

Justice in Compensation: How it affects Talent Retention in Malaysian Electric & Electronics Industry

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Abstract

Purpose: The purpose of this study is to explore the relationship between justices in compensation management with talent retention. It also intends to explore how individual justice dimension relates to talent retention.

Design/methodology/approach: This study used cross-sectional research design and employed survey method using questionnaire to collect data from Malaysian Electric and Electronics Industry. Reliability test and correlations analysis were used to test the research framework using data collected.

Findings: This study found that there is enough evidence to conclude that the practice of organizational justice in compensation management strongly correlated with talent retention. It was also found that interpersonal justice, distributive justice and distributive justice strongly correlated with talent retention while this study do not found evidence of correlation of informational justice in compensation management with talent retention.

Research limitations/implications: This study employed cross-sectional research method using questionnaire to collect data in Malaysian Electric and Electronics Industry. Findings from this study and generalizability about it should be used by taking these elements into consideration.

Practical implications: Findings from this study will help human resource management practitioners to design effective compensation management strategies for productive organizational outcomes. Perceived fairness from the organizational justice theory should be employed systematically in the compensation systems for sustainable organizational performance.

Originality/value: This study was developed from previous research in organizational justice in compensation management. A new parsimonious research framework of justice in compensation management and talent retention was developed and data from Malaysian industry was used to the research framework. This specific study is scarce and have not been carried out in Malaysia.

Keywords: Fairness in Compensation, Organizational Justice, Talent Retention

Introduction

Sustainable organizational productivity and its associated economic rewards, such as profits and market value, are achieved through the human resources and talents in the organization. Changing the paradigm of the management-employee relationship to view and treat employees

as a strategic asset and most valued resource must be translated into strategic human resource management practices. In order for the employee's compensation and rewards system productively contributes to overall organizational performance and sustainable competitive advantage, it should be viewed from the perspective of integrated and holistic human resource system within a scope of fairness or organizational justice not only as an isolated unrelated human resource practice.

Fairness in compensation system is an important topic that attracted the interest of researchers as well as practitioners in the area of human resource management. Previous study focused on the several components of organizational justice in compensation and how these components related to employee satisfaction (Gerhart et al., 2003). While other studies focused on how organizational justice in compensation affects employee commitment as consequences of perceived fairness practices (Walsh, 2003). Some researchers argued that organizational justice in compensation does affect employee engagement and retention (Jawahar & Stone, 2011; Gerhart et al., 2003; Saks & Rotman, 2006) as the outcome but less attention has been made to prove this argument with empirical evidence especially in Malaysia. In order to understand the theory of organizational justice in compensation and how it affects talent retention, we need to explore the relationship of all organizational justice components (procedural, distributive, interpersonal and informational) relate to employee retention, individually or as a whole. Overall purpose of this study is to explore the relationship of organizational justice in compensation and rewards system with employee retention. Further, it intends to explore the relationship of the individual justice dimensions to talent retention.

Literature Review

Compensation System

Systematic reward design or compensation system is an essential strategic human resource practice. It can be regarded as how an organization manages several types of compensation plans such as monetary rewards and non-monetary rewards to compensate its employees as an exchange of the employees' execution of jobs or services (Henderson, 2006) according to the standards and indicators set by the organization. A design of a pay structure is important element in a compensation system as it guides the method used by organization to decide on number of pay levels and structure of salary or pay to compensate and reward employees who work in a similar job groups or different job categories (Milkovich et al, 2011). Many researchers (Milkovich et al., 2011; Jawahar & Stone, 2011; MacKain, 2010; Henderson, 2006) in this area argued that the compensation design which consists of various levels and several structure of pay should be congruent to overall organizational strategies and goals. Only then the compensation design can be considered as meaningful, developmental and productive tool. Therefore, human resource (HR) practitioners must have a clear understanding of the organizational goals to be embedded into basic elements, and choices of their compensation systems if they want to attract the right talent, keep the productive players and motivate competent employees which in-turn contribute to sustainable competitive advantage in a global economy (Milkovich et al., 2011).

