THE EFFECT OF STRATEGIC PAY SYSTEMS AND FINANCIAL INCENTIVES ON EMPLOYEE ENGAGEMENT AND RETENTION: A LITERATURE REVIEW

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ABSTRACT

Background: Effective human resource management, particularly employee retention, strategic compensation systems, and performance-based incentives, has become a major organizational challenge in an era of global competition. Objective: This article aims to review and synthesize the literature on the effects of strategic pay systems and financial incentives on employee engagement and employee retention during 2022-2024. Method: The literature search was conducted in the Scopus and Google Scholar databases using the keywords "employee retention," "strategic compensation," "financial incentives," "performance-based pay," and "employee engagement." A total of 18 articles were included after the selection process using the PRISMA framework. Findings: The review identified three main themes: (1) compensation strategies and their effects on employee retention, (2) financial incentive systems and their influence on motivation and engagement, and (3) the integration of strategic pay planning into modern human resource management. Conclusion: Strategically designed performance-based pay systems were found to increase employee engagement and reduce employee turnover. Research gaps were identified in the contexts of developing countries and micro, small, and medium-sized enterprises (MSMEs).

Keywords: *Employee Retention, Employee Engagement, Strategic Compensation, Financial Incentives, Performance-Based Pay.*

INTRODUCTION

1. Background of the Topic

In an increasingly competitive global business landscape, organizations face significant challenges in retaining top talent while maintaining employee productivity and engagement. Effective human resource management (HRM) has become one of the determinants of an organization's long-term success. Three interrelated core elements of modern HRM include the management of employee retention and engagement, the development of strategic pay plans, and the implementation of performance-based pay systems and financial incentives.

Employee retention refers to an organization's ability to retain high-quality employees over the long term. High turnover rates not only generate substantial recruitment and training costs but also contribute to lower productivity and organizational morale (Shahzad et al., 2024). At the same time, high employee engagement has been shown to correlate positively with job satisfaction, individual performance, and organizational loyalty (Boccoli et al., 2023).

Strategic compensation systems play a central role in attracting, motivating, and retaining employees. Strategically designed pay plans should balance internal equity, external competitiveness, and organizational affordability. Performance-based financial incentives, such as bonuses, commissions, and merit pay, can also become strong motivational drivers when they are designed appropriately and communicated transparently to employees (Fulmer et al., 2023).

Modern human resource management practices emphasize talent management and compensation systems as key factors in improving performance and retaining employees.

Talent management is a critical strategy because it can increase employee retention by providing career-development opportunities, management support, and competitive compensation systems; consequently, employees are more likely to remain in organizations that provide clear career paths and adequate rewards (Kumar, 2022). Compensation is also a fundamental element of the employment relationship, functioning not only as remuneration but also as a strategic mechanism for attracting, motivating, and retaining employees through pay-for-performance approaches that link performance to rewards (Fulmer et al., 2023). Therefore, integrating talent-management practices with strategic compensation systems is important for building organizational competitive advantage through improved performance and employee loyalty.

Although these elements have frequently been studied separately, comprehensive syntheses that integrate them within a single analytical framework remain limited, particularly across different industries. This literature review therefore seeks to bridge that gap and provide an integrated overview of the relationships among strategic pay systems, financial incentives, employee engagement, and employee retention.

2. Review Objectives and Questions

Component	Description
Review Objective	To synthesize and integrate the literature on the effects of strategic pay systems and financial incentives on employee engagement and retention across industries.
Review Question 1 (RQ1)	What compensation approaches and strategies are used by organizations to increase employee retention?
Review Question 2 (RQ2)	How do performance-based financial incentives influence employee motivation and engagement?
Review Question 3 (RQ3)	What research gaps are identified in the integration of compensation management, incentives, and employee retention?

3. Scope of the Review

Component	Scope
Time Period	2021-2025
Source Languages	English and Indonesian
Types of Studies Included	Scopus-indexed journal articles, scientific proceedings, and research reports
Topical Boundaries	Studies addressing strategic compensation, financial incentives, employee engagement, and employee retention in organizational contexts.

