LECTURE 2: INTRODUCTION TO COMPENSATIONS AND WAGES

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for Students of 1 Master, HRM

Course: Wages and incentives management

Learning Objectives

- To understand the concept of compensation.
- To understand Methods of Compensation
- To know the concept of Wage Level and Wage Rate.

The Definition of Compensation

- Compensation refers to a wide range of financial and non financial rewards to employees for their services rendered to the organization.

Types of Compensation

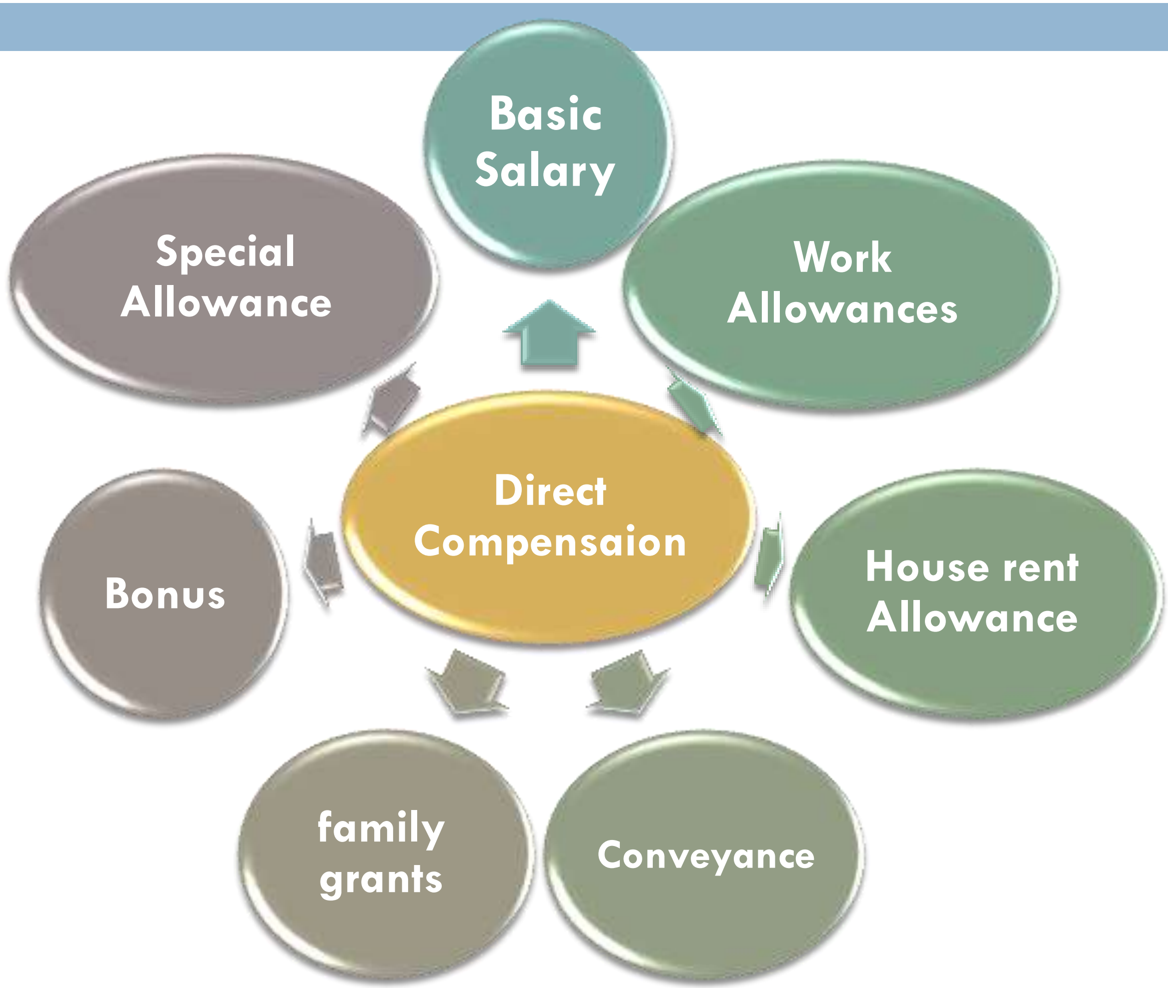
Direct Compensation

- refers to monetary benefits offered and provided to employees in return of the services they provide to the organization.
- Whereby the employer provides monetary rewards for work done and performance results achieved.

Indirect Compensation

- refers to non-monetary benefits offered and provided to employees in lieu of the services provided by them to the organization.
- It given to an employee or group of employees as part of membership in the organization.

Direct Compensation components



Direct Compensation components

Basic Salary	Various work allowances
Salary is the money an employee receives from his/her employer by rendering his/her services.	It is allowances vary according to the type of job.

Direct Compensation components

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.

Direct Compensation components

Family grants

- A cash grant for the partner and/or children. It is related to the family status of the worker.

Bonus

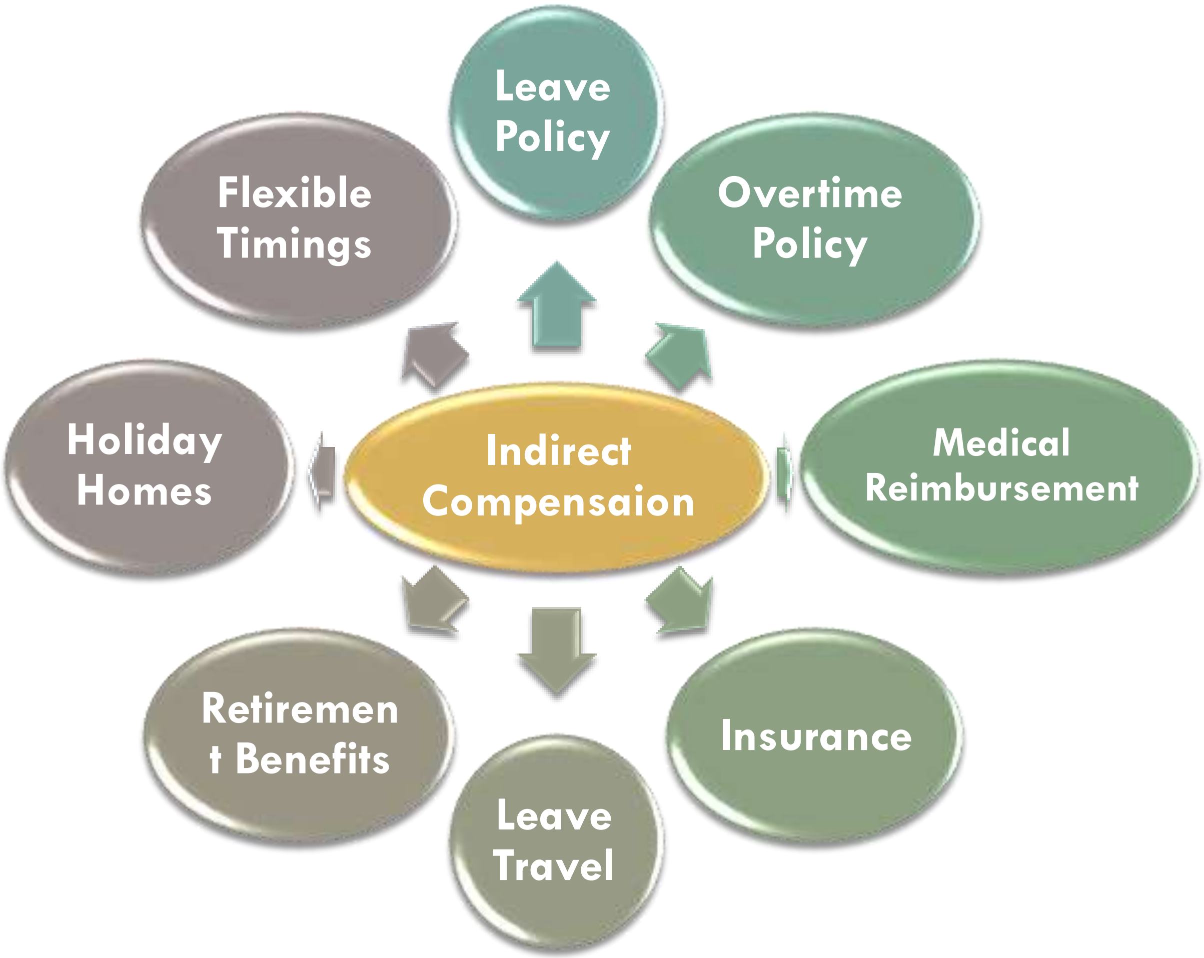
- Bonus is paid to the employees during festive seasons to motivate them and provide them the social security.

Direct Compensation components

Special Allowance

- Special allowance such as overtime, mobile allowances, meals, travel expenses, etc are provided to employees to provide them social security and motivate them which improve the organizational productivity.

Indirect Compensation components



Indirect Compensation components

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.

Indirect Compensation components

Hospitalization and medical Reimbursement

- The employees are provided with medi-claims for them and their family members. These medi-claims include health-insurances and treatment bills reimbursements. Also the employees should be provided allowances to get their regular check-ups, say at an interval of one year.

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.

Indirect Compensation components

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.

Indirect Compensation components

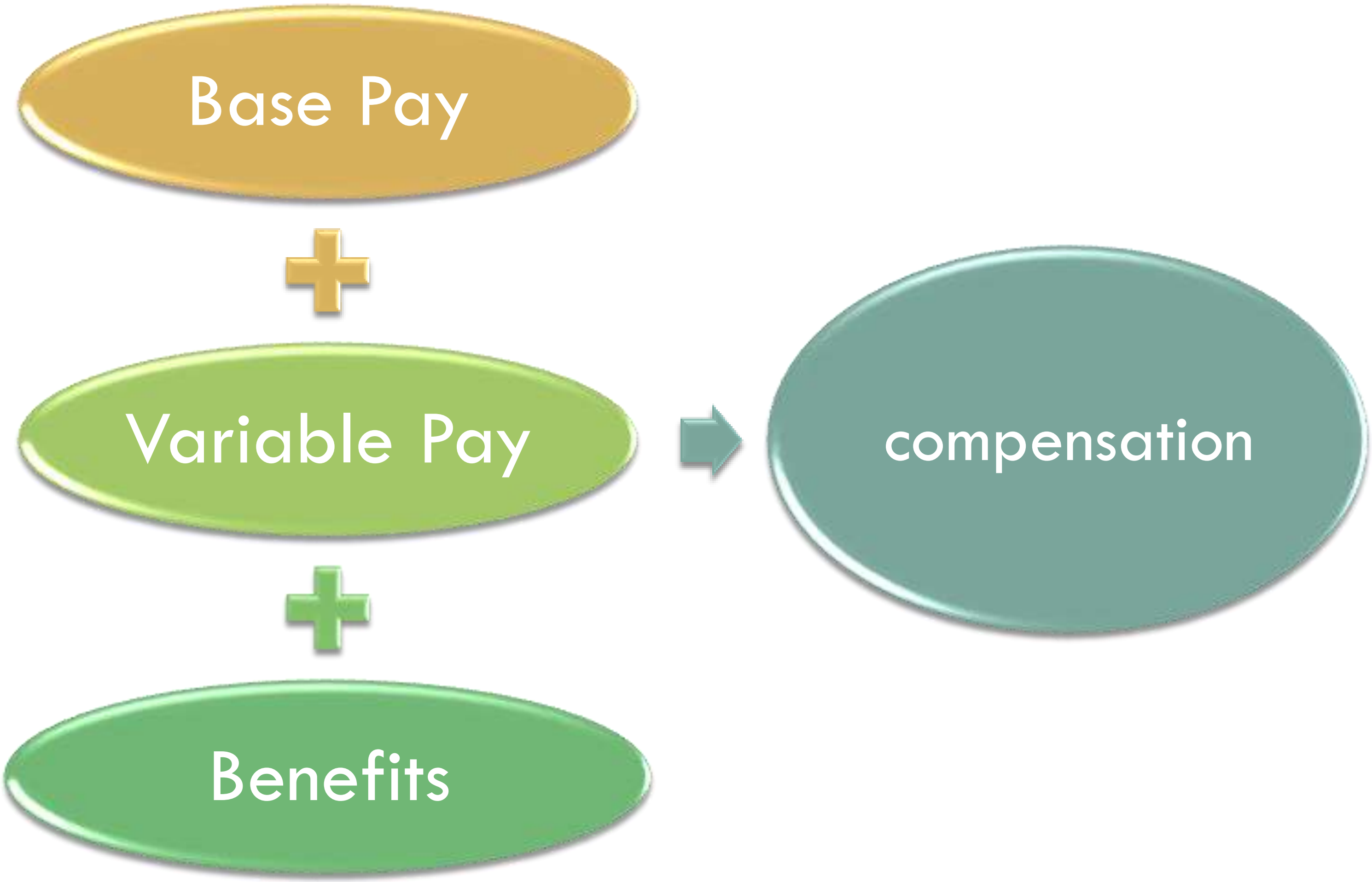
Holiday Homes

- 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.

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.

Also the compensation can classified into:



Base Pay

- The basic compensation that an employee receives, usually as a wage or a salary, is called **base pay.**
- Employees paid hourly receive **wages,** which are payments calculated based on time worked. In contrast, people paid **salaries** receive the same payment each period regardless of the number of hours worked.

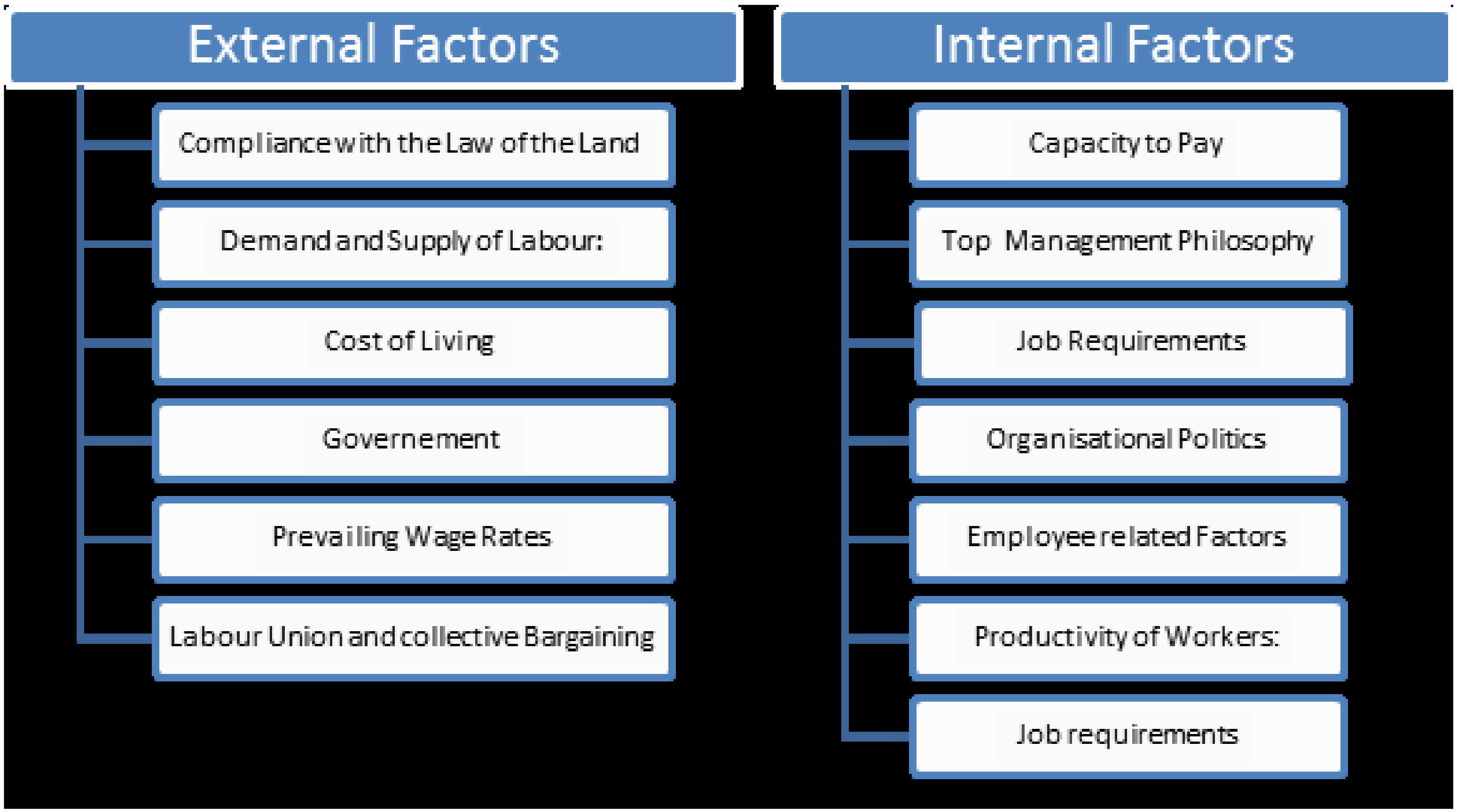
Variable Pay

- Another type of direct pay is **variable pay**, which is compensation linked directly to individual, team, or organizational performance. The most common types of variable pay for most employees are bonuses and incentive program payments.

Benefits

- Many organizations provide rewards in an indirect manner. With indirect compensation, employees receive the tangible value of the rewards without receiving actual cash. A **benefit** is a reward—for instance, health insurance, vacation pay, or a retirement pension—given to an employee or a group of employees for organizational membership, regardless of performance.

Factors Considered in Deciding the Compensation



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

- 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.

External Factors

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.

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.

External Factors

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.

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.

Top Management Philosophy

- Wage rates to be paid to the employees are also affected by the top management's philosophy, values and attitudes. For Example; 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.

Internal Factors

Productivity of Workers

- To achieve the best results from the worker and to motivate him to increase his efficiency, wages have to be productivity based. 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 job. Explicitly, job may be graded in terms of a relative degree of skill, effort and responsibility needed and the adversity of working conditions, hardship, difficulty of learning the job , Stability of employment, Job Responsibility and Change for success or failure in the work.

Internal Factors

Employees Related Factors

- i) Performance: productivity is always rewarded with a pay increase.
- ii) Seniority: seniority is the most objective criteria for pay increases.
- iii) Experience: Makes an employee gain valuable insights.
- 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.

Internal Factors

Organizational Politics

- 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 and
- iv) Results of employee performance appraisal may be intentionally disported by the supervisor

Objectives of Compensation Management

1.To Establish a Fair and Equitable Remuneration

- Effective compensation management objectives are to maintain internal and external equity in remuneration paid to employees. Internal equity means similar pay for similar work.

2.To Attract Competent Personnel

- A sound wage and salary administration helps to attract qualified and hard-working people by ensuring an adequate payment for all jobs.

Objectives of Compensation Management

3.To Retain the Present Employees

- By paying competitive levels, the company can retain its personnel. It can minimize the incidence of quitting and increase employee loyalty.

4.To Improve Productivity

- Sound wage and salary administration helps to improve the motivation and morale of employees which in turn lead to higher productivity

Objectives of Compensation Management

5.To Control Cost

- Through sound compensation management, administration and labor costs can be kept in line with the ability of the company to pay.

6.To Improve Union Management Relations

- Compensation management based on jobs and prevailing pay levels are more acceptable to trade unions. Therefore, sound wage and salary administration simplifies collective bargaining and negotiations over pay.

Objectives of Compensation Management

7.To Improve Public Image of the Company

- Wage and salary program also seeks to project the image of the progressive employer and to company with legal requirements relating to wages and salaries.

8.To Improve Job Satisfaction

- If employees would be happy with their jobs and would love to work for the company they get fair rewards in exchange of their services.

Objectives of Compensation Management

9.To Motivate Employees

- Employees Some of them want money so they work for the company which gives them higher pay. Some of them value achievement more than money, they would associate themselves with firms which offer greater chances of promotion, learning and development.

10.Peace of Mind

- Offering of several types of insurances to workers relieves them from certain fears; as a result workers now work with relaxed mind.

Objectives of Compensation Management

11.Increases Self-Confidence

- Every human being wants his/her efforts to get acknowledgment. Employees gain more and more confidence in them and in their abilities if they receive just rewards.

Compensation Approaches

- Compensation is a systematic approach to providing monetary value to employees in exchange for work performed.

Traditional Compensation Approach

- The traditional approach to the design of compensation package involves four basic components: the basic pay, some mechanism of compensation for loss of purchasing power of money, incentive for putting effort beyond the norm and fringe benefits.
- It may be more legally defensible, less complex, and viewed as more “fair” by average and below average employees. It reflects a logical, rational approach to compensating employees.

Traditional Compensation Approach

Job Analysis

Job Documentation

Job Rating

Create Job Worth Hierarchy

Prepare to Survey

Conduct Survey

Analyze Market Data

Reconcile Internal and External Considerations

Develop Pay Structure

Total Rewards Approach

- It tries to place a value on individual rather than just the jobs. Widespread use of various inventive plans, team bonuses, organizational gain sharing programs, and other designs serves to link growth in compensation to results.

Total Rewards Approach

Total Rewards

compensation

Base Pay (wages & salaries)

Variable Pay (Bonuses, incenticves, stock options)

Benefits

Medical insurance

Life insurance

Paid time off

Retirement

Worl-life Support

Performance and Talent Management

Performance apprisasals

Goal Setting

Training

Human Resource Develoment

Career & Succession Planning

Differences between Traditional Compensation Approach and Total Rewards Approach

Traditional Compensation Approach	Total Rewards Approach
1. Compensation is primarily base pay	1. Variables pay is added to base pay
2. Bonuses/perks are for executives only	2. Annual/long-term incentives are provided to all
3. Fixed benefits are tied to long tenure	3. Flexible and portable benefits are offered
4. Pay grade progression is based on organizational promotion	4. Knowledge/ skill-based broad band's determine pay grade
5. Organizational wide standard pay plan exists	5. Multiple plans, consider job family, location and business units

3 P's Approach to Compensation Management

- There are 3P approach of developing a compensation policy centered on the fundamentals of paying for **Position**, **Person** and **Performance.** Drawing from external market information and internal policies, this approaches helps to establish guidelines for an equitable grading structure, determine capability requirements and creation of short and long-term incentive plans. The 3P approach to compensation management supports a company's strategy, mission and objectives.

3 P's Approach to Compensation Management

- 1. Paying for position
- 2. Paying for person
- 3. Paying for performance

- Specificity is Key
- Pay is Relative
- Pay is Not Created Equal
- Pay Based on the Performance

Paying for performance

- pay-for-performance philosophy requires that compensation changes reflect performance differences. Organizations operating under this philosophy do not guarantee additional or increased compensation simply for completing another year of organizational service. Instead, they structure pay and incentives to reflect performance differences among employees. Employees who perform satisfactorily maintain or advance their compensation levels more than marginal performers. The bonuses and incentives are based on individual, group, and/or organizational performance.

Thank you for your attention