

## THE INFLUENCE OF CHARACTERISTICS ON DIFFERENT ELEMENTS OF COMPENSATION SYSTEM TOWARD MOTIVATION

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Employee is one of the most valuable resources for the company. One factor that could make the company succeed is its employee performance. Performance evaluation is one of the qualitative measurements for giving the compensation for employee.

This research aimed to determine whether the transparency, fairness, and controllability as characteristics on compensation system could influence the employees' motivation in the company. Data for this research using questionnaire that being sent to employees in companies.

Multiple regressions were used to test the hypothesis. Result of this research showed that perceived transparency and perceived fairness of the different elements of the compensation system significantly influences the extrinsic motivation. Perceived controllability over the different elements of the compensation system significantly has a positive relationship with extrinsic motivation. The perception of transparency, controllability and fairness of the monetary part of the compensation system has no significant effect on intrinsic motivation. The perception of transparency, controllability and fairness of the promotion opportunities has a positive and significant effect on intrinsic motivation. The perception of transparency, controllability and fairness of the compensation system has no significant influence towards motivation level indicator.

*Keywords :* Compensation system, characteristic of compensation system, intrinsic motivation, extrinsic motivation, motivation indicator.

## INTRODUCTION

Empirical researched in economic, especially for management accounting found that non-financial measurement has direct influence towards management performance, and finally influence the financial report. One important factor, but least analyzed that affect the organizational behavior is the internal compensation system. Performance measurement used as a base of compensation system.

Primary organization objective was to maximize shareholders wealth (Martin, et.al., 1997). This can be defined as an effort to maximize company stock value (Sudarsono, 2002). Compensation system can facilitate organizational change through their effect on the motivation and productivity of individuals in the organization (Wruck, 2000). Researchers today generally agree that compensation systems encourage individuals to engage in expected behaviors (Wruck, 2000).

There are three basic assumptions underlying agency theory. The first assumption states that agents are self-interested. The second assumption concerns for the attitude toward risk. The third assumption concerns for asymmetry information. According to Cornell and Shapiro, stated on Sudarsono (2002), agent can become a safety player, and it cause loss on investing opportunity of profit investment. Agents can behave in a way that is beneficial to them, but harmful to the principal, whenever the performance measurement used in the incentive contract is not perfectly in line with the principal's objective.

Indonesian firms have been starting to apply the theory of compensation system and performance measurement to increase the organization performance. Lately, most principals in Indonesia begin to use many forms of compensation to motivate the agents, including incentive compensation such as bonus payment, profit sharing, promotion, stock options, and etc.

This research tries to determine the influence of the characteristics in a compensation system including performance measurement on Indonesian employees, by using Indonesian economic condition and Indonesian firm cultures, and decided not to use the study case only for one organization, but trying to find out the result from many organizations. Research framework divided into introduction, theoretical background and hypothesis development, research methodology, analysis and explanation, conclusion, research limitation, and recommendation. Finally this study will be benefited for the companies in Indonesia in order to have understanding whether transparency, fairness, and controllability characteristics of the compensation system will have significant influence toward motivation and motivation level indicators.

## THEORITICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

### Compensation System

Rewards can take many different forms, and economists, while recognizing that non-monetary rewards for performance can be important tend to focus on monetary rewards because individuals are willing to substitute non-monetary for monetary rewards. Stated on Van Herpen, *et.al.*, (2003), Fama (1980) showed the potential effects of career concerns on current behavior. Career concerns occur whenever the labor market uses the current output of a worker to adjust their belief on the worker's ability. The labor market up dates their belief based on the future wages. In this manner, career concerns may serve as a substitute for incentive compensation.

The performance measurement is used to evaluate the performance of the employee, and are to be selected based on two criteria (Van Herpen, *et.al.*, 2003) :

