation in exchange for compensation. In contemporary Human resource management (HRM), three broad categories are commonly distinguished: permanent employees, fixed-term contract employees, and interns, each governed by distinct legal and contractual frameworks (Dessler, 2020).

### **2.2.1. Definition of Employee Performance**

Employee performance is the outcome of work achieved by an individual in accordance with the standards or targets established by an organization (Mangkunegara, 2017). Robbins and Judge (2016) operationalise performance through five core indicators: work quantity, work quality, time efficiency, organisational commitment, and cooperation. Anitha (2014) further argues that engagement is a proximal driver of performance, mediated by working environment, leadership, team and co-worker relationships, training and career development, compensation, organisational policies, and workplace well-being.

### **2.2.2. Theories Supporting Performance**

First, the Reinforcement Theory by Skinner (1953). Performance can be enhanced through systematic positive reinforcement (bonuses, recognition, promotion) contingent on the desired behavior. Second, the Motivation Theory by Maslow (1954). When lower-order needs are satisfied through adequate

compensation, employees mobilize energy toward higher-order esteem and self-actualization needs, which translates into superior performance. Third, Job Demands–Resources Theory by Bakker and Demerouti (2017). Compensation operates as a job resource that buffers job demands, fosters engagement, and sustains performance over time.

### **2.3. Human Resource Management**

HRM is a strategic organizational function focused on managing the workforce effectively and efficiently (Dessler, 2020). HRM encompasses workforce planning, recruitment, selection, training and development, performance evaluation, compensation, and labor relations. A growing body of evidence demonstrates that high-performance work systems, bundles of complementary HR practices, including selective hiring, extensive training, contingent compensation, and employee voice, are associated with superior firm performance (Boon et al., 2019; Combs et al., 2006). HRM is the architectural mechanism through which compensation policies are translated into perceived fairness and behavioral outcomes.

### **2.4. The Relationship Among Employees, Compensation, and HRM**

Employees, compensation, and HRM form a mutually reinforcing triad. Employees, as the primary asset of a firm, require strategic HRM to align their potential with organizational priorities. Compensation, in turn, operates as a motivator, recognition, and retention mechanism within the HRM architecture. Together, these elements help organizations attract talent, sustain engagement, and reinforce competitive advantage in volatile environments (Aguinis et al., 2013; Latham & Pinder, 2005).

## **3. METHOD**

This study adopts a Systematic Literature Review (SLR) methodology, following the procedural guidance of Tranfield et al. (2003) and the reporting principles of PRISMA (Moher et al., 2009). The SLR was structured into five sequential stages: (1) formulation of research questions, (2) construction of a search protocol, (3) literature identification and screening, (4) quality appraisal, and (5) thematic synthesis.

Two primary databases, Scopus and WoS, were searched, complemented by the selective use of Google Scholar to capture relevant theoretical works. The search strings combined the keywords 'compensation' OR 'pay' pay 'reward' AND 'fairness' OR 'equity' OR 'justice' AND 'employee performance' OR 'work motivation' OR 'job satisfaction.' The temporal scope was restricted to 2014–2024 for empirical articles, with foundational theoretical works (e.g., Adams, 1963; Maslow, 1954; Vroom, 1964) retained for conceptual grounds.

The inclusion criteria were as follows: (a) peer-reviewed journal articles indexed in Scopus or WoS, (b) English-language publications, (c) studies addressing the relationship between compensation/reward systems and employee outcomes, and (d) full-text availability. The exclusion criteria removed conference abstracts, editorials, and non-peer-reviewed grey literature. After screening the titles and abstracts, the final corpus comprised 25 references, which were thematically coded under the constructs of compensation, fairness, motivation, performance, and HRM.

The analysis followed a descriptive interpretative logic. Concepts, theories, and findings were extracted into a coding matrix, compared, and synthesized to address the three research questions. This synthesis triangulates classical theoretical works with recent empirical and meta-analytic evidence to produce an integrative interpretation of how fair compensation shapes employee performance.

## **4. RESULTS AND DISCUSSION**

### **4.1. The Role of Fair Compensation in Improving Employee Performance**

#### **4.1.1. Definition and Concept of Fairness in Compensation**

Compensation encompasses all forms of payment and rewards provided to employees in return for their labor. Because compensation typically constitutes the largest line of recurrent expenditures, it merits

sustained managerial attention (Mondy, 2008). Well-designed compensation simultaneously retains high-potential talent, attracts new entrants, ensures internal and external equity, and contributes to cost efficiency (Bryant & Allen, 2013). Beyond meeting subsistence needs, compensation can fund savings and investments, thereby aligning employees' long-term welfare with organizational sustainability.