Perceived Fairness of Compensation System

Compensation system design, perceived fairness of the system and satisfaction with compensation outcomes are some of the important elements to employees' satisfaction and employer concern. There are several strategic reasons why fairness in compensation is crucial. The main reason is that compensation is one of the biggest costs incurred by an organization and this cost is constantly rising on each year, which caused concern among employers. Furthermore, there are both theoretical and empirical evidence suggests that there are

behavioural consequences resulting from satisfaction and dissatisfaction towards compensation systems (Gerhart et al., 2003). These behavioural consequences will in-turn affect the short-term and long-term organizational performance. Understanding of the antecedents and consequences of fairness in compensation system thus indirectly influence organization performance and productivity.

Our understanding of perceived fairness or organizational justice in compensation system is very important for organization achievement due to its association towards employees' job satisfaction, organizational commitment and other productive related employees' behaviours; subsequently, their tendency to search for another job. Fairness in compensation management and reward system also important in predicting employees' affective conditions and behaviours (Cropanzano et al., 2007). In most situation, when employees think that the organization treat them fairly, they will in return display their feeling of satisfaction and higher level of commitment (Greenberg & Cropanzano, 2001; Adams, 1965; Leventhal, 1980; Bies & Moag, 1986) which a clear indication of talent retention. From the perspective of organizational theory, fairness or **organizational justice** consists of four different types of subjective perceptions (Jawahar & Stone, 2011; Colquitt et al., 2001; Cropanzano et al., 2007; Greenberg, 1996), which normally cited by literature as (i) procedural justice, (ii) distributive justice, (iii) interpersonal justice, and (iv) informational justice.

Many scholars refer **distributive justice** to the fair practice in resources or outcomes allocation to an employee as compare to other employees (Milkovich et al, 2011). In other words, what the employee received as the outcomes, resources or rewards as an exchange of their job performance are referred to distributive justice (Milkovich et al., 2011). Folger and Greenberg (1985) describe distributive justice as the perceived fairness of the contents of the outcomes, or rewards and the consequences of the outcomes distributes. On the other hand, distributive justice has been described as fairness perception of employee on the distribution of rewards which includes working environment and things that will affect employee happiness (Deutsch, 1985). Employees' perceived fairness of distribution of rewards may affect emotion and reactive actions of an employee as it relates to individual's affective and rational decision making process (Greenberg, 1996). According to Greenberg and Cropanzano (2001), when employees feel that they are being treated fairly in relation to distribution of rewards and resources tends to result in negative attitudes and behaviors as compared to those who are treated fairly. These negative behaviours would be negatively contributed to organization productivity and effectiveness.

Literature in organizational justice theory describes **procedural justice** as the ways or approaches by which rewards or outcomes are allocated. It refers to the procedures, processes, methods and ways of how the rewards or outcomes are assigned not specifically to the outcomes themselves. Procedural justice refers to the establishment of certain principles which specify and govern the roles of employees within the decision making system and process. Many researchers argued that procedural justice seems to be essential in maintaining institutional and organizational legitimacy (Cropanzano et al., 2007). Therefore, many scholars refer procedural justice to the perceived fairness of equity of the policies and procedures used in making rewards decisions and distribution, such as disbursement of bonus and executing promotion (Lemons & Jones, 2001). Hence, the concept of procedural justice focusing on employee concern in the policies, procedures and decisions making process of compensation and rewards system (Milkovich et al., 2011; Folger & Konovsky, 1989). The participants of the process are concerned about whether the decision process is seen as fair and the procedures used to determine the outcome was seen be to be just (Folger & Greenberg, 1985). As mentioned by **Lord Hewart**, the then Lord Chief Justice of England in the case of *Rex v. Sussex* (Jacob, 2014), "*Justice must not only be done, but must also be seen to be done*". In

order for the procedural justice to be seen, these procedures shall be perceived and seen as consistently practiced, free from bias and inclusive of all concerns of different groups and be morally acceptable (Leventhal, 1980).

