**Chapter Seven**

**Compensation**

**Definition:** In layman’s language the word ‘compensation’ means something, such as money, given or received as payment for service. The word compensation may be defined as money received in the performance of work, plus the many kinds of benefits and services that organization provides their employee. It refers to wide range of financial and non-financial rewards to employee for their service rendered to the organization.

It is paid in the form of wages, salaries , special allowance and employee benefits such as paid vacation, insurance, maternity leaves, free travel facility , retirement benefits etc.

**According to Wendell French,**” Compensation is a comprehensive term which includes wages, salaries and all other allowance and benefits.”

**7.1. Importance of Compensation**

Compensation can include monetary and non-monetary components. Compensation often includes an employee’s base salary and additional benefits, such as health insurance, retirement plans and performance bonuses. The compensation packages a business offers to employees affects the company’s recruitment rate, retention rate and employee satisfaction. Several federal laws affect the compensation that businesses offer. A business owner should understand the importance of compensation and the prevailing laws to remain competitive in the market. Importance of compensation in the workplace are:

1. **Recruitment**

The compensation packages that businesses offer to employees play an important role in the company’s ability to attract top talent as job candidates. Top-performing employees greatly impact the competitiveness and productivity of a business.

1. **Motivation**

Compensation often impacts an employee’s motivation and job satisfaction, although it is not the only factor. According to an article written by Mae Lon Ding of Personnel Systems Associates, compensation systems positively impact a large percentage of workers' performances. Many employees feel motivated to help their companies succeed if the employer shares its profits with employees, such as with bonuses or profit-sharing plans. The greatest impact of money on productivity and performance is in jobs where performance is directly related to compensation. For example, the knowledge of receiving a bonus after achieving a certain sales quota will likely motivate a salesperson to increase productivity.

1. **Retention**

Retaining productive employees is critical to running a successful business. Retaining employees saves companies money in training costs and helps maintain an efficient and knowledgeable workforce. Health insurance and retirement packages are benefits that many employees desire from their employers. Companies that offer these benefits have a much better chance of retaining workers than businesses that fail to offer benefit packages. Other ways to retain employees is through regular promotions, which not only provide an employee with a higher base salary, but also the ability to take on more responsibility in the workplace.

**Objectives of Compensation Planning**

The basic purpose or objective of establishing sound compensation is to establish and maintain an equitable rewards system. The other aim is the establishment and maintenance of an equitable compensation structure i.e an optimal balancing of conflicting personnel interest so that the satisfaction of employees and employers is maximized and conflicts minimized, the compensation management is concerned with the financial aspect of employees need, motivation and rewards.

A sound compensation structure tries to achieve these objectives:

* To attract manpower in a competitive market.
* To control wages and salaries and labor costs by determining rate change and frequency of increment.
* To maintain satisfaction of employees by exhibiting that remuneration is fair adequate and equitable.
* To induce and improved performance, money is an effective motivator.

**a) To Employees**:

* Employees are paid according to requirement of their jobs i.e highly skilled jobs are paid more compensation than low skilled jobs. This eliminates inequalities.
* The chances of favoritism are minimized.
* Jobs sequence and lines of promotion are established wherever they are applicable.
* Employee’s moral and motivation are increased because of the sound compensation structure.

**b) To Employers:**

* They can systematically plan for and control the turnover in the organization.
* A sound compensation structure reduces the likelihood of friction and grievance over remunerations.
* It enhances an employee morale and motivation because adequate and fairly administrative incentives are basis to his wants and need.
* It attracts qualified employees by ensuring and adequate payment for all the jobs.
* In dealing with a trade union, they can explain the basis of their wages programme because it is based upon a systematic analysis of jobs and wages facts.

**7.2. Factors Affecting Compensation**

Factors determining compensation of an employee considerable amount of guess word and negotiation are involved. But following are the certain factors which have been extracted as having an important bearing upon the final decision:

1. **Supply and Demand of Labor**: Whatever the organization produces as commodity they desire services and it must pay a price that of workers acting in concert. If more the labor is required, such as at war time prosperity, there will be tendency to increase the compensation; whereas the situation when anything works to decrease the supply of labor, such as restriction by a particular labor union, there will be a tendency to increase the compensation. The reverse of each situation is likely to result in a decrease in employee compensation, provided, labor union, ability to pay, productivity, government do not intervene.
2. **Ability to Pay**: Labor Unions have often demanded an increase in compensation on the basis that the firm is prosperous and able to pay.
3. **Management’s Philosophy:** Management’s desire to maintain or improve moral, attract high caliber employees, reduce turnover, and improve employees standard of living also affect wages, as does the relative importance of a given position to a firm.
4. **Legislation:** Legislation related to plays a vital role in determining internal organization practices. Various acts are prescribed by government of country for wage hours laws. Wage-hour laws set limits on minimum wages to be paid and maximum hours to be worked.

**7.3. Employee Benefits and Service**

**Various Modes of Compensation**

Various modes of compensation are as follows

1. **Wages and Salary-** Wages represent hourly rates of pay and salary refers to monthly rate of pay irrespective of the number of hours worked. They are subject to annual increments. They differ from employee to employee and depend upon the nature of jobs, seniority and merit.
2. **Incentives-** These are also known as payment by results. These are paid in addition to wages and salaries. Incentive depends upon productivity, sales, profit or cost reduction efforts. Incentive scheme are of two types:
3. Individual incentive schemes.
4. Group incentive schemes.
5. **Fringe Benefits-** These are given to employees in the form of benefits such as provident fund, gratuity, medical care, hospitalization, accident relief, health insurance, canteen, uniform etc.
6. **Non- Monetary Benefits-** They include challenging job responsibilities, recognition of merit, growth prospects, competent supervision, comfortable working condition, job sharing and flexi time.

