



# The Influence of Ethical Leadership, Compensation, and Culture on Employee Performance

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This study analyzes the effect of ethical leadership, compensation, and organizational culture on employee performance. This research is quantitative with a sample of 42 employees through the census method. The multiple linear regression analysis showed several results. First, ethical leadership has no significant effect on employee performance. Second, compensation has a significant impact on employee performance. Third, organizational culture has a significant negative impact on employee performance. Although the results contradict previous studies, ethical leadership, compensation, and organizational culture still have an essential role in achieving employee performance. The results provide positive implications for improving employee performance through applying for compensation and work culture. However, the implementation of work culture needs to be accompanied by other variables such as good corporate governance.

**Keywords :** Leadership, compensation, culture and performance.

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## INTRODUCTION

Company employees are one of the essential elements in determining the company's success (Almatrooshi, Singh, & Farouk, 2016; Sihombing, Astuti, Al Musadieg, Hamied, & Rahardjo, 2018). Employees dominate in planning, implementing, and realizing company goals. Employee performance consists of task and contextual performance (Kluemper, DeGroot, & Choi, 2013). Task performance is formally related to one's job, while contextual performance is informally focused on one's job (organizational citizenship behavior). Previous research explained that task and contextual performance are essential foundations of organizational performance (Yang & Wei, 2017).

Organizational performance depends on leaders' skills and ethical behavior in implementing strategies (Almatrooshi et al., 2016; Yang & Wei, 2017). Leadership with ethical behavior is also the main focus because ethical or unethical behavior will affect how employees think and behave (Yang & Wei, 2017). Ethical leaders treat employees with respect and are responsible. Previous researchers argue that ethical behavior is a critical component in leadership theories (Brown, Treviño, & Harrison, 2005), such as synergy of transformational-servant leadership (Muhammad & Sari, 2021), authentic leadership (Gardner, Karam, Alvesson, & Einola, 2021), and spiritual leadership (Egel & Fry, 2017). The substance of ethical leadership emphasizes humane leadership with integrity, fairness, simplicity, and responsibility. A leader who displays ethical behavior in his employees will show better performance and put more effort into organizational improvement. Previous studies have shown that ethical leadership encourages employees to develop morals, feel job satisfaction, and improve performance (Neubert, Wu, & Roberts, 2013; Shin, Sung, Choi, & Kim, 2015).

The study of ethical leadership is essential because organizations still have many leadership deviations. Some examples of such irregularities include the scandals of Oxfam and Save the Children (STC) (Scurlock, Dolsak, & Prakash, 2020) and organizational governance failures caused by the negligence of leaders, such as the Enron and WorldCom scandals (Bedendo, Cathcart, & El-Jahel, 2018). Recently, a company in the banking industry, Wells Fargo, faced a crisis of fake bank accounts (Austin-Campbell, 2021). Previous research has also shown that unethical leaders will lose trust in leaders (Boddy, Ladyshevsky, & Galvin, 2010). The evidence above indicates that ethical leadership is essential for maintaining and developing an ethical culture in every organization (Sarwar, Ishaq, Amin, & Ahmed, 2020). Examples of ethical leadership behavior are shown, such as treating employees humanely and respecting employee rights by giving employees awards or rewards for contributions to the organization.

Giving rewards to employees affects their willingness to perform tasks. In addition, employees will feel valued by the organization where they work. Furthermore, fair

compensation can also improve employee performance and overall organizational effectiveness. Previous studies have discussed the relationship between compensation and employee (Küster & Canales, 2011; Mohd Nasurdin, Tan, & Naseer Khan, 2020; Shiah-Hou & Cheng, 2012). Ethical behavior shown by a leader continuously will create an excellent organizational culture, affecting how employees think and work behavior.

Organizational culture is related to values and beliefs that are understood, adhered to, and manifested in practices, behaviors, and various artifacts shared by members of the organization (Pawirosumarto, Sarjana, & Gunawan, 2017; Raharjo, Nurjannah, Solimun, & Achmad Rinaldo Fernandes, 2018). Specific organizations uniquely own culture as a differentiator from one organization to another. One of the causes of poor employee performance and organizational failure is the absence of a harmonious culture between employees, superiors, subordinates, or fellow employees. Previous studies on organizational culture and employee performance showed a difference. The study's results explain that organizational culture has no significant effect on employee performance (Pawirosumarto et al., 2017), while others show significant results (Raharjo et al., 2018). The difference in the results above indicates the need to review how the influence of organizational culture on employee performance.

This research discusses ethical leadership, compensation, and the culture of employee performance in microfinance institutions. The selection of several variables was based on their relationship to each other in theory and solid empirical research support. The research object was chosen because microfinance institutions are vulnerable to fraud that hurts the organization. The triggers include the absence of government supervision regulations, weak standard operating procedures for corporate governance, and there is no periodic control by the related institution. KSP Amanat Kesejahteraan Rakyat is a microfinance institution as the object of research because of its contribution to distributing funds to unbanked customers. This institution has only been established for four years but already has six branches spread across various sub-districts and is one of the largest microfinance institutions in the Malang Regency, Indonesia.

## LITERATURE REVIEW

### Employee Performance

Employee performance is a person's capacity to complete work that contributes to organizational development and determines organizational success (Yang & Wei, 2017). Employee performance consists of task and contextual performance. Task performance is formally recognized as part of one's job in return for a salary, while contextual performance is informally focused on one's job, such as organizational citizenship behavior (Kluemper et al., 2013; Mohd Nasurdin et al., 2020).

Task performance refers to technical work and behavior in

achieving organizational goals. Therefore, in completing task performance, employees must have knowledge, skills, abilities, and task skills (Bhardwaj & Kalia, 2021). That is, employees with the skills and technical knowledge are expected to produce goods or services that benefit the organization. Meanwhile, contextual performance refers to the tendency and willingness of employees. Contextual performance is not directly related to the technical work but supports the organizational, social and psychological environment. Contextual performance behaviors include volunteering to help co-workers who are behind on work, acting to maintain working relationships, and the extra tasks (Santos, Reis Neto, & Verwaal, 2018).

Previous research explains that contextual performance is helpful for organizations. First, contextual performance involves the effort to increase the work effectiveness of employees and managers. Second, helpful, caring, and cooperative behavior is expected to increase workgroup effectiveness, improve coordination, and control the organization by reducing employee friction. Third, innovative and voluntary behavior increases the organization to solve unexpected problems (Van Scotter, 2000).

### **Ethical Leadership**

The results of empirical studies and theoretical support state that leadership behavior, in addition to influencing organizational culture, determines the way of thinking and behavior of organizational members and impacts employee performance. Ethical leadership refers to values and actions that conform to ethical norms through personal actions and interpersonal relationships. Ethical leadership demonstrates leader behavior to followers through two-way communication, reinforcement, and decision-making (Nguyen et al., 2021; Yang & Wei, 2017). Ethical leaders treat others with respect for their rights and dignity. Previous studies also emphasized the sub-components of ethical leadership characteristics, including people-oriented/human-oriented leaders, integrity, fairness, simplicity, and responsibility (Eisenbeiss, van Knippenberg, & Fahrbach, 2015). The substance of ethical leadership consists of two dimensions, namely moral managers and moral employees. A moral manager sets moral standards using rewards, while a moral employee refers to behaviors such as honesty, trustworthiness, and concern for others.

Ethical leaders are oriented to how employees understand their duties by clarifying the organization's tasks. It aims to help employees understand the responsibilities, expectations, and targets. Clear responsibilities and goal setting contribute to job completion and improve employee performance (Kalshoven, Den Hartog, & De Hoogh, 2011). Ethical leaders create attractive role models so that their followers imitate their ethical behavior. Ethical decision-making theory suggests that individuals learn from the people, and subordinates will imitate the behavior. Researchers have examined the effectiveness of the relationship between ethical leadership and employee

performance. Most studies show that ethical leadership positively affects employee performance (Piccolo, Greenbaum, Hartog, & Folger, 2010; Schwepker & Dimitriou, 2021; Yang & Wei, 2017). Employee trust in ethical leaders has an impact on improving performance. Based on the explanation of the concept and previous empirical research on the influence of ethical leadership on employee performance, the hypotheses of this research are:

Ha: Ethical leadership has a significant effect on employee performance.

### **Compensation**

Compensation is an essential part of the human resource management function because it is the core of the relationship between employees and superiors. Employees expect compensation for the stability of lives, while managers rely on employees for the company's sustainability. Motivation theory asserts that compensation is the primary stimulus in improving employee performance, which is related to social exchange between employees and leaders (Kim & Jang, 2020). Compensation rewards employees who feel valued and do various organizational tasks (Mohd Nasurdin et al., 2020). The provision of compensation to employees is divided into two types: tangible compensation such as salaries and incentives. In contrast, intangible compensation includes verbal praise, guaranteed promotions, and internal or external recognition (Kim & Jang, 2020).

Several empirical studies show a significant relationship between compensation and employee (Kim & Jang, 2020; Küster & Canales, 2011; Mohd Nasurdin et al., 2020; Shiah-Hou & Cheng, 2012). Employees who have received positive rewards tend to show recursive behavior in the future (Kim & Jang, 2020). Employees will behave to positive rewards and avoid activities that lead to negative rewards. This pattern of behavior implies that high rewards follow high employee performance. Employee motivation and behavior in the workplace are also influenced by perceived fairness. Employees who feel mistreated will reduce the effort expended or leave their job (Kim & Jang, 2020). The research above highlights the effect of compensation on employee behavior in the organization, which impacts employee and company performance.

Based on the explanation of the concept and previous empirical research on the effect of compensation on employee performance, the hypotheses of this research are:

Ha: Compensation has a significant effect on employee performance

### **Organizational culture**

Several definitions of organizational culture include the identity that differentiates one organization from another. That is, organizational culture describes what the organization looks like, how it operates, focuses on, and treats customers, employees, and shareholders (AlShehhi, AlZaabi, Alnahhal, Sakhrieh, & Tabash, 2021). Another definition states it is a value system that all members

believe in the organization, adhere to, implement in behavior, and develop as a company reference system in achieving goals (Pawirosumarto et al., 2017; Raharjo et al., 2018). Previous studies on organizational culture have studied the model developed by Schein and Martin (Yaari, Blit-Cohen, & Savaya, 2021). Schein's model deals with artifacts, values, and basic assumptions (Schein, 2004). Artifact levels are what is seen, heard, and felt in the organization. The second levels are latent (hidden) values, but members of the organization are aware of them. The values are related to perceptions of acceptable behavior in the organization. The organization adopts these values and what it wants to achieve, although they do not have to be implemented as daily norms. When these values are deeply rooted in organizational culture, they will guide employees' work behavior and have an impact on performance.

In contrast to Schein's model, Martin proposes three organizational cultural perspectives: integration, differentiation, and fragmentation (Martin, 1992). From the perspective of integration, there is consensus among all organizational groups about organizational values, norms, and certainty. Differentiation perspective, there are differences in organizational group cultures, values, and norms that are appropriate for one group but not for another. In contrast, there is some consensus but not overall. There are differences between subcultures as well as between departments. The fragmentation perspectives state the potential for inconsistency in subcultures, which is a permanent characteristic of organizational culture. Martin (1992) states that every organization has several cultures related to integration, differentiation, and fragmentation. Schein and Martin's organizational culture models are both aligned with the dominant type of culture and sub-culture culture (Robbins & Judge, 2013). The dominant culture is the values of company members, while a sub-culture is a mini culture of different departments and geography. Both the dominant culture and the sub-culture culture play a role in guiding the daily work behavior of employees and have an impact on organizational performance.

Previous findings showed different variations. Organizational culture has no significant effect on employee performance (Pawirosumarto et al., 2017). This means that organizational culture has no impact on improving employee performance. The existing organizational culture is considered less than optimal for employees and is considered less than optimal. Pawirosumarto et al. (2017) used seven dimensions: innovation and risk-taking, attention to details, accuracy at work, result orientation, employee orientation, team orientation, aggression and enthusiasm at work, and stability.

Meanwhile, other studies have shown significant results (AlShehhi et al., 2021; Raharjo et al., 2018). That is, a solid organizational culture enhances good performance as well. The cultural dimensions developed by Raharjo et al. (2018) include career, control, opportunities, decision making, and employee careers in measuring organizational culture. Based on previous empirical research, the hypotheses of

this research are:

Ha: Organizational culture has a significant effect on employee performance

## METHOD

This study uses a quantitative approach related to the systematic investigation of social phenomena. Using statistical or numerical data involves measurement and assumes that the phenomenon under study can be measured (Watson, 2015). The structure of the questionnaire consists of several statements related to ethical leadership variables (Eisenbeiss et al., 2015), compensation (Kim & Jang, 2020), organizational culture, and employee (Pawirosumarto et al., 2017). Ethical leadership indicators include people/human orientation, integrity, fairness, modesty, and responsibility (Eisenbeiss et al., 2015). Compensation indicators include salaries, incentives, praise, guaranteed promotions, and internal and external recognition (Kim & Jang, 2020). Indicators of organizational culture include innovation and risk-taking, accuracy in work, result orientation, employee orientation, team orientation, aggression and enthusiasm at work, and stability (Pawirosumarto et al., 2017). Meanwhile, performance indicators include quality, quantity, efficiency, effectiveness, supervision, and self-influence (Pawirosumarto et al., 2017). Each respondent's statement was asked to rate on a five-point scale (Likert scale) ranging from 1 (very dissatisfied), 2 (not satisfied), 3 (quite happy), 4 (comfortable), and 5 (very satisfied). The research sample was 42 employees from KSP Amanat Kesejahteraan Rakyat, Malang, East Java, with census techniques (Nirel & Glickman, 2009). Data analysis used multiple linear regression (Moore, Anderson, Das, & Wong, 2006) to analyze the relationship between a single dependent variable (employee performance) and several independent variables, namely ethical leadership (x1), compensation (x2), and organizational culture (x3).

## RESULTS AND DISCUSSION

### Validity test

The validity test of the research instrument aims to determine whether an instrument has met the criteria for a valid value if it is used as a data or information mining tool (Taherdoost, 2016). The test criteria are if the correlation coefficient  $r_{stat} > r_{table}$ , the questionnaire item is valid. The results of the validity test are presented in the following table:

[Table 1 about here.]

The results of the calculation of the product-moment correlation in Table 1 above show that the instruments are valid, with a value of  $r$  greater than  $r_{table}$  (0.312). This means that all instruments can be used as a data collection tool.

### Reliability Test

The reliability test was used to measure the reliability of the research instrument with the Alpha Cronbach technique (Taherdoost, 2016). The stipulation is that if the Cronbach Alpha value is greater than 0.60, an instrument is reliable, and vice versa. The results of the reliability test of this research instrument are as follows:

[Table 2 about here.]

The table above shows that the Cronbach Alpha value is greater than 0.6, meaning that all instruments are reliable for data collection.

### Multiple Linear Regression Analysis

The results of multiple linear regression test the effect of Ethical Leadership (X1), Compensation (X2), and Organizational Culture (X3) on Performance (Y) are as follows:

[Table 3 about here.]

Statistically, the ethical leadership variable has no significant effect, indicated by a  $p$ -value greater than 0.05; the compensation variable has a significant effect because the  $p$ -value is less than 0.05. In contrast, the organizational culture variable has a significant effect because of  $p$ -value is less than 0.05.

### Ethical Leadership

The results of this study indicate that ethical leadership has no significant effect on the performance of microfinance employees, and the increase in employee performance is not influenced by ethical leadership. The reason underlying the results of this study is that the implementation of values such as employee orientation, integrity, fairness, simplicity, and responsibility are not the primary work guidelines and improve their performance. Ethical leadership is beneficial and has an effect on improving employee performance if there are other influencing factors, such as the results of previous research explaining that ethical leadership does not directly affect employee performance but is mediated and moderated by ethical culture and corporate ethics programs (Eisenbeiss et al., 2015). This means that the effectiveness of ethical leadership in influencing organizational performance depends on a solid organizational ethics program.

The organization's ethics program includes creating ethical leadership patterns, risk assessment, operational supervision, ethical guidelines and behavioral standards, socialization of corporate cultural values, reward and punishment standards, and ongoing revision of ethics programs. The organizational ethics programs should be carried out by the company's leadership effectively. Through a living example pattern, a code of conduct at vulnerable points (e.g., forgery, fictitious transactions, and manipulation), the leadership as an ethics committee,

providing a sense of security to employees who report fraud and so on, is a bridge to ethical leadership. Because of the neglect of these ethical programs, likely, ethical leadership does not change employee performance.

Another interpretation shows that leaders have not fully implemented ethical leadership values, such as leaders are not always employee-oriented and have not shown high integrity. The company leadership does not in detail introduce the code of ethics to new employees (management trainees). Leaders emphasize achieving company targets, either landing or funding economically. Regular morning and evening meetings focus on the company's profit strategy and efforts to overcome net-performing loans. The impact is that employees tend to pay attention to the direction of the leadership in the context of economic achievements beyond the ethics attached to their leadership. This fact indicates that the leadership in decision-making is always done top-down. So ethical leadership values such as employee orientation, integrity, fairness, simplicity, and responsibility can become guidelines and work culture in cooperatives. Cooperative leaders should provide examples or examples of continuous implementation of ethical values that will lead to collaborative work culture. The results of previous studies support this study; namely, ethical leadership has no significant effect on performance (Harmoko & Sulisty, 2014). These results explain that elements such as appropriate behavior, service opportunities for achievement, and the values of leaders' honesty are not appropriately implemented, resulting in poor organizational goals, attitudes, and productivity.

### Compensation

The finding showed that compensation significantly affects the performance of microfinance employees. That is, compensation is effective in improving employee performance. Several reasons underlie the results of this study that employees who receive appropriate and fair compensation tend to show positive work behavior, leading to increased employee performance. Furthermore, implementing good compensation in the company serves as a stimulus for employees in increasing the company's output to a greater extent. This pattern of behavior shows that high compensation is followed by high employee performance. Payment can be tangible, such as salaries and incentives, or intangible, such as praise and rewards from management to employees. This compensation will direct employees to be positive and repetitive to improve performance.

Respondents' answers also showed positive results. Employees responded well to the salary and incentive system in microfinance institutions. This means that the compensation given to employees is assessed according to the duties and responsibilities of the employee. Incentives are also given when employees meet the work targets that have been set. In addition, non-material compensation is also given to employees, such as praise and recognition when employees perform well. This fact shows that

implementing compensation in these institutions affects employee work behavior, linearly improves employee performance, and leads to organizational performance in the future. This study's results align with previous research that compensation has a significant effect on employee performance (Kim & Jang, 2020; Küster & Canales, 2011; Mohd Nasurdin et al., 2020; Shiah-Hou & Cheng, 2012).

### Organizational culture

The results indicate that organizational culture significantly negatively affects employee performance. Secondary data on the company's performance also shows that the company's receivables are still significant, and this receivable is due to the low settlement of customer liability. Another fact also shows that account officers work with results orientation, innovate and dare to take risks, especially in achieving company targets in terms of providing financing approvals. However, there are weaknesses in analyzing customer eligibility, business guarantees, customer business feasibility, ability to pay, and others. These weaknesses are suspected to be the cause of the increase in the company's non-performing finance. This fact shows that the work culture built both in the form of result orientation and risk audacity is not entirely linear with achieving results if a comprehensive analysis does not follow it. This indicates that the company's quality, efficiency, effectiveness, and internal control are still low.

