THE IMPACT OF COMPENSATION, REWARD, AND PUNISHMENT ON THE PERFORMANCE OF SME EMPLOYEES IN SURABAYA

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Abstract: Small and Medium Enterprise (SME) is a significant sector in the local and national economy, a provider of employment and a driver of economic growth. However, challenges in human resource management, including compensation, reward, and punishment, often affect employee performance and business sustainability. This study aims to analyse the effect of compensation, reward, and punishment on employee performance in SMEs in Surabaya City. Using the SEM-PLS analysis method and involving 50 SME employee respondents, this study found that: (1) Compensation has a significant positive effect on employee performance; (2) Reward and punishment also have a significant positive effect on employee performance; and (3) Punishment has a significant positive effect on employee performance. The results of the study indicate that compensation has the most dominant effect on employee performance in SMEs. These findings provide suggestions for SME business actors to evaluate and develop compensation, reward, and punishment programmes periodically to maximise employee performance and achieve company goals.

Keywords: Compensation, Reward, Punishment, Employee Performance, Small and Medium Industries (SMEs)

1. Introduction

Surabaya is one of the largest cities in Indonesia and it has great potential in the development of SMEs with access to a wide market, adequate infrastructure, and supportive government policies (Ardiansyah et al., 2023). SMEs are one of the economic sectors that have significant contribution to the local and national economy (Prasetyo et al., 2021; Mochklas et al., 2024). Small and medium enterprises not only create jobs, but also encourage innovation and development of local products (Dahmiri, 2023). Employees working in SMEs contribute significantly to the innovation and competitiveness of companies in competitive markets. (Maulita et al., 2021; Mochklas et al., 2024). They are often directly involved in various aspects of production and product development, thus having unique insights to improve processes and create creative solutions. The active involvement of employees in daily operations enables rapid response to market changes and customer needs (Hasan, 2017).

Employee performance is a key element in the operational success and sustainability of SMEs because high-performing employees can increase productivity, efficiency, and product quality (Nugroho & Ratnawati, 2021) . In addition, good performance helps in meeting business targets, increasing customer satisfaction, and creating a positive reputation for the company (Tate et al., 2021) . With optimal employee performance, SMEs can face market challenges, develop new products, and maintain sustainable growth, all of which are important for the long-term success of small and medium enterprises. Motivated and skilled employees can drive improvements in product quality and operational efficiency, which in turn increases the ability of SMEs to compete with larger and more established companies (Uka & Prendi, 2021) . The challenge of maintaining and improving employee performance is one of the main issues faced by SMEs. One way to achieve optimal performance is to implement an effective compensation, reward, and punishment system. Limited SME resources such as limited capital, limited workforce, and limited technology make it difficult for SMEs to implement an effective compensation, reward , and punishment system (Fitrios et al., 2021; Kurnia & Gunawan, 2023).

Compensation is a reward given by a company to employees as a reward for their contribution to the organisation (Adibah Abdul Kadir et al., 2019) . Compensation includes all forms of payment or rewards received by employees, both financial and non-financial, and aims to motivate employees, improve performance (Priyatono, 2019), and ensure their satisfaction and loyalty to the company (Sutrisno et al., 2022). Employees who feel appreciated through adequate compensation tend to have better performance (Prihatiningtyas, 2016). Many SMEs experience limitations in providing competitive compensation, which has a negative impact on employee motivation and productivity (Dewi et al., 2022). This condition is caused by limited capital that limits their ability to provide adequate salaries and benefits, tight competition with large companies that are able to offer higher compensation, low profits that limit the budget for salaries, and a lack of expertise in designing an effective compensation system. This makes it difficult for SMEs to retain and motivate employees, potentially reducing the company's performance and competitiveness.

Rewards are a form of appreciation given by a company or organisation to employees as recognition of their contributions, achievements, or positive behaviour (Hussain et al., 2019). Providing appropriate rewards , such as bonuses, recognition, or promotions, can increase work enthusiasm (Mea, 2022) and support employee career development (Indrawati & Aulia, 2020) will motivate employees to improve their performance (Putra et al., 2020; Lestari & Muslihat, 2023), and strengthen loyalty and job satisfaction (Baqir et al., 2020), this is one effective way to motivate employees. Several SMEs have not implemented an effective reward system, hence employee potential cannot be fully maximised (Ngwa et al., 2019). Small and medium enterprises that have not implemented an effective reward system face various negative impacts, employees may lose motivation and productivity, feel unappreciated, and look for work elsewhere, thereby increasing the turnover rate. (Jimmi et al., 2021). Difficulty in attracting and retaining quality talent can also occur. Employee satisfaction and loyalty decline, hindering innovation and creating a less positive work environment (Muhammad & Mutmainah, 2020) . In addition, employee career development

is hampered, and the company's image can be damaged, all of which contribute to a decline in the company's overall performance and competitiveness.

