Compensation Administration

compensation is generally a broad concept covering incentives, allowances, and benefits, besides the basic salary. Rewarding the employees for their job efforts is the focus of the definitions of compensation. We may define compensation as the sum of the rewards for the job-related efforts of the employees and also for their commitment to and involvement in the job.

Definitions:

 A systematic approach to providing value to employees in exchange for work

performance.

 Providing monetary value to employees in exchange for work performed.

 May achieve several purposes like assisting in recruitment, job performance, and job

satisfaction.

"Compensation is a broad term pertaining to financial rewards received by persons through their employment relationship with an organization." —Terry Leap

"Compensation means all forms of pay or rewards going to employees and arising from their employment." —Gary Dessler

"Compensation is the total of all rewards provided to employees in return for their services. The overall purposes of providing compensation are to attract, retain, and motivate employees."—R. Wayne Mondy

Objectives of Compensation Administration

- **Equity in Compensation**

The primary objective of compensation administration is to ensure internal and external equity in the payment of salary and other benefits to the employees. Internal equity refers to the payment of equal compensation for jobs of similar nature and worth within the organization. The organization should determine the worth of each job through a job evaluation process. Through job evaluation, jobs with similar characteristics could be brought under a single job grade for the purpose of fixing the same pay grade. External equity refers to the payment of compensation to the employees at par with the wages and salary paid by similar companies for similar jobs in the industry.

- **Enhancing Individual and Organizational Efficiency**

Achieving the desired level of individual and organizational efficiency is also an objective of compensation administration schemes. Every organization considers compensation as an effective instrument to fulfil the organizational goals and objectives by enhancing the productivity, performance and commitment of the employees.

- **Employee Motivation and Retention**

Retaining the existing employees is another objective of the compensation programmes. A well-designed compensation scheme motivates the employees and facilitates the retention of the best employees for a long time in the organization. I

- **Goodwill in the Labour Market**

Encouraging the best candidates to apply for the job vacancies and to make them accept the job offers issued by the organization after successful selection is another objective of compensation administration.

- **Adherence to Laws and Regulations**

Complying with the prevailing laws and legislation of the country of operation is another objective of the compensation administration system. A sound compensation system would normally consider the challenges and constraints imposed by the government on compensation management.

- **Controlling the HR Cost**

Any compensation administration aims at keeping the HR cost well under control. Certainly, a good compensation policy would neither overpay nor underpay its employees.

- **Improving Industrial Relations**

An effective compensation administration scheme intends to improve the labour–management relations in the firm. In many organizations, compensation is the major source of conflict between the management and the labour unions.

Types of Compensation

Typically, an organization provides compensation to its employees in two forms. These are: direct and indirect compensation. Depending upon its size and the compensation policy, an organization may determine the compensation packages for various categories of jobs. Small organizations usually restrict the number of components in a compensation package and also give more weightage to direct cash compensations like basic pay and variable pay. In contrast, large organizations may include several components in a compensation package. They may also offer different kinds of compensation packages for different categories of employees.

Direct Compensation

Direct compensation normally includes the amount payable to the employees as direct cash rewards for the work extracted from them. This may include any form of monetary benefit payable to the employee at periodic intervals. The basic pay and variable pay are the important components of direct compensation.

Basic Pay This is the basic salary received by the employee as a direct compensation for the work done by him. It is a fixed component in the compensation and it often forms the basis for the computation of variable components like bonus and other benefits.

It does not usually include any incentives or allowances. The basic pay in a compensation package actually reflects the worth of a job determined through job evaluation. Generally, the compensation policy of an organization and the external labour market conditions influence the determination of the basic pay for a job.

