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Leader-member exchange and reactions to performance appraisal: A scenario-based study

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**BUSINESS
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Department of Human Resources and Organizational Behaviour

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Resumo

A teoria do leader-member exchange (LMX) é baseada no princípio de que o relacionamento de qualidade dos líderes com seus funcionários é diferente. Conforme abordado na literatura anterior, mais pesquisas devem examinar a influência da diferenciação de LMX nas reações dos funcionários ao fenômeno que estamos examinando neste estudo. Portanto, a pesquisa atual investiga a relação entre a qualidade da LMX, a diferenciação da LMX e as reações à avaliação de desempenho. Os dados foram coletados para este estudo usando um estudo experimental baseado em cenários com funcionários que trabalham em várias empresas na Croácia, para uma amostra total de 139 participantes. Depois de analisar os dados, os resultados revelaram que a qualidade da LMX está positivamente correlacionada com a equidade percebida da avaliação recebida e que a diferenciação da LMX não modera a relação entre a qualidade da LMX e a equidade percebida, particularmente durante o controle de gênero. Esta tese contém uma discussão sobre as implicações teóricas e práticas de nossas descobertas.

Palavras-chave: qualidade de LMX, diferenciação de LMX, reações, avaliação de desempenho

Classificação JEL:

L290 - Firm Objectives, Organization, and Behavior: Other

O150 - Economic Development: Human Resources; Human Development; Income Distribution; Migration

Abstract

Leader-member exchange (LMX) theory is based on the principle that the leaders' quality relationship with their employees differs. As addressed in the previous literature, more research should examine the influence of LMX differentiation on employee reactions, which is the phenomenon we are focusing on in this study. Hence, the current research investigates the relationship between LMX quality, LMX differentiation and reactions to performance appraisal. Data were collected for this study by using a scenario-based experimental analysis carried out on employees working in several companies in Croatia, with a total sample of 139 participants. After analysing the data, the results revealed that LMX quality is positively correlated with perceived fairness of the appraisal received and that LMX differentiation does not moderate the relationship between LMX quality and perceived fairness, particularly while controlling for gender. This thesis contains a discussion of the theoretical and practical implications of our findings.

Keywords: LMX quality, LMX differentiation, reactions, performance appraisal

Classifications of the JEL Classification System:

L290 - Firm Objectives, Organization, and Behavior: Other

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Index

Acknowledgment	i
Resumo	iii
Abstract	v
Introduction	1
I) Literature Review	3
1. Performance Appraisal (PA)	3
1.1 Reactions to Performance Appraisal	5
1.2 Factors Influencing Employees' Reactions to Performance Appraisal	8
2. Leader – Member Exchange (LMX)	11
2.1 LMX Quality	12
2.2 LMX Differentiation	14
2.3 LMX Quality and LMX Differentiation	16
2.4 The Relationship between LMX and Performance Appraisal	18
II) Empirical Study	22
3. Methodology	24
3.1 Participants	24
3.2 Procedure	24
3.3 Measures	25
4. Results	28
4.1. Preliminary Analyses – Manipulation Check	28
4.2. Testing of the Model – Main Analyses	30
5. Discussion	34
6. Limitations and Future Research	37
7. Practical Implications	38
Conclusion	39
References	41

List of Tables

Table 3. 1 Descriptive statistics for socio-demographic variables (n = 116-127).....	24
Table 4. 1 One-way ANOVA: differences in LMX quality and LMX differentiation with regard to different group scenarios (N = 139).....	28
Table 4. 2 Correlations between LMX quality, LMX differentiation, perceived fairness and demographics variables (N = 115-139).....	31
Table 4. 3 Multiple linear regression: predicting perceived fairness with gender as control variable (N = 127)	32

List of Figures

Figure 4. 1 Differences in LMX quality with regard to different group scenarios	30
Figure 4. 2 Differences in LMX differentiation with regard to different group scenarios	30
Figure 4. 3 Illustration for the absence of moderation effect of LMX differentiation on the relationship between LMX quality and perceived fairness	33

Introduction

For a company to grow and develop, successful and motivated employees are essential. Nowadays, when new businesses and companies occur on a daily basis, the struggle to stay competitive on the market is becoming more and more noticeable. Various organizations are investing in their employees in order to improve their satisfaction, which will result in a higher level of performance. For a management to know what needs to be improved, gaps and potential problems should be pinpointed. Different employees will have different needs and wants; therefore, one cannot expect the same motivation will work the same way for everyone. To determine what makes every single employee do better at their job, companies started implementing performance appraisals. DeNisi & Murphy (2017) consider it is most important to recognize how the quality and performance appraisal programs contribute to the well-being and achievement of organizations. Besides feedback frequency helping in appraisal reactions (Pichler, Beenen, & Wood, 2018), employee perceptions of fairness and a process of performance appraisal are connected to quality of relationship with the supervisor, where supervisors can achieve better employees' reactions to performance appraisal (Pichler et al., 2016). This study aims to present factors that explain how individuals react to performance appraisals.

The main objective of this study is to examine leader-member exchange theory and the effects on performance appraisal reactions. This study aimed to determine whether LMX quality is positively correlated with perceived fairness, and to clarify if LMX differentiation does not change the relationship between LMX quality and perceived fairness.

Throughout this paper, several elements of performance appraisal and employees' reactions will be presented. An existing literature review will be incorporated as an essential part of scenario-based research. In addition, the leader-member exchange theory is used to describe how LMX quality has an additional aspect to be considered, which is LMX differentiation, and how it is presumed that leader-member quality relationships differ inside teams (Martin et al., 2018). Even though research regarding leader-member exchange has been going on for several decades, the differentiation component should be more observed, not only in a theoretical but also in a practical way. Thus, leader-member dyadic relationship grows into focal interest in teams (Schyns & Day, 2010). As stated in Pichler et al.'s (2019) research, in order to grasp why supervisors develop high and low quality relationships with their subordinates, more research

needs to be conducted. The benefit of filling a research gap by this study refers to these mentioned research necessities.

The current thesis is divided into two sections, literature review and empirical study. The literature review shows important theories and already known empirical research involving the key variables, which are LMX quality, LMX differentiation and perceived fairness in performance appraisal. The second section states the hypotheses and afterward the methodology, results and discussion are presented. Also, study limitations, directions for future research and practical implications are recognized and presented for both practitioners and companies.

I) Literature Review

1. Performance Appraisal (PA)

Performance appraisal is only one name by which this method is known as. Some may call it performance evaluation, while some recognize it as a review. Regardless of how one may name it, the idea is the same. The main goal of this method is to document employees' job performance and to evaluate it. By doing so, companies can recognize employees' development and advancement, as well as recognize certain areas where improvement should be implemented. *"Performance appraisal is frequently performed in organizations for a variety of purposes, including administrative decisions (e.g., raise, promotion), feedback and development, and personnel research"* (Cawley, Keeping, & Levy, 1998: 615).

Although, there are plenty of variants of performance appraisal definition, a recent study from Pichler, Beenen, & Wood (2018) defined performance appraisals as feedback that helps employees improve their performance, with recognising feedback as a key condition for improving performance. According to Bacal (2004), performance appraisal is usually *"a face-to-face meeting between manager and employee to discuss the employee's performance for the purpose of removing barriers to performance"* (p. 10), allowing both employers and employees to define, communicate, and review expectations, goals, and progress in achieving strategic objectives.

Performance appraisal is defined as *"the formal process of evaluating organizational members"*(Erdogan, 2002: 556). In this research, the appraisal process is carried out by supervisors in the role of raters, as they are the ones with a connection to the subordinates. They concluded that high performance ratings can increase justice perceptions and could lead to higher performance in the future because of a need to correspond to the supervisor. The consequences of employees' actions throughout the performance appraisal process can be predicted and improved by developing other ways of action where the employees can make progress in the current and perceived fairness of performance appraisals.

Previously, companies were only focusing on the general management of the evaluation process and whether work was well organized (Keeping & Levy, 2000). Researchers think that performance appraisal is considered effective when their employees estimate it to be of use for them (Keeping & Levy, 2000; Levy & Williams, 2004). DeNisi & Murphy (2017) considered it essential to indicate that reviews and performance documentation should happen on a regular

basis. The results and documentation should be shared with employees so they would also have a clear idea where they stand. In order to develop, they should have the company's support, but also a clear idea of what is expected of them. It is important to mention the performance management plan. This plan includes various types of activities such as training, goal setting, feedback, reward systems, and what will be discussed in this thesis: performance appraisal. A formal process such as performance appraisal takes place occasionally, when employees are evaluated by a supervisor who appraises the employee's performance, grades their achievements, and then typically informs the employees about their evaluation. (DeNisi & Murphy, 2017).

Aggarwal & Thakur's (2013) review talks about various techniques of performance appraisal and their advantages and disadvantages. The authors divided performance appraisal into two groups, traditional methods and modern methods. Graphic rating scales, narrative essays, ranking and critical incident methods are older approaches of performance appraisal, and therefore part of the traditional methods. Management by objectives, behaviourally anchored rating scale, HR accounting, assessment centres, 360 degree and 720 degree feedback are part of the modern methods. In other words, they were developed in order to improve the traditional methods of performance appraisal.

DeNisi and Murphy (2017) conducted a literature review about performance management and performance appraisal from the most important studies published in the *Journal of Applied Psychology* carried out over a period of 100 years. The authors found that concepts such as rating scales and demographic characteristics, which have been used over the years, have less impact on performance appraisal. Also, the authors agreed that providing rater training in the organization improves the accuracy of rating performance appraisal. They suggest applying the knowledge collected throughout the research into practice, since most of the reviewed literature used to create the articles with more theoretical than empirical background. Over the years it has been determined that improvement in individual work does not mean work improvement at the company level, nor that the company would get more efficient in job performance. Murphy & Cleveland (1995) argued, and DeNisi & Murphy (2017) share the same viewpoint, that when it comes to performance appraisal evaluation, the opinion of a rater differs from the rating in the process of evaluation.

