Compensation Management: Definition, Objectives, Importance

Compensation ManagementCompensation 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 employmen.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 follow"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;

Non-monetary Compensation.

Direct Compensation.

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 non-monetary 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 possibleObjectives of compensation management are;

Acquire qualified personnel.

Retain current employees.

Ensure equity.

Reward desired behavior.

Control costs.

Comply with legal regulations.

Facilitate understanding.

Further administrative efficiency.

Motivating Personnel.

Consistency in Compensation.

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 costs. 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 comply.

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 want 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:

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

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.

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

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

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

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

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

Importance of Sound Wage Structure

A sound wage policy is to adopt a job evaluation program in order to establish fair differentials in wages based upon differences in job contents.

Besides the basic factors provided by a job description and job evaluation, those that are usually taken into consideration for wage and salary administration are;

The organizations' ability to pay.

Supply and demand of labor.

Prevailing market rate.

The cost of living.

The living wage.

Psychological and Social Factors.

Skill Levels Available in the Market.

1. The organizations' ability to pay

Wage increases should be given by those organizations which can afford them.

Companies that have good sales and, therefore, high profits tend to pay higher those who are running at a loss or earning low profits because of a higher cost of production or low sales. In the short run, the economic influence on the ability to pay is practically nil.

All employers, irrespective of their profits or losses, must pay no less than their competitors and need to pay no more if they wish to attract and keep workers. In the long run, the ability to pay is important.

2. Supply and demand of labor

If the demand for certain skills is high and supply is low, the result is a rise in the price to be paid to these skills. The other alternative is to pay higher wages if the labor supply is scarce and lower wages when it is excessive.

Similarly, if there is a great demand for labor expertise, wages rise; but if the demand for workforce skills is minimal, the wages will be relatively low.

3. Prevailing market rate

This is known as the ‘comparable wage’ or ‘going wage rate’, and is the widely used criterion.

An organization compensation policy generally tends to conform to the wage rate payable by the industry and the community. This is done for several reasons.

First, competition demands that competitors adhere to the same relative wage level.

Second, various government laws and judicial decisions make the adoption of uniform wage rates an attractive proposition.

Third, trade union encourages this practice so that their members can have equal pay, equal work, and geographical differences may be eliminated.

Fourth, a functionally related firm in the same industry requires essentially the same quality of employees, with the same skill and experience. This results in a considerable uniformity in wage and salary rates.

Finally, if the same or about the same general rates of wages are not paid to the employees as are paid by the organizations' competitors, it will not be able to attract and maintain a sufficient quantity and quality of workforce.

4. Cost of living

The cost of living pay criterion is usually regarded as an automatic minimum equity pay criterion. This criterion calls for pay adjustments based on increases or decreases in an acceptable cost of living index.

When the cost of living increases, workers and trade unions demand adjusted wages to offset the erosion of real wages.

5 Living wage

The living wage criterion means that wages paid should be adequate to enable an employee to maintain himself and his family at a reasonable level of existence.

However, employers do not generally favor using the concepts of a living wage as a guide to wage determination because they prefer to base the wages of an employee on his contribution rather than on his need.

6. Psychological and Social Factors

Psychologically, persons perceive the level of wages as a measure of success in life; people may feel secure; have an inferiority complex, seem inadequate, or feel the reverse of all these. They may not take pride in their work, or in the wages they get.

Therefore, these things should not be overlooked by the management in establishing a wage rate.

Sociologically and ethically, people feel that “equal work should carry equal that wages should be commensurate with their efforts, that they are not exploited, and that no distinction is made on the basis of caste, color, sex or religion.”

To satisfy the conditions of equity, fairness, and justice, management should take these factors into consideration.

7. Skill Levels Available in the Market

With the rapid growth of industries’ business trade, there is a shortage of skilled resources. The technological development, automation has been affecting the skill levels at faster rates.

Thus the wage levels of skilled employees are constantly changing, and an organization has to keep its level up to suit the market needs.

Challenges or Problems of Compensation Management

Even the most rational methods of determining pay must be tempered by good judgment when challenges arise.

The implications of these demands may cause analysts to make further adjustments to compensation.

Strategic Objectives.

Prevailing Wage Rates.

