

COURSE TITLE

ORGANIZATION AND MANAGEMENT

Chapter 10

COMPENSATION MANAGEMENT

Lecture 10 (week 10)

Concept of compensation management, Types of compensation, Determinants of compensation, Incentive and wages, Classification and forms of incentive

Lecturer: Associate Prof. Ishwar Adhikari

Learning Objective

The main objective of this lecture is to understand about:

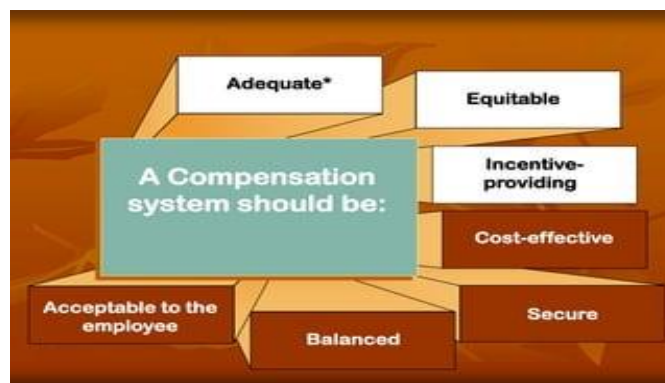
- 10.1 Concept of Compensation management
- 10.2 Types of Compensation.
- 10.3 Determinants of compensation.
- 10.4 Incentive and wages.
- 10.5 Classification and forms of incentive.

10.1 CONCEPT OF COMPENSATION MANAGEMENT

All employees work for certain purpose and hence their efforts need to be compensated. Compensation is what employees receive in exchange of their contribution to the organization. Compensation refers to all forms of financial returns, tangible services, and benefits employees receive as part of an employment relationship. [1] It doesn't include salary only but it is the sum total of all rewards and allowances provided to the employees in return to their services.

In a competitive market, effective compensation management is key for employee retention and attracting top talent. Compensation management is the process of determining employees' monetary and non-monetary remuneration to support hiring and retention in accordance with business strategy. [2] Compensation management is an organized practice that involves balancing the work-employee relation by providing monetary and non – monetary benefits to the employees.

Compensation management involves managing, analysing, and determining the salary, benefits, and incentives paid to the employees. Compensation systems are designed keeping in mind the strategic goals and business objectives. Compensation system is designed on the basis of certain factors after analysing job work and responsibilities.



SOURCE: [3]

Purpose and Uses of Compensation

- To attract potential job applicants.
- To retain good employees.
- To motivate employees.
- To administer pay with legal requirements.
- To facilitate organizational strategic objectives.

Objectives of Compensation

- Stopping the employees from switching over to another job by providing them adequate compensation.
- Compensation system should follow the management principle of Equity pay.
- Compensation management plays a crucial role in attracting and retaining top talent.

- Compensation management should focus on lowest cost pay structure, since rewards don't come free of cost, it is very much important to maintain the compensation package within the budget of the organization.
- It also solve the disputes between the union and management, they work in mutual benefits through collective bargaining.
- If injustice and fairness is not perceived by workers in terms of compensation then the motivation and performance level will go down.
- It contributes to the high organizational productivity if effectively managed.
- It ensures that every employee gets paid a fair wage based on industry standards, work experience, company budget, etc.

10.2 TYPES OF COMPENSATION

1. Direct Compensation (Financial)

Direct compensation refers to monetary benefit offered and provided to employees in return of the services they provide to the organization. These are paid in the definite interval of time. It includes: Basic salary, house rent allowance, leave travel allowance, medical reimbursement, special allowance, bonus etc. Direct compensation can be further elaborated as: [4]

Hourly

Hourly wages are often provided to unskilled, semi-skilled, temporary, part-time, or contract workers in exchange for their time and labor. Jobs where some employees receive hourly wage include the retail, hospitality, and construction industries. Employees who receive hourly wages are usually able to earn overtime pay. This pay consists of any additional hours worked outside of their set contract. When setting employees' wages, manager need to be compliant with the local minimum wage legislation.

