

Incentive Compensation, Organizational Commitment and Managerial Performance in Zakat Institutions

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Abstract

This paper explores the relationship between incentive compensation and managerial performance in Malaysian Zakat Institution and the intervening effect of organizational commitment. Organizational commitment is operationalized as affective and normative commitment. Survey questionnaires were sent to middle managers of Malaysian Zakat Institution and 133 responses were received. Using path analysis, the results indicate that organizational commitment, specifically, affective commitment plays a mediating role on the relationship between incentive compensation and managerial performance. Findings of the study have implication in the design of incentive compensation systems for middle managers in Zakat Institutions.

Keyword: *Incentive compensation, Commitment, Performance, Zakat Institution*

1. INTRODUCTION

It is widely acknowledged that incentive compensation is an important motivation factor to salaried staff. In profit oriented organization, incentive compensation is used to ensure that employees' effort can be channelled toward activities that facilitate the achievement of organizational goals (Chong & Eggleton, 2007). A fundamental objective of incentive compensation is to motivate employees in organizations to exert effort to improve their performance. While most studies in profit organization found that incentive compensation can increase performance (Sprinkle, 2000), there is no evidence that similar effect would also occur in non-profit oriented organizations. Although non-profit organizations do not mainly operate to make profit, it would be unjust to assume that their staffs are also working for welfare purposes only. They are only human who needs proper income to survive especially in the current economic condition.

Malaysian Zakat Institution is a non-profit religious-oriented organization that have pivotal role in managing zakat fund. It has a responsibility in economic and social development. As a welfare organization, the effectiveness of Zakat Institution has always been a subject of interest. In management control studies, incentive compensation and reward has been acknowledged as control mechanisms that are associated with managerial effectiveness (Chong & Eggleton, 2007). In Malaysian Zakat Institutions, a study by Sharifah Norzehan et al. (2008) indicates that rewards are given to employees in terms of annual bonuses as well as pay-for-performance plan such as commission. Unfortunately, to this date, there has been no systematic study that examines the relationship between incentive compensation and performance in this institution. To fill in this gap, this research aims to build an understanding on the effect of incentive compensation on managerial performance in Zakat Institution. It may also be argued that as non-profit organizations, staffs in Zakat institutions may possess similar characteristic as suggested by Merchant and Van der Stede (2003) that is, having high organizational commitment. Prior researchers have argued that employees with high organizational commitment may have high potential for improving work outcome and subsequently improve performance (Randall 1990; Nouri & Parker 1998). Furthermore,

it has been found that subordinates with high level of organizational commitment are more likely to be more responsible in their effort to achieve organizational goal (Chong & Eggleton, 2007). Based on these arguments, this study will also seek to understand the role of organizational commitment in the relationship between incentive compensation and managerial performance. The remainder of this paper is organized as follows. Next section will review relevant literature that formed the basis for this study and the development of the hypotheses. This is followed by a discussion on the research methodology and presentation of the results. Finally, conclusions drawn.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Incentive compensation and managerial performance

It is widely acknowledged that incentive compensation has great impact on people's behaviour. The design of the compensation system thus, is considered an important tool in the management control systems of organizations. According to Chong and Eggleton (2007), incentive compensation can be defined as "to the extent to which pay incentives (such as salary, bonus, or profit sharing) are used by organization as the compensation strategy. Tsai (2005) mentioned in his study that a reward and compensation system is based on the expectancy theory, which suggests that employees are more likely to be motivated to perform when they perceive that there is a strong link between their performance and the reward they receive.

