Introduction

Generally the term compensation refers to compensating any damage, loss or mental harassments, wages or salaries as reward for physical and/or mental efforts to perform any agreed task or job. But the concept of equity in remunerating any work or task has forced us to perceive wages and salaries as compensation, because people work efficiently only when they are paid according to their worth or feel satisfied with the remunerations.

Besides basic salaries or wages, companies are forced to view the benefits and services to justify the positional and esteem needs of employees and to provide adequate cushion for inflations. Though the cost of human resources is estimated at between 2% to 20% of the operating cost (depending upon the type of industry), to retain the employees or to avoid job-hopping, some of the industries are even forced to adopt varying scales and benefits.

Today, the pay being competitive, it is logical for employers to look for employees with attributes other than knowledge and skill, attributes which can enrich their experience at work. They can find out the potential in the employee and provide opportunities for learning and career growth. Thus compensation designs and compensation programmes are being so designed so as to attract the winning horses.

It is compensation which directly affects one's standard of life, meets the needs of his/ her family, enables him/her to save for future liabilities and justifying his/her worth for a job. Wages/salaries, on the other hand, add to the cost of production and are a vulnerable part of a company's overhead, which affects the profit to the employers.

Both employers and the employees are concerned about the adequacy of the compensation. Employers are interested to hire competent employees by offering attractive and bearable cost to the company, while employees try to get maximum return on their skills, knowledge, expertise or payment to justify their worth.

Meaning

Compensation is the reward that the employees receive in return for the work performed and services rendered by them to the organization. Compensation includes monetary payments like bonuses, profit sharing, overtime pay, recognition rewards and sales commission, etc., as well as nonmonetary perks like a company-paid car, company-paid housing and stock opportunities and so on.

Apart from the basic financial pay the employees receive paid vacations, sick leave, holidays and medical insurance, maternity leave, free travel facility, retirement benefits, etc., and these are called benefits.

Compensation is a vital part of human resource management decision making as it helps in encouraging the employees and improves the organizational effectiveness.

Compensation packages with good pay and benefits help to attract and retain the best employees. Employees consider pay package to be fair when the amount of wage covers basic living expenses, keep up with inflation, leave some money for savings (perhaps for retirement) and leisure and there is increment over time.

Types of Compensation – Classified as Financial and Non-Financial Compensation

Compensation is what employees receive in exchange for the services rendered in an organization. The term 'compensation' refers to all forms of financial returns and tangible benefits that employees receive as part of the employment relationship.

Compensation refers to as a wide range of financial and non-financial rewards given to employees for their services rendered to the organization. It is paid in the form of wages, salaries and employee benefits such as paid vacation, insurance, maternity leave, free traveling facility, retirement benefits, etc.

Compensation can be classified into two categories:

1. Financial Compensation

2. Non-Financial Compensation

Type # 1. Financial Compensation:

Financial compensation is most popular and important compensation that is given in the form of money. It is the most important motivational factor that satisfies employees' basic needs like food, clothing, etc.

It is further categorized into two parts:

I. Direct Compensation:

Direct compensation means compensating employees by paying them money in the following forms:

a. Wages-Wages means remuneration paid in cash for the work performed by an employee.

b. Bonus- Bonus means extra cash paid to an employee for exceeding his performance or on completion of specified project or target.

Other financial incentives that are directly given to employees in the form of cash.

II. Indirect Compensation (Fringe Benefits):

Dessler refers to indirect compensation as the indirect financial and non- financial payments employees receive for continuing their employment with the company which are an important part of every employee's compensation. Other terms such as fringe benefits, employee services, supplementary compensation and supplementary pay are used.

Armstrong says indirect compensation or employee benefits are elements of remuneration given in addition to the various forms of cash pay. They also include items that are not strictly remuneration such as annual holidays.

Management uses it ostensibly to facilitate its recruitment effort or influence the potential of employees coming to work for a company, influence their stay or create greater commitment, raise morale, reduce absenteeism in general and improve the strength of the organization by instituting a comprehensive programe in this area.