Salary

Annual salaries are typically provided to most full-time employees or skilled employees and those who fill management positions. A salary often indicates that the organization has invested in this employee for the long-term future. Examples of employees who receive a salary include teachers, accountants, doctors, and retail and hospitality managers. Both hourly wages and salary make up an employee's base pay or base salary.

Commission

Commission is a common form of compensation provided to employees in sales roles. It will usually be based on a predetermined quota or target. The higher the quota reached, the higher the commission pay will be. Commission rates are often based on various specified factors, including revenue and profit margins. Some employees will work on commission only or obtain a salary with commission.

Bonuses

Companies often offer bonuses to employees based on year-end business results or the individual meeting their set goals. Sometimes, the decision is at the manager's discretion.

Bonuses can be paid annually, quarterly, or even after the completion of each project. Both commission and bonuses fall under incentive pay, along with piece rate, profit sharing, stock options, and shift differentials.

2. Indirect Compensation

It refers to non-monetary benefits offered and provided to employees in lieu of the services provided by them to the organization. It includes leave policy, overtime policy, car policy, and hospitalization, insurance, leave travel, retirement benefits, holiday homes, flexi hours etc. All of the indirect benefits has some financial value. However, employees do not directly receive it in cash form. Certain types of indirect compensation are viewed as monetary while others are deemed as non-monetary which varies between organizations.

10.3 DETERMINANTS OF COMPENSATION

1. External Factors

Legal framework

Various laws specify things like minimum wages, overtime rates, working times, child labor restrictions, records keeping and benefits. Violating provisions of the labor act will be very costly to the organization and has to pay high rate of compensation to the employees. Hence it is important for every organization to follow the rules and regulation put forward by the governments.

Union pressure

Trade union law has given union legal protection and granted employee the right to organize, to bargain collectively and to engage in concerned activities for the purpose of collective bargaining and other mutual activities. Union negotiates for other pay related issues, income security, cost of living adjustment, health care, safety etc. Hence union plays an important role in compensation package.

Equity consideration

As per the equity theory “no one likes to think they are paid less than they deserved”. Hence both internal and external equity is crucial in determining pay. External pay must compare favorably with rates in other organization or an employer will find hard to attract good employees. Pay must be equitable internally also. Employee should be able to perceive fairness within the organization pay structure.

Competition

Compensation should be according to the current trend happening the market. Management should be able to understand and evaluate what the rival and competitors are following. According to the situation compensation package should be maintain to retain workers within the organization.

Cost of living

Geography coverage also plays an important role in compensation package. Cost of living differs between cities should be considered.

Labor market adjustment

Labor market is related with demand and supply of required workers in the market. It helps in determining the flow of workers either surplus or shortage, employment and unemployment rate in market. Depending upon the situation, compensation package can be maintain to attract the desirable people in the organization.

2. Internal Factors

Organization's compensation policies

Ideologies and principles followed by the management affect the compensation package. Issues such as seniority or performance based, pay cycle, how to award salary increases, promotions, overtime policy, leaves, and holiday etc. all depends upon the management practices. Organization can be leader or follower while maintaining the compensation package.

Job evaluation

Job evaluation is using the information developed from job description and job specification to systematically determine the value of each job in relation to all jobs within the organization. It seeks to rank all the jobs in the organization and place them in a hierarchy that will reflect the relative value of each. On the basis of job evaluation compensation package can be maintain.

Productivity

Pay structure of the organization very much depends upon the productivity of the employee as well as the organization. Higher the productivity higher will be the compensation package.

Nature of employees

There are different types of employee working in the organization. Some have recently joined the organization, some have been with the organization more than decades. Hence it is very much important to know what are nature of the employee how they should be compensated. It can be either tenure based or performance based.