Sprinkle (2000) suggests that incentive can enhance the individual performance by inducing individuals to work longer and smarter, thereby increasing the likelihood that they will develop and use the innovative strategies frequently required to perform well in complex judgment tasks and learning situations. Similarly, prior studies (Chow 1983 and Bailey et al. 1998) also found positive relationship between incentive compensation and managerial performance. On the other hand, there are also studies that found negative relationship between incentive compensation and managerial performance (Jenkins, 1986; Jenkins et al, 1998). They argued that incentive compensation does not always enhance the performance. Review of prior studies by Chong and Eggleton (2007) only managed to find mixed results of the relationship between incentive compensation and managerial performance. It is also arguable if incentive compensation can have significant influence on employees in the Zakat institution. In Hoque and Rossingh (2006), Parker (2001) described a non-profit organization as characterized by the religious focus on social activities and volunteer management to adopt a complex and multiple objectives. As religious oriented organization, employees in the Zakat Institution are constantly reminded with reward by Allah S.W.T in hereafter which is more intrinsic than monetary rewards. Based on the mixed findings and the uniqueness of the Zakat Institution, it is possible that the effect of incentive compensation is more complex than of a simple direct relationship. It is likely that the effect may be indirect through some intervening variables of which one could be, through increasing staff's commitment.

2.2 Incentive compensation and organizational commitment

Organizational commitment is known as the acceptance of employee on objectives of organization and their willingness to give more effort to achieve the objective (Namelfi & Sofiah 2011). Meyer and Allen (1997) states that the organization commitment consists of three distinct components which are affective commitment, continuance commitment and normative commitment. *Affective Commitment* refers to the emotions and feelings of workers and the extent of their participation in organization. *Continuance Commitment* is about an employee's perceptions of work-related options outside the organization and cost if an employee leaves the organization. *Normative Commitment* on the other hand is the responsibility to work within the organization because they believe that they have done a good thing.

Previous studies have discussed the relationship between incentive compensation and organizational commitment. Liu and Zhou (2011) stated that commitment is an effective motivator and the employee will perform his job well when they are committed although they receive less monetary inducement. Chong and Eggleton (2007) argued that incentive can be an influencing factor to ensure managers with low commitment increase their effort.

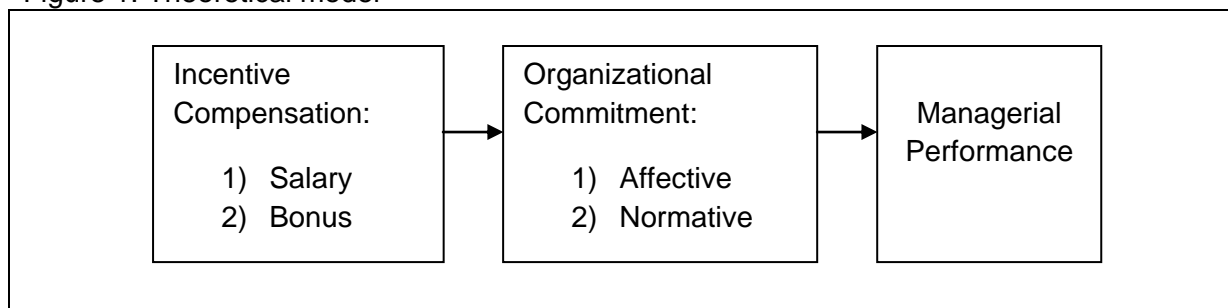
A study in Pakistan educational sector by Nawab and Bhatti (2011) found positive relationship between incentive compensation and organizational commitment. Their study also explains that affective commitment is significantly related to non-financial compensation; while, the normative and continuous commitment have significant relationship with financial incentive compensation. In other words, the higher the incentive compensation received, the higher is the employee commitment.

2.3 Organizational commitment and managerial performance

Many studies prove that people with high commitment can improve their performance as employee (Randall 1990; Nouri & Parker 1998; Chuang 2007; Chong & Eggleton 2007). Randall (1990) concludes that organizational commitment has positive relationship with managerial performance. Chong and Eggleton (2007) mentioned that employee with high level of organizational commitment tend to use valuable information to achieve organizational goal compare to employee with low level commitment, as they use the information to pursue their self-interest (Nouri & Parker 1998). It was also shown that affective commitment has significant effect on performance. Recently, it was found that top management's commitment strongly improved environmental performance (Spencer et al. 2013).

In sum, Figure 1 below shows the framework for this study.

Figure 1: Theoretical model



Purang (2011) suggests that providing positive work experience through fair rewards and recognition communicate to employees that organisation value their contribution. Accordingly, it was found that employees' commitment increase as they become more dedicated to the organisation. Similarly in the Zakat institutions, it is likely that the incentive compensation is positively related to organizational commitment (section 2.2). Organizational commitment in turn, is likely to be positively related to managerial performance (section 2.3). These relationships as shown in Figure 1, suggest that the effect of incentive compensation on managerial performance in the Zakat Institution may be indirect through organizational commitment (section 2.1). While there has been no particular study suggesting the relationship in a non profit organisation, organisational commitment has been found to mediate the relationship between Human Resource practices including compensation and turnover intention in the Malaysian environment (Juhdi 2013). Based on the discussions above, the following hypothesis is suggested:

H1: Incentive compensation has indirect effect on managerial performance through organizational commitment.

3. METHODOLOGY

Data was gathered using survey questionnaire and middle managers in Zakat Institution are selected as respondents as they are considered the most appropriate individuals to answer questions regarding commitment and controls of managers.

3.1 Measurement of variables

3.1.1 Incentive compensation

Incentive compensation are measured by asking respondent to indicate the salary received based on four range of salaries provided (1=below RM2,000; 2=RM2,001-RM2,500; 3=RM2,501-RM3,000;4= Above RM3,500). For bonus, respondents are required to tick the appropriate box if they received bonuses (1= Yes, 0= No).

3.1.2 Organizational commitment

There are three commonly studied dimensions of organizational commitment in the management control literature, namely, affective, continuous and normative commitment. In this study, only affective and normative commitments were found relevant to the Zakat institution with less competitive compensation packages (Namelfi & Sofiah, 2011). Two components of organizational commitment was measured using the twelve-item scale from Meyer et al. (1993) with a seven point Likert-type scale ranging from one (strongly disagree) to seven (strongly agree). Satisfactory reliability and validity for the scale have been reported in previous studies (Chen & Francesco, 2003). The items were factor analyzed to test for unidimensionality using Principal components analysis (PCA) as the extraction method. All items load well in excess of 0.32 (as recommended by Tabachnick and Fidell, 2001) and therefore were retained in the analysis. In the current study, the Cronbach's alpha for each component is 0.789 and 0.820 respectively.

3.1.3 Managerial performance

The nine dimensional of Mahoney *et al.* (1965) self-rating measure was selected for this study. The managerial activities are planning, investigating, coordinating, evaluating, supervising, staffing, negotiating, representing and one for the overall performance. A seven point Likert scale ranging from one (below average performance) to seven (above average performance) was used. The scores were analyzed by averaging across items. This instrument is a much more established instrument and has been tested and used extensively in management accounting research (Lau & Lim 2002; Hall 2008). Cronbach's alpha for this instrument is 0.894 well above the standard suggested by Nunnally (1978). The result from factor analysis shown that this nine item shaped into one component (Eigenvalue = 4.988, total variance explained = 55.43%).

3.2 Sample and respondent

This study considers the Zakat Institution around Malaysia as sample for the study and manager as unit of analysis. Questionnaires were distributed to 260 managers of the institutions all over Malaysia. 141 questionnaires were completed giving a response rate of 54.23 percent. A total of 133 questionnaires or 51.15 percent were usable for analysis. 8 questionnaires are incomplete and therefore are not considered for further analysis. Breakdown of the responses received according to gender and location are displayed in Table 1. Of the 133 respondents who participated in the survey, 93 (69.9 per cent) are male and 40 (30.1 per cent) are female. Selangor represents the highest number of respondents (19 per cent) while the lowest number of respondents came from Kedah, Perlis and Terengganu (7%).

Table 1: Survey response

Demographic	N	%
Gender		
Male	93	69.9
Female	40	30.1
Total	133	100
Location	N	%
Kedah	7	5.4
Kuala Lumpur	21	15.8
Melaka	20	15.0
Negeri Sembilan	10	7.5
Pahang	14	10.6
Perlis	7	5.3
Pulau Pinang	12	9.0
Sabah	9	6.8
Selangor	26	19.4
Terengganu	7	5.3
Total	133	100

4. FINDINGS

4.1 Correlation matrix and descriptive statistics

Table 2 presents the correlation coefficients and descriptive statistics for all variables under study. The correlation between two types of incentive compensation (salary and bonus) and affective commitment are positive and significant (.254, $p < .05$; .120, $p < .10$). Correlation between both salary and bonus and normative commitment are however not significant. It is also shown that the correlation between two components of organizational commitment and managerial performance are positive and significant with affective commitment (.291, $p < 0.001$) and normative commitment (.386, $p < 0.001$).

Table 2: Pearson correlation matrix and descriptive statistics

	1	2	3	4	5	Mean	Std. Deviation
1.Salary	1.000					2.52	1.22
2.Bonus	.288*** (.001)	1.000				0.00	0.00
3.Affective Commitment	.254** (.003)	.120* (.090)	1.000			5.23	1.06
4.Normative Commitment	.084 (.336)	.024 (.782)	.670*** (.000)	1.000		5.38	1.04
5.Managerial Performance	.120 (.170)	.141 (.105)	.291** (.001)	.386*** (.000)	1.000	5.12	0.90

Note: *. $p < 0.1$ (2 tailed), ** $p < 0.05$ (2 tailed), *** $p < 0.001$ (2 tailed).

4.2 Hypothesis testing

Path analysis using multiple regressions was used to analyze the data. It is seen as more appropriate to examine the indirect effect of incentive compensation and managerial performance via organizational commitment. In order to test for adequacy of the regression models, normality, homogeneity of variance of the residuals and appropriateness of linear models has been validated.

Notably, the direct relationship between salary and bonus and managerial performance are insignificant as shown by the correlations $r=.120$ ($p>.10$) and $r=.141$ ($p>.10$) respectively. The results motivate the search into indirect relationship via organizational commitment.

Table 3 presents the results of the path coefficients with affective commitment as the intervening variable while Table 4 presents the results of the path coefficients with normative commitment as the intervening variable. From the results, the significant indirect relationship is only between salary and managerial performance via affective commitment. According to Bartol (1983) this indirect relationship is meaningful as they exceeded the threshold of 0.06.

Table 3: Path analysis result (affective commitment as intervening)

Dependent Variable	Independent Variables	Path Coefficient	t-value	p-value
Affective Commitment	Salary	.254	3.012	.003**
	Bonus	.148	1.710	.090*
Managerial Performance	Salary	.023	.261	.795
	Bonus	.095	1.078	.283
	Affective Commitment	.271	3.119	.002**

Note: * $p<0.10$, ** $p<0.01$.

Calculation of the indirect effect:

Salary-AC-MP = $.254 \times .271 = 0.068$

Bonus-AC-MP = $.148 \times .271 = 0.040$

Figure 2: The relationship between independent, intervening (affective commitment) and dependent variable.

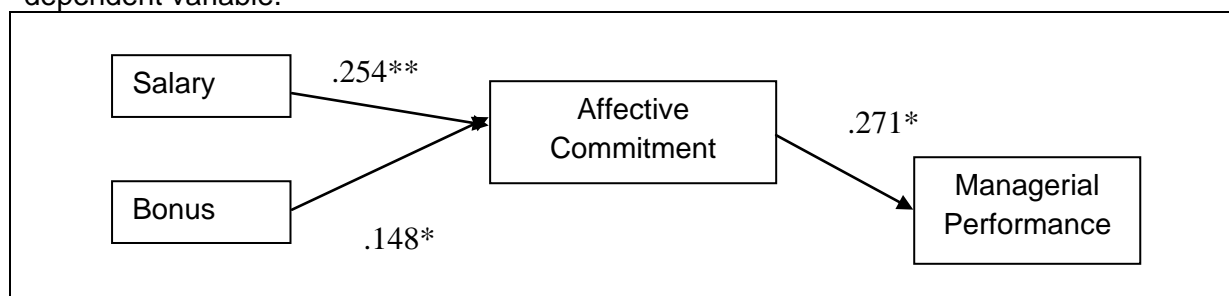


Table 4: Path analysis result (normative commitment as intervening)

Dependent Variable	Independent Variables	Path Coefficient	t-value	p-value
Normative Commitment	Salary	.084	.966	.336
	Bonus	.024	.278	.782
Managerial Performance	Salary	.054	.645	.520
	Bonus	.117	1.391	.166
	Normative Commitment	.379	4.699	.000***

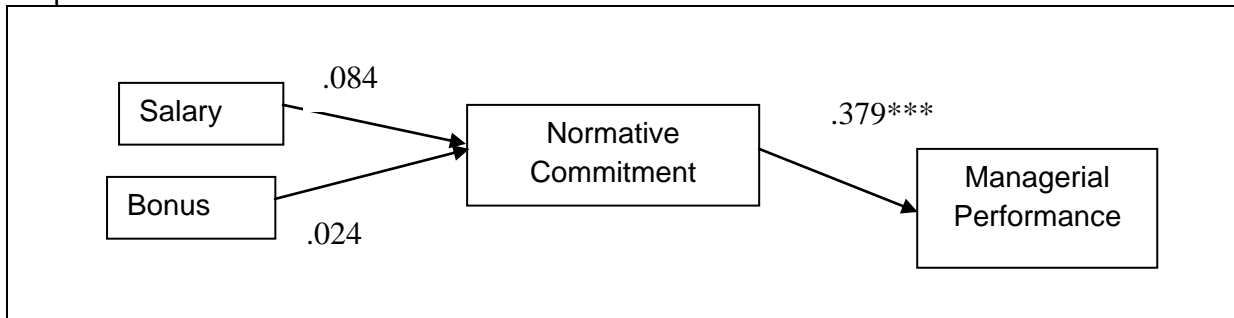
Note: *** $p<0.001$.

Calculation of the indirect effect:

Salary-NC-MP = $.084 \times .379 = 0.032$

Bonus-NC-MP = $.024 \times .379 = 0.009$

Figure 3: The relationship between independent, intervening (normative commitment) and dependent variable



The data also revealed the existence of normative commitment that is directly related to managerial performance and not influenced by salary or bonuses.

5. CONCLUSION

This study aims to build an understanding on the effect of incentive compensation on managerial performance in Zakat Institution. As expected, the results of this study suggest incentive compensation namely salary and bonus do not directly affect performance of middle managers in Zakat Institution, but instead it affects via organizational commitment. Although the finding is inconsistent with most prior literature (Sprinkle 2000; Chong and Eggleton 2007), it does prove to some extent, on the uniqueness of non-profit organization particularly that with a religious orientation. Thus, what is the role of incentive compensation in this organization?

The management control theory suggests that the relationship between incentive compensation and managerial performance might not be simple and direct. Employees of the Zakat Institution have been trained to understand their commitment towards the moslem community (Namelfi and Sofiah 2011). They are expected to embed elements of voluntary management and not merely seeing their jobs as means of increasing wealth or power. Nevertheless, as humans, the salary is means of survival and in the Zakat Institution, it was found that salary does enhance commitment, which in turn increase managerial performance. In particular, this study found the role of affective commitment in mediating the relationship between salary and managerial performance. In simple words, salary improves employee's feeling about organization such as happy with their work (i.e. affective commitment) and notably, is not associated with spiritual commitment (i.e. normative commitment) although both dimensions of commitment were found to improve the managerial performance. Incentive compensation is therefore seen as motivator to ensure employee are committed with their job. On the other hand, as employees are committed when they feel they ought to i.e. normative commitment, neither salary nor bonus is expected to influence their performance.

6. IMPLICATION, LIMITATION AND FUTURE RESEARCH

This study extends the management control theory into non-profit organizations particularly a religious oriented organization. It has an implication to the management of zakat institution as it can be used as a guideline to improve the staff commitment and performance of employee. Although incentive compensation might not be directly related to performance, it does assist in increasing the employees' commitment. It should be highlighted that this study only examines organizational commitment as the intervening variable. Future studies may consider other factors in examining the relationship between incentive compensation and managerial performance such as non-financial incentive compensation which include

medical allowance or allowance to perform “*umrah*”. It has been found that other than salary and bonus, some Zakat Institutions provide non-financial incentive to middle manager (Sharifah Norzehan et al. 2008) which may be of a different value to the staffs of the Zakat Institution.

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