1.1 Reactions to Performance Appraisal

It is important and relevant to study reactions because if employees react well to performance appraisal, they will probably put more effort in working on the feedback received, and perhaps accept it. Negative reactions probably mean that people do not accept or that they deny the feedback. Our main interest are the reactions, and why people react in a certain way. Pichler (2012: 710) defines employee reactions as “*individual-level attitudinal evaluations of and responses to the performance appraisal process*”. Feedback can be defined as information that shows employees how good or bad they did on job performance (Greller, 1975).

A study by Posthuma & Campion (2008), conducted on a survey of about 50 000 respondents, discovered that 6% of CEOs and 13% of employees and supervisors had answered that processes of performance management were useful. Previous research found factors related to reactions to performance appraisals and especially appraisal satisfaction. Researchers have found that appraisal reactions include perceptions of fairness and the relationship between the supervisor and the employee (Dusterhoff et al., 2014). The authors stated that the purpose of the performance appraisal was to improve the way employees contributed to job performance and goals in the company. Appraisals are planned to sustain, advance, and help an employee grow overcoming obstacles to performance.

Research from Ilgen, Peterson, Martin, & Boesch (1981) and Steelman et al. (2004) stated that *consideration* in giving feedback was positively related to perceptions of the feedback session and helpfulness of the performance feedback. Kluger & DeNisi (1996) indicated that negative feedback could be operating in unexpected ways. In their research, Steelman, Levy, & Snell (2004: 177) shared the same opinion claiming that “*employees may be more satisfied with, motivated to use, and willing to seek out additional feedback when that negative feedback accurately reflects performance*”. In review and meta-analysis, Kluger and DeNisi (1996) found that feedback mostly has only a moderately positive effect on performance and that more than 38% of the effects were negative.

Spence & Keeping (2010) recognized that employees did not particularly enjoy hearing criticism, even though it might be portrayed with the best possible intentions. Depending on the way in which it is presented and the individual’s character, the employee who received a negative feedback, may start to have a lower level of productivity, instead of improving to a higher one. Such reactions will be negative for the company’s overall performance and will not result in a positive change. Managers tend to want to avoid that kind of a behaviour, hence there

are times when they are not willing to share that kind of feedback simply to avoid potential conflict and negative emotional influence (Spence & Keeping, 2010).

Omillion-Hodges & Baker (2017) recognized that a strong leader will help his employees reach a desired level of productivity only if he/she is willing to grow and develop as well. Many leaders or managers tend to keep the performance appraisal results to themselves simply because they are not willing to confront anyone. However, even though they may think that they are helping an individual or a company, the reality is completely different. By keeping the results from them, they are giving them the idea that the current performance level is satisfactory, while it should be improved. Those leaders who tend to neglect the fact that without constant learning and development, they provide less support to their employees which usually ends with fewer satisfied and advanced employees. Individuals who do not see progress or an opportunity for career advancement tend to leave their current job position in order to find one where they will feel supported and gain new knowledge. While not many get overly excited over a critique, in the business world such feedback is a direction through which one can still learn, grow and advance (Omillion-Hodges & Baker, 2017).

There are three empirical studies that have been conducted concentrating on relationship dynamics, with attention to the experience of a negative performance feedback for a member at work (Eberly et al., 2017). The authors are using vignettes which lead them to significant findings about interdependent workplace relationships. In the study, there is one matter emerging regarding usage of vignettes, and that is having a broad view of a realistic feedback. The purpose of Study 1 was, by having five samples and diverse methodologies, to validate an expanded scale to incorporate relational attributions. Eberly and colleagues wanted to evaluate the relational attribution construct, to initiate *“the construct’s validity, and to test whether relational attributions are indeed distinct from internal and external attributions”* (p. 716). Study 2 examined the connection among Kelley’s dimensions and the arrangement of relational attributions and started to observe the connection among relational attributions and relational improvement behaviours. Study 3 investigated if individuals instinctively make relational attributions with no instruction to consider relational causes for performance related events and to discover the nature of the connection between relational attributions and relational improvement behaviours within a sample of the employees. In other words, the authors measured the attributions of employees about the negative feedback received by the supervisor. It showed a stronger relationship when participants perceived they had enough time and energy to invest in relationship development. Research did not show if the relationships reported in Study 3 were perceived as positive and balanced or negative and unbalanced. Based on Study

2 and Study 3, “*relational attributions were significantly related to relational improvement behaviours*” (p. 725), implementing criterion related validity.

Pichler (2012) presented a meta-analysis of the literature on the social context of performance appraisal and appraisal reactions. The author used a *composite measure of relationship quality* in order to check other models of relationship quality in the process of the appraisal. The idea for this study was to test competing models of employee reactions to performance appraisals; a composite reactions variable was used similar to earlier research by Cawley et al. (1998). Pichler did this study to find out if appraisal reactions are connected to performance appraisal with variables studied. The rater-ratee relationship quality (i.e., supervisor satisfaction, supervisor support, supervisor trust) is more strongly related to appraisal reactions than appraisal participation or performance ratings (Cawley et al., 1998; Pichler, 2012). In the appraisal process, rewards and beneficial treatment have been indicated to be a result of exchange quality and that the social context within which the evaluation occurs is certainly important. Pichler noted that even when rating favourability and appraisal participation are controlled, the leader-member relationship quality is an important predictor of appraisal reactions. These results recommend that organizations should be interested in the mutual relationship between supervisor and employee, especially in the employee reactions in moments of work performance feedback. It is suggested that work be done on previous and subsequent supervisor-employee communication.

A meta-analytic review by Cawley, Keeping and Levy (1998) studied steps and concepts in performance appraisal participation in relation to several employee reactions. The authors elaborated several findings on general reactions associated to different forms of involvement, different form of involvement specified for several reactions, as well as involvement connected to general reactions and narrower types of reactions. Cawley and colleagues pointed out a few ways in which members can contribute to a process of appraisal. Some of them are letting members set goals and express their opinions, taking part in creating appraisal systems and carrying out self-appraisal. Keeping and Levy (2000) explored performance appraisal reactions by different measurements. They wanted to research the part related to reactions, so they tested if appraisal reaction concepts were assessed effectively. Also, authors wanted to understand if the change of method influences positive and negative reactions in the appraisal. As a result, Keeping and Levy indicated that appraisal reactions, both positive and negative, are not biased by method variance. Affect is not bias in relationships of appraisal reaction concepts.

Pichler and colleagues (2016) developed a model which shows that the quality of relationship with the supervisor and climate of procedural justice are correlated to employee

perceptions of fairness and the process of performance appraisal. As a result, the authors state that employee performance and motivation can be improved, as well as that supervisors can encourage better reactions to performance appraisal. What is most important is that supervisors control the perceptions of fairness within each individual and in teams (Pichler et al., 2016). Pichler et al. (2018) showed the relationship between feedback frequency and appraisal reactions. Furthermore, the authors created an appraisal reaction and feedback frequency model which can help research in the future and overall practice. The authors have a suggestion on how human resource departments can accomplish performance appraisal programs. Consequently, the authors encourage future researchers to use the model in order to improve performance appraisal effectiveness and increase the employee's performance at work.

1.2 Factors Influencing Employees' Reactions to Performance Appraisal

Evaluation of the job performance includes feedback sessions and formal reviews. Performance appraisal outcomes can have an important influence on employees' reactions toward their work, their supervisors, and their company. The process of appraisal can become a source of frustration and dissatisfaction when employees notice that the appraisal system is biased, irrelevant or political (Skarlicki & Folger, 1997).

A study by Dulebohn & Ferris (1999) tested how using *influence tactics* (i.e., voice) throughout the process of evaluation affects the employees' perceptions of fairness. The focus was put on the performance evaluation systems and how employees articulate justice and fairness reactions while being evaluated. The authors found that low justice procedural evaluations were connected to the use of job-focused influence tactics, while the positive relationship among the use of supervisor-focused tactics and procedural justice evaluations is suggestive of a voice effect. The use of job-focused influence tactics was related with negative evaluations.

Based on an article by Spence and Keeping (2010), performance appraisal review is also influenced by non-performance factors. The authors identified three of them as most essential. In career development, factors such as organizational norms and individuals' interests have been recognized before, but employees' reactions to such a method is a new field of interest for research. Supervisors change ratings of performance since negative feedback is related to negative reactions. After testing the mentioned factors, the authors found that they had significant connections with performance ratings. Research by Spence and Keeping provided a

result which says that, in the process of performance rating, raters consider their own judgement despite the fact that the ratee's job performance is explained in a transparent way.

Research by Harari and Rudolph points out the importance of rater accountability on performance ratings. They used meta-analyses of findings from thirty-five samples. When raters were accountable by the ratee, rater *accountability* resulted in higher performance rating scores. On the other hand, there was no major effect when raters were held accountable by a superior (Harari & Rudolph, 2017). Superior accountability is not related to performance ratings, while ratee accountability is positively related with performance ratings. While researching, the authors found two manipulation categories, identification and justification. Both manipulations had a similar impact on performance ratings. Another finding of authors Harari and Rudolph regards the performance appraisal purpose, where Jawahar & Williams (1997) indicate that ratings are lower for developmental purposes and higher for administrative purposes. A meta-analysis of 22 studies (Jawahar & Williams, 1997) has made known that administrative purposes of performance appraisal have been the focus of research more than developmental purposes.

In their paper, Iqbal, Akbar, & Budhwar (2015) aimed their attention at the ratee reactions-based view of effectiveness of performance appraisal. The measurement criteria of performance appraisal effectiveness, (i.e., *purposefulness, fairness and accuracy*) recognized their connections to employee reactions. Through this review, the companies can understand what their employee's needs are; for example, an employee's negative reactions (low level of satisfaction). Some researchers identify ratees' perceptions as the most important criteria for determining the effectiveness of performance appraisal systems (Keeping & Levy, 2000; Levy & Williams, 2004; Pichler, 2012).