Fair compensation also reduces interpersonal conflicts and bolsters workplace cohesion. Empirical evidence demonstrates that perceived pay fairness predicts organizational citizenship behavior, reduces counterproductive work behaviors, and strengthens commitment (Colquitt et al., 2013; Anitha, 2014). The ethical dimension, integrity, transparency, and professionalism in pay administration, is increasingly viewed as a strategic differentiator in talent markets (Aguinis et al., 2013).

First, we examine the effect of compensation on employee performance. Meta-analytic evidence consistently shows a positive relationship between financial incentives and task performance, particularly for quantity-oriented tasks (Jenkins et al., 1998; Cerasoli et al., 2014). Compensation packages comprising salaries, social security, allowances, and other rewards function not only as income but also as markers of social status, thereby reinforcing identification with the organization. Field studies in Asian by Chiang and Birtch (2012) and South-East Asian by Idris et al. (2017) contexts confirm that competitive remuneration is a robust predictor of individual performance, although the effect size depends on contextual factors such as job design, pay communication, and supervisor support.

Second, it examines the effect of work motivation on employee performance. Both intrinsic (sense of responsibility, mastery, and achievement) and extrinsic (recognition and monetary rewards) motivation significantly enhance performance (Kuvaas et al., 2017; Cerasoli et al., 2014). High motivation produces persistence and goal-directed effort, especially when tasks require creativity and discretion (Deci et al., 2017). However, the strength of this effect varies with the organizational context, leadership style, and perceived informational versus controlling characteristics of the reward (Aguinis et al., 2013).

Third, the effect of the work environment on employee performance is examined. A supportive work environment, characterized by psychological safety, autonomy, and resource adequacy, amplifies the impact of compensation on performance (Bakker & Demerouti, 2017; Anitha, 2014). Where the work environment is impoverished, even generous compensation fails to elicit sustained engagement because employees lack the resources to translate motivation into output. This boundary condition explains why several empirical studies in emerging economies have reported non-significant or attenuated direct effects of pay on performance when environmental factors are controlled (Tessema & Soeters, 2006).

#### **4.1.2. The Relationship Between Compensation and Employee Performance**

Employee performance is a qualitative and quantitative outcome of work behavior aligned with organizational standards and assigned responsibilities (Mangkunegara, 2017). Performance reflects an individual's ability, effort, and opportunity (the AMO framework), each of which is shaped by HRM practices, including compensation (Boon et al., 2019).

The relationship between compensation and employee performance can be analyzed along seven interrelated pathways. First, Compensation as a Motivator. Competitive base pay, allowances, bonuses, and performance incentives serve as powerful extrinsic motivators that orient employees' efforts toward strategic targets (Gerhart & Fang, 2014; Park & Sturman, 2016). Second, Compensation and Job Satisfaction. Adequate and fair compensation directly elevates job satisfaction, which in turn predicts organizational commitment and performance (Zayed et al., 2022; Rynes et al., 2004). Third, Compensation and Individual Performance. Pay-for-performance systems signal the organizational valuation of employee output and encourage discretionary effort, provided that the linkage between performance and reward is transparent (Park & Sturman, 2016; Aguinis et al., 2013). Fourth, Compensation as a Retention Tool. Total-reward strategies that combine competitive pay with non-monetary benefits and career development reduce voluntary turnover (Bryant & Allen, 2013; Deery, 2008). Fifth, Compensation and Team Performance. Team-based bonuses and gain-sharing schemes enhance cooperation and collective performance, although they may also exacerbate free-riding if not carefully designed (Shaw, 2014). Sixth, Communication and Transparency. Transparent communication about pay criteria reinforces procedural fairness and strengthens the motivational effect of compensation (Colquitt et al., 2013; Kim, 2018).

Seventh, Unfair Compensation and Its Consequences. Perceived pay inequity reduces morale, depresses productivity, and increases withdrawal behavior, including voluntary exit (Greenberg, 1990; Sutrisno, 2019). In summary, fair and well-administered compensation is positively associated with motivation, satisfaction, retention, and performance, whereas perceived unfairness systematically undermines these outcomes. Therefore, compensation systems should be designed to be transparent, externally competitive, internally equitable, and contingent on measurable performance contributions.