Punishment also has a role in maintaining employee discipline and performance (Hartawan & Welta, 2017). Punishment is an action taken by a company or organisation in response to employee behaviour or performance that does not comply with established standards or rules (Wijaya, 2021). The goal is to correct or stop unwanted behaviour and prevent other employees from making the same mistakes. Punishment is one of the tools in human resource management to maintain discipline and order in the work environment (Gligor et al., 2024). The application of punishment fairly and proportionally can prevent violations and increase compliance with company rules, which can create a more disciplined work environment, improve employee performance, and ensure operational standards are maintained (Tonry, 2017) . However, the application of punishment that is not appropriate can create a sense of injustice and reduce employee motivation. This can lead to dissatisfaction, increased *turnover* , and decreased productivity and work morale, which ultimately harms the company as a whole (Duus-Otterström, 2021).

This research is crucial considering the lack of studies that specifically examine the effect of compensation, reward, and punishment on employee performance in SMEs in Surabaya. Previous studies have focused more on large companies and often ignore the unique characteristics of SMEs. This study aims to identify and analyse the effect of compensation, reward, and punishment on employee performance in SMEs. By understanding the extent to which these three factors affect employee performance, this study can provide in-depth insights into effective human resource management practices in SMEs. This analysis will help identify specific elements in compensation, reward and punishment that have the most impact on employee motivation and productivity. As a result, SME managers can design and implement more appropriate strategies to improve employee performance and, in turn, support the growth and competitiveness of the company in a competitive market.

The results of the study are expected to provide practical recommendations for SME managers to improv employee performance through effective compensation, reward and punishment strategies. By implementing a fair compensation system, appropriate rewards and proportional punishments, SMEs can motivate employees, increase productivity, and build loyalty. These recommendations will also help SMEs to create a positive and disciplined work environment, which is important for maintaining competitiveness and growth in an increasingly competitive market. The implementation of this strategy is expected to optimise the business potential of SMEs, support business sustainability, and increase their contribution to the local economy.

2. Research Method

This research adopts a quantitative method that is based on the philosophy of positivism (Sugiyono, 2018). Quantitative data analysis is utilised to test the established hypothesis, namely the effect of compensation, reward and punishment on the performance of SME employees. The quantitative data collection method is to measure the attitudes and opinions of respondents using a Likert scale. According to Sekaran & Bougie (2016), Likert

scale is an interval scale to assess how strongly respondents agree or disagree using a five-point scale or greater. This research was conducted in SMEs under the auspices of the Surabaya City Trade and Industry Service. The SMEs include the Sawahan Shoe Center, Tambaksari Shoe Center, Jumput Tie Center, Bag Village, Handicraft Village, and Shell Craft Center. The population in this study were employees working in SMEs with a sample criterion having worked for at least one year. The survey managed to collect responses from 50 respondents who completed the questionnaire accordingly. Data analysis to test the predetermined research hypothesis using sample data obtained using Smart PLS.

The operational definition and measurement of variables in this study are as follows:

I. Performance is the result of work done and is influenced by many factors to achieve company goals within a certain period of time (Sinaga et al., 2020). SMEs employee performance indicators include: quality, quantity, timeliness, effectiveness and independence.

II. Compensation is a form of anything of value for the benefit of all employees as a reward for the contributions, services and efforts made by employees to the industry (Siahaan & Meilani, 2019) compensation indicators include salary, incentives and facilities .

III. Reward is a form of industrial appreciation to employees for certain work achievements obtained by employees for employee contributions to the industry which can be financial or non-financial (Satria & Sudiro, 2018). Indicators of appreciation include recognition through promotion, flattery or praise, and fulfillment of life needs including incentives (Aprilyanti, 2017)

IV. Punishment explains that in an industry punishment is given as a form of punishment for carelessness, and negligence so that an error arises that causes problems that can harm the company, where the punishment indicator according to (Suparmi & Septiawan, 2019) is a light punishment in the form of a warning, moderate sanctions in the form of a warning letter, and severe sanctions in the form of layoffs .

