



COMPENSATION MANAGEMENT

What is Compensation?

- All forms of payment(s) received by the employees as a result of their employment is referred as employee compensation.

It is among the major factors in economic and social life of any community and the single most motivator in an organized society.

- In an economic sense, it represents payment in return for work done.
- In a sociological sense, it characterizes satisfaction of occupational categories.
- In a psychological sense, it satisfies needs directly or indirectly in response to changing employee aspirations.
- In a legal sense, it is a component invariably satisfies governmental rules and regulations of the country.

Objectives of Compensation

The most important objective of any pay system is fairness or equity. The term equity has three dimensions:

- Internal Equity – This ensures that more difficult jobs are paid more.
- External Equity – This ensures that jobs are fairly compensated in comparison to similar jobs in the labor market.
- Individual Equity – It ensures equal pay for equal work i.e. each individual's pay is fair in comparison to others doing the same / similar jobs.

Theories of Compensation

- **CONTINGENCY THEORY**

It states that compensation should be based on particular contingencies or situations prevailing in a country or the industry/organization's position in the market. Organizations will have pay systems that fit with their business strategy. Organizations that have "fit" will outperform those without "fit"

- **RESOURCE-BASED THEORY**

The theory suggests that an organization should pay well to attract and train competent people who contribute to the competitive advantages.

- **THE AGENCY THEORY**

There exists a principal-agency relationship between the organization's headquarters and subsidiaries, the former being the principal and latter acting as agents. The principal delegates responsibilities to the agents.

- **THE EQUITY THEORY**

There should be a fair balance between an employee's contribution to an organization and what he or she receives as compensation.

Wage and Salary

- The term “Wage” is used to denote payment made to the employees ordinarily termed as “workers” or the ‘blue’ collar employee and are engaged in manual production or supporting jobs in unskilled, semi-skilled or skilled jobs
- “Salary” is the term, which is used in respect of payment made to the white-collar employees doing clerical, administrative and managerial jobs.

- Wages have been classified into three categories: (1) Living wages (2) Minimum wages (3) Fair wages
- According to Fair Wages Committee Report: "The living wage should enable the male earner to provide himself and his family not merely the basic essentials of food, clothing and shelter but a measure of frugal comfort including education for the children, protection against ill-health, requirement of essential social needs and measures of insurance against old age."

- Minimum Wages—The minimum wage may be defined as the lowest wage necessary to maintain a worker and his family at the minimum level of subsistence, which includes food, clothing and shelter.
- Fair Wages —A fair wage is something more than the minimum wages. Fair wage is a mean between the living wage and the minimum wage. While the lower limit of the fair wage must obviously be the minimum wage, the upper limit is the capacity of the industry to pay fair wage compares reasonably with the average payment of similar task in other trades or occupations requiring the same amount of ability.

Wage can broadly be divided into 3-parts :

- The settled wage – Rate per day or rate per month or rate per week on actual job.
- Gross earnings – Which include overtime payment, incentive payment and allowances payable in cash.
- Take home pay – Which would be gross earnings excluding standard deductions.

Minimum Wage Rates across Indian States



minimum wage
rates

Source: Minimum Wages Act 1948. (2014, November 13). Retrieved from http://en.wikipedia.org/wiki/Minimum_Wages_Act_1948

Main components of Salary

- Salary = Basic + DA (Dearness Allowance) + Other Allowances
- **Basic Salary:** As the name suggests, this forms the very basis of salary. This is the core of salary, and many other components may be calculated based on this amount. It usually depends on one's grade within the company's salary structure. It is a **fixed** part of one's compensation structure.
- **DA** introduced in the cotton textile industries in Bombay and Ahmadabad and called as "dear food allowance". Ad hoc allowances were paid to employees to compensate the rise in the cost of living. However, in the advanced countries, employees are generally compensated through periodical salary revisions.

- **Cost of Price Index (CPI)** – It is the mechanism to measure the rise or fall in consumer prices in percentile form over a period of time for commodities consumed by a particular population group belonging to a particular centre or area.
- **Cost of Living Index (COLI)** – Includes habit of the consumers and standard of living along with the rise or fall of prices of essential commodities and services.
- DA is calculated on CPI only. CPI of base period is always considered 100. The essential commodities and services are known as Basket of Commodities and Services.

Calculation of DA

- It is the additional pay made by the employer to his employees to compensate them to a certain extent for the rise in CPI. In the context of changing pattern of prices and consumption, real wage of the employee are likely to fluctuate greatly. DA serves as a device to protect to a greater extent the real income of wage earners from the effect of rising price.
- The Government of India presently calculates the level of inflation for purposes of grant of dearness allowance to Central Government Employees on the basis of the All India Consumer Price index Number for Industrial Workers (1982=100) (AICPI). The twelve monthly average of the AICPI (1982 base) as on 1st January and 1st July of each year is used for calculating the Dearness Allowance (DA). Recently the government raised dearness allowance to central government employees by seven percent in view of persisting high inflation

Wage Differentials

- Wages differ in different employments or occupations, industries and localities, and also between persons in the same employment or grade. It is directly related to the allocation of the economic resources of a country, including manpower, growth of national income, and the pace of economic development. Wage differentials reflect differences in physical and mental abilities of workers, in productivity and efficiency of management, and in consumer preferences.