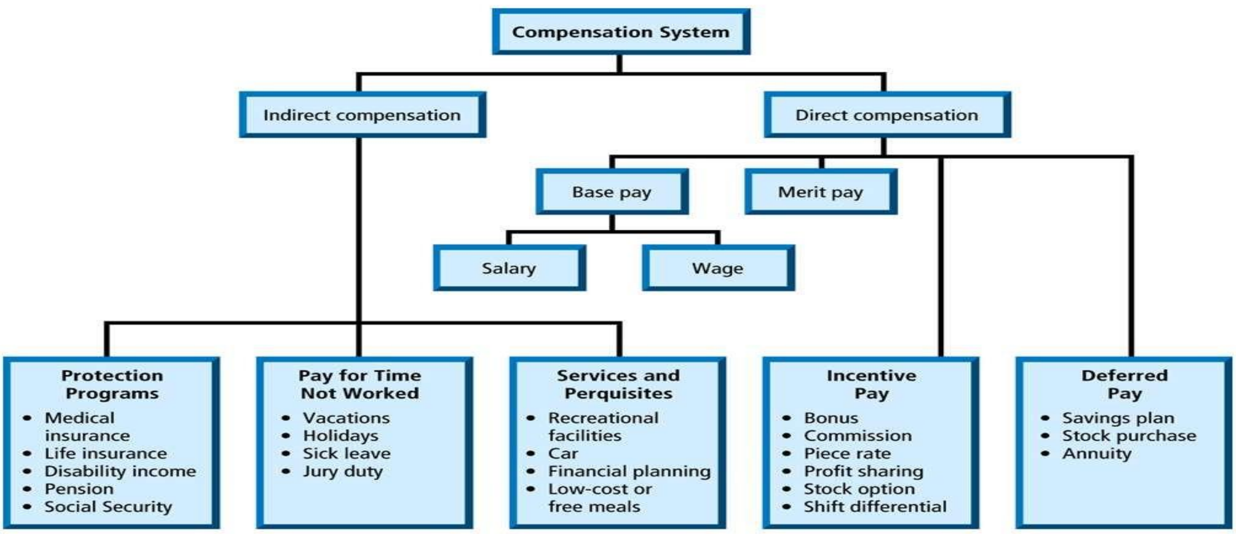
Variable Pay

This is a pay which is basically linked to the performance of the individual, group or the organization. Organizations normally offer a portion of the compensation in the form of variable pay to its employees. Variable pay may include incentives, commissions, profit-sharing, gain-sharing, and bonuses. It can be defined as an alternative compensation scheme that correlates the pay with the business results and promotes a participative management process.4 We shall now discuss a few components of the variable pay.

Profit-sharing—In this variable type of pay, an organization distributes a part of its profit to its employees. An important form of a profit-sharing plan is the bonus plan, in which the employees get a share of the profit at the end of the year. However, some organizations may defer the payment of the shares of profit till the expiry of a specific period. Till such time, the deferred profit share would be in the account of the employees but maintained by the company.

Gain-sharing — In gain-sharing, compensation is determined on the basis of the group or organizational performance. Normally, savings in costs, increase in quality, productivity, and customer satisfaction are the measures used for sharing the gains made by the organization.

Equity plans—Equity stock option plans (ESOPs) offered by the companies are also one of the direct compensation schemes. The purpose of ESOPs is to create an ownership interest for the employees in the organization. In this form of direct compensation, employees stand to gain from the overall performance of the organization. This can also help the employees in integrating their individual interests with the organizational interest.

