## MUKTHAGANGOTHRI, MYSURU-570 006.

## DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

## **M.B.A III Semester**

## COURSE - 18 C

# COMPENSATION MANAGEMENT AND PERFORMANCE APPRAISAL

## **BLOCK**

# 1

## INTRODUCTION TO COMPENSATION & BENEFITS

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# BLOCK-1:INTRODUCTION TO COMPENSATION & BENEFITS

The fundamental motive of any employee or worker is to earn monetary rewards for his/her efforts. The poor rewards lead to employee disatisfaction and high rewards lead to incease in the output cost. Therefore, there is need to strike balance between these two and motivate employees to achieve organizational objectives. This block deals with the introductory part of compenstation and benefit. This block is divided into four units.

Unit-1 deals with basics of compenstation, components of compenstation and objective and need of compenstation. This unit also, discusses compenstation management system, factors determining compenstation.

Unit-2 deals with employee benefits .This unit discusses of types, objective and factors influencing employee benefits. Further this unit also discussesm, advantage and disadvantage of employee benefits.

Unit-3 focuses on incentives. It discusses incentive plans, reasons to link pay to performance. The unit classifies incentives and breifes on executive compenstation.

The unit -4 is concerned with compensation and benefits laws and regultions. The manager should have knowledge of various laws and regulations before fixing compensation. This unit at the outset explain purpose of enactment of laws, history and dvelopment of labour laws in India. Further, it discusses payment of wages Act,1936 payment of bonus Act,1965 and minium wage Act,1948.

## **UNIT-1: BASICS OF COMPENSATION MANAGEMENT**

## **Structure:**

- 1.0 Objectives
- 1.1 Introduction
- 1.2 Meaning of compensation
- 1.3 Components of compensation
- 1.4 Terminologies
- 1.5 Compensation management
- 1.6 Objectives of compensation management
- 1.7 Need and importance of compensation management
- 1.8 Compensation management system
- 1.9 Factors Determining compensation
- 1.10 Case study
- 1.11 Notes
- 1.12 Summary
- 1.13 Keywords
- 1.14 Self assessment questions
- 1.15 References

## 1.0 OBJECTIVES

After reading this unit, you should be able to:

- define what is compensation and compensation management
- identify and understand the components of compensation
- define different terminologies relating to compensation
- understand the objectives of compensation management
- evaluate the need and importance of compensation management
- explain compensation management system
- discuss the factors determining compensation

#### 1.1 INTRODUCTION

"If you pick the right people and give them the opportunity to spread their wings - and put compensation and rewards as a carrier behind it - you almost don't have to manage them."

#### - Jack Welch

We all are familiar with and have used the word compensation at least once in our life time. What does compensation mean? This unit will give you a comprehensive understanding of the basics of compensation and its management.

Compensation is one of the vital functions of human resource management. It is very important to compensate employees for their contribution in business process of company. Along with monetary payment in the form of salary, employees are also provided with other benefits. Today compensation and employee benefits constitute the major part of total costs in an organization. Attraction and retention of employees depend on the compensation they get in return for their skill and efforts put in. Hence, compensation management begins with employment and lasts till they leave the organization. It is essential to know about compensation and benefits and their management in a firm. So, let us start with basic questions-What is compensation? What is compensation management? Who fix the compensation packages? What are the other benefits provided to employees?

## 1.2 MEANINGOF COMPENSATION

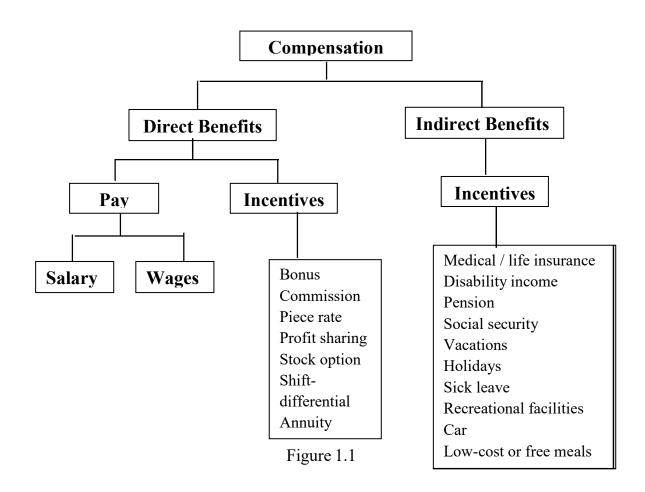
Deluca (1993) and Rajkumar (1996) described that "compensation is defined as pay, reward, remuneration, or salary and wage management". In simple words, Compensation is the total amount of the monetary and non-monetary pay provided to an employee by an

employer in return for work performed as required. Therefore, constitutes more than simply the salary workers receive for employment. What an employee receives in pay initially, when entering a career, influences future salary offers from competing organizations seeking to secure the employees' services. However, compensation involves much more than the yearly salary received in exchange for one's knowledge, skills and efforts. The tangible income which comes in the form of monthly salary closely relate to traditional or classical form of compensation. Employee benefits, pension and other perks are considered to determine holistic compensation. The concept of holistic compensation can be expressed as:

"Compensation= Wages/ Salary + Employee benefits + Employee pension + Perks + Other quality of work-life factors"

## 1.3 COMPONENTS OF COMPENSATION

The organisation's compensation system involves not only the pay for work or performance but also other parts of the package. It can be roughly divided into direct salary/ wages and indirect benefits. In this section we shall discuss those components of compensation package in detail.



As discussed above compensation comprises of monetary salary and other benefits which are direct or indirect, cash or non-cash. As defined by Milkovich & Newman, benefits are the part of the total compensation package provided to the employee in whole or in part by payments from the employer and it does not comprise of the pay for time spent on work.

## I. Direct Benefits

- i. Basic Pay. The main part of pay package is basic pay. For blue-collar workers basic wage may be based on work done (price wage system) but for white-collar employees, supervisory staff and managers, basic salary is generally time bound. Basic pay is generally determined through job evaluation which is the process of systematically ascertaining the relative worth of a job.
- **1. Allowances.** Several allowances are paid in addition to basic pay. Some of these allowances are given below:
- **a. Dearness Allowance:** This allowance is given to protect real income against inflation. Generally, dearness allowance (DA) is paid as a percentage of basic pay.
- **b. House Rent Allowance:** Employers who do not provide living accommodation and pay house rent allowance (HRA) to employees. This allowance is calculated as a percentage of basic pay (Percentage varies according to Class of city from 10% to 35% of basic pay in case of government employees).
- **c. City Compensatory Allowance:** This allowance is paid generally to employees in metros and other big cities where cost of living is comparatively high. City compensatory allowance (CCA) is generally a fixed amount per month.
- **d.** Conveyance Allowance: Some employers pay transport allowance (TA) to their employees. A fixed sum is paid every month to cover a part of traveling charges. In some cases, medical allowance, education allowance for children, Tiffin allowance are also paid.
- **ii. Incentives:** Incentive compensation is performance-linked remuneration paid with the aim to encourage employees to work more and perform better. Both individual incentives and group incentives are used. Some of the examples of incentives are listed above.

## **II. Indirect Benefits**

i. Fringe Benefits/Perquisites: Different types of benefits are paid particularly to senior managers. Provident funds, pensions, gratuity, encashment of earned leave, company house, company car, leave travel concession (LTC), medical aid, interest free loan, holiday homes, entertainment, stock options, etc. are examples of such benefits.

## 1.4 TERMINOLOGIES

There are some words which are often used in the concept which one must be aware of. These give us an in depth understanding of the whole concept. Let us have a look at various terminologies and concepts relating to employee compensation.

- Wage: wages are the remuneration paid to the employees by the employer for their services on hourly, daily, weekly or fortnightly basis. It also means the remuneration paid to production and maintenance employees.
- Salary: Salary refers to the remuneration paid to employees in clerical and managerial cadre and who are employed monthly or annual basis.
- o Salary and wage are used interchangeably and treated same nowadays. Hence, we can define salary and wage together as direct remuneration paid to employees in return for their performance in the organisation.
- Nominal wage: Nominal wage is the rate of pay at which employees are compensated.
- Real wage: It is the amount of wage arrived at after considering the living cost. Real wage, on the other hand, takes inflation into account.
- ♦ Minimum wage: Minimum wage is the minimum amount of compensation/ salary an employee must be paid. It is enforced through law and payment of wage less than the minimum wage is an illegal action. The minimum wage attempts to protect employees from exploitation, allowing them to afford the basic necessities of life. The minimum wage rate fluctuates between countries, and sometimes between states or provinces. The Minimum Wage Act, 1948 sets the minimum wage to be paid in India.
- ♦ Fair Wage: It is that wage which is above the minimum wage but below the living wage. According to the Committee on Fair Wage, 1948 fair wage must be determined by taking into account the productivity of the labour, the present rate of wages in similar occupations, the level of national income and its distribution, the employers capacity to pay and the place where the industry stands.
- ♦ Living wage: According to the Committee on Fair Wage, living wage is the highest pay than minimum and fair wages. It must be paid considering the basic amenities of life, efficiency of workers and social needs of the workers such as medical, educational, retirement, etc.
- ◆ **Performance linked wage**: It is a <u>salary</u> or <u>wages</u> paid based on how well one works. Car salesmen or production line workers, for example, may be paid in this way, or through commission.

- Wage discrimination: Wage discrimination occurs when similar workers receive different wages on the basis of race, sex, ethnicity, age or other factors not directly related to productivity. Workers subject to wage discrimination may earn lower wages in a given job, be assigned to low-wage jobs within firms, or employed in low-wage firms.
- Internal Compensation Equity: It ensures that employees possessing similar skills, abilities, knowledge, time-in-service and responsibilities receive approximately the same wages. Also called Horizontal Equity, ICE seeks to provide equity to others working at approximately the same horizontal level in the organizational structure.
- Vertical equity: Refers to providing progressive increases in pay as an employee's level of skills, knowledge, abilities and responsibilities increases in the organisation.
- ♦ External Compensation Equity: It is used when a firm is attempting to retain a highly talented employee. ECE seeks to secure approximately equivalent compensation levels with individuals who work in the same or a comparable position in other organizations. Primarily, ECE ensures that organizations pay their employees market competitive salaries as determined through comparisons with other similar labour market positions.
- Piece rate: Wage paid for unit of the product produced by an employee. Each employee is paid based on the number of units/ pieces produced by him/her at a fixed rate.
- ◆ **Time rate:** Some organizations follow time rate system for the remuneration of employees. Workers paid for the time (hourly or weekly) spent on the work it is based on time rate system.

## 1.5 COMPENSATION MANAGEMENT

Effective and efficient process of managing the earnings – financial and non financial rewards of the employees in an organization based on their performance towards organizational goal is called compensation management. It is a systematic approach to the problem of ensuring that employees are paid in a logical, equitable and fair manner. Here the firm's efforts are put to sustain a competitive compensation position within its local labour market, given current and anticipated future financial resources. For governments, compensation management is complicated by the fact that while the organisation seeks to take care of its employees, it also has an obligation to live within a reasonable budget so as not to overburden its citizens through rising tax burden. Compensation management strategies are designed to achieve the organizational objectives by ensuring that the organisation can attract, retain and motivate competent and committed employees.

Compensation management encompasses considerations of pay equity within and across organizational boundaries. Organisations must consider two types of equity when seeking to determine the fairness of their compensation plan; Internal Compensation of Equity (ICE) and External Compensation Equity (ECE) (Explained in later part of the unit). Both forms of equity are important to the effective distribution of compensation as well as the retention of valued employees.

## 1.6 OBJECTIVES OF COMPENSATION MANAGEMENT

Compensation as a strategic decision plays a crucial role in achieving performance and sustainable competitive advantages.

- **a. Attraction of efficient employees:** Compensation package of an organisation is a factor that attracts potential employees in the job market. Compensation is a distinguishing factor for comparisons of firms in a particular industry.
- **b. Motivational factor:** Compensation helps an employer to make his employees to put in their best for organizational performance.
- **c. Retention of existing employees:** Helps for the retention of existing employees. The talent attracted should be retained. An effective compensation system can keep employees motivated and to stick on to the firm.
- **d. Increase productivity:** A good compensation package is significant to stimulate the employees to increase the organizational productivity.
- **e. Goal achievement:** Compensation is provided to work for the organization. Compensation helps in running an organization successfully and to achieve its goals.
- **f. Cost controlling:** An effective compensation system help to attract and retain employees at reasonable costs. Failure to have an effective system could lead to over or under-remuneration of workers.
- **g. Self-actualization needs:** Salary is just a part of the compensation system, the employees have other psychological and self-actualization needs to fulfill. Thus, compensation serves the purpose.
- **h. Organisational culture:** Compensation conveys the message about the values, behaviours and outcomes that the organisation prizes and is willing to pay for.
- i. Other objectives include, comply with legal regulations, facilitate the movement of expatriates from one subsidiary to another, from home to subsidiary, and back from subsidiary to home, provide a consistent and reasonable relationship between the pay levels of employees at headquarters, domestic affiliates and foreign subsidiaries.

## 1.7 NEED AND IMPORTANCE OF COMPENSATION MANAGEMENT

It is demonstrated by many studies that good compensation is essential for every industry and helps to give proper return to the workers for their contributions to the organization. And an efficient compensation management is an important function of human resource management. It communicates a positive control on the competence of workers and encourages them to give their best and accomplish the specific standards. It forms a basis of pleasure and satisfaction for the workers that minimizes the labour turnover and presents a steady organization. It increases the job evaluation process which consecutively helps in establishing more realistic and achievable standards. It is planned to obey with the various labour acts and therefore does not result in disagreement between the worker union and the management. This builds up a peaceable relationship between the employer and the employees. It creates an environment of self-esteem, efficiency and cooperation among the workers and provides satisfaction to the workers. It motivates the employees to increase efficiency and show their excellence. It provides growth and development opportunities to the deserving employees.

## 1.8 COMPENSATION MANAGEMENT SYSTEM

As the compensation is a vital organ of human resource management, the development of compensation system becomes a tough job for line managers. A strong foundation will assist in the development of good compensation strategy and help in achieving organizational goal. Generally, line managers determine the compensation packages based on the organisation's policy and philosophy. Before development of your compensation philosophies, there are some basic questions to address on your current compensation packages.

- 1. From the employee's perspective, what is a fair wage?
- 2. Are wages too high to achieve financial health in your organization?
- 3. Do managers and employees know and buy-into your compensation philosophy?
- 4. Does the pay scale reflect the importance of various job titles within the organization?
- 5. Is your compensation good enough to retain employees?
- 6. Are laws being met with the compensation package?
- 7. Is your compensation philosophy keeping in line with labor market changes, industry changes, and organizational changes?

Once these basic questions are addressed, we can see where we might have "holes" in our compensation package and begin to develop new philosophies in line with our strategic plan, which benefits the organization.

Let's discuss some internal and external factors determining compensation in more detail.

## 1.9 FACTORS DETERMINING COMPENSATION

A number of factors influence the remuneration payable to employees. They can be categorized into (i) external and (ii) internal factors.

#### I. Internal Factors

These factors include the following:

## A. Ability to pay:

This is one of the most significant factors influencing employee compensation. Generally, a firm, which is prosperous and successful, has the ability to pay more than the competitive rate. This way it can attract superior, caliber personnel. Often the labour unions also demand an increase in compensation on the grounds that the organisation is prosperous and is able to pay more.

## **B.** Employee:

Numerous employees related factors also influence his or her compensation. These include the following:

- **Performance** It is always rewarded with pay increase and as a result it motivates the workers to do better in future.
- Experience- This makes a person perfect by providing valuable insights and thus rewarded also. Today companies are demanding for 10 to 20 years experience candidates especially for the executive positions. The organizations presume that experienced candidates posses leadership skills which influence the other behavior and performance. And also the experienced candidates perform the job without need of training which is time consuming and deals with matter of cost to company. It is because of this reason that experienced candidates demand more pay than the inexperienced candidates.
- Seniority- In today's environment seniority of employee making difference in payment of compensation compared to junior employees. Naturally senior employees demands for more salary than fresher because of their hold on related job and its functions. Today many companies are demanding senior employees for key positions by offering

fat pay and even sometimes retired employees are offered with handsome salary for key positions which deals with multitasking in organisation. Trade unions always prefer this objective criterion for pay rises.

Potential- Firms also pay their employees, especially young ones on the basis of their potential. Software companies are very good example for this, IT graduate just who completed his education having potential in the subject can gain a good job with high payment anywhere in the world. Good example, student of Indian Information Technology (IIT) from Delhi had bagged job of payment 7 million (70 lakhs) Indian rupees per year in Twitter Inc famous social networking website.

## C. Job Requirements:

Wages are also influenced by the requirements of a job such as physical and mental requirement. Jobs, which demand more skill, responsibility, efforts and are of hazardous in nature, will carry high wage tag with them.

## **D.Job/Evaluation:**

A job evaluation is a systematic way of determining the value or worth of a job in relation to other jobs in an organization. It tries to make a systematic comparison between jobs to assess their relative worth for the purpose of establishing a rational pay structure. It establishes a consistent and systematic relationship among base compensation rates for all jobs. In other words, it establishes the satisfactory wage differentials.

## E. Organization Strategy:

The organization's strategy regarding wages also influences employee compensation. For example, an organisation, which wants rapid growth, will set higher wages than competitors. On the other hand, organizations that want smooth going and just maintain the current earning will pay average or below average.

## II. External Factors:

## A. Industry standard:

Prevailing rates of remuneration in similar or comparable industries determines the salary level. It becomes essential to pay going rate for same rate of remuneration for similar jobs in similar industry. It helps to secure and retain competent employees.

## **B.** Cost of living:

The cost of living is another important factor that determines the quantum of salary. The employees expect that their purchasing power be maintained at least at the same level, if not increased by adjusting wages to changes in cost of living.

## C. Trade unions pressure:

The wages are sometimes also influenced by trade unions, their bargaining capacity and their strategies. Managements, sometimes, have to fix the wages influenced by the collective bargaining power and other tactics of trade unions.

## 1.10 CASE STUDY

## Traditional v/s Holistic Compensation

Vignesh and Diya are married. Recently they graduated from university with commerce degrees. Each entered employment as financial analysts for different firms within the same metropolitan city. Both work in positions with relative good job security. Vignesh earns a salary of Rs. 35,000 per month while Diya gets monthly salary of Rs. 28,000. Both receive virtually identical pension plans. Vignesh's workweek averages to seventy to seventy-five hours. Often he is required to work weekends with less than a day's notice. Diya works forty-five hour workweek and rarely is required to work longer hours. During her weekends she enjoys various non-work related interests. Both have same potential for promotion. Taking all other compensation issues as equal, which company would you rather work if given the choice?

| 1.11          | NOTES |                 |
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## 1.12 SUMMARY

Compensation means the remuneration paid to workers/ employees for their services in the organisation. It consists of cash and/ or non-cash, direct and/ or indirect benefits. They include basic pay, allowances, incentives and non- monetary benefits such as insurance facilities, recreational benefits etc. Compensation package is influenced by many factors which are internal and external to the organisation such as job evaluation (relative worth of the job), employee's skills and abilities, oraganisation strategies and abilities to pay, job requirements etc. External factors include compensation in similar industry, trade unions pressures and cost of living. Development and management of an efficient system of compensation management is crucial task of personnel management. Compensation management serves the purpose of attracting potential employees from the job market, motivate and retain existing skilled labour and also to meet the legislative standards.

## 1.13 KEYWORDS

- ♦ Compensation: something given or received as an equivalent for services, debt, loss, injury, suffering, lack, etc
- ♦ **Basic pay:** a standard rate of pay before additional payments such as allowances and bonuses.
- ♦ Allowance: is an amount of money given or allotted usually at regular intervals for a specific purpose
- ♦ **DA-Dearness allowance:** is a cost of living adjustment allowance
- ♦ HRA-House Rent Allowance: is an amount paid by employers to employees as a part of their salaries. It provides employees with tax benefits for what they pay towards accommodations every year.
- ♦ CCA- City Compensatory Allowance: allowance offered by companies to their employees to compensate for the high cost of living in metropolises and large cities
- ◆ CA-Conveyance Allowance: Any allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit
- **Incentive:** a payment or concession to stimulate greater output or investment.
- Fringe Benefits: are *benefits* provided by an employer to an employee, independent contractor or partner, some of which are tax-exempt when certain conditions are met.
- ♦ Compensation Management: is an organized practice that involves balancing the workemployee relation by providing monetary and non-monetary benefits to employees.

## 1.14 SELFASSESSMENT QUESTIONS

- 1. What are the objectives of compensation management?
- 2. Distinguish between Minimum wage and Fair wages. What should be the wage policy for a developing country?
- 3. Why do you think there has been continuing sensitivity in recent years to the issue if equal pay?
- 4. Describe the factors determining compensation.

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## **UNIT - 2 :EMPLOYEE BENEFITS**

## **Structure:**

| 2.0  | Objectives                              |
|------|---|
| 2.1  | Introduction                            |
| 2.2  | Features of employee benefits           |
| 2.3  | Types of employee benefits              |
| 2.4  | Objectives of employee benefit packages |
| 2.5  | Factors influencing employee benefits   |
| 2.6  | Advantages of employee benefits         |
| 2.7  | Disadvantages of employee benefits      |
| 2.8  | Case study                              |
| 2.9  | Notes                                   |
| 2.10 | Summary                                 |
| 2.11 | Keywords                                |
| 2.12 | Self assessment questions               |
| 2 13 | References                              |

## 1.0 OBJECTIVES

After reading this unit, you should be able to:

- define the meaning and features of employee benefits
- describe types of employee benefits
- bring out the objectives of employee benefit packages
- identify the factors influencing employee benefits
- explain advantages and disadvantages of employee benefits

## 2.1 INTRODUCTION

Employee benefits are the awards which are supplementary to normal pay. Benefits, which was, once the neglected issue now has become daily news. Childcare, health care costs and coverage, social security and changes in pension benefits are among the best known compensation topics today. According to a study of Bureau of Labour Statistics, at present time benefits offered to employees equal to almost fifty percent of the direct compensation for companies with 500 hundred or more employees. Further, some benefits given favorable tax treatment, the employee need not to pay tax on the value of health insurance and many more advantages.

## 2.2 FEATURES OF EMPLOYEE BENEFITS

The main features of benefits, as they stand today, may be stated as under;

- a. They are paid to all employees (unlike incentives which are paid to specific employees whose work is above standard) based on their membership in the organization.
- b. They are supplementary forms of compensation.
- c. They help raise the living conditions of employees.
- d. They are indirect compensation because they are usually extended as a condition of employment and are not directly related to performance.
- e. They may be statutory or voluntary. Provident fund is a statutory benefit whereas transport is a voluntary benefit.

## 2.3 TYPES OF EMPLOYEE BENEFITS

The major categories of benefits include mandatory benefits, pay for time not worked, and optional protection

## I. Mandatory or Statutory Benefits:

Although most employee benefits are provided at the employer's discretion, some are required by law. Legally required benefits include Social Security, unemployment compensation, and workers' compensation. General statutory benefits in India include the following: Provident Fund, Gratuity, Medical Coverage, Bonus, Leave and Holidays, Working Hours & Overtime

a. Social Security: Social Security for employees is a concept which over time has gained importance in the industrialized countries. Broadly, it can be defined as measures providing protection to working class against contingencies like retirement, resignation, retrenchment, maternity, old age, unemployment, death, disablement and other similar conditions.

India does not have a Social Security system. However, there are statutory employee benefits controlled by legislature. Under the Employees' Provident Fund and Miscellaneous Provisions Act (EPFMP), employers are obligated to provide provident fund benefits.