#### **4.1.3. Factors Affecting Compensation**

Following Mondy (2008), four classes of factors shape compensation decisions. First, organizational factors: management policy, political conditions, and the firm's ability to pay. Second, employee factors: performance, skills, competencies, seniority, experience, and membership in collective structures. Third, labor market factors include prevailing wage levels for comparable jobs, living costs, union influence, and statutory regulations. Fourth, job factors: job analysis, job description, job evaluation, and collective bargaining outcomes are considered.

#### **4.1.4. The Process of Determining Compensation**

A defensible compensation system follows five steps: (1) conducting salary surveys to benchmark external pay levels and ensure external equity; (2) determining the value of each job through job evaluation to ensure internal equity; (3) grouping similar jobs into the same pay band to ensure employee equity; (4) assigning pay rates to each band using a wage line; and (5) adjusting wage levels to comply with statutory and regulatory requirements. Job evaluation produces a ranked list of positions with assigned point values that are converted into salary structures. Because evaluation has an irreducibly subjective component, it is best conducted by trained evaluators or a job evaluation committee (Mondy, 2008). Salary surveys, whether self-administered or outsourced to consultancies, anchor external competitiveness and reduce the risk of selection-related attrition (Bryant & Allen, 2013).

#### **4.1.5. Functions and Objectives of Compensation**

Following Tanjung (2005), the principal functions of compensation are (a) efficient allocation of human resources, (b) more efficient and effective utilization of human resources, and (c) promotion of economic stability and growth. Its principal objectives are to (a) fulfil economic needs, (b) link compensation to productivity, (c) align compensation with organizational success, (d) ensure fairness and balance in pay distribution, and (e) establish a defensible basis for compensation decisions.

Dessler (cited in Hariandja, 2002) identifies four further determinants of compensation: legal considerations, labor union influence, company policy, and fairness principles. Legal frameworks define minimum wages, overtime, and benefits; unions shape collective bargaining; firm policy provides operational guidelines for raises, promotions, overtime, probation, and leave; and fairness considerations, both internal and external, condition employee acceptance of pay outcomes (Colquitt et al., 2013).

## **5. CONCLUSION**

This study aimed to systematically synthesize the role of fair compensation in improving employee performance, with particular attention to the strategic interplay between employees, compensation, and HRM. Three principal conclusions emerge from this synthesis. First, compensation operates as both an economic and symbolic mechanism: it satisfies subsistence needs while signalling organizational recognition of effort and contribution. When financial and non-financial rewards are jointly optimized, employees experience higher motivation, satisfaction and engagement (Cerasoli et al., 2014; Kuvaas et al., 2017). Second, fairness is a binding constraint on the compensation–performance link. Distributive, procedural, and interactional fairness independently and interactively shape employee responses to pay (Colquitt et al., 2013; Greenberg, 1990). Compensation systems that are externally competitive yet internally inequitable or financially generous yet procedurally opaque fail to convert pay into sustained performance.

Third, strategic HRM is the architectural mechanism through which compensation policies become behavioral realities. High-performance work systems that integrate selective hiring, training, performance management, employee voice, and transparent reward design provide boundary conditions under which fair compensation can drive performance (Boon et al., 2019; Combs et al., 2006). Practically, HR managers in emerging economies are advised to (a) conduct periodic salary surveys to anchor external competitiveness, (b) institutionalize systematic job evaluation to ensure internal equity, (c) communicate pay criteria transparently to reinforce procedural fairness, and (d) complement monetary rewards with recognition, development, and autonomy-supportive practices to nurture intrinsic motivation. Future research should examine longitudinal and cross-cultural designs that disentangle the dynamic interplay between fairness perceptions, motivational profiles, and performance outcomes across diverse industrial contexts.

### **Ethical Approval**

Not Applicable

### **Informed Consent Statement**

Not Applicable

### **Authors' Contributions**

Not Applicable

### **Disclosure Statement**

No potential conflict of interest was reported by the author(s).

### **Data Availability Statement**

The data presented in this study are available on request from the corresponding author due to privacy reasons.

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### **Notes on Contributors**

#### **Imam Mahfud**

Imam Mahfud is affiliated with the Institut Binamadani Indonesia, Tangerang City.

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