

CHAPTER 2

LITERATURE REVIEW

Chapter 2 explores the Literature Review pertaining to the key issues of Compensation Policy and Organisational Commitment. The chapter also presents some of previous research results that had been carried out on the same subject.

2.1 Conceptual of Compensation Policy

Compensation policies provide guidelines for the implementation of compensation strategies and the design and management of its processes. They will be influenced strongly by the compensation philosophy of the organisation.

The compensation policies will be concerned with the level of compensation, the relative importance attached to market rates and equity, the relationship of compensation to business performance, the scope for the use of contingent compensation related to performance competence or skill, the degree of flexibility required in the system, and the need to communicate compensation policies to employees (Michael Armstrong & Helen Murlis 1998).

As Tan Kwang How (2001) explained, before making any recommendation on compensation policy, organisations need to consider factors like salary levels, performance related rewards, basic benefits entitlements, and differences in benefits due to rank. She also highlighted the main areas to formulate compensation policies are pay posture and market rate influence, internal equity, salary structure, performance related rewards, amount of freedom for line managers, total remuneration, and the communication of the policy with employees.

Richard I Henderson (1976) identified some of the more general compensation policy, which includes posture of becoming market leader-follower, internal equity, market forces, payment and its form.

The publication and dissemination of compensation policy vary greatly among organisations. Practically every organisation has elements of its policy that carry with them certain degrees of secrecy, Richard further explained.

An issue facing organisations today, however, concerns whether or not the benefits gained from openly communicating compensation facts are worth the possible costs incurred, quoted in Personnel Journal (1974) "Pay policies: Secret or Open? And Why?"

Stockton (1959) reports that only 7 percent of firms in his study indicated that surveys were the only factors considered. Other factors were given equal or greater importance by over 80 percent of the firms, with job evaluation given the most importance. The 1972 BNA survey suggests that surveys may be considered more important during that time than before, although the most common response still "useful as a guide".

Having said all that, the study proposed the following criteria to be considered as the measure of the extent of the compensation policy in the participating organisations.

1. Internal Equity

Top management together with its human resource manager normally develop policy as to how much it wants to aim for achieving equity. Total internal equity is something that is virtually impossible to achieve in real life but the organisation has a choice of having a policy to achieve as high

a degree of equity as possible or to totally ignore this problem and not even have a job evaluation system.

2. *External market forces*

Organisation cannot ignore market rates totally because if its salaries were to be too much below market, there could be high staff turnover and problems in recruiting.

What the organisation may do is to strictly follow market rates perhaps only on specialised jobs and put more emphasis on internal equity for the bulk of other jobs. In this situation, the specialised jobs would not fit into the internal salary structure but they could be placed as special cases (Tan Kwang How 2001).

3. *Performance related rewards*

Policy can also be formed on the extent to which performance will be rewarded financially. An organisation that wants to be dynamic and innovative would want to have a substantial amount of its financial rewards for employees based on performance.

4. *Communication/Secrecy*

There is a policy whereby the company established on how much communication and information should be provided on compensation package especially on salaries (Tan Kwang How 2001).

The practice varies tremendously among organisations. The openness that the study is referring to is the additional rewards compensated to the

employees, beside their basic salary, such as bonus, paid-holiday, ESOS, company car, and etc.

If the organisation were dynamic and aggressive with a wish to recruit high flyers, then the pay posture would be above the market rates, says Tan Kwang How (2001). Where there is a need to recruit many people with specialised skills or qualifications, again paying above market rates will help tremendously.

2.2 Conceptual of Organisational Commitment

Employee commitment is a variable receiving considerable attention in the organisational literature. Among other reasons for its prominence in academic literature, commitment has repeatedly been identified as an important variable in understanding the work behaviour of employees in organisations (Mowday, Porter & Steers 1979).

Identification, attachment, a sense of loyalty, a feeling of belonging is attempts to describe the attitude of organisational commitment, a sense of linkage employee feels toward the organisation. The concept has been examined as both an attitude (Buchanan 1974; Porter, Steers, Mowday & Boulian 1974; Sheldon 1971) and as behaviour (Becker 1960; Hrebibiak & Alutto 1972; Salancik 1977; Weiner & Gechman 1977).

Defined by the rational organisational behavioural school of thought, commitment is an attitude or set of behavioural intentions (Porter et al. 1974; Steers 1977). The object of attitudinal and behavioural commitment is the identification of the employee with the organisation (Mowday, Porter & Steers 1982).

Studies suggest there is a connection between attitudinal and behavioural commitment. Mowday and McDade (1979) state that organisationally relevant

behaviours that are committing, made of free choice and difficult to revoke, may lead to attitude consistent with these behaviour.