- Wage differentials have considerable economic and social significance and therefore, have certain specific principles and rationalism, like –
- Wages should be commensurate with work.
- Equal wages should be paid for equal work.
- Differentials should be such as to provide a sufficient incentive for accruing skill and improving productivity.
- Differentials should be sufficient to attract workers to jobs in industries in which there is a shortage of labour.

- Wage differential can be classified into several categories, like –
- Occupational differential or differentials based on skill.
- Inter firm differentials.
- Inter area or regional differentials.
- Inter industry differentials.
- Personal wage differentials

Job Evaluation

It is a process of analyzing & describing positions, grouping & determining their relative value by comparing the duties of different positions in terms of their different responsibilities and other requirements (responsibilities, skill, physical effort, mental abilities and working conditions etc.).

Characteristics –

- It is the process of determining the worth of one job in relation to that of other without regards of the personalities.
- Analysis and assessment of the job content helps to make a standard for effective basis of fair and logical remuneration system.

- Job evaluation can be made either by Qualitative or Non-quantitative basis by simply listing jobs in order of difficulty, these are – (i) Ranking method, (ii) Job Classification or Grading method or on Quantitative basis where point values are assigned to the various demands of a job, & its relative worth determined by sum of such point values, these are (iii) Point system and (iv) Factor Comparison system.

Methods of Job Evaluation

Ranking System – This system of job evaluation usually measures each job in comparison with other jobs in terms of relative importance of the following five factors –

- Supervision & leadership of subordinates.
- Co-operation with associates outside the line of authority.
- Probability & consequences of errors (in terms of waste, damage of equipment, delay, complaints etc.).
- Minimum experience requirement.
- Minimum education required.

Following are the five steps are involved in this method –

(a)Preparation of Job Description.

(b)Selection of raters – Most organization uses a committee of raters.

©Each member of the Committee ranks the jobs independently either by – first identifying those jobs which comes at the two extremes of the scale & locating the rest in the middle region or comparing each job with every other job, one at a time.

For increasing the dependability of result, each member is allowed to rank the jobs 3- times.

(d)If some members differ significantly on the ranking of a job, the difference be eliminated on mutual discussion.

(e)Finally, the 3-sets of ranking are averaged for data of all the Committee members & final ranking of jobs are declared. Wage level is then finalized.

- e.g. Ranking for University personnel –

<u>Ranking order</u>	<u>Pay Scale</u>
• Professor	XXXXXX
• Associate Professor	YYYYYY
• Assistant Professor	ZZZZZZ
• Registrar	WWWWW
• Dy. Registrar	VVVVV
• Asst. Registrar	QQQQQ
• Superintendent	PPPPP
• UDC	CCCCC
• LDC	BBBBB
• Group- D staff	AAAAA

- (ii) **Classification or Grading method** – In this case a certain no. of grades or classes of jobs are decided upon & then all jobs in the organization are filled into these classes, e.g. in an Engg. Organization say there are 60- different manual operations which need to be grouped say in 4- classes, Highly skilled, Skilled, Semi-skilled & Un-skilled.
- All occupation in one grade will be treated alike in the matter of base pay.
- Steps – (a) A no. of job classes are pre-determined & description of each class written by the Evaluation committee. (b) Each job description is read and characteristic of each job matched with those of the different class description. (c) The job is finally allocated to the class which fits it best.

<u>Grade</u>	<u>Description of job classification</u>
• Unskilled	Pure routine concentration, speed & accuracy, works under supervision.
• Semi-skilled	Skilled for the job by having an exhaustive knowledge of the details. Supervision is required.
• Skilled	As above with more responsibility & capable to work independently.
• Highly-skilled	As above with ability to supervise the others. Capable of independent thinking and decision taking in critical situation of department.

- (iii) **The Point System** : The method, designed & developed originally by the Western Electric Co. and enjoy widest acceptance today. Steps involved are –
 - (a) Jobs are first broken into a certain no. of factors e.g. skill, effort, responsibility & working conditions depending upon management discretion.
 - (b) Each factor is further broken down into a no. of smaller factors as for example :
 - Skill – Education, experience & initiative.
 - Effort – Physical (sex, age, eyesight, standing), mental (intelligence, memory, reasoning) & visual.
 - Responsibility – For equipment/ process, material/product, safety of others & work of others.