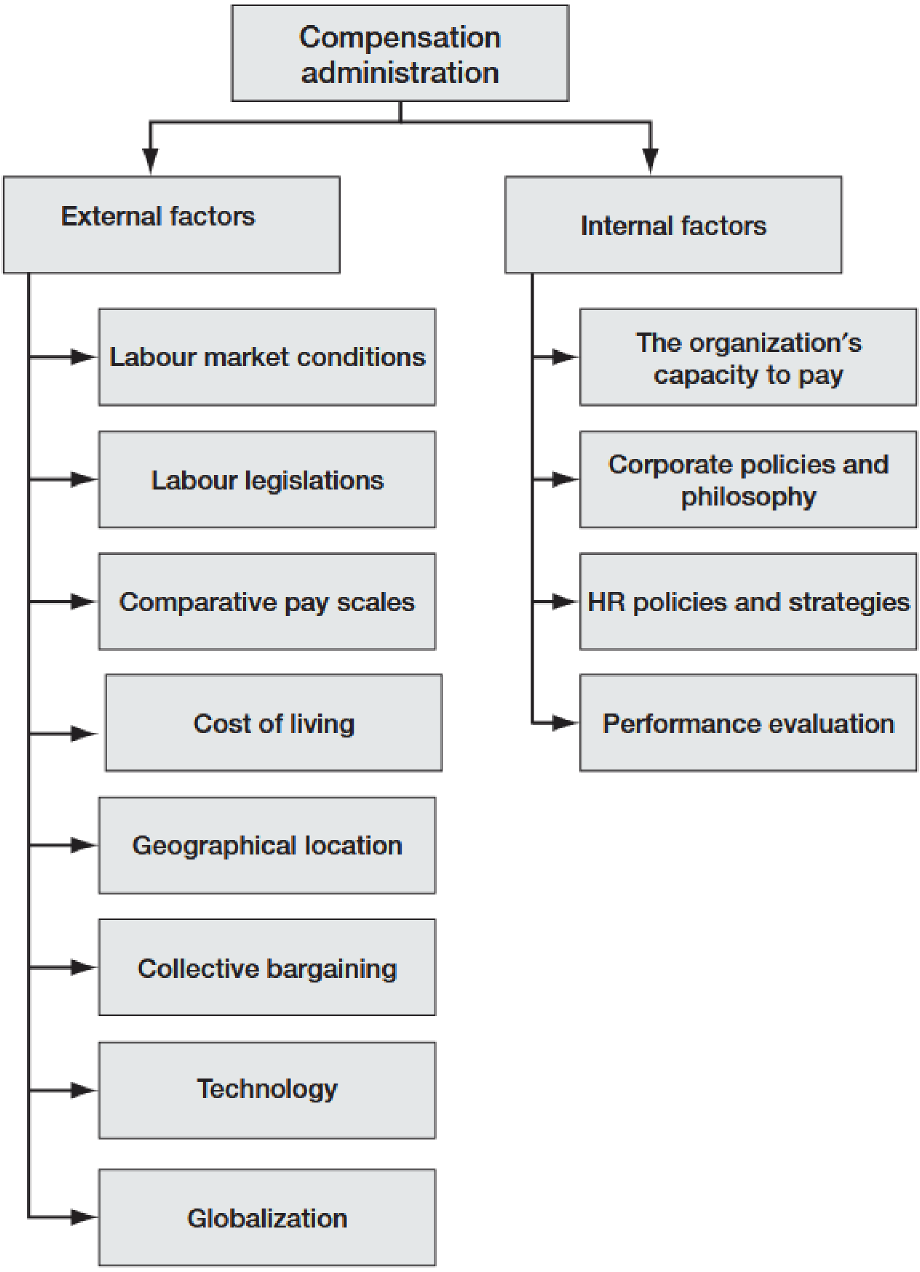


Indirect Compensation

Indirect compensation includes the benefits enjoyed by the employees but paid by the organization. Usually, indirect compensations are available to all the employees irrespective of their performance in the job. Mostly, the decisions relating to indirect compensation are influenced by the employees' length of service and eligibility. Besides, indirect compensation decisions are normally guided by the policies and benefits offered by similar organizations.

Factors Influencing Compensation

the nature and amount of compensation payable by an organization is influenced by a host of internal and external factors. But, the degree of influence of these factors might differ from one organization to another and also from one situation to another. In the globalized and intensely competitive market conditions, organizations continuously make varied efforts to achieve cost-effectiveness and need fulfilment through their compensation policies.



External Factors
The external factors remain outside the purview of an organization and yet influence its compensation administration. In fact, most of the factors influencing compensation administration are external.
Labour Market Conditions
The difference between the demand for specific categories of employees and their supply in the labour market influences the compensation administration decisively. When the demand for labour exceeds its supply, there would be a labour shortage. In such a situation, the organizations are forced to offer higher rates of compensation to get the required number of suitable employees. This is because the people possessing the required skills would obviously demand more compensation for their services. In contrast, it would be sufficient to offer a minimum amount of compensation to employees possessing skills which are abundantly available in the labour market.

Labour Legislations
Labour laws and regulations normally have a specific influence on the wages and salary administration of an organization. Generally, the legislations enacted by the central and state governments regulate the minimum wages and bonus payable to the employees, the workloads and the working hours.

Comparative Pay Scales
Organizations should consider the wages paid by similar organizations in the industry for similar jobs.

Cost of Living
At times of rising prices, the cost of living emerges as a major factor in determining the salary levels of the employees. When there is an upward movement in the cost of living, the real wages decline, affecting the purchase power of the employees. Due to the changes in the cost of living, organizations usually keep a portion of the employees' compensation (such as dearness allowance) in a variable form.

Collective Bargaining
The strength of the unions is one of the important influencing factors in compensation administration. When the unions in an organization are strong, the wage agreements are usually concluded in favour of the employees. This is because these unions exert strong pressure on the employers, both internally and externally, during wage negotiations.

Technology
The level and sophistication of the technology available in the industry can also influence compensation administration. When the manually performed jobs are easily and effectively replaceable with the existing technology, the organization may not be inclined to offer higher wages for such jobs.

Geographical Location

The location of the organization is also a major factor influencing compensation administration. When the organization is located in cities or urban areas, it may have to hire employees for higher wages due to the high cost of living prevailing in these areas.

Globalization

Globalization has brought in several multinational companies to the country. The compensation policies and philosophies of these globalized companies have begun to influence and shape the HR and wages practices of the Indian companies.

Internal Factors

The internal factors influencing the compensation administration are also significant in number.

Capacity of the Organization to Pay

Organizations may have the willingness to pay more compensation to their employees but they may not have the financial ability to do so. Understandably, the financial strength of the organization is one of the highly critical factors that determine compensation administration.

Corporate Policies and Philosophy

Corporate philosophy, mission and vision statements provide overall directions to the entire organization and this includes its compensation administration. Organizations may deliberately pay the industry's best wages and salary to attract and retain the high-calibre employees.

Human Resource Policies and Strategies

The HR policies of an organization which deal with various aspects of human resource management also influence compensation administration. They usually form the basis for the terms and conditions of the employment.

Performance Evaluation Report

Compensation administration is also influenced by performance evaluation results, job evaluation report, job description and job specification statements. The employees' performance assessed through performance evaluation techniques may be used for determining the wage levels of the employees.