Spence and Keeping (2013) provided a model which clarifies various rating purposes that the rater can have while evaluating a ratee. Here, the authors combined several components of performance appraisal research, those motivational, cognitive and contextual. The purpose of the model was to evaluate correctly, reducing potential disagreement. Overall, the mentioned model forecast a supervisor's evaluation goal by affecting the supervisor's mindset in order to evaluate with a precise aim.

DeNisi and Smith (2014) presented a review and a model where the aim was to show if there is a connection among performance appraisal of an individual, performance techniques and progress in performance concerning the company. The authors argued that they found a method how to improve performance of an individual employee but not on the whole company level. While reviewing the previous literature and models, the authors decided to combine

several models in order to produce a model for the development of performance management. They also found that employee performance is influenced by traditional performance management systems, as well as that the companies in general can be associated with human resource routines. What they wanted to explain is that the already mentioned human resource routines can be related to several procedures of performance inside the company.

The purpose of Dello Russo and colleagues' (2017) article was to examine if coaching leadership style could interpret *employees' perceptions of the appraisal as a politicized event*. Also, they wanted to discover differences in the perceptions of politics in an age-diverse personnel. They used the hierarchical linear model (HLM) on a sample of 576 employees and 112 leaders, collected from the employees, and added leaders' answers to the leadership scale aiming to check the leadership style of every supervisor. It was found that coaching leaders are recognized as less manipulative in their performance appraisal, especially by older employees. The authors did not find significant variability in the perceived organizational politics in performance appraisal on the company level. It is demonstrated that if the leader is acting as a coach, by following moral norms, setting high goals, offering constructive feedback and motivating the employees, all of this will have positive effects (Dello Russo et al., 2017).

Cawley et al. (1998) pointed out that appraisal reactions are affected by perceptions of fairness. Jawahar (2007) presented a study where *perceived fairness and appraisal processes* are combined. Distributive justice influences ratee satisfaction with the rater and the performance feedback. The author stated that procedural justice, as well as informational justice, can influence ratee satisfaction with performance feedback.

Dello Russo, Miraglia, & Borgogni (2017) presented research on the social context of *performance management*, by putting an accent on employees' reactions to performance appraisal (Farndale & Kelliher, 2013; Keeping & Levy, 2000; Levy & Williams, 2004) and adding the examination of the perceptions of organizational politics in the performance appraisal. Pichler (2012) tested the quality of the relationship between supervisor and employee on top of which Dello Russo and colleagues developed *the predictors* of mentioned reactions, incorporating the leadership style. As stated in Levy & Williams' (2004) review, this can be connected to employee reactions to feedback, since after receiving the appraisal, there is a possibility for the employee not to actively follow his/her performance improvement (Levy & Williams, 2004). Employees answer with negative attitudes (e.g., lowered organizational commitment) if they consider that the appraisal was not fair (Farndale & Kelliher, 2013).

2. Leader – Member Exchange (LMX)

Every evaluation is an outcome of the previous relationship between people, in this case leader and member. The leader-member exchange theory (LMX) identifies that leaders form different relationships with their subordinates. They form relationships with a subgroup of subordinates that involve more attention and support which go beyond formal job descriptions, while they form a more formal and distant relationship with other subordinates (Erdogan & Liden, 2002).

Scandura (1999) defined LMX as relationship-based social exchange between leaders and members. As Erdogan & Liden (2002) and Dulebohn, Bommer, Liden, Brouer, & Ferris (2012) noted, while originally based on role theory, over time LMX research has relied on the theory of social exchange (Masterson & Lenses, 2015). Defined as the quality of exchange between supervisors and their subordinates, leader-member exchange has an important incentive to improve performance at a workplace (Erdogan, 2002; Graen & Uhl-Bien, 1995).

After its contribution to leadership literature, LMX has continued to be the subject of research interest for more than 40 years. There are several reasons for this long-lived attention, including the evolutionary aspect of LMX (Day & Miscenko, 2015), the particular concentration on the relationship between a leader and a follower that has given rise to interest in wider interpersonal leadership theories (Uhl-Bien, 2006), the multi-level complexity of LMX affecting people, dyads and, recently, workgroups and companies, and the value of followers' interactions with their leaders, offering a framework for observing the entire work environment (Gerstner & Day, 1997).

LMX theory is consistent with the idea that leaders and followers exchange values, and that their relationships are at the core of the process of leadership (Hoyt & Goethals, 2009). Le Blanc & González-Romá (2012) argue that LMX theory occurs throughout a series of work-related exchanges; leaders develop differential types of relationships with each of their subordinates. Eberly et al. (2017) see the LMX theory as an especially well-fitting concept of leadership in the field of interpersonal attributions as it illustrates the complexities that develop over time as leaders and followers discuss their relationship.

2.1 LMX Quality

The quality of the LMX, particularly with the supervisor, can result in different employee outcomes. The outcomes have suggestions for improving employee engagement through interventions aimed at improving LMX quality. Improving work-related engagement by training may lead to higher-level workplace performance due to higher rates of satisfaction with HR activities (Yousaf et al., 2011).

Meta-analytic research has presented that high-quality relationships are related with positive work-related outcomes, for example employee's commitment, performance and satisfaction (Gerstner & Day, 1997). According to Graen & Uhl-Bien (1995), LMX is focused on the quality of the dyadic exchange which progresses between leaders and followers. One of the first leadership theories to include the follower in leadership processes was LMX's leadership-making model. This model implies that the connection between leader and participant is focused on the system of role-making and job performance (competence) of their interactions (Wee & Ahmad, 2011). The theory further recognizes that both sides are contributing to the continuous quality of the relationship. The development of LMX research has been identified by authors as shifting from an *individual* to a *dyadic* perspective into a *group* network perspective (Graen & Uhl-Bien, 1995). They claimed that as elite members gain leadership encouragement and emotional satisfaction, they would make more effort to do well and have stronger interpersonal commitment. High agreement (low variance) together with positive quality of the relationship (high mean) is a desirable and successful way to lead (reaching success in LMX). Leaders must be capable of providing all members an exchange-quality offer (Schyns & Day, 2010).

Leadership research on LMX and voice behaviour of employees has been investigated. When employees received higher levels of empowerment, the positive relationship between LMX and employee voice behaviour was found to be stronger (Chan & Yeung, 2016). The principle of LMX describes the relationship between various leaders and followers in terms of high to low quality (Graen & Uhl-Bien, 1995). High-quality interactions suggest better relationships between followers and their leaders. These interactions mean that followers develop better social reinforcement, better communication channels, increased confidence, and empowered performance (Chan & Yeung, 2016).

Liden, Wayne, & Stilwell (1993) argued that the most significant variables in the evolution of LMX are *liking* and *perceived similarity*. This longitudinal study of LMX covered less than one year of research. As reported by Dulebohn et al. (2012), long-term longitudinal research is

the best way to assess relationship development, maintenance, and decline. The aim of Dulebohn et al.'s meta-analysis (2012) is to review aggregate research on the antecedents and consequences of LMX, check the role of LMX as a mediator between antecedents and consequences, and analyse moderators of the relationship between LMX antecedents and LMX (Masterson & Lensges, 2015). The results showed that most of the outcome variation was explained by LMX's mediating role. Most leader and member activities seem to be viewed in terms of their importance to LMX relationships by both leaders and members, leading to the conclusion that LMX relationships may be significant in organizational functioning. The authors identified evidence for consequences varying from performance and *organizational citizenship behaviour* to attitudes such as organizational commitment and job satisfaction. Dulebohn et al. (2012) concluded that leaders' mindsets and actions are key determinants of LMX quality. Elicker, Levy, & Hall (2006) touched on the subject of employees' satisfaction, stating that when the leader-member relationship is more positive, then the satisfaction of the employee with the appraisal is higher, and he/she is more likely to support the process of the appraisal. That is why the relationship between supervisor and employee is essential.

It is assumed that the LMX quality relationship reflects the extent to which leaders and subordinates exchange resources and support each other. Focusing on the exchange relationship quality that progresses between a leader and each follower, "*the vast majority of empirical research on the LMX theory has concentrated on testing relationships between LMX quality and work-related outcomes at the dyadic (i.e., leader-member) level*" (Le Blanc & González-Romá, 2012: 534).

LMX theory recognizes the value of the dyadic interaction between leaders and members as the key to understanding the impact of leadership on individuals, groups and organizations (Bauer & Erdogan, 2015; Erdogan & Liden, 2002). Leaders are closer, more comprehensive and communicative with some members who report to them, according to the LMX approach. On one hand, the leader has a lower-quality exchange with a team member, and on the other hand, he/she forms a high-quality trust and respect-based relationship with another team member (Bauer & Erdogan, 2015).

In another area of leader-member personality similarity and its effect on LMX quality that has been examined, Bernerth, Armenakis, Feild, Giles, & Walker (2008) found that leader-member differences in *emotional stability, intellectual openness, agreeableness, and conscientiousness* were negatively related to employees' perception of LMX quality.

The connection between LMX and performance has important implications for practice. Research proposes that leaders should develop high LMX relationships with all their followers

at the individual level (Graen & Uhl-Bien, 1995; Scandura, 1999) not only to improve the performance of the job, but also to increase a range of positive results, including health, well-being and job satisfaction (Anand et al., 2011; Martin et al., 2010). Martin, Guillaume, Thomas, Lee, and Epitropaki (2016) stated that it is clearly beneficial to achieve high LMX with all members, but it is challenging to achieve it in corporate settings. To bring LMX to a high level, it is necessary to have constant social exchange between leader and employee, as well as having material resources and time.