- **b. Unemployment Compensation**: Unemployment insurance benefits are mandatory and vary by state. Employees terminated with just cause will not receive unemployment benefits.
- c. Workers' Compensation: If an employee suffers an accident on the job, workers' compensation insurance usually pays for medical costs, and time off in some cases. Workers' compensation varies by state, and the federal government administers its own program for federal workers. Workers' compensation does not always have to relate to accidents taking place on the job. In some instances, a medical condition related to workplace conditions is covered by workers' compensation.

## **II.** Benefits outside the work for time not worked:

Some employers provide full time employees with some payments for time not worked.

**a. Holidays**: Generally all employers pay employees for major national holidays. Some service oriented institutions like hospitals generally provide over-time pay to employees who work on holidays.

- **b.** Vacation: Most employers offer paid vacations to their permanent employees usually depending on the length of employees' service.
- c. Sick leave: A usual benefit as pay for time not worked is sick leave. Many employees accrue sick leave in proportion to days worked. For example, half-a-day paid sick leave will be granted for every fifteen days of work.

#### **III.** Protection Benefits:

These benefits are provided though they are not mandated by law to keep the employees protected, competitive and satisfied. They include;

**a. Health or Medical Insurance:** The purpose of medical or health insurance is to provide partial or complete coverage of medical expenses incurred by the employees and their families. Here the employer may directly pay to the hospital or reimbursing the employee for hospital charges, surgery or other personal or family medical expenses.

It covers the costs of physician and surgeon fees, hospital rooms, and prescription drugs. Dental and optical care might be offered as part of an overall benefits package. It may be offered as separate pieces or not covered at all. Employers usually pay all or part of the premium for employee medical insurance. Often employees pay a percentage of the monthly cost.

**b. Life Insurance:** Life insurance protects employee's family in case of death of the employee. Benefits are paid all at once to the beneficiaries of the policy, usually a spouse or children.

One can get life insurance through an employer if they sponsor a group plan. Companysponsored life insurance plans are standard for almost all full-time workers in medium and large firms across the country. An employee can also buy it privately, but this is usually more expensive.

- **c. Disability insurance:** It replaces all or part of the income that is lost when a worker is unable to perform their job because of illness or injury. This benefit is not commonly offered. There are two main types of disability insurance:
- i. Short-term disability insurance begins right away or within a few weeks of an accident, illness, or some other disability. For example, someone hurt in a car accident would be offered a few paid weeks to recover.
- ii. Long-term disability insurance provides benefits to an employee when a long-term or permanent illness, injury, or disability leaves the individual unable to perform his or

her job. For example, an employee with spinal injuries could be entitled to long-term disability benefits until retirement age.

#### d. Retirement Benefits:

Retirement benefits are funds set aside to provide people with an income when they end their careers. Retirement benefits create a feeling of security about old age among employees. These benefits are also called old age benefits. Provident fund, pension, gratuity are the examples of retirement benefits. Retirement plan may be in the form of a). In **defined benefit plans-** the benefit amount is pre-determined based on salary and the years of service. In these plans, the employer bears the risk of the investment or b). In **defined contribution plans** employer or employee contributions are specified, but the benefit amount is usually tied to investment returns, which are not guaranteed.

Following are the important types of retirement benefits;

- ♦ **Pension:** A pension is a benefit after the retirement of employee out of the investment made at regular intervals with accumulated interest, dividends and capital gains. In some cases pensions are entirely funded by employer contributions and in most of the cases it is shared by employer and employee.
- ◆ Provident Fund: Provident fund benefit is meant for the economic welfare if the employees. The Employees Provident Fund, Family Pension Fund and Deposit Linked Insurance Act 1952 regulate the provident fund schemes in factories and other establishments.
- **Gratuity:** This is another type of retirement benefit provided at the retirement or at the disability of an employee. It is reward to an employee for his or her long term service with the present employer.

## e. Other Benefits:

Many organizations offer additional benefits which provide innovative opportunities to employees. Some of them;

- i. Wellness programs: some employers promote wellness of employees by offering recreational facilities, reimbursement of employees' health club memberships, encouragement through monthly stipend to participate in exercise program, encouraging keeping up the good habits for good health.
- **ii.** Child care assistance: Day care facility for employee's children, on-site child care, financial assistance etc...,

- **iii.** Educational support: many companies encourage their employees pursue education while they work. This would also help the company to have qualified and skilled work force.
- **iv. Domestic servants:** some organizations provide the home maid assistance to employees. These benefits, generally, are provided to employees working in higher level.

## v. Others include:

- Social recognition like informal recognition, recognition at office get-together, etc...
- Free lunches, lunch with the family members, lunch with superiors, picnics, birthday treats.
- ♦ Company watches, tie-pins, diaries, calendars
- ♦ Involvement in decision making
- Awards like trophies, certificates

## 2.4 OBJECTIVES OF EMPLOYEE BENEFIT PACKAGES

There are some reasons why organizations offer benefit packages. They are;

- To attract and retain staff by the generosity of benefits offered and by facilitating career longevity and work life balance.
- ♦ To create and improve sound industrial relations
- ♦ To boost up the employee morale
- To motivate the employees by satisfying their unsatisfied needs
- ♦ To encourage the employees commitment to the organizations products by offering employee discounted rates.
- ♦ To demonstrate corporate social responsibility by giving more benefits than statutory levels like sick pay, paternity leave, pension provisions, employee assistance and many more.
- To promote desirable behaviours and values in employees.
- To offer rewards of received high value to employees, ideally with discounted or marginal costs to the employer.
- To protect the employees from the work related hazards.
- To promote their welfare by taking up welfare measures like recreational facilities.
- To meet the legislative requirements.

## 2.5 FACTORS INFLUENCING EMPLOYEE BENEFITS

A number of factors influence the programme of employee benefits. They are as given below;

- The financial ability of the company or organisation.
- ♦ Employees needs
- The strength and bargaining power of trade unions
- ♦ Employees significance to the organisation
- Tax benefits to the organizations and individual employees.
- Need for building public image for the organisation.
- Awareness about organisation's social responsibilities.

## 2.6 ADVANTAGES OF EMPLOYEE BENEFITS

Following are the obvious merits of employee benefits.

- i. They motivate employees to perform better.
- ii. Benefits satisfy the employees' need of self-esteem.
- iii. It improves employees' loyalty to the company.
- iv. Benefits give the employer an opportunity to learn and satisfy the employee's needs.
- v. They help in building a strong good will and reputation of the organisation.
- vi. Employee benefits create close bandage between the company and employees.

## 2.7 DISADVANTAGES OF EMPLOYEE BENEFITS

Though benefits are advantageous, they also suffer from some disadvantages.

- i. The benefits de-motivate the employees if the benefit program and procedure is lack transparency.
- ii. These benefits may result in unhealthy competition among employees.
- iii. Work life may intrude the personal life of employees.
- iv. When the monetary compensation plan is not adequate and the company concentrates more on indirect benefits, it leads to un-satisfaction among employees.

#### 2.8 CASE STUDY

Headquartered in Texas, this restaurant chain has over 103 restaurants in nine states. With over 1400 employee and 700 employees enrolled on their benefits programs Craford's benefits consulting group has facilitated management of a 4.5 million dollar annual benefits budget since 2006.

When spun off from their parent company, they had no corporate infrastructure. In order to focus on their core competencies, they made the decision to outsource their administrative Human Resources and financial functions to a third party partner. Late in 2007, poor results led them to take finance in house and move the benefits eligibility and administration to Craford's Technology Solutions and Services team.

## **Challenges faced:**

With 103 locations with an average of 35 employees per location, with extremely high turnover, a challenging demographic and de-centralized Human Resources administration, this leading restaurant required assistance with communicating and managing their complex benefits program. The challenges they faced in 2006 and 2007 with their TPA led to a qualifications marketing in the benefits administration outsourcing industry to improve overall service, compliance, data integrity, and economic strength.

Craford provided a full suite of benefits administration and Human Resource self-service and support services. Our national team of seasoned HR and Benefits professionals internally configures their systems, provides direct client management, and supports a multi-lingual call center to a very dynamic workforce. We worked with our client as an extension of their HR and Benefits Department to analyze and improve the current organizational workflow. We implemented a solution which streamlined and automated the cumbersome benefits administration function.

Craford maintains best-in-class technology to supply a paramount solution, utilizing web-based communication platforms, online and telephonic enrollment and a multi-lingual call center. This led to a cost-savings of over a quarter of the benefits budget due to a decrease in headcount for the HR, Payroll and IT departments. Further, the employees now experience uniform messaging regarding their benefits programs and the healthcare issues which affect the consumer on a daily basis. Their HR management team relies on Craford for election data which can be trusted and therefore does not result in incorrect premium amounts which affects the overall organizational budget.

## **Question:**

1. "Employee benefit is the crucial issue in Human Resource Management". Comment.

| 2.9         | NOTES                                   |
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## 2.10 SUMMARY

Issues related to employee benefits have become a major topic as benefit constitutes almost half of the human resource costs. Employers, domestic as well as global, take employees benefits as a serious factor for securing and retention of employees. Employee benefits include statutory benefits, benefits for time not worked, protection benefits, retirement benefits and many more indirect non- monetary benefits. Employee attraction, motivation and retention, improving the industrial relations, demonstrating corporate social responsibilities are the major objectives of benefits. While the benefits are advantageous in fulfilling all the above objectives, they may also prove to be demerits if an employee benefit system is not transparent, may create unhealthy competition among employees and thereby raise difference of opinion. The financial ability of the company to afford benefits, employee needs, bargaining power of the trade union, employee's skill etc., determine the employees benefits package.

#### 2.11 KEY WORDS

- Employee benefits: are the awards which are supplementary to normal pay.
- Social security: measures providing protection to working class against contingencies like retirement, resignation, retrenchment, maternity, old age, unemployment, death, disablement and other similar conditions.
- Worker's compensation: is a form of insurance providing wage replacement and medical benefits to employees injured in the course of employment in exchange for mandatory relinquishment of the employee's right to sue his or her employer for the tort of negligence
- Sick leave: is time off from work that workers can use to stay home to address their health and safety needs without losing pay
- ♦ Medical/health insurance: an insurance to provide partial or complete coverage of medical expenses incurred by the employees and their families.
- ◆ Disability insurance: is a form of <u>insurance</u> that insures the beneficiary's earned income against the risk that a <u>disability</u> creates a barrier for a worker to complete the core functions of their work.
- **Pension:** is a benefit after the retirement of employee out of the investment made at regular intervals with accumulated interest, dividends and capital gains

- **Provident fund:** an investment fund contributed to by employees, employers, and (sometimes) the state, out of which a lump sum is provided to each employee on retirement.
- Gratuity: is a part of salary that is received by an employee from his/her employer in gratitude for the services offered by the employee in the company at the time of retirement.

## 2.12 SELFASSESSMENT QUESTIONS

- 1. Explain various statutory benefits and their advantages.
- 2. Do small firms need to develop an employee benefit scheme? Yes or No? Justify your answer.
- 3. What are the advantages of indirect benefits?
- 4. Discuss the advantages and disadvantages of benefits.

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## **UNIT-3: INCENTIVE COMPENSATION**

## **Structure:**

- 3.0 Objectives
- 3.1 Introduction
- 3.2 Meaning of incentive
- 3.3 Incentive plans
- 3.4 Reasons to link pay to performance
- 3.5 Classification of incentives
- 3.6 Executive compensation
- 3.7 Case study
- 3.8 Notes
- 3.9 Summary
- 3.10 Keywords
- 3.11 Self assessment questions
- 3.12 References

## 3.0 OBJECTIVES

After reading this unit, you should be able to:

- define the meaning of incentive
- discussnow incentive plans
- analyse the reasons to link pay to performance
- Classify the incentives
- explain the executive compensation

## 3.1 INTRODUCTION

In today's competitive environment, attracting and retaining skilled personnel is largely dependent on how competitive is the compensation package of the company. Hence, employers must be innovative in their approach to employee rewards. Organizations need to be proactive making the compensation package more qualitative to enhance the motivation among staffs. Apart from the common rewards such as wage and salary, employers have adopted a technique of linking the pay to the employee's performance. They are generally called incentives. This chapter explains you the concept of incentive, methods and types.

## 3.2 MEANING OF INCENTIVE

Incentive is a tool to increase productivity in an organisation. It is neither a solution for industrial problems nor is it a substitute for good industrial relations. The basic aim of compensation is to encourage the employees to put forth high performance. And to increase the output consistently with defined quality standards. Normally, wages or salary is paid on the basis of workers attendance and for a normal level of performance for a particular duration.

## 3.3 INCENTIVE PLANS

Incentives can be monetary or non- monetary in nature, they can be individual or group. The organizations can choose any one type or a combination of the both as its strategy for compensation. Under individual scheme, each employee is rewarded based on his own performance while in group incentive plan employer compensates a number of employees for their performance as a team. However, the incentive schemes may differ from organisation to oragnisation or from industry to industry. Following are the incentive plans as per the ILO classification which guides the employer about the suitable incentive plan.

## ■ Straight Piece- work System:

♦ It is a simple incentive plan. It compensates the employee proportionately to the number of units (output of the product) produced by him or her. Employee gets paid a specified rate for each unit. So the incentive will be equal to the rate per piece multiplied by total number of units produced.

## ■ Standard Hour System:

o Under this plan, the task establishes standards expressed in time (hour). A definite rate is paid for each task hour of work performed. The unit of payment is the time taken for completing the work.

## Halsey Premium Plan:

- o This plan is developed by F A Halsey. A standard time is set for completing a job or a unit of work which is usually based on past production records. The worker gets the guaranteed wage if he completes the job in the allowed time or more than the allowed time. If the job is completed in less than the standard time, the worker is paid for the actual hours worked at the time rate in addition to extra wage for a particular percentage of time saved.
- o For example; i. Standard time = 10 hours
- Hourly rate = Rs. 12
- Actual hours worked = 6 hours
- o Then, total earnings =  $(6 \text{ hours} \times \text{Rs. } 12) + 50\% (4 \times 12)$
- o = Rs. 72 + Rs. 24
- o = Rs. 96
- o Fifty percent of the time saved is paid as premium for saving the time. This percentage may vary from 30 to 70 percent.

## **Rowan Plan:**

- ♦ This plan is introduced by D. Rowan. In this system time a standard time is allowed for a job and a bonus is paid if the job is completed in less than the standard time. The time saved is calculated as percentage of the standard time and the same percentage of the workers' rate is credited as bonus for the time saved. Guaranteed time-rate will be paid for standard and below standard performances.
- o For example; i. Standard time = 10 hours

- ii. Hourly rate = Rs. 12
- iii. Actual hours worked = 6 hours
- o Then, total earnings;
- o Time saved as a percentage of the standard time = Time saved/ Standard time
  - 4 hours/ 10 hours
  - =40%
- o Bonus rate per hour =  $40\% \times 12$  i.e., Rs. 4.80
- o Total earnings =  $(6 \times 12) + (40\% \times 6 \times 12)$ 
  - =72 + 28.80
  - =Rs. 100.28

## ■ Taylors Differential Piece-rate Plan:

o This system is developed by P.W. Taylor. There is a low piece rate for output below standard and a higher rate for output above standard as high as 50% of the time rate is paid for standard output. Hence, Taylor's plan while rewarding handsomely the above standard workers, penalizes the below standard workers.

## Merrick Differential Piece-rate System:

o This is a modification of the Taylor system. Straight piece rates are paid up to 83% of standard output at which a bonus of 10% of the time rate is payable. At standard, an additional 10% bonus is paid with high piece rate above standard.

#### ■ Gantt Task and Bonus Plan:

o At the standard performance, which is usually set at high level, the worker is paid a bonus of 20% of his time wages. High piece rates are paid for performance above standard. Similar to Taylor and Merrick plans, this plan also rewards high performance of the employees. This scheme provides for a guaranteed time rate for performance below standard.

## **Emerson Efficiency Plan:**

Under this plan the efficiency of the employee is arrived at by dividing the standard time by the actual time taken. Up to the efficiency level of 67%, the worker is paid at his usual time-rate. Above this and up to 100% a bonus is paid. The bonus will be equal to certain specified fraction of 1% the hourly rate for each addition to 1% of efficiency. At 100% efficiency a 0% bonus is payable. Thereafter, an additional 1% bonus is paid for each additional 1% efficiency.

#### 3.4 REASONS TO LINK PAY TO PERFORMANCE

Employees believe that reward systems in general and incentive system in particular influence performance. Many employers and also workers prefer that pay be liked to performance to reinforce motivation to reward system. Following are the reasons to link pay to performance.

- **a. Motivation:** Several studies have indicated that when pay is dependent on performance, individual and group performances are consistently higher than when pay is not dependent on performance.
- **b. Retention:** linking pay to performance is likely to improve work force composition. High performance will tend to gain a larger share of compensation resources and thus be motivated to stay with the organisation.
- **c. Productivity:** When performance is linked to rewards, employees tend to improve their productivity which ultimately leads to improved organizational performance.
- **d.** Cost Saving: A benefit of pay linked to performance is the capability to link compensation costs with productivity results. By basing pay on performance, employers can ensure that compensation costs will be tied to performance results. When performance is poor, organisation is less able to pay leading to low compensation costs.
- e. Organizational objectives: It is always challenge to make sure all employees understand organizational objectives. Because of their important influence on motivation and satisfaction, reward systems have the ability to communicate organizational objectives. By linking incentives to performance, employees are motivated to put in their best to improve their performance. This ensures that individual objectives are in line with organizational objectives.

## 3.5 CLASSIFICATION OF INCENTIVES

## **Individual and Group Incentives:**

## I. Individual Incentives:

When individual productivity is measurable, individual incentives are most successful in boosting performance through a fairly direct link between performance and rewards. Following are the important individual incentives plans.

## 1) Piece rate incentive:

This is the most common form of individual incentive for production workers. Employees are paid a fixed rate for each unit of output produced. The amount to pay per unit is determined

this way; first, the job rate for the job is determined through process of wage determination. Second, the typical output that can be produced under normal condition by the worker per day is determined. Then the average daily wage is divided by the no. of units per day determined.

Some piece rate systems pay only on the basis of units produced, so an employee who produces less units than average units, will be paid only for the actual number of units produced. However, many guarantee a base wage equal to the standard output level that employees must at least be paid at the average daily standard. Standard Piece-rate is an example of piece rate incentive.

## 2) Commission:

It is a payment or reward to employees as a percentage of his or her gross receipts. This system of rewarding is usually used in sales jobs. They are paid a certain percentage of sales as their commission. About two thirds of all sales persons are paid on a commission basis which either may be straight commission or a base salary plus commission. Commission is a clear link between pay and performance of employees and therefore it is an effective financial incentive. Commission plans are easy to administer and justify because there is no subjective element rewards are purely a function of performance.

However, this system of incentive requires active control on the part of the management as it may lead to more competition among workers and reduce cooperative team work because each employee tries to sell more than others or they may compete to get the most lucrative sales territory. Hence, they try to convince the customers to buy at any cost and besiege them for that.

## 3) Bonus:

One of the most popular trends in compensation is bonuses. Bonus is an extra payment to the workers beyond the normal wage. It is paid as lump-sum amount. It is argued that bonus is deferred wage which aims at bridging the gap between actual wage and need-based wage. It is also argued that bonus is a share of the workers in the prosperity of an organisation. And some more argue that bonus is a share in the surplus.

A major advantage of bonus is that it is based on organizational performance.. in a bad year when profit is less, bonus will be very less or sometimes bonus will not be paid at all. Some employers pay bonus voluntarily to keep up the morale of the workers, while in some cases employees demand bonus as share in the profit or to bridge the gap between real wage and money wage.

The Government of India appointed the Bonus Commission in December, 1961 having M. R. Mehar as chairman because of the persisting demands made by the employees and trade unions. Bonus Commission submitted its report in the year 1964 recommending for payment of bonus to workers. Bonus, as said in report, is a right of workers as they have a share in the prosperity of the company. The Payment of Bonus Act, 1965 regulates the bonus payment in India (discussed in unit 3). This act was amended at various time (1977, 1980, and 1985) intervals to incorporate changes.

## 4) Merit Pay:

Merit pay is reward based on how well an employee has done the assigned job. The payout is dependent on individual employees' performance. It is a subjective evaluation of performance. Advocates of this system call it the most valid type of pay increase. It is an annual increment ties to the employee's performance during the preceding year. Performance that rewarded is likely to be repeated. People tend to do things that are rewarded.

Merit raises represent a permanent commitment to an increased salary. Unfortunately, merit raises may not always achieve their intended purpose. Unlike a bonus, merit raise may be continues year after year even when performance declines. When this takes place, employees expect the increase in salary and see it as unrelated to performance. And further, evaluating merit is not a easy job. In most cases, merit raise may be based on seniority or favoritism or sometimes just cover rising inflationary pressure. And other difficulties in linking pay to performance in merit pay is, firstly merit increases are usually awarded annually, so they do not immediately follow the specific instances of good performance that the organisation wishes to reinforce. Secondly, variations in the size of merit raises are generally not large enough to be highly motivating. Despite the drawbacks, merit pay is likely to remain a staple compensation system.

## 5) Knowledge Pay or Skill-Based Pay:

It is a reward system that pays employees for their work-related skills than associating rewards with performance levels or seniority. Under a typical skill-based plan, an employee is hired and receives initial training on one job. He or she then joins a work group at the entry-level rate of pay and has the opportunity to learn new job-related skills through on-the-job experience and further training. As the employee demonstrates mastery of different jobs performed by other group members, his or her pay is increased. However, employees need to have mastery of all skills which need a minimum of three to four years.

The biggest advantage of skill-based pay is increased flexibility. Because workers know more than one job, they can move to provide expertise when and where required. Linking

pay to skill creates an incentive for learning, self-improvement and performance. The success of the plan depends on the needs of the organisation and employees.

# **II.** Group Incentives:

Group incentives are designed to accomplish the same objectives as individual incentives, which are to link rewards to performance. The difference is that performance is measured on the level of an organizational unit and is viewed as resulting from the combined efforts of a group rather than from individual effort. Group incentive has some negative aspects too. If the group is too large, employees may feel that their efforts will have little effect on the total performance. Group members may also become concerned about overproduction and thus restrict output. Following are the important of group incentive plans.

# 1) Profit Sharing:

Profit sharing an incentive system in which designated employees shares the business profits. Here, the employers pay a certain portion of net profits to their employees on compliance with certain service conditions and qualifications. The main purpose of introducing profit sharing scheme is strengthen loyalty of employees by offering them an annual bonus provided they are on the service rolls of the firm for a definite period. The employees share in the profit may be provided in cash or in the form of shares in the company. These shares are called the bonus shares. In India, the share of the worker is governed by the Payment of Bonus Act. This incentive method induces motivation in the workers and other staffs for quicker and better work so that profits of the firm are increased which in turn increases the share of worker therein.

There are three types of profit sharing plans;

- a. Current distribution plans: It pays a share of the company's profits in cash or in shares
- b. Deferred payout plans: a plan in which an employee's share of the company's profits is placed in a trust funds which to be distributed at a later date.
- c. Combination of both plan: It provides both cash payments and deferred payments.

Employees will not get any incentive where there no profits made by the company. This plan makes the employees be more aware of the organisation's competitive position in the industry and facilitate a cooperative atmosphere. However, an efficient worker will not be rewarded in the bad year in spite of his or her good performance.

