

Quadrant II - Notes

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Module Name: Concept, Principles and Practices

Definition

Gary Dessler in his book Human Resource Management defines compensation in these words "Employee compensation refers to all forms of pay going to employees and arising from their employment." The phrase 'all forms of pay' in the definition does not include non-financial benefits, but all the direct and indirect financial compensations.

The Concept of Compensation

Compensation refers to a wide range of financial and nonfinancial rewards to employees for their services rendered to the organization. It is paid in the form of wages, salaries and employee benefits such as paid vacations, insurance maternity leave, free travel facility, retirement benefits etc., Monetary payments are a direct form of compensating the employees and have a great impact in motivating employees.

The system of compensation should be so designed that it achieves the following objectives.

- The capable employees are attracted towards the organization
- The employees are motivated for better performance
- The employees do not leave the employer frequently

Types of Compensation / Base and Supplementary Compensation

The types of compensation are divided into two Direct /Base Compensation and Indirect/Supplementary Compensation.

Direct /Base Compensation

Basic Salary Salary is the amount received by the employee in lieu of the work done by him/her for a certain period say a day, a week, a month, etc.

House Rent Allowance Organizations either provide accommodations to its employees who are from different state or country or they provide house rent allowances to its employees. This is done to provide them social security and motivate them to work.

Conveyance Organizations provide for cab facilities to their employees. Few organizations also provide vehicles and petrol allowances to their employees to motivate them

Leave Travel Allowance These allowances are provided to retain the best talent in the organization. The employees are given allowances to visit any place they wish

with their families. The allowances are scaled as per the position of employee in the organization.

Medical Reimbursement Organizations also look after the health conditions of their employees. The employees are provided with medi-claims for them and their family members. These medi-claims include health-insurances and treatment bills reimbursements.

Bonus is paid to the employees during festive seasons to motivate them and provide them the social security. The bonus amount usually amounts to one month's salary of the employee.

Special Allowance such as overtime, mobile allowances, meals, commissions, travel expenses, reduced interest loans; insurance, club memberships, etc are provided to employees to provide them social security and motivate them which improve the organizational productivity

Indirect /Supplementary Compensation

Leave Policy It is the right of employee to get adequate number of leave while working with the organization. The organizations provide for paid leaves such as, casual leaves, medical leaves (sick leave), and maternity leaves, statutory pay, etc.

Overtime Policy Employees should be provided with the adequate allowances and facilities during their overtime, if they happened to do so, such as transport facilities, overtime pay, etc.

Hospitalization The employees should be provided allowances to get their regular check-ups, say at an interval of one year. Even their dependents should be eligible for the medi-claims that provide them emotional and social security.

Insurance Organizations also provide for accidental insurance and life insurance for employees. This gives them the emotional security and they feel themselves valued in the organization.

Leave Travel The employees are provided with leaves and travel allowances to go for holiday with their families. Some organizations arrange for a tour for the employees of the organization. This is usually done to make the employees stress free.

Retirement Benefits Organizations provide for pension plans and other benefits for their employees which benefits them after they retire from the organization at the prescribed age.

Holiday Homes Organizations provide for holiday homes and guest house for their employees at different locations. These holiday homes are usually located in hill station and other most wanted holiday spots. The organizations make sure that the employees do not face any kind of difficulties during their stay in the guest house.

Flexible Timings Organizations provide for flexible timings to the employees who cannot come to work during normal shifts due to their personal problems and valid reasons.

Factors Considered in Deciding the Compensation

External Factors

Demand and Supply of Labour Wage is a price or compensation for the services rendered by a worker. The firm requires these services, and it must pay a price that will bring forth the supply which is controlled by the individual worker or by a group of workers acting together through their unions. The primary result of the operation of the law of supply and demand is the creation of the going wage rate. It is not practicable to draw demand and supply curves for each job in an organization even though, theoretically, a separate curve exists for each job.

Cost of Living Another important factor affecting the wage is the cost of living adjustments of wages. This tends to vary money wage depending upon the variations in the cost of living index following rise or fall in the general price level and consumer price index. It is an essential ingredient of long-term labour contract unless provision is made to reopen the wage clause periodically.

Labour Union Organized labor is able to ensure better wages than the unorganized one. Higher wages may have to be paid by the firm to its workers under the pressure or trade union. If the trade union fails in their attempt to raise the wage and other allowances through collective bargaining, they resort to strike and other methods hereby the supply of labour is restricted. This exerts a kind of influence on the employer to concede at least partially the demands of the labour unions.

Government To protect the working class from the exploitations of powerful employers, the government has enacted several laws. Laws on minimum wages, hours of work, equal pay for equal work, payment of dearness and other allowances, payment of bonus, etc., have been enacted and enforced to bring about a measure of fairness in compensating the working class. Thus, the laws enacted and the labour policies framed by the government have an important influence on wages and salaries paid by the employers. Wages and salaries can't be fixed below the level prescribed by the government.

Prevailing Wage Rates Wages in a firm are influenced by the general wage level or the wages paid for similar occupations in the industry, region and the economy as a whole. External alignment of wages is essential because if wages paid by a firm are lower than those paid by other firms, the firm will not be able to attract and retain efficient employees. For instance, there is a wide difference between the pay packages offered by multinational and Indian companies. It is because of this difference that the multinational corporations are able to attract the most talented workforce.

