



IMPACT OF INDIVIDUALS' MARKET RATE COMPENSATION ON PERCEIVED INTERNAL EQUITY - MODERATING EFFECT OF ORGANIZATION COMMITMENT: EMPLOYEES' PERSPECTIVE

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Abstract

This study is about the issues of compensating professionals with special skills at Market rate and maintaining motivation of their co-workers receiving lower packages while working towards the same targets. The situation is normally observed in case of expatriates working with local hires. This study considers Individual Market Rates as independent variable with Perceived Internal Equity as dependent variable under the moderating effects of organizational commitment assuming that in the presence of such commitment the negative impact of individual market rates on perceived Internal equity is reduced. The data collected has proved this assumption correct. The final part of the study presents some solutions to the situation, where the employer is compelled to pay some professionals above the fixed compensation system.

Keywords: Individual Market Rate. Compensation, Organizational Commitment, Perceived Internal Equity, Employee Motivation

INTRODUCTION

Compensation Structure of an organization is one of its vital tools to accomplish its business targets. Organization sees compensation as expenditure but the manager knows that it's a source of achieving competitive edge. If compensation system is not properly structured and not oriented towards organizational business goals, then it may become an unaccounted expenditure.

Every organization has certain budget limit for salaries and other components of compensation. This budget fixation is from perspective of financial affordability of achieving business targets and profit generation (in short and long terms). Keeping these perspectives in focus, organization willingly meet the demand of the professionals who can effectively contribute in business targets adding to the profit of the organization and while staying within its financial affordability. Despite of an established pay structure the organization goes out of the fixed range of salaries to accommodate professional holding market reputations and are expected to contribute significantly to the business cause.

Apparently, compensation is a tool of market competition and is widely applied by majority of the corporate sector companies. This paper focuses on issue arising within an organization due to the salary packages fixed for such professional. One of the main issues that arise out of this kind of hiring of these high priced professional due to their demand in the market and whose salary packages are fixed on individual market rates, is the dissatisfaction and demotivation of other workers.

Under the current management approach of teamwork, each and every employee from top to bottom in a team, has a role to play and the role of each employee compliment the role of others. Teams develop when members feel associated with each other which further help them synchronize their activities as per their roles. This association can only be developed when the team members embraces the presence of each other in a clear and meaningful way. Referring back to the main issue, if the salary of team member hired at individual market pricing exceeds the salary range of the compensation structure fixed for that team then it can be a cause of discontentment among the other team members. And under the circumstances, the association required by the members to develop a team would be difficult to create. As a result, such team members would take a longer period to evolve as a effective team. In certain cases, they may not even become a team and would remain just a group of employees with no team harmony and articulation.

In certain cases, the members of such a team in order to save their jobs would apparently act as supportive team members but internally, they would continue to nurture that feeling of resentment. This, from time to time creates hindrance in team activities lowering the performance of the team. Such kind of dissatisfaction can negatively affect creativity, loyalty and coworker support.

Such a disparity, technically suppresses one of the main purposes of compensation i.e. to achieve employee satisfaction/motivation. While, creativity and commitment are sources for gaining competitive edge in the market. Compensation Structure are used as a tool to inculcate

the very essence of creativity and commitment. The above illustrated scenario could become a source of diluting the effect of the compensation package fixed for such teams.

Individual markets pricing of some professionals soar very high as the companies see an associated profit increase with their presence. But such discontentment among the other team members, such hiring may not lead to meaningful increase in profit or prove to be a sustainable basis for business development. If the team is a one-person team for a specific task, then such salary fixation may not bear any negative implication proving to be a successful strategy. But, in case of multiple members' team where the rest of the members are managed under different compensation system, this may bear deteriorating effects on the team bonding and performance.

When a greater disparity exists in compensation given to the individual team members, an ambiguity on policy is found amongst the employees of the company, as they are not sure where they stand in ranking with respect to the salary structure. A structured system eliminates such uncertainty, but gross deviation from pay scales results in demotivation, as any such practice is perceived as inequity by the employees. On the other hand, as a business development strategy the companies do need professionals with repute in the market and hence would want them to become part of their employees' strength.

On the other hand, these professionals after long and intense grooming of their skills have earned their market repute, so without compensating them for their specialized talent, any such offer would not be an attractive proposal for them. Given this scenario, In order to hire such professionals, the company has to pay them the price which the market has fixed for their services keeping in view the demand for their talent.