Interpersonal justice defined by many scholars as the execution of the policies and procedures or during the determination of outcomes by managers or supervisors with politeness, dignity, and respect. Interpersonal treatment as postulated by many researchers includes interpersonal communication (Folger & Cropanzano, 1998; Greenberg, 1996) during the process and distribution outcomes of the process. Interpersonal justice is a result of the degree of the treatment by managers or supervisors with politeness, dignity, and respect by management while executing the procedures and delivering the outcomes. Many researchers argued that ignoring the practicing of positive elements of this dimension of justice will cause the good procedures and fairly distributed outcomes will not produce positive impact to employees' reciprocal behaviour.

Scholars refers **informational justice** to the justification and clarifications of why certain procedures were used in a certain manner and/or rewards were distributed in a certain fashion. They argued that informational justice emphasizes on the reasons of the implementation of the decisions made and clarification on decision making procedures used in deciding the reward (Greenberg, 1996). Again, ignoring of using fair treatment in giving information about the procedures and distributed outcomes, will caused a well-designed procedures (Murphy & Cleveland, 1995; Greenberg, 1996) and sound distributed outcomes not causing a productive and positive employees' reciprocal behavior.

The Effect of Compensation on Talent Retention

Many scholars argue that employee satisfaction will affect the employee affective and emotional state, subsequent to employee's behavioral choices (Biswas et al, 2013). Scholarly, employee satisfaction is described as a path of an emotional state, or affective direction, resulting from the assessment of employee's work and work experience (McFarlin & Rice, 1991). Locke (1969) defines employee satisfaction as a state of positive emotional feeling act from a result of employee's evaluation of their job performance as they compare between what they expect from their job and what they actually get from it. MacKain (2010) postulated that salary, perceived organizational support and relationships in the organization community appeared as being important elements to overall employee satisfaction. Overall, employee satisfaction is determined based on a range of different elements or variables which in return influencing the way individuals feel about their work environments (Locke 1969 as cited in McFarlin & Rice, 1991). Satisfied employee will directly and indirectly enggages into positive and productive reciprocal behaviour such as willingness to stay, engage and contribute to the organizational performance and productivity.

The perceived fairness of compensation practices by employees may lead to individual well-being when the distribution of rewards is seen as fair and just; consequently this will increase the feeling of satisfaction among the employees. Satisfied employee will tend to be loyal and intend to retain in the organization. Previous studies found that if employees perceived that they received unfair content of rewards they have a tendency to display the reciprocal feeling of dissatisfaction in form of negative behaviours or other negative consequences (Cropanzano & Greenberg 1997). Dissatisfied employee will normally be resorting to a negative and counterproductive behavior such as intention to leave, reduce commitment to the organization and lowering the level of engagement. In short, satisfied employee contribute to talent retention and vice versa.

Distributive justice has been found to be stronger predictor of employee satisfaction, as compared to procedural justice, in relationship with reward system, as mentioned by researchers (Folger and Konovsky, 1989; McFarlin and Sweeney, 1992) in the studies of employee's reaction toward organizational compensation and reward system. When employees feel that they are being treated fairly with regards to compensation and reward received, they will be reciprocated with satisfaction behavior as well as demonstrated higher level of commitment and intention to stay.

Other researcher (Lawler, 2000) argued that the distribution of compensation outcomes such as performance evaluations ratings, salary increase, promotion, employment status and job tenancy, have significant positive relationship on several outcomes, specifically job organizational performance, quality of work life and employee satisfaction,.

In the job satisfaction research, distributive justice has been found to be stronger predictor as compared to procedural justice (McFarlin and Sweeney, 1992)). Distributive justice in-turn was found to be a better predictor of personal outcomes such as pay satisfaction.