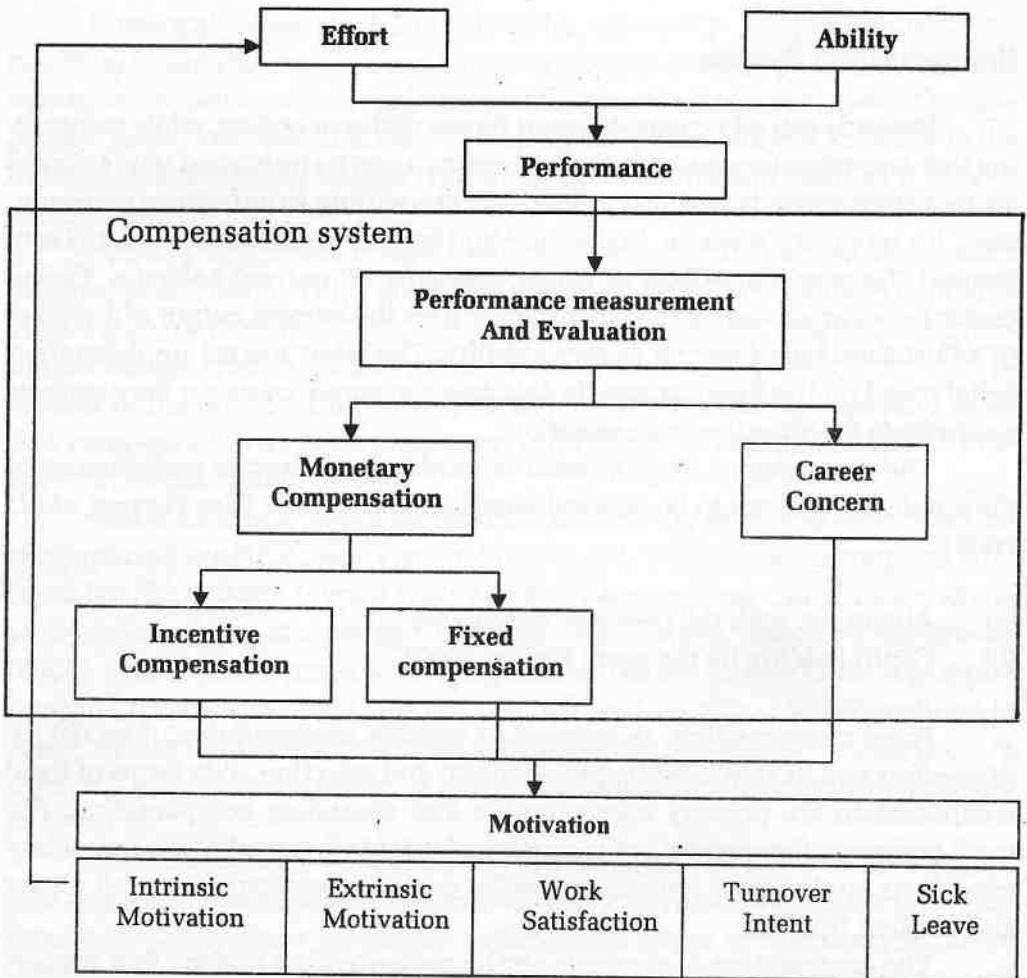
- (a) Alignment with the principal's objective.
- (b) Controllability by the agent (Baker, 2002).

Fixed compensation, as opposed to variable compensation, does not induce effort and its role is limited to retention and selection. Two forms of fixed compensation are primary compensation and secondary compensation. Primary compensation consists of monetary payments for employees. Secondary conditions are the non- monetary benefits such as a company car, cell phone and pension benefits.

The combination of elements on the compensation system, that are *performance measurement and evaluation, monetary compensation and career concerns* link employee performance to motivation, which in turn affects effort and other indicators for the level of motivation.

Thierry (1987) statement's on Van Herpen, *et.al.*, 2003, stated that the effectiveness of a compensation system depends on three perceived characteristics, namely (1) *transparency*, (2) *fairness* and (3) *controllability*

**Conceptual Model**



Source: Van Herpen, *et.al.*,(2003)

**Transparency**

Transparency is clarity of compensation system, performance measurement, and career concern that have been applied within the company that make the employees know clearly about how the salary, promotion, and their bonus being set up. Perceived transparency of a compensation system depends on two characteristics: communication and complexity. Clear communication of the compensation system rules and firm objectives towards the personnel will enhance the understanding of the methodologies, measures and targets used and thereby create a better basis of support for the compen-

sation system. On the other hand, uncertainty will decrease the effectiveness of incentive compensation (Gibbons, 1998).