**Incentives**

Incentives are monetary benefits paid to workers in lieu of their outstanding performance. Incentives vary from individual to individual and from period to period for the same individual. They are universal and are paid in every sector. It works as motivational force to work for their performance as incentive forms the part total remuneration. Incentives when added to salary increase the earning thus increase the standard of living. The advantage of incentive payment are reduced supervision, better utilization of equipment, reduced scrap, reduced lost time, reduced absenteeism and turnover & increased output.

**Kinds of Incentives**

Incentives can be classified under the following categories:

1. Individual and Organizational Incentives

2. Financial and Non-Financial Incentives

3. Positive and Negative Incentives

1. **Individual and Organizational Incentives**- According to L.G. Magginson, “Individual incentives are the extra compensation paid to an individual for all production over a specified magnitude which stems from his exercise of more than normal skill, effort or concentration when accomplished in a predetermined way involving standard tools, facilities and materials.” Individual performance is measured to calculate incentive where as organizational or group incentive involve cooperation among employees, management and union and purport to accomplish broader objectives such as an organization-wide reduction in labour, material and supply costs, strengthening of employee loyalty to company, harmonious management and decreased turnover and absenteeism

**I) Individual Incentive System is of two types:**

Some important these plans of incentive wage payments are as follows:

**Halsey Plan-** Under this plan a standard time is fixed in advance for completing a work. Bonus is rewarded to the worker who performs his work in less than the standard time and paid wages according to the time wage system for the saved time.

**The total earnings of the worker = wages for the actual time + bonus**

Bonus = 33.5% of the time saved (standard time set on past experience)

Or

50% of the time saved (standard are scientifically set)

Example: Time required to complete job (S) = 20 hours

Actual Time taken (T) = 15 hours

Hourly Rate of Pay (R) = $ 1.5

Calculate the wage of the worker.

Solution: T X R + (S-T ) X R

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15 X 1.5 + (20-15 ) X 1.5 = 22.5 + 3.75 = $26.25

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In this equation $3.75 are the incentives for saving 5 hours.

**II) Group Incentive System is of following types**

1. Co-Partnership Plan
2. Profit Sharing
3. **Financial and Non-financial Incentives-** Individual or group performance can be measured in financial terms. It means that their performance is rewarded in money or cash as it has a great impact on motivation as a symbol of accomplishment. These incentives form visible and tangible rewards provided in recognition of accomplishment. Financial incentives include salary, premium, reward, dividend, income on investment etc. On the other hand, non-financial incentives are that social and psychological attraction which encourages people to do the work efficiently and effectively. Non-financial incentive can be delegation of responsibility, lack of fear, worker’s participation, title or promotion, constructive attitude, security of service, good leadership etc..
4. **Positive and Negative Incentives-** Positive incentives are those agreeable factors related to work situation which prompt an individual to attain or excel the standards or objectives set for him, where as negative incentives are those disagreeable factors in a work situation which an individual wants to avoid and strives to accomplish the standards required on his or her part. Positive incentive may include expected promotion, worker’s preference, competition with fellow workers and own ‘s record etc. Negative incentives include fear of lay off, discharge, reduction of salary, disapproval by employer etc.

**Fringe Benefits**

Employees are paid several benefits in addition to wages, salary, allowances and bonus. These benefits and services are called ‘fringe benefits’ because these are offered by the employer as a fringe. Employees of the organization are provided several benefits and services by the employer to maintain and promote employee’s favorable attitude towards the work and work environment. It not only increases their morale but also motivate them. These provided benefits and services forms the part of salary and are generally refereed as fringe benefits.

**According to D. Belcher**, “ Fringe benefits are any wage cost not directly connected with the employees productive effort, performance, service or sacrifice”. **According to Werther and Davis**, “Fringe embrace a broad range of benefits and services that employees receive as part of their total compensation, package pay or direct compensation and is based on critical job factors and performance”.

**According to Cockman**, “ Employee benefits are those benefits which are supplied by an employer to or for the benefits of an employee and which are not in the form of wages, salaries and time rated payments”.

These are indirect compensation as they are extended condition of employment and are not related to performance directly.

**Kinds of Fringe Benefits**

The various organizations offer fringe benefits that may be categorized as follows:

1. **Old Age and Retirement Benefits** - these include provident fund schemes, pension schemes, gratuity and medical benefits which are provided to employee after their retirement and during old age as a sense of security about their old age.
2. **Workman’s Compensation** - these benefits are provided to employee if they are got ignored or die under the working conditions and the sole responsibility is of the employer.
3. **Employee Security-** Regular wage and salary is given to employee that gives a feeling of security. Other than this compensation is also given if there is lay-off or retrenchment in an organization.
4. **Payment for Time Not Worked –** Under this category of benefits, a worker is provided payment for the work that has been performed by him during holidays and also for the work done during odd shifts. Compensatory holidays for the same number in the same month are given if the worker has not availed weekly holidays.
5. **Safety and Health –** Under this benefit workers are provided conditions and requirements regarding working condition with a view to provide safe working environment. Safety and Health measures are also taken care of in order to protect the employees against unhealthy working conditions and accidents.
6. **Health Benefits –** Employees are also provided medical services like hospital facility, clinical facility by the organization.