The Impact of Compensation on Employee Performance in Commercial Banks in Kigali City, Rwanda

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Abstract- This study investigates the impact of compensation on employee performance in commercial banks in Kigali City, Rwanda. The banking sector plays a crucial role in Rwanda's economy, but there are concerns about employee motivation and high turnover intentions. The study aims to examine the relationship between various compensation components (monetary incentives, health insurance benefits, transportation benefits, and professional development opportunities) and employee performance. The research employs a descriptive research design with both descriptive and explanatory components, using a quantitative approach. A sample of 180 employees from 10 commercial banks in Kigali City was selected using stratified random sampling. Data was collected through a structured questionnaire and analyzed using descriptive and inferential statistics. The findings reveal that monetary incentives and health insurance benefits have the strongest positive correlations with employee performance, while professional development opportunities are rated poorly and have the weakest impact. Overall compensation significantly influences employee performance, with the multiple regression model explaining 69.4% of the variance. The results align with Maslow's Hierarchy of Needs and Herzberg's Two-Factor Theory, emphasizing the importance of addressing both basic and growth needs. The study concludes that compensation plays a crucial role in driving employee performance in Rwandan commercial banks and recommends that banks implement balanced compensation strategies, regularly review and adjust packages, and improve professional development programs. Policy makers are advised to develop guidelines for minimum compensation standards, create incentives for employee development, and promote transparency in compensation practices. The findings contribute to the understanding of compensation's impact on employee performance in the Rwandan banking sector and provide valuable insights for banks and policy makers to enhance motivation and retention strategies.

Indexed Terms- Compensation, Employee Performance, Commercial Banks, Rwanda, Motivation

I. INTRODUCTION

Background on the importance of compensation in motivating employees:

Compensation plays a crucial role in motivating employees and influencing their performance within organizations. As Tulaseenaidu (2018) notes, compensation is the remuneration received by employees in exchange for their contribution to the organization. It encompasses both monetary and non-monetary benefits, including salaries, bonuses, profit sharing, overtime pay, recognition rewards, and sales commissions. Effective compensation management is essential for attracting, retaining, and motivating talented employees, which in turn contributes to organizational effectiveness and success.

Brief overview of the banking sector in Rwanda:

The banking sector is a significant contributor to Rwanda's economy. According to the National Bank of Rwanda (2018-2019), commercial banks account for 97.4% of banking industry assets and 97.2% of total banking deposits in Rwanda. The sector plays a critical role in mobilizing resources and investing in various economic sectors, thereby fostering economic growth. However, employees in Rwandan commercial banks work under competitive pressure to serve both internal and external customers (Rahman, 2013a), highlighting the importance of effective motivation strategies.

Problem statement:
Despite the crucial role of the banking sector in Rwanda's economy, there are growing concerns about the ability of firms to keep their employees motivated for optimal performance. The National Bank of Rwanda (2018-2019) reported that most commercial banks in Rwanda lacked mitigating strategies to retain their trained and experienced employees, which hampered their operational performance. This issue manifested in delays in cheque clearing and payment, time wasted in bank halls as customers queued for service, errors, and fraud-related cases. Furthermore, field data collected by the National Bank (2020) indicated that approximately 68.8% of employees intended to leave their banks in the near future, with 23.0% unsure if they could remain due to heavy workloads. This high turnover intention and dissatisfaction among employees pose a significant threat to the sector's stability and performance.

Research objectives:
The main objective of this study is to determine the effect of compensation on employee performance in commercial banks in Kigali City, Rwanda. Specifically, the study aims to:

1. Examine the relationship between monetary incentives and employee performance.
2. Assess the impact of health insurance benefits on employee performance.
3. Evaluate the influence of transportation benefits on employee performance.
4. Investigate the effect of professional development opportunities on employee performance.

Significance of the study:
Firstly, the findings will provide invaluable insights for commercial banks, enabling them to assess the effectiveness of their current compensation strategies. By understanding the relative importance of various compensation components, such as monetary incentives, health insurance benefits, transportation benefits, and professional development opportunities, banks can refine their approaches to better motivate and retain employees. This, in turn, can lead to improved organizational performance, as motivated employees are more likely to deliver high-quality work and contribute to the bank's success.

Moreover, the study's results will inform policymakers in their decision-making processes related to labor practices in the banking sector. The insights gained from this research may prompt the development of improved regulations that foster better working conditions and employee motivation. Such policies can help create a more stable and productive banking sector, which is crucial for the overall economic growth of Rwanda.

The study's outcomes also have the potential to directly benefit employees in the banking sector. By highlighting the importance of various compensation components and their impact on performance, the study may encourage banks to improve their compensation practices. This could lead to better working conditions, increased job satisfaction, and enhanced career development opportunities for bank employees in Rwanda.

II. LITERATURE REVIEW

Theoretical framework:
Maslow's Hierarchy of Needs Theory, proposed by Abraham Maslow in 1943, is a significant theoretical framework that can be applied to the context of compensation and employee motivation. The theory suggests that human needs are organized in a hierarchical order, consisting of five levels: physiological, safety, love/belonging, esteem, and self-actualization. In terms of compensation, physiological needs can be met through a basic salary that covers essential needs such as food and shelter. Safety needs can be addressed by providing job security, health insurance, and retirement benefits. Love/belonging needs can be fulfilled through fostering positive work relationships and organizing team bonding activities. Esteem needs can be met by offering recognition, promotions, and status symbols. Finally, self-actualization needs can be satisfied by providing challenging work, autonomy, and opportunities for growth. To effectively motivate employees, compensation strategies should take into account these various levels of needs and strive to address them accordingly.

Frederick Herzberg's Two-Factor Theory, also known as the Motivation-Hygiene Theory, is another important theoretical framework that sheds light on the factors influencing job satisfaction and dissatisfaction. According to this theory, two distinct sets of factors impact employee motivation: hygiene factors and motivators. Hygiene factors are extrinsic factors that, when absent, lead to job dissatisfaction; however, their presence does not necessarily motivate employees. These factors include salary, job security, working conditions, and company policies. On the other hand, motivators are intrinsic factors that, when present, lead to job satisfaction and motivation. These factors include achievement, recognition, responsibility, and growth opportunities.

The Two-Factor Theory highlights the importance of addressing both hygiene factors and motivators in compensation strategies. While ensuring that hygiene factors are met is crucial for preventing job dissatisfaction, it is equally important to focus on providing motivators to truly enhance employee motivation and performance. This theory suggests that a comprehensive approach to compensation, which goes beyond merely offering competitive salaries and benefits, is necessary to create a highly motivated workforce.

Empirical review of previous studies on compensation and employee performance:
Several empirical studies have investigated the relationship between compensation and employee performance across various contexts. Mangale (2016) conducted a study on the effects of compensation on employee productivity at Kenya Literature Bureau. The findings revealed that direct financial compensation, indirect compensation, and non-financial compensation all had positive effects on employee productivity. This suggests that a comprehensive approach to compensation, encompassing both monetary and non-monetary rewards, can significantly enhance employee performance.

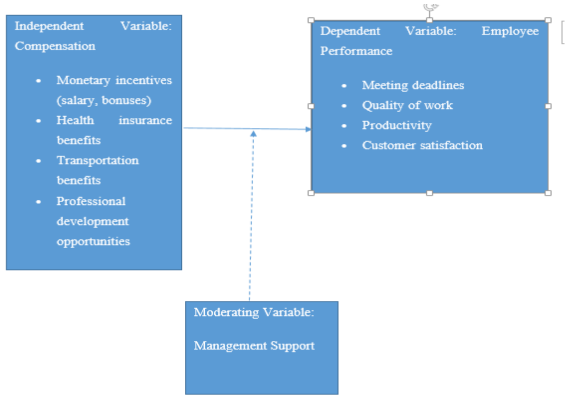
In the context of the banking industry, Irshad (2016) investigated the impact of extrinsic rewards on employee performance in the United Arab Emirates. The study concluded that salary and working conditions significantly impact employee performance. Similarly, Ali et al. (2015) analyzed extrinsic rewards and employee satisfaction in Somtel Company, Somaliland. Their findings revealed a positive relationship between extrinsic rewards, such as salaries, bonus payments, regular commissions, and working conditions, and employee satisfaction. These studies underscore the importance of competitive compensation packages and favorable working environments in driving employee performance and satisfaction within the banking sector.

However, the role of motivation in employee performance may vary across different cultural contexts. Abusharbeh & Nazzal (2018) studied the role of motivation in employee performance in the Palestinian banking industry. Interestingly, they found that moral motivations significantly and positively predicted employee performance, while material and social incentives did not. This finding suggests that in some contexts, intrinsic factors such as moral motivations may be more influential in driving employee performance than extrinsic rewards.

In the Rwandan context, Uwineza & Muturi (2015) examined the effects of extrinsic rewards on employee performance in public institutions. Their study concluded that financial incentives were directly related to workforce production and recommended comprehensive incentive plans in every area of business. This emphasizes the need for well-designed compensation strategies that align with organizational goals and employee needs to foster optimal performance.

Overall, these empirical studies provide valuable insights into the complex relationship between compensation and employee performance. While the majority of the studies highlight the positive impact of various forms of compensation on performance, the findings also suggest that the effectiveness of different compensation components may vary depending on the specific context and cultural factors. Therefore, it is crucial for organizations to consider their unique circumstances when designing compensation strategies to maximize employee performance and satisfaction.

Conceptual framework:



Research gaps identified:
The review of empirical studies on compensation and employee performance has revealed several research gaps that warrant further investigation, particularly in the context of the Rwandan banking sector. Firstly, there is limited research specifically focusing on the impact of compensation on employee performance within Rwandan banks. While studies have been conducted in other countries and industries, the unique cultural, economic, and regulatory environment of Rwanda may influence the relationship between compensation and performance differently. Therefore, there is a need for more context-specific research to provide insights that are directly applicable to the Rwandan banking sector.

Secondly, there is a lack of studies examining the relative importance of different compensation components, such as monetary versus non-monetary rewards, in the African banking context. Different aspects of compensation may have varying degrees of influence on employee performance, and understanding these nuances is crucial for designing effective compensation strategies. Comparative studies that explore the impact of various compensation components on performance in the African banking sector would provide valuable insights for decision-makers.

Thirdly, the moderating role of management support in the relationship between compensation and employee performance has not been sufficiently explored. Management support, in terms of leadership style, communication, and the overall organizational culture, may significantly influence the effectiveness of compensation strategies. Investigating how management support interacts with compensation to impact employee performance would provide a more comprehensive understanding of the dynamics at play. Fourthly, there is a scarcity of longitudinal studies assessing the long-term effects of compensation strategies on employee performance and retention in the banking sector. Most existing studies have adopted cross-sectional designs, which provide a snapshot of the relationship at a single point in time. However, the impact of compensation on performance and retention may evolve over time, and longitudinal studies would help capture these temporal dynamics and provide insights into the sustainability of compensation strategies.

Lastly, there is a lack of comparative studies between different types of banks, such as commercial banks versus microfinance institutions, in terms of their compensation strategies and the resulting effects on employee performance. Different types of banks may have distinct organizational structures, target markets, and financial resources, which can influence their approach to compensation. Comparative studies would shed light on the potential variations in the effectiveness of compensation strategies across different types of banks and inform tailored recommendations for each segment.

These identified research gaps highlight the need for more context-specific, nuanced, and longitudinal research in the Rwandan banking sector. By addressing these gaps, future studies can provide valuable insights that inform the development and implementation of effective compensation strategies, ultimately enhancing employee performance and contributing to the overall success of Rwandan banks.

III. METHODOLOGY

Research design: A descriptive research design with both descriptive and explanatory components was employed in this study. The descriptive aspect allowed for the characterization of compensation practices and employee performance in commercial banks, while the explanatory component enabled the examination of the cause-effect relationship between compensation and employee performance. A quantitative approach

was used to collect and analyze numerical data, facilitating statistical analysis and hypothesis testing.
Target population and sampling: The target population consisted of 1,500 employees working in 10 commercial banks located in Kigali City, as reported in the National Bank of Rwanda Report 2021-2022. A stratified random sampling technique was used to select a sample of 180 employees from the target population. The population was stratified based on the banks, and then simple random sampling was applied within each stratum to select 18 respondents from each bank. This approach ensured representation from all banks and gave each employee an equal chance of being selected. The sample size was determined using Yamane's (1967) formula with a 95% confidence level and a 5% margin of error.

Data collection methods: Primary data was collected using a structured questionnaire administered to the selected employees of the commercial banks in Kigali City. The questionnaire consisted of closed-ended questions using a five-point Likert scale (strongly disagree to strongly agree) to measure respondents' perceptions of compensation factors and their impact on employee performance. The questionnaires were self-administered and distributed to the respondents in hard copy format. Respondents were given one week to complete the questionnaires, after which they were collected for analysis.

Reliability and validity: To ensure the reliability and validity of the research instrument, several measures were taken. A pilot test was conducted with 30 employees from two banks not included in the main study to assess the internal consistency of the questionnaire items using Cronbach's alpha. The overall Cronbach's alpha coefficient was 0.876, indicating high reliability. Face validity was established through a review of the questionnaire by experts in human resource management and organizational behavior. Content validity was assessed by a panel of three experts to ensure the questionnaire adequately covered all aspects of compensation and employee performance relevant to the study objectives. The average content validity index was 0.76, indicating acceptable validity. Construct validity was confirmed through factor analysis.

Data analysis techniques: Both descriptive and inferential statistics were used to analyze the data, facilitated by the Statistical Package for Social Sciences (SPSS) version 26. Descriptive statistics, including frequencies, percentages, means, and standard deviations, were used to summarize the demographic characteristics of the respondents and their responses to the questionnaire items related to compensation and performance. Inferential statistics, such as correlation analysis, simple linear regression, multiple linear regression, and hierarchical regression, were employed to examine the relationships between compensation variables and employee performance, as well as to test the moderating effect of management support.

Ethical considerations: Approval was obtained from the Kibabii University Institutional Ethics Review Committee before commencing the study. Informed consent was obtained from all participants, and their anonymity and confidentiality were assured throughout the research process.

IV. RESULTS AND DISCUSSION

Descriptive statistics on compensation variables:

Table 4.1: Descriptive Statistics for Compensation Variables

Variable	Mean	Std. Deviation
Monetary Incentives	3.51	1.271
Health Insurance	3.54	1.051
Transportation Benefits	3.30	1.168
Professional Development	2.05	1.339
Overall Compensation	3.12	1.243

The results in Table 4.1 show that health insurance benefits had the highest mean score (3.54), followed closely by monetary incentives (3.51). This suggests that employees generally viewed these aspects of compensation positively. Transportation benefits were also rated fairly positively (3.30). However, professional development opportunities received a low rating (2.05), indicating potential dissatisfaction in this area.

Correlation analysis between compensation and employee performance:

Table 4.2: Correlation Analysis Results

Variable	Correlation Coefficient	Sig. (2-tailed)
Monetary Incentives	0.712**	0.000
Health Insurance	0.689**	0.000
Transportation Benefits	0.573**	0.000
Professional Development	0.421**	0.000
Overall Compensation	0.784**	0.000

** Correlation is significant at the 0.01 level (2-tailed)

Table 4.2 shows that all compensation variables have significant positive correlations with employee performance. The strongest correlation is between overall compensation and employee performance ($r = 0.784$, $p < 0.01$), followed by monetary incentives ($r = 0.712$, $p < 0.01$).

Regression analysis results:

Table 4.3: Simple Linear Regression Results

Variable	R Square	F	Sig.	Unstandardized B	Standardized Beta
Monetary Incentives	0.507	171.234	0.000	0.562	0.712
Health Insurance	0.475	151.687	0.000	0.654	0.689
Transportation Benefits	0.328	81.762	0.000	0.490	0.573
Professional Development	0.177	36.058	0.000	0.314	0.421
Overall Compensation	0.615	267.803	0.000	0.630	0.784

Table 4.4: Multiple Linear Regression Results

Variable	Unstandardized B	Standardized Beta	t	Sig.
(Constant)	1.276		3.987	0.000
Monetary Incentives	0.312	0.395	5.621	0.000
Health Insurance	0.287	0.302	4.436	0.000
Transportation Benefits	0.156	0.182	2.874	0.005
Professional Development	0.089	0.119	2.013	0.046
R Square = 0.694, Adjusted R Square = 0.686, F = 93.452, Sig. = 0.000				

Discussion of key findings in relation to literature and theories:

Importance of monetary incentives:

The strong correlation ($r = 0.712$) and significant impact ($\beta = 0.395$, $p < 0.001$) of monetary incentives on employee performance align with Herzberg's Two-Factor Theory, which identifies salary as a hygiene factor. This supports findings by Irshad (2016) in the UAE banking sector, emphasizing the crucial role of competitive salaries in motivating employees. The results underscore the importance of ensuring that employees' basic financial needs are met through adequate monetary compensation, as this forms the foundation for job satisfaction and motivation.