Because of the increasing costs of fringe benefits, some people also label them as 'hidden payroll.' Benefits currently account for almost 40 per cent of the total compensation costs for each employee. The basic purpose of fringe benefits or supplementary compensation is to attract and maintain efficient human resources within the organization and to motivate them.

Types of Indirect Compensation:

Below are some of the more popular indirect compensations offered by today's organizations.

a. Social Security:

This is a federally administered insurance system. According to law, both employer and employee must pay into the system, and a certain percentage of the employee's salary is paid up to a maximum limit. How much is paid by employer and employee is calculated on the average monthly wage (weighted towards the later years). It is provided mainly to give financial security to employees when they retire.

b. Workers' Compensation:

It is meant to protect employees from loss of income and to cover extra expenses associated with job-related injuries or illness. The laws generally provide for replacement of lost income, medical expenses, rehabilitation of some sort of death benefits to survivors, and lump-sum disability payments.

c. Retirement Plans:

Retirement and pension plans, which provide a source of income to people who have retired, represent money paid for past services. Private plans can be funded entirely by the organization or jointly by the organization and the employee during the time of employment.

One popular form of pension plan is the defined-benefit plan. Under this plan, the employer pledges to provide a benefit determined by a definite formula at the employee's retirement date. The other major type of retirement plan is the defined contribution plan, which calls for a fixed or known annual contribution instead of a known benefit.

d. Paid Holidays:

These comprise Christmas Day, New Year's Day, Independence Day, Labor Day, etc. One relatively new concept is the floating holiday, which is observed at the discretion of the employee or the employer.

Another relatively new concept is referred to as personal time-off or personal days. Under this concept, organizations give employees a certain number of days with pay to attend to personal affairs. Normally these days can be taken at the employee's discretion.

e. Paid Vacations:

Typically, an employee must meet a certain length-of-service requirement before becoming eligible for paid vacation. The time allowed for paid vacations generally depends on the employee's length of service.

Unlike holiday policies that usually affect everyone in the same manner, vacation policies may differ among categories of employees. Most organizations allow employees to take vacation by the day or week but not in units of less than a day.

f. Other Benefits:

Organizations may offer a wide range of additional benefits, including food services, exercise facilities, health and first-aid services, financial and legal advice, and purchase discounts. The extent and attractiveness of these benefits vary considerably among organizations. For example, purchase discounts would be especially attractive to employees of retail store or an airline.

Type # 2. Non-Financial Compensation:

Non-financial compensation refers to compensating employee not in form of money but in some other forms that stimulate employees' morale and also improve his performance.

It can be in the following forms:

I. Job security

II. Recognition

III. Participation

IV. Pride in job

V. Delegation of responsibility

VI. Other incentives

Theories of Compensation

1.Reinforcement and Expectancy Theory: This theory is based on the assumption that, the reward-earning behavior is likely to be repeated, i.e. an employee would do the same thing again for which he was acknowledged once.

Similarly, in the case of Expectancy Theory, given by Vroom, the employee is motivated to do a particular thing for which he is sure or is expected that performance will be followed by a definite reward or an outcome.

2. Equity Theory: According to this theory, there should be equity or the uniformity in the pay structure of an employee's remuneration. If the employee feels he is not being paid fairly for the amount of work he does in a day will result in lower productivity, increased turnover and high absenteeism. The remuneration system should comply with three types of equity:

2.1 Internal Equity: The employee perceives the fairness in different pay for different jobs based on the nature of work involved, i.e. he must feel that pay differentials among the jobs are fair.

2.2 External Equity: The employee should feel the fairness in what they are being paid is in line with what other players in the same industry are paying to their employees for the same kind of job.

2.3: Individual Equity: The employee perceives the pay differentials among the individuals who are performing the same kind of a job and within the same organization. Usually, an individual with more experience gets high remuneration as compared to the fresher irrespective of the nature of a job.

3. Agency Theory: This theory states that both the employer and the employee are the stakeholders of the company, and the remuneration paid to the employee is the agency cost. The employee will try to get an increased agency cost whereas the employer will try to minimize it. Hence, the remuneration should be decided in such a way that the interest of both the parties can be aligned.

Thus, these theories posit that the compensation in the form of salary or wages can be decided on the basis of the outcome or the behavior of an employee.