# 2) Gain Sharing:

Gain sharing is a type of incentive in which a portion of the gains of the organisation realized from the group effort is shared with group. This plan demonstrates organizational

philosophy of cooperativeness and trust needed to facilitate group efforts. it is based on a mathematical formula that compares a baseline of performance with actual productivity during a given period. When productivity exceeds the baseline an agreed-upon savings is shared with employees. Profit sharing is different from gain sharing in two aspects, viz,

- a. Profit sharing is often implemented corporation-wide, whereas gain sharing is implemented at the unit level.
- b. Profit sharing use a formula based on profit rather than on productivity improvement.

There major gain sharing plans in use are, Scanlon plan, Rucker plan and Improshare plan. Gain sharing is directly related to individual behavior and distributed on monthly or quarterly basis.

- a. Scanlon Plan: this plan is developed and implemented by Joseph Scanlon in 1920. This plan involves employee participation in reducing labour cost. The two main features of are a system of departmental and plant wide screening committees to evaluate and implement employee cost-saving suggestions and sharing labour cost savings with employees as incentives. Savings are determined as the ration of payroll to sales value production and are usually calculated with baseline months to determine the bonus shared.
- **b.** Rucker Plan: this plan differs slightly from Scanlon plan. Bonus under this plan includes the cost value of all materials, supplies and services used to make the product. The Rucker plan provides an incentive to save on all inputs both human and material.
- **c. Improshare**: This plan is developed by Mitchell Fein and first used in 1974. It is noteworthy approach to gain sharing. Under this plan workers share a fixed percentage of savings resulted from reduced cost of production which is lower than the standard cost.
- **d. Winsharing**: It is a combination of profit sharing and profit sharing. Winsharing pays out to all employees in the group on the basis of group performance compared with predetermined goals.

# 3) Employee Stock Ownership Plan:

This is a unique plan where eligible employees are allotted company's shares below the market price. The term stock option implies the right of an eligible employee to purchase a certain amount of stock in future at an agreed price. The criteria for incentive payment may include duration of employee's service, performance, etc. Employees may pay the value of stock in installments or even advance money to be recovered from their salaries. This plan is originally originated in USA. However, in 1988 the Government of India allowed stock options to software professionals, recognizing the importance of retaining talent within the country.

#### **III.** Incentives for Indirect Workers:

In manufacturing industry indirect workers play an important role. They are as important as direct workers hence; they should be paid incentives in order to create team spirit, zeal and enthusiasm. It also helps in maintaining the efficiency of services like plant repairs, store maintenance, material handling, etc. The indirect workers include repairs and maintenance staff, store staff, office staff, material handling staff, etc.

#### 3.6 EXECUTIVE COMPENSATION

The top **executive compensation** is a special and specific area of compensation and benefits, which is usually confidential and it is not open to all employees in the organization. The top executives hold the responsibility for the organization, they lead the development of the organization and they have a tremendous impact on the results of the organization. Organizations decide executive compensation packages consisting of basic pay, allowances, perquisites, stock options and other number of factors. In India Executive compensation is basically built around three factors viz, job complexity, organisation's ability to pay and executive as a resource. The complexity of an executive job depends on the size of the company, earnings and assets growth, the geographic dispersal of the unit, etc. The employer's ability to pay is also an important factor that determines the executive compensation.

The executive compensation consists usually two main parts:

- Short Term Pay
- Long Term Pay

The short term pay of the executives is about the base salary and short term bonuses, which are paid on the basis of the immediate performance of the organization. The bonuses are usually deferred over a period of time. The short term pay is usually fully cash based executive compensation component.

The long term pay is about the stock options, shares, restricted stocks and pay based on the performance against the index. The shareholders use these long term compensation components to protect the value of the organization and betting of the top executives on the growing value of the organization on the market. The long term compensation components can be realized just in case, the stock price of the organization grows. The long term pay component is usually non-cash based.

#### Components of Executive Compensation:

- ♦ Base salary
- Incentive pay, with a short-term focus, usually in the form of a bonus
- Incentive pay, with a long-term focus, usually in some combination of stock awards, option awards, non-equity incentive plan compensation
- Extra benefits and perquisites, such as cars and club memberships
- Deferred compensation earnings

# 3.7 CASE STUDY

# Case Study 1:

# **Employee Benefits and Rewards**

"You HR people seem to have no other work." Shouted Praveen, the Managing director of Apex Financial services. "You keep coming with great ideas on how to spend money. Where is the money? Now get me the hard facts on why we should change our benefits plan? "Continued Praveen. He has reason to lose his cool. Chetan, the HR manager felt it was time to review the employee benefits and incentive plan and hence he mooted the idea before his boss. Chetan did not expect Praveen to be so intemperate, but he was a bit comforted when Chetan was asked to get back with facts to justify revision of benefits. Back in his office, Chetan called in Maya, his deputy for help.

#### **Questions:**

- 1. Assume that you are a part of the HR team assigned by Chetan and Maya to survey the present range to benefits and rewards offered by the company.
- i) Design the questionnaire to survey on
  - a. Employee perception of the company's present benefits/incentive programme.
  - b. The ranking the employees give to the existing or alternative benefits an
  - c. Any changes the employees want to be introduced to the present programme.

# Case Study 2:

# **Pay Inequalities:**

Amrit Electrical is a family owned company of approximately 250 employees. Mr. Rajesh Khaitan recently took over as president of the company. A short time after joining the company, he, began to following a discussion with the HR director that the pay of the salaried

employees was very much a matter of individual bargaining. Factory workers were not a part of the problem because they were unionized and their wages were set by collective bargaining. An examination of the salaried payroll showed that there were 75 employees ranging in pay from that of the president to that of receptionist. A closer examination showed that 20 of the salaried employees were females. Five of these were front time factory supervisors and one was the HR director. The other fourteen were non-management.

This examination also showed that the HR director was underpaid and that the five female supervisors were paid somewhat less than any of the male supervisors. However, there were no similar supervisory jobs in which there were both male and female supervisors. When questioned, the HR director said that she thought that the female supervisors were paid at a lower rate mainly because they were women and because they supervised less skilled employees than did the male supervisors. However, Mr. Khaitan was not convinced that this was true. He decided to hire a compensation consultant to help him. Together they decided that all 75 salaried jobs should be in the same job evaluation cluster, that a modified job evaluation method should be used and that the job descriptions recently completed by the HR director were correct and usable in the study, the job evaluation also showed that the HR director and the five female supervisors were being underpaid in comparison with the male employees.

Mr. Khaitan was not sure, what to do. If he gave these four female employees an immediate salary increase which may large enough to bring them up to where they should be, he was afraid the male supervisors could be upset and the female supervisors might comprehend the situation and demand arrears of pay. The HR director agreed to take a sizeable salary increase with the no arrears of pay. So this part of the problem was solved. Mr. Khaitan believed that he had three choices relative to the female supervisors: (1) To gradually increase their salaries (ii) to increase their salaries immediately (iii) to do nothing.

#### **Questions:**

- 1. What would you do if you were Mr. Khaitan?
- 2. How do you think the company got into a situation like this in the first place?

| 3.8   | NOTES                                   |      |
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# 3.9 SUMMARY

Skill based and performance based payment programs have gained popularity since they motivate workers and improve individual productivity and performance which ultimately lead to increased organizational performance. These incentive plans also assist in attracting and retaining skilled employees. Incentives may be individual or group, monetary or non-monetary. International Labour Organisation (ILO) has defines some incentive plan based on different performance criteria viz, Straight Piece- work System, standard hour system, Halsey premium plan, Rowan plan, Emerson efficiency plan, Taylors Differential piece-rate plan, Merrick differential piece-rate system, Gantt task and bonus plan. Incentives classified as individual or group are such as piece-rate system, commission, bonus, merit pay and skill based are the major individual incentives plans. Some employers pay incentives based on the team outcome and performance. Such incentives are called group incentives. Profit-sharing, gain-sharing, winsharing and Employee Stock Ownership Plans are the most widely used schemes across the organizations. ESOP has gained more popularity as they give employee an offer to buy the stock at low prices. Indirect workers like repairs and maintenance workers, workers handling materials are also being included in incentive programs. Executive compensation is another much debated part of compensation management which is usually confidential and it is not open to all employees in the organization. The executive compensation consists usually two main parts, short term pay and long term pay. Short term pays are paid on the basis of the immediate performance of the organization such as base salary and bonuses. The long term pay is about the stock options, shares, restricted stocks and pay based on the performance against the index.

# 3.10 KEY WORDS

- **Incentive:** Incentive is a tool to increase productivity in an organisation.
- Retention: refers to the ability of an organization to retain its employees
- **Piece rate incentive:** form of individual incentive for production workers. Employees are paid a fixed rate for each unit of output produced.
- **Commission:** It is a payment or reward to employees as a percentage of his or her gross receipts.
- **Bonus:** is an extra payment to the workers beyond the normal wage.
- Merit pay: is reward based on how well an employee has done the assigned job
- Knowledge pay: is a reward system that pays employees for their work-related skills
- **Profit sharing: is** an incentive system in which designated employees share the business profits.

- **Gain sharing:** is a type of incentive in which a portion of the gains of the organisation realized from the group effort is shared with group.
- Employee stock ownership plan (ESOP): This is a unique plan where eligible employees are allotted company's shares below the market price.
- **Group incentive:** Compensation system which links pay to a group's combined performance measured by reduction in costs, increase in productivity, progress in attaining firm's objectives, etc.
- Executive compensation: Executive Compensation is a broad term for the financial compensation awarded to a firm's executives. Executive Compensation packages are designed by a company's Board of Directors, typically by the Compensation Committee consisting of independent directors, with the purpose of incentivizing the executive team, who have a significant impact on company strategy, decision-making, and value creation (Pay for Performance) as well as enhancing Executive Retention.

# 3.11 SELF ASSESSMENT QUESTIONS

- 1. Define Merit Pay. What are the considerations for linking pay to performance?
- 2. Write short notes on;
  - a. Rowan Plan
  - b. Halsey Plan
  - c. ESOP
- 3. Compare and contrast between straight piece work and hourly-rate plan with examples.
- 4. Discuss the advantages and disadvantages of linking pay to performance.

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# UNIT-4: COMPENSATION AND BENEFITS: LAWS AND REGULATIONS

#### **Structure:**

| 4.0 | Objectives                 |
|-----|----------------------------|
| 4.1 | Introduction to labour law |

- 4.2 Purpose behind enactment of laws
- 4.3 History and development of labour laws in India
- 4.4 Major Labour Laws in India
- 4.5 Acts relating to Wages
- 4.6 The Payment of Wages Act, 1936
- 4.7 The Payment of Bonus Act, 1965
- 4.8 Minimum Wage Act, 1948
- 4.9 Case study
- 4.10 Notes
- 4.11 Summary
- 4.12 Keywords
- 4.13 Self assessment questions
- 4.14 References

#### 4.0 OBJECTIVES

After reading this unit, you should be able to:

- discuss the importance of labour law and its purpose
- discuss the history and development of labour law in India
- identify major labour laws in India
- discuss Acts relating to wages
- explain the provisions and features of the Payments of Wages Act, 1936
- analyse the provisions and features of the Payment of Bonus Act, 1965
- evaluate the provisions and features of the Minimum Wage Act, 1948

#### 4.1 INTRODUCTION OF LABOUR LAW

Labour law also known as employment law is the body of laws, administrative rulings, and precedents which address the legal rights of working people and their organizations. As such, it mediates many aspects of the relationship between trade unions, employers and employees. One such aspect of labour law is compensation. Generally, labour law covers Industrial relations like certification of unions, labour-management relations, collective bargaining and unfair labour practices, Workplace health and safety, Employment standards, including general holidays, annual leave, working hours, unfair dismissals, minimum wage, layoff procedures and severance pay. There are two broad categories of labour law. First, collective labour law relates to the tripartite relationship between employee, employer and union. Second, individual labour law concerns employees' rights at work and through the contract for work. The labour movement has been instrumental in the enacting of laws protecting labour rights in the 19th and 20th centuries. Labour rights have been integral to the social and economic development since the industrial revolution.

# 4.2 PURPOSE BEHIND ENACTMENT OF LAWS

Labour legislation is adapted to the economic and social challenges of the modern world of work to fulfill three crucial roles:

1. **Establishment of Legal System:** It establishes a legal system that facilitates productive individual and collective employment relationships, and therefore a productive economy by providing a framework within which employers, workers and their representatives can interact with regard to work-related issues.

- **2. Achieving Industrial Relations:** It serves as an important vehicle for achieving harmonious industrial relations based on workplace democracy.
- 3. Provision of Principles and Rights: It provides a clear and constant reminder and guarantee of fundamental principles and rights at work which have received broad social acceptance and establishes the processes through which these principles and rights can be implemented and enforced.

But experience shows that labour legislation can only fulfill these functions effectively if it is responsive to the conditions on the labour market and the needs of the parties involved. The most efficient way of ensuring that these conditions and needs are taken fully into account is if those concerned are closely involved in the formulation of the legislation through processes of social dialogue. The involvement of stakeholders in this way is of great importance in developing a broad basis of support for labour legislation and in facilitating its application within and beyond the formal structured sectors of the economy.

#### 4.3 HISTORYAND DEVELOPMENT OF LABOUR LAWS IN INDIA

Considering the purposes they serve, many countries took up the initiatives and carved various laws to regulate the labour related issues. The purpose of this chapter would not be served without a look into the history of labour related legislation and the developments there on in India.

The law relating to labour and employment is also known as Industrial law in India. The history of labour legislation in India is interwoven with the history of British colonialism. The industrial/labour legislations enacted by the British were primarily intended to protect the interests of the British employers. Considerations of British political economy were naturally paramount in shaping some of these early laws. Thus came the Factories Act. It is well known that Indian textile goods offered stiff competition to British textiles in the export market and hence in order to make India labour costlier the Factories Act was first introduced in 1883 because of the pressure brought on the British parliament by the textile magnates of Manchester and Lancashire. Thus India received the first stipulation of eight hours of work, the abolition of child labour, and the restriction of women in night employment, and the introduction of overtime wages for work beyond eight hours. While the impact of this measure was clearly welfares the real motivation was undoubtedly protectionist.

The earliest Indian statute to regulate the relationship between employer and his workmen was the Trade Dispute Act, 1929 (Act 7 of 1929). Provisions were made in this Act for restraining the rights of strike and lock out but no machinery was provided to take care of

disputes. The original colonial legislation underwent substantial modifications in the post-colonial era because independent India called for a clear partnership between labour and capital. The content of this partnership was unanimously approved in a tripartite conference in December 1947 in which it was agreed that labour would be given a fair wage and fair working conditions and in return capital would receive the fullest co-operation of labour for uninterrupted production and higher productivity as part of the strategy for national economic development and that all concerned would observe a truce period of three years free from strikes and lockouts. Ultimately the Industrial Disputes Act (the Act) brought into force on 01.04.1947 repealing the Trade Disputes Act 1929 has since remained on statute book.

#### 4.4 MAJOR LABOUR LAWS IN INDIA

Given below are some of the major legal issues in India which have many Acts and Rules to regulate the particular issue. Each of them has been enacted to serve said purpose.

- 1. The Factories Act, 1948
- 2. Industrial Relations
- 3. Industrial Safety and Health
- 4. Child Labour
- 5. Women Labour
- 6. Social Security
- 7. Labour Welfare
- 8. Employment and Training
- 9. Wages
- 10. Others

This unit concentrates on the wages issues. Three major acts covering that issue are discussed here in detail

# Which are the Acts relating to Wages?

#### 4.5 ACTS RELATING TO WAGES

- 1. The Payment of Wages (Amendment) Act, 2005
- 2. The Payment of Bonus Rules, 1975
- 3. The Payment of Bonus Act, 1965

- 4. The Working Journalist (Fixation of Rates of Wages) Act, 1958
- 5. The Minimum Wages (Central) Rules, 1950
- 6. The Minimum Wages Act, 1948
- 7. The Payment of Wages Rules, 1938
- 8. The Payment of Wages Act, 1936
- 9. Working Journalist (Conditions of service) and Miscellaneous Provisions Rule, 1957
- 10. Working Journalist (Conditions of service) and Miscellaneous Provisions Act, 1955

# Let us go in detail

Three important acts under wage laws have been discussed here

# 4.6 THE PAYMENT OF WAGES ACT, 1936

The growth in industries in India resulted in the wage payment problem in industries. In 1926, Government of India wrote to local governments to ascertain the position with regard to the delays which occurred in the payment of wages to the persons employed in Industry. Material so collected was placed before the Royal Commission on Labour which was appointed in 1929. On the report of the Commission, Government of India re-examined the subject and in February, 1933 the Payment of Wages Bill, 1933, was introduced in the Legislative Assembly and circulated for the purpose of-eliciting opinions. This bill was failed.

In 1935 the Payment of Wages Bill, based upon the same principles as the earlier Bill of 1933 but thoroughly revised was introduced in the Legislative Assembly on 15th February, 1935. The Bill was referred to the Select Committee. The Select Committee presented its report on 2nd September, 1935. Incorporating the recommendations of the Select Committee, the Payment of Wages Bill, 1935 was again introduced in the Legislative Assembly.

This act is enacted with the objective to regulate the payment of wages to certain classes of employees.

# **Applicability:**

This act extends to the whole of India.

It applies to the payment of wages to persons employed in any factory to persons employed (otherwise than in a factory) upon any railway by a railway administration or either

directly or through a sub-contractor by a person fulfilling a contract with a railway administration and to persons employed in an industrial or other establishment.

And applies to the workers whose earnings do not exceed ten thousand rupees per month.

# Responsibility for payment of wages:

Every employer shall be responsible for the payment of all wages required to be paid under this Act to persons employed by him and in case of persons employed

- a. In factories and in industrial
- b. Other establishments if there is a person responsible to the employer for the supervision and control of the industrial or other establishment;
- c. upon railways (other than in factories), if the employer is the railway administration and the railway administration has nominated a person in this behalf for the local area concerned
- d. In the case of contractor, a person designated by such contractor who is directly under his charge and
- e. In any other case, a person designated by the employer as a person responsible for complying with the provisions of the Act; the person so named, the person responsible to the employer, the person so nominated or the person so designated, as the case may be, shall be responsible for such payment.

If the contractor or the designated person fails to pay the wages, it is the responsibility of the employer to make the payment it is required by the act.

# Wage Period:

According to the act, the person responsible for wage payment fixes the wage period in respect of which wages are paid. However, the wage period should not exceed a period of one month.

A railway worker has to be paid before the expiry of the seventh day and any industrial or other establishments' employees must be paid on or before completion of tenth day.

Another provision of the act is that payment must be made in current coin or currency or in both.

# 4.7 THE PAYMENT OF BONUS ACT, 1965

The payment of Bonus Act provides for payment of bonus to persons employed in certain establishments of the basis of profits or on the basis of production or productivity and for matters connected therewith.

It extends to the whole of India and is applicable to every factory and to every other establishment where 20 or more workmen are employed on any day during an accounting year.

# **Eligibility for Bonus**

Every employee receiving salary or wages up to Rs. 10,000 p.m. and engaged in any kind of work whether skilled, unskilled, managerial, supervisory etc. is entitled to bonus for every accounting year if he has worked for at least 30 working days in that year.

Where an employee has not worked for all the working days in an accounting year, the minimum bonus of one hundred rupees or, as the case may be, of sixty rupees, if such bonus is higher than 8.33 per cent, of his salary or wage for the days he has worked in that accounting year, shall be proportionately reduced.

However employees of L.I.C., Universities and Educational institutions, Hospitals, Chamber of Commerce, R.B.I., IFCI, U.T.I., IDBI, NABARD, SIDBI, Social Welfare institutions are not entitled to bonus under this Act.

#### **Disqualification for Bonus**

Notwithstanding anything contained in the act, an employee shall be disqualified from receiving bonus, if he is dismissed from service for fraud or riotous or violent behaviour while in the premises of the establishment or theft, misappropriation or sabotage of any property of the establishment.

# Minimum and Maximum Bonus Payable

#### **Minimum Bonus**

The minimum bonus which an employer is required to pay even if he suffers losses during the accounting year or there is no allocable surplus is 8.33 % of the salary or wages during the accounting year, or Rs. 100 in case of employees above 15 years and Rs 60 in case of employees below 15 years at the beginning of the accounting year, whichever is higher.

#### **Maximum Bonus**

If in an accounting year, the allocable surplus, calculated after taking into account the amount 'set on' or the amount 'set of' exceeds the minimum bonus, the employer should pay

bonus in proportion to the salary or wages earned by the employee in that accounting year subject to a maximum of 20% of such salary or wages.

# **Time Limit for Payment**

The bonus should be paid in cash within 8 months from the close of the accounting year or within one month from the date of enforcement of the award or coming into operation of a settlement following an industrial dispute regarding payment of bonus. However if there is sufficient cause extension may be applied for

# **Duties and Rights of Employer**

#### 1. Duties

- To calculate and pay the annual bonus as required under the Act
- To submit an annual return of bonus paid to employees during the year, in Form D, to the Inspector, within 30 days of the expiry of the time limit specified for payment of bonus.
- To co-operate with the Inspector, produce before him the registers/records maintained, and such other information as may be required by them.
- To get his account audited as per the directions of a Labour Court/Tribunal or of any such other authority

# 2. Rights

An employer has the following rights,

- Right to forfeit bonus of an employee, who has been dismissed from service for fraud, riotous or violent behaviour, or theft, misappropriation or sabotage of any property of the establishment.
- Right to make permissible deductions from the bonus payable to an employee, such as festival/interim bonus paid and financial loss caused by misconduct of the employee.
- Right to refer any disputes relating to application or interpretation of any provision of the Act, to the Labour Court or Labour Tribunal.

# **Rights of Employees**

- Right to claim bonus payable under the Act and to make an application to the Government for the recovery of bonus due and unpaid, within one year of its becoming due.
- Right to refer any dispute to the Labour Court/Tribunal Employees, to whom the Payment of Bonus Act does not apply, cannot raise a dispute regarding bonus under the Industrial Disputes Act.

• Right to seek clarification and obtain information, on any item in the accounts of the establishment.

# 4.8 MINIMUM WAGE ACT, 1948

The Minimum Wages Act 1948 grants each local government the power to fix minimum wage rates for: Time work, Piece work and Overtime work. The concept of Minimum Wages was first evolved by ILO in 1928 with reference to remuneration of workers in those industries where the, level of wages was substantially low and the labour was vulnerable to exploitation, being not well organised and having less effective bargaining power. The need for a legislation for fixation of minimum wages in India received boost after World War – II when a draft bill was considered by the Indian Labour Conference in 1945.

On the recommendation of the 8th Standing Labour Committee, the Minimum Wages Bill was introduced in the Central Legislative assembly on 1946 to provide for fixation of minimum wages in certain employments. The Minimum Wages Bill was passed by the Indian Dominion Legislature and came into force on 15th March, 1948. Under the Act, both State and Central Government are 'Appropriate Governments' for fixation or revision of minimum rates of wages for employments covered by the Schedule to the Act. The minimum rates of wages also include Special Allowance (Variable Dearness Allowance) linked to Consumer Price Index Number which are revised twice a year effective from April and October. The rates of wages once fixed are revised at an interval not exceeding of five years.

The minimum wage to which an employee is entitled depends on:

- The nature of the employment.
- The geographic location of the employment.
- ♦ The employee's age

# **Objectives of the Act:**

- 1. The fundamental objective of this act is to prevent the exploitation of Workers by the employers by fixing the minimum wages. It is a statutory obligation on employer to compensate the employee above a standard rate.
- 2. To bring the social justice by giving the workers to earn a minimum return from the company in return for their service.
- 3. To enable the working class to have a minimum standard of life.
- 4. To fix or revise the minimum rate of wages for the scheduled employments.