### **Fairness**

Fairness is the fair amount of a relative compensation from the company owner to the employees. Locke and Henne on Van Herpen, *et.al.* (2003) stated that the agent is expected to compare her performance ratio over reward to the same ratio of other agents. Any deviation in this ratio causes a state of inequity. The effect of fairness is the employees feel that what they get from the company appropriate with their effort for the company. Reciprocity theory emphasizes the agent's need to receive a fair amount of compensation relative to the principal. The surplus, created by the agency contract, should be fairly divided in order to maximize incentives, according to this theory.

### **Controllability**

Controllability is to measured how big the management's ability to control or influence the outcome. Baker (2002) defined *controllability* as the extent to which the agent is able to control or influences the outcome. Within the cognitive evaluation theory, the controlling and informing elements of a compensation system are expected to have an effect not only on performance but on motivation as well (Frey, 1997). According to Deci and Ryan (1985) stated on Van Herpen, *et.al.*, 2003, "Employees perceive controllability and the controlling element of the compensation system as two opposite sides of the same coin".

### **Differentiation within motivation**

Economy evolution theory has been considered to establish psychology effect. Therefore, motivation theory was developed from the economic point of view without ignoring the psychological assessment. The output or performance of an agent is a function of effort, ability and an error term, capturing all uncontrollable factors, can be formulated as follows:

$$\text{Job Performance} = f(\text{ability})(\text{effort})$$

This function shows the relationship between ability and effort toward job performance, where the motivation became a key on increasing employees' effort, which finally increased the individual job performance of the employee.

Extrinsic motivation was defined as motivation that caused by external factors to perform an activity to get reward or because of the existence of pres-



sure. Extrinsic motivation was related to monetary compensation, where the agency experts exclusively rely on extrinsic motivation in order to assess the expected efforts from the agents.

Intrinsic motivation was defined as motivation that caused by internal factors, that indicates under certain conditions employees are prepared to undertake a task for immediate need satisfaction or for their own sake without being paid (Van Herpen, *et.al.*, 2003).

In the psychological and economical literature (e.g. Lawler, 1986) motivation is viewed as a proxy for the amount of effort that will be exerted. Effort, ability and external circumstances determine actual performance, which in turn determines compensation. Both types of motivation will determine the total motivation. Therefore, both types of motivation must be taken into account while analyzing the optimal amount of effort that can be reached.

### Indicator for the level of motivation

Besides the expected relationships discussed above, the perceived quality of compensation system is also likely to be related to other indicators of motivation that are more tangible than intrinsic and extrinsic motivation, which are:

- (1) *Work satisfaction*, which should be positively related to the perceived quality of the compensation system. Work satisfaction is the employee satisfaction toward systems that have been applied in the company,
- (2) Turnover intent, a proxy of undesired *employee turnover*, which we expect to be negatively correlated to the perceived quality of the compensation system. Turnover intent defines as the frequencies of employees that come and leave the company.
- (3) *Absenteeism caused by sick leave*, which is assumed to be negatively correlated to the perceived quality of the compensation system.

### Hypotheses

- Ha1 : Perceived transparency of the different elements on the compensation system significantly influences the extrinsic motivation.
- Ha2 : Perceived fairness of the different elements on the compensation system significantly influences the extrinsic motivation
- Ha3 : Perceived controllability of the different elements on the compensation system significantly influences the extrinsic motivation.

- Ha4 : Perception of transparency, controllability and fairness of the monetary part on the compensation system significantly have no influence on intrinsic motivation.
- Ha5 : Perception of transparency, controllability, and fairness of the promotion opportunities significantly influence the intrinsic motivation
- Ha6 : Perception of transparency, controllability, and fairness of the compensation system significantly influence the motivation level indicator.

## RESEARCH METHODOLOGY

### Research Objects

Population on this research is companies residing in DKI Jakarta. Sampling analysis for this research is taken from individual level of employee from each company with demographics factors classification that are age, gender, tenure, incentive compensation, and level of education.

### Operational Variables and Measurement

#### A. Independent Variables

##### *Transparency*

The perceived transparency for each element of the compensation system was assessed by asking questions concerning the complexity and the clarity of communication of each element. This variable was measured by using 5 point of likert scale that have range from 1 (1 = strongly disagree) until 5 (5 = strongly agree).

##### *Fairness*

This variable was measured by using 5 point of likert scale.

##### *Controllability*

This variable was measured by using 5 point of likert scale.