The facts show that several things need to be considered so that good work culture, such as innovation, willingness to take risks, and results orientation, contributes positively to employee performance through good corporate governance. First, the principles of thoroughness, prudence, and responsibility must be emphasized and applied by employees when analyzing customer eligibility in terms of business guarantees, customer business feasibility, ability to pay, and others. Second, there must be a straightforward standard operating procedure in conducting a financing analysis that will be used as a working guide for employees. Third, the leadership is responsible for monitoring and evaluating employee performance when providing customer financing approvals. If these three things become the primary concern and are applied in cooperatives, then high performance will be fulfilled in terms of quality, quantity, effectiveness, and efficiency. The arguments above are in tune with the principles of Good Corporate Governance, including fairness, accountability, responsibility, transparency, and independence (Burak, O. Erdil, & E. Altındağ, 2017). Implementing these principles is the primary basis for the organization to sustain performance.

The findings of this study contradict previous studies. Pawirosumarto et al. (2017) explained in their study that organizational culture has no significant effect on employee performance. Corporate culture such as innovation and risk-taking, accuracy in work, result orientation, employee orientation, team orientation, aggressive and enthusiasm at work, and stability are not optimal, so they are not used as a reference for completing

the work. Meanwhile, the organizational culture in this study is implemented and becomes a reference for employees in completing their duties and responsibilities.

Other studies also show results that are not in line with the results of this study. Raharjo et al. (2018) explain in their study that organizational culture significantly positively affects employee performance. They explain that implementing a solid work culture improves employee performance effectively. While this study indicated something else, organizational culture hurts performance. The implementation of culture must be balanced with an increase in other variables such as good governance. Empirical facts show that good corporate governance has not been found for small-scale companies such as cooperative institutions. The consequences of this fact lead to an increase in a culture that is not linear with the final performance.

### CONCLUSION

Employees in the organization are strategic resources an organization. The output resulting from the implementation of employee duties is called performance. High employee performance on an ongoing basis can affect the organization's success in the future. Employee performance cannot be separated from influencing factors, including ethical leadership, compensation, and work culture. This study indicates that ethical leadership has no significant effect on employee performance. Second, compensation has a significant effect on employee performance. Third, this study also indicates that organizational culture significantly negatively affects organizational employee performance.

This study provides positive implications to improve employee performance by implementing direct and indirect compensation and organizational culture as a working guide in carrying out employee duties and responsibilities. However, organizational culture in micro-companies needs to be balanced with good corporate governance to be followed by high employee performance results. The development of this research can examine the correlation between organizational culture and micro-scale organizational governance to strengthen the argument of this research.

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**TABLE 1**/Validity Test Results

<b>Variable</b>	<b>Item</b>	<b>r</b>
X <sub>1</sub> (Ethical Leadership)	X1.1	0.351
	X1.2	0.377
	X1.3	0.415
	X1.4	0.392
	X1.5	0.430
X <sub>2</sub> (Compensation)	X2.1	0.457
	X2.2	0.575
	X2.3	0.340
	X2.4	0.406
	X2.5	0.509
X <sub>3</sub> (Organizational Culture)	X3.1	0.400
	X3.2	0.509
	X3.3	0.366
	X3.4	0.451
	X3.5	0.429
	X3.6	0.532
	X3.7	0.353
Y (Performance)	Y.1	0.315
	Y.2	0.432
	Y.3	0.419
	Y.4	0.768
	Y.5	0.405
	Y.6	0.344

**TABLE 2/Reliability Test Results**

<b>Variable</b>	<b>Cronbach's Alpha</b>
X <sub>1</sub>	0.673
X <sub>2</sub>	0.659
X <sub>3</sub>	0.710
Y	0.623

**TABLE 3/**Results of Multiple Linear Regression Analysis

<b>Model</b>	<b><math>\beta</math>-value</b>	<b>Std. Error</b>	<b>t</b>	<b>Sig</b>	<b>Descriptions</b>
(Constant)	3.733	.867	4.308	.000	
Ethical Leadership (X1)	-.014	.142	-.097	.923	Refuse
Compensation (X2)	.537	.138	3.876	.000	Support
Organizational Culture (X3)	-.388	.186	-2.080	.044	Support
F-value	= 5.592				
Sig	= .000				
R	= .553 <sup>a</sup>				
R <sup>2</sup>	= .306				
n	= 42				