Pichler et al. (2019) argue that in a highly diverse setting, variations between subordinates in LMX quality and therefore relative LMX are an important consideration. In other words, supervisor-subordinate dyads that vary in their quality of LMX based on nationality differences, and relative dissimilarities in quality of LMX subordinates may have significant effects on employee performance. The theory of LMX suggests that variation occurs within groups as to the degree of supervisor-subordinate relationship performance (Henderson et al., 2008; Liden et al., 2006; Martin et al., 2010). The authors proposed that in a highly diverse setting, subordinates, from various countries of origin, in their workgroup will be keen to compare their LMX performance with others. They were the first ones to test if supervisor-subordinate nationality similarity is related to the exchange between leader and member. Recent research has shown that it is important to consider variations in the relationship between quality supervisors and different subordinates as associated to subordinate performance (Henderson et al., 2009). Employee performance should be linked to expectations that one is perceived positive by a supervisor compared to other group members (Pichler et al., 2019).

2.2 LMX Differentiation

Henderson et al. (2009: 519) defined LMX differentiation as *“a process by which a leader, through engaging in differing types of exchange patterns with subordinates, forms different quality exchange relationships (ranging from low to high) with them”*. The idea of differentiation is based on the notion that leaders want to form relationships of high quality with the most valuable subordinates, such as those with the most knowledge, skill and ambition (Graen & Scandura, 1987).

LMX differentiation has been described as the gradation of variability of the quality of LMX relationships that are developed within working groups (Liden et al., 2006). The authors found a meaningful interaction impact on team performance showing the anticipated sign, and

found a meaningful interaction impact on team strength and team pressure showing a sign counter to expectations. Le Blanc & González-Romá (2012) stated that the function of LMX differentiation at team level has not yet been completely clarified and that more empirical research is needed to advance the theory of LMX concept since the results are inconsistent. The main objective of the research is to investigate the correlation between LMX differentiation and affective team commitment and team performance. More expected variations between team members are attributed to more variation of LMX scores within the team.

The process of LMX differentiation establishes different quality relationships between leader and each employee within the team. Most supervisors have “*different quality relationships with different members of their team*” (Liden & Graen, 1980; Martin, Thomas, Legood, & Dello Russo, 2018: 164). Because of limitations in leaders’ time and resources (Graen & Uhl-Bien, 1995; Henderson et al., 2009), there are good theoretical arguments for the inevitability of high levels of LMX differentiation and therefore relative position of LMX (Hooper & Martin, 2008).

According to Henderson et al. (2009), greater differentiation within a working group or team implies that the overall quality of LMX is high, while weaker differentiation corresponds to a context in which the overall quality of LMX within a working group or team is low. If group differentiation is low, individual-in-group comparison might not be significant for individuals, and social interaction mechanisms related to individual-level expectations of overall relationship performance could more accurately predict their behaviour.

Limited theoretical or empirical study has been provided about the outcomes of LMX differentiation at the organizational level, possibly because of the emphasis of the LMX theory on individual working groups (supervisor and his/her subordinate). Because the LMX model relies on distinct interactions and relationships in working groups, the concept itself seems to be multilevel in nature. Unless a working group consists of a leader and a single subordinate, LMX differentiation provides a group-level framework in which the variability and quality of the leader-subordinate relationships occur within a group (Liden et al., 2006). Erdogan & Liden (2002) noted that being close to the leader, when there is high LMX differentiation in a group, gives more benefits and support to the member. Recently, LMX research has focused on LMX differentiation, in a degree to which leaders form relationships of changeable quality (high to low) with different members within a team (Erdogan & Bauer, 2010). This viewpoint varies from prior work focused on the dyadic relationship only between a leader and participant because it considers the participants' knowledge that there are different quality relationships (Masterson & Lensges, 2015).

A broader distinction can weaken group dynamics, with inequity and favouritism in the case of distinct differences in LMX quality within group members (Harris, Li, & Kirkman, 2014; Liden et al., 2006; Schyns & Day, 2010). Even though LMX largely includes the development of dyadic relationships with individual member over time, these dyadic relationships provide a broader social background at the group level (Schyns & Day, 2010). Consequently, a leader with a different quality of social interaction with members throughout the group will face significant relational difficulties (Liden et al., 2006; Schyns & Day, 2010). A leader must communicate with every member within the group; one way for leaders to enhance the mutually perceived quality of the relationship between members of groups is to make structured offers of high-quality social interactions for all members of the group (Schyns & Day, 2010). Given the chance to interact with the leader, employees may affect (possibly through group activities) *individual perceptions* and *group dynamics* (Bernerth & Hirschfeld, 2016).

The shared exchange which represents relationships of high LMX leads to increased affective connection between leaders and members (Gerstner & Day, 1997). Some variations in the appraisal of the behaviour of the same leader are considered to reflect real differences in the relationship between leader and member in relationship-based leadership theories such as LMX. Schyns & Day (2010) state that the action of a leader also differs within a group of followers as a result of different qualities and interpersonal relationships that form between the leader and followers. Work-based relationships are important segments in any organization, especially those including a superior.

While some studies show a positive correlation of LMX differentiation and performance controlling for LMX quality (Naidoo et al., 2011), others do not (Liden et al., 2006). Le Blanc & González-Romá's (2012) study reported a positive relationship between LMX variability and group participation and team performance, but only when the LMX quality team median was low.

2.3 LMX Quality and LMX Differentiation

In their review, Martin et al. (2018) revealed that LMX differentiation is an essential continuation of the LMX concept and that it explains how LMX quality is important for work related results. LMX differentiation research supports the transfer of theoretical analysis from the dyadic to the group level.

Hooper & Martin (2008) created a perceived variability measure for the overall quality of LMX. For the evaluation of situations in their environments, the authors suggest that people have confidence in the fairness norms of equity and equality. Team equity standards promote rivalry and disharmony between members while equality standards encourage solidarity and relational harmony, suggesting that LMX differentiation has negative implications for job satisfaction and the well-being of participants. Their study findings confirmed that statement. LMX differentiation was found to be positively related to relational team conflict and negatively related to subordinate reports of job satisfaction and well-being. Researchers have dedicated attention to addressing *individual and group-level influences of LMX* (Henderson et al., 2009; Hooper & Martin, 2008; Vidyarthi, Liden, Anand, Erdogan, & Ghosh, 2010).

Leader member exchange theory is based on the principle that leaders distinguish between their employees. Leaders set up relationships of high quality with a few employees and poorer relationships of lower quality with other employees (Anand et al., 2016). Erdogan & Bauer (2010) argued that the relationship between the differentiation of LMX and the outcomes of workers relies on the workgroup justice environment. Le Blanc & González-Romá (2012) demonstrated that median LMX quality moderates the relationship between LMX differentiation and team outcomes. Justice climate advanced the interaction between LMX differentiation and outcomes so that a difference occurs when the climate of justice is low (Erdogan & Bauer, 2010). Upon checking for individual LMX quality, Hooper & Martin (2008) used the principles of equality and the consistency of the theory of justice to suggest negative consequences for individual interpretations of LMX differentiation. The authors found that LMX differentiation developed feelings of mutual conflict and subsequently decreased job satisfaction and well-being of employees. In high-justice groups, LMX differentiation may have positive effects, but negative effects of LMX differentiation could be caused by a lack of justice.

In the meta-analysis by Tse, Troth, Ashkanasy, & Collins (2018), the goal was to test the main role of affect in determining the nature of leader-member dyadic relationships at different levels of organizational analysis. The authors conducted “*a qualitative review of the literature on LMX published between 2000 and 2017, focusing on the role of affect at five levels of analysis; within-person, between persons, interpersonal, team, and organizational levels, as well as potential effects across multiple levels of analysis*” (Tse et al., 2018: 135). This review is the first to combine theory, methodology, and findings regarding the role of affect-related constructs in LMX progress over different levels of analysis.

Leader-rated LMX in-team differentiation predicts subsequent team performance (six-month project), but not earlier periods, which is in line with the notion that it takes time for

LMX relationships to establish and experience the relationships of others before output effects are detected (Naidoo et al., 2011). The variables in team development were examined, including team morale, but the authors did not find relationships with LMX differentiation (Tse et al., 2018).

Bernerth & Hirschfeld (2016) studied LMX differentiation in the group, with the aim of understanding leaders' affective well-being. Differentiation was positively related to leaders' job stress only when groups had low average LMX quality, and increased differentiation was related to less positive affect in leaders. The authors explored leaders' well-being at the group level of LMX quality, by means of *positive affect* and *job stress*. The LMX dyadic relationship between leader and member, with time, became the centre of interest for the social context in large teams (Schyns & Day, 2010).

2.4 The Relationship between LMX and Performance Appraisal

“LMX influences reactions to when employees attribute performance outcomes to a peer relationship, inasmuch as high LMX quality could be viewed as a valuable resource in the relationship improvement process” (Eberly et al., 2017: 727).

Trust is at the core of the LMX structure as LMX is described as a *trust-building process* (Bauer & Green, 1996; Liden et al., 1993; Scandura & Pellegrini, 2008). A meta-analytic review by Martin et al. (2016) reports the relationship between LMX relationship quality and performance. It was designed to address theoretical matter, developed from LMX theory, with respect to the mentioned relationship between LMX quality and performance. It has been demonstrated that the effects of LMX on a different performance basis (negative with counterproductive performance and positive with performance of task and citizenship) are of moderate to large size and establish a moderate positive effect size on objective performance. They found factors for mediating the correlation between LMX and performance, with trust in the leader having the largest effect. The authors proved that, even if it involves objective measures of performance, LMX is positively associated with task performance (Martin et al., 2016).

LMX's construct is characterized as a form of social exchange that focuses on dyadic relationships between leaders and their members (Graen et al., 1982). This suggests that fairness perceptions shaped in the dyadic exchange can play a valuable role in forming perceptions of LMX (Selvarajan et al., 2018). For instance, low quality exchange relationships could lead to unfairness and not being treated fairly (Deluga, 1994). In a review about performance appraisal research, DeNisi & Pritchard (2006) indicate that motivating employees to improve their

performance should be the goal of performance assessment. LMX serves as a crucial mechanism that motivates member behaviours in the light of interactional fairness (Burton et al., 2008; Masterson et al., 2000).