The conceptual framework of the research is shown in Figure 1.
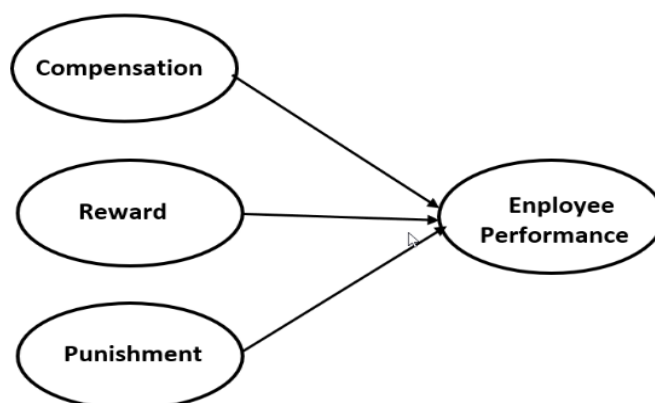

Figure 1. Research Conceptual Framework of Employee Performance

The research hypothesis is formulated based on a conceptual framework that connects the main variables of compensation, reward, punishment and employee performance. This hypothesis is proposed to be tested in the context of (SMEs in Surabaya, to understand the extent to which each variable influences each the other. The research hypothesis is as follows:

H1 - Compensation has an effect on the performance of employees in
       small and medium industries.
H2 - Rewards have an effect on the performance of small and medium
       industry employees.
H3 - Punishment has an effect on the performance of employees in
       small and medium industries.

3. Results And Discussion

3.1. Results

Research data was processed using Partial Least Square (PLS) analysis with the SmartPLS 3.0 program. This section discusses the evaluation of the inner model that explains the validity and reliability of the measurement model, and the evaluation of the inner model that explains the connection between variable in accordance with the hypothesis of this study.

3.1.1 External Model Evaluation

Following served path diagram construction which among other things describes evaluation structure outside the model in research this:
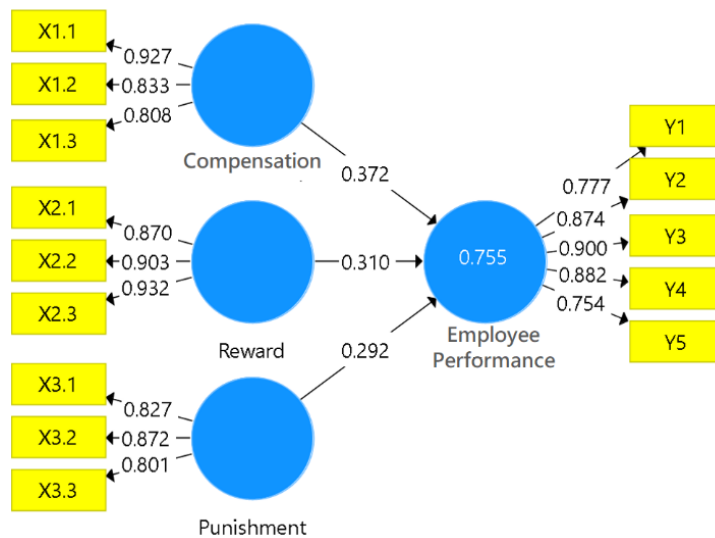

Figure 2. Path Diagram Construction

3.1.2 Convergence of Validity

The first evaluation of the outer model is the convergent validity, that is measured by looking at the value of each outer model. An indicator is said to meet convergent validity if it

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has an outer loading and AVE value is greater than 0.5. The outer values loading and AVE each research variable is shown in table 1. Based on table 1, the outer value which known as loading of each indicator on the four research variables are all worth more than 0.5. In addition, the AVE value on each variable is more than 0.5. This means that the indicators used are appropriate in measuring each variable being measured. These results indicate that convergent validity has been met.