Reviewing the above deliberations, we conclude that pursuing the strategy of individual market pricing can result in destabilizing internal equity stemming out of this imbalance in compensation. In contrast to this, ignoring the market worth of an individual can be seen unfair by individuals who had set their rates through their performance.

In this study on one hand the focus is on identifying the correlation between the individual market pricing and the team members motivation in the presence of perceived inequity arising out of the variable pay-scale systems in the compensation structure. The study highlights that consideration of individual market pricing as an integral part of the pay structure can actually disturb the equilibrium of internal equity and justice. In this process organizational commitment can play the role of a moderating factor. This means the presence of organization commitment can reduce the risk of disability to a certain extent.

Individual market pricing is normally resorted to as an option when the overall compensation structure is not strong enough to attract such high-grade employees, which is normally the case in medium and small companies.

The situation is also being faced by the newly established companies where the compensation structure is not clearly spelled out due to its rapidly evolving shape. This study would identify the level of correlation among the factors manipulating the effects of compensation packages with the possible strategy to resolve this issue.

LITERATURE REVIEW

Paik, Parboteeah & Shim (2007) while discussing Host Country Workforce (HCW) developed an in-depth understanding of the behavioral manifestation such as turnover and indicated that the perception about unfairness bears strong consequence for organizations. Chen, Choi & Chi (2002) also endorsed the fact that gaps in pay level of an expatriates and local workforce are inevitable in the presence of certain factors such as cultural adjustment, family displacement etc. .Adam (1963, 1965) analyzed that according to equity theory it is a natural tendency that individual compare their salaries with others on the basis of the ratio of their output. This impression creates an image which is labeled either equitable or inequitable. Perception of inequitable compensation creates dissatisfaction as concluded by Sweeney, McFarlin & Inderrieden (1990) and finally results in employee turnover especially of high performers (Hasenhuttl & Harrison, 2002).

Further fortifying this notion, Lazear (1989) brings out the negative impact of higher pay differentials on cooperative behavior. In contrast, Shaw, Gupta & Delery (2002) highlighted that such a dispersion could be very counter-productive in terms of performance associated with pay for performance. In another words, again if there is a clear and well-founded explanation for such differentials, the problem arises, firstly about the organization system if it is transparent enough to enabling employees understanding of the logic developed behind creating such a large differential.

While discussing compensation system in subsidiaries of the multinational Goodman (1974) and Ho & Levesque (2005) deliberated that the choice of pay referent is subject to the availability of information of the pay of the other referents and the presence of relevant skills such as output, skill, abilities etc. When such information is not available then individuals' logic for comparison of his salary is weak. Furthermore, the comparison conducted across such subsidiaries may result in creating sense of inequity among the employees (Yanadori and Kang, 2011). Whatever the logic behind the wide differentials in these pay or additional pay components, if explainable should be implemented effectively, otherwise on one hand if this

strategy works to attract and retain professional employees on another it may be a cause of demonization and raise sense of inequity among colleagues.

While developing a pay structure, market pay level is considered but the firms usually deviates from this curve in order to balance their own internal compensation system while aligning the salaries to an acceptable range across all levels of pay structure (Leonard, 1989) further, if these pay levels are identifiable for all the grades only then it is acceptable to all the employees. In case of some professional individual when market rates are considered as per demand for those individual's skills, then it becomes difficult for the company to justify such spotlight rates when there is a wide gap in firm's pay structure and these spotlight rates. The situation is further perplexed, if these individuals have to work with teams from the firm with different pay scales. Organization recognition for the level of contribution through compensation is an effective strategy (Lepak and Snell 1999).

Simultaneously, Leonard 1989 has stated that large deviation from the market rates has negative repercussion for the organization. Moving back and forth on the arguments for and against the application of market rates strategy with all the strong rational behind it, in each case we also see that too much deviation from an established structure of compensation, bears negative impact on the employee motivation (one of the main objective of compensation strategies). According to Folger and Konovsky (1989), perception of fairness is connected with the distribution of rewards such as pay, bonuses and promotions.

Chen, Friedman, Yu & Sun (2011) while supporting the same notion calls it comparative distributive justice. Chen at All (2011) argues on compensation disparity as a source of perceived inequity when it is more in favor of the social referent. Receiving more favorable treatment indicates that recipients are more valued and respected by the company, which is equitable only if such treatment is matched by proportion of contribution. This means that if the employees are unable to judge rightly the proportion of such contribution and are unable to see the high value associated with such contribution then, such a disproportional spotlight rates are perceived as organizational inequity.

