Unit - 4

COMPENSATION MANAGEMENT

Organizations expect efficient performance from their employees in order to contribute to the attainment of the individual goals. Organizations reward their performance who contributed to the achievement of organizational goals.

The term compensation is used to indicate the employee's gross earnings in the form of financial rewards and benefits.

Compensation management, also known as wage and salary administration, remuneration management, or reward management, is concerned with designing and implementing total compensation package.

Compensation is the human resource management function that deals with every type of reward individuals receive in exchange for performing an organizational task.

The consideration for which labor is exchanged is called compensation.

Compensation is what employees receive in exchange for their work. It is a particular kind of price, that is, the price of labor. Like any other price, remuneration is set at the point where the demand curve for labor crosses the supply curve of labor.

Compensation is referred to as money and other benefits received by an employee for providing services to his employer.

Compensation refers to all forms of financial returns: tangible services and benefits employees receive as part an employment relationship, which may be associated with employee's service to the employer like provident fund, gratuity, insurance scheme and any other payment which the employee receives or benefits he enjoys in lieu of such payment.

According to **Dale Yoder**, "Compensation is paying people for work".

"Compensation is what employees receive in exchange for their contribution to the organization". – Keith Davis

In the words of **Edwin B. Flippo**, "The function compensation is defining as adequate and equitable remuneration of personnel for their contributions to the organizational objectives".

Cascio has defined compensation as follows;

"Compensation includes direct cash payments, indirect payments in the form of employee benefits and incentives to motivate employees to strive for higher levels of productivity"

Beach has defined wage and salary administration as follows;

“Wage and salary’ administration refers to the establishment and implementation of sound policies and practices of employee compensation. It includes such areas as job valuation, surveys of wages and salaries, analysis of relevant organizational problems, development, and maintenance of wage structure, establishing rules for administering wages, wage payments, incentives, profit sharing, wage changes and adjustments, supplementary payments, control of compensation costs and other related items.”

Compensation can be in the form of cash or kind. Compensation may be defined as money received in the performance of works, plus the many kinds of benefits and services that organizations provide their employees.

Different Types of Compensation

There are different types of compensation. Schuler identified three major types of compensation, which are mentioned below;

1. Non-monetary Compensation.
2. Direct Compensation.
3. Indirect Compensation.

Non-monetary Compensation

It includes any benefit that an employee receives from an employer or a job that does not involve tangible value. Examples are career development and advancement opportunities, opportunities for recognition, as well as work environment and conditions.

Direct Compensation

Direct Compensation comprises of the salary that is paid to the employees along with the other health benefits.

Money is included under direct compensation. It is an employee’s base wage which can be an annual salary or hourly wage and any performance-based pay that an employee receives.

Direct compensation consisting of pay received in the form of wages, salaries, bonuses, and commissions provided at regular and consistent intervals.

These include the basic salary, house rent allowances, medical benefits, city allowances, conveyance, provident funds, etc. It also includes bonuses, payments for holidays, etc.

Indirect Compensation

Indirect compensation can be thought of as the nonmonetary benefits an employee gets from the organization.

It includes everything from legally required public protection programs such as Social Security to health insurance, retirement programs, paid leave, childcare or moving expenses.

While benefits come under indirect compensation and may consist of life, accident, health insurance, the employer's contribution to retirement, pay for a vacation, employer's required payment for employee welfare as social security.

Rewards and recognitions, promotions, responsibility, etc., are some factors that induce confidence in the employees and motivate them to perform better. It also instills the faith in them that their good work is being recognized and they can boost their career opportunities if they continue to work harder.

Objectives of Compensation Management

The basic objective of compensation management can be briefly termed as meeting the needs of both employees and the organization.

Employers want to pay as little as possible to keep their costs low. Employees want to get as high as possible.

Objectives of compensation management are:

1. Acquire qualified personnel.
2. Retain current employees.
3. Ensure equity.
4. Reward desired behavior.
5. Control costs.
6. Comply with legal regulations.
7. Facilitate understanding.
8. Further administrative efficiency.
9. Motivating Personnel.
10. Consistency in Compensation.
11. To be adequate.

Compensation management tries to strike a balance between these two with specific objectives:

Acquire qualified personnel

Compensation needs to be high enough to attract applicants. Pay levels must respond to the supply and demand of workers in the labor market since employees compare for workers.