Many researchers (Milkovich et al., 2011; Saks & Rotman, 2006) and practitioners believed that compensation or remuneration is an indispensable human resource management practices to employee retention and engagement. Many researchers agreed that compensation and rewards system motivate employees, encourage them not only to be loyal to the organization but to contribute more and hence put more effort on their performance and job related personal development. It involves both financial and non-financial rewards. Employee is provided in return for their contribution to the organization. As noted by some researchers (Saks & Rotman, 2006) employee recognition and compensation are significant antecedents of employee retention and employee engagement. The study stated that if the employees received rewards and recognition from their organization as a result of their performance, they will in return feel obliged to react with a better performance, higher level of engagement and intention to stay.

Kahn (1990) views that the level of employee engagement is an aggregate of their perceptions of the compensation they received from the role they played and performance they delivered. Therefore, many researchers (Milkovich et al., 2011; Jawahar & Stone, 2011) conclude that, we can expect employees will be more likely to perform better, more committed and raise their engagement level as a result of receiving perceived just amount of compensation and deserved recognition from their organization. Maslach et al. (2001) have also postulated that a perceived lack of rewards and recognition will lead to employee burnout. They also suggested that appropriate employee recognition and reward is also important for employee engagement and talent retention.

The concept of treating employees fairly will engage them into pro-social behavior on behalf of their organization and act favorably to contribute to organizational performance has become a foundation of many researches on organizational justice (Barling & Phillips, 1993). From the social exchange theory (SET), organizational justice research focus on employees observable behaviour and perceived fairness at the workplace, and how they direct their social exchange relationships in the organization (Kashyap et al., 2007). According to Cropanzano and Mitchell (2005), a strong theoretical foundation in SET, in describing the reasons why some employees choose to be more or less loyal and behave in a manner that they are more engaged in their work and more loyal to their organization. This study argued that SET is a well-established theoretical framework in organizational justice research, and this theory is useful in explaining how employees' perception about compensation and reward system may influence talent retention with the organization and employee engagement with their work.

Many researches (Kashyap et al., 2007; Cropanzano & Mitchell, 2005) within the SET framework have indicated that the quality of social exchange between employees and their organizations is directly related from the practice of organizational justice (Bhatnagar &

Biswas, 2010). They also found that organizational justice will lead to reciprocal employee behavior such as employee engagement and talent retention (Biswas et al., 2013).

Therefore, when the perceptions of employees are high on fairness towards organization compensation system, they are also more likely to act fairly in their job role and performance by giving more to the organization through higher levels of work engagement (Cropanzano & Mitchell, 2005) as well as willingness to stay with the organization. In contrast, low perceptions of fairness in compensation and reward system are likely to force employees to act negatively in their work performance and reduce their level of engagement (Biswas et al., 2013) and might consider leaving their current employer and looking for better pasture.

Theoretical Framework and Hypothesis Development

Based on the above argument and literature reviews discussed, this study proposes the following hypotheses;

- H1: There is a significant positive relationship between organizational justice and talent retention.
- H1a: There is a significant positive relationship between distributive justice and talent retention.
- H1b: There is a significant positive relationship between procedural justice and talent retention.
- H1c: There is a significant positive relationship between informational justice and talent retention.
- H1d: There is a significant positive relationship between interpersonal justice and talent retention.

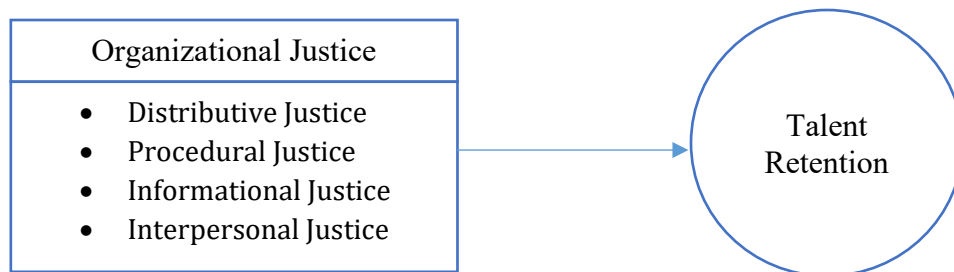


Figure 1: Theoretical Framework: Relationship between Organizational Justice in Compensation Management and Talent Retention