As expected by the theory of social exchange, appreciated members appear to be more driven to improve their performance due to the improved quality of the exchange relationship between leader and member. However, prior research did not empirically identify LMX as a mediator of the interaction between equality and employee behaviours. LMX mediates between fairness and employee willingness for improving their performance (Erdogan, 2002).

A study by Liden et al. (2006) used a multi-level approach to analyse the associations between LMX differentiation and individual performance, and between LMX differentiation and team performance. The authors discussed that the impact of LMX differentiation on individual performance is determined by the leader-member exchange of that individual, and that the impact of differentiation on team performance is moderated by team task interdependence and median LMX. The relationship between LMX and individual performance has been examined in plenty of research studies (Erdogan & Liden, 2002), presenting a positive correlation between leader-member exchange and performance ratings (Gerstner & Day, 1997). This outcome was interpreted considering a combination of valid differences in the performance of high and low LMX subordinates as well as by leader bias in the rating (Liden et al., 2006).

Extensive research presented that the dyadic relationship between members and leaders plays an important role in influencing critical *attitudes* and *behaviours* of members (Dulebohn et al., 2012; Gerstner & Day, 1997; Harris et al., 2014). Supervisors are more likely to distinguish their interactions with subordinates who are like themselves and who believe that they share similar values and attitudes (Pichler et al., 2019). Some researchers share the opinion that establishing high-quality interactions with all of the supervisors' subordinates is not an effective use of time and other assets (Dansereau et al., 1975; Graen & Scandura, 1987).

A meta-analysis explored job attitudes as effects of LMX instead of as a descriptive function of the interaction between LMX and performance. LMX is closely related to leader-rated performance if LMX was assessed by the leader rather than by the employee (Gerstner & Day, 1997). Positive relationships between LMX quality and member reactions are persistent throughout meta-analyses of the literature (Dulebohn et al., 2012; Gerstner & Day, 1997) and work performance (Martin et al., 2016). Liden et al. (1993) interpret the theory of social exchange as relationships of high quality among supervisors and subordinates that encourage better results for employees. The studies looked at conditions for understanding how LMX defines job satisfaction (Harris, Wheeler, & Kacmar, 2009). Chan & Yeung (2016) stated that

if employees can take part in decision-making, the relationship of trust between the leader and the employee will be strengthened. When employees are motivated to express their views, the relationship between LMX and, for example, employee voice behaviours are strong. The quality of the relationship often depends on several different factors, like personality and employee performance (Gerstner & Day, 1997; Graen & Uhl-Bien, 1995; Wang et al., 2019).

Studies have identified several factors related to overall performance evaluation reactions and appraisal satisfaction. Reactions to appraisal are influenced by fairness perceptions of the supervisor and the employee interactions (Cawley et al., 1998). Employees respond to the perceived fairness or lack of fairness from supervisor by developing lower exchanges of quality (Erdogan & Liden, 2006). As the equity theory suggests, fairness implies perceived outcome-related fairness (Dusterhoff et al., 2014).

Liden, Erdogan, Wayne, & Sparrowe (2006) argued that based on employees' feelings of unfair approach, LMX differentiation will lead to low performance. Fairness perception regarding differentiation appears to be relevant when seeing the results of agreement in LMX (Scandura, 1999). The reasons for an absence of agreement is LMX development and how followers view their relationship quality with their leader. At the beginning of LMX relationships, as development of the dyadic relationship, characteristics of leader and follower must be observed (Schyns & Day, 2010).

Performance appraisal fairness relates to a set of rules and practices that ensure justice in the performance appraisal system (Iqbal et al., 2015). Skarlicki & Folger (1997) found justice to have a significant negative effect on employees' organizational revenge behaviour; if employees perceive unfairness, they could try to create justice in their own way (e.g. being counterproductive, manipulating ratings or showing revenge). Iqbal et al. (2015: 526) stated that *"the higher the perceived fairness is, the lower the ratee centric biases will be, and vice versa"*.

A meta-analysis by Cawley et al. (1998) described that participation is highly correlated with employee reactions and the importance of justice perceptions in the process of performance appraisal. Important predictors of fairness perceptions and rating precision are regular evaluations, supervisor knowledge and pinpointing goals to improve weaknesses (DeNisi & Murphy, 2017). A good leader-member working relationship has a positive impact on organizational fairness perceived by employees. Employees perceive more organizational fairness and feel performance appraisal satisfaction when there is a good leader-member exchange relationship. When a leader's decision-making process includes employees

individually, it significantly increases the sense of fairness in the employee. When employees feel fairness, they are loyal and have a positive response to the performance appraisal process (Wang et al., 2019). Attitudes regarding the supervisor and the system in general are predicted by the employees' fairness perceptions of the performance appraisal practices (Thurston & McNall, 2010).

II) Empirical Study

In the first part of this thesis, a significant portion of the literature on leader-member exchange and reactions to performance appraisal was reviewed. Performance appraisal represents the official procedure in which the employee is evaluated by his/her supervisor. In other words, the supervisor tracks the overall progress of the company member (Cawley et al., 1998; Erdogan, 2002). Reactions to PA can be positive or negative. Nonetheless, appraisal of performance can improve the employees' job performance (Omilion-Hodges & Baker, 2017). As mentioned in the literature review, LMX theory has been researched for more than four decades and is described as a social exchange between leader and member over a certain period of time (Day & Miscenko, 2015; Eberly et al., 2017). LMX quality represents the relationship between leader and member, and with the introduction of LMX differentiation as a continuation of LMX quality, LMX differentiation allows the analysis of different relationships between leader and members at the team level. Most leaders have different quality relationships with their team members.

Hence, this study aims to investigate LMX quality and LMX differentiation and their connections with reactions to performance appraisal. The empirical study will focus on the perceived fairness of performance appraisal, providing new information about the leader-member exchange theory in the organizations as well as on employees' reactions to performance appraisal.

LMX quality is concentrated on the dyadic relationship between leader and member, aiming to create deeper interpersonal commitment in terms of high to low quality (Graen & Uhl-Bien, 1995). Having high quality relations means having better relations between leader and member, and better performance and communication of the employees (Chan & Yeung, 2016). Reactions to PA depend on the relationship between a leader and an employee, and hence, on the quality of their LMX. Researchers found that *“appraisal reactions are affected by perceptions of fairness.”* (Cawley et al., 1998; Dusterhoff et al., 2014: 266). In fact, perceptions of fairness are one of the possible reactions which include also other variables as reviewed in the literature review. In the literature, it is shown that the LMX relationship influences the employee's performance evaluation reaction, and that the fairness of the procedure as well as the member's involvement in the performance appraisal are impactful: *“Research has overwhelmingly indicated that the opportunity to have some sort of a say in a process that affects us is important to individuals.”* (Pichler, 2012: 715). Consequently, we

hypothesize a positive relationship between the leader-member exchange and perceived fairness. A positive relationship means that if the LMX quality increases, perceived fairness in evaluations also increases, and the other way around, if one decreases, the other one also decreases. A positive relationship means that two variables covary in the same direction.

Hypothesis 1: LMX quality is positively correlated with perceived fairness.

In the LMX differentiation process, the supervisor creates a different quality relationship with each team member (Liden & Graen, 1980; Martin et al., 2018). Different relationships among leader and employee can impact other relationships in the company and in that way influence leadership results in the group (Schyns & Day, 2010). Even though research about LMX quality has been going on for several decades, the role of LMX differentiation needs more attention for exploration of individual and group performance in order to further develop LMX theory in general (Gerstner & Day, 1997; Hooper & Martin, 2008; Le Blanc & González-Romá, 2012; Liden et al., 2006; Scandura, 1999). It was further explained that “*an obvious reason why LMX differentiation may affect employee reactions is because of the relative advantage afforded to individuals in high quality LMX relationships, but not to individuals in low quality LMX relationships. High quality LMX relationships involve more tangible and intangible resources being exchanged within the leader–employee dyad.*” (Hooper & Martin, 2008: 21). Bias in performance appraisal can negatively influence the relationships between team members (Graen & Uhl-Bien, 1995). The second hypothesis involves differentiation as a moderator. We expect that high LMX differentiation weakens the relationship between LMX and perceived fairness. It is important to point out that ‘weaken’ means that the relationship goes up less steeply, meaning, it is still positive but less strong.

Hypothesis 2: The LMX-perceived fairness relationship is moderated by LMX differentiation, being less positive when differentiation is high.

3. Methodology

3.1 Participants

A total of 139 participants took part in the survey. The questionnaire consists of two parts, the first part are the questions regarding what they read in the scenario, and the second part are demographic questions. In other words, 139 participants answered the first part of the questionnaire, while in the second part of the questionnaire, which is related to demographic information, 116 to 127 participants replied to certain questions.

Table 3. 1 Descriptive statistics for socio-demographic variables (n = 116-127)

		<i>fn</i>	<i>%</i>			
Gender	Male	60	47.2			
	Female	67	52.8			
Education	High school	19	15.0			
	Bachelor diploma	14	11.0			
	Master's diploma	93	73.2			
	Doctoral	1	0.8			
		<i>n</i>	<i>Min</i>	<i>Max</i>	<i>M</i>	<i>SD</i>
Other socio-demographic variables	Age	127	23	62	38.19	9.59
	Total work experience (in years)	118	.42	39	13.77	9.24
	Time in current organization (in years)	116	.08	35	7.33	7.54
	Time with current superior (in years)	116	.08	33	3.04	4.54

As reported in Table 3.1, out of 127 participants, 60 (47.2%) were male and 67 (52.8%) were female, with an average age of $M = 38.19$ years ($SD = 9.59$), with 15% of participants completing high school, 11% of participants holding a bachelor's degree, 73.2% a master's degree and only one participant (0.8%) having completed a doctoral degree. The average work experience of the participants in this research is $M = 13.77$ years ($SD = 9.24$), the average work experience in the current organization is $M = 7.33$ years ($SD = 7.54$), while the average number of years spent with the current supervisor is $M = 3.04$ years ($SD = 4.54$).