Union Power.

Government Constraints.

Comparable Worth and Equal Pay.

Compensation Strategies and Adjustments.

International Compensation Challenges.

Productivity and costs.

1. Strategic Objectives

Compensation management is not limited to internal and external equity. It also can be used to further an employer's strategy. Employee compensation might have been initially anchored by the relative worth of jobs and the prevailing wage rates in the local market.

2. Prevailing Wage Rates

Market forces may cause some jobs to be paid more than their relative worth. Demographic shifts and relative supply and demand relationships affect compensation.

3. Union Power

When unions represent a portion of the workforce, they may be able to obtain wage rates that are out of proportion to the relative worth of the jobs.

Unions may also limit management's flexibility in administering merit increases since unions often argue for raises that are based on seniority and are applied across the board equally.

4. Government Constraints

The government sets minimum wage, overtime pay, equal pay, child labor, and record-keeping requirements. The minimum-wage and overtime provisions require employers to pay at least a minimum hourly rate regardless of the worth of the job.

5. Comparable Worth and Equal Pay

Beyond "equal pay for equal work" is the idea of "comparable pay for comparable work" called comparable worth. It requires employers to pay equal wages for jobs of comparable values.

Comparable worth is used to eliminate the historical gap between the incomes of men and women.

6. Compensation Strategies and Adjustments

Most organizations have compensation strategies and policies that cause wages and salaries to be adjusted.

A common strategy is to give nonunion workers the same raises that are given to unionized employees; this often is done to prevent further unionization.

7. International Compensation Challenges

The globalization of business affects compensation management.

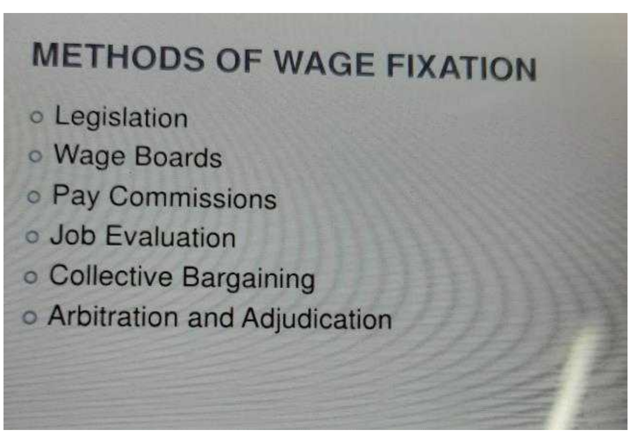
Compensation analysts must focus not only on equity but on competitiveness too. The growing globalization of business also means a greater movement of employees among countries.

As employees are relocated, compensation specialists are challenged to make adjustments that are fair to the employee and the company while keeping competitiveness in mind.

8. Productivity and costs

Regardless of the company or social policies, employers must make a profit to survive. Without profits, they cannot attract enough investors to remain competitive.

Therefore, a company cannot pay its workers more than the workers give back to the firm through their productivity. The company needs some creative techniques for compensation.



## WAGE BOARDS

Wage board is an important institution set up by the Government of India for fixation and revision of wages. Separate wage boards are set up for separate industries. Government of India started instituting Wage Boards in accordance with the recommendations of the Second Five-year Plan, which were reiterated by the Third Five-year Plan. Wage boards are not governed by any legislation but are appointed on an *ad hoc* basis by the Government.

Each wage board consists of one neutral Chairman, two independent members and two or three representatives of workers and management each. The wage boards have to study various factors before making any recommendations. The recommendations of wage board are first referred to the Government for acceptance. The Government may accept them and then they are enforceable by the parties concerned.

The wage boards take the following factors into consideration for fixing or revising the wages in various industries:

(i) Job evaluation, (ii) Wage rates, for similar jobs in comparable industries, (iii) Employees' productivity, (iv) Firms' ability to pay, (v) Various wage legislations, (vi) Existing level of wage differentials and their desirability, (vii) Government's objectives regarding social justice, social equality, economic justice and economic equality (viii) Place of the industry in the economy and the society of the country and the region, (ix) Need for incentives, improvement in productivity, etc.

The wage boards fix and revise various components of wages like basic pay dearness allowance, incentive earnings, overtime pay, house rent allowance and other allowances.

## PAY COMMISSIONS

Wages and allowances of Central and State Government employees are determined through the pay commissions appointed by the appropriate government. So far, the Central Government has appointed six pay commissions. The disputes arising out of pay commission awards and their implementation are decided by commissions of inquiry, adjudication machinery and the joint consultative machinery.

### Bonus

An important component of employees' earnings, besides salary, is bonus. Starting as an *ad hoc* and ex-gratia payment, in the course of labour history, it metamorphosed from a reward or an incentive for good work, into a defendable right, a just claim. Subsequently, under the Payment of Bonus Act, 1965, it secured the character of a legal right. It created a minimum 8.33% and maximum 20% an bonus to be paid. Minimum is to be paid irrespective of profit/loss, whereas h... depends upon the profits. The meaning of 'bonus' is an extra payment to workers beyond the normal wage. It is argued that bonus is a deferred wage pay

10. Adjusting the salary levels accordingly with a view to enabling the employees to reach unreached goals and fulfil the unfulfilled needs and aspirations.

## actors Influencing Compensation Levels

The amount of compensation received by an employee should reflect the effort ut in by the employee, the degree of difficulty experienced while expending his nergies, the competitive rates offered by others in the industry and the demand-upply position within the country, etc. These are discussed below:

(a) **Job needs:** Jobs vary greatly in their difficulty, complexity and challenge. Some need high levels of skills and knowledge while others can be handled by almost anyone. Simple, routine tasks that can be done by many people with minimal skills receive relatively low pay. On the other hand, complex, challenging tasks that can be done by few people with high skill levels generally receive high pay.

(b) **Ability to pay:** Projects determine the paying capacity of a firm. High profit levels enable companies to pay higher wages. This partly explains why computer software industry pays better salaries than commodity production based industry. Likewise, multinational companies also pay relatively high salaries due to their earning power and strong foundation.

(c) **Cost of living**: Inflation reduces the purchasing power of employees. To overcome this, unions and workers prefer to link wages to the cost of living index. When the index rises due to rising prices, wages follow suit.

(d) **Prevailing wage rates:** Prevailing wage rates in competing firms within a industry are taken into account while fixing wages. A company that doe not pay comparable wages may find it difficult to attract and retain talent.

(e) **Unions:** Highly unionized sectors generally have higher wages because w organized unions can exert pressure on management and obtain all sorts benefits and concessions to workers.

(f) **Productivity:** This is the current trend in most private sector compan when workers' wages are linked to their productivity levels. If your performance is good, you get good wages. A sick unit for example, can hope to pay competitive wages, in tune with profit making units.

(g) **Stage regulation:** The legal stipulations in respect of minimum wages, bor dearness allowance, etc., determine the wage structure in an industry.

h) **Demand and supply of labour:** The demand for and the supply of cer skills determine prevailing wage rates. High demand for softv professionals, R&D professionals in drug industry, telecom and electro engineers, financial analysts, management consultants ensure higher w In the education field there is a high demand for professors in enginee medical and management education. Oversupply kills demand for a ce category of employees leading to a steep fall in their wages as well.

## ADJUDICATION OF WAGE DISPUTES

*Collective bargaining* is a procedure through which employee problems relating *to various issues* including wages are settled through the process of joint *consultation, in an atmosphere of* 'give and take', trust and mutual confidence. If *these problems are not* settled through collective bargaining, they may be settled *through voluntary* arbitration or adjudicator or collective bargaining agreements *rom the basis for* fixing wages in various organizations.

## Factors influencing wage and salary administration

- The organizations ability to pay
- Supply and demand of labour
- The prevailing market rate
- Living wage
- Trade unions bargaining power
- Job requirements
- Psychological and sociological factors
- Levels of skills available in the market

## PRINCIPLES OF WAGE AND SALARY ADMINISTRATION

- Should be sufficiently flexible.
- Job evaluation must be done scientifically.
- Must always be consistent with overall organizational plans and programs.
- Should be in conformity with the social and economic objectives
- Should be responsive to the changing local and national conditions.
- Should maintain Equity
- Should maintain competitiveness in market
- Optimized employee and employer interest.