Premium wages are sometimes needed to attract applicants working for others.

Retain current employees

Employees may quit when compensation levels are not competitive, resulting in higher turnover.

Employees serve organizations in exchange for a reward. If pay levels are not competitive, some employees quit the firm. To retain these employees', pay levels must be competitive with that of other employers.

Ensure equity

To retain and motivate employees, employee compensation must be fair. Fairness requires wage and salary administration to be directed to achieving equity.

Compensation management strives for internal and external equity.

Internal equity requires that pay be related to the relative worth of a job so that similar jobs get similar pay.

External equity means paying workers what comparable workers are paid by other firms in the labor market.

Reward desired behavior

Pay should reinforce desired behaviors and act as an incentive for those behaviors to occur in the future. Effective compensation plans reward performance, loyalty, experience, responsibility, and other behaviors.

Good performance, experience, loyalty, new responsibilities, and other behaviors can be rewarded through an effective compensation plan.

Control costs

A rational compensation system helps the organization obtain and retain workers reasonable cost. Without effective compensation management, workers could be overpaid or underpaid.

Comply with legal regulations

A sound wage and salary system considers the legal challenges imposed by the government and ensures employers compliance.

Facilitate understanding

The compensation management system should be easily understood by human resource specialists, operating managers and employees.

Further administrative efficiency

Wage and salary programs should be designed to be managed efficiently, making optimal use of the HRIS, although this objective should be a secondary consideration with other objectives.

Motivating Personnel

Compensation management aims at motivating personnel for higher productivity.

Monetary compensation has its own limitations in motivating people for superior performance. Besides money people also wants praise, promotion, recognition, acceptance, status, etc. for motivation.

Consistency in Compensation

Compensation management tries to achieve consistency-both internal and external in compensating employees. Internal consistency involves payment on the basis of the criticality of jobs and employees' performance on jobs.

Thus, higher compensation is attached to higher-level jobs. Similarly, higher compensation is attached to higher performers in the same job.

To be adequate

Compensation must be sufficient so that the needs of the employee are fulfilled substantially.

Pre-requisites for Effective Compensation Management

An effective compensation system should fulfill the following criteria:

1. **Adequate:** Minimum governmental, union, and managerial pay level positions must be met by the compensation system.

2. **Equitable:** Care should be taken so that each employee is paid fairly, in line with his/her abilities, efforts, education, training, experiences, competencies, and so on.

3. **Balanced:** Pay, benefits, and other rewards must provide a reasonable compensation package.

4. **Secure:** Employees security needs must be adequately covered by the compensation package.

5. **Cost-Effective:** Pay must be neither excessive nor inadequate, considering what the enterprise can afford to pay.

6. **Incentive Providing:** The compensation package should be such that it generates motivation for effective and productive work.

7. **Acceptable to all Employees:** All employees understand the pay system well and feel it is reasonable for the enterprise and the individual.

Job Evaluation

Job evaluation is a method used for deciding the comparative worth of each job in the organization. The basic purpose of assessing the value of each job against another is to fix up the pay scale for each of these jobs. Job evaluation provides a critical input for the grading of jobs in the organization in an orderly and acceptable form. Job grading in turn helps the organization in determining the pay grades for different categories of job. The essence of job evaluation is the assessment of the efforts required to perform the job. Usually, jobs are evaluated on the basis of the duties, responsibilities, work pressures and contribution of each job to organizational goal accomplishment. Simply state job evaluation is the classification of jobs according to rank in an organization. It attempts to compare the relative intrinsic value of jobs within an organization.

Objectives of Job Evaluation

The major objective of job evaluation is to establish comparative worth of various jobs in an organization to serve as a basis for developing a salary structure characterized by equity or fairness. An ILO Report states that the aim of the most of systems of job evaluation is to determine, on agreed logical basis, the comparative values of various jobs in a plant. It aims at deciding the comparative significance of a job. The guideline of any job evaluation effort is that of depicting and estimating officially the worth of various jobs in the enterprises in terms of various indicators.

The objectives of job evaluation may be enumerated as:

- Ascertain wage differentials characterized by equity between different jobs in the organization.
- To get rid of wage inequalities.
- To be sure that similar wages are paid for the like work.
- Construct a foundation for implementing incentives
- To decide a reference point for settling personal grievances relating to wage rates.
- Make available information for the purposes of organization of work, selection of employees, placement, training and other similar issues.
- To determine a benchmark for making organization career planning.
- Establish a procedure which serves as a standard for ascertaining the relative value of each job.