The minimum wages act covers farm labourers, landless labourers, factory workers, and people working in cottage industries and Construction workers etc. working in agricultural, industrial and small- scale sectors.

# **Guidelines for Employers:**

Following points guide employers in administration of aspects related to minimum wages and their payments.

- Wages must be paid in cash.
- For the fixation of minimum wages, the employment must have been in Schedule originally or added to the Schedule by a notification under Section 27 of the Act.
- ♦ The employer can take actual work on any day up to 9 hours in a 12 hours shift, but he must pay double the rate for any hour or part of an hour of actual work in excess of 9 hours or for more than 48 hours in any week
- Once a minimum wage is fixed according to the provisions of the Act, the employer must pay to every employee engaged in a Scheduled employment, minimum wages notification for that class of employees.
- The employer should fix wage-period for the payment of wages at intervals not exceeding one month or such other larger period as may be prescribed.
- The employer should pay wages on a working day within seven days of the end of wage period or within 10 days if 1000 or more persons are employed in an establishment.
- ♦ The employer should pay the wages to a person discharged not later than the second working day after his discharge.
- Every employer should maintain a register of wages at workplace specifying the minimum rate of wage, number of days overtime worked, gross wages, wages actually paid and the date of payment.
- Every employer should get the signature or the thumb impression of every person employed on the wage book and the wage slips.
- ♦ The employer should exhibit at main entrance to the establishment and its offices, a notice in respect of the following in English and local language:
  - a. Minimum rates of wages
  - b. Abstracts of the Acts and rules made there under
  - c. Name and address of the Labour Inspector/Asst. Commissioner of Labour etc.

The labour laws regulate the wage fixation and administration of wage payment system in India. Following institutions are engaged in the job of wage fixation.

# **Wage Fixation:**

# 1. Collective bargaining:

Through this mechanism workers representatives achieve a voice in the establishment of wages, hours of work and other conditions of work. In collective bargaining unions are primarily concerned with general levels wage rates differentials among occupations, bonus, incentives and fringe benefits and their administration.

# 2. Wage board:

It is a voluntary negotiating body set by organized employers and workers to regulate wages, working hours and other employment related conditions. It can also be set up as a legal authority to establish minimum wages and other standards of employment which are then legally enforceable in the particular trade or industry to which the board's decision relate.

There are two types of wage boards; a. statutory wage board and b. Tripartite wage board set up on the recommendations of central government.

# 3. Pay commissions:

This is another institution which fixes and revises wages allowances to the employees of government and military divisions. These are set up by central and state governments. Till now seven pay commissions have been set up.

#### 4.9 CASE STUDY

Mr. Umar founded a small steel fabricator company in Gaziabad. He developed the company to its present 130 employees and considered each employee as a friend. In the early, 1990 he decided that having some employees paid by the hour and others as salaried employees created an unnecessary division within his family. As a result he sought help from a consultant and followed the recommendation to create an all-salaried work force at the company. The time clock used by hourly employees was removed and al employees were paid a fixed monthly salary.

Recently, Mrs. Mary, a long-time employee was dismissed as a result of difference of opinion with her superior. Mr. Umar was surprised to learn that Mrs. Mary had filed a claim seeking wage and hour back pay for the overtime she worked over a five year period. More specifically, approximately five years before she was dismissed, she asked and was granted

permission to arrive at work thirty minutes early every day so that she could ride to the plant with her husband. Mary was now claiming that these approximately 600 extra hours worked over the five years were overtime, a potential cost. More troubling to Umar was the fact that many employees had been given permission to vary their schedules in the same way that Mary had done.

# **Questions:**

- a. Would the company be liable for back overtime pay for all employees who worked extra hours? If yes, why?
- b. What should the company have done to avoid the type of claim Mrs. Mary filed?

| 4.10  | NOTES                                   |
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## 4.11 SUMMARY

Labour law also known as employment law is the body of laws, administrative rulings, and precedents which address the legal rights of, and restrictions on, working people and their organizations. It covers Industrial relations like certification of unions, labour-management relations, collective bargaining and unfair labour practices, Workplace health and safety, Employment standards, including general holidays, annual leave, working hours, unfair dismissals, minimum wage, layoff procedures and severance pay. Establishment of a full pledged legal System, achieving industrial relations and provision of principles and rights are the objectives of labour legislation. There are numerous laws relating to the labour and industrial relations. They cover all aspect like, child and women labour, employee safety, wages, social security, training etc., The unit considers acts relating to wages, hence The Payment of Wages Act, 1936, The Payment of Bonus Act, 1965 and The Minimum Wage Act, 1948 have been discussed.

# 4.12 KEY WORDS

- ◆ **Labour law:** is the body of laws, administrative rulings, and precedents which address the legal rights of, and restrictions on, working people and their organizations.
- ♦ Collective bargaining: is a process of negotiation between employers and a group of employees aimed at reaching agreements to regulate working conditions.
- Unfair labour practice: is any unfair act or omission at the workplace, involving unfair conduct of an employer relating to the promotion or demotion or probation of an employee, unfair conduct relating to the provision of training of an employee.
- ♦ *Employment standards*: are minimum standards of employment for employers and employees in the workplace.
- ♦ **Minimum wage:** The *minimum* amount of compensation an employee must receive for performing labor.
- ♦ Wage board: It is a voluntary negotiating body set by organized employers and workers to regulate wages, working hours and other employment related conditions.
- ◆ **Pay commission:** institution which fixes and revises wages allowances to the employees of government and military divisions.

# 4.13 SELF ASSESSMENT QUESTIONS

- 1. What is collective bargaining?
- 2. Give a note on the history and development of labour laws in India.
- 3. Describe the objectives of Minimum Wage Act, 1948.
- 4. What is the minimum and maximum bonus criteria in Indian wage law?
- 5. Bring out the features of the Payment of Bonus Act, 1965
- 6. What are the provisions of the Payment of Wages Act, 1936? Discuss.
- 7. Mention the Acts pertaining to wages in India.
- 8. Write a note on pay commission in India.

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# MUKTHAGANGOTHRI, MYSURU-570 006.

# DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

# **M.B.A III Semester**

# COURSE - 18 C

# COMPENSATION MANAGEMENT AND PERFORMANCE APPRAISAL

# **BLOCK**

2

# PERFORMANCE APPRAISAL

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# **BLOCK-2:PERFORMANCE APPRAISAL**

Employee performance is one of major factor which decides his/her compenstation. This block deals with performance apprasial. Which is divided into four units.

Unit-5 focusses on basic aspects of performance appraisal, meaning, defenition, scope, onjectives of performance apprasial and organizational uses.

Unit-6 deals with steps in performance apprasial, problems of performance apprasial and five ways to deal with poor apprasial.

Unit-7 is concerned with methods of performance appraisal it initially distingushed the traditional and modern methods of performance appraisal. Further, it explain in detail all the traditional methods of performance appraisal.

Unit-8 deals with modern methods of performane apprasial, which explains in detail all the important modern techniques of performance apprasial. Further, the unit discusses emerging trends in performance apprasial system.

# **UNIT - 5: BASICS OF PERFORMANCE APPRAISAL**

# **Structure:**

- 5.0 Objectives
- 5.1 Introduction
- 5.2 Meaning
- 5.3 Definition
- 5.4 Scope
- 5.5 Objectives of performance appraisal
- 5.6 Organizational uses of performance appraisal
- 5.7 Case study
- 5.8 Notes
- 5.9 Summary
- 5.10 Keywords
- 5.11 Self assessment questions
- 5.12 References

#### 5.0 OBJECTIVES

After reading this unit, you should be able to:

- define performance appraisal
- define the scope of the performance appraisal
- explain the objectives of performance appraisal
- elaborate the organizational uses of performance appraisal

#### 5.1 INTRODUCTION

The history of performance appraisal is quite brief. Its roots in the early 20th century can be traced to Taylor's pioneering Time and Motion studies. But this is not very helpful, for the same may be said about almost everything in the field of modern human resources management.

As a distinct and formal management procedure used in the evaluation of work performance, appraisal really dates from the time of the Second World War, about seventy years ago.

Yet in a broader sense, the practice of performance appraisal is an ancient art. In the scale of things historical, it might well lay claim to being the world's second oldest profession!

There is, says <u>Dulewicz (1989)</u>, "... a basic human tendency to make judgments about those one is working with, as well as about oneself." Appraisal, it seems, is both inevitable and universal. In the absence of a structured system, people will tend to judge the work performance of others, including subordinates, informally and arbitrarily.

The hardwired human inclination to judge can cause big problems in the workplace. Without a structured system of appraisal, there is little if any chance of ensuring that such judgments will be accurate, fair and useful.

Performance appraisal began as an attempt to rationally correlate rewards and outcomes. That is, appraisal was used to decide whether or not the salary or wage of an individual employee was justified.

The process was firmly linked to material outcomes. If an employee's performance was found to be less than ideal, a cut in pay would follow. On the other hand, if their performance was better than the supervisor expected, a pay rise was in order.

Little consideration, if any, was given to the developmental possibilities of appraisal. If was felt that a cut in pay, or a rise, should provide the only required impetus for an employee to either improve or continue to perform well.

Sometimes this basic system succeeded in getting the results that were intended; but more often than not, it failed.

For example, early motivational researchers were aware that different people with roughly equal work abilities could be paid the same amount of money and yet have quite different levels of motivation and performance.

These observations were confirmed in empirical studies. Pay rates were important, yes; but they were not the only element that had an impact on employee performance. It was found that other issues, such as morale and self-esteem, could also have a major influence.

As a result, the traditional emphasis on reward outcomes was progressively rejected. In the 1950s in the United States, the potential usefulness of appraisal as tool for motivation and development was gradually recognized. The general model of performance appraisal, as it is known today, began from that time.

# 5.2 **MEANING**

The very purpose of performance uprising is to know performance of employee, subsequently to decide whether training is needed to particular employee or to give promotion with additional pay hike. Performance appraisal is the tool for determining whether employee is to be promoted, demoted or sacked (remove) in case of very poor performance and no scope for improvement. The performance appraisal is the process of assessing employee performance by way of comparing present performance with already established standards which have been already communicated to employees, subsequently providing feedback to employees about their performance level for the purpose of improving their performance as needed by the organization. Every corporate sector uses performance appraisal as a tool for knowing about the employee and take decisions about particular employee. For the purpose of performance appraisal of employees there are different methods under the category of traditional methods and modern methods which are discussed in following chapters.

There is, says Dulewicz (1989), "... a basic human tendency to make judgements about those one is working with, as well as about oneself." Appraisal, it seems, is both inevitable and universal. In the absence of a carefully structured system of appraisal, people will tend to judge the work performance of others, including subordinates, naturally, informally and arbitrarily.

**Performance appraisals**, also called annual reviews, evaluate an **employee's** skills, achievements and growth, or lack thereof.

Performance Appraisal is the systematic evaluation of the performance of employees and to understand the abilities of a person for further growth and development. Performance appraisal is generally done in systematic ways which are as follows:

- 1. The supervisors measure the pay of employees and compare it with targets and plans.
- 2. The supervisor analyses the factors behind work performances of employees.
- 3. The employers are in position to guide the employees for a better performance.

#### 5.3 **DEFINITION**

"An annual review of an **employee's** overall contributions to the company by his/her manager.

The process by which a manager or consultant examines and evaluates an employee's work behavior by comparing with preset standards, documents the results and uses the results to provide feedback to the employee for his/her improvement if needed with or without training and helps the organization to promote/demote/retain/fire such employee.

#### 5.4 SCOPE

The scope of any performance appraisal should include the following: provide employees with a better understanding of their role and responsibilities; increase confidence through recognizing strengths while identifying training needs to improve weaknesses; improve working relationships and communication between supervisors and subordinates; increase commitment to organizational goals; develop employees into future supervisors; assist in personnel decisions such as promotions or allocating rewards; and allow time for self-reflection, self-appraisal and personal goal setting. (See Reference 3: Performance Appraisal System).

#### 5.5 OBJECTIVES OF PERFORMANCE APPRAISAL

Employees would like to know from a performance appraisal system:

- Concrete and tangible particulars about their work; and
- assessment of their performance.

This would include how they:

- did:
- could do better in future;
- could obtain a larger share of rewards; and
- could achieve their life goals through their position.

Therefore an employee would desire that the appraisal system should aim at:

- their personal development;
- their work satisfaction; and
- their involvement in the organization.

From the point of view of the organization, performance appraisal serves the purpose of:

- providing information about human resources and their development;
- measuring the efficiency with which human resources are being used and improved;
- providing compensation packages to employees; and
- maintaining organizational control.

Performance appraisal should also aim at the mutual goals of the employees and the organization. This is essential because employees can develop only when the organization's interests are fulfilled. The organization's main resources are its employees, and their interest cannot be neglected. Mutual goals simultaneously provide for growth and development of the organization as well as of the human resources. They increase harmony and enhance effectiveness of human resources in the organization.

#### 5.6 ORGANIZATIONAL USES OF PERFORMANCE APPRAISAL

It is said that performance appraisal is an investment for the company which can be justified by following advantages:

# 1.6.1 Promotion:

Performance Appraisal helps the supervisors to chalk out the promotion programmes for efficient employees. In this regards, inefficient workers can be dismissed or demoted in case.

#### 5.6.2 Compensation:

Performance Appraisal helps in chalking out compensation packages for employees. Merit rating is possible through performance appraisal. Performance Appraisal tries to give worth to a performance. Compensation packages which include bonus, high salary rates, extra benefits, allowances and pre-requisites are dependent on performance appraisal. The criteria should be merit rather than seniority.

# 5.6.3 Employees Development:

The systematic procedure of performance appraisal helps the supervisors to frame training policies and programmes. It helps to analyze strengths and weaknesses of employees so that new jobs can be designed for efficient employees. It also helps in framing future development programmes.

#### 5.6.4 Selection Validation:

Performance Appraisal helps the supervisors to understand the validity and importance of the selection procedure. The supervisors come to know the validity and thereby the strengths and weaknesses of selection procedure. Future changes in selection methods can be made in this regard.

# 5.6.5 Communication:

For an organization, effective communication between employees and employers is very important. Through performance appraisal, communication can be sought for in the following ways:

- a. Through performance appraisal, the employers can understand and accept skills of subordinates.
- b. The subordinates can also understand and create a trust and confidence in superiors.
- c. It also helps in maintaining cordial and congenial labour management relationship.
- d. It develops the spirit of work and boosts the morale of employees.

All the above factors ensure effective communication.

#### 5.6.6 Motivation:

Performance appraisal serves as a motivation tool. Through evaluating performance of employees, a person's efficiency can be determined if the targets are achieved. This very well motivates a person for better job and helps him to improve his performance in the future. be instrumental in creating a positive and healthy climate in the organization that drives employees to give their best while enjoying doing so; and assist in a variety of personnel decisions by periodically generating data regarding each employee.

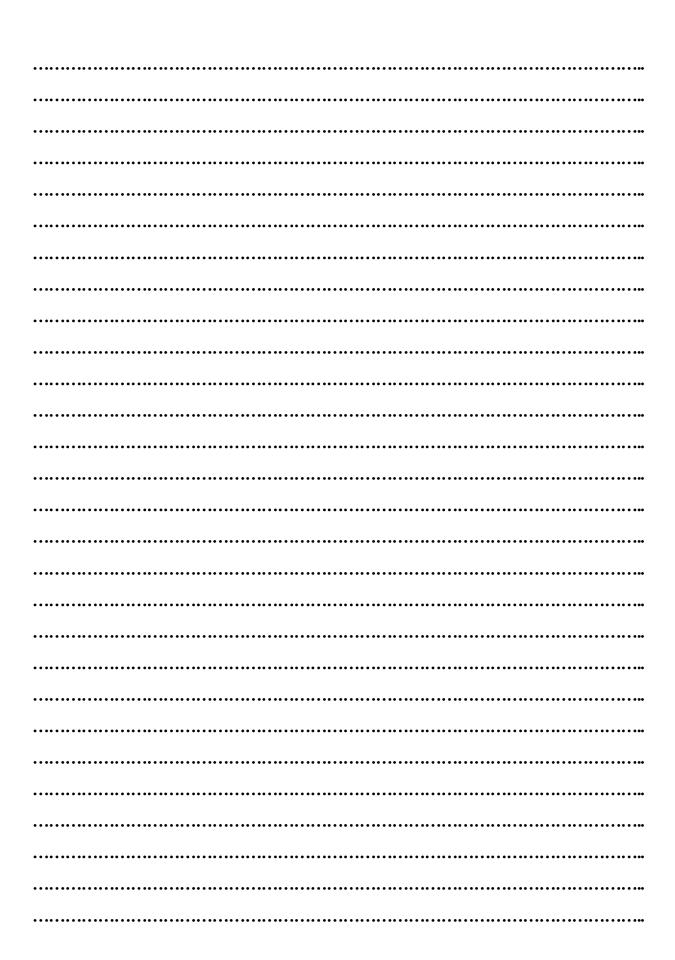
#### 5.7 CASESTUDY

Mr. Shroff is a talented and well experienced human resources manager of Britestar Company. He undertakes his role of HR manager by being an administrative expert and a change agent. He has always been an inspiration for his subordinates and the employees whose performance is measured and appraised by him. It is because of Mr. Shroff's 15 years of experience of working in HR departments helped him to get acquainted with various Performance Appraisal methods for evaluating the performance of his employees in a better way every time.

He had always been implementing only those methods which he found result-oriented in terms of enabling the employees to know about their performance in the organization, to help them in providing adequate training, if required, to increase their potential, to provide concrete feedback and evaluate their current job performance to determine transfer, retention and termination of employees. He has been working in Britestar since last 5 years and has gained good amount of respect and faith from his employees due to his appropriate and fair performance appraisal techniques that facilitated the uses of performance appraisal. The mostly used techniques by him are Checklist method, 360ÚFeedback and Assessment centers.

Because of Mr. Shroff's good rapport and close relations in the recent months with his subordinates Ram Kumar and P.K. Gupta, he has developed a new tendency to appraise the performance of those employees known to Kumar and Gupta with leniency and because he finds them similar to him (personality and knowledge wise). As a result of this unfair and inappropriate appraisal of Mr. Shroff, he also evaluates the performance of the employees taking into account their recent performances only. Hence, most of the employees' productivity has reduced and is inefficient, even some of the good employees have become irresponsible towards their tasks along with different behavior showing no interest to put in their best efforts to realize the goals and mission of the company. Some employees are planning to resign as no proper feedbacks are provided when required and no better prospects for Promotions are expected to see the light of the day.

| <b>5.8</b>  | NOTES |     |
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#### 5.9 SUMMARY

The process of performance appraisal helps the employee and the management to know the level of employee's performance compared to the standard/ predetermined level. Performance appraisal is essential to understand and improve the employee's performance through HRD. In fact, performance appraisal is basis for HRD. The performance appraisal helps the organization in various ways like employee promotion/ transfer, salary determination and the like. Hence we can say that the performance appraisal an importance component of HR activities.

#### 5.10 KEY WORDS

**Performance appraisal:** degree of accomplishment of the tasks that make up an individual's job. It indicates how well an individual is fulfilling the job demands.

**Motivation:** internal and external factors that stimulate desire and energy in people to be continually interested and committed to a job, role or subject, or to make an effort to attain a goal.

**Promotion:** Promotion is reassignment to a higher level job to an internal employee with higher authority, and responsibility.

# 5.11 SELFASSESSMENT QUESTIONS

- 1. Discuss the difference between performance management and performance appraisal
- 2. Do you really think that it is possible for a performance appraisal to be motivational? Why or why not?
- 3. Define performance appraisal. What are the organizational uses of performance appraisal?
- 4. Explain the objective of performance appraisal.

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# **UNIT - 6: STEPS IN APPRAISING PERFORMANCE**

# **Structure:**

- 6.0 Objectives
- 6.1 Introduction
- 6.2 Steps in performance appraisal
- 6.3 Problems of performance appraisal
- 6.4 Five ways to deal with poor appraisal
- 6.5 Case study
- 6.6 Notes
- 6.7 Summary
- 6.8 Keywords
- 6.9 Self assessment questions
- 6.10 References

#### 6.0 OBJECTIVES

After reading this unit, you should be able to:

- explain various steps involved in performance appraisal
- analyze the implications of the steps of performance appraisal
- explain the ways to deal with poor appraisal
- understand the problems of performance appraisal

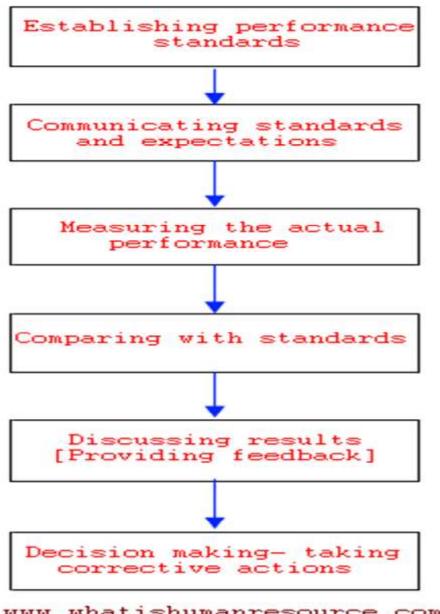
#### 6.1 INTRODUCTION

As you studied in the previous module performance appraisal has got number of advantages to the organization. Hence it is important to design a systematic style to appraise the performance of the employees of an organization. The performance appraisal is a six step process. Each one of them is discussed in detail in the following section.

#### 6.2 STEPS IN PERFORMANCE APPRAISAL

# a) Establishing performance standards

The first stage, performance standards are established based on job description and job specification. Performance appraisal is the setting up of the standards which will be used to as the base to compare the actual performance of the employees. This step requires setting the criteria to judge the performance of the employees as successful or unsuccessful and the degrees of their contribution to the organizational goals and objectives. The standards set should be clear, easily understandable and in measurable terms. In case the performance of the employee cannot be measured, great care should be taken to describe the standards



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# b) Communicating the standards

Once set, it is the responsibility of the management to communicate the standards to all the employees of the organization. The employees should be informed and the standards should be clearly explained to the employees. This will help them to understand their roles and to know what exactly is expected from them. The standards should also be communicated to the appraisers or the evaluators and if required, the standards can also be modified at this stage itself according to the relevant feedback from the employees or the evaluators.

# c) Measuring the actual performance

Appraisal process is measuring the actual performance of the employees that is the work done by the employees during the specified period of time.

It is a continuous process which involves monitoring the performance throughout the year.

This stage requires the careful selection of the appropriate techniques of measurement, taking care that personal bias does not affect the outcome of The process and providing assistance rather than interfering in an employees work.

#### d) Comparing actual performance with desired performance

The actual performance is compared with the desired or the standard performance. The comparison tells the deviations in the performance of the employees from the standards set. The result can show the actual performance being more than the desired performance or, the actual performance being less than the desired performance depicting a negative deviation in the organizational performance. It includes recalling, evaluating and analysis of data related to the employee's performance.

# e) Discussing results[Feedback]

The result of the appraisal is communicated and discussed with the employees on one-to-one basis. The focus of this discussion is on communication and listening. The results, the problems and the possible solutions are discussed with the aim of problem solving and reaching consensus. The feedback should be given with a positive attitude as this can have an effect on the employees' future performance. Performance appraisal feedback by managers should be in such way helpful to correct mistakes done by the employees and help them to motivate for better performance but not to demotivate. Performance feedback task should be handled very carefully as it may leads to emotional outburst if it is not handing properly. Sometimes employees should be prepared before giving them feedback as it may be received positively or negatively depending upon the nature and attitude of employees.