Method

This study is a cross-sectional research design which used survey questionnaire as a procedure to gather data and test the research framework. Measurements of all dimensions of organizational justice were adapted and developed from Bies and Moag (1986), and Walsh (2003). While measurement for employee retention were adopted from Milkovich et al. (2011). All variables were measured with 7-points Likert-type scale with anchors of 1 = strongly disagree and 7 = strongly agree.

A survey with non-probability sampling method was administered. The selection of the companies and respondents were based on convenience and willingness to participate. Data were obtained from full time employees of Electric and Electronic companies in Klang Valley, Penang and Johore Bahru in Malaysia. 550 surveys electronic form were sent directly to employee by email and 380 returned forms were good for further analysis, with response rate of 69%. This study conducted two stages of data analysis; Firstly, checking for data entry,

testing for validity and reliability of variables, identification outliers and normality of the data. Secondly, correlation analysis was conducted.

Findings

Table 1 shows that majority respondents were males (52.4%), with Bachelor Degree (or equivalent) level of education (65.8%). It is also found that most respondents were among the Middle Management job position - group whom viewed as highly involved in overall compensation system processes. Half of the respondents (57.1%) were having less than 10 years' experience with the company, while 79.5% were 5 to 9 years holding present job position.

Table 1: Demographic Profile of Respondent

Gender	n	%	Race	n	%
Male	199	52.4	Malay	184	48.4
Female	181	47.6	Chinese	99	26.1
			Indian	97	25.5
Job position			Level of education		
General Manager/Top Management	26	6.8	Master Degree or equivalent and above	130	34.2
Middle Management	354	93.2	Bachelor Degree or equivalent	250	65.8
Years worked for this company			Years in present job position		
30 years and above	12	3.2			
20 - 29 years	14	3.7	10 years and above	20	5.3
10 - 19 years	137	36.1	5 - 9 years	302	79.5
Less than 10 years	217	57.1	Less than 5 years	58	15.3

The reliability of composite variables is presented in Table 2. Hair et al. (2006) suggested that usual lower limit for Cronbach alpha is .70, but in exploratory research, this limit may decrease to 0.6. The Cronbach alpha of all the variables for this study is above 0.6.

Table 2: Reliability Test and Correlations

		Correlations of all variables					
Variables		1	2	3	4	5	6
1	Distributive Justice (no. of items = 5)	$\alpha = .810$					
2	Procedural Justice (no. of items = 6)	.686**	$\alpha = .818$				
3	Informational Justice (no. of items = 5)	.297**	.776**	$\alpha = .690$			
4	Interpersonal Justice (no. of items = 5)	.447**	.741**	.587**	$\alpha = .667$		
5	Organizational Justice (no. of items = 21)	.748**	.965**	.782**	.831**	$\alpha = .901$	
6	Talent retention (no. of items = 6)	.378**	.275**	-.108*	.554**	.343**	$\alpha = .838$

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

*Correlation is significant at the 0.05 level (2-tailed).

Table 2 shows the results of Pearson correlation analysis. The correlation coefficients for the relationship between the independent variable (i.e., distributive justice, procedural justice, informational justice, interpersonal justice and overall organizational justice) were less than 0.90, indicating the data were not affected by serious collinearity problem (Hair et al., 2006). Thus, these statistical results provide evidence of validity and reliability for measurement scales used in this research (Hair et al., 2006).

As shown in the table 2, the strongest linear relationship was found to exist between relationship of interpersonal justice and talent retention ($r = 0.554$, $p = 0.01$). It followed by distributive justice ($r = 0.378$, $p = 0.01$) and procedural justice ($r = 0.275$, $p = 0.01$). The finding shows that there is no positive relationship between informational justices and talent retention. Based on the findings, we accept H1a, H1b, H1d and reject H1c. While the linear relationship between overall organization justice and talent retention is strong as well ($r = 0.343$, $p = 0.01$), therefore, we accept H1.