There are many options to retain intellectual capital of organizations. Programs like employee stock ownership plan and reduced work load among professionals seeking work life balance. Reduced working hours require special attention and interventions for sustaining productivity. Human behaviors in isolation and in groups at work places can provide managers with insight to arrange work and lessen assignments burden on employees for mutual welfare. (Lirio, Lee, Williams, Haugen & Kossek (2008). Murphy and Williams (2008) stated this as an effective strategy for employee retention after putting in a length of service. This ideology behind this strategy is to recognize employee association with the organization.

Schell and Solomon (1997) comment that compensation strategy is a powerful means of focusing attention and signals out clearly about the expected attitudes and behaviors.

This research analyzes that if a clear transparent compensation policy is implemented across the board then it will encourage healthy competition for high performance and preferred attitudes and behaviors. If the focus of such compensation policy is to retain only few employees focused on generating expected profit they are going to generate, then it becomes a cause of discontentment among the other employees. Though the agency theory may support such interventions but tasks or projects are never accomplished by individuals single handedly. There is always a teamwork at the back where everyone plays his/her role and contribute to the final accomplishment of the tasks. If an assignment is being handled by single individual then fixation of compensation package according to the spot rates of the individual may not affect the behaviors of other employees. As this would be seen as an exceptional/special case, i.e. in case of consultants.

The above arguments also explains the logic for the conflicting situation that arise out of the comparison being made between expatriates and local workforce compensation packages. This means that hiring of expatriates for the purpose to enhance team performance with their rich experience could bear negative consequences if not handled effectively. Welsh, Luthans and Sommer (1993) study also focuses on extrinsic factors, behavioral trainings for employees to have a sense of loyalty and responsibility towards the workplace and participation of employees thus lead to organization wide unity and positivity.

Market Rate Compensation relationship with Organizational Commitment

The employees sense of organizational belongingness is increased when there is an open and transparent compensation system exists which is competitive to market rate. Kim and Shin (2019) also highlight this important relationship and conclude that commitment oriented or commitment based Human Resource Management systems yield better results for organizational outcomes and stability in employees stay in the organization.

In another research carried out by Kahn (2018) it is again highlighted that compensation that is a mix of all extrinsic components of wage i.e. insurance, retirement savings plans and paid leaves can enable employees to enjoy a sustainable life through job. Hence, these means necessary to face any crisis or emergencies be provided to workers as a retention strategy and improving employee employer relations. As these financial elements in one's career are major anchors for long term investments in education, building home or other entrepreneurial ventures.

Chew and Chan (2008) also concluded that organizational commitment is positively correlated by sound remuneration, person organization fit, recognition of employees' efforts and opportunities towards advancement in career.

Perceived Internal Equity relationship with Organization Commitment

The Equity Theory by J. Stacey Adams stresses that individuals compare and observe their input with output of jobs they are performing with the input/efforts and the output of their colleagues. Their quality of output generally is commensurate with what organizations are offering or giving them in return of their efforts and hard work. This leads to distributive justice and procedural justice. Distributive justice means individuals perceive the extent of rewards either extrinsic or intrinsic as a fair dealing by the employer. Procedural Justice signifies the procedures/processes involved in distribution of these rewards. The absence of equity or inequity then results in decrease productivity, increasing absenteeism rate thus high organization turnover and low organization commitment (Robbins & Coulter, 2016). This is because of the feeling of injustice developed to due to lack of distributive or procedural justice.

In a recent study by Kollmann, Stöckmann, Kensbock & Peschl (2019) it is examined that younger aged employees focus on extrinsic rewards as a compensation for their job whereas the older or senior employees look for more meaningful assignments which fall under key business indicators- KPIs critical for organization's success. This research postulates that organization must cater for the motivational needs of these junior and senior employees which can be effective in resolving the issue stemming out of the compensation differential.

Buttner and Lowe (2017) emphasize that internal pay equity has a close and direct effect on organizations' turnover and employees who perceive that internal or system wide pay equity is just then their intentions are not to quit and, simultaneously, commitment level to the company is high.

Theoretical Framework

Based on literature review following research model is proposed. There are three variables under discussion i.e. Market Rate Compensation is an independent variable, Perceived Internal In Equity is a dependent variable and Organization Commitment is a moderator which can influence the relationship between independent and dependent variables.