#### f) Decision-making

The purpose of conducting employee performance appraisal is for making decisions about employees without any bias by the HR manager. Decision-making by HR managers about employees rewarding, promotions, demotions, transfers and sometimes suspensions/dismissal of employees are depended upon the employee performance appraisal. The decision taken by HR manager should match exactly with performance appraisal results of employees to avoid grievance or disturbances in between them, as they affect overall performance of the organization.

#### 6.3 PROBLEMS OF PERFORMANCE APPRAISAL

#### The major problem in performance appraisal is-

- 1. Rating Biases: The problem with subjective measure is that rating which is not verifiable by others) has the opportunity for bias. The rater biases include: (a) halo effect, (b) the error of central tendency (c) the leniency and strictness biases, (d) personal prejudice, and (e) the recency effect.
- a) Halo effect: it is the tendency of the raters to defend excessively on the rating of one trait or behavioral consideration in rating all other traits or behavioral considerations. One way of minimizing the halo effect is appraising all employees by one trait before going to rate on the basis of another trait.
- b) The error of Central Tendency: Some raters follow play safe policy in rating by rating all the employees around the middle point of the rating scale and they avoid rating the people at both the extremes of the scale. They follow play safe policy because of answerability to management of lack of knowledge about the job and the person he is rating or least interest in his job.
- c) The Leniency and Strictness: The leniency bias crops when some raters have tendency to be liberal in their rating by assigning higher rates consistently. Such ratings do not serve any purpose. Equally damaging one is assigning consistently low rates.
- **d) Personal Prejudice:** if the rater dislikes any employee or any group, he may rate them at the lower end, which may distort the rating purpose and affect the career of these employees.
- e) The Recency Effect: The raters generally remember the recent actions of the employees at the time of rating and rate on the basis of these recent actions- favourable or unfavourable rather than on the whole activities.
- 2. Failure of the superiors in conducting performance appraisal and post performance appraisal interviews.
- 3. Most part of the appraisal is based on the subjectivity.
- 4. Less reliability and validity of the performance appraisal techniques.
- 5. Negative ratings affect interpersonal relations and industrial relations.
- 6. Influence of external environmental factors and uncontrollable internal factors.
- 7. Feedback and post appraisal interview may have a setback on production.

- 8. Management emphasizes on punishment rather than development of an employee in performance appraisal.
- 9. Some ratings particularly about the potential appraisal are purely based on guess work.
- 10. Relationship between appraisal rates and performance after promotions was not significant.
- 11. Some superiors completed appraisal reports within a few minutes.
- 12. Absence of inter- rater reliability.
- 13. The situation was unpleasant in feedback interview.
- 14. Superior lacks that tact of offering the suggestions constructively to subordinates.
- 15. Superiors were often confused due to too many objectives of performance appraisal.

#### 6.4 FIVE WAYS TO DEAL WITH POOR APPRAISAL

Bad appraisals, like bad hair days (one of those days when nothing seems to be going right), happen to the best of us. Quitting is not a solution. Rather, take a good look at your performance and concentrate on the course ahead.

- i. Look Within: The first step in dealing with a bad appraisal is to keep an honest mindset and introspect about your performance. "First ask yourself the question: 'What is wrong with me?'. Once you attack that, other things usually fall into place," says Dabur India HR head A Sudhakar.
- ii. Talk to the Boss: Speak to the boss about the performance review. "There is a good chance your boss may not have remembered critical activities and initiatives you have undertaken," says Meenakshi Roy, senior vice president, human resource, Reliance Broadcast Network.
- **iii. Take it in your Stride:** There is a good chance that your boss' critical evaluation is spot on. "Try never to take these critiques personally and quit. That may be your biggest mistake. Consider consulting another senior colleague or a mentor," says Roy.
- **iv. Plan Ahead:** "Be actively involved in setting your targets for the year ahead based on your strengths," says S Roy, a midlevel manager in an IT firm. Also, periodically review your performance with your boss. That way, there will be fewer unpleasant surprises.
- v. Move on Gracefully: At times, reasons not connected with your performance affect the appraisal you deserve. "You can bring up the issue with your bosses. But if nothing comes of it, it's time to move on," says Sudhakar. But don't make an ugly exit. "You never know when it can come back to haunt you," he adds.

#### 6.5 CASE STUDY

#### **Performance Management System**

That was first Monday of May. I just finalized the list of officers and engineers who were selected for 2-year Executive Management Development Programme (EMDP) which was suppose to commence from June end. EMDP was sponsored by the company and was affiliated with renowned management institute.

Let me tell about the course. The criteria for selection was as under:

- 1) Employee must complete minimum five years with the company.
- 2) He should be rated minimum "Meets Expectations (ME)" during last three years Performance Appraisal.
- 3) He should complete other training programmes related to the managerial and executive effectiveness. (These programmes are residential programmes from 3-8 days)

Methodology for selection was as under

- a) Every year the list of the officers who fulfils above criteria is declared,
- b) Management Institutes carries Entrance Test (Written, GD, Presentations and Interview)
- c) The participants are assed thoroughly.
- d) Final list of successful employees is declared for the course

Employees who are selected for the course has to sign three years Bond with the company. During the course every participant has to give the presentation on the progress and he has to take one developmental project in a month. This course has to be done after officer hours. Management Institute has designed the programme, which suits the requirement of the company and its business.

30 Employees were selected for the course and I sent the list to my VP for his approval. I relaxed as I completed one task. The whole process was smooth. VP called me on phone and told that the list is fine with him. I just made a circular with details plan for communication. I save the file and was suppose to fire the print.

I saw Mr. Pradeep Jani coming towards me. Pradeep is a Sr. Manager and a very good Automobile Engineer who was handling the team of 10 engineers and around 150 blue-collar workmen in his shop. He was known for his short tempered and for his reactive personality among all the employees.

"Come on Pradeep. How are you?" I asked "You people are not making me fine" he responded "What's happened yaar, we are here for you, tell me what's happened? "Tell me what the criteria for the selection for EMDP?" he asked. I explained him whole process.

"If your process is so through why I was not called for the entrance test? I am old employee, competed almost 11 years in the company, I am good engineer. My performance is good. Then why I am not called. Raman who is junior for me, new in the company got the opportunity?" He blasted on me. "Cool down Pradeep. Let me check the case, will you take a coffee?" I got two cups from vending machine.

Pradeep was furious on me and was holding me responsible for not calling him for appearing for the test. I check the personal history of Pradeep and told "Pradeep, I am sorry, but you are not consistent during last three appraisals"

"How? How you can say this? I explained him about that data which was available on HRIS. Data shows that Pradeep was rated ME two times and onetime RME, i.e. "Reasonably meets expectations". It means he meets expectations, but need more consistent in his work. He agreed with the data available. "Oh, Vinod, I did not know this fact that my rating will be linked everywhere. Otherwise I had not agreed with....." He left the sentence in between. "Yaa, tell me" I asked him He was reluctant to tell. I decided to go in detail.

#### **Problem**

"When last time, our Performance Appraisal was done, I had a long discussion with Mr. Ramchandran (Pradeep's immediate boss). He was fully agreed with the achievements I had done. However he told me that he had to rate the employees in different tiers (i.e. Performance classification). I was rated "ME" for last two years. He told that there would no effect on payouts (i.e. Performance Bonus) though the overall rating is "RME" This year he will rate me "RME" because he had decided to rate other and everybody should get the opportunity." The problem I could trace out from above discussion

Every department head has to follow the performance bell and during every appraisal, the employees would be classified in different tiers. The department head decided to classify the employees not on Performance but just on quota system. The purpose of the performance appraisal and classification is not at all achieved.

| 6.6   | NOTES                                   |
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#### 6.7 SUMMARY

The performance appraisal is the six step process starts with the establishment of the performance standards end ends with the decision making – taking corrective actions. These steps show the entire picture of the performance appraisal. Although the performance appraisal is very useful for both organizational and employees it is not free from the drawbacks, it has got many problems such as rating biases, Failure of the superiors in conducting performance appraisal and post performance appraisal interviews, most part of the appraisal is based on the subjectivity etc.,. To deal with these poor performance appraisal systems there are five different ways to deal with the poor performance appraisal, such as looking within, talk to the boss, taking it to in your stride.

#### 6.8 KEYWORDS

**Halo effect:** The halo effect is type of cognitive bias in which our overall impression of a person influence how we feel and think about his or her character. Essentially, your overall impression of a person ("He is nice!") impacts your evaluations of that person's specific traits ("He is also smart!").

One great example of the halo effect in action is our overall impression of celebrities. Since we perceive them as attractive, successful, and often likeable, we also tend to see them as intelligent, kind, and funny.

**Prejudice:** Preconceived opinion that is not based on reason or actual experience

# 6.9 SELFASSESSMENT QUESTIONS

- 1. Explain the different steps in the performance appraisal.
- 2. What are the major problems in performance appraisal?
- 3. Explain the ways to deal with the poor appraisal.

#### 6.10 REFERENCES

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| nployee Name:                                 | Department:   | <b>Evaluation Period:</b>                    | Type of Appraisal  |
|---|---|--|--------------------|
|   |   | to   | 6 Month            |
| assification:                                 | Working Ti  | tle:   | Annual             |
|   |   |  | Other              |
|   |   |  |                    |
|   | RATING C  | RITERIA                                      |                    |
| (5) Outstanding: requirements of the          |   | is area far exceeded expe                    | ctations and       |
| (4) Exceeds Expe                              | ctations: Accomplished                                | d more than expected.                        |                    |
| (3) Meets Expect expectations neces           | ations: Fully compete<br>ssary to further the Univers | ent; consistently meets rec<br>sity mission. | quirements and     |
| (2) Needs Improvement performance improvement | vement: Required signi                                | ficant amount of direction                   | n and supervision; |
| (1) Failed to Mee                             | et Expectations: Major im                             | provement is expected in                     | nmediately.        |
| PERFORMANCI                                   | E FACTORS   | 5 4  | 3 2 1              |
|   | _   |  |                    |
| PERFORMANC                                    | E GOALS:  |  |                    |
| Consider results ac                           | chieved against each perfor                           | mance objective.                             |                    |
|   |   |  |                    |
| MANAGEMENT                                    | RESPONSIBILITIES:                                     |  |                    |
| Consider ability to                           | effectively plan, delegate,                           | and utilize assigned reso                    | urces.             |
| PROFESSIONAI                                  | LEFFECTIVENESS:                                       |  |                    |
| Consider knowled                              | ge of assigned work includ                            | ing thoroughness, attention                  | on to detail, and  |
| accuracy. Also con                            | nsider any improvements r                             | nade in outcomes, progra                     | ms or processes.   |

| TIME MANAGEMENT:   |
|--|
| Consider productivity, efficiency, and timeliness in   |
| completing projects and meeting deadlines.   |
| COMMUNICATION:  Consider interaction with all levels of staff and management, collegiality, ability to develop collaborative relationships, and commitment to service.  Where applicable, consider writing or presentation skills.                       |
| PERSONAL DEVELOPMENT:  Consider commitment to personal and professional development.   |
| JOB KNOWLEDGE AND INITIATIVE:  Consider knowledge and skills required to achieve performance objectives; understanding of applicable policies and legislation; willingness to learn new skills, expand knowledge, and take on additional responsibility. |
| PLANNINGAND ORGANIZATION:  Consider ability to anticipate needs and plan, prioritize,  organize, and monitor work. Also consider attention to detail and follow-through.   |
| FOR MANAGEMENT AND SUPERVISORY POSITIONS ONLY  |
| LEADERSHIP/MANAGEMENT:  Consider ability to guide, motivate, develop, evaluate and train subordinates.   |
| STAFF DEVELOPMENT  Consider ability to hire and retain competent staff  and the commitment to staff's professional growth and development.   |

# **UNIT - 7: METHOD OF PERFORMANCE APPRAISAL**

# **Structure:**

- 7.0 Objectives
- 7.1 Introduction
- 7.2 Difference between the traditional and modern methods of performance Appraisal
- 7.3 Traditional methods of performance appraisal
- 7.4 Summary
- 7.5 Key words
- 7.6 Self assessment questions
- 7.7 References

# 7.0 OBJECTIVES

After reading this unit, you will be able to:

- describe various performance appraisal methods
- explain the traditional methods of performance appraisal

# 7.1 INTRODUCTION

There are traditional and modern methods of performance appraisal. Each method has certain advantages and disadvantages. You understand these methods once you go through each method of performance appraisal.

The following table exhibits various methods of performance appraisal.

| Traditional methods | Modern methods                    |
|---------------------|-----------------------------------|
| Ranking             | Management by Objectives(MBO)     |
| Paired Comparision  | Behaviorally anchored rated scale |
| Grading             | Assessment centre                 |
| Forced distribution | 360-degree appraisal              |
| Forced choice       | Cost accounting method            |
| Checklist           |                                   |
| Critical instance   |                                   |
| Graphic scale       |                                   |
| Essay method        |                                   |
| Field review        |                                   |
| Confidential report |                                   |

# 7.2 DIFFERENCE BETWEEN TRADITIONALAND MODERN METHODS OF PERFORMANCE APPRAISALS

| Categories        | Traditional Appraisals                         | Modern, Systems<br>Appraisals              |
|-------------------|--|--|
| Guiding Values    | Individualistic, Control oriented, Documentary | Systematic, Developmental, Problem solving |
| Leadership Styles | Directional, Evaluative                        | Facilitative, Coaching                     |
| Frequency         | Occasional                                     | Frequent                                   |
| Formalities       | High   | Low  |
| Rewards           | Individualistic                                | Grouped, Organizational                    |

# 7.3 TRADITIONAL METHODS OF PERFORMANCE APPRAISAL

# 7.3.1 Graphic scale method

# **Example which explains the Graphic Rating Scales Method**

| Performance Trait           | Excellent | Good | Average | Fair | Poor |
|-----------------------------|-----------|------|---------|------|------|
| Attitude                    | 5         | 4    | 3       | 2    | 1    |
| Knowledge of Work           | 5         | 4    | 3       | 2    | 1    |
| Managerial Skills           | 5         | 4    | 3       | 2    | 1    |
| Team Work                   | 5         | 4    | 3       | 2    | 1    |
| Honesty                     | 5         | 4    | 3       | 2    | 1    |
| Regularity                  | 5         | 4    | 3       | 2    | 1    |
| Accountability              | 5         | 4    | 3       | 2    | 1    |
| Interpersonal relationships | 5         | 4    | 3       | 2    | 1    |
| Creativity                  | 5         | 4    | 3       | 2    | 1    |
| Discipline                  | 5         | 4    | 3       | 2    | 1    |

This is the very popular, traditional method of performance appraisal. Under this method, core traits of employee pertaining to his job are carefully defined like Attitude, Knowledge of Work, Managerial Skills, Team Work, Honesty, Regularity, Accountability, Interpersonal relationships, Creativity and Discipline etc. These traits are allotted with numerical scale to tabulate the scores gained by appraisee (employee) in performance assessment relating to his job by appraiser (employer) and sum-up to determine the best performer. Appraiser ticks rating of particular trait depending upon his endeavor in his job. Score vary from employee to employee depending up on his performance levels and endeavor in his job.

This method is popular because it is simple and does not require any writing ability. The method is easy to understand and use. Comparison among pairs is possible. This is necessary for decision on salary increases, promotion, etc.

Companies like *DELL*, Maruthi Suzuki India Ltd and airtel are using this graphic rating scale method to appraise performance of their employees in their jobs and to take decisions regarding the matters concerned to employees

# 7.3.2 Alternative ranking method

How do we use the ranking method? Under the ranking method, the manager compares an employee to other similar employees, rather than to a standard measurement. An offshoot of ranking is the forced distribution method, which is similar to grading on a curve. Predetermined percentages of employees are placed in various performance categories, for example, excellent, above average, average, below average, and poor. The employees ranked in the top group usually get the rewards (raise, bonus, promotion), those not at the top tend to have the reward withheld, and those at the bottom sometimes get punished. In Self-Assessment and Skill Builder 8-1, you are asked to rank the performance of your peers.

Why and when do we use the ranking method? Managers have to make evaluative decisions, such as who is the employee of the month, who gets a raise or promotion, and who gets laid off. So when we have to make evaluative decisions, we generally have to use ranking. However, our ranking can, and when possible should, be based on other methods and forms. Ranking can also be used for developmental purposes by letting employees know where they stand in comparison to their peers—they can be motivated to improve performance. For example, when one of the authors passes back exams, he places the grade distribution on the board. It does not in any way affect the current grades—but it lets students know where they stand, and he does it to motivate improvement.

#### 7.3.3 Paired Comparison method

A better technique of comparison than the straight ranking method, this method compares each employee with all others in the group, one at a time. After all the comparisons on the basis of the overall comparisons, the employees are given the final rankings.

#### 7.3.4 Critical instance method

This technique of performance appraisal was developed by Flanagan and Burns. The manager prepares lists of statements of very effective and ineffective behavior of an employee. These critical incidents or events represent the outstanding or poor behavior of employees on the job. The manager maintains logs on each employee, whereby he periodically records critical incidents of the workers behavior. At the end of the rating period, these recorded critical incidents are used in the evaluation of the workers' performance. An example of a good critical incident of a sales assistant is the following:

July 20 – The sales clerk patiently attended to the customers complaint. He is polite, prompt, enthusiastic in solving the customers' problem.

On the other hand the bad critical incident may appear as under:

July 20 – The sales assistant stayed 45 minutes over on his break during the busiest part of the day. He failed to answer the store manager's call thrice. He is lazy, negligent, stubborn and uninterested in work.

This method provides an objective basis for conducting a thorough discussion of an employee's performance. This method avoids recency bias (most recent incidents get too much emphasis). This method suffers however from the following limitations:

- Negative incidents may be more noticeable than positive incidents.
- The supervisors have a tendency to unload a series of complaints about incidents during an annual performance review session.
- It results in very close supervision which may not be liked by the employee.
- The recording of incidents may be a chore for the manager concerned, who may be too busy or forget to do it.

# 7.3.5 Confidential records

Confidential report system is well known method of performance appraisal system mostly being used by the Government organizations. In this method of appraising system, subordinate is observed by his superiors regarding his performance in the job and on his duties done. Thereafter Superior writes confidential report on his performance, mainly on

his behaviour in the organization and conduct and remarks if any. Confidential reports will be kept confidential and will not be revealed to anyone and finally confidential reports will be forwarded to the top management officials for taking decision against person on whom confidential report has made. Confidential reports are the main criteria for promoting or transferring of any employee mainly in the government sector. All governmental organizations example judiciary, police Department and other government departments in the India are using confidential reports method as a tool to know about the employee and to take any decision connecting to him.

# Procedure of confidential report system

The superiors who appraises their subordinates performance, behaviour and other key issues will be kept in the form of writing on paper, which is called as confidential report. Confidential report should not be sent openly on a paper, it must be kept in a sealed cover to send it to decision-making authorities. Only authorized persons are allowed to open the sealed covers which consist of confidential reports. Confidential reports shall not be handed over in loose sheets to the subordinates.

# Key factors assessed in Confidential Report writing

- ♦ Character and conduct of an employee
- ♦ Absenteeism of an employee
- ♦ Knowledge of an employee
- ♦ His nature and quality of work
- Punctuality of employee
- Unauthorised absenteeism or leave without permission
- Behaviour of an employee with colleagues, superiors and with public
- Ability of supervision and controlling
- ♦ His/her integrity and honesty
- If any complaints against employee

# 7.3.6 Essay method

This traditional form of appraisal, also known as "Free Form method" involves a description of the performance of an employee by his superior. The description is an evaluation of the performance of any individual based on the facts and often includes examples and evidences to support the information. A major drawback of the method is the inseparability of the bias of the evaluator.

Under this method, the rater is asked to express the strong as well as weak points of the employee's behavior. This technique is normally used with a combination of the graphic rating scale because the rater can elaborately present the scale by substantiating an explanation for his rating. While preparing the essay on the employee, the rater considers the following factors:

- Job knowledge and potential of the employee;
- Employee's understanding of the company's programmes, policies, objectives, etc.;
- The employee's relations with co-workers and superiors;
- The employee's general planning, organizing and controlling ability;
- The attitudes and perceptions of the employee, in general.

Essay evaluation is a non-quantitative technique. This method is advantageous in at least one sense, i.e., the essay provides a good deal of information about the employee and also reveals more about the evaluator. The essay evaluation method however, suffers from the following limitations:

- It is highly subjective; the supervisor may write a biased essay. The employees who are sycophants will be evaluated more favorably than other employees.
- Some evaluators may be poor in writing essays on employee performance. Others may be superficial in explanation and use flowery language which may not reflect the actual performance of the employee. It is very difficult to find effective writers nowadays.
- The appraiser is required to find time to prepare the essay. A busy appraiser may write the essay hurriedly without properly assessing the actual performance of the worker. On the other hand, appraiser takes a long time, this becomes uneconomical from the view point of the firm, because the time of the evaluator (supervisor) is costly.

#### 7.3.7 Behaviourally Anchored Rating Scales (BARS)

The problem of judgmental performance evaluation inherent in the traditional methods of performance evaluation led to some organizations to go for objective evaluation by developing a technique known as "Behaviourally Anchored Rating Scales (BARS)" around 1960s. BARS are descriptions of various degrees of behaviour with regard to a specific performance dimension.

It combines the benefits of narratives, critical incidents, and quan-tified ratings by anchoring a quantified scale with specific behavioural examples of good or poor performance.

The proponents of BARS claim that it offers better and more equitable appraisals than do the other techniques of performance appraisal we discussed so far.

# **Developing BARS typically involves five steps:**

# 1. Generating Critical Incidents:

Critical incidents (or say, behaviours) are those which are essential for the performance of the job effectively Persons who are knowledgeable of the job in question (jobholders and/ or supervisors) are asked to describe specific critical incidents of effective and ineffective performance. These critical incidents may be described in a few short sentences or phrases using the terminology.

# 2. Developing Performance Dimensions:

The critical incidents are then clustered into a smaller set of performance dimensions, usually five to ten. Each cluster, or say, dimension is then defined.

#### 3. Reallocating Incidents:

Various critical incidents are reallocated dimensions by another group of people who also know the job in question. Various critical incidents so reallocated to original dimensions are clustered into various categories, with each cluster showing similar critical incidents. Those critical incidents are retained which meet 50 to 80% of agreement with the cluster as classified in step 2.

#### 4. Scaling Incidents:

The same second group as in step 3 rates the behaviour described in each incident in terms of effectiveness or ineffectiveness on the appropriate dimension by using seven to nine points scale. Then, average effectiveness ratings for each incident are determined to decide which incidents will be included in the final anchored scales.

#### **5. Developing Final BARS Instrument:**

A subset of the incidents (usually six or seven per cluster) is used as a behavioral anchor for the final performance dimensions. Finally, a BARS instru-ment with vertical scales is drawn to be used for performance appraisal, as in Figure 27-5.

How BARS is developed can be exemplified with an example of grocery checkout clerks working in a large grocery chain.

A number of critical incidents involved in checking out of grocery can be clustered into seven performance dimensions:

#### 1. Knowledge and Judgment

- 2. Conscientiousness
- 3. Skill in Human Relations
- 4. Skill in Operation of Register
- 5. Skill in Bagging
- 6. Organizational Ability of Check stand Work
- 7. Skill in Monetary Transactions
- 8. Observational Ability

Now, a BARS for one of these performance dimensions, namely, "knowledge and judgment" can be developed, as in Figure 28-5. Notice how the typical BARS is behaviourally anchored with specific critical incidents.