Discussion and Conclusion

Many HRM practitioners are concerned about how compensation and reward systems will effectively contribute to employee satisfaction, commitment and talent retention. As compensation system is major cost to the organization, answer to this question is crucial. The perception of fairness on compensation system has become an important subject of discussions and topics of research among practitioners and academia. Many researchers (e.g. Jawahar & Stone, 2011; Blau, 1999, Moorman, 1991) have proven that the application of organizational justice theory in the compensation system did contribute to human resource outcomes such as job satisfaction, commitment, organizational citizenship behaviour and performance (Cropanzano et al., 2007; Greenberg, 2003; Adams, 1965; Leventhal, 1980; Bies & Moag, 1986). A good compensation system and psychometrically perfect tool do contribute to acceptance of the system by employees. Findings from this study found that interpersonal, distributive justice and procedural justice are strongly correlated to talent retention. Further, this study does not provide evidence on the relationship of informational justice and talent retention. The perception of employees on the fairness of the compensation system and its processes should be understood as it will affect the effective implementation of the system.

Previous studies also found that distributive justice and procedural justice of the compensation system are strongly correlated with employee satisfaction and talent retention. Folger and Konovsky (1989) and McFarlin and Sweeney (1992) found that distributive justice to be a stronger predictor of pay satisfaction than procedural justice. Findings from this study show the similar result with additional evidence of strong relationship of interpersonal justice to talent retention in the perception of fairness in compensation system. This study contributes to our understanding of how individual dimension of organizational justice affects employees' perceived fairness on the compensation system and in turn how it affects the talent retention.

Literature in organizational justice postulated that interpersonal justice construct consists of treatment with politeness, dignity, and respect by those who execute the performance appraisal procedures, compensation process implementation or determine the outcomes of the process (Folger & Cropanzano, 1998; Greenberg, 1996). These are the role and responsibility of the supervisor to practice effective interpersonal treatment so that the procedures will be perceived as fair by the employees. Further, distributive justice which specifically refers to the fairness of allocation of resources demands the executor of the compensation system to implement and seen to be implementing a well distributed outcomes according to work performed. Whereas procedural justice focusing on the means of the compensation processes, compensation system should consist of not only procedurally sound methods but it must be exhibit fair code of conduct. Finally, the whole set of organizational justice in compensation management will

definitely contribute more to talent retention, the whole is better than the sum of individual justice dimensions.

Findings of this study shed some light to our understanding of how perceived fairness of one of the most important HR systems, compensation management, will affect talent retention. The findings also trigger our thinking of what are the next levels of organization justice research and how this could benefit to our understanding of effectiveness of compensation systems management or other HR practices in improving the productive management of human resource and talent management. Further research is required to explore how individual organizational justice relationship to compensation management using more rigorous methods of data analysis such as regression analysis or structural equation modelling. These will give us more evidence of these complex relationships. Further, organizational justice theory should be tested to other HR practices which related to compensation system such as performance appraisal system and employee promotion system.

Although this study shows many consistent relationships between perceptions of fairness in compensation system and talent retention, several limitations deserve mention, and the results must be considered in light of these limitations. First, the sample, coming from a limited number of Electric and Electronic companies in Malaysia, is unique enough to prompt concerns over generalizability. All the companies are large public companies with good human resource practices and they do not appear to have a strong problem with a lack of fairness. Most of the supervisors or representatives of the companies have been briefed or trained to implement the performance appraisal procedures as well as its implication on compensation system. Perhaps the relationships found here would be different in a company in which lack of fairness was more pervasive. Second, this study used a cross-sectional method of data collection. A conclusion should be viewed from this limitation. Perhaps the relationship found here could be further concluded by the longitudinal method of data collection. Research in the future could be conducted to overcome these limitations.

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