Table 1. External Loadings and AVE Values

Variables	Indicator	*Outer Loading*	AVE
Compensation (X1)	X1.1	0.927	
	X1.2	0.833	0.735
	X1.3	0.808	
Reward (X2)	X2.1	0.870	
	X2.2	0.903	0.813
	X2.3	0.932	
Punishment (X3)	X3.1	0.827	
	X3.2	0.872	0.695
	X3.3	0.801	
Employee Performance (Y)	Y1	0.777	
	Y2	0.874	
	Y3	0,900	0.705
	Y4	0.882	
	Y5	0.754	

3.1.3 *Discriminant Validity*

Evaluation of the outer model is the discriminant validity which is tested using cross loading value. An indicator is said to fulfil discriminant validity if the cross value the loading of the indicator on a variable is the largest when compared to cross loading on other variables. Table 2 shows that the research results indicate the Cross Loading values for each indicator meet discriminant validity, where each indicator has the highest loading value on the variable it measures compared to other variables.

Table 2. Cross Value Loading

Indicator	Employee Performance	Compensation	Punishment	Reward
X1.1	0,757	0,927	0,692	0,661
X1.2	0,633	0,833	0,430	0,610
X1.3	0,628	0,808	0,611	0,530
X2.1	0,656	0,697	0,636	0,870
X2.2	0,713	0,601	0,665	0,903
X2.3	0,725	0,608	0,594	0,932
X3.1	0,537	0.572	0.827	0.472
X3.2	0.632	0.594	0.872	0.526
X3.3	0.708	0.535	0.801	0.716
Y1	0.777	0.611	0.604	0.558
Y2	0.874	0.685	0.682	0.778
Y3	0,900	0.757	0.693	0.654
Y4	0.882	0.672	0.673	0.700
Y5	0.754	0.566	0.526	0.538

Referring to Table 3, indicators X1.1–X1.3 are valid for the compensation variable, X2.1–X2.3 are valid for the reward variable, and X3.1–X3.3 are valid for the punishment variable, as each demonstrates the highest loading value on its respective variable. Similarly, indicators Y1–Y5 are valid for the performance variable, following the same pattern. Overall, these results confirm that the indicators used in the study consistently measure the appropriate variables, fulfilling the requirements for discriminant validity.

3.1.4 Composite Reliability

The next evaluation on the outer model is reliability. Composite reliability tests the reliability value of indicators in a construct. A construct or variable is said to meet composite reliability if it has a composite reliability value greater than 0.7. Table 3, shows that the composite reliability value of each research variable is more than 0.7. Thus, it can be concluded that each variable has good reliability.

Table 3. Composite Reliability Values

Variables	Composite Reliability
Compensation	0.893
Present	0.929
Punishment	0.872
Employee performance	0.922

3.1.5 Inner Model Evaluation

Inner model evaluation can be done by looking at the R- Square value or coefficient of determination. Based on data processing with PLS, the resulting R- Square value is as follows:

Table 4. R- Square Value

Variables	R- Square
Employee performance	0.755

From table 4, it shows the R-Square value of 0.755 for the employee performance variable, meaning that 75.5% of the variation in employee performance in SMEs in Surabaya can be explained by the independent variables in the model, namely compensation, reward , and punishment . In other words, around 75.5% of changes in employee performance can be explained by compensation, reward, and punishment factors, while the remaining 24.5% is explained by other factors that are not included in this research model. This indicates that the compensation, reward and punishment variables are relevant and influential in improving or influencing employee performance in SMEs in Surabaya.

4. Hypothesis testing

The research hypothesis can be accepted if the resulting t-statistic value is greater than 1.96 and the p- value is less than 0.05. The bootstrapping results showing the t-statistic value of each path are demonstrated in Figure 3:
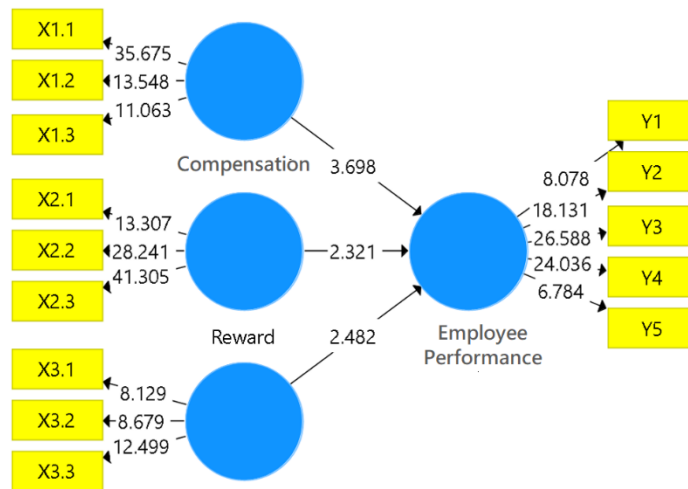
Figure 3. PLS Bootstrapping Results