Internal Factors

Ability to Pay Employer's ability to pay is an important factor affecting wages not only for the individual firm, but also for the entire industry. This depends upon the financial position and profitability of the firm. However, the fundamental determinants of the wage rate for the individual firm emanate from supply and demand of labour. If

the firm is marginal and cannot afford to pay competitive rates, its employees will generally leave it for better paying jobs in other organizations. But, this adjustment is neither immediate nor perfect because of problems of labour immobility and lack of perfect knowledge of alternatives. If the firm is highly successful, there is little need to pay more than the competitive rates to obtain personnel. Ability to pay is an important factor affecting wages, not only for the individual firm but also for the entire industry.

Top Management Philosophy Wage rates to be paid to the employees are also affected by the top management's philosophy, values and attitudes. As wage and salary payments constitute a major portion of costs and /or apportionment of profits to the employees, top management may like to keep it to the minimum. On the other hand, top management may like to pay higher pay to attract top talent.

Productivity of Workers To achieve the best results from the workers and to motivate him to increase his efficiency, wages have to be productivity based. There has been a trend towards gearing wage increase to productivity increases. Productivity is the key factor in the operation of a company. High wages and low costs are possible only when productivity increases appreciably.

Job Requirements indicating measures of job difficulty provide a basis for determining the relative value of one job against another in an enterprise. Explicitly, job may be graded in terms of a relative degree of skill, effort and responsibility needed and the adversity of working conditions. The occupational wage differentials in terms of a) Hardship, b) Difficulty of learning the job c) Stability of employment d) Responsibility of learning the job and f) Change for success or failure in the work.

Objectives of Compensation Management

To Establish a Fair and Equitable Remuneration Effective compensation management objectives are to maintain internal and external equity in remuneration paid to employees. Internal equity means similar pay for similar work. In other words, compensation differentials between jobs should be in proportion of differences in the worth of jobs External equity implies pay for a job should be equal to pay for a similar job in other organizations. Payments based on jobs requirements, employee performance and industry levels minimize favoritism and inequities in pay.

To Attract Competent Personnel A sound wage and salary administration helps to attract qualified and hardworking people by ensuring an adequate payment for all jobs. For example IT companies are competing each other and try their level best to attract best talents by offering better compensation packages.

To Retain the Present Employees By paying competitive levels, the company can retain its personnel. It can minimize the incidence of quitting and increase employee loyalty. For example employees attrition is high in knowledge sectors (Ad-agency, KPO, BPO etc.,) which force the companies to offer better pay to retain their employees.

To Improve Productivity Sound wage and salary administration helps to improve the motivation and morale of employees which in turn lead to higher productivity.

Especially private sectors companies' offer production linked compensation packages to their employees which leads to higher productivity.

To Control Cost Through sound compensation management, administration and labour costs can be kept in line with the ability of the company to pay. It facilitates administration and control of pay roll. The companies can systematically plan and control labour costs.

To Improve Union Management Relations Compensation management based on jobs and prevailing pay levels are more acceptable to trade unions. Therefore, sound wage and salary administration simplifies collective bargaining and negotiations over pay. It reduces grievances arising out of wage inequities.

To Improve Public Image of the Company Wage and salary programme also seeks to project the image of the progressive employer and to comply with legal requirements relating to wages and salaries.

To Improve Job Satisfaction If employees would be happy with their jobs and would love to work for the company if they get fair rewards in exchange of their services.

To Motivate Employees: Employees All have different kinds of needs. Some of them want money so they work for the company which gives them higher pay. Some of them value achievement more than money, they would associate themselves with firms which offer greater chances of promotion, learning and development. A compensation plan that hits workers' needs is more likely to motivate them to act in the desired way.

Significance of Compensation

From individual standpoint -remuneration is a major source of an individual's purchasing power. It determines his or her status, prestige & worth in society.

From enterprise stand point- compensation is a crucial element in the cost of production, which is expected to permit adequate profits leading to increase in new capital, expansion production, and capacity.

From national point of view –dissatisfied work force hampers equitable distribution of aggregate real income among various group involved . it causes inflation.

Principles of Compensation

- Compensation policy should be developed by taking into consideration of the views of employers, the employees, the consumers and the community.
- The compensation policy or wage policy should be clearly defined to ensure uniform and consistent application.
- The compensation plan should be matching with overall plans of the company.
- Management should inform the wage/salary related policies to their employees.

- All wage and salary related decisions should be checked against the standards set in advance in the wage/salary policy
- The compensation policy and programme should be reviewed and revised periodically in conformity with changing needs.
- Differences in pay should be based on differences in job requirements.
- Wage & salary level should be in line with those prevailing in the job market.
- Follow the principle of equal pay for equal work.
- The wages should be sufficient to ensure for the worker & his family reasonable standard of living.
- There should be a clearly established procedure for redressal of grievances concerning wages
- The wage & salary structure should be flexible .
- Wages due to employees should be paid correctly & promptly.
- A wage committee should review & revise wages from time to time.