- Working condition – Environmental influences (atmosphere, ventilation, illumination, noise, cognition, fellow- workers etc. Political climate) or Hazards from the work or surroundings or Hours of work.
- © The total no. of points – as desired by the committee be decided for the entire system. A decision is to be made about the number of points that are to be allocated to each major and minor factor. Points assigned to each major and minor factor indicate its relative importance.

e.g. For a particular job say the total point is 500 which is distributed as –

<u>Major Factor</u>	<u>Minor factor</u>	<u>No. of points</u>	
Skill	Education	75	250
	Experience	100	
	Initiative	75	
Effort	Physical	50	75
	Mental	15	
	Visual	10	
Responsibility	Equipment	25	100
	Material	25	
	Safety of others	25	
	Work of others	25	
Working condition	Environmental influence	50	75
	Hazards	25	
Total			<u>500</u>

- (d) Each minor factor is converted into scale by dividing it into certain number of degrees & assigning point value to them. Definition of these degrees is also given. E.g. Education can be converted into 5-point scale as follows –
 - 15 – Read, write & subtract.
 - 30 – Passed High School level.
 - 45 – H.S. + 1- year trade training.
 - 60 – Graduate
 - 75 – P.G. level completed.
 - The above scale for education can be used for any job in the system.

- (e) Evaluation of job is done by comparing the Job definition & Job specification with degree of definitions on the factor scale & deciding at which degree the job falls on each factor.
- A totaling of points for all factors gives the final rating of the job in terms of points. Finally, assign money value to points. For this the total points for the job is translated to money with a pre- determined formula.

- **Job points translated to Job Rupees**

Point Range	Hourly rate range (Rs.)	Job grade
• 101-150	1.60 to 2.10	1
• 165- 200	2.00 to 2.50	2
• 201-250	2.40 to 2.90	3
• 251-300	2.80 to 3.30	4
• 301-350	3.20 to 3.70	5
• 351-400	3.60 to 4.10	6
• 401-450	4.00 to 4.50	7

- **(iv) Factor Comparison system** : This method was developed to eliminate 2- problems encountered in developing point rating plans viz. Determining the relative importance of factors & describing degrees of factors.
- Steps involved in this system are –
- (a) About 15-20 well-known/ easily recognized jobs often known as key jobs are selected.

- These jobs should be a good cross- section of all jobs in the plant/ office covering as many departments as possible as also the pay level of all jobs.
- (b) Factors, in terms, of which the jobs are to be evaluated are determined & defined, especially those factors – Mental effort, Skill, Physical effort, responsibility & working condition.
- © All key jobs are ranked under each factor by individual member of committee. Average of rating is then considered. If there is a wide difference among the members, the matter to be reviewed.

Job condition	Skill	Responsibility	Effort	Working
1	A	B	E	D
2	B	A	D	E
3	C	C	B	C
4	D	D	C	B
5	E	E	A	A

Wherein A → Excellent; B → Good; C → Average; D → Moderate; E →
Poor.

- (d) The existing salary of each key job is apportioned among the factors on the basis of relative importance of each factor on the job. Each committee member will then allocated the revised rate of salary on the basis of factors. Each factor so valued will then be averaged.

<u>Key Job</u>	<u>Prevalent rate /hour (Rs.)</u>
1	19.00
2	14.50
3	11.50
4	6.25
5	3.75

- Money apportioned to each job

<u>Job</u>	<u>Skill</u>	<u>Resp</u>	<u>Effort</u>	<u>Working Conc</u>
• 1	A=8.50	B=5.00	E=3.00	D=2.50
• 2	B=5.50	A=4.50	D=2.25	E=2.25
• 3	C=4.50	C=3.00	B=2.00	C=2.00
4	D=2.50	D=1.25	C=1.00	B=1.50
• 5	E=1.00	E=0.75	A=1.00	A=1.00

(e) Other jobs are then evaluated by comparing them to the list of key jobs in each scale.

- The above method is expensive and complicated.

Limitations of Job Evaluation :

- Highly subjective process & there is much room for judgment and human error.
- Fails to consider no. of variables that influence the value of a given job – supply & demand of a particular skill, continuity of employment, career prospect, social status, and congeniality of co-workers & tightness of incentive standard.

International Compensation

Mostly the basic components remain same as that of parent country , only the allowances and incentive part differ.

Allowances:

- Relates to the cost of living: An adjustment for differences in the cost of living between the home country and foreign assignment
- Spouse Assistance: Provided to help guard against or offset the income lost by an expatriate's trailing spouse
- Housing Allowances are paid either on an assessed or on actual basis.

- Home leave allowance are offered to facilitate an expatriate to visit his home country at least once in a year.
- Relocation allowance covers such expenses moving, shipping and storage charges, temporary living expenses , subsidies regarding appliances or car purchase or lease-related charges.
- Educational Allowance is given to an expatriate's children. Often extended to expatriate's trailing spouse.

FOREIGN SERVICE/HARDSHIP PREMIUM

- It is often perceived as an inducement in the form of salary premium to accept an overseas assignment.
- Generally, salary premiums vary from 5-40 percent of the base salary.
- Actual value depends upon the assignment, actual hardship, tax consequences and length of assignment.