Employer's ability to pay

No compensation comes free of cost, it focuses on all the financial benefits and tangible services provided to the employee raised form their employment. It is important to analyze the payment ability of the employer which basically depends upon the profitability of the organization. Higher the profit, higher will be the ability of employer to pay.

10.4 INCENTIVES AND WAGES

Compensation is to give something in return whether in terms of money or product (goods & services). Incentives and wages are the form of compensation given to the worker who provides services to the organization. From the organizational point of view, to give something (generally in terms of money) for the work we obtain from the employees. Ex: salary. To attract and retain effective & efficient manpower sound compensation policy has to be designed. Incentive mean something which encourages a person to do something or the extra financial reward/motivation.

Incentive is the performance link reward to improve motivation and productivity of the employees. Incentive include all that provide extra pay for the extra performance in addition to regular wages for the job. Wages in the widest sense mean any economic compensation paid by the employer under some contract to his workers for the services rendered by them. [5] Wages is the return given to workers for the mental and physical effort they put into production process. Giving satisfactory and fair amount of incentive and wages can eliminate most of the labor disputes.

Importance of Incentives and Wages

- Workers are likely to work at their best when they are offered monetary rewards for good performance.
- Provide opportunity for hard working and ambitious employees to earn more.
- To improve work flow, work method and man-machine relationship.
- To bring employee involvement to make employee innovative.
- Sound technique for improving productivity.
- Help to improve industrial relation and discipline.
- The cost of supervision are reduced.
- To obtain desired result.

The fundamental methods of wages are time wage and piece wage.

1. Time wage system

In this system, the worker is paid on the basis of time spent on the work irrespective of the amount of work done. The basis of this time may be hour, day, week or month. This is the oldest system and widely employed in those organization where:

- Quality of work is more important than the volume.
- Production involves delay and interruption due to uncontrollable factor.
- Where the work requires high degree of skill.
- Efficiency of work and be measured by close supervision.

Merit of time wage system

- Clear and simple
- Provides guaranteed minimum wages
- Quality is maintained
- Reduces labor turnover rate
- Wages payable are predetermined
- Suitable for industries where measuring output is impossible.

Demerit of time wage system

- Fails to motivate efficient and industrious workers.
- Work needs supervision. Thus the cost of supervision increases.
- Cannot be considered a progressive wage system.
- Possibilities of worker being negligent towards work or production.

2. Piece Rate System

Under this system, the workers are paid at a stipulated rate per piece or unit of output. Here speed is the basis of payment, instead of time. In this system, the rate is fixed per piece of work and the worker is paid according to the number of pieces completed or the volume of work done by him, irrespective of time taken to complete that work. [5] It is applicable where quality of work is not important, work is of repetitive nature, there is sufficient demand for output to guarantee continuous work and the job is standardised one.