Researchers on commitment have focused upon some processes that foster an employee's belief in organisational goals, effort expenditure, and membership continuance. They have been designed to identify antecedent conditions such as personnel characteristic, job characteristics, and work experiences that related to such behaviours as turnover, absenteeism, and performance. The results suggest that employees expressing high levels of commitment are more likely to behave in a manner supportive of organisational goal and effectiveness.

Commitment, is therefore can be viewed as a combination of psychological linkages to the organisation, reflecting attitudes of loyalty and identification (Hall & Schneider 1972), attachment (Goffman 1961), and feeling of belonging (Mowday 1974). Defined in this manner, commitment assessment may enable the prediction to employee effort and performance (Angle & Perry 1978).

Becker, Sobowale and Cobbey (1979) found that income is an important predictor of employee commitment. In addition, organisational position is known to positively correlate with normative and affective commitment (Tan and Akhtar 1998).

Research within this perspective has tended to focus on individual differences as antecedents of commitment, revealing that factors such as age and employee tenure tend to co-vary with one's position in the organisation and are known to positively correlate with commitment (Allen and Meyer 1990; Mowday, Porter, and Steers 1982; Angle and Perry 1981; Mathieu and Zodiac 1990; Steers 1997). Mathieu and Zodiac (1990) further suggested that older workers are more satisfied with their job, receiving better positions and having 'cognitively justified' their remaining in the organisation.

In terms of gender, Avon, Parker, and McEvoy (1993) found that gender and affective commitment were unrelated. In addition, research done in the past reports a weak relationship between gender and commitment (Mathieu and Zajac, 1990). There have also been researches indicating that gender has no direct effect on the overall organisational commitment (Ngo and Tsang 1998; Parasumaran and Greenhaus 1993).

It is noted that organisational commitment can be divided into 3 component; Affective, Normative, and continuance commitment (Allen and Meyer 1990). Affective commitment refers to the psychological (emotion) attachment to the organisation, normative commitment refers to a perceived obligation to remain with the organisation and continuance commitment refers to the costs associated with leaving the organisation such as benefits or seniority.

For the purpose of this study, it is proposed that only overall organisational commitment (affective, normative and continuance) will be taken into consideration.

2.3 Relationship between Compensation and Commitment

Compensation dissatisfaction has been found to be associated with high turnover rates in a number of studies, and two studies show that dissatisfaction with compensation is related to high absenteeism rates (Lawler 1971). Lawler believes that pay dissatisfactions more closely associated with higher turnover in times of full employment than when jobs are scarce.

A study in US of an automobile parts company also indicated that compensation dissatisfaction had a differential relationship to the quitting rate, depending on the number of perceived alternative job opportunities (Goode & Fowler 1971).

Research discussion had focused on the consequences of satisfaction or dissatisfaction with pay in terms of absenteeism, turnover, total job satisfaction, and performance (Allan N. Nash & Stephen J. Carroll, Jr 1875)

Michael Armstrong & Helen Murlis (1995) wrote that managing compensation is largely about managing expectations – what employees expect from their employers in return for their contribution and what employers expect from their employees in return for their pay and the opportunity to work and develop their skill.

Some interesting insights into the nature of compensation affect were provided by the IPD/Templeton/Birkbeck College research conducted in 1995. This revealed the following:

- 1) 65 % of respondents felt that they had a lot of direct involvement in deciding how to organize their works
- 2) 40 % had a lot of commitment and loyalty to their company
- 3) 26 % trusted their company to provide security

Motivating individuals to join the organisation does little if the organisation cannot retain them. Like motivating people to join, motivating individuals to stay with an organisation is also influenced by a complex set of variables actually.

Attractive compensation practice influences the employee's decision to stay (Frederick S. Hills & Thomas J. Bergmann & Vida G. Scarpello 1994). The attitudes and leadership styles can also influence the decision to remain with the organisation. Regardless of these influences over the individual's decision to stay, organisations can use the compensation policies to influence staying and motivate commitment to their employees.

Lawler (1971), research showed that younger organisational; members demanding less secrecy and more participation by employees in the design of compensation policy.

In developing compensation policy, organisation must consider the goals and objectives of its stakeholders. Once the goals and objectives are made, both employees and organisations will develop an emotional bond that critically affects workers performance and organisational profitability.

The job and its compensations not only dictate a certain standard of living, but they also define the social status and economic worth of an employee to himself, his fellow workers, his family, and the organisations.

The success of an organisation depends to a large degree on the assumptions and expectations each worker develops concerning the effort and abilities he expends and the compensations he receives for improving organisational productivity. Without it, the compensation structure would soon collapse into disorder and disarray.

Compensation policy identifies the importance the organisation places on individual effort and contribution. It establishes rules for recognising superior performance. Above all, it sets into motion the flow of information that communicates the benefits and opportunities the organisation offers to each member.