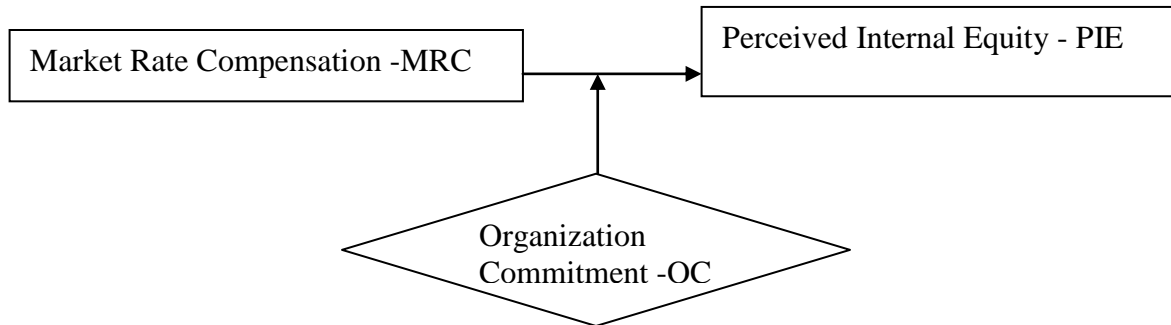


Figure 1 Theoretical framework

Definition of Variables

Market Rate Compensation for Individual Professionals:

This variable may be defined as the rates fixed for specific individuals by the competitors in the market, so as to attract these professionals to enhance the business target accomplishment ratio. This may also be interpreted as the demand for certain individuals as per business needs. In case of this model Market Rate Consideration has been taken as an independent variable.

Perceived Internal Equity:

Internal Equity with respect to compensation means that every position/employee within the compensation structure is paid in accordance with the value of services as expected and as being delivered to accomplish the organizational tasks. This value is normally assigned to certain positions or jobs by calculating the contribution of the job to the business goals, the type of tasks to be performed on that position and work conditions etc. This paper considers perceived Internal Equity as the equity understood by employees because most of the times their own job seems to be more important than any other jobs. So, perceived Internal Equity may be defined as the equitable disbursement of salary packages/compensation as seen by the employees. According to this model Perceived Internal Equity will be affected if one person of the team gets higher salary as compare to other members. This variable has been taken as dependent variable.

Organizational Commitment:

This study has selected Organizational Commitment as a moderating variable based on the assumption that higher the organizational commitment lower would be the impact created by variation in employees' salaries. Organizational Commitment may be defined as the loyalty of the individual to stay with the organization and be committed to his/her job despite any unfavorable situation or condition that may arouse while management role is at play to manage

the activities directed towards the best outcomes. The presence of such commitment would moderate the negative impact of any tough or deviant decision which at times the management has to take while chasing certain targets.

Hypotheses

Following hypotheses have been drawn on the basis of research model for assessing the relationships of the variables.

H₁ : higher the dependence on market rates for individual salary packages, lower would be the level of perceived equity among the employees

H₂: Higher is the organizational commitment of the employees, higher is the level of perceived internal equity within the organization.

H₃: higher is the organizational commitment of the employees, lower is the impact of Individual market rates on perceived equity

RESEARCH METHODOLOGY

Design

This study employs both quantitative and qualitative analysis of the data as any single aspect does not aptly explain the role of the factors at play in this process. Quantitative analysis includes the regression analysis, correlations among the variables and hypothesis testing, for which the results are listed the qualitative in the quantitative part. Some of the aspect has been covered through two of the interview questions supplemented by some metadata analysis.

Sampling

Purposive sampling technique was used to gather the sample from private sector organizations in Pakistan. The total sample size was 85 respondents. Public sector and Government sector organizations have been excluded from the selected sample due to their fixed salary packages and fixed responsibilities. The culture and nature of the work at public or government run organizations does not permit to hire professionals on market rate compensation. The number of expatriate professionals working in different organizations are too small and hence, the number of such organizations are few. This study had included some of the medium size companies where such kind of hiring could be witnessed.

Data Collection Instrument

A survey method is used for gathering information on the variables under study. Structured questionnaire was used to collect data from the respondents serving in private sector

organizations. A 5 point likert scale was applied to the questions for better understanding of respondents sharing their views. The total number of questions were 19. Questionnaire was developed for this study and the reliability test was carried for the instrument as shown in the analysis.

Analytical Approach

Data collected for this study has been tested for reliability, correlation and finally, regressed to establish the validity of the hypothesis. Descriptive statistics have also been added for additional information.

It is applied to test the relationship of independent variable and dependent variable whether it is influenced by third variable or not. The moderator in current study is an Organization Commitment which can influence the relationship between Market rate compensation and Perceived internal in equity.

ANALYSIS AND RESULTS

Demographic Details

The data in Annexure II/ Table 1 reveal that there are 63 male respondents and 22 female respondents. Individual's compensation based on market rate in private companies is 32.9%, company-based compensation is 65.9% and for some employees hiring is carried out by other or third party recruitment agency. The percentage of these employees given by these external professional private companies is 1.2%. Experience of respondents for 1-5 years is 54.1%, 6-10 years is 3.5%, 11-15 years is 4.7% , 16-20 years is 16.5% and employees with 20 years above is 21.2%.

Reliability

Cronbach alpha is a standardized measure of reliability and the questionnaire used in the present study is reliable with Cronbach alpha value .879 of 12 items (Taber, 2018). It is indicated in table below.

Table 1 Reliability

Cronbach's Alpha	N of Items
.879	12

Correlation Analysis

Table 2 Correlation between Market Rates Consideration (MRC) and Perceived Internal Equity(PIE)

	MRC1	MRC4	PIE1	PIE2	PIE4
MRC1 Pearson Correlation	1				
MRC4 Pearson Correlation	.141	1			
PIE1 Pearson Correlation	.728**	.244*	1		
PIE2 Pearson Correlation	.683**	.270**	.828**	1	
PIE4 Pearson Correlation	.581**	.410**	.501**	.587**	1

** . Correlation is significant at the 0.01 level (1-tailed).

* . Correlation is significant at the 0.05 level (1-tailed).

The above correlation statistics of MRC1 with PIE1 and PIE2 i.e about 73% and 68% reflecting upon the facts that the satisfaction of the employee with their salary range is strongly connected with their perception about how fair and transparent their salary structure is. Their perception about the fact if they are given full value of their work is 58%, showing a little lower strength as this may be attributed to the natural human tendency of self-appreciation. The above table also show that the factors of Perceived Internal Equity are 25%, 27% and 51% correlated with the Market Rates Consideration.

Regression Analysis

Regression analysis carried out reflected clear dependence of the outcome variable (Annexure II/ Table 2 and 3). Following are the results of regression and student-t test:

H₁: Higher the dependence on market rates for individual salary packages, lower would be the level of perceived internal equity among the employees.

Results indicate that $R=.584$ i.e. 58.4% relationship exists between MRC and PIE. R^2 which explains variation in dependent variable due to change in independent variable in present study is .341 with p level 0.000 i.e. $p < 0.005$, explaining that 34.1% change in perceived internal equity can be brought by change in MRC. The t statistic for this hypothesis is 6.559 at p level 0.000 i.e. $p < 0.05$. In this case the hypothesis stands true that higher dependence on MRC practices for Individual professionals can be a factor of perceived internal inequity in the eyes of other employees whose salaries may be lower than these professionals.

H₂: Higher is the organizational commitment of the employees, higher is the level of perceived internal equity within the organization.

The results indicate that $R=.715$, $R^2=.512$ t statistic= 9.327 at p level $0.000 < 0.05$. 51.2% change in perceived internal equity can be brought by organization commitment. If employers pay attention and special consideration to retain employees by balancing internal equity as compared to each other then employees can have positive perception in terms of internal equity. Value of t statistic is 9.327 i.e. greater than 2 signifying that this statement is also true.

(Moderation) H₃: higher is the organizational commitment of the employees, lower is the impact of Individual market rates on perceived equity

This is a moderation focused study in which organization commitment –OC is a moderator between market rate compensation – MRC and perceived internal equity – PIE. The details of the results tabulated are mentioned in table 2 and 3 in appendix section. This regression has three steps i.e.

1. Independent variable MRC regressed on PIE.

Before running the moderation analysis the variables were standardized. The results specify that ZMRC and ZPIE $R= .584$ $R^2=.341$ at p 0.00 i.e. $p < 0.05$.

2. Independent variable and Moderating variable MRC and OC regressed on PIE.

When moderating variable OC is also applied then combined $R=.768$ the relationship between MRC and PIE raised to 76.8% from 58.4%. $R^2=.590$ when moderating variable is added i.e. change in PIE is 59% due to combined change brought in both MRC and OC.