Health insurance as a motivator:

The high mean score (3.54) and significant impact ($\beta = 0.302$, $p < 0.001$) of health insurance benefits on employee performance correspond to Maslow's safety needs. This aligns with Ali et al.'s (2015) study in Somaliland, highlighting the importance of comprehensive benefits packages in enhancing employee satisfaction and performance. By providing health insurance, banks can create a sense of security and well-being among their employees, which in turn fosters a more motivated and productive workforce.

Transportation benefits:
While showing a moderate correlation ($r = 0.573$) and impact ($\beta = 0.182$, $p = 0.005$) on performance, transportation benefits were not as influential as monetary incentives or health insurance. This suggests that while important, they may be viewed more as a hygiene factor in Herzberg's theory, preventing dissatisfaction rather than actively motivating employees. Transportation benefits can help alleviate the stress and financial burden associated with commuting, but they may not be as effective in driving performance compared to other compensation components.

Professional development opportunities:
The low mean score (2.05) and relatively weak impact ($\beta = 0.119$, $p = 0.046$) of professional development on performance are concerning. This contrasts with Maslow's self-actualization needs and Herzberg's motivators, suggesting a potential area for improvement in Rwandan banks. The finding diverges from Mangale's (2016) study in Kenya, which found a positive effect of training on productivity. The lack of emphasis on professional development may hinder employees' growth and long-term motivation, as they may feel stagnant in their roles and unable to reach their full potential.

Overall compensation impact:
The strong correlation ($r = 0.784$) and high explanatory power ($R^2 = 0.615$) of overall compensation on employee performance support the general premise that comprehensive compensation packages significantly influence employee performance. This aligns with Uwineza & Muturi's (2015) findings in Rwandan public institutions, emphasizing the need for holistic compensation strategies. A well-designed compensation package that addresses various aspects of employee needs, from basic financial security to opportunities for growth and development, can create a highly motivated and engaged workforce.

V. CONCLUSION AND RECOMMENDATIONS

Summary of key findings:
1. Monetary incentives and health insurance benefits showed the strongest positive correlations with employee performance ($r = 0.712$ and $r = 0.689$ respectively).
2. Overall compensation had a significant impact on employee performance, explaining 61.5% of the variance ($R^2 = 0.615$).
3. Professional development opportunities were rated poorly (mean = 2.05) and had the weakest impact on performance ($\beta = 0.119$).
4. Transportation benefits had a moderate impact on employee performance ($\beta = 0.182$).
5. The multiple regression model including all compensation components explained 69.4% of the variance in employee performance (Adjusted $R^2 = 0.686$).

Conclusions drawn from the results:
1. Compensation plays a crucial role in driving employee performance in Rwandan commercial banks.
2. Monetary incentives and health insurance benefits are the most influential components of compensation in motivating employees.
3. There is a significant gap in the provision and perceived value of professional development opportunities.
4. A comprehensive approach to compensation, addressing various employee needs, is more effective than focusing on individual components.
5. The impact of compensation on performance aligns with both Maslow's Hierarchy of Needs and Herzberg's Two-Factor Theory, emphasizing the importance of addressing both basic and growth needs.

Recommendations for commercial banks:
1. Regularly review and adjust monetary compensation packages to ensure they remain competitive within the industry.
2. Maintain and potentially enhance health insurance benefits, as they are highly valued by employees and significantly impact performance.
3. Critically evaluate and improve professional development programs to address the current perceived inadequacy and boost employee growth and performance.
4. Develop a more comprehensive transportation benefits package that may include options like fuel allowances, car loans, or partnerships with transportation providers.

5. Implement a balanced compensation strategy that addresses both extrinsic (e.g., salary, benefits) and intrinsic (e.g., recognition, career growth) motivators.
6. Conduct regular employee surveys to assess satisfaction with various compensation components and adjust strategies accordingly.

Recommendations for policy makers:
1. Develop guidelines for minimum standards of employee compensation in the banking sector, including both monetary and non-monetary benefits.
2. Create incentives for banks that invest in comprehensive employee development programs, such as tax benefits or recognition awards.
3. Establish a regulatory framework that promotes transparency in compensation practices across the banking sector.
4. Collaborate with educational institutions to develop programs that address the specific skill needs of the banking sector, enhancing the overall quality of professional development.
5. Implement policies that encourage work-life balance and employee well-being, which can complement banks' compensation strategies.

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