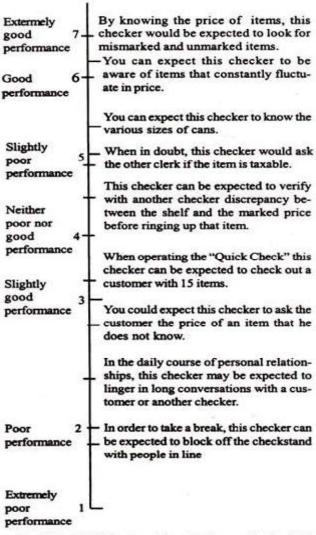


Fig. 28.5: BARS for Appraising of a Grocery Checker's Job

BARS method of performance appraisal is considered better than the traditional ones because it provides advantages like a more accurate gauge, clearer standards, better feedback, and consistency in evaluation. However, BARS is not free from limitations.

The research on BARS indicates that it too suffers from distortions inherent in most rating scales. The research study concluded that "it is clear that research on BARS to date does not support the high promise regarding scale independence In short, while BARS may outperform conventional rating techniques, it is clear that they are not a panacea for obtaining high interrater reliability"

#### 7.3.8 Assessment Centres:

The introduction of the concept of assessment centres as a method of performance method is traced back in 1930s in the Germany used to appraise its army officers. The concept gradually spread to the US and the UK in 1940s and to the Britain in 1960s.

The concept, then, traversed from the army to business arena during 1960s. The concept of assessment centre is, of course, of a recent origin in India. In India, Crompton Greaves, Eicher, Hindustan Lever and Modi Xerox have adopted this technique of performance evaluation.

In business field, assessment centres are mainly used for evaluating executive or supervisory potential. By definition, an assessment centre is a central location where managers come together to participate in well-designed simulated exercises. They are assessed by senior managers supple-mented by the psychologists and the HR specialists for 2-3 days.

Assesses is asked to participate in in-basket exercises, work groups, simulations, and role playing which are essential for successful performance of actual job. Having recorded the assesses behaviour the raters meet to discuss their pooled information and observations and, based on it, they give their assessment about the assesses. At the end of the process, feedback in terms of strengths and weaknesses is also provided to the assesses.

The distinct advantages the assessment centres provide include more accurate evaluation, mini-mum biasedness, right selection and promotion of executives, and so on. Nonetheless, the technique of assessment centres is also plagued by certain limitations and problems. The technique is relatively costly and time consuming, causes suffocation to the solid performers, discourages to the poor performers (rejected), breeds unhealthy competition among the assesses, and bears adverse effects on those not selected for assessment.

#### 7.4 SUMMARY

With the evolution and development of appraisal system, a number of methods or techniques of performance appraisal have been developed. The performance appraisal methods can be broadly categorize in two i.e., traditional and modern methods. Each method has its advantages and disadvantages. Organizations can use any one or more than one of these methods based on their necessities to assess the performance of their employees.

#### 7.5 KEY WORDS

- 1. Behaviourally anchored rating scale
- 2. Assessment centres
- 3. Critical incidence

#### 7.6 SELFASSESSMENT QUESTIONS

- 1. Explain the traditional methods of performance appraisal.
- 2. Distinguish between the traditional and modern methods of performance appraisal

#### 7.7 REFERENCES

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# UNIT- 8: MODERN METHODS OF PERFORMANCE APPRAISAL

# **Structure:**

- 8.0 Objectives
- 8.1 Introduction
- 8.2 Modern Techniques of performance appraisal
- 8.3 Emerging trends in performance appraisal system
- 8.4 Case study
- 8.5 Notes
- 8.6 Summary
- 8.7 Keywords
- 8.8 Self assessment questions
- 8.9 References

#### 8.0 OBJECTIVES

After studying this unit you should able to:

- explain the modern methods of performance appraisal
- analyse the emerging trends in performance appraisal system

#### 8.1 INTRODUCTION

In the previous unit you have studied the traditional methods of performance appraisal; in the present unit you will study the modern methods of performance appraisal. As industries and technology grows the expected skill to do the job also changes, as the skill requirement change the techniques of their performance appraisal have also changed. The modern methods of performance appraisal are more sophisticated and they able to satisfy the demands of the modern industry.

#### 8.2 MODERN TECHNIQUES OF PERFORMANCE APPRAISAL

#### 8.2.1 Management by Objectives (MBO)

Most of the traditional methods of performance appraisal are subject to the antagonistic judgments of the raters. It was to overcome this problem; Peter F. Drucker propounded a new concept, namely, management by objectives (MBO) way back in 1954 in his book "The Practice of management".

The concept of MBO as was conceived by Peter Drucker, can be described as a "process whereby the superior and subordinate managers of an organization jointly identify its common goals, define each individual's major areas of responsibility in terms of results expected of him and use these measures as guides for operating the unit and assessing the contribution of each its members".

In other words, stripped to its essentials, MBO requires the manager to goals with each employee and then periodically discuss his or her progress toward these goals.

In fact, MBO is not only a method of performance evaluation. It is viewed by the Practicing managers and pedagogues as a philosophy of managerial practice because .t .s a method by wh.ch managers and subordinates plan, organise, communicate, control and debate.

An MBO programme consists of four main steps: goal setting, performance standard, compari-son, and periodic review. In goal-setting, goals are set which each individual, s to attain. The superior and subordinate jointly establish these goals. The goals refer to the desired outcome to be achieved by each individual employee.

In performance standards, the standards are set for the employees as per the previously arranged time period. When the employees start performing their jobs, they come to know what is to be done, what has been done, and what remains to be done.

In the third step the actual level of goals attained are compared with the goals agreed upon. This enables the evaluator to find out the reasons variation between the actual and standard performance of the employees. Such a comparison helps devise training needs for increasing employees' performance it can also explore the conditions having their bearings on employees' performance but over which the employees have no control.

Finally, in the periodic review step, corrective measure is initiated when actual performance deviates from the slandered established in the first step-goal-setting stage. Consistent with the MBO philosophy periodic progress reviews are conducted in a constructive rather than punitive manner.

The purpose of conducting reviews is not to degrade the performer but to aid in his/her future performance. From a motivational point of view, this would be representative of McGregor's theories.

Present the MBO method of performance appraisal presently used by an engineering giant i.e., Larsen and Turbro Limited.

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| 1. | INNOVATIVENESS   | Ability to think new and better ways of doing<br>things that result in introduction of new ideas or<br>improvements of the systems and operations.  | OUTSTANDING  | V.GOOD   | COOD     | ADEQUATE   | INADEQUAIT   |
| 2. | INITIATIVE   | Ability to determine and initiate actions that<br>result in improved handiling of jobs, without<br>waiting to be told.  |  |          |          |  |  |
| 3. | INTERPERSONAL &<br>TEAM RELATIONSHIP   | Ability to interact effectively with people at<br>all levels to gain their confidence and respect<br>and work in a collaborative and participative<br>manner.   |  |          |          |  |  |
| 4. | RESOURCEFULNESS  | Ability to muster resources to achieve desired<br>results and devise ways and means of solving<br>problems in difficult situations.   |  |          |          |  |  |
| 5. | COMMUNICATION<br>SKILLS  | Ability to convey thoughts and feelings clearly<br>both through oral as well as written expres-<br>sions for better understanding.  |  |          |          |  |  |
|    | Specific role related attributes   | (Identified in the beginning of the year)   |  | _        |          | _  |  |
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Fig. 28.4: MBO Method of Performance Appraisal at Larsen and Toubro Limited

## Limitation of MBO:

MBO is not a panacea, cure for all organisational problems.

# As with other methods, it also suffers from some limitations as catalogued below:

# (i) Setting Un-measurable Objectives:

One of the problems MBO suffers from is unclear and un-measurable objectives set for attainment. An objective such as "will do a better job of training" is useless as it is un-measurable. Instead, "well have four subordinates promoted during the year" is a clear and measurable objective.

#### (ii) Time-consuming:

The activities involved in an MBO programme such as setting goals, measuring progress, and providing feedback can take a great deal of time.

# (iii) Tug of War:

Setting objectives with the subordinates sometimes turns into a tug of war in the sense that the manager pushes for higher quotas and the subordinates push for lower ones. As such, goals so set are likely to be unrealistic.

# (iv) Lack of Trust:

MBO is likely to be ineffective in an environment where management has little trust in its employees. Or say, management makes decisions autocratically and relies heavily on external controls.

#### 8.2.2 360 – Degree Appraisal

Yet another method used to appraise the employee's performance is 360 – degree appraisal. This method was first developed and formally used by General Electric Company of USA in 1992. Then, it travelled to other countries including India. In India, companies like Reliance Industries, Wipro Corporation, Infosys Technologies, Thermax, Thomas Cook etc., have been using this method for appraising the performance of their employees. This feedback based method is generally used for ascertaining training and development requirements, rather than for pay increases.

Under 360 – degree appraisal, performance information such as employee's skills, abilities and behaviours, is collected "all around" an employee, i.e., from his/her supervisors, subordinates, peers and even customers and clients.

In other worlds, in 360-degree feedback appraisal system, an employee is appraised by his supervisor, subordinates, peers, and customers with whom he interacts in the course of his job performance. All these appraisers provide information or feedback on an employee by completing survey questionnaires designed for this purpose.

All information so gathered is then compiled through the computerized system to prepare individualized reports. These reports are presented to me employees being rated.

They then meet me appraiser—be it one's superior, subordinates or peers—and share the information they feel as pertinent and useful for developing a self-improvement plan.

In 360 – degree feedback, performance appraisal being based on feedback "all around", an em-ployee is likely to be more correct and realistic. Nonetheless, like other traditional methods, this method is also subject to suffer from the subjectivity on the part of the appraiser. For example, while supervisor may penalise the employee by providing negative feedback, a peer, being influenced by 'give and take feeling' may give a rave review on his/her colleague.

# 8.2.3 Self appraisal

Employee self-appraisal, within a performance management or annual performance review system involves asking the employee to self-evaluate his or her job performance.

Typically, prior to meeting with an employee, the manager will ask the employee to complete an evaluation form on his or her own, to be used as a **basis for discussion** during the annual performance review meeting. Then at the meeting, the manager and employee discuss the self-appraisal results, and negotiate final evaluations based on both the manager's perceptions and those of the employee.

It's rare that self-appraisal or self evaluation results are used without discussion and negotiation and they should not be.

Actual self evaluations as part of performance management can take the form of evaluating progress towards pre-defined annual objectives and performance standards, involve the employee in <u>rating him or her self using the same rating form the manager uses</u>, or even involve self-ranking.

# 8.2.4 Computer performance appraisal

Computers have been playing an increasing role in PA for some time. There are two main aspects to this. The first is in relation to the electronic monitoring of performance, which affords the ability to record a huge amount of data on multiple dimensions of work performance. Not only does it facilitate a more continuous and detailed collection of performance data in some jobs, e.g. call centres, but it has the capacity to do so in a non-

obvious, covert manner. The second aspect is in mediating the feedback process, by recording and aggregating performance ratings and written observations and making the information available on-line; many software packages are available for this. The use of IT in these ways undoubtedly helps in making the appraisal process more manageable, especially where multiple rating sources are involved, but it also raises many questions about appraisees' reactions and possible effects on PA outcomes. Mostly, the evidence so far is positive.

#### 8.3 EMERGING TRENDS IN PERFORMANCE APPRAISAL SYSTEM

#### **Introduction:**

Performance appraisal system changes from time to time according to the needs and growth of an organization. The modern methods are based on emerging trends and scope for adaptability based on modernization and change in the attitude and employers' perception.

#### 8.3.1 Balanced score card

### Meaning

The Balanced Scorecard allows supervisors and managers to objectively analyze the employee's performance and contribution to the company. It prevents the problems associated with subjective evaluation by providing concrete metrics that can be applied equally to every employee.

#### Scope

One of the great advantages of the Balanced Scorecard management system is its tremendous versatility. It is easily adapted to any aspect of business management, and *employee evaluation* is no exception.

Balanced Scorecard in Employees Appraisal

This protects the company in two ways. First, it ensures that supervisors do not, deliberately or unconsciously, give more favorable evaluations to employees they enjoy working with. Second, it provides the company with demonstrable data that can be used to defend against discrimination or unfair labor practice lawsuits.

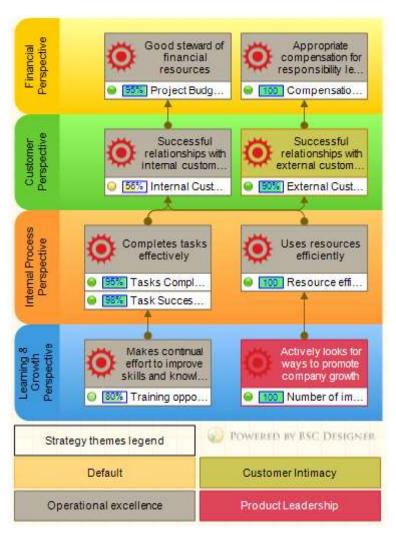
The Balanced Scorecard also provides managers with a more rounded view of each employee's role in the company.

• For example, how does one effectively evaluate a salesperson who is popular with his clients, but consistently far over budget in expenses?

♦ Likewise, how does one determine the business value of a department leader who is outstandingly efficient, but whose taskmaster mentality leads to a high employee turnover?

### Realistic view of employee contribution

The Balanced Scorecard allows you to select criteria in each of the four key perspectives – Financial, Customer, Internal Process, and Learning and Growth – to develop a realistic view of employee contribution. You will consider your employee requirements from each of the four business perspectives:



Fundamentally, your purpose is to determine whether the employee is doing everything possible to help the company succeed. Each of the perspectives evaluates how well the employee is doing in achieving that purpose in specific areas. Here are some commonly used examples of evaluation criteria and suggested measurements for each.

#### Financial:

- ♦ Good steward of financial resources: Percentage of projects completed within budget or the number of months their department operated within budget
- ♦ Appropriate compensation for responsibility level: Variance from company's historical salary for comparable position or variance from industry standard for comparable position

#### **Customer:**

Successful relationships with internal customers (coworkers, subordinates, superiors): Number of complaints received or number of positive responses on employee satisfaction surveys

Successful relationships with external customers (clients, vendors, business associates): Number of positive responses in satisfaction surveys for those customers employee interacts with

#### **Internal Processes:**

Completes tasks effectively: Percentage of projects completed by deadline or number of days operating without failure or injury

Uses resources efficiently: Waste-to-production ratio in department or by assigned project

#### **Learning and Growth:**

Makes continual effort to improve skills and knowledge: Number of training opportunities participated in

Actively looks for ways to promote company growth: Number of suggestions given to supervisor

Once you've obtained the data for each of these four areas, you can objectively analyze the employee's strengths and weaknesses. Each employee will have areas of excellence and areas where they could improve. For example, the taskmaster will have high scores in Internal Process criteria, but low scores in Customer criteria. You can then recommend actions that this employee should take as an objective activity rather than as a personal criticism. This increases the chance that the suggestion will be acted upon. It is the difference between telling the employee, "Your subordinates think you're too hard on them," and "Your Customer perspective isn't performing as well as it should."

# Weight of the performance indicator

Weighting is especially helpful for employee evaluation because it allows you to customize the same scorecard to various positions within your company.

• For example, positive relationships with external customers should carry extra weight in your sales team's evaluations, but completing tasks on time and without injury would be more heavily weighted in your logistics team.

By applying weights accordingly, you can build your scorecard to encourage expertise in the areas essential to each employee's work requirements.

One of the most important principles of balanced scorecard use is open communication both up the company hierarchy and down.

You should also use the four perspectives to give your employee the opportunity to evaluate his relationship with the company.

# **Employee's perception**

The employee's perception plays a significant role in the level of effort he or she will readily commit to. You can increase the possibility that the employee will take decisive action to improve his scores if you take time to ensure the employee's concerns are acknowledged and where possible, addressed. Employee perceptions can typically be obtained using a simple survey as part of the evaluation process.

#### Financial:

- ♦ Compensation: Does the employee feel his or her compensation is appropriate for the amount of work required?
- Access to financial resources: Does the employee feel his or her budget is realistic?

#### **Customer:**

- Relationship with internal customers: Does the employee feel he or she has a good relationship with coworkers, subordinates and supervisors?
- Relationship with external customers: Does the employee feel he or she has a good relationship with external customers?

#### **Internal Processes:**

♦ Workload: Does the employee feel the number of tasks assigned is reasonable for his normal work schedule? (i.e. 40 hours)

- ♦ **Process participation:** Does the employee feel he has enough control over the processes involved in the tasks required for his job?
- Resource availability: Does the employee feel the company is providing the resources needed to effectively do the work required?

## **Learning and Growth:**

- ♦ **Personal Growth Opportunities:** Does the employee feel he has opportunities to increase his skills and advance in the company?
- ♦ Company Growth Involvement: Does the employee feel he directly contributes to the company's success and that his or her suggestions are taken seriously?

By applying the Balanced Scorecard to employee evaluations, you can objectively analyze whether each employee is making consistent progress toward becoming an essential part of your company. You will have the data you need to improve your employees' performance and ultimately, ensure your success.

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#### **Customer:**

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- ♦ Relationship with external customers: Does the employee feel he or she has a good relationship with external customers?

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#### Automation with KPI software

Let's review an example of how this appraisal can be automated with BSC Designer software. In the appraisal form we have:

• Current pay: Rs.40,000

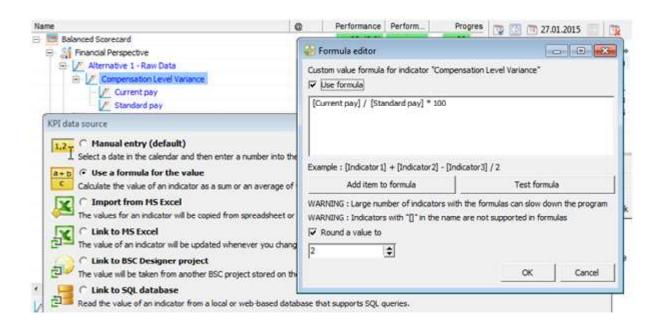
Standard pay: Rs.39,500

Variance (current / standard) = 1.01

## Making raw calculations in the software

The first approach (not the best one) is to copy the calculation model that we have in the appraisal form to the software.

- I'm creating "Compensation Level Variance" indicator, and add inside two more indicators "Current pay" with the value Rs.40,000 and "Standard pay" with the value Rs.39,5000.
- Then I'm changing the container's value to the "self-standing," and selecting to use "Formula" as a data source, and using the this formula: [Current pay] / [Standard pay].



Now the calculated value of the container is 1.01 (101%). You can find it in the "Financial Perspective -> Alternative 1 - Raw Data" in the sample project.

## Using performance calculation functions

The example above is not the best way to use the software, instead we can create an indicator: "Compensation Level Variance" and simply put "39,500" in the *target* field, and 40,000 in the *value* field.



The software will automatically calculate your current performance as 101%. In the sample project you'll find it in "Financial Perspective > "Alternative 2-KPI"

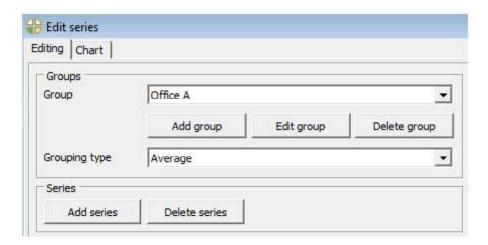
## Appraisal data series automation

Another aspect where automation software can help is working with a data series. Let's say you have created your own appraisal scorecard that looks like this:

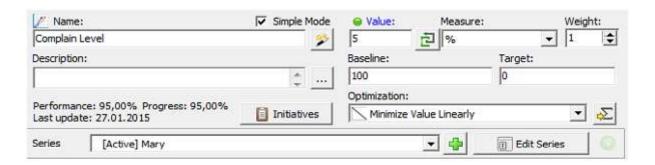


Now, let's select "Financial Performance" and change its data source to "Data series."

We'll create a new appraisal group (for example "Office A"). I'll need an average performance figures, so I'm choosing "average" as a grouping type. To finalize setup process I'll add there several data series (one for each of the employees).



Data series panel will be displayed in the software. It allows you to enter performance data for each employee. I'm selecting in the list an employee and entering his/her performance data.



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Some users prefer to enter data directly into the data table:

The program keeps all the data and calculates the average performance for the "Office A." In the same way we can fill in the data for other indicators.

The scorecard that we have in the end:

Group result

- Contains appraisal data for each employee
- ♦ Average performance figures for each appraisal indicator used

84

♦ The total performance index

## 8.3.2 Team Based Appraisal

Performance appraisals, whether team or individual, provide feedback to workers or organizational teams. Traditionally, performance evaluations provide information to help improve performance, increase efficiency and define management's expectations. Performance appraisals compare work performed against measurable objectives that the employee and supervisor agreed to at the beginning of the appraisal period. As work has become more team oriented, performance appraisals now measure how a team of workers perform rather than just how an individual performs his job.

## **Definition of Team Performance Appraisals**

As jobs become more intricate, organizations must rely on teams of people to accomplish tasks. To evaluate job performance by teams of people, organizations institute team performance appraisals. Team performance appraisals assess the performance of teamwork on organizational performance. Team performance appraisals can range from

recognition of individual performance and its contribution to group outcomes to only an assessment of the organization's performance. When only an organization's performance is evaluated, no individual appraisals are completed and individuals do not receive performance ratings.

## **Types of Team Performance Appraisals**

The culture and organizational structure of the workplace environment influence the type of team performance appraisal best suited to evaluate and measure performance. If work teams exist in the organization, but are used only occasionally to accomplish projects, individual performance measurements are used to determine a final rating of the employee. When an organization uses teamwork more frequently, performance appraisals still emphasize individual performance but introduce an assessment of the worker's contribution to the team effort. If an organization uses a significant amount of teamwork to accomplish its objectives, team performance appraisals link team productivity measurements with individual performance measurements. Organization's with only a team approach do not utilize individual performance appraisals. Team performance measurements determine monetary rewards.

## **Elements of Individual Performance Appraisals**

Individual performance appraisals are the traditional appraisals that measure individual performance against measurable objectives. Individual performance appraisals provide an opportunity for employees and supervisors to share ideas and reach mutually agreed upon objectives. Individual performance appraisals focus on the skills required to perform the current job and skills that must be acquired for promotion. Individual performance evaluations are tools to determine monetary compensation. This type of performance appraisal provides feedback and recognition to the individual.

## Comparison of Individual and Team Performance Appraisals

Individual performance appraisals measure an employee's work against standard performance measures. Standard performance measures are derived from individual job descriptions. Often, a direct link exists between performance and pay based on an employee's job rating from the appraisal. Team performance appraisals assess an individual's contribution to the team. Team performance appraisals are appropriate to support an organization's efforts to transition from an individual-based organization to an team-based organization. Team performance appraisal, for example, assess whether the team met its goals, produced a quality product and worked well together.

List of journals, News papers, magazines pertaining to this topic Group decisions: Theories

## Books:

- 1. A Cognitive Approach to Performance Appraisal: A Program of Research By Angelo S. DeNisi
- 2. Cognitive Psychology Applied By Chizuko Izawa Lawrence Erlbaum Associates, 1993
- 3. An Introduction to Applied Cognitive PsychologyBy Anthony Esgate; David Groome; Kavin Baker; David Heathcote; Richard Kemp; Mora Maguire; Corriene ReedPsychology Press, 2005
- 4. Cognitive Psychology: An Overview for Cognitive ScientistsBy Lawrence W. BarsalouLawrence Erlbaum Associates, 1992
- 5. Cognitive Psychology Applied Chizuko Izawa Publisher: Lawrence Erlbaum Associates, 1993
- 6. An Introduction to Applied Cognitive Psychology

Contributors: Anthony EsgateDavid GroomeKavin BakerDavid

Publisher: Psychology Press, 2005

7. Cognitive Psychology: An Overview for Cognitive Scientists

Contributors: Lawrence W. Barsalou

Publisher: Lawrence Erlbaum Associates, 1992

For journals, books, news papers and magazines please refe to the following web:

Source: https://www.questia.com/library/107675712/a-cognitive-approach-to-performance.