Job Evaluation Process

Though the usual objectives of job evaluation is to ascertain officially the relative worth of jobs in an enterprise, there is no common procedure of job evaluation all organizations may follow. As such, the job evaluation procedure differs from organization to organization.

Step 1: Establish Jobs to be assessed: The establishment of jobs to be assessed under the evaluation process is the beginning point of job evaluation. It is usually complex for an organization to assess entire jobs of the organization. It, therefore, selects a few main jobs which can be representative of a group of similar jobs for job evaluation purposes. Having identified jobs for evaluation, the next stage is the deciding of factors to be evaluated in a job. The evaluator may evaluate one or more the job factors like physical efforts, mental efforts, concentration, communication and leadership skills, education and experience, job complexity and pressure. However, the need for job factor identification may not arise if the evaluator settles for paired comparison in which 'whose man to whole man' comparison is done.

Step 2: Collecting job information: The next phase in the process of job analysis is the collection of essential information about the job being assessed.. For this purpose the techniques like interviews, questionnaire and observation may be used addition to sheets of job description At this stage, the evaluator need to satisfy himself entirely about the adequateness of information gathered for assessing the value of the job. Thus, the evaluators should undertake a broad analysis of all the information available with them.

Step 3: Decision on ranking of job: An analysis of all the pertinent information about the job is carried. Then, the evaluator assesses the degree of the presence or absence of chosen factors in the jobs. Based on the findings of such assessment, the evaluator establishes the rating of each job. Since identical factors are evaluated in the process, the ratings are indicative of the relative worth of a job when compared to other jobs in the organization.

Step 4: Benchmarking job: The ground objective of job evaluation is to evolve pay grades for each kind of jobs. In this connection it is essential for an organization to understand the payments made by other organizations for identical jobs. However, it may not be feasible for an organization to ascertain the comparative pay scales of all the jobs in the organization. Therefore, the persons responsible for job evaluation may select a few jobs usually found in every organization and are comparable in nature. These jobs are commonly known as benchmark jobs which serve as measurements for deciding the pays of all other jobs in the organization.

Step 5: Wage and Salary Surveys: An organization carries out a survey of pay scales of the jobs regarded as benchmark in other organizations in the industry. An organization may carry out a salary surveys in a formal or informal way, may be either a direct survey to collect pertinent information or published reports of professional agencies or magazines may be used. The monetary equivalent of each job is decided on the basis of such survey. Informal survey such as telephonic surveys, newspapers and the internet survey for may be conducted by several organizations for salary surveys.

Step 6: Periodic Review and Feedback: Developments taking place in the outer environment affect the organizations on a continuous basis and also create changes in the internal environment. For instance, technological developments affect the job features and needs deeply.

As a result, organizations are compelled to reconsider the jobs at periodic at recurring intervals of time to decide their value in the transformed context. Feedback should also be gathered from diverse stakeholders like job holders, supervisors, managers and trade unions about the various facets of job evaluation to regularly grow the job evaluation process.

Merits and Demerits of job evaluation

According to an ILO publication job evaluation is advantageous for the following reasons:

Job evaluation is a process involving logic and objective method which assists in evolving a just, fair and holding firmly wage and salary structure based on the comparative value of jobs in an organization.

By removing wage differentials within the organization, job evaluation renders assistance for reducing contradiction between labor and management which in turn helps in encouraging agreeable relations between them.

Job evaluation makes wage administration less complicated by bringing the quality of being uniform in wage rates.

It makes a logical ground for negotiations of wage and collective bargaining.

In the case of new jobs, job evaluation makes spotting into the existing wage and salary structure.

In the modem times, performance is dependent more on the machines than on the worker himself/herself.

In such cases, job evaluation gives the realistic basis for fixing of wages. The information generated by job evaluation may also be applied for upgradation of procedures of selection, transfer and promotion on the basis of relative job requirements.

Job evaluation evaluates the job and not the job performer. Organizations have different areas of specializations. Job evaluation assists in ranking all the jobs so as to fix the wages and salary and removing uncertainty in them.