REVIEW METOD

1. Literature Search Protocol

Component	Description
Databases	Scopus, Google Scholar, Web of Science, ScienceDirect
Search Keywords	"employee retention" AND "strategic compensation" OR "financial incentives" AND "employee engagement" OR "performance-based pay"

Component	Description
Search Filters	Publication years: 2022-2024; Languages: English and Indonesian; Document types: Article, Review
Search Date	April 2026
Initial Search Results	87 articles identified across all databases

2. Inclusion and Exclusion Criteria

Inclusion Criteria	Exclusion Criteria
Published between 2022 and 2024	Duplicate articles
Explicitly discusses compensation, incentives, or retention	Articles without a clear methodology
Full text available	Opinion/editorial articles without empirical data
Indexed in Scopus or another reputable database	Studies outside the defined topic

3. Article Selection Process (PRISMA)

Stage 1 - Identification: 87 articles were identified from the databases (Scopus: 42, Google Scholar: 28, Web of Science: 17). Stage 2 - Screening: 61 articles remained after 26 duplicates were removed. Stage 3 - Eligibility: 32 articles remained after title and abstract screening, with 29 irrelevant articles excluded. Stage 4 - Inclusion: 20 final articles were analyzed after 12 articles failed to meet the inclusion criteria.

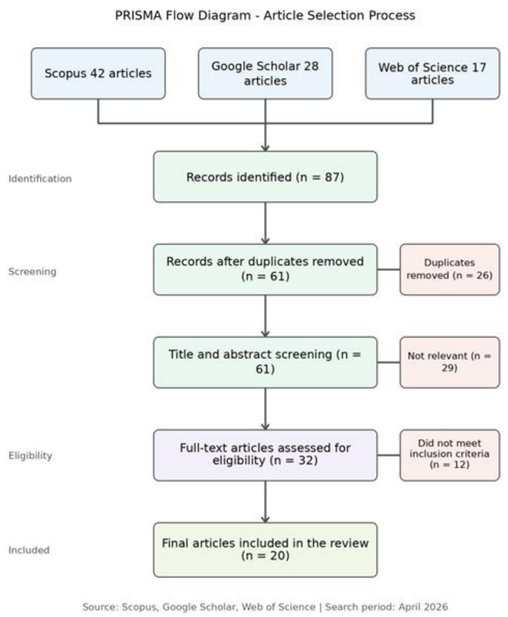

Figure 1. PRISMA flow diagram of the article selection process

4. Analysis and Synthesis Techniques

Method	Description
Review Type	Systematic Literature Review (SLR)
Content Analysis	Thematic categorization, pattern identification, and cross-study narrative synthesis

Method	Description
Quality Appraisal	JBI Critical Appraisal Tool to assess the methodological quality of included articles

RESULTS AND DISCUSSION

1. Overview of the Analyzed Articles

Characteristic	Description
Final Number of Articles	20 articles
Publication-Year Range	2021-2025
Journals with the Most Articles	Personnel Psychology (3 articles), Journal of the Knowledge Economy (2 articles)
Most Common Author Countries	United States (6 articles), Pakistan (4 articles), South Africa (3 articles)
Dominant Methods in the Literature	Quantitative (55%), Mixed Methods (25%), Qualitative (20%)

2. Literature Synthesis Matrix

No.	Author(s) (Year)	Title / Focus	Method	Main Findings
1	Shahzad et al. (2024)	Strategic HR practices and talent retention through job satisfaction and engagement	Quantitative (SEM-PLS)	Strategic HR practices significantly influence talent retention, with job satisfaction serving as a mediator.
2	Fulmer & Gerhart (2023)	Compensation and performance: review and future recommendations	Systematic Review	Pay-for-performance (PFP) has a significant positive effect on employee performance when it is appropriately designed.
3	Zamri & Abd Halim (2024)	Employee retention and talent management: a systematic literature review	SLR - PRISMA	Data-driven retention strategies and work-life balance are key factors in contemporary employee retention.
4	Boccoli et al. (2023)	Employee engagement as a mediator between job resources and turnover intention	Quantitative (SEM)	Engagement significantly mediates the relationship between job resources and turnover intention.
5	Ramadhina et al. (2024)	Bibliometric analysis of rewards using the Scopus database	Bibliometric - VOSviewer	Extrinsic rewards positively influence intrinsic motivation; reward systems are associated with performance.
6	Figueiredo et al. (2025)	Contribution of reward systems in the work context: systematic review	SLR - Scopus, WoS	Reward management influences motivation, satisfaction, and retention, with greater relevance after the pandemic.

