

The Impact of Compensation System on Job Satisfaction from the Perspective of Equity Theory

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Abstract

The compensation is an import issue for proprietors and is a key factor to solve the employee's management problems. If an organization has a good compensation system, it creates job satisfaction of employees. In case, an organization does not have a good compensation system of compensation, it may damage the good intentions of the system. Thus, this paper is based on the equity theory to confer the relationship between the compensation and job satisfaction. This paper selected organization equity as the moderate variable and demographics as the control variable. This paper chose census to send 318 questionnaires out of which 311 valid responses were returned. This analysis was based on questionnaires which were collected from China employees of Taiwan listed and OTC companies and made a 98% response rate. The analytical methods include descriptive statistics, reliability analysis, validity analysis, factor analysis and regression analysis. The result of this paper showed a positive relationship between the compensation and job satisfaction, which includes internal satisfaction and external satisfaction. Moderate analysis result showed that organizational equity can strengthen the positive influence effect of the compensation on job satisfaction.

Keywords: *Equity Theory, Compensation System, Job Satisfaction, Moderate.*

Introduction

Economic downturn dictates a number of enterprises to gradually reduce business size or employee salary and welfare in order to reduce business costs. Many enterprises often apply means of leave without pay, layoff or severance to enter "downsizing." Without filling vacancies within the organization, the amount of work for employees will increase, which leads to employee complaints, job dissatisfaction or even employees seeking to leave the organization and start their own business (Malik, Ahmad, & Hussain, 2010). These phenomena will have adverse impacts on the organization and destructs the purpose of organization retention. Therefore compensation system will have highly significant effect on employee job satisfaction, particularly in mainland China where salaries of staff are generally low and the impact of pecuniary rewards on attitudes is even more evident (Chiou, Ou, & Chen, 2010). Robbins and Judge (2008) argued that compensation does not necessarily create job satisfaction and they stated in some studies that

somewhere between compensation contributing or not to satisfaction implies a moderating factor within. Adams (1965) proposed equity theory and mentioned that the job satisfaction of organization members mainly depends on organization equity and the comparative psychology of members. Jane (2007) also argued that although good compensation will have positive effect on the organization, the absence of fairness may also contribute to the adverse effects on the organization. The researcher of this study also believes that although proprietors may satisfy each employee with compensation system, employees may still compare with each other. It is likely that employees hold comparative psychology and believe that their input vs. output falls far behind others; or they may even make self-comparisons and will be dissatisfied with organization when they fail to meet organization system. Such phenomenon has gone beyond the one-to-one relationship between the proprietor and individual members of organization but involves the perception and performance of the overall organization. The level of impact may spread to members of the entire organization or even produce vicious mentality between departments and companies. In their study, Wallace and Fay (1988) also stated that compensation managers must regard equity as important issue and the pursuit of compensation system should take into account of equity in all construct. Cowherd and Levine (1992) also suggested that low-level employees where the mentality towards compensation comparison is particularly evident. In China, the majority of people engage in low-level work and the study intends to explore the impact of employee compensation on job satisfaction in mainland China upon becoming an occasion of global factory, and whether if such impact will encounter interference from organizational equity, in order to provide the industry with appropriate recommendations.

Objectives of Research

Research objectives of this study are to;

- Discuss the impact of compensation system on job satisfaction.
- Discuss the moderating effect of compensation system under organizational equity on job satisfaction.
- Propose proprietors with appropriate recommendation.

Review of Literature

Equity Theory

Adams (1965) proposed the equity theory, also known as the Social Comparison Theory, to mainly discuss the incentive effect among organization members subject to equity impact. He also believed that each person will compare his or her own input with the rewards obtained as well as maintaining the equity. The satisfaction of organization members depends on the fairness between the rewards obtained from work and the relative input to work. It is considered fair when the ratio between input and rewards is equal, however the inequality between the input and rewards will produce ideas of unfairness, which may lead to cognitive dissonance and more actions will be taken to justify the results. Equity theory believes that the comparison subjects of fairness recognized by organization members include: Others, referring to people with similar work within the organization; system, referring to salary policy and organizational management of the organization; and self, referring to the mutual comparison between input vs. rewards, as well as the comparison between input and rewards obtained from current and past. Tax and Brown (1998) divided organization equity into three variables: 1. result equity, the assessment of whether if there is equity between the member inputs vs. the rewards. 2. Procedural equity, the assessment of equity between organization processing member comments and the procedures of process. 3. Interactional equity, the assessment of fair treatment between organization and members and between superiors and subordinates. Wallace and Fay (1988) also divided equity theory into four variables, including: 1. External equity, the assessment of whether if the compensation level of organization members reflects the level of employees in the job market. 2. Internal equity, the assessment of whether if the compensation level of organization members is reflected on the skills, responsibilities and knowledge. 3. Individual equity, the assessment between compensation level of organization with inputs and efforts. 4. Procedural equity, the assessment of

openness of compensation decisions in organization, communication with members and options of grievance channels.