#### B. Dependent Variables

##### *Extrinsic motivation*

Extrinsic motivation was measured by using 5 point of likert scale that have range from 1 (1 = strongly disagree) until 5 (5 = strongly agree).

### ***Intrinsic motivation***

This variable was measured by using 5 point of likert scale that have range from 1 (1 = strongly disagree) until 5 (5 = strongly agree).

### ***Work satisfaction***

This variable was measured by using 5 point of likert scale that have range from 1 (1 = strongly dissatisfaction) until 5 (5 = strongly satisfaction).

### ***Turnover intent***

This variable was measured by using 5 point of likert scale that have range from 1 (1 = strongly disagree) until 5 (5 = strongly agree).

These independent and dependent variables were tested by using questionnaires adopted from Van Herpen, *et.al.*, (2003).

## **Control Variable**

Individual differences in demographic factors can have an impact on the relationship between the variables (e.g. Janssen, 2001). Therefore, demographic control variables were used in each of the analyses. Demographic factors classifications are age, gender, tenure, incentive compensation, education discipline, and level of education.

## **Data Collections Technique**

Data at this research is written self report data, consist of written opinion, attitude, characteristics or experience of someone or a group of people that being the subject research (respondent). The written response is a form of conception towards questionnaire that being asked by researcher. This data collection technique is survey method with questionnaire, and using one shot study for time horizon data collection.

## **Analysis Method**

Correlation, to determine how one variable is related to another, using correlation matrix.

Simple Regression model, which involves a single independent variable is used to test hypothesis 1 until 5.



Multiple Regression, to show the direction of the relationship between independent and dependent variable, and is used to test the last hypothesis as a whole.

Hypothesis testing was done with the usage of statistic for multi variables and OLS (ordinary least square) method. The regression models are:

1.  $Y_1 = a + b_1x_1 + \varepsilon$   
 $Y_1$  : Extrinsic Motivation  
 $a$  : Intercept  
 $b_1$  : Regression coefficient of transparency  
 $x_1$  : Transparency  
 $\varepsilon$  : Error term
2.  $Y_2 = a + b_2x_2 + \varepsilon$   
 $Y_2$  : Extrinsic Motivation  
 $a$  : Intercept  
 $b_2$  : Regression coefficient of fairness  
 $x_2$  : Fairness  
 $\varepsilon$  : Error term
3.  $Y_3 = a + b_3x_3 + \varepsilon$   
 $Y_3$  : Extrinsic Motivation  
 $a$  : Intercept  
 $b_3$  : Regression coefficient of controllability  
 $x_3$  : Controllability  
 $\varepsilon$  : Error term
4.  $Y_4 = a + b_4x_4 + \varepsilon$   
 $Y_4$  : Extrinsic Motivation  
 $a$  : Intercept  
 $b_4$  : Regression coefficient of monetary compensation system  
 $x_4$  : Perception about transparency, controllability, and fairness of monetary compensation system  
 $\varepsilon$  : Error term
5.  $Y_5 = a + b_5x_5 + \varepsilon$   
 $Y_5$  : Extrinsic Motivation  
 $a$  : Intercept  
 $b_5$  : Regression coefficient of promotion opportunity  
 $x_5$  : Perception about transparency, controllability, and fairness of promotion opportunity  
 $\varepsilon$  : Error term

$$6. Y_6 = a + b_1x_1 + b_2x_2 + b_3x_3 + \varepsilon$$

- Y<sub>6</sub> : Motivation level indicator  
 a : Intercept  
 b<sub>1</sub> : Regression coefficient of transparency  
 x<sub>1</sub> : Transparency  
 b<sub>1</sub> : Regression coefficient of fairness  
 x<sub>1</sub> : Fairness  
 b<sub>1</sub> : Regression coefficient of controllability  
 x<sub>1</sub> : Controllability  
 ε : Error term

## ANALYSIS AND EXPLANATION

### First Hypothesis

**TABEL 1**

**Simultaneous Significance Test Result for Perceived Transparency on Different Elements of the Compensation System toward Extrinsic Motivation**

#### ANOVA

F	Sig.
142.044	.000

Sources: analyzed from primary data research

ANOVA or F test show the significance level for this research is 0.000, which mean the regression model can be used to predict the influence of transparency on different element of compensation system toward extrinsic motivation.