Table 5, below presents the coefficient values, t-statistics, and p- values to test the hypothesis in this study:

Table 5. Estimated Values of Coefficients, T-Statistics, and P- Values

Hypothesis	Coefficient	t-statistic	p-value
Compensation è Employee performance	0.372	3.698	0,000
Rewardè Employee performance	0.31	2,321	0.021
Punishment è Employee performance	0.292	2.482	0.013

Table 5, shows that the three variables compensation, rewards, and punishments have a significant positive influence on employee performance based on statistical tests. Regarding compensation on employee performance, the coefficient of 0.372 with t-statistic of 3.698 and p-value, 0.000 indicates that compensation has a significant positive effect on employee performance. Since the p-value <0.05, the hypothesis that compensation affects employee performance is accepted. These results emphasise the importance of an effective compensation system to improve the performance of employees working at SMEs in Surabaya.

About rewards on employee performance, a coefficient of 0.310 with a t-statistic of 2.321 and a p-value of 0.021 indicates that giving gifts or awards also has a significant positive effect on employee performance. A p-value smaller than 0.05 supports the hypothesis that rewards improve performance, hence awards or incentives become an important motivational factor. Regarding punishment on employee performance, the coefficient of 0.292 with t-statistic 2.482 and p-value, 0.013 also shows that punishment has a significant positive effect on employee performance. With a p-value <0.05, this means that the application of clear and firm punishment can improve employee discipline and performance positively. Overall, all variables on compensation, reward, and punishment provide a significant contribution to improving employee performance in SMEs, with compensation having the greatest influence.

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5. Discussion

Based on the results of data analysis, both through testing the R- Square value and hypothesis testing, this study reveals several main findings that provide an in-depth understanding of the factors that influence employee performance in SMEs in Surabaya City.

With an R- Square value of 0.755, the research model can explain 75.5% of the variation in employee performance, indicating that compensation, reward, and punishment factors play a major role in influencing employee performance. The implication is that management in SMEs must pay special attention to how they manage the three factors to ensure employees remain motivated and perform well. For example, a fair and competitive compensation policy can be the main key to increasing employee productivity, since research shows that compensation is the most dominant variable. Likewise, rewards and punishments if, which when implemented properly, can reinforce positive behaviour and minimise errors.

In addition, the R- Square value also indicates that other factors besides compensation, reward, and punishment contribute around 24.5% of the variation in employee performance. This opens up opportunities for management to explore additional factors that may affect performance, such as the work environment, leadership, or career development opportunities. However, priority should still be given to the three main factors identified in this study, as they have been shown to have a significant impact on performance. Management that is able to optimise the three variables will be more effective in creating a productive work environment and encourage employees to be productive.

Overall, the findings highlight the importance of implementing effective compensation, reward, and punishment policies in improving employee performance, with a particular focus on compensation as the most dominant factor. A competitive compensation policy not only serves as an incentive for employees to work harder, but also creates a positive work environment, where employees feel appreciated and motivated to contribute optimally. In addition, the implementation of a fair reward system and appropriate recognition will further strengthen employee commitment and loyalty to the company. Therefore, SME management needs to review and design a human resource management strategy that covers all aspects involving compensation, reward, and punishment, to ensure optimal performance and business sustainability amidst increasingly fierce competition.

This study offers a contrasting perspective to the findings of Sultan (2021), who identified that compensation has a negative and significant effect on employee performance. Meanwhile, a study by Neksen et al. (2021) concluded that costs do not significantly affect employee performance, reasoning that cost allocation must be aligned with the workload assigned to employees to achieve effectiveness. In contrast, Dewi et al. (2022) found that although compensation positively influences employee performance, the effect is not significant. This suggests an unequal distribution of compensation, making the amount insufficient to produce a meaningful impact on performance. Moreover, employees tend to perceive compensation as an entitlement they naturally deserve, which diminishes its motivational and productivity-enhancing effects. These findings collectively shed light on the intricate dynamics between compensation, costs, and employee performance. They

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underline that these factors are influenced not only by their magnitude but also by employees' perceptions and the fairness of their distribution and application.