#### 8.4 CASE STUDY

## Performance Appraisal Implementation Problems at Albion Drinks

## **Background**

Albion Drinks is a manufacturer of its own-brand soft drinks which are sold in grocery stores and supermarkets across the UK, and the company also provides private-label products to the major supermarket chains. It is part of a larger parent organisation which manufactures a wide range of products across the whole fast-moving consumer goods (FMCG) spectrum. Its main manufacturing base (which is also its head office) is located in the North West of England. At its main location, the company employs around 1,200 staff of whom 1,000 are factory-based production operatives, with a further 200 based in the head office, undertaking

support activities including finance, marketing, sales, product development, human resources and logistics.

Trade Union membership within the factory is high (almost 100%) although only 25% of the head office employees are in a Trade Union. Two different Trade Unions represent the two separate groups of employees. The Employee Relations climate is generally good, although factory-based employees have traditionally been resistant to change, and are often slow to adopt new working practices.

#### The New HR Director

The company recently appointed a new HR Director following the retirement of his predecessor who had been in post for approximately 20 years. The newly-appointed HR Director did not come from a traditional HR background, but rather from production management in one of Albion's sister companies. Staff generally believed that he had been appointed with a brief to generally "shake things up a bit."

## "Just something that we can use immediately"

Upon appointment, one of the first activities of the new HRD was to task the Head Office HR Manager with the responsibility of introducing an appraisal system for all employees in the Head Office. His brief - or rather his instruction - to the HR Manager was to establish contact with the HR Director in one of Albion's sister companies and simply lift their existing appraisal process and introduce it within Albion's Head Office. "We don't want anything fancy or best practice; just something that we can use immediately with the minimum of cost and fuss" was his stated recommendation.

The HR Manager followed his boss's instructions and obtained copies of the relevant paperwork which was rather more complicated that he had expected, particularly as the appraisal system in the sister company not only contained annual assessment against the year's objectives, but also an evaluation of each employee's performance in key competency areas which seemed appropriate within the sister company, but somewhat alien to Albion Drinks.

Albion's sister division had not only trained its managers, but had also produced a comprehensive "How To Undertake An Employee Appraisal" guide. The HR Director therefore decided to save valuable time and money, and circulated copies of the training material in November to all appraising managers, along with copies of the relevant paperwork, with the instruction that all employees were to have received an appraisal by the end of December, by which date all documentation was to have been returned to the HR department. "These guys are experienced managers," said the HR Director, "so they shouldn't need any training in how to conduct an appraisal, should they?"

## The problems begin

The first murmurings of dissent started almost immediately when some of the Head Office managers raised questions over who they were supposed to be appraising. Certain departments had a shared resource pool of secretaries and administrative staff, and it had never been made clear who reported to whom, so there was confusion over who exactly was the appraising manager for some employees. In a few departments it was evident that managers and supervisors were using the lack of clarity as a way to evade responsibility for undertaking appraisals.

It wasn't too long after this that managers raised their concern over the terminology in the key competencies section of the appraisal documentation, particularly one area that required them to assess the "Innovation and Creativity" of their subordinates. One manager commented, "I pay my staff to come to work and make sure that the books balance at the end of the month. Whether or not they are innovative or creative has got nothing to do with the job."

Issues took a further negative turn when representatives from both Trade Union groups (i.e. both the Head Office Trade Union and the one representing factory-based staff) requested to see the HR Manager. The TU official representing the factory staff made his view perfectly clear by stating, "You might think that you can force something like this on the guys in the Head Office, but there's no way that my members in the factory will agree to have such a shoddy process imposed on them. I'll be instructing them to refuse to co-operate if you introduce something like this without consulting with the shop stewards."

The HR Manager raised his concerns with his boss the HR Director, who suggested that they let events take their course, as he was certain that at least in the Head Office the majority of managers would comply with the requirement to have all appraisals completed by the end of the year.

## The New Year

The HR Manager left it until after the Christmas and New Year break before he counted the returned appraisal paperwork. Less than 45% had been returned.

Early in the New Year the HR Director and HR Manager sat down to review events. "Where did we go wrong and how could we have managed this better?" was his question.

## How do you believe the HR Manager should have responded?

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| 8.5         | NOTES                                   |         |
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#### 8.6 SUMMARY

Formal performance appraisal has become a widespread instrument of human resource management. Performance appraisal is a measurement of how well someone performs jobrelevant tasks. These measurements can serve different organisational purposes, but the most common goal is to improve or sustain performance levels by eliciting behavioural change. The underlying assumption with regard to this tool is thus that it is able to raise the performance of a whole organisation by raising the individual performance of each employee. But what became apparent is that in practice very often performance appraisal does not fulfil its promised benefits. Reason for this lack of effectiveness was found to be lacking support by the users of the system. It became clear that their acceptance and thus their perceptions of the performance appraisal determine if the money and time spend on development and implementation was good invested or just wasted. Performance Management system is now widely recognized as a significant vehicle for improving performance and productivity of both employees and organizations. Therefore many organizations are reexamining their current performance management systems. This research evaluates the efficacy of current performance appraisal systems and then identifies the significance and implications of the introduction of 360 degree feedback as a form of appraisal and its impact on the productivity of employees. The ranking method and management by objectives are the two most commonly used appraisal systems in the industry, but a strong preference has been observed for implementation of the 360 degree feedback system.

#### 8.7 KEY WORDS

- Quality and quantity of work: accuracy, thoroughness, productivity and goal attainment
- Communication and interpersonal skills: teamwork, cooperation, listening, persuasion and empathy
- **Planning, administration and organization**: goal setting, prioritizing and profit orientation
- Leadership: accessibility, responsiveness, decisiveness, collaboration and delegating
- **Job knowledge and expertise**: knowledge base, training, mentoring, modeling and researching
- **Attitude**: dedication, loyalty, reliability, flexibility, initiative, energy and volunteering

- Ethics: diversity, sustainability, honesty, integrity, fairness and professionalism
- Creative thinking: innovation, receptiveness, problem solving and originality
- **Self-development and growth**: learning, education, advancement, skill building and career planning.

## **Establishing performance standards**

The first step in the process of performance appraisal is the setting up of the standards which will be used to as the base to compare the actual performance of the employees. Management by Objectives (MBO). MBO requires the manager to goals with each employee and then periodically discuss his or her progress toward these goals.

## 360 – Degree Appraisal:

Performance information such as employee's skills, abilities and behaviours, is collected "all around" an employee, i.e., from his/her supervisors, subordinates, peers and even customers and clients.

## Self appraisal

Employee self-appraisal, within a performance management or annual performance review system involves asking the employee to self-evaluate his or her job performance

## Computer performance appraisal

Which affords the ability to record a huge amount of data on multiple dimensions of work performance.

## **Balanced score card**

The Balanced Scorecard allows supervisors and managers to objectively analyze the employee's performance and contribution to the company. It prevents the problems associated with subjective evaluation by providing concrete metrics that can be applied equally to every employee.

#### TEAM BASED APPRAISAL

Team performance appraisals assess the performance of teamwork on organizational performance.

## 8.8 SELFASSESSMENT QUESTIONS

- 1. Explain the modern techniques of performance appraisal
- 2. Explain emerging trends in performance appraisal
- 3. What is MBO? What are its limitations

## **8.9 REFERENCES**

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## MUKTHAGANGOTHRI, MYSURU-570 006.

## DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

## M.B.A III Semester

## COURSE - 18 C

# COMPENSATION MANAGEMENT AND PERFORMANCE APPRAISAL

## **BLOCK**

3

# WAGE PAYMENT SYSTEM, THEORIES OF MOTIVATION AND WAGES

| UNIT - 9                                 |       |
|--|-------|
| DEVELOPMENT OF PAYMENT SYSTEM OF INDIA   | 01-15 |
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# BLOCK-3: WAGE PAYMENT SYSTEM AND THEORIES OF MOTIVATION AND WAGES

The block deals wage payment system, theories of motivation and wages, which is divided in four units.

Unit-9 is concerned with dvelopment of payment system in India. At the beginning, the unit discusses development of payment system in India. The Techonology adoption in compenstation system can ease the process, thus the unit discussed electronic payment and settlement system in India , electronic clearing services. The unit also throughs light on credit and debit cards, real time settlement, NEFT and channels of E-Payment and role of the RBI in encouraging E-Payments.

Unit-10 is concerned with compensation types. At the outset it defines compensation, types and components of compensation, and non monetary benefit. Further, the unit discuses types of compensation; direct and indirect compensation. The unit also focusses on factors to be considered in deciding compensation.

Unit-11 focusses on theories of motivation. While fixing compensation the manager should have the knowledge various factor which influences on motivation. Thus, the theories of motivation helps manager to understand various factors which motivate employees. This unit discusses the concept of motivation and theories of motivation.

Unit-12 is concerned with theories of wage. Initially the unit provides the meaning , types and concept of wage; then it continous by discussing on importance of wage payment system, essential characteristics of good wage payment system. Further, the unit focusses determination of wages and salary structure and wage structure in India . The unit also focusses wage theories.

## UNIT-9: DEVELOPMENT OF PAYMENT SYSTEM IN INDIA

## **Structure:**

- 9.0 Objectives
- 9.1 Introduction
- 9.2 Development of payment system in India
- 9.3 Electronic payment and settlement system in India
- 9.4 Electronic Clearing Services (ECS Credit)
- 9.5 Electronic Clearing Services (ECS Debit)
- 9.6 Credit Cards and debit cards
- 9. 7 Real Time Gross Settlement
- 9.8 National Electronic funds transfer (NEFT)
- 9.9 Channels of E-payments
- 9.10 Role of the RBI in encouraging E-payments
- 9.11 Case Study
- 9.12 Notes
- 9.13 Summary
- 9.14 Keywords
- 9.15 Self assessment questions
- 9.13 References

## 9.0 OBJECTIVES

After reading this unit, you should be able to:

- trace out the development of payment system in India
- explain the different payment systems
- examine the role of RBI

## 9.1 INTRODUCTION

Payment and settlement systems in India are regulated by the Payment and Settlement Systems Act, 2007 (PSS Act), legislated in December 2007. The Reserve Bank of India continually strives towards ensuring the smooth progress of the payments system. In India it is the BPSS (Board for Regulation of Payment and Settlement Systems) which is in charge of regulating these systems. India has multiple payments and settlement systems. RBI Still continues to evolve new payment methods and slowly revamping the payments and settlement capability in India. India supports a variety of electronic payments and settlement system, both Gross as well as Net settlement systems.

## 9.2 DEVELOPMENT OF PAYMENT SYSTEM IN INDIA

The different payment systems evolved over the period are;

## a. The Gross systems is

• Real Time Gross Settlement (RTGS)

## b. The Net settlement systems are;

- ECS Credit
- ECS debit
- Credit cards and Debit cards
- National Electronic Fund Transfer (NEFT)
- Indo-Nepal Remittance Facility Scheme
- Immediate Payment Service

## 9.3 ELECTRONIC PAYMENT AND SETTLEMENT SYSTEM IN INDIA

The Reserve Bank of India is doing its best to encourage alternative methods of payments which will bring security and efficiency to the payments system and make the whole process easier for banks. The Indian banking sector has been growing successfully, innovating and trying to adopt and implement electronic payments to enhance the banking system. Though the Indian payment systems have always been dominated by paper-based transactions, e-payments are not far behind. Ever since the introduction of e-payments in India, the banking sector has witnessed growth like never before.

According to a survey by **Celent**, the ratio of e-payments to paper based transactions has considerably increased between 2004 and 2008. This has happened as a result of advances in technology and increasing consumer awareness of the ease and efficiency of internet and mobile transactions.

In the case of India, the RBI has played a pivotal role in facilitating e-payments by making it compulsory for banks to route high value transactions through Real Time Gross Settlement (RTGS) and also by introducing NEFT (National Electronic Funds Transfer) and NECS (National Electronic Clearing Services) which has encouraged individuals and businesses to switch to electronic methods of payment. With the changing times and technology so have changed the methods of payments in India. E-payments in India have been growing at a fast rate of 60% over the last 3 years.

In India 'plastics' have been fast over-taking 'papers'. With 130 million cards in circulation currently, both credit and debit, and an increasing consumer base with disposable income, India is clearly one of the fastest growing countries for payment cards in the Asia-Pacific region. Behaviourial patterns of Indian customers are also likely to be influenced by their internet accessibility and usage, which currently is about 32 million PC users, 68% of whom have access to the net. However these statistical indications are far from the reality where customers still prefer to pay "in line" rather than online, with 63% payments still being made in cash. E-payments have to be continuously promoted showing consumers the various routes through which they can make these payments like ATM's, the internet, mobile phones and drop boxes.

Due to the efforts of the RBI and the BPSS now over 75% of all transaction volume are in the electronic mode, including both large-value and retail payments. Out of this 75%, 98% come from the RTGS (large-value payments) whereas a meagre 2% come from retail payments. This means consumers have not yet accepted this as a regular means of paying their bills and still prefer conventional methods. Retail payments if made via electronic modes are done by ECS (debit and credit), EFT and card payments.

## 9.4 ELECTRONIC CLEARING SERVICES (ECS CREDIT)

Known as "Credit-push" facility or one-to-many facility this method is used mainly for large-value or bulk payments where the receiver's account is credited with the payment from the institution making the payment. Such payments are made on a timely-basis like a year, half a year, etc. and used to pay salaries, dividends or commissions. Over time it has become one of the most convenient methods of making large payments.

## 9.5 ELECTRONIC CLEARING SERVICES (ECS DEBIT)

Known as many-to-one or "debit-pull" facility this method is used mainly for small value payments from consumers/individuals to big organizations or companies. It eliminates the need for paper and instead makes the payment through banks/corporate or government departments. It facilitates individual payments like telephone bills, electricity bills, online and card payments and insurance payments.

#### 9.6 CREDIT CARDS AND DEBIT CARDS

As mentioned above India is one of the fastest growing countries in the plastic money segment. Already there are 130 million cards in circulation, which is likely to increase at a very fast pace due to rampant consumerism. India's card market has been recording a growth rate of 30% in the last 5 years. Card payments form an integral part of e-payments in India because customers make many payments on their card-paying their bills, transferring funds and shopping.

Ever since Debit cards entered India, in 1998 they have been growing in number and today they consist of nearly 3/4<sup>th</sup> of the total number of cards in circulation.

Credit cards have shown a relatively slower growth even though they entered the market one decade before debit cards. Only in the last 5 years has there been an impressive growth in the number of credit cards- by 74.3% between 2004 and 2008. It is expected to grow at a rate of about 60% considering levels of employment and disposable income. Majority of credit card purchases come from expenses on jewellery, dining and shopping.

Another recent innovation in the field of plastic money is co branded credit cards, which combine many services into one card-where banks and other retail stores, airlines, telecom companies enter into business partnerships. This increases the utility of these cards and hence they are used not only in ATM's but also at Point of sale (POS) terminals and while making payments on the net.

## 9.7 REAL-TIME GROSS SETTLEMENT

The acronym 'RTGS' stands for real time gross settlement. The Reserve Bank of India (India's Central Bank) maintains this payment network. Real Time Gross Settlement is a funds transfer mechanism where transfer of money takes place from one bank to another on a 'real time' and on 'gross' basis. This is the fastest possible money transfer system through the banking channel. Settlement in 'real time' means payment transaction is not subjected to any waiting period. The transactions are settled as soon as they are processed. 'Gross settlement' means the transaction is settled on one to one basis without bunching with any other transaction. Considering that money transfer takes place in the books of the Reserve Bank of India, the payment is taken as final and irrevocable.

Fees for RTGS vary from bank to bank. RBI has prescribed upper limit for the fees which can be charged by all banks both for NEFT and RTGS. Both the remitting and receiving must have core banking in place to enter into RTGS transactions. Core Banking enabled banks and branches are assigned an Indian Financial System Code (IFSC) for RTGS and NEFT purposes. This is an eleven digit alphanumeric code and unique to each branch of bank. The first four letters indicate the identity of the bank and remaining seven numerals indicate a single branch. This code is provided on the cheque books, which are required for transactions along with recipient's account number.

RTGS is a large value (minimum value of transaction should be <sup>1</sup> 2,00,000) funds transfer system whereby financial intermediaries can settle interbank transfers for their own account as well as for their customers. The system effects final settlement of interbank funds transfers on a continuous, transaction-by-transaction basis throughout the processing day. Customers can access the RTGS facility between 9 am to 4:30 pm (Interbank up to 6:30 pm) on weekdays and 9 am to 2:00 pm (Interbank up to 3:00 pm) on Saturdays. However, the timings that the banks follow may vary depending on the bank branch. Time Varying Charges has been introduced w.e.f. 1 October 2011 by RBI. The basic purpose of RTGS is to facilitate the transactions which need immediate access for the completion of the transaction.

Banks could use balances maintained under the cash reserve ratio (CRR) and the intraday liquidity (IDL) to be supplied by the central bank, for meeting any eventuality arising out of the real time gross settlement (RTGS). The RBI fixed the IDL limit for banks to three times their net owned fund (NOF).

The IDL will be charged at <sup>1</sup> 25 per transaction entered into by the bank on the RTGS platform. The marketable securities and treasury bills will have to be placed as collateral with a margin of five per cent. However, the apex bank will also impose severe penalties if the IDL is not paid back at the end of the day.

The RTGS service window for customer's transactions is available from 8:00 hours to 19:00 hours on week days and from 8:00 hours to 13:00 hours on Saturdays.

No Transaction on weekly holidays and public holidays.

## **Service Charge for RTGS**

- a) Inward transactions no charge to be levied.
- b) Outward transactions For transactions of <sup>1</sup>2 lakhs to <sup>1</sup>5 lakhs -up to <sup>1</sup>25 per transaction plus applicable Time Varying Charges (<sup>1</sup> 1/- to <sup>1</sup> 5/-); total not exceeding <sup>1</sup> 30 per transaction, (+ Service Tax).

Above <sup>1</sup> 5 lakhs - <sup>1</sup> 50 per transaction plus applicable Time Varying Charges (<sup>1</sup> 1/- to <sup>1</sup> 5/-); total charges not exceeding <sup>1</sup> 55 per transaction, (+ Service Tax).

No time varying charges are applicable for RTGS transactions settled up to 1300 hrs.

## 9.8 NATIONAL ELECTRONIC FUNDS TRANSFER (NEFT)

Started in Nov. 2005, the National Electronic Fund Transfer (NEFT) system is a nationwide system that facilitates individuals, firms and corporate to electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country. It is done via electronic messages. Even though it is not on real time basis like RTGS (Real Time Gross Settlement), hourly batches are run in order to speed up the transactions.

For being part of the NEFT funds transfer network, a bank branch has to be NEFT-enabled. NEFT has gained popularity due to it saving on time and the ease with which the transactions can be concluded. As at end-January 2011, 74,680 branches / offices of 101 banks in the country (out of around 82,400 bank branches) are NEFT-enabled. Steps are being taken to further widen the coverage both in terms of banks and branches offices.

## Comparison

The key difference between RTGS and NEFT is that while RTGS is on gross settlement basis, NEFT is on net settlement basis. Besides, RTGS facilitates real-time ("push") transfer, while NEFT involves twelve settlements from 8 am to 7 pm on week days and six settlements from 8 am to 1 pm on Saturdays. Customers can access the RTGS facility between 9 am to 4:30 pm on weekdays and 9 am to 1:30 pm on Saturday. Thus if a customer has given instruction to its bank to transfer money through NEFT to another bank in the morning hours, money would be transferred the same day, but if the instruction is given much later during the day, money may be transferred next day.

RTGS facility is available in over 1,13,000 branches across India, while NEFT is available in little over 1,15,000 branches of a 100 banks.

## 9.9 CHANNELS OF E-PAYMENTS

In their effort to enable customers to make payments the electronic way banks have developed many channels of payments viz. the internet, mobiles, ATM's (Automated Teller Machines) and drop boxes.

The internet as a channel of payment is one of the most popular especially among the youth. Debit and credit payments are made by customers on various bank's websites for small purchases, (retail payments) and retail transfers (ATM transfers).

ATM's serve many other purposes, apart from functioning as terminals for withdrawals and balance inquiries, such as payment of bills through ATM's, applications for cheques books and loans can also be made via ATM's.

Banks also provide telephone and mobile banking facilities. Through call agents payments can be made and as the number of telephone and mobile subscribers are expected to rise, so is this channel of payment expected to gain popularity.

Drop boxes provide a solution to those who have no access to the internet or to a telephone or mobile. These drop-boxes are kept in the premises of banks and the customers can drop their bills along with the bill payment slips in these boxes to be collected by third party agents.

#### 9.10 ROLE OF THE RBI IN ENCOURAGING E-PAYMENTS

As the apex financial and regulatory institution in the country it is compulsory for the RBI to ensure that the payments system in the country is as technologically advanced as possible and in view of this aim, the RBI has taken several initiatives to strengthen the e-payments system in India and encourage people to adopt it.

- ♦ The Payment and Settlement Systems Act, 2007 was a major step in this direction. It enables the RBI to "regulate, supervise and lay down policies involving payment and settlement space in India." Apart from some basic instructions to banks as to the personal and confidential nature of customer payments, supervising the timely payment and settlement of all transactions, the RBI has actively encouraged all banks and consumers to embrace e-payments.
- In pursuit of the above-mentioned goal the RBI has granted NBFC's (Non-Banking Financial Companies) the permission to issue co branded credit cards forming partnerships with commercial banks.

- ♦ The Kisan Credit Card Scheme was launched by NABARD in order to meet the credit needs of farmers, so that they can be free of paper money hassles and use only plastic money.
- A domestic card scheme known as RuPay has recently been started by the National Payments Corporation of India (NPCI), promoted by RBI and Indian Banks Association (IBA), inspired by Union pay in China, which will be promoting the use of cards ie. "plastic money". Initially functioning as an NPO, Rupay will focus on potential customers from rural and semi-urban areas of India. Rupay will have a much wider coverage than Visa, MasterCard or American Express cards which have always been used for card-based settlements.
- ♦ The NREGA (National Rural Employment Guarantee Scheme) introduced by the Government will ensure rural employment in turn ensuring that the employees get wages. Each employee will have a smart card functioning as his personal identification card, driver's license, credit card which will also function as an electronic pass book, thus familiarising the rural populations with e-payments.

## 9.11 CASE STUDY

Company Overview Our client is India's new age private sector Bank; it has established a high quality, customer centric, service driven, private Indian Bank catering to "Emerging India". Our client has adopted international best practices, the highest standards of service quality and operational excellence, and offers comprehensive banking and financial solutions to all its valued customers. A key strength and differentiating feature of our client is its knowledge driven approach to banking. The Bank has formed a specialized 'Development and Knowledge Banking Division' focusing on key sunrise growth sectors. Business Challenges As per the recent notification/mandate given by RBI – it was important for all banks to upgrade their Payment & Settlement System. To follow the guideline by the RBI, our client decided to up-grade and migrate their current RTGS/NDS/CCIL Infrastructure. Suggest our clients by answering following questions.