No.	Author(s) (Year)	Title / Focus	Method	Main Findings
7	Okoye & Ghapar (2024)	Effects of financial incentives and the work environment on employee motivation	Quantitative - survey	Financial incentives increase short-term motivation but need to be combined with intrinsic factors.
8	Velghe et al. (2024)	Motivation, effort, and employee performance under a merit-pay system: systematic review protocol	SLR Protocol	Merit pay is effective in structured jobs where performance can be measured clearly.
9	Alzbaidi & Abu Madi (2023)	Antecedents of employee retention: the role of compensation and organizational culture	Quantitative	Competitive compensation and a positive organizational culture are the strongest predictors of retention.
10	Weng et al. (2023)	Work engagement, organizational support, and work-life balance in employee retention	Quantitative longitudinal	Work-life balance and organizational support play major roles in retaining employees.
11	Conte & Siano (2023)	Data-driven talent management in HR communication strategies	Empirical survey	Talent analytics helps identify retention risks and optimize HR strategies.
12	Beqiri & Aziri (2022)	Total reward management and employee performance in commercial banking	Quantitative	A total reward system has a positive and significant effect on employee performance in commercial banks.
13	Febrian et al. (2025)	Job satisfaction as a mediator between compensation, leadership, and digital-workforce performance	Quantitative (SEM-PLS)	Job satisfaction is a significant mediator between compensation and performance. Leadership does not have a direct effect but operates through job satisfaction.
14	Sismiati et al. (2025)	Effects of leadership, compensation, and burnout on employee performance	Quantitative (Regression/ SEM)	Leadership significantly affects performance, while compensation does not always have a direct effect; psychological variables such as motivation also play a role.

No.	Author(s) (Year)	Title / Focus	Method	Main Findings
15	Kumar (2022)	Effects of talent-management practices on employee turnover and retention	Quantitative (Descriptive & Regression)	Talent management significantly affects employee retention. Major factors include career development, management support, and competitive compensation; employees tend to remain where career opportunities and rewards are clear.
16	Lintner (2024)	Effects of performance-based financial incentives on higher-education student performance	Meta-analysis (RCT, PRISMA)	Financial incentives increase academic credits and test scores and slightly improve GPA. Effects are not always consistent and depend on incentive design and potential crowding-out of intrinsic motivation.
17	Wang et al. (2022)	Relationship between financial incentives and primary-care-provider performance in China	Quantitative (Cross-sectional, logistic regression)	Financial incentives do not always improve performance; negative effects may occur because of weak compensation systems and crowding-out of intrinsic motivation.
18	Aschenbrücker & Kretschmer (2022)	Effects of financial incentives on innovation activities in small German manufacturing firms	Quantitative (Empirical survey, organizational analysis)	Effects vary by type of work: positive for exploitative innovation among managers but negative for exploratory innovation; compensation-system transparency is a key factor.
19	Hassan (2022)	HRM practices and employee retention through compensation and reward-system mediation in the Maldives retail sector	Quantitative (survey, 250 respondents)	Compensation and reward systems significantly mediate the relationship between HRM practices and retention; performance appraisal and training strengthen the effect.
20	Sinisterra et al. (2024)	Talent management, employee engagement, and turnover intention: systematic review	Systematic Review (PRISMA)	Talent management positively affects employee engagement; high engagement consistently reduces turnover intention across industries.

3. Main Themes from the Review

Theme 1: Compensation Strategies and Their Effects on Employee Retention

The analyzed literature consistently shows that competitive and equitable compensation systems are among the strongest predictors of employee retention. Shahzad et al. (2024) found that strategic HR practices, including competency-based compensation, significantly affect talent retention through the mediating roles of job satisfaction and employee engagement. Alzbaidi and Abu Madi (2023) likewise emphasized that competitive compensation combined with a positive organizational culture is one of the most consistent predictors of retention across different industry contexts.

Total reward systems that include base pay, benefits, career development, and non-financial recognition appear more effective than monetary compensation alone (Figueiredo et al., 2025). Zamri and Abd Halim (2024), in their systematic review, found that data-driven retention strategies and work-life balance are key factors in retaining employees in the modern era, particularly after the pandemic. These findings are consistent with Weng et al. (2023), who showed that organizational support and work-life balance play major roles in employees' decisions to remain with an organization.

Theme 2: Performance-Based Financial Incentives and Employee Engagement

Performance-based financial incentives, such as merit pay, performance bonuses, and commissions, have become major instruments for encouraging employee motivation and engagement. Fulmer et al. (2023), in a comprehensive review covering more than 30 years of research, found that pay-for-performance (PFP) has a significant positive effect on employee performance, particularly when performance can be measured objectively and clearly. However, the effectiveness of PFP depends strongly on system design, communication transparency, and employees' perceptions of fairness.