The research result support studies conducted by Putri (2021) and Aldo (2023) that, indicate compensation has a significant positive effect on employee performance in the Micro, Small and Medium Enterprises (MSME) sector. This means that increasing compensation, whether in the form of salary, benefits, or other incentives, can encourage employees to work better and increase their productivity. Employees who feel financially appreciated tend to be more motivated, loyal, and committed to achieving company goals. This shows that fair compensation that is in accordance with employee contributions is important in maintaining satisfaction and work enthusiasm, which ultimately has a direct impact on performance.

This study strengthens the argument that effective compensation policies not only affect employee retention but also improve individual and organisational performance as a whole (Fausia & Kuswinarno, 2024) . In the MSME sector, where resources are often limited, compensation is an important tool in maintaining optimal employee performance (Sono & Limpo, 2024). These results provide practical guidance for MSME owners to design a competitive compensation system to attract and retain quality workers, while motivating them to give their best performance.

Compensation must be based on job specifications and work standards. These job specifications are carried out by conducting a review related to the remuneration system so that a design for compiling a remuneration system is obtained. The wage plan that has been prepared is used as a medium for making regulations in the industrial world which is then linked to job standardisation. In this way employee performance assessments can be carried out which can ultimately provide fair compensation to employees based on their performance.

Regarding the influence of rewards on the performance of employees, the results of this study differ from Adityarini (2022) which states that rewards do not affect employee performance. An increase in the reward variable will not affect performance improvement, hence the effect of rewards can be ignored. According to Adityarini (2022) the implementation of rewards still not fully influence the lack of motivation among employees that cause decline of productivity in the company. Rewards given by the company must be objective, fair and maximal given to increase the motivation of employees.

The results of this study support the findings put forward by Naqiyyah (2016) and Pramesti et al. (2019) , which states that rewards have a significant influence on employee performance. Rewards, which include financial and non-financial rewards, are one of the important factors that motivate employees to achieve their best performance. Providing appropriate rewards, such as bonuses, awards, or recognition for achievement, can increase work motivation, strengthen loyalty, and encourage enthusiasm to continue contributing. When employees feel valued and appreciated for their efforts, this will have a positive impact on overall performance.

This study also emphasises the importance of a structured and fair reward system in an organisation. In many sectors, including SMEs, rewards given to employees are often an effective tool to improve productivity (Riyandah & Kusuma, 2024). By providing rewards according to achievement, companies can create a competitive and results-oriented work environment. This strengthens the argument that providing adequate and proportional rewards can motivate employees to work harder and focus more on achieving company targets. The implementation of a reward program run by the company will be able to maximise the objectives of the reward initiatives, where management can establish a programme for providing bonuses and allowances periodically so that employees feel appreciated and will have a positive impact on employees performance and company goal.

Regarding the influence of punishment on the performance of employees of SMEs in Surabaya City, this study differs from Pramundi et al. (2021) which states that punishment has an effect on the lack of employee motivation and causes a decrease in company productivity. Lusiana et al. (2023) found that punishment does not have a significant effect on employee performance. If the regulations applied by the company to its employees are based only on rules without exceptions, this will not provide justice for all employees working in the company. The results of this study support the findings of Naqiyyah (2016) and Pramesti et al. (2019) which shows that punishment has an effect on employee performance.

Punishment, which is used as a tool to correct behaviour that is not in accordance with company standards, can serve as a driver of discipline and performance improvement. When punishment is applied appropriately, employees will be more alert and motivated to avoid behaviour that can reduce their performance. In other words, punishment can be an effective reminder for employees to obey the rules and focus on increasing productivity. However, it is important to note that punishment must be applied fairly and transparently so as not to create dissatisfaction among employees (Yusuf et al., 2024). Injustice in giving punishment can actually reduce work enthusiasm and create an unconducive atmosphere. Therefore, this study emphasises the need for companies to design clear and consistent punishment policies, which not only correct mistakes but also motivate employees to improve their overall performance. Punishment to warn employees if the work does not comply with the regulations made by the company, can regulate a person's actions and behaviour with a happy feeling and will usually make them do good deeds repeatedly (Rio et al., 2020).

Regarding compensation, this study found that compensation has the most dominant influence on the performance of SME employees in Surabaya City. This result shows that of the various factors studied, compensation plays a key role in increasing employee productivity and motivation. Fair and competitive compensation encourages employees to work harder and more efficiently, because they feel that their efforts and contributions are appreciated by the company. Thus, compensation becomes one of the most effective managerial tools to encourage employee performance in the SME sector. The results of this study are in line with the findings put forward by Hartanto and Thoyib (2016) and Saputra and Darmanah (2019), which also emphasised that compensation has the greatest influence in improving employee performance. Both studies emphasise the importance of companies to design a compensation system that is not only adequate, but also competitive in attracting and retaining quality employees. In the context of SMEs in Surabaya, where the challenges of competition and

resource constraints often arise, an effective compensation policy can provide a competitive advantage while ensuring sustainable productivity.

6. Implications

The finding that compensation, reward, and punishment have a significant positive effect on the performance of SMEs employees in Surabaya City strengthens several motivational theories in human resource management. One of the relevant theories is Expectancy Theory from Vroom (1995), which states that individuals will be motivated to work hard if they believe that their efforts will result in good performance and that performance will result in the desired rewards. In this case, the compensation, reward, and punishment systems function as factors that strengthen employees' belief that their performance will be recognised and appreciated, or conversely, punished if it is not up to standard.

The finding that compensation has the most dominant influence on employee performance supports Equity Theory from Adams (1963), which emphasises the importance of perceptions of fairness in employment relationships. Employees compare the ratio of the rewards they receive to the effort they put in, and comparing them with other coworkers. If they feel that the compensation they receive is fair and commensurate with their efforts, they will be more motivated to perform optimally. Therefore, appropriate compensation is considered a dominant factor in improving employee performance, because it affects their perceptions of fairness and job satisfaction.

Another relevant theoretical implication is Reinforcement. Theory from Skinner (2014), which states that behaviour that is rewarded will tend to be repeated, while behaviour that is sanctioned will decrease. An effective reward and punishment system in SME companies functions as positive and negative reinforcement, which can shape employee behaviour. When good performance is rewarded, employees are more likely to continue to demonstrate the behaviour. Conversely, clear punishment for poor performance also provides a negative reinforcement effect, hance employees are more careful in improving their performance. Employee performance is not only influenced by compensation, rewards, and punishments but also by other factors such as work culture, leadership style, and organisational environment. Future research can examine the interaction between compensation, rewards, and punishments with these factors to provide a more in-depth analysis. Thus, this study not only provides important initial insights but also opens up opportunities for further exploration, so that it can be a reference in developing strategies to improve employee performance holistically.

The practical implications of the findings that compensation, rewards, and punishments have a significant positive effect on employee performance in SMEs in Surabaya City indicate that company needs to implement an effective reward and sanction system. In practice, SMEs need to design fair and competitive compensation policies, including salaries, benefits, and incentives that are in accordance with employee contributions. In addition, rewards for performance achievements, such as bonuses or public recognition, must be given consistently to encourage motivation. At the same time,

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sanctions for poor performance need to be clearly implemented to maintain discipline and accountability in the workplace.

The finding that compensation has the most dominant influence on employee performance provides practical direction that SMEs should prioritise appropriate compensation policies to improve productivity. Companies need to evaluate and adjust salary and incentive schemes periodically to ensure that the compensation provided is in accordance with industry standards and employee contributions. This will help attract and retain talented employees and increase job satisfaction. In addition, competitive compensation also has the potential to reduce turnover rates and increase employee loyalty, which ultimately strengthens business stability and growth in the long term.

7. Conclusion

This study concludes that compensation, reward, and punishment have a significant positive effect on employee performance in SMEs in Surabaya City, with compensation showing the most dominant effect. This means that fair and competitive compensation policies are key factors in driving employee performance. Rewards and punishments also play an important role in increasing employee motivation and discipline, but their effects are not as large as compensation. These results strengthen the findings of previous studies and emphasise the importance of effective human resource management in increasing productivity and performance in the SME sector.

This study has several limitations. First, the scope of the study is limited to SMEs in Surabaya City, hance results may not apply to other areas with different characteristics. Second, this study only examines three variables, namely compensation, reward, and punishment, so other factors that also have the potential to affect employee performance, such as work environment, leadership, and organizational culture, are not discussed. In addition, the data collected are cross-sectional, which may not fully describe the dynamics of employee performance in the long term.

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