## **Questions**

- 1. What are benefit of implementing Payment and Settlement System?
- 2. Explain RTGS, NDS and CCIL infrastructure importance in development of payment and settlement system.

| 9.12  | NOTES                                   |
|-------|---|
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## 9.13 SUMMARY

Indian banking system suffers from some defects due to certain socio-cultural factors which hampers the spread of the e-payments culture even though there are many effective electronic payment channels and systems in place. Despite the infrastructure being there nearly 63% of all payments are still made in cash. A relatively small percentage of the population pays their bills electronically and most of that population is from urban India-the metropolitans. Also in some cases the transaction is done partially online and partially "offline". The main reason for this apathy to switch to e-payments comes from lack of awareness of the customer despite various efforts by the Government.

## 9.14 KEYWORDS

- Credit Card,
- Debit Card,
- Real Time Gross Settlement,
- Real Time Net Settlement,
- Electronic fund transfer,
- e-payment,
- ATM
- Plastic Money

## 9.15 SELFASSESSEMENT QUESTIONS

- 1. Describe evolutionary process of payment system in India.
- 2. Explain the different net settlement systems in India.
- 3. Distinguish between ECS credit and ECS debit.
- 4. Distinguish between RTGS and NEFT.
- 5. Explain the role of RBI in encouraging e-payment in India.

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   Text, Cases and Games. New Delhi: Himalaya publishing House, 2010.

## **UNIT-10: BASIC CONCEPTS AND TYPES OF COMPENSATION**

## **Structure:**

| 10.0  | Objectives  |
|-------|---|
| 10.1  | Introduction                                      |
| 10.2  | Definition of compensation                        |
| 10.3  | Concept of compensation                           |
| 10.4  | Components of compensation                        |
| 10.5  | Non- monetary benefits                            |
| 10.6  | Types of compensation                             |
| 10.7  | Direct compensation                               |
| 10.8  | Indirect compensation                             |
| 10.9  | Factors to be considered in deciding compensation |
| 10.10 | Case study  |
| 10.11 | Notes   |
| 10.12 | Summary   |
| 10.13 | Keywords  |
| 10.14 | Self assessment questions                         |
| 10.15 | References  |

#### 10.0 OBJECTIVES

After reading this unit, you should be able to:

- define the basic concepts like compensation, wages, salary, fair wages, etc.
- examine the components of compensation
- explain the types of compensation
- describe the determinants of compensation

## 10.1 INTRODUCTION

Compensation of employees for their services is important responsibility of human resource management. Every organization must offer good wages and fringe benefits to attract and retain talented employees with the organization. If at any time, the wages offered by a firm are not competitive as compared to other firms, the efficient workers may leave the firm. Therefore, workers must be remunerated adequately for their services. Compensation to workers will vary depending upon the nature of job, skills required, risk involved, nature of working conditions, paying capacity of the employer, bargaining power of the trade union, wages and benefits offered by the other units in the region or industry etc., Considering that the current trend in many sectors (particularly the knowledge intensive sectors like IT and Services) is to treat the employees as "creators and drivers of value" rather than one more factor of production, companies around the world are paying close attention to how much they pay, the kind of components that this pay includes and whether they are offering competitive compensation to attract the best talent.

## 10.2 DEFINITION OF COMPENSATION

Gary Dessler in his book Human Resource Management defines compensation in these words "Employee compensation refers to all forms of pay going to employees and arising from their employment." The phrase 'all forms of pay' in the definition does not include non-financial benefits, but all the direct and indirect financial compensations.

According to **Thomas J. Bergmann (1988)** compensation consists of four distinct components: Compensation = Wage or Salary + Employee benefits +Non-recurring financial rewards+ Non-pecuniary rewards.

## 10.3 CONCEPT OF COMPENSATION

Compensation refers to a wide range of financial and non financial rewards to employees for their services rendered to the organization. It is paid in the form of wages, salaries and employee benefits such as paid vacations, insurance maternity leave, free travel facility, retirement benefits etc., Monetary payments are a direct form of compensating the employees and have a great impact in motivating employees.

The system of compensation should be so designed that it achieves the following objectives.

- The capable employees are attracted towards the organization
- The employees are motivated for better performance
- The employees do not leave the employer frequently

#### 10.4 COMPONENTS OF COMPENSATION

## **Basic Wages/Salaries**

Basic wages / salaries refer to the cash component of the wage structure based on which other elements of compensation may be structured. It is normally a fixed amount which is subject to changes based on annual increments or subject to periodical pay hikes.

Wages represent hourly rates of pay, and salary refers to the monthly rate of pay, irrespective of the number of hours put in by the employee. Wages and salaries are subject to the annual increments. They differ from employee to employee, and depend upon the nature of job, seniority, and merit.

## **Dearness Allowance**

The payment of dearness allowance facilitates employees and workers to face the price increase or inflation of prices of goods and services consumed by him. The onslaught of price increase has a major bearing on the living conditions of the labour.

The increasing prices reduce the compensation to nothing and the money's worth is coming down based on the level of inflation. The payment of dearness allowance, which may be a fixed percentage on the basic wage, enables the employees to face the increasing prices.

## **Incentives**

Incentives are paid in addition to wages and salaries and are also called 'payments by results'. Incentives depend upon productivity, sales, profit, or cost reduction efforts.

#### There are:

- (a) Individual incentive schemes, and
- (b) Group incentive programmes.

Individual incentives are applicable to specific employee performance. Where a given task demands group efforts for completion, incentives are paid to the group as a whole. The amount is later divided among group members on an equitable basis.

## **Bonus**

The bonus can be paid in different ways. It can be fixed percentage on the basic wage paid annually or in proportion to the profitability. The Government also prescribes a minimum statutory bonus for all employees and workers. There is also a bonus plan which compensates the managers and employees based on the sales revenue or profit margin achieved. Bonus plans can also be based on piece wages but depends upon the productivity of labour.

#### 10.5 NON-MONETARY BENEFITS

These benefits give psychological satisfaction to employees even when financial benefit is not available. Such benefits are:

- (a) Recognition of merit through certificate, etc.
- (b) Offering challenging job responsibilities,
- (c) Promoting growth prospects,
- (d) Comfortable working conditions,
- (e) Competent supervision, and
- (f) Job sharing and flexi-time.

#### **Commissions**

Commission to managers and employees may be based on the sales revenue or profits of the company. It is always a fixed percentage on the target achieved. For taxation purposes, commission is again a taxable component of compensation. The payment of commission as a component of commission is practiced heavily on target based sales. Depending upon the targets achieved, companies may pay a commission on a monthly or periodical basis.

## **Mixed Plans**

Companies may also pay employees and others a combination of pay as well as commissions. This plan is called combination or mixed plan. Apart from the salaries paid,

the employees may be eligible for a fixed percentage of commission upon achievement of fixed target of sales or profits or Performance objectives. Nowadays, most of the corporate sector is following this practice. This is also termed as variable component of compensation.

## **Piece Rate Wages**

Piece rate wages are prevalent in the manufacturing wages. The labourers are paid wages for each of the Quantity produced by them. The gross earnings of the labour would be equivalent to number of goods produced by them. Piece rate wages improves productivity and is an absolute measurement of productivity to wage structure. The fairness of compensation is totally based on the productivity and not by other qualitative factors.

## **Fringe Benefits**

Fringe benefits may be defined as wide range of benefits and services that employees receive as an integral part of their total compensation package. They are based on critical job factors and performance. Fringe benefits constitute indirect compensation as they are usually extended as a condition of employment and not directly related to performance of concerned employee. Fringe benefits are supplements to regular wages received by the workers at a cost of employers. They include benefits such as paid vacation, pension, health and insurance plans, etc. Such benefits are computable in terms of money and the amount of benefit is generally not predetermined. The purpose of fringe benefits is to retain efficient and capable people in the organization over a long period. They foster loyalty and acts as a security base for the employees.

## **Profit Sharing**

Profit-sharing is regarded as a stepping stone to industrial democracy. Profit-sharing is an agreement by which employees receive a share, fixed in advance of the profits. Profit sharing usually involves the determination of an organization's profit at the end of the fiscal year and the distribution of a percentage of the profits to the workers qualified to share in the earnings. The percentage to be shared by the workers is often predetermined at the beginning of the work period and is often communicated to the workers so that they have some knowledge of their potential gains. To enable the workers to participate in profit sharing, they are required to work for certain number of years and develop some seniority. The theory behind profit-sharing is that management feels its workers will fulfill their responsibilities more diligently if they realize that their efforts may result in higher profits, which will be returned to the workers through profit-sharing.

## 10.6 TYPES OF COMPENSATION

Total compensation returns are more transactional. They include pay received directly as cash (like base, merit, incentives, cost of living adjustments) and indirectly as benefits (like pensions, medical insurance, programs to help balance work and life demands, brightly coloured uniforms). Programme to pay to people can be designed in a wide variety of ways, and a single employer typically uses more than one.

## **Direct /Base Compensation**

Direct compensation refers to monetary benefits offered and provided to employees in return of the services they provide to the organization. The monetary benefits include basic salary, house rent allowance, conveyance, leave travel allowance, medical reimbursements, special allowances, bonus, Pf/Gratuity, etc. They are given at a regular interval at a definite time.

## **Basic Salary**

Salary is the amount received by the employee in lieu of the work done by him/her for a certain period say a day, a week, a month, etc. It is the money an employee receives from his/her employer by rendering his/her services.

## **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.

## **Leave Travel Allowance**

These allowances are provided to retain the best talent in the organization. The employees are given allowances to visit any place they wish with their families. The allowances are scaled as per the position of employee in the organization.

## **Medical Reimbursement**

Organizations also look after the health conditions of their employees. The employees are provided with medi-claims for them and their family members. These medi-claims include health-insurances and treatment bills reimbursements.

#### **Bonus**

Bonus is paid to the employees during festive seasons to motivate them and provide them the social security. The bonus amount usually amounts to one month's salary of the employee.

## **Special Allowance**

Special allowance such as overtime, mobile allowances, meals, commissions, travel expenses, reduced interest loans; insurance, club memberships, etc are provided to employees to provide them social security and motivate them which improve the organizational productivity.

#### 10.7 DIRECT COMPENSATION

## **Indirect/Supplementary Compensation**

Indirect compensation refers to non-monetary benefits offered and provided to employees in lieu of the services provided by them to the organization. They include Leave Policy, Overtime Policy, Car policy, Hospitalization, Insurance, Leave travel Assistance Limits, Retirement Benefits, Holiday Homes.

## **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.

## Hospitalization

The employees should be provided allowances to get their regular check-ups, say at an interval of one year. Even their dependents should be eligible for the medi-claims that provide them emotional and social security.

## 10.8 INDIRECT COMPENSATION

#### 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.

## **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.

## **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. The organizations make sure that the employees do not face any kind of difficulties during their stay in the guest house.

## 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.

## 10.9 FACTORS TO BE CONSIDERED IN DECIDING THE COMPENSATION

Employers decide on what is the right compensation after taking into account the following points. The Job Description of the employee that specifies how much should be paid and the parts of the compensation package. The Job Description is further made up of responsibilities, functions, duties, location of the job and the other factors like environment etc. These elements of the job description are taken individually to arrive at the basic compensation along with the other components like benefits, variable pay and bonus. It needs to be remembered that the HRA or the House Rental Allowance is determined by a mix of factors that includes the location of the employee and governmental policies along with the grade of the employee. Hence, it is common to find a minimum level of HRA that is common to all the employees and which increases in proportion to the factors mentioned above.

# The following factors are considered while deciding the quantum of compensation;

### A. EXTERNAL FACTORS

# i. 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. The primary result of the operation of the law of supply and demand is the creation of the going wage rate. It is not practicable to draw demand and supply curves for each job in an organization even though, theoretically, a separate curve exists for each job.

# ii. Cost of Living

Another important factor affecting the wage is the cost of living adjustments of wages. 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. It is an essential ingredient of long-term labour contract unless provision is made to reopen the wage clause periodically.

#### iii. 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.

If the trade union fails in their attempt to raise the wage and other allowances through collective bargaining, they resort to strike and other methods hereby the supply of labour is restricted. This exerts a kind of influence on the employer to concede at least partially the demands of the labour unions.

#### iv. 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., have been enacted and enforced to bring about a measure of fairness in compensating the working class. Thus, the laws enacted and the labour policies framed by the government have an important influence on wages and salaries paid by the employers. Wages and salaries can't be fixed below the level prescribed by the government.

### B. INTERNAL FACTORS

# i. 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. However, the fundamental determinants of the wage rate for the individual firm emanate from supply and demand of labour. If the firm is marginal and cannot afford to pay competitive rates, its employees will generally leave it for better paying jobs in other organizations. But, this adjustment is neither immediate nor perfect because of problems of labour immobility and lack of perfect knowledge of alternatives. If the firm is highly successful, there is little need to pay more than the competitive rates to obtain personnel. Ability to pay is an important factor affecting wages, not only for the individual firm but also for the entire industry.

# ii. Top Management Philosophy

Wage rates to be paid to the employees are also affected by the top management's philosophy, values and attitudes. 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. On the other hand, top management may like to pay higher pay to attract top talent.

# iii. Productivity of Workers

To achieve the best results from the workers and to motivate him to increase his efficiency, wages have to be productivity based. There has been a trend towards gearing wage increase to productivity increases. Productivity is the key factor in the operation of a company. High wages and low costs are possible only when productivity increases appreciably.

# iv. Job Requirements

Job requirements indicating measures of job difficulty provide a basis for determining the relative value of one job against another in an enterprise. Explicitly, job may be graded in terms of a relative degree of skill, effort and responsibility needed and the adversity of working conditions. The occupational wage differentials in terms of

- a. Hardship,
- b. Difficulty of learning the job
- c. Stability of employment
- d. Responsibility of learning the job and
- e. Change for success or failure in the work.

This reforms a basis for job evaluation plans and thus, determines wage levels in an industry.

# v. Employees Related Factors

Several employees related factors interact to determine his remuneration. These include

- a) **Performance:** productivity is always rewarded with a pay increase. Rewarding performance motivates the employees to do better in future.
- **Seniority:** Unions view seniority as the most objective criteria for pay increases whereas management prefer performance to effect pay increases.
- c) Experience: Makes an employee gain valuable insights and is generally rewarded
- **d) 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.

# vi. Organizational Politics

Compensation surveys, job analysis, job evaluation and employee performance are all involved in wage and salary decisions. Political considerations may enter into the equation in the following ways:

- a) 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.
- b) Choice of compensable factors for the job evaluation plan: Again, the job value determined by this process could be manipulated
- c) Emphasis placed on either internal or external equity and
- d) Results of employee performance appraisal may be intentionally disported by the supervisor

Thus, a sound and objective compensation system may be destroyed by organizational politics.

# 10.10 CASE STUDY

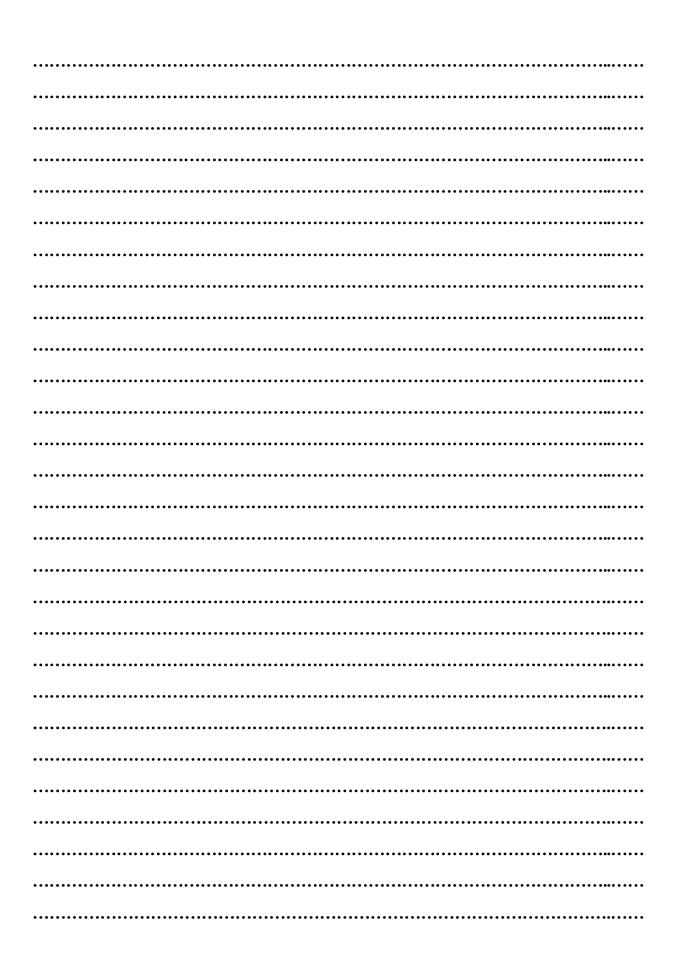
In 2007, the Indian subsidiary of a multinational refinery became a Government of India company. The government company had announced an ambitious expansion programme which meant doubling the work force in less than four years. In 2007 at the time of wage revision, the union and management agreed to a two-tier pay structure. Those already employed will be eligible for a higher grade and those who are (to be) recruited afresh will get a lower grade though jobs are similar in skill, responsibility and effort. Both the union and the management justified that this is an innovative practice widely followed in deregulated companies abroad, particularly the airlines in North America.

# Questions

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| <ol><li>Would it</li></ol> | contravene with | n the concept o | f equal | l pay for | equal | work? |
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| 10.11 NOTES                             |        |  |  |  |
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#### **10.12 SUMMARY**

Today's compensation systems have come from a long way. With the changing organizational structures workers' need and compensation systems have also been changing. From the bureaucratic organizations to the participative organizations, employees have started asking for their rights and appropriate compensations. The higher education standards and higher skills required for the jobs have made the organizations provide competitive compensations to their employees. Compensation strategy is derived from the business strategy. The business goals and objectives are aligned with the HR strategies. Then the compensation committee or the concerned authority formulates the compensation strategy. It depends on both internal and external factors as well as the life cycle of an organization.

### 10.13 KEYWORDS

- Compensation,
- Fringe Benefits,
- Profit Sharing,
- Holiday Homes

# 10.14 SELFASSESSMENT QUESTIONS

- 1. Define compensation and explain its significance.
- 2. Describe the components of compensation.
- 3. Examine the role of fringe benefits in boosting employee's morale.
- 4. Describe the determinants of compensation.

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# **UNIT-11: THEORIES OF MOTIVATION**

# **Structure:**

- 11.0 Objectives
- 11.1 Introduction
- 11.2 Concept of Motivation
- 11.3 Theories of motivation
- 11.4 Case Study
- 11.5 Notes
- 11.6 Summary
- 11.7 Keywords
- 11.8 Self assessment Questions
- 11.9 References

### 11.0 OBJECTIVES

After reading this unit, you should be able to:

- identify rationale behind employee motivation
- evaluate the different theories of motivation
- devise the most suitable model in the light of a particular organisation

# 11.1 INTRODUCTION

Motivation is a term that refers to a <u>process</u> that elicits, controls, and sustains certain behaviors. It is a group phenomenon which affects the nature of an individual's behavior, the strength of the behavior, and the persistence of the behavior. For instance: an individual has not eaten, so he or she feels hungry, and as a response he or she eats and diminishes feelings of hunger.

There are many approaches to motivation: physiological, behavioral, <u>cognitive</u>, and social. It is the crucial element in setting and attaining <u>goals</u>—and research shows you can influence your own levels of motivation and self-control. According to various theories, motivation may be rooted in a basic need to minimize physical pain and maximize pleasure; or it may include specific needs such as eating and resting; or a desired object, goal, state of being, or ideal; or it may be attributed to less-apparent reasons such as altruism, selfishness, morality, or avoiding mortality. Conceptually, motivation should not be confused with either volition or optimism. Motivation is related to, but distinct from, emotion.

At one time, employees were considered just another input into the production of goods and services. But this changed after the Hawthorne studies. The Hawthorne studies were conducted by Elton Mayo at Hawthorne Plant in the 1920s. The researchers were studying the effect of different working environments on productivity. They used lighting as an experimental variable (the effect of bright lighting and dull lighting). Initially they noticed that employees were working harder but it was not because of the lighting. They concluded that productivity increased due to attention that the workers got from the research team and not because of changes to the experimental variable. The Hawthorne studies found that employees are not motivated solely by money but motivation is linked to employee behavior and their attitudes. The Hawthorne Studies began the human relations approach to management, so the needs and motivation of employees became the primary focus of management.

### 11.2 CONCEPT OF MOTIVATION

Motivation is the word derived from the word 'motive' which means needs, desires, wants or drives within the individuals. It is the process of stimulating people to actions to accomplish the goals. In the work goal context the psychological factors stimulating the people's behaviour can be -

- desire for money
- success
- recognition
- job-satisfaction
- team work, etc

One of the most important functions of management is to create willingness amongst the employees to perform in the best of their abilities. Therefore the <u>role of a leader</u> is to arouse interest in performance of employees in their jobs. The process of motivation consists of three stages:-

- 1. A felt need or drive
- 2. A stimulus in which needs have to be aroused
- 3. When needs are satisfied, the satisfaction or accomplishment of goals.

Therefore, we can say that motivation is a psychological phenomenon which means needs and wants of the individuals have to be tackled by framing an incentive plan.

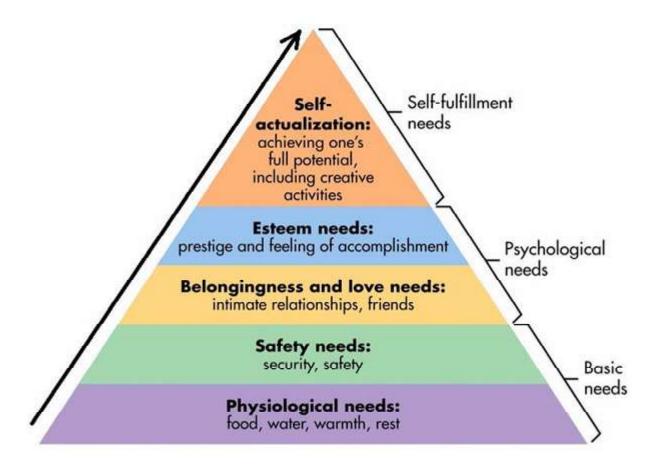
#### 11.3 THEORIES OF MOTIVATION

### A. Maslow's Hierarchy of Needs Theory

**Abraham Maslow** is well renowned for proposing the Hierarchy of Needs Theory in **1943**. This theory is a classical depiction of human motivation. This theory is based on the assumption that there is a hierarchy of five needs within each individual. The urgency of these needs varies. These five needs are as follows-

- 1. **Physiological needs-** These are the basic needs of air, water, food, clothing and shelter. In other words, physiological needs are the needs for basic amenities of life.
- **2. Safety needs-** Safety needs include physical, environmental and emotional safety and protection. For instance- Job security, financial security, protection from animals, family security, health security, etc.

- **3. Social needs-** Social needs include the need for love, affection, care, belongingness, and friendship.
- **4. Esteem needs-** Esteem needs are of two types: internal esteem needs (self- respect, confidence, competence, achievement and freedom) and external esteem needs (recognition, power, status, attention and admiration).
- **5. Self-actualization need-** This include the urge to become what you are capable of becoming / what you have the potential to become. It includes the need for growth and self-contentment. It also includes desire for gaining more knowledge, social- service, creativity and being aesthetic. The self- actualization needs are never fully satiable. As an individual grows psychologically, opportunities keep cropping up to continue growing.



According to Maslow, individuals are motivated by unsatisfied needs. As each of these needs is significantly satisfied, it drives and forces the next need to emerge. Maslow grouped the five needs into two categories - **Higher-order needs** and **Lower-order needs**. The physiological and the safety needs constituted the lower-order needs. These lower-order needs are mainly satisfied externally. The social, esteem, and self-actualization needs

constