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The Moderating Role of Psychological Well-Being on The Relationship Between Compensation and Employee Performance

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Abstract: *This study aims to examine the effect of compensation on employee performance with psychological well-being as a moderating variable in Islamic banks in Sidoarjo. Using quantitative methods with a survey approach, data were collected from 100 Islamic bank employees who met certain criteria. The results showed that compensation has a significant influence on employee performance. In addition, psychological well-being is proven to strengthen the effect of compensation on employee performance, which indicates the importance of psychological well-being in maximizing the effectiveness of compensation. This research provides an important contribution for management in designing a fair compensation system and effective welfare programs to improve employee performance.*

INTRODUCTION

In the modern world of work, employee performance is a determining factor in the success of an organization. High performance from employees reflects individual competencies, and the extent to which they are motivated by the work environment. Employee performance should be a major concern of management as it is directly related to the sustainability and success of the organization. Given the importance of employee performance to organizational success, management needs to pay attention to and effectively manage the factors that influence this performance (Jannah, 2023).

Employees must be provided with adequate support, including training, constructive feedback, and recognition for their achievements. They are valuable resources, and investing in their development will yield positive results for the organization as a whole. By evaluating valuable employees, management can identify potential areas for further development and create a work environment that fosters growth and innovation (Mardikaningsih & Hariani, 2020).

Management must ensure that each employee is motivated and equipped with the necessary tools to achieve optimal work outcomes (Darmawan, 2024). Issues related to suboptimal performance can significantly impact individuals and hinder the overall achievement of organizational goals. According to Pfeffer (1998), organizations that fail to maximize employee performance will struggle to maintain competitiveness and achieve strategic objectives. The consequences can be detrimental, especially in terms of reduced productivity and service quality, which can ultimately threaten the organization's sustainability (Irfan et al., 2023).

LITERATURE REVIEW

When employees are not working efficiently, it can hinder productivity, reduce the quality of output, and eventually harm the organization's profitability and competitiveness (Darmawan et al., 2020; Eddine et al., 2023). Therefore, it is crucial for management to understand the factors that influence employee performance, including how compensation interacts with other factors such as psychological well-being.

One of the key drivers of performance is the compensation received by employees (Putra, 2022). Jiang et al. (2012) found that fair and competitive compensation has a significant positive impact on employee performance. Good compensation is viewed as a reward for the effort and dedication provided by employees (Werdati et al., 2020). Compensation, which includes salary, incentives, and various other benefits, is often considered a primary tool for motivating employees and achieving their best performance. Compensation is one of the key elements in human resource management designed to motivate employees to achieve optimal performance. However, research by Lazear (2000) shows that inappropriate or unfair compensation can lead to dissatisfaction and decreased performance. Human resource management systems are essential to prevent this from happening (Mardikaningsih, 2024). An integrated system ensures that compensation policies are effectively implemented. Therefore, it is crucial for organizations to design a compensation system that is not only competitive but also fair and aligns with employee expectations.

However, in many cases, problems arise when the compensation provided does not meet employee expectations. Dissatisfaction with compensation can lead to decreased motivation, increased turnover, and ultimately a decline in performance. Compensation must be designed to be both fair and effective. However, compensation alone may not be sufficient. A mismatch between the compensation provided and employee expectations can become a serious issue in the workplace, undermining the overall organizational climate (Lawler, 2003).

Conversely, evidence shows that even when compensation is well-structured, employee performance may not always be optimal. In various organizations, it is often observed that employees fail to meet expected targets despite receiving adequate compensation. This phenomenon raises fundamental questions about other factors that influence employee performance. Why do some employees continue to underperform despite receiving competitive compensation? Are there other factors at play that ensure compensation is truly effective in enhancing performance?

Although compensation is often considered the primary motivator, many organizations face challenges with suboptimal employee performance. Studies by Gerhart and Fang (2015) indicate that financial compensation, including salaries and bonuses, is a significant motivating factor but often not sufficient to drive employees to achieve optimal performance.

Research by Gupta and Shaw (2014) found that even when employees receive competitive compensation, they may still experience a decline in performance if their emotional and psychological needs are not met. This suggests that compensation alone is not enough, and greater attention needs to be given to other factors, such as psychological well-being, to ensure optimal employee performance.

This indicates that other factors also play a role in improving employee performance in the workplace. This necessitates an understanding of how other elements, such as psychological well-being, can affect the effectiveness of compensation in enhancing performance. Armstrong and Taylor (2014) emphasize that employee performance is a valuable asset that must be well-managed. Organizations need to understand that employee performance depends not only on financial compensation but also on their psychological well-being.

Good psychological well-being enhances motivation, commitment, and employee performance (Devonish, 2016). When employees feel happy and psychologically satisfied, they are more likely to be motivated to work hard and achieve set targets. Additionally, employees with good psychological well-being tend to feel more connected to the organization (Kundi et al., 2021). This connection can drive them to strive to give their best, thereby strengthening the relationship between compensation and performance (Putra & Mardikaningsih, 2022). Psychological well-being can influence how employees perceive the compensation they receive. Employees who feel good emotionally and mentally are more likely to see compensation as a positive form of recognition, which can enhance their performance (Huang et al., 2016).

Although there has been extensive research examining the relationship between compensation and employee performance, there is still a research gap regarding how psychological well-being can moderate this relationship, particularly in the Islamic banking industry. Beauregard and Henry (2009) highlight the importance of further research to understand the role of psychological well-being in unique work environments such as Islamic banks, where ethical and religious values may influence employees' perceptions of compensation and performance. While there has been considerable research on the relationship between compensation and employee performance, studies specifically exploring the role of psychological well-being as a moderating variable in Islamic banks remain limited. This research aims to fill that gap by exploring how psychological well-being can strengthen the influence of compensation on employee performance.

METHOD

This study employed a quantitative method with a survey approach to collect data from employees of Islamic banks in Sidoarjo. The research is explanatory in nature, aiming to explain the relationship between the variables of compensation, psychological well-being, and employee performance.

The population of this study consists of all employees of Islamic banks in Sidoarjo who have been working for at least two years. The sampling technique used was purposive sampling, with a total sample size of 100 respondents. The sample was selected based on specific criteria to ensure that the respondents have sufficient work experience to provide relevant and valid data.

Compensation (X) is defined as the financial rewards received by employees, such as salary, bonuses, and allowances. The indicators used in this study include internal equity, external equity, competitiveness, and payment regularity, as adapted from the research by Milkovich and Newman (2005).

Psychological Well-Being (M) refers to the psychological condition of employees that reflects emotional and mental balance. The indicators used include self-acceptance, positive relationships, autonomy, environmental mastery, life purpose, and personal growth, according to Ryff's model (1989).

Employee Performance (Y) is defined as the level of task and responsibility achievement measured against organizational standards. The indicators used in this study include work quality, work quantity, timeliness, and initiative, as adapted from the research by Robbins (2003).

Data were collected through questionnaires distributed online to Islamic bank employees in Sidoarjo. The questionnaires were designed to measure employees' perceptions of compensation, psychological well-being, and their performance using a 5-point Likert scale.

The collected data were analyzed using regression techniques with a moderating variable to test the effect of compensation on employee performance and the role of psychological well-being as a moderating variable. The analysis was conducted with the assistance of the SPSS statistical

software.

RESULT AND DISCUSSION

The respondents in this study comprised employees of Islamic banks in Sidoarjo who have been working for at least two years. Among the 100 respondents, the majority were aged between 31-35 years, with most having a bachelor's degree as their educational background. According to Sturman (2003), work experience, indicated by a minimum of two years of service, has a significant relationship with employee performance. Longer experience allows employees to better understand their work environment, positively impacting their performance and contribution to the organization. Ng and Feldman (2009) state that formal education provides employees with better analytical and problem-solving skills, enabling them to comprehend the dynamics and complexities within the workplace. Education also influences employees' perceptions of compensation fairness and how their psychological well-being is affected by company policies.

The respondents' job roles varied, ranging from administrative positions to management, providing a representative sample of the employee population within the Islamic banks. Kuvaas (2006) suggests that employee satisfaction with compensation and well-being varies according to their organizational level. While administrative employees value stability and direct support, managers often seek opportunities for career development and enhanced professional status, reflected in their expectations regarding compensation and well-being. This variation is important as it offers a more comprehensive view of how compensation and psychological well-being impact performance across different organizational levels. The diversity of positions allows the study to capture various perspectives on how compensation and psychological well-being affect performance throughout the organizational hierarchy.

The validity and reliability testing of the research instruments yielded excellent results. The corrected item-total correlation values for all indicators exceeded 0.3, indicating adequate validity. Additionally, the Cronbach's Alpha values for the compensation variable were 0.842, for psychological well-being 0.892, and for employee performance 0.883, indicating very high reliability. This demonstrates that the instruments used in this study are consistent and trustworthy.

The results of the regression analysis with psychological well-being as a moderating variable are presented in Table 1 below..

Table 1. Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-3.051	8.033		-.380	.705
	X	6.495	1.434	1.088	4.530	.000
	M	5.696	1.534	.962	3.714	.000
	XM	.590	.255	.988	2.309	.023

Table 1 presents the results of the linear regression analysis examining the effect of compensation (X) and psychological well-being (M) as a moderating variable on employee performance (Y). The following is a scientific interpretation of these results:

The B coefficient for the interaction between compensation and psychological well-being (XM) is 0.590, with a standard error of 0.255. The t-value is 2.309 with a significance of 0.023, indicating that the interaction between compensation and psychological well-being has a

statistically significant effect on employee performance at the 5% significance level ($p < 0.05$). This positive coefficient suggests that the interaction between compensation and psychological well-being enhances employee performance. In other words, the impact of compensation on employee performance is greater when psychological well-being serves as a moderator.

Table 2 shows the coefficient of determination for the direct effect of the compensation variable on employee performance. The R Square value of 0.707 indicates that 70.7% of the variance in employee performance can be explained by variations in compensation. In other words, compensation accounts for approximately 70.7% of the changes in employee performance, demonstrating that compensation is a strong predictor of employee performance.

Table 2. Model Summary of the Effect of Compensation on Employee Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.841[a]	.707	.701	4.341

a. Predictors: (Constant), X

Table 3 is the coefficient of determination of the effect of compensation variables on employee performance with psychological well-being variables as moderators. The R Square value of 0.762 indicates that 76.2% of variations in employee performance can be explained by variations in compensation with psychological well-being as a moderator.

Table 3. Model Summary with Psychological Well-Being as moderator

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.873[a]	.762	.754	3.936

a. Predictors: (Constant), X,M,XM

Based on the results of the table, it can be stated that both compensation and psychological well-being have a significant influence on employee performance. In addition, the interaction between compensation and psychological well-being also shows a significant effect on employee performance, which means that an increase in psychological well-being will strengthen the effect of compensation on employee performance. This shows the importance of psychological well-being as a moderator factor that can increase the effectiveness of compensation to improve employee performance.

The regression analysis results indicate that compensation has a significant impact on employee performance. This finding aligns with the research by Gerhart and Fang (2015), which found that compensation significantly influences employee motivation and performance. The study by Jiang et al. (2012) also supports this finding, where fair and competitive compensation is linked to improved employee performance.

When psychological well-being is included as a moderating variable, the R-value increases to 0.873 and the R Square to 0.762, meaning that 76.2% of the variance in employee performance can be explained by compensation and psychological well-being. In comparison, the standalone effect of compensation on employee performance yields an R-value of 0.841 and an R Square of 0.707, indicating that 70.7% of the variance in employee performance can be explained by compensation. This shows that psychological well-being strengthens the impact of compensation on employee performance. This finding is supported by research from Beauregard and Henry (2009), which shows that employee psychological well-being can enhance the positive effects of compensation on performance. Wright and Cropanzano (2000) also found that high psychological well-being can improve productivity and performance in the workplace.

This study shows that compensation significantly affects employee performance in Islamic banks in Sidoarjo, consistent with the first hypothesis. These findings are in line with previous research indicating that competitive compensation can enhance employee motivation and performance

(Gerhart & Fang, 2015; Jiang et al., 2012; Dahar & Mardikaningsih, 2022; Bangsu et al., 2023). Organizations need to regularly evaluate their compensation systems to ensure that the compensation provided is fair, competitive, and aligned with employee expectations (Djazilan & Darmawan, 2020). Compensation that includes not only base salary but also incentives, bonuses, and relevant benefits will be more effective in motivating employees to achieve optimal performance. Additionally, it is essential for management to communicate transparently about the compensation structure so that employees feel valued and motivated to contribute more (Putra, 2024). This will create a positive work environment and increase employee loyalty to the organization. Therefore, organizations must consider various external and internal factors that can influence employees' perceptions of compensation, including labor market conditions and company culture.

Moreover, the second hypothesis, which states that psychological well-being enhances the effect of compensation on employee performance, is also proven true. This result is consistent with research showing that employee psychological well-being plays a role in enhancing the effectiveness of compensation (Beauregard & Henry, 2009; Wright & Cropanzano, 2000). Therefore, it is important for management to focus not only on financial aspects but also on creating well-being programs that support employees' mental and emotional health. These programs can include stress management training, counseling, and activities that encourage social interaction among employees, thus creating a more positive and productive work environment. Consequently, investing in employee well-being benefits both the individuals and the overall performance of the organization.

Management should integrate psychological well-being into human resource (HR) policies as a critical element that supports performance. This could involve adjusting workloads, recognizing achievements, and increasing employee involvement in decision-making to enhance their sense of ownership and emotional attachment to the organization (Infante, 2022; Wulandari, 2024). In this way, creating an environment that supports psychological well-being benefits both employees and the organization as a whole (Magnier-Watanabe et al., 2017). Organizations that invest in psychological well-being programs may see improvements in employee performance (Jahroni et al., 2023). These improvements can manifest in various ways, such as increased productivity, reduced absenteeism, and enhanced job satisfaction. Additionally, employees who feel valued and supported are more likely to remain loyal to the company, which can further reduce recruitment and training costs.

Management must implement regular monitoring and evaluation systems to measure the effectiveness of compensation systems as well as the psychological well-being of employees. Employee feedback should also be accommodated to make necessary adjustments to ensure optimal performance. Human resource management should play an active role in creating a supportive work environment, including providing the necessary training and resources to enhance mental well-being (Sharma et al., 2016). Consequently, companies will benefit from more productive employees and foster a positive and sustainable work culture.

This study also shows that employee psychological well-being serves as a buffer or protection against work stress and as a catalyst that amplifies the positive impact of compensation on employee performance. This is important because it shows that organizations need to focus on providing competitive compensation and ensuring that employees' psychological well-being is well-maintained. These findings support Maslow's (1943) hierarchy of needs theory, which suggests that fulfilling psychological needs will motivate individuals to achieve higher performance

CONCLUSION

As a final part, based on the previous description, two important things can be concluded to answer the problem formulation, namely

1. Compensation has a significant influence on employee performance at Sidoarjo Islamic banks, with fair and competitive compensation positively affecting performance levels..
2. Psychological well-being strengthens the effect of compensation on employee performance, indicating that the psychological well-being of employees is an important factor that must be considered by the organization..

From this, two other things can be suggested based on the results of this study, namely

1. Islamic bank management in Sidoarjo needs to ensure that the compensation system implemented is fair and competitive to motivate employees and improve their performance..
2. Companies should develop programs that support employees' psychological well-being, such as work-life balance programs and mental health support, to maximize the positive impact of compensation on employee performance

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