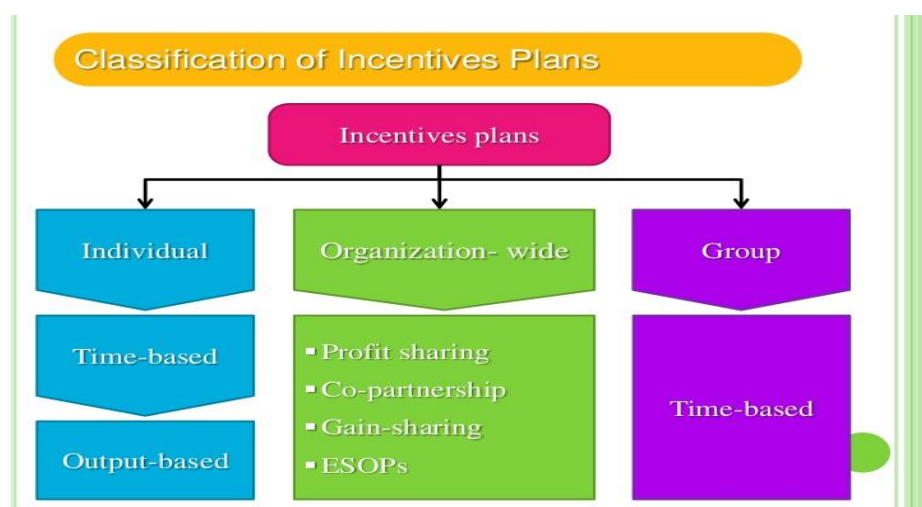
Merit of piece wage system

- Worker skill is taken into account
- No need for supervision and inspection.
- Efficient workers are given more incentives and rewards.
- Easy to calculate wages.
- More production and best results is the motto of this system.

Demerit of piece wage system

- Quality is not maintained.
- Workers intentionally ignores safety rules, inviting accidents.
- Sense of job satisfaction is less among workers.
- Administrative expenses are high.
- Workers feel a sense of security.

10.5 CLASSIFICATION AND FORMS OF INCENTIVES



SOURCE: [6]

Individual

1. Time based incentive plan

Under this per hour wage rate is determined and incentives paid on the basis of time saved. Time based plan is divided into four parts: Hasley plan, Rowan plan, Emerson plan, Bedeuax plan. [6] This all plan are more or less follow same method: (pay bonus on the time saved by employee) but with different formula.

2. Output based incentive plan

Under this, per piece wage rate is determined and incentives paid on the basis of output produced. More output in Standard time OR standard output in less time.

Organization Wise

1. Profit Sharing

It is an arrangement by which employees receive in addition to wages. A share is fixed in advance in profit of the enterprise. It is an agreement between employee and employer. "Profit sharing is a method of industrial remuneration under which an employer undertakes to pay to employee, a share in net profit of the enterprise in addition to regular wages" (ILO)

2. Co-partnership

Co partnership is the extension of profit sharing. Worker's share in company's profit is paid in the form of share by which they become entitled to participate in decision making process.

3. Gain Sharing

Aims at increasing productivity and decreasing labor cost and sharing the result gains with employee. Based on mathematical formula which compare a standard performance with actual performance. When actual performance exceeds the standard performance, saving are shared with employees.

4. ESOP (Employee stock Option Plan)

The eligible employee are allotted company's share below the market price. The term "stock plan" implies the right of eligible employee to purchase a certain amount stock in future at an agreed price. The eligibility criteria may include length of service, contribution to the department etc.

Group

This plan rewards all team members equally based on overall performance of the team member. Under this plan, the individual output cannot be measured. Team performance is evaluated on the basis of time taken rather than output produced. If team complete their target well in advance than standard time, the team members are eligible for incentives. Incentive may be made in the form of cash bonus or non-cash bonus such as pleasure trip, time off, or luxury items.

REFERENCES:

- [1] A Handbook of Organizational Behaviour and Human Resource Management: Niraj Mishra, Second Edition, Asmita Publications, Kathmandu, Nepal, 2006.
- [2] What Is Compensation Management? A Comprehensive Guide, by Finn Bartram. Accessed on 30th April 2024. <https://peoplemanagingpeople.com/strategy-operations/compensation-management/>
- [3] Compensation Management by Indu George, April 4th 2014. Accessed on 2nd May 2024. <https://www.slideshare.net/Indudominic/compensation-33117825>
- [4] Types of Compensation: Everything HR Professionals Need to Know, by Shani Jay. Accessed on 30th April 2024. <https://www.aihr.com/blog/types-of-compensation/>
- [5] Construction Management and Equipment: Saurabh Kumar Soni, First Edition, S.K. Kataria and Sons, New Delhi, India, 2014.
- [6] Incentive: by Jyothi Bandaru, March 23rd 2015. Accessed on 4th May 2024. <https://www.slideshare.net/jyothibandaru5/incentive-120311235821phpapp01>