Ramadhina et al. (2024), through a bibliometric analysis, found that reward systems, particularly extrinsic rewards, positively influence employees' intrinsic motivation. Okoye and Ghapar (2024), however, found that although financial incentives can increase short-term motivation, they are insufficient to sustain professional growth without a structured development framework. Boccoli et al. (2023) further noted that high employee engagement not only promotes productivity but also significantly reduces turnover intention by mediating the relationship between job resources and employees' decisions to leave.

Theme 3: Integration of Strategic Pay Planning into Modern HRM

Strategic pay planning that is integrated with organizational objectives differentiates organizations that succeed in retaining top talent from those that do not. Conte and Siano (2023) showed that data-driven approaches to talent management, including the use of talent analytics, help organizations identify retention risks early and optimize compensation-budget allocation. Velghe et al. (2024) emphasized that merit pay is most effective in structured jobs with clearly measurable performance indicators.

Furthermore, integrating financial and non-financial compensation within a total rewards system appears more effective from a holistic perspective. The literature indicates that organizations that align compensation strategies with organizational values and long-term objectives tend to achieve higher retention, stronger engagement, and more consistent productivity (Figueiredo et al., 2025; Shahzad et al., 2024). Transparency in compensation communication is also identified as a critical factor influencing employees' perceptions of fairness and satisfaction with the prevailing pay system.

Discussion

1. Synthesis and Interpretation of Findings

Overall, the analyzed literature indicates a complex and mutually reinforcing relationship among strategic pay systems, financial incentives, employee engagement, and employee retention. Cross-study findings confirm that no single compensation instrument can independently guarantee optimal retention and engagement. Instead, the most effective approach integrates competitive financial compensation, transparent performance-based incentive systems, and engagement strategies rooted in employees' intrinsic needs.

This review also confirms the continued relevance of classical motivation theories, such as Vroom's Expectancy Theory and Adams' Equity Theory, in explaining how financial incentives operate. Employees tend to be motivated by incentives that they perceive as fair, attainable, and relevant to their contributions. This implication is important for HR practitioners designing compensation systems that are not only externally competitive but also internally equitable.

2. Gaps and Contradictions in the Literature

Gap / Contradiction	Explanation
Contextual gap	Most studies were conducted in developed countries. Research in developing countries, particularly Southeast Asia and Africa, remains very limited.
Sectoral gap	Studies in MSMEs, start-ups, and the informal economy are nearly absent, even though these sectors employ a large proportion of the global workforce.
Methodological gap	Most studies are cross-sectional; longitudinal studies measuring the long-term effects of compensation systems on retention remain rare.
Contradictory findings	Some studies suggest that financial incentives may weaken intrinsic motivation through a crowding-out effect, while others identify complementary effects between financial and intrinsic motivation.

3. Theoretical and Practical Implications

Theoretically, this review reinforces the argument that an integrated approach to compensation management is more relevant than a single-mechanism model. The findings support the development of compensation frameworks based on AMO Theory (Ability, Motivation, Opportunity), which positions compensation as one of three pillars that drive employee performance.

Practically, HR managers are advised to: (1) design compensation systems that integrate financial and non-financial components; (2) ensure transparency in communicating compensation to all employees; (3) use data analytics to identify turnover risks proactively; and (4) adapt incentive strategies to different generational characteristics and types of work within the same organization.

CONCLUSION

Main Conclusions

RQ1: The compensation strategies considered most effective in increasing employee retention include total rewards approaches that integrate competitive salaries, benefits, career development, and non-financial recognition. Competency-based compensation and data-driven retention strategies are becoming increasingly prominent.

RQ2: Performance-based financial incentives are shown to improve employee motivation and engagement, particularly when combined with transparent communication, measurable performance indicators, and strong perceptions of fairness. Pay-for-performance is most effective in jobs whose outputs can be measured objectively.

RQ3: The main research gaps include limited evidence from developing countries and MSMEs, a shortage of longitudinal studies, and continuing debate regarding the effects of financial incentives on employees' intrinsic motivation.

Review Limitations

This review is limited by potential selection bias in article inclusion, the restriction of searches to specific databases, and the 2021-2025 time window, which means that findings from earlier studies were not examined in depth.

Future Research Agenda

Future research is recommended to: (1) explore the effects of strategic pay systems in developing-country contexts, including Indonesia; (2) examine MSMEs, which have received limited attention; (3) use longitudinal designs to measure long-term effects; and (4) investigate the role of HR analytics technologies in optimizing performance-based compensation systems.

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