

## **CHAPTER II**

### **LITERATURE REVIEW**

#### **A. Theoretical Framework**

The explanation about employee performance, leadership style, and compensation will be discuss one by one include definition and type of them.

##### **1. Employee Performance**

The explanation of employee performance is include definition, factors affecting performance, and performance assessment.

###### **a. Definition of employee performance**

Performance has diverse insight from various experts, but still has similarity. Hasibuan (2009) suggests that performance (achievement of work) is a result achieved by a person in carrying out the tasks assigned to him/her based on his/her skill, experience and sincerity and time. Meanwhile, Rivai (2004) says that performance is a tangible behavior that is displayed in every person as a work performance generated by employees in accordance with its role in the company. It could be concluded that the employee performance is the work of employees both in terms of quality and quantity in performing and completing their tasks charged to the employee by their leader based on his role within the company.

Simanjuntak (2005) says that performance is a result of work function/activity of a person or group in an organization that is

influenced by various factors to achieve organizational goals within a certain period of time. Performance is the result of work that can be achieved by a person or group of people within an organization in accordance with their respective authority and responsibility in an effort to achieve organizational goals (Mangkuprawia, 2009). The results of the work done by the employee will show how good the performance has been. However, there are several factors that may affect the employee performance itself.

b. Factors affecting performance

Based on previous explanation, we can identify that performance is an achievement or the work of employees with respect to its obligations to the company and in certain period. In addition, there are several factors that affect the achievement of work or employee performance as proposed by Mangkunegara (2011). He argues that there are two factors that affect the achievement of performance, namely ability and motivation. Ability is the combination of knowledge and skills. In the world of work, to be able to achieve good performance, employees or workers must have the ability to suit the work it does. Motivation is an impulse to perform activities to obtain or achieve goals. Employee motivation to work is usually formed due to certain reasons, for example to get a salary, gift, and so forth.

c. Performance assessment

Employee performance appraisal is done to see work result, work achievement and employee performance in the past or to predict work performance in time will come. According to Dharma (2003) indicators that can be used to assess employee performance are:

1) Quantity

Quantity is the amount of output or output that must be generated by employees in carrying out their work. Market control is one of the marketing strategies that should be the main consideration for the company, therefore the quantity of production will determine the ability of the organization to dominate the market by offering as much as possible the product that can be produced. With the quantity of work that can be produced the company is expected to give a positive impression to the position of products in the market.

2) Quality

Quality is the quality of output that must be generated by employees in carrying out their work. For companies both engaged in manufacturing and services, the provision of quality products is a demand for the organization to survive in various forms of competition. Increased purchasing power and the existence of consumer support to the existence of the quality of work offered

will further improve the sustainability of the organization in achieving the goals more effectively.

### 3) Timeliness

Timeliness is the conformity of time generated by employees in completing the work with the planned. The ability of firms to define the most efficient and effective working time at all levels of management. Working time is the basis for an employee in completing a product or service that is his responsibility.

## **2. Leadership style**

### a. Definition of leadership

According to Nawawi and Martini (1995), a leader means person and leaders in activity. In terms of organization, leadership can be defined as the ability or intelligence to encourage a number of people (two or more people) to work together in carrying out activities that are directed to a common goal. Leadership style is a strategy or way taken by a leader in behaving with a view to influence subordinates to behave in accordance with direction or direction leaders to achieve certain goals. Leader must adjust his style or way of leadership with his subordinates.

Rafferty and Griffin (2004) defines leadership as both process and attribute. As a leadership process it is the use of non-coercive influence to shape group or organizational goals, motivating behavior toward achieving such goals and helping to define group or organizational

culture. A leadership attribute is a group of characteristics possessed by individuals who are viewed as leaders.

b. Types of leadership style

There are some experts who explain about the types of leadership styles. One of them is the type of leadership style according to Siagian (2002), which is described as follows:

1) Autoractic type

An autocratic leader is a leader who has the following criteria:

- a) Assume the organization as a private owner.
- b) Identify personal goals with organizational goals.
- c) Assume subordinates as a tool solely.
- d) Does not accept criticism, suggestions and opinions.
- e) Too dependent on his formal power.
- f) In the act of mobilizing it often uses a coercive and punitive approach.

2) Military type

A leader who has a military type is a leader with the following criteria:

- a) More often use command in moving the subordinate system.
- b) Usually moving subordinates depends on rank and position.
- c) Pleased at the exaggerated formality.

- d) Demanding a high and rigid discipline of subordinates.
- e) It is difficult to accept criticism from his subordinates.
- f) Follows ceremonies for various circumstances.

### 3) Paternalistic type

A leader who belongs to a paternalistic leader is one who has the following characteristics:

- a) Regarding subordinates as immature human beings, and being overly protective.
- b) Rarely gives an opportunity to his subordinates to make a decision.
- c) Rarely gives an opportunity to his subordinates to take the initiative.
- d) Rarely gives an opportunity to his subordinates to develop his creative and fantasy power.
- e) Often being omniscient.

### 4) Charismatic type

Until now the experts have not managed to find the causes why a leader has charisma. The lack of knowledge about the cause of one's being a charismatic leader, it is often said only that such a leader is endowed with supernatural powers. Wealth, age, health, profile can not be used as criteria for charismatic type leaders.

### 5) Democratic type

A leader who belongs to a paternalistic leader is one who has the following characteristics:

- a) In the process of moving subordinates always starting from the opinion that man is the world's noblest creature.
- b) Always seek to synchronize the interests and goals of the organization with personal interests and goals rather than its subordinates.
- c) Pleased to accept suggestions, opinions, and even criticism from his subordinates.
- d) Always strive to prioritize cooperation and teamwork in an effort to achieve goals.
- e) Sincere gives the widest possible freedom to his subordinates to make mistakes which are then corrected so that the subordinate no longer make the same mistake, but more daring to make other mistakes.
- f) Always strive to make his subordinates more successful.
- g) Strive to develop his personal capacity as a leader.

While Robbins (2006) identified four types of leadership styles, among others:

#### 1) Charismatic Leadership Style

The followers are encouraged by the heroic or extraordinary leadership abilities when they observe the behavior of certain leaders. There are five main characteristics of charismatic leaders:

- a) Vision and articulation. He has a vision aimed at the ideal goal that wishes the future better than the status quo, and is able to clarify the importance of visions that can be understood by others.
- b) Personal ratio. Charismatic leaders are willing to take high personal risks, bear enormous costs, and engage in self-sacrifice to achieve the vision.
- c) Sensitive to the environment. They are able to assess realistically the environmental constraints and resources needed to make changes.
- d) Sensitivity to followers' needs. Charismatic leaders are perceptive to others' abilities and responsive to their needs and feelings.
- e) Unconventional behavior. Charismatic leaders engage in behavior that is considered new and contrary to the norm.

## 2) Transactional Leadership Style

Transactional leaders are leaders who guide or motivate their followers toward defined goals by clarifying the terms of roles and tasks. Transactional leadership style focuses more on the leader-subordinate relationship without any effort to create change for his subordinates. There are four characteristics of transactional leaders:



- a) Contingent rewards: exchange contracts rewarded for the effort made, promising rewards for good performance, recognizing achievements.
- b) Management based exceptions (active): view and search for deviations from rules and standards, take corrective action.
- c) Management by exception (passive): intervenes only if standards are not met.
- d) Laissez Fair: release responsibility, avoid making decisions.

### 3) Transformational Leadership Style

The transformational leadership style devotes attention to the things and development needs of each follower. The transformational leader changes the followers' consciousness of the problems by helping them view old problems in new ways, and they are able to excite, awaken, and inspire followers to spend extra effort to achieve group goals. There are four characteristics of transformational leaders:

- a) Charisma: gives vision and a sense of mission, instills pride, gains respect and trust.
- b) Inspiration: communicating high expectations, using symbols to focus on effort, illustrates the point of importance simply.
- c) Intellectual stimulation: encouraging intelligence, rationality, and problem solving Carefully individual

considerations: giving personal attention, serving employees personally, training and counseling.

#### 4) Visionary Leadership Style

The ability to create and articulate a realistic, credible and exciting vision of the future of an organization or organizational unit is growing and improving today. This vision, if properly selected and implemented, has great power so that it can lead to an early jump into the future by awakening the skills, talents, and resources to make it happen.

Bass et al. (2003) and Locander et al. (2002) identified two types of leadership styles, they are transactional leadership style and transformational leadership style. Transactional leaders are leaders who guide or motivate their followers toward defined goals by clarifying the terms of roles and tasks, whether transformational leadership style devotes attention to the things and development needs of each follower.

Transactional leadership, the leader who motivates their followers in the direction of the objectives is enforced by clarifying the role and task demands. Leaders will motivate or influence their subordinates by exchanging rewards with certain performance. That is, in a subordinate transaction is promised to be rewarded if able to complete the task in accordance with the agreement. According to Bass (1998) leaders promise rewards for efforts achieved by subordinates,

and feel responsive to subordinate interests when satisfied with the results of their performance.

The theory underlying this variable is agency theory. Agency theory proposed by Jensen and Meckling (1976) revealed that in organization consisting of two parties namely principal and agent there are differences of interests. In this Transactional leadership, backed by the difference between the leader and his subordinates. Leaders and subordinates are independent parties who each has their own goals, needs and interests. Therefore transactions occur between the leader and his subordinates to reach agreement with a predetermined reward.

Transformational leadership, the leader has a role as a catalyst for the changes that will be implemented, it means that the leader plays a role in improving the existing human resources and tries to give a reaction that raises the spirit and high workforce for members. Transformational leadership strives to inspire subordinates to achieve maximum results.

### **3. Compensation**

The explanation of compensation is include definition and type of compensation.

#### **a. Definition of compensation**

Compensation is given by the company to employees as a form of appreciation or gratitude and compensation. Provision of compensation can provide a positive impact to employees, generate

work motivation, morale and ultimately will improve the performance of the employees themselves. Improving employee performance will have a positive impact on overall company performance.

Aritonang (2005) states that compensation is all income in the form of money or goods directly or indirectly received by employees in return for services provided to agencies. Notoatmodjo (2009) states that compensation is anything that employees receive in return for their work or service. That means that compensation may be money or something else given by company to the employees as a reward.

Based on the description and explanation of compensation from the experts above, it can be concluded that the compensation is everything received by employees either directly or indirectly, in the form of revenue material or non-materi as a reward for contributions, work, devotion to the company or organization. Compensation provided by the company should be appropriate with the achievement of employee's performance. As a result, employees have a passion to keep improving their performance and make a positive impact to the company.

Compensation is important for employees as individuals because the amount of compensation reflects the size of their work among the employees themselves, the family and society (Handoko, 2003). Compensation is a broad term related to the financial rewards earned by people through their employment relationships with

organizations (Simamora, 2004). Employee compensation is any form of payment or compensation paid to employees and arises from the employment of that employee (Desler, 2006). Compensation is everything that employees receive in return for their work (Handoko, 2003).

b. Types of compensation

According to Dessler (2000), compensation has three components as follows:

- 1) Direct money payments (direct financial payments) in the form of salary, and intensive or bonus / commission.
- 2) Indirect payment in the form of allowances and insurance
- 3) Non-financial rewards such as flexible working hours and prestigious offices.

## **B. Literature Review and Hypotheses Development**

Hypotheses in this research is based on relevance theory and also supported by result in previous research. Hypotheses development for each hypotheses is as follow:

### **1. Financial Compensation and Employee Performance**

Employees often complain about the work they have. It starts from factors related to the work itself, the salary they earn, the incentives they receive, or it could be because of the environment in which they work. This can cause employee performance to be not optimal, which will harm the company itself.

Vroom (1996) points out expectancy theory, which states that employee's motivation is an outcome of how much an individual wants a reward (valence), the assessment that the likelihood that the effort will lead to expected performance (expectancy) and the belief that the performance will lead to reward (instrumentality). In other words, employee expect that performance will increase if their effort increases too, and a good performance will get rewards from the company. Logically, employee will try to improve their performance to get reward from company (compensation).

The compensation given by the company to its employees will increase the morale of employees to do their work. This is in line with research conducted by Sugiyarti (2012). His research examines the effect of work environment, organizational culture and compensation on job satisfaction to improve employee performance. One of the findings of this study is that compensation has a positive effect on employee performance. In other words, employee performance will increase if the compensation received by employees is higher.

Another study was conducted by Kende et al. (2016) which resulted in financial compensation that has a significant effect on employee performance with positive relationship coefficient in the form of positive, meaning that the higher the financial compensation is, the greater the employee performance will be. Noe (1993) suggests compensation is

divided into financial and non-financial compensation, while financial compensation is divided into salaries, allowances, and incentives.

Based on the description, it can be concluded that the compensation by the company to employees is important. Company achievement generally depends on the employee performances. According to expectancy theory, employees will hope to get reward from their effort and performance. Therefore, employees will strive to improve their performance and try to do their best and achieve a good performance in hope of receiving rewards or compensation. Therefore, the higher compensation given, the better employee performances will be. From some of the above description, the authors formulate the hypothesis as follows:

H<sub>1</sub> : Compensation has positive effect on the employee performance

## **2. Leadership Style and Employee Performance**

Manager's leadership style will influence the performance of employees who work at the company. Leaders who can provide good motivation and direction will facilitate and help employees feel comfortable in the work so that they will try as much as possible to perform tasks and roles in the company. While the leader, who is indifferent and doesn't give attention to employees will emancipate employees to behave in accordance with their own willingness.

Fiedler (1967) presents leadership contingency model theory in which he proposed that effective employees performance depended on

leaders' ability to lead is contingent upon situational factors that include the leaders' capabilities, preferred style, and behavior, competency of employees. In other words, the level of employee performance is influenced by the motivation from the leader and the extent to which the leader can control and influence a particular situation.

Leadership style according to Bass et al. (2003) and Loeferer et al. (2002) is divided into transactional leadership and transformational leadership. Transactional leadership bases itself on the principle of exchange then transformational leadership is based on the principle of developing subordinates (follower development). Transformational leaders evaluate the ability and potential of each subordinate to perform a task/job. In a study conducted by Kende et al. (2016), transformational leadership has a positive and significant effect on employee performance.

Both types of leadership, transactional and transformational are always related to the achievement of company goals. Transformational leadership always deals with greater outcomes for individual and organizational goals. Bass (1998) reveals that transformational leadership articulates the vision and stimulates his subordinates, gives great support, and through teamwork, individuals are given the flexibility to adapt and be responsible. Transactional leadership only encourages employees to see what affects them because they are only rewarded for their own performance. From the description above, the researcher formulated the hypothesis as follows:



H<sub>2</sub> : Leadership style has positive effect on the employee performance.

### **3. Financial Compensation, Leadership Style and Employee Performance**

It is important for companies to improve their employee performances. Providing financial compensation as well as existing leadership styles in the company can affect employee performances. The higher the financial compensation is, the greater the employee performance will be. Similar with leadership style, the better leadership style in the company then the employee will be able to do their job and have a good performance. Therefore, the third hypothesis of this study is:

H<sub>3</sub> : Financial compensation and leadership style have positive effect on the employee performances.

#### **C. Research Model**

Based on previous explanation we can find three hypotheses in this research. H<sub>1</sub> and H<sub>2</sub> is about the influence of each independent (financial compensation and transformational leadership style) towards dependent variable (employee performance). H<sub>3</sub> is about the influence of all independent variable (financial compensation and transformational leadership style) towards dependent variable (employee performance) simultaneously. Therefore, the model of this research is as follows:

