

Compensation

Compensation

- **Definition** – According to **Thomas J. Bergmann(1988)** compensation consists of four distinct components: **Compensation = Wage or Salary + Employee benefits +Non-recurring financial rewards+ Non-pecuniary rewards.**

Compensation is a **systematic approach to providing monetary value** to employees in **exchange for work performed**. Compensation may achieve several purposes assisting in recruitment, job performance, and job satisfaction.

- *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.

Components of Compensation

- **Basic Wages/Salaries** - Basic wages / salaries refer to the **cash component** of the wage structure based on which other elements of compensation may be structured. It is normally a fixed amount which is subject to changes based on annual increments or subject to periodical pay hikes. **Wages** represent **hourly rates of pay**, and **salary** refers to the **monthly rate of pay**, irrespective of the number of hours put in by the employee. Wages and salaries are subject to the annual increments. They differ from employee to employee, and depend upon the nature of job, seniority, and merit.

- **Bonus** - The bonus can be paid in different ways. It can be **fixed percentage** on the **basic wage** paid annually or **in proportion** to the **profitability**. The Government also prescribes a minimum statutory bonus for all employees and workers. There is also a bonus plan which compensates the managers and employees based on the sales revenue or profit margin achieved. Bonus plans can also be based on piece wages but depends upon the productivity of labour.
- **Non-Monetary Benefits** - These benefits give **psychological satisfaction** to employees even when financial benefit is not available. Such benefits are:
 - (a) Recognition of merit through certificate, etc.
 - (b) Offering challenging job responsibilities,
 - (c) Promoting growth prospects,
 - (d) Comfortable working conditions
 - (e) Competent supervision
 - (f) Job sharing and flexi-time.

- **Commissions** - Commission to managers and employees may be based on the sales revenue or profits of the company. It is always a fixed percentage on the target achieved. For taxation purposes, commission is again a taxable component of compensation. The payment of commission as a component of compensation is practiced heavily on target based sales. Depending upon the targets achieved, companies may pay a commission on a monthly or periodical basis.
- **Mixed Plans** - Companies may also pay employees and others a combination of pay as well as commissions. This plan is called combination or mixed plan. Apart from the salaries paid, the employees may be eligible for a fixed percentage of commission upon achievement of fixed target of sales or profits or Performance objectives. Nowadays, most of the corporate sector is following this practice. This is also termed as variable component of compensation.

- **Piece Rate Wages** - Piece rate wages are prevalent in the manufacturing wages. The laborers are paid wages for each of the Quantity produced by them. The gross earnings of the labour would be equivalent to number of goods produced by them. Piece rate wages improves productivity and is an absolute measurement of productivity to wage structure. The fairness of compensation is totally based on the productivity and not by other qualitative factors.
- **Fringe Benefits** - Fringe benefits may be defined as wide range of benefits and services that employees receive as an integral part of their total compensation package. They are based on critical job factors and performance. Fringe benefits constitute indirect compensation as they are usually extended as a condition of employment and not directly related to performance of concerned employee. Fringe benefits are supplements to regular wages received by the workers at a cost of employers. They include benefits such as paid vacation, pension, health and insurance plans, etc. Fringe benefits may be defined as wide range of benefits and services that employees receive as an integral part of their total compensation package.

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- **Profit Sharing** - Profit-sharing is regarded as a stepping stone to industrial democracy. Profit-sharing is an agreement by which employees receive a share, fixed in advance of the profits. Profit sharing usually involves the determination of an organization's profit at the end of the fiscal year and the distribution of a percentage of the profits to the workers qualified to share in the earnings. The percentage to be shared by the workers is often predetermined at the beginning of the work period and is often communicated to the workers so that they have some knowledge of their potential gains. To enable the workers to participate in profit sharing, they are required to work for certain number of years and develop some seniority. The theory behind profit-sharing is that management feels its workers will fulfill their responsibilities more diligently if they realize that their efforts may result in higher profits, which will be returned to the workers through profit-sharing.

Types of Compensation - Base and Supplementary Compensation

Total compensation returns are more transactional. They include pay received directly as cash (like base, merit, incentives, cost of living adjustments) and indirectly as benefits (like pensions, medical insurance, programs to help balance work and life demands, brightly coloured uniforms).

- **Direct /Base Compensation** - Direct compensation refers to monetary benefits offered and provided to employees in return of the services they provide to the organization. The monetary benefits include basic & salary, house rent allowance, conveyance, leave travel allowance, medical reimbursements, special allowances, bonus, Pf/Gratuity, etc. They are given at a regular interval at a definite time.
- **Basic Salary** – Basic 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. It is the money an employee receives from his/her employer by rendering his/her services.

- **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** - 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** - 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

Types of Compensation: Indirect /Supplementary Compensation

- **Indirect compensation** refers to non-monetary benefits offered and provided to employees in lieu of the services provided by them to the organization. They include Leave Policy, Overtime Policy, Car policy, Hospitalization, Insurance, Leave travel Assistance Limits, Retirement Benefits, Holiday Homes
- **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

Compliance with the Law of the Land

Demand and Supply of Labour:

Cost of Living

Governement

Prevailing Wage Rates

Labour Union and collective Bargaining

Internal Factors

Capacity to Pay

Top Management Philosophy

Job Requirements

Organisational Politics

Employee related Factors

Productivity of Workers:

Job requirements

- **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.
- **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. 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. 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** - 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
 - f) Change for success or failure in the work.
- **Employees Related Factors** - Several employees related factors interact to determine his remuneration. These include
 - i) Performance: productivity is always rewarded with a pay increase. Rewarding performance motivates the employees to do better in future.
 - ii) Seniority: Unions view seniority as the most objective criteria for pay increases whereas management prefer performance to effect pay increases.
 - iii) Experience: Makes an employee gain valuable insights and is generally rewarded
 - iv) Potential: organizations do pay some employees based on their potential. Young managers are paid more because of their potential to perform even if they are short of experience.

- **Organizational Politics** - Compensation surveys, job analysis, job evaluation and employee performance are all involved in wage and salary decisions. Political considerations may enter into the equation in the following ways:
 - i) Determination of firms included in the compensation survey: managers could make their firm appear to be a wage leader by including in the survey those organizations that are pay followers.
 - ii) Choice of compensable factors for the job evaluation plan: Again, the job value determined by this process could be manipulated
 - iii) Emphasis placed on either internal or external equity
 - iv) Results of employee performance appraisal may be intentionally distorted by the supervisor