**TABEL 2**

**Individual Parameter Test Result for Perceived Transparency on Different Elements of the Compensation System toward Extrinsic Motivation**

#### Coefficients

Variable	B	Sig.
a	13.540	.000
Transparency	1.387	.000

Sources: analyzed from primary data research

From result value on the table above, the linear regression for this research is:

$$EM = 13.540 + 1.387 \text{ Trans} + \epsilon$$

Significance level of the transparency on different elements of compensation system toward extrinsic motivation on the regression test result is 0.00, which is below probability of 0.05 or 5 %. According to the significance level value of 0.000, the alternative hypothesis is accepted. It means that perceived transparency of the different elements of the compensation system significantly influences the extrinsic motivation

## Second Hypothesis

**TABEL 3**

**Simultaneous Significance Test Result for Perceived Fairness on Different Elements of the Compensation System toward Extrinsic Motivation**

ANOVA	
F	Sig.
365.836	.000

Sources: analyzed from primary data research

ANOVA or F test show the significance level for this research is 0.000, which mean the regression model can be used to predict the influence of fairness on different element of compensation system toward extrinsic motivation.

**Table 4**

**Individual Parameter Test Result for Perceived Fairness on Different Elements of the Compensation System toward the Extrinsic Motivation**

Coefficients		
Variable	B	Sig.
a	9.868	.000
Fairness	1.336	.000

Sources: analyzed from primary data research

From result value on the table above, the linear regression for this research is:

$$EM = 9.868 + 1.336 \text{ Fair} + \epsilon$$

Significance level of the fairness toward extrinsic motivation on the regression test result is 0.00, which is below probability of 0.05 or 5 %. According to the significance level value of 0.000, the alternative hypothesis is accepted. It means that perceived fairness of the different elements of the compensation system significantly influences the extrinsic motivation.

### Third Hypothesis

**TABEL 5**  
**Simultaneous Significance Test Result for Perceived Controllability on Different Elements of the Compensation System toward the Extrinsic Motivation**

ANOVA	
F	Sig.
204.045	.000

Sources: analyzed from primary data research

ANOVA or F test shows the significance level for this research is 0.000, which mean the regression model can be used to predict the influence of controllability on different element of compensation system toward extrinsic motivation.

**Table 6**  
**Individual Parameter Test Result for Perceived Controllability on Different Elements of the Compensation System toward the Extrinsic Motivation**

Coefficients		
Variable	B	Sig.
a	9.689	.000
Controllability	1.712	.000

Sources: analyzed from primary data research

From result value on the table above, the linear regression for this research is:

$$EM = 9.689 + 1.712 \text{ Control} + \varepsilon$$

Significance level of the controllability toward extrinsic motivation on regression test result is 0.00, which is below probability of 0.05 or 5 %. According to the significance level value of 0.000, the alternative hypothesis is accepted. It means that perceived controllability of the different elements on the compensation system significantly influences the extrinsic motivation.

#### Fourth Hypothesis

**TABEL 7**

**Individual Parameter Test Result for the Perception of Transparency, Controllability and Fairness on Monetary Part of the Compensation System toward Intrinsic Motivation**

Coefficients		
Variable	B	Sig.
a	11.406	.000
Monetary	0.333	.000

Sources: analyzed from primary data research

From result value on the table above, the linear regression for this research is:

$$IM = 11.406 + 0.333 TRCM + \epsilon$$

Significance level of transparency, fairness, and controllability on monetary compensation of the regression test result is 0.00, which is below probability of 0.05 or 5%. According to the significance level value of 0.000, the alternative hypothesis is accepted. It means that perception of transparency; controllability and fairness of the monetary part on the compensation system significantly have no influence on intrinsic motivation.

#### Fifth Hypothesis

**TABEL 8**

**Simultaneous Significance Test Result for the Perception of Transparency, Controllability and Fairness of Promotion Opportunities on the Compensation System toward Intrinsic Motivation**

ANOVA	
F	Sig.
54.001	.000

Sources: analyzed from primary data research

ANOVA or F test shows the significance level for this research is 0.000, which mean the regression model can be used to predict the influence of

transparency, fairness, and controllability on promotion opportunity toward intrinsic motivation.