Compensation

Zhu, Qi and Li (1995) suggested that the design of compensation should take into account the impact of external factors such as price index, cost of living and salary survey. He also induced the key elements of compensation design into four projects, including health-based payroll, position-based payroll, performance-based payroll, and skills-based payroll. Lawler (1987) distinguished enterprise salary payments by position compensation, skill compensation and performance compensation as well as defining salary payment as direct, general and financial work rewards from employers to employees, including base salary, bonus, commission, benefits, and other allowances. Huang (1997) proposed the classification of salary payment based by: Skill-oriented salary, position-oriented salary and performance-oriented salary. After discussing the payment base for various compensation systems, Mahoney (1989) induced the main factors of compensation design into three aspects: position, performance and individual employee, according to the significance, purpose and base of compensation. (1) Position: Measuring value of position through work analysis and job evaluation, in addition to using value of position as reference of core salary. For example, salary system and wage system. (2) Performance: Using employee performance and presentation as main reference for core salary, for example, piece-rate system, commission, profit-sharing, and bonus from proposal. (3) Individual: Applying skills, qualification, education and other individual factors as reference to core salary, for example skill-oriented salary, expertise level salary, and qualification salary payment.

Job Satisfaction

Seibert and Kraimer (2001) believed that job satisfaction refers to the various factors hidden in work, which is subject to influence from the subjective evaluation of the work itself and expectations. Simply put, the scale of job satisfaction is a psychological perception resulted from the subjective evaluation and comparison between the finished work and the goal or expectations. Robbins (2002) argued that job satisfaction is the general attitudes which the employees hold towards work, whereas holding positive attitudes to work implies job satisfaction and vice versa. Weiss, Dawis, England and Lofquist (1967) divided job satisfaction area into two variables, the intrinsic satisfaction from employees themselves or outside of employees. For example, factors such as organization and superiors are known as extrinsic satisfaction. Chien (2004) suggested that job satisfaction refers to the satisfaction of overall subjective perception from workers to the work. The measurement of intrinsic satisfaction and extrinsic satisfaction come from the attitudes which the employees hold or from external factors that affect the work. Dunn and Stephens (1972) defined job satisfaction as the perception of reaction from employees to the entire work conditions. Such perception comes from gap between the acquisition from work and the practical experiences.

The Impact of Compensation on Job Satisfaction

Chen (1994) summarized various empirical results and suggested that employees regard salary as an important outcome or rewards, therefore they are naturally to have many reactions towards behaviors and attitudes. Chan (2000) indicated in his study that the organization must emphasize on the perception of distributive equity, expected salary from employees, whether if the bonus is sufficient, and achievement motivation of employees to enhance salary satisfaction of employees, thereby satisfy employees in work and strengthen their willingness to work. Lawler and Porter (1963) discovered outcomes such as absenteeism, slowdown, job dissatisfaction, and leaving are results of salary dissatisfaction from employees. Salaries are incentives to work performance while dissatisfaction of salary from employees often lead to adverse work reactions, such influence on work performance, slowdown, absenteeism, and work dissatisfaction (Lawler, 1971). Therefore compensation system is closely related to job satisfaction,

and a good compensation system will satisfy employees in salary by improving employee job satisfaction and reducing the probability of inclinations to leave. Heneman (1984) discovered in his study, that regularly salary adjustment based on performance will also improve work motivation, job satisfaction and work performance. In sum of the aforementioned statements, the study asserts the following hypothesis:

H1: Compensation system has impact of positive significance on job satisfaction.

The Moderating Effects of Equity Theory

Jane (2007) suggested in his study that the compensation system has impact on organizational performance and nonetheless should avoid inequality phenomenon in inequality pay or perception of inequality among organization members. It is important to emphasize on equality in the design of compensation system. Adams (1963) indicated in his proposal of equity theory, that members tend to compare the rewards they obtain and if they receive unfair treatment, they will perceive dissatisfaction. As a result, employees will cut back efforts and generate lower output when they perceive that they have received lower rewards. Cowherd and Levine (1992) also discovered the impact of perceived equity of compensation, particularly in low-level employees, and there is positive correlation between compensation equity and product quality, implying that compensation equity will bring positive effects to the organization. Wallace and Fay (1988) stated that compensation managers must treat equity as one important issue while the compensation system should pursue equity in all aspects. Chan (2000) indicated that the design of compensation system should take into consideration of employees in procedural equity and perception of cognitive equity to strengthen employees' job satisfaction and willingness to work.

H2: Organization equity will strengthen the positive impact of compensation system on job satisfaction.

Research Methods

Research Framework

The research framework is shown in the following diagram, which intends to discuss the influence of employee compensation to job satisfaction according to the comprehension of motivation and relevant theoretical literature review discussed earlier in the introduction and literature review section of the paper. The study further probes into understanding whether if organizational equity can be used as confounding variable can strengthen the positive effect of compensation on job satisfaction, in addition to inducing discussion on qualification, demographic variables in income.

Research Subject and Questionnaire Survey

Due to the large number of workers, proprietors are less likely to offer official staff directory while there are only few official-level secondary data for use in the research investigation. For this reason, the research only applied convenience sampling due to difficulty in random sampling. Nonetheless the study conducted sampling in OTC or list companies in Taiwan to pursue representation. The study subjects consisted of employees from a specific Taiwanese listed or OTC company in mainland China, who participated in the census. A total of 318 questionnaires were issued with 311 valid questionnaires, contributing to an effective rate of 98%.

Scale development and operational definitions

The study discusses the variables used by a number of experts in compensation, inclination to leave and job satisfaction studies, with reference and modification for design on the questionnaires. The following is a summary of aspects of discussion from different scholars. Since most employees prefer to maintain privacy to their compensation, the study adopted the measurement of respondent's skill-based salary, position-

based salary, and performance-based salary using satisfaction from the study conducted by Lawler (1987). To avoid similarity between measurement questions for compensation satisfaction and job satisfaction, Chiou, Ou, and Chen (2010) recommended using the MSQ scale developed by Weiss et al. (1967) to distinguish the two variables, including internal and external satisfaction, where internal satisfaction is measured in reverse question in question no. 5. Organizational equity is the aspect of organization equity developed by Tax and Brown (1998), which distinguishes result equity, procedural equity and interactional equity. The questionnaire was designed with Likert scale (whereas 1 being highly disagree and 5 being highly agree) for measurement. The study introduces scale, variables, questions, and operational definitions described in the following table 1.

Table 1: Scale Development and Operational Definitions Table

Aspect	Variable	Operational Definition	Questions of Measurement(Question Number)	Source
Compensation	Single Variable	Employee perceived satisfaction on compensation given by company.	(01) I am satisfied with the company compensation based on my skills. (02) I am satisfied with the company compensation based on my performance. (03) I am satisfied with the company compensation based on my position.	Lawler (1987)
Job Satisfaction	Intrinsic Satisfaction	Individual employee satisfaction towards work.	(04) My job offers me stability in work. (05)I can provide guidance or work for others at work. (06) I can bring my talents into full play at work. (07) I attempt to handle things in my own way at work. (08) I cannot obtain sense of achievement from work (reverse question).	Weiss et al. (1967)
	Extrinsic Satisfaction	Employee satisfaction through others or perception of work.	(09) I am satisfied with the way the superior treats the employees. (10) I agree with the capability of superiors in decision making. (11) I agree with the approach the company promotes its policy. (12) This work offers promotion. (13) I will receive praises when I do my job well.	
Organizational equity	Results equity	equity for inputs vs. rewards for organization members.	(14) I receive the same rewards from peers with similar work content. (15) I am satisfied with the tangible and intangible rewards from the company.	Tax and Brown (1998)
	Procedural equity	equity in procedural processing for organization	(16) There is direct and easy reaction channel for company recommendation or grievance. (17) The company maintains a pluralistic handling for employee recommendation.	
	Interactional equity	equity treatment between organization and members, and superiors and subordinates.	(18)I feel that the company is honest and sincere towards the recommendation and question brought by the employees. (19) The company exhibits due empathy towards the recommendation or questions brought by the employees.	

Note: The number within the parenthesis of questions of measurement indicates the question number of scale.

Data Analysis

Analysis of Descriptive Statistics

The study applied analysis of descriptive statistics on the basic information to draw induction for different question groups, as shown in the following table 2.

Table 2: Basic Information Table

Statistical Variables of Respondents	Category	Number of People	Percentage (%)
Gender	Male	101	32.5
	Female	210	67.5
Monthly Income	Below NT\$1500	164	52.7
	NT\$1501~2500	120	38.6
	NT\$2501~3500	10	3.2
	NT\$3501~4500	6	2.0
	NT\$4501 and higher	11	3.5
Qualifications	0~0.5 Year	125	40.2
	0.5~1.5 Year	121	38.9
	1.5~2.5 Year	24	7.7
	2.5~3.5 Year	17	5.5
	3.5 Year and higher	24	7.7
Position	Workers	170	54.7
	Leader, Supervisor, Clerk, Warehouse Staff	119	38.3
	Section Manager and Manager	22	7.0

Reliability Analysis, Validity Analysis, Factor Analysis

The study conducted reliability on Cronbach's α with emphasis on compensation, job satisfaction and organization equity to obtain the construct of compensation system, job satisfaction and organization equity as well as various sub-variables. The questions of questionnaire exceeded the acceptable reliability level of 0.5, as recommended by Chow (2002), which implies that the scale contains excellent reliability as shown in the following table 3.

Table 3: Factor Analysis and Reliability Analysis

Construct	Variable	No.	Factor Loadings	Cronbach's α and eigenvalue	KMO and Bartlett Test
Compensation	Single Variable	No. 1	0.883	Reliability : 0.849 Eigenvalue : 2.305	KMO=0.719 Bartlett Significance=0.000*** Explained Variance=76.842%
		No. 2	0.898		
		No. 3	0.848		
Job Satisfaction	Intrinsic Satisfaction	No. 4	0.480	Reliability: 0.628 Eigenvalue: 1.362	KMO=0.755 Bartlett Significance=0.000*** Explained Variance =51.548%
		No. 5	0.767		
		No. 6	0.843		
		No. 7	0.617		
	No. 8	0.584			
	Extrinsic Satisfaction	No. 9	0.740	Reliability: 0.750	
		No. 10	0.739	Eigenvalue: 3.379	

		No. 11	0.631		
		No. 12	0.707		
		No. 13	0.613		
Organizational equity	Result equity	No. 14	0.885	Reliability: 0.895	KMO=0.878 Bartlett Significance=0.000 Explained Variance =88.949%
		No. 15	0.691	Eigenvalue: 2.339	
	Procedural equity	No. 16	0.707	Reliability: 0.831	
		No. 17	0.878	Eigenvalue: 1.295	
	Interactional equity	No. 18	0.629	Reliability: 0.836	
		No. 19	0.888	Eigenvalue: 1.704	

The validity analysis of the study mainly proceeded by adopting content validity analysis and construct validity analysis with conscientiousness. With regards to content validity, the experts and scholar's research literature on compensation, job satisfaction and organization equity were referred to understand the construct and variables in the design of questionnaire scale. With regards to construct validity, the study applied confirmatory factor analysis to first conduct KMP and Bartlett tests. All construct of the scale in this study contain KMO values greater than the standard value of 0.7 as recommended by Chow (2001), with significance less than 0.01 and implying suitability for factor analysis. Next, the principal component analysis of factor analysis was used to delete factoring loading less than the standard value of 0.45 recommended by Chow (2001) from the questions. The eigenvalues of all variables in this study were greater than 1, which implies that one variable is independent and the overall aspect explained variance exceeds 50%. The aspect question contains explanation while the factor loading of each question variable exceeds 0.45, implying construct validity, as shown in the following table 3.

Hierarchical Regression Analysis

The study conducted hierarchical regression analysis to get an insight to the relationship between variables from compensation to the job satisfaction, in addition to using organization equity as confounding variables to discuss whether if it will strengthen the positive relationship between compensation and job satisfaction.

Table 4: Intrinsic Satisfaction Regression Analysis

Dependent Variables	Independent Variables	Model 1		Model 2		Collinearity Diagnostics VIF
		Standardized β	Significance	Standardized β	Significance	
Job Satisfaction	Age (Control Variable)	0.049	0.380	0.045	0.414	1.340
	Qualification (Control Variable)	0.126	0.023*	0.114	0.039*	1.307
	Compensation	0.100	0.078 ⁺	0.095	0.091 ⁺	1.373
	Organizational equity	0.433	0.000***	0.446	0.000***	1.382
	Organizational equity *Compensation			0.116	0.017*	1.022
Remark		Adjusted R-square=0.278 Model Significance =0.000***		Adjusted R-square=0.289 Model Significance =0.001***		

Note : $p < 0.1^+$ $p < 0.05^*$ $p < 0.01^{**}$ $p < 0.001^{***}$

The above table shows the R^2 with regression adjustment in model 1 and model 2 are very close to the standard value of 0.18 for cross-sectional analysis as recommended by Chow (2002). The overall models contain significance, implying that the coefficient of determination has met the standard and is suitable for regression analysis while the VIF value of collinearity diagnosis does not exceed 10, implying that the regression does not contain issue with collinearity (Chow, 2002). In pursuit of conscientiousness, the study applied hierarchical regression analysis to test the hypothesis. Model 1 emphasizes on the analytical control variables and independent variables for regression analysis. Model 2 is the analytical result from increasing the confounding variables. The analytical result of model 1 shows that the influence coefficient of compensation is 0.100 with positive significant impact on job satisfaction, while the interactional influence coefficient between compensation and organization equity after adding confounding variables to organization equity in model 2 becomes 0.116, which strengthens the influence relationship between compensation and job satisfaction. For this reason, the study holds validity towards hypothesis 1 and hypothesis 2, as shown in table 4.

Discussion

Conclusion

The study is based on equity theory with study subjects consisting of Chinese employees of one Taiwanese listed company in China, to discuss the impact of compensation on job satisfaction, using organization equity as the confounding variables, and qualification of demographics and income as the controlled variables. The regression analysis shows that compensation has positively significant impact on job satisfaction. Adding confounding variables of organization equity will positively and significantly strengthen the positively significant impact of compensation on job satisfaction. The result implies that organization equity has pivotal position in the relationship with employee attitudes, and the absence of equity in organization will not create employee satisfaction regardless of the amount of compensation.

Recommendation

Relationship between Compensation and Retention

In a society experiencing economic down, compensation is the critical factor of consideration for employees, as well as the lesson that merits evaluation from the businesses. The study discovers that the compensation system will positively affects job satisfaction. To avoid inability to retain talents after layoff, enterprises are suggested to provide excellent skill-based compensation, position-based compensation and performance-based compensation for existing talents within the organization, so that these talents will be paid with attention and obtain higher job satisfaction.

Relationship between organizational equity and job satisfaction

Regardless of managerial talents, technicians, or sales and marketing staff, they will all receive excellent job satisfaction and lower intention to leave. However the study also discovers that organization equity will strengthen the positively significant impact of compensation on the external satisfaction of job satisfaction. The aspect is compliant with the result of equity theory and that job satisfaction of employees is closely related to the fair treatment from the organization. Therefore, the proprietors are recommended to use fair, open and justified methods in the formulation of compensation system, in order to make the system more transparent. Proprietors may also offer compensation with scientific quantitative indicators to avoid misunderstanding, as well as utilizing team performance for team compensation system so the members of organization will not compete with each other. However it is necessary to be aware of any free-ride behaviors within the members.

Research limitation and future research recommendation

Due to the large number of workers, the proprietors tend not to provide official employee directory, while there are limited resources of official secondary data for conducting survey for this research. The difficulty of random sampling has led to the research with investigation on case company. However to pursue representativeness and scale, the study conducted census on the Chinese employees of specific Taiwanese listed company in China. The results may be subject to influence from enterprise culture and regulations with somewhat bias phenomenon. The study is based on cross-sectional sampling analysis with lack of research on longitudinal time series. In the future studies, it is recommended that the perceived differentiation by respondents at different time slots can be taken into consideration. Finally although the study is a quantitative-scientific research, the discussion of human resource issue is still based on people and understanding human tendencies require more flexibility. For future studies, qualitative research methods and interview research can be incorporated with validity test on questionnaire survey to achieve a balanced qualitative and quantitative research, thereby linking theories with practices.

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