3.2 Procedure

The data for this primary research were collected by questionnaires in diverse organizations with offices in Zagreb, Croatia. Participants were from several private sector companies such as a medium-sized European oil company with a leading role in the Croatian oil business, an international chain of stores with Scandinavian roots that sells furniture and additional

essentials, a developing software firm and several other individual respondents from different organizations.

Data was collected with a one-time questionnaire and distributed by Qualtrics, which involved sending the link to the employees' professional emails. The questionnaire was sent to the human resources departments in the form of a link, after which members of HR departments distributed the link with the questionnaire to all the members who fit the profile in the request sent to the companies; it was targeting employees who are familiar with periodical performance appraisal by their superior (supervisor, manager, team leader).

The time-period for data-gathering was five weeks, between the 1st of July 2019 and 2nd of August 2019. The questionnaire was based on scales validated in English and then translated into Croatian language. For all participants filling in the questionnaire, Croatian language is the mother tongue. Participation was voluntary, anonymous and communicated absolute confidentiality of the provided responses.

To motivate HR department members and the employee's engagement and truthful responses, the option to deliver a report with the relevant results via email after the finalization of the study was communicated. After the initial communication and agreement with the human resources departments of each company, three reminders were sent to them so they could resend the information about filling in the questionnaire to respondents who had not completed them as well as to employees who did not take the opportunity to respond to the questionnaire.

3.3 Measures

The questionnaire had a duration of nearly 15 minutes. A short introduction was included with the intention to explain the goal of the study and its importance. Furthermore, the participants had to read one of in total four different scenarios that they had randomly received after which they had to answer the questions regarding what they had read. At the end, the questionnaire had several demographic questions.

Scenario-based research was used. This requires manipulation of the independent variable, in other words, exposing the participants to different situations or conditions in order to compare their answers/results. The scenario describes a fictional situation and the vignette is the informational pattern used for the manipulation (Aguinis & Bradley, 2014).

A vignette is also known as a scenario; it is a social situation description with the factors which are significant for the judgment/decision-making process of participants filling in the survey (Alexander & Becker, 1978). Sanders, Cogin, & Bainbridge (2014) point out that, in order to activate the participants' reactions, one or more short stories which are familiar to them

can be used instead of direct questions. The participants react to actual and experienced situations since it develops higher realism (Wason & Cox, 1996), and because of that, by using vignettes, there is a higher possibility for the participants to answer accurately than by using abstract and direct questions (Weber, 1992). Alexander & Becker (1978) state that the vignette technique lets researchers differ the independent variable systematically. Researchers manipulate the independent variable by changing words and sentences in the vignette (Sanders et al., 2014). Contrastive vignette technique incorporates concepts from the experimental design with the sample survey procedures (Burstin et al., 1980; Wason et al., 2002) where “*participants are randomly assigned to different versions of the same basic vignette*” (Sanders et al., 2014: 107).

In the scenario, for the supervisor (manager), used was a gender-neutral name common in Croatia (Vanja). The questionnaire comprised four vignettes. Scenario 1 described a good work relationship for both Vanja and the individual participating in the questionnaire and Vanja with the rest of the team. This represents low LMX differentiation as both the individual and all team members have the same relationship with Vanja. Scenario 2 explained that Vanja and the participant have a good relationship, but the rest of the team have a bad relationship with Vanja, which represents high LMX differentiation. In scenario 3, Vanja and the participant have a bad working relationship, however, the rest of the team have a good relationship with Vanja, representing high LMX differentiation. In scenario 4, both the participant and the rest of the team members have a bad relationship with Vanja. This represents low LMX differentiation. Qualtrics randomly showed one of the four vignettes to each participant.

The questionnaire included several variables, some are the focus of this study and others are not taken into consideration for not being relevant in this analysis.

Leader member exchange quality

Leader member exchange quality was used as a manipulation check, to make sure that the participants who read each scenario understood their respective level of LMX. In other words, that the manipulation worked: those participants reading the “High LMX” vignettes should report higher values on these variables than those who read the “Low LMX” vignettes. LMX quality was measured with a single item from the LMX 7 scale (Graen & Uhl-Bien, 1995). The sample item is “*How would you characterize your working relationship with Vanja?*” and the respondents were requested to answer using a 5-point Likert-type scale ranging from 1= Extremely ineffective to 5= Extremely effective.

Leader member exchange differentiation

Leader member exchange differentiation was used as a second manipulation check. There are two scenarios showing that the relationship Vanja has with everybody from the team is the same as with the person, and the other two showing it is the opposite. LMX differentiation was measured by the item “*The quality of the relationships that Vanja has with the team members is mostly...*” and the respondents were assessed by the item on a 6-point Likert scale ranging from 1= Very different to 6= Very similar. The question was created by us, following the classification by Martin, Thomas, Legood, & Dello Russo (2018).

Perceived fairness

The participants were asked to rate the feedback received from their supervisor/manager Vanja from the story, and the sample items included were “*the evaluation was based on accurate information*”, “*the evaluation was free of bias*” and “*the evaluation upheld ethical and moral standards*”. Perceived fairness was measured by the mentioned three items on a 7-point Likert from 1= Strongly Disagree to 7= Strongly Agree, using the scale developed by Colquitt (2001).

Control variable

Gender, age, years of work experience, time in current organization and time with current supervisor were included as demographic control variables in this research. Gender is coded 1 for male and 2 for female. Details regarding the gender control variable are provided in the following paragraphs in the results section.

4. Results

4.1. Preliminary Analyses – Manipulation Check

To determine that the manipulation was successful and that all the participants who read different group scenarios truly understood their LMX position and the LMX position of other team members in relation to their superior, two one-way ANOVAs were conducted to test for differences between three or more groups. Manipulation is considered successful if participants who received a scenario of good relationship with a superior had higher scores on the LMX quality variable than those who received scenarios which described poor relationship with a superior. Equally, manipulation is successful if participants who received a scenario with a similar relationship with a superior as the other team members had with the leader showed higher scores on the LMX differentiation variables than those participants who received a scenario describing a different relationship with a superior than other team members experienced (higher scores indicate greater similarity or lower LMX differentiation).

Table 4. 1 One-way ANOVA: differences in LMX quality and LMX differentiation with regard to different group scenarios (N = 139)

		<i>n</i>	<i>M</i>	<i>SD</i>	<i>F</i>	<i>p</i>
LMX quality	Scenario 1 (High LMX- Low LMX Diff)	29	3.31 ^a	1.51	34.346*	< .001
	Scenario 2 (High LMX- High LMX Diff)	34	3.29 ^a	1.27		
	Scenario 3 (Low LMX- High LMX Diff)	44	1.55 ^b	0.59		
	Scenario 4 (Low LMX- Low LMX Diff)	32	1.53 ^b	0.51		
LMX differentiation	Scenario 1 (High LMX- Low LMX Diff)	29	4.69 ^a	1.37	60.160*	< .001
	Scenario 2 (High LMX- High LMX Diff)	34	2.50 ^b	1.11		
	Scenario 3 (Low LMX- High LMX Diff)	44	2.05 ^b	1.40		
	Scenario 4 (Low LMX- Low LMX Diff)	32	5.22 ^a	0.79		

Note. * $p < .001$.

The results of post-hoc tests were denoted by the same letter if there was no significant group difference and by a different letter if there was significant group difference at $p < .05$ level. As we can observe, both manipulations worked well.

Table 4.1 shows that a statistically significant difference was obtained in LMX quality ($F(3, 135) = 34.346, p < .001$) and LMX differentiation ($F(3, 135) = 60.160, p < .001$), depending on what group scenario was read.

LMX quality showed statistically significant differences between almost all groups: Scenario 1 (High LMX-Low LMX Diff) with Scenario 3 (Low LMX-High LMX Diff) ($p < .001$) and with Scenario 4 (Low LMX-Low LMX Diff) ($p < .001$), as well as Scenario 2 (High LMX-High LMX Diff) with Scenario 3 ($p < .001$) and with Scenario 4 ($p < .001$). In other words, participants who read Scenario 1 and Scenario 2 rated their relationship with their superior on average better than those who read Scenario 3 and Scenario 4. At the same time, no statistically significant differences were found in LMX quality, i.e., in the evaluation of the relationship with the superior, between those who read Scenario 1 and Scenario 2 ($p = .950$), nor between those who read Scenario 3 and Scenario 4 ($p = .952$).

With LMX differentiation, statistically significant differences were obtained between the expected groups: Scenario 1 with Scenario 2 ($p < .001$) and with Scenario 3 ($p < .001$), as well as Scenario 4 with Scenario 2 ($p < .001$) and with Scenario 3 ($p < .001$). In other words, participants who read Scenario 1 and Scenario 4 rated the superior's relationship with team members more similar (higher values) compared to those who read Scenario 2 and Scenario 3. At the same time, no statistically significant differences were found in LMX differentiation, i.e., in assessing the similarity of the superior-team relationship with those who read Scenario 1 and Scenario 4 ($p = .089$), nor between those who read Scenario 2 and Scenario 3 ($p = .101$).

The results obtained are consistent with the logic of each individual scenario and indicate that the manipulation for LMX quality and LMX differentiation was successful. A more detailed view of the results obtained can be seen in the following graphs (Figure 4.1 and Figure 4.2).

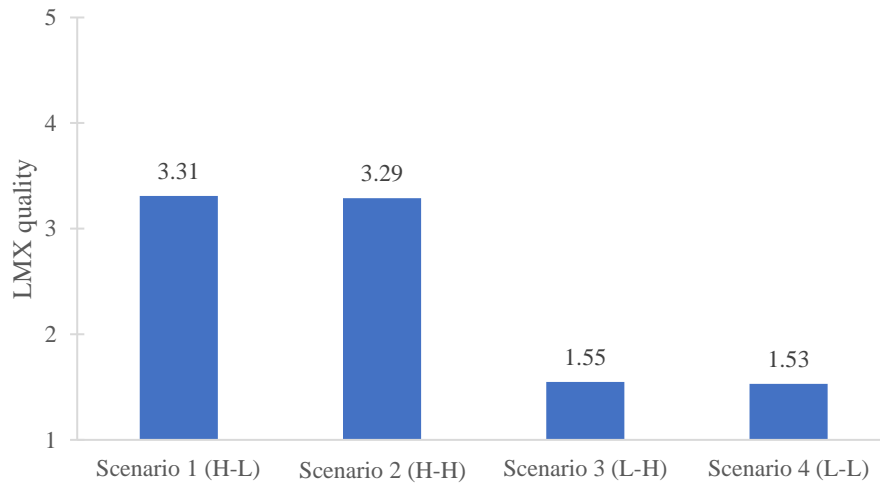


Figure 4. 1 Differences in LMX quality with regard to different group scenarios

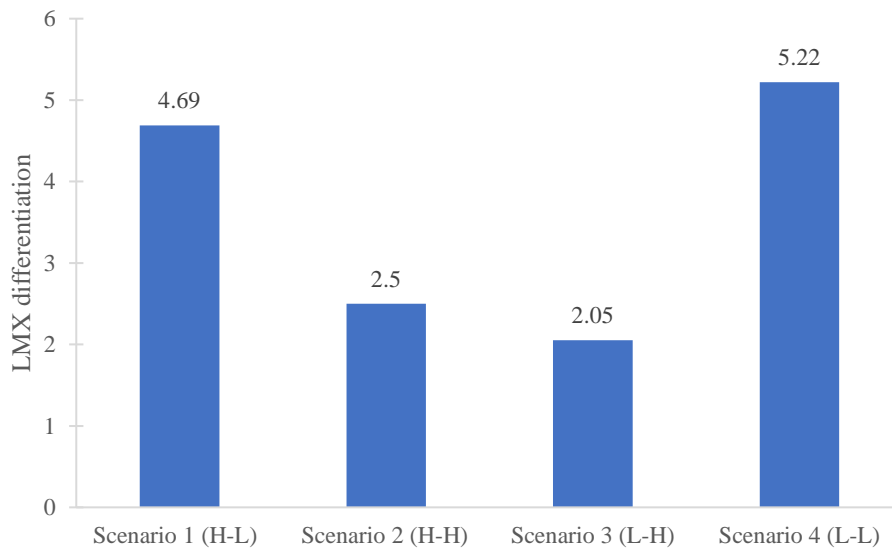


Figure 4. 2 Differences in LMX differentiation with regard to different group scenarios

4.2. Testing of the Model – Main Analyses

Before conducting multiple regression analyses, Pearson's coefficients of association of predictors (LMX quality) and moderators (LMX differentiation) with the criterion (perceived fairness) were calculated (Table 4.2).

Table 4. 2 Correlations between LMX quality, LMX differentiation, perceived fairness and demographics variables (N = 115-139)

	LMX Q.	LMX D.	Gend.	Age	Educ.	Work exp.	Org. time	Sup. time
P. Fairness	.30**	.08	-.18*	.02	.02	.00	.07	.03
LMX Q.		.05	-.04	-.10	-.07	-.10	.05	.17
LMX D.			.06	-.10	-.03	-.05	-.14	-.09
Gender ^b				.00	-.04	-.07	.00	.02
Age					-.17	.96**	.54**	.14
Education						-.26**	-.18	-.23*
Work exp.							.54**	.18
Org. time								.53**

Note. ^b Gender is coded 1 = male; 2 = female; ** $p < .01$; * $p < .05$.

From Table 4.2, it can be seen that there is a statistically significant slight positive correlation between LMX quality and perceived fairness ($r = .30$, $p < .001$). This means that higher scores on LMX quality are associated with greater perceived fairness, and vice versa. Therefore, the higher the relationship with the superior, the higher the perception of his/her honesty and vice versa, the worse the relationship with the superior, the lower the perception of his/her fairness. At the same time, no statistically significant association was found between LMX differentiation and perceived fairness ($r = .08$, $p = .367$) and LMX differentiation and LMX quality ($r = .05$, $p = .593$). Thus, there is no correlation between perceiving the superior's relationship with other team members and perceiving his/her fairness as there is no correlation between perceiving the superior's relationship with other team members and perceiving own relationship with superior.

From the socio-demographic variables, only gender was statistically significantly slightly negatively correlated with perceived fairness ($r = -.18$, $p = .048$). This means that male participants tend to perceive their superior as more fair than female ones do. The correlations between perceived fairness, LMX quality, and LMX differentiation with other socio-demographic variables were not statistically significant ($p > .05$).

To test the model, i.e. the moderation effect of LMX differentiation on the relationship between LMX quality and perceived fairness we used multiple regression analyses with gender

as the control variable (Table 4.3). In the first block we entered both variables as predictors of perceived fairness and gender as the control variable, and in the second block we entered their interaction (LMX quality*differentiation) to see if there would be any significant changes in the percentage of the explained variance in perceived fairness due to the moderation effect. Prior to the analyses, variables LMX quality and LMX differentiation were mean centred.

Table 4. 3 Multiple linear regression: predicting perceived fairness with gender as control variable (N = 127)

		β	t	p	R^2	F	p
Step 1: multiple regression	LMX quality	0.32	3.81**	.000	.138	6.555**	.000
	LMX differentiation	0.06	0.74	.462			
	Gender ^b	-0.17	-2.00*	.048			
Step 2: moderation effect	LMX quality	0.32	3.77**	.000	.153	2.157	.144
	LMX differentiation	0.09	1.03	.304			
	Gender ^b	-0.17	-2.05*	.043			
	LMX quality * differentiation	0.13	1.47	.144			

Note. ^b Gender is coded 1 = male; 2 = female; ** $p < .01$; * $p < .05$.

In the first block, the model is statistically significant ($F(3, 123) = 6.555, p = .000$), i.e., a linear combination of LMX quality, LMX differentiation and gender explains 13.8% of the variance of perceived fairness. However, only LMX quality ($t = 3.81, p < .001, \beta = 0.32$) and gender ($t = -2.00, p = .048, \beta = -0.17$) were a statistically significant predictor of perceived fairness, whereas LMX differentiation did not prove statistically significant ($t = 0.74, p = .462, \beta = 0.06$). Thus, higher LMX quality (better relationship with the superior) predicts higher perceptions of the superior's fairness, while perceiving the superior's relationship with other team members does not predict perceptions of the superior's fairness. Also, male participants, in contrast to female ones, have higher perceptions of the superior's fairness.

In the second step, to test the moderating effect of LMX differentiation, an LMX quality * differentiation interaction is introduced. This model was not statistically significant ($F(1, 122) = 2.157, p = .144$), i.e., the addition of the interaction effect did not statistically significantly increase the explanation of variance of perceived fairness ($\Delta R^2 = 0.15$) indicating that there is no moderating effect of LMX differentiation on the relationship between LMX quality and perceived fairness while controlling for gender.

A clearer view of the results can be seen in Figure 4.3, which shows that there is no moderating effect, i.e., LMX differentiation does not change the relationship between LMX quality and perceived fairness with gender as the control variable.

Our Hypothesis 1 had presumed that LMX quality is positively correlated with perceived fairness. The beta coefficient of LMX quality in the model is statistically significant. Thus, hypothesis 1 was supported. In Hypothesis 2 we stated that the LMX-perceived fairness relationship is moderated by LMX differentiation, being less positive when differentiation is high. The beta coefficient of the LMX quality * differentiation interaction is not statistically significant. Thus, hypothesis 2 was not supported.

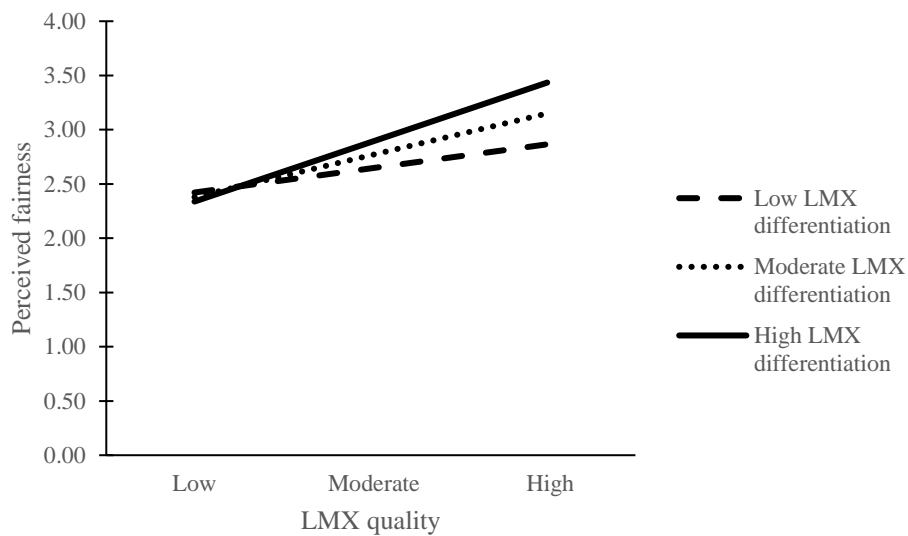


Figure 4. 3 Illustration for the absence of moderation effect of LMX differentiation on the relationship between LMX quality and perceived fairness

5. Discussion

The main findings from this study suggest that LMX quality is positively correlated with perceived fairness and that LMX differentiation does not change the relationship between LMX quality and perceived fairness while controlling for gender. It is important to study the mentioned pair of variables to discover how people react to the previous relationship with the supervisor. In addition to single LMX quality, we added the quality of relationships in the larger group as a very new element to our research. To our knowledge, this is the first study that has explored the matter of leader-member exchange and reactions to performance appraisal using scenarios. Using a scenario study is relevant since it is innovative; it proved to be effective in showing the study in a creative way.

The results of this study supported our hypothesis 1 which proposed that LMX quality is positively correlated with perceived fairness. There was evidence of a statistically significant slight positive correlation between LMX quality and perceived fairness. Furthermore, LMX quality and gender as the control variable were a statistically significant predictor of perceived fairness. Next, hypothesis 2 had proposed that the LMX-perceived fairness relationship would be moderated by LMX differentiation, being less positive when differentiation is high. The effect of the LMX-perceived fairness relationship was not confirmed as predicted. The beta coefficient of the LMX quality * differentiation interaction was not statistically significant, which means that the relationship between LMX quality and perceived fairness does not change depending on the amount of LMX differentiation but remains the same (slightly positive). Data from our sample show that there was a pronounced slight trend in the direction assumed by hypothesis 2, but it was not large enough for this interaction to be statistically significant, i.e., the connections between LMX quality and perceived fairness at different degrees of LMX differentiation are not different enough to be statistically significant.

LMX quality has been shown to be related to fairness perceptions, therefore continuing the relevance of a correlation reported by a number of previous studies established by authors in the area of LMX quality. Higher LMX quality, i.e., better relationship with the superior, predicts higher perceptions of the superior's fairness, and also, the worse the relationship with the superior, the lower the perception of his/her fairness in evaluations. There is little research on the influence on employees' reactions to the previous relationship with the supervisor. Pichler et al. (2019) proved that supervisors are more likely to differentiate their relationships with subordinates who are like themselves and who believe that they share similar values. On a

similar note, Martin, Thomas, Legood, & Dello Russo (2018) stated that the majority of the supervisors have different quality relationships with their team members. Dusterhoff, Cunningham, & MacGregor (2014) have found that appraisal reactions include perceptions of fairness and the supervisor–employee relationship. The leader sets up a relationship of lower-quality with a team member, and on the other hand, he/she develops a high-quality, trustworthy and respect-based relationship with another team member (Bauer & Erdogan, 2015; Anand, Vidyarthi, & Park, 2015). We can add that if employees acknowledge that the appraisal was not fair, they answer with negative attitudes (Farndale & Kelliher, 2013). As we have already stated, there are several research studies regarding the dyadic relationship between the supervisor and the employee where similar results can be found as in our study.

Furthermore, there were no significant changes in the percentage of the explained variance in perceived fairness due to the moderation effect of LMX differentiation on the relationship between LMX quality and perceived fairness while controlling for gender. When there is a good leader-member exchange relationship, employees perceive more organizational fairness and have a positive response to the performance appraisal process (Wang et al., 2019). In line with this reasoning, we find that perceived fairness in appraisals is related to the quality of relationship each person has with the leader and not to the different nature of relationships in the larger group. Erdogan & Bauer (2010) presented LMX research that has focused on LMX differentiation, where leaders form relationships of high and low quality with different members within a team. This point of view differs from previous work, which focused only on the dyadic relationship between a superior and employee, because it recognizes employees' knowledge that there are different quality relationships. Liden, Erdogan, Wayne, & Sparrowe (2006) confirmed that based on employees' feelings of unfair approach, LMX differentiation will head to low performance. Employees' fairness perceptions of the performance appraisal practices predict attitudes regarding the supervisor and the system in the organization in general (Thurston & McNall, 2010). Employees respond to the perceived fairness or lack of fairness from supervisor by developing lower exchanges of quality (Erdogan & Liden, 2006). Even if there has been some research in recent years regarding LMX differentiation and it touches upon fairness matter, to our knowledge, there were no matches from the literature considering the moderation effect of LMX differentiation on the relationship between LMX quality and perceived fairness and in that way, this research fills an existing gap in the literature.

While examining our results, it appears that gender, as a socio-demographic variable, has influenced how people experience reactions to a previous relationship. We have found a new viewpoint through this research and we can point out that our research findings provide

important insights and new knowledge. LMX quality and gender were a statistically significant predictor of perceived fairness, i.e., males, in regard to females, tend to have higher perceptions of the leader's fairness.

A similar pattern as in this study has been observed before, however, other researchers were observing general LMX concepts, as mentioned in Liden et al.'s (2006) study, and/or in combination with different dependent variables. Some of them which are closely related to our topic are explained in the previous paragraphs and chapters. Agreeing with DeNisi & Murphy (2017), supervisor knowledge, identifying goals for improvements and regular evaluations are important predictors of rating accuracy and fairness perceptions. Hypothesis 1 was confirmed with prior literature, and hypothesis 2 provided new insights in the existing theoretical foundation and gave a good base for potential future research. Our findings do not support the role of LMX differentiation. Ultimately, it seems that even though supervisors develop different types of relationships, what matters in the reactions to one's own evaluation is one's own quality of LMX. Our findings deliver an important contribution to the research on the concept of LMX theory and most of all LMX differentiation and perceived fairness which needs to be adequately explored since it is still in the developing phase. Other possible limitations which may have influenced the results of this study and consequently future research will be further developed in the next chapters.

6. Limitations and Future Research

Our study provides important findings for research in the field of LMX and reactions to PA, and it sets a base for future research as well as further development of the theory for LMX differentiation. However, several limitations have occurred in the current research which should be detailed in further forming suggestions for future research.

The variable that could affect findings is a relatively small sample size consisting of 139 participants. With a higher number of participants, perhaps the second hypothesis would be accepted, thus, this is something to suggest for future research. The questionnaire scales were validated in English and then translated into Croatian, which could have led to some misunderstanding of the questions. Validation of the scale with the Croatian version is needed.

Moreover, a relevant limitation in terms of interpreting the results of our work was access to people needed for the questionnaire. In other words, we want to point out the culture of the organizations, i.e., Croatian employees' culture. Employees in Croatia might not be willing to provide complete answers admitting what they think while responding to the questionnaire. Additionally, this might impact the generalization of the results to other cultures. Also, data was collected at a time when many employees might be absent due to vacation, and therefore participation rates might go down. Furthermore, another limitation that might impact the findings and needs to be acknowledged is delaying the beginning of data collection. This might be connected to the employees' lack of trust to share their opinions by filling out the questionnaire. In addition, employees may be discouraged to focus on answering the questions as a result of tiredness while taking the questionnaire and time pressure. These limitations should be improved in the future.

Research on LMX differentiation is sorely lacking. The lack of research on this issue points out that the degree of the studies and attention to such matters are disproportionate with the seriousness of the problem. There is an urgent need for conducting studies on LMX differentiation and reactions to performance appraisal in order to better understand their value and to further develop these models of LMX. On another note, even though we relied on a few sources of data from several private sector companies, individual characteristics of the employees as additional variables would be worth collecting in future research. Over time, leadership processes might be analysed on the individual, dyad, group and organizational levels (Day & Miscenko, 2015). As a suggestion for future studies, the researchers may want to gather qualitative studies, such as interviews, to better understand the progress of the relationships.

7. Practical Implications

The results from our study show important implications for the companies, especially for team leaders. Our study can affect future prospects in the subject area of reactions to performance appraisal and leader-member exchange. For example, as proposed by Harris, Li, & Kirkman (2014: 325), “*Training programs should raise leader awareness about the importance of providing adequate explanations for their differentiated actions*”, as well as, “*Training programs could include modules on how to enhance a climate of fairness to offset varying levels of LMX quality*”. Therefore, it would be useful to create periodical meetings where leaders and members could exchange knowledge and develop deeper understanding among each other, all in light of improving communication aimed at a better response to the inevitable performance appraisal process. One option is the introduction of training during which employees would be informed about all the necessities regarding their role in the company and their career in general. Ultimately, we want to suggest introducing new ways of deepening the relationship between leader and employee. As it is discovered in the current research, the better the relationship with the leader, the higher the perception of his/her honesty, which should be the goal when their interaction is concerned. The human resources department could contribute by nurturing a progressive culture of the company, where their approach would have beneficial results.

Furthermore, given the results obtained, managers should address the reactions according to gender. We want to touch upon differences in the perception of fairness between the genders and suggest a possible approach for the mentioned area. Male participants tend to perceive their superiors as fairer than female participants do, and in addition, the employees’ reactions to their own job performance evaluation could differ. Leaders should invest their effort and time in understanding whether there is a need for the gender element in their attempt to build a better work experience, given males and females had different perceptions of leader fairness while receiving performance appraisal. The strategies suggested for practitioners serve to encourage better connections between leaders and members which can be readily implemented and are based on what we have found in our study.

Conclusion

The aim of this study was to investigate LMX quality and LMX differentiation and their connections with reactions to performance appraisal. After many authors pointed out the need for research expansion regarding this area of leadership and opportunities for advancement, we intended to fill that research gap by examining the reactions to performance appraisal, and to our knowledge, this is the first empirical study which tested this matter using a scenario-based analysis.

Through the research, in cooperation with the respondents, we wanted to see how not only the LMX quality of the individual relationship with the supervisor affects the perceived fairness of the performance appraisal, but also what part is played by the broader context of LMX differentiation. Using a particular theory about the relationship between leader and member, we collected data and analysed the results. The objectives from our research were partially fulfilled, as stated in the results chapter. The significant findings revealed that the better the relationship with the superior, the higher the perception of his/her fairness and vice versa.

Accomplishments from the current research can certainly be considered as progress. They have implications for today's organizations and are an addition to the existing literature. Since inconsistency between research and practice is still present, and in order to understand the reasons why supervisors develop high and low quality exchanges with their subordinates, more research needs to be done in the foreseeable future.

Overall, this thesis has made some worthwhile contributions to our understanding of performance appraisal, perceived fairness and LMX theory and it should have a critical role in the future progress of this field.

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