TABEL 9

**Individual Parameter Test Result for the Perception of Transparency, Controllability and Fairness on Promotion Opportunities of the Compensation System toward Intrinsic Motivation**

Coefficients		
Variable	B	Sig.
a	12.612	.000
Non Monetary	0.409	.000

Sources: analyzed from primary data research

From result value on the table above, the linear regression for this research is:

$$IM = 12.612 + 0.409 TRCNM + \varepsilon$$

Significance level of transparency, fairness and controllability on promotion opportunity of the regression test result is 0.00, which is below probability of 0.05 or 5 %. According to the significance level value of 0.000, the alternative hypothesis is accepted. It means that perception of transparency, controllability, and fairness of the promotion opportunities significantly influences intrinsic motivation.

### Sixth Hypothesis

TABEL 10

**Individual Parameter Test Result for the Perception of Transparency, Controllability and Fairness of the Compensation System toward Motivation Level Indicator**

Coefficients		
Variable	B	Sig.
a	1.552	0.001
Transparency	0.019	0.651
Fairness	0.260	0.000
Controllability	0.113	0.013

Sources: analyzed from research primary data



From result value on the table above, the linear regression for this research is:

$$MLI = 1.552 + 0.019Trans + 0.260Fair + 0.113Ctrl + \epsilon$$

Significance level of the regression test result for transparency is 0.651, which is upper probability of 0.05 or 5 %. According to the significance level value of 65.1%, the alternative hypothesis is unaccepted. It means that perception of transparency significantly doesn't influence motivation level indicator.

Significance level of the regression test result for fairness is 0.000, which is below probability of 0.05 or 5 %. According to the significance level value of 0.000, the alternative hypothesis is accepted. It means that perception of fairness significantly influence motivation level indicator.

Significance level of the regression test result for transparency is 0.013, which is below probability of 0.05 or 5 %. According to the significance level value of 1.3%, the alternative hypothesis is accepted. It means that perception of controllability significantly influence motivation level indicator.

Results test for hypothesis 1-5 were consistent Van Herpen, *et.,al* research (2003), but result for hypothesis 6 was not consistent with Van Herpen, *et.,al* research (2003).

## CONCLUSION, LIMITATION AND RECOMMENDATION

### Conclusion

Based on regression hypothesis test, the conclusion as follow:

- a. Perceived transparency of the different elements of the compensation system significantly influences the extrinsic motivation. Based on the research, the extrinsic motivation is influenced by transparency on the compensation system. Clear communication of the compensation system rules and firm objectives towards the personnel will enhance the understanding of the methodologies, measures and targets used and thereby create a better basis of support for the compensation system.
- b. Perceived fairness of the different elements of the compensation system significantly has a positive relationship with extrinsic motivation. Reciprocity theory emphasizes the agent's need to receive a fair amount of compensation relative to the principal. Fairness is fair amount of a relative compensation from the company owner to the employees. The effect of fairness is the employees feel that what they get from the company appropriate with their effort for the company.
- c. Perceived controllability over the different elements of the compensation system significantly has a positive relationship with extrinsic

- motivation. Within the cognitive evaluation theory, the controlling and informing elements of a compensation system are expected to have an effect not only on performance but on motivation as well (Frey, 1997).
- d. The perception of transparency, controllability and fairness of the monetary part of the compensation system has no significant effect on intrinsic motivation. The result of the research shows that intrinsic motivation is not influence by transparency, controllability and fairness of the monetary part of the compensation system.
  - e. The perception of transparency, controllability and fairness of the promotion opportunities significantly has a positive effect on intrinsic motivation. Non-monetary compensation can influence the intrinsic motivation if the characteristics of compensation system are transparent, fair and can be controlled by the employee.
  - f. The perception of transparency, controllability and fairness of the compensation system significantly doesn't influence motivation level indicator.

### **Limitation**

Limitation on this research as follow:

- a. Sampling method on this research is non-probability sampling and use convenience sampling method for choosing the sample. Non-probability method used because the populations do not have the same chance of being chosen as objects in the sample.
- b. The respondents can't ask the researcher about the question if they don't understand about the question because the questionnaires were sent through contact person. It can cause bias answer from the respondent.

### **Recommendation**

- a. It would be better if the next research will be better if uses purposive sampling. The data can have normal distribution if the questionnaire is collected from many field of company that has different policies.
- b. It's better to make an interview with the respondent. So the question will answer correctly.

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