3. Interaction term MRC and OC regressed on PIE.

The interactive term $MRC*OC$ further improved $R =.770$ the relationship between MRC and PIE when OC added increased to 77%. $R^2=.592$ at p .463 i.e. greater than $p > 0.05$. Value of t =.738 at p level .463 which is greater than standard p level 0.05.

Moderation analysis t value less than 2 and increase in $R^2 .592$ with p .463 greater than standard p value 0.05 proves that OC moderates the relationship between the independent variable MRC and dependent variable PIE. The result proves that the presence of OC moderates the effects of MRC This means that the presence of OC counters the promotion of sense of inequity making the environment more stable.

RECOMMENDATIONS

The above results reflect that whenever there is a marked disparity in the compensation packages of the members of the same team the motivation level of the co-worker decreases. This may also pacify the effects of hiring a high quality skilled professional, apparently hired for

improving the performance of that team. Such problems are encountered often when expatriates are hired on high compensation packages to supplement the skills needed by a team. These kinds of solutions are adopted as quick fixes to enhance team performance. In short term projects this may be an effective strategy but in long term projects a significant difference in packages can become a source of demotivation of other team members. In order to resolve to a sustainable business approach, the following model is suggested to overcome the motivation issues of the rest of the team member-

1. As business are always target oriented, the management should break down those targets making them simple enough to be understood by the team and decode these outputs in terms of their skill requirement. This will help them understand the importance of skill that they lack and that could be brought in the team in the form of expat member.
2. Once the required skill/competency and its level in terms of its quality and specialization is identified, then the team members must be shared the information about the existing skills gap and the time constraint regarding the accomplishment of goal.
3. The management should also split the salary package accommodating for such competencies and creating provision for recognition of such special skills. If such package designs are formulated using a reliable tool like point factor scheme, this would strongly justify the special package offered for such special skill. As a result it would make the rest of the team member understand the value of that special skill making the induction more convenient for the employer.
4. The management should take all the team members on board about the new hire. A regular ice-breaking session should be organized to initiate team building. If not once then such sessions may be arranged two three times in order to promote the we feeling among the team members.
5. Such a provision for special skill would also pave way for fair performance evaluation given that other factors would remain constant for all the team members

The above strategy will prove to be helpful for maintaining the team-sprit, and would hence, help overcome any anticipated demotivation of the co-workers.

WAY FORWARD

Given that this research has considered single moderator i.e. organizational commitment, whereas, multiple other factors may also prove to moderate the effects of Individual Market Rate. It is therefore, recommended that factors like ergonomics, team hierarchies may also moderate or mediate the effects of fixing above scale salary package of single team member.

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ANNEXURE

Annexure I

Questionnaire

Basic Data:

Sr# _____

Name: _____

Organization: _____

Designation: _____

Deptt: _____

Years of employment: _____

Current Salary range: _____

Salary was fixed as per: a. Market Rates _____ or b. Salary structure of the company _____

Variables:

1. Market Rates Consideration:

	Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1	You are getting salary at par with your other colleague					
2	Some of your colleagues are getting above the salary range (Included for cross-checking)					
3	The salaries fixed above the fixed range are justified					
4	Your salaries are competitive with other companies					

2. Perceived Internal Equity:

	Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1	Your salary scale is transparent					
2	Your salary system is fair to all					
3	High package for any other employee does not affect your motivation level for your work					

	(Included for cross-checking)					
4	Your salary aptly cover for the value of your work					

3. Organizational Commitment:

	Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1	You intend to stay more than 2 years with this organization					
2	You feel motivated for contributing towards company's goals					
3	You strongly support the decisions of your seniors					
4	You take pride in being part of this company					

Note: Identity of the respondents will be kept confidential

Thank you

Annexure II

Data tables

Table 1 Demographic detail

		Frequency	%
Gender	MALE	63	74.1
	FEMALE	22	25.9
	Total	85	100.0
Salary structure	Market Based	28	32.9
	Company Wide	56	65.9
	Other	1	1.2
	Total	85	100.0
	Year of experience	1-5	46
	6-10	3	57.6
	11-15	4	62.4
	16-20	14	78.8
	>20	18	100.0
	Total	85	

Table 2 Moderation

Model	R	R Square	Sig. Change
1	.584 ^a	.341	.000
2	.768 ^b	.590	.000
3	.770 ^c	.592	.463

1. MRC regressed on PIE.
2. MRCOC regressed on PIE
3. INTMRCOC regressed on PIE

Table 3 Moderation

Model	T	Sig
ZMRCOC	.738	.463