Besides many advantages, job evaluation undergoes the following **drawbacks**:

Job evaluation is under domination of human error and personal judgment. While there is no approved list of factors to be taken into account for job evaluation, there are some factors that cannot be gauged exactly, Job evaluation fixes variation between wages. The jobs ranking high as compared with the market are those of junior, nurse and typist, while craft rates are comparatively low. An evaluation plan renders services to weaker groups better than by the market. The first time application of job evaluation in an organization generates doubts in the minds of workers whose jobs are subjected to collective bargaining for determining wage rates. Job evaluation methods being lacking in scientific basis are often looked upon with doubts about the effectiveness of ways of job evaluation. Job evaluation is a time taking process needing specialized technical personnel to carry it out and, thus, is likely to be costly as well. Job evaluation is not found suitable for fixing the comparative value of the skill oriented managerial jobs which cannot be measured in quantitative terms. Given the changes in job contents and work conditions, periodic evaluation of jobs is essential. This is not ever so easy and simple. Job evaluation causes considerable modifications in wage and salary structure. This, in turn, creates financial pressure on organization.

Job Evaluation Methods

Most wage paying organizations apply job evaluation. The following kind of job evaluation methods are commonly used in practice.

1. The ranking method: The person evaluating the job ordinarily gives ranks to different jobs. However, the effort to decide the factors critical to the each job is not made at this stage. As an accepted alternative, an overarching act of judgment is done concerning the comparative value of each job, and the job is given a position in hierarchy. In order of their value from the easiest to the most complex or in the reverse order, all the jobs are ranked. The duties, responsibilities and demands on the job holder are the parameters of judging the significance of order of jobs. Since difficulties in ranking a number of jobs are experienced, the method of paired comparison ranking is often resorted to. This technique enables decisions about the comparative worth of one or two jobs at one time. Since each job is compared with every other job, the number of comparisons increases fast when a job is added to the list of comparisons. Generally accepted guidelines are not available to determine elements or factors to be included in the list of factors the organization thinks valuable. Thus, there are no yardsticks for evaluating the value of the job and the assumptions of the rankers ranking never come to the fore. There is, thus, a risk that the subjectivity creeps into the ranking. The impressions dominate the ranking rather than objective information available.

2. Grading Method: The entire job is the basis of job grading technique. An organized body or a committee of job evaluator decides job grades or class of a job. A group of different jobs involving identical difficulty needing similar skills to perform constitutes a job grade. The information obtained from job analysis becomes the basis of job grade. The job grades are placed in proper order of their importance as a schedule. The jobs requiring more physical effort and strict supervision but little responsibility fall in the lowest job grade Each higher grade job involves more of skill and responsibility with decreasing supervision.

3. The Factor Comparison Method: This method begins with the selection of factors such as mental requirements, skills, physical exertion, responsibility, and job conditions. These factors are assumed to be constant for all the jobs. Each factor is ranked individually with other jobs. For example, all the jobs may be compared first by the factor physical requirements, responsibility, and working conditions are ranked. Thus, a job may rank near the top in skills but low in physical requirements. Total point values are then assigned to each factor. The relative worth of a job is then obtained by adding together all the point values. This method facilitates that jobs of different nature, for example, manual, clerical and supervisory- may be assessed with the same factors. However, this method is difficult and expensive.

4.Paired Comparison: In this method, each job is individually compared with every other job in the organization. If, during the comparison, a job is found to have more value than another, it is assigned some reward points, and at the end of the multiple comparisons, ranking are done on the basis of aggregate scores. In the paired comparison method too, a job described statement is an essential document for determining the relative worth of each job. The paired comparison method is simply and easy to compare one job with another. Each job gets equal attention in the multiple pair comparisons and thus, better consistency is established in the job grading. However, it is a subjective process as the whole job is compared with another whose job and, as such, the unique job characteristics are overlooked in the comparisons. It is difficult to apply this method if there are a large number of jobs as multiple comparisons would involve numerous computations.

Thus, the ranking method, grading, point and factor comparison methods are most commonly used for job evaluation.

Wage Structure

Wage and salary administration is essentially the application of a systematic approach to the problem of ensuring that employees are paid in a logical, equitable and fair manner.

Wage: wage and salary are used interchangeably. But ILO defined the term wage as "the remuneration paid by the employer for the services of hourly, daily, weekly and fortnightly employees." It also means that remuneration paid to production and maintenance or blue collar employees.

Salary: the term salary is defined as the remuneration paid to the clerical and managerial personnel employed on monthly or annual basis. The term salaries / wages can be defined as the direct remuneration paid to an employee compensating his services to an organization. Salary can also be known as basic pay.

Earnings: earnings are the total amount of remuneration received by an employee during a given period. These include salary (pay), dearness allowance, House Rent Allowance, City Compensatory allowance, other allowances, overtime payments etc.

Nominal Wage: it is the wage paid or received in monetary terms. It is also known as money wage.

Real Wage: Real wage is the amount of wage arrived after discounting nominal wage by the living cost. It represents the purchasing power of money wage.

Take Home Salary: It is the amount of salary left to the employee after making authorized deductions like contribution to the provident fund, life insurance premium, income tax, and other charges.

Minimum wage: It is the amount of remuneration which could meet the "nominal needs of the average employee regarded as a human being living in a civilized society." It is defined as the amount or remuneration "which may be sufficient to enable a worker to live in reasonable comfort, having regard to all obligations to which an average worker would ordinarily be subjected to."

Statutory Minimum Wage: It is the amount of remuneration fixed according to the provisions of the Minimum Wage Act, 1948.

Wage Differentials

Wage differentials among workers working in the same unit, among different units, occupations, regions and the like are common features of labour markets in various countries. Inter – personal wage differentials are mainly due to variations in personal characteristics like sex, age, skill, knowledge etc., of employees who work in the same unit and are in the same or similar occupations. Inter-firm or inter – unit wage differentials reflect relative wage levels of workers in different units in the same or similar occupation. These differentials are mostly because of varying abilities of the firms to pay wages. Inter-occupational wage differentials are due to varying requirements of physique skills, endurance, knowledge etc, varying demand and supply conditions and the like. Inter – area differentials are mainly due to varying demand and supply factors, living costs, abilities of employers to pay and the like.

Wage differentials and economy functions

Wage differentials perform important economic, functions like labour productivity, attracting the people to different jobs. Since most of the workers are mobile with a view to maximizing their earnings, wage differentials reflect in varieties in productivity, efficiency of management, maximum utilization of human force etc. attracting efficient workers, maximization of productivity can be fulfilled through wage differentials as the later determines the direct allocation of manpower among different units, occupations and regions so that national production can be maximized. Thus wage differentials provide an incentive for better allocation of human force, labour mobility among different regions and the like.

Wage differentials play a vital role in planned economy in the regulation of wages and development of national wage policy by allocating the skilled human force on priority basis. Development of new skills, knowledge etc., is an essential part of human resource development. Shortage of technical and skilled personnel is not only a problem for industries but it creates bottlenecks in the attainment of planned goals. Thus wage differentials, to certain extent, are desirable from the view point of national interest. As such, they probably become an essential part of national wage policy. Complete uniform national wage policy is impracticable and undesirable.

Are wage differentials justified?

Wage differentials on the basis of occupations, units and areas can be justified in view on the basis of equal pay for equal work among workers. They are also justified in view of varying conditions of demand and supply and varied job requirements like skill, knowledge, aptitude, ability, experience etc. but the object of the government is to minimize income inequalities and inequalities in the distribution of wealth. Thus, wage differentials are not desirable in a socialistic pattern of society. However, formulating uniform wage policy ignoring differences in individual skills, knowledge etc., units ability to pay, varying living costs in different regions, varying demand and supply conditions, differences in occupations etc., is practically not possible. Hence a compromise between uniform wage policy and wage differentials has to be developed in view of the principles of socialistic pattern of society.

Inter- personal, inter – unit, inter – occupational wage differentials are more predominant in the unorganized sector of Indian economy. But even in organized sector and public sector units, wage differentials are quite common. But the tendency appears to be towards minimization and regularization of personal wage differentials and to narrow down the gap between maximum and minimum wage in an unit. Wage differentials are on the basis of sex are however common mainly in unorganized sector of the economy. It is observed that certain industrial tribunals has awarded different wages for male and female workers not on the ground that the work done is unequal but on the grounds that the wages of female employees have always been somewhat lower than those of male workers, that women workers support a smaller family and that the cost of employing women workers is higher. However, it is felt that further steps should be taken in order to minimize wage differentials not only in unorganized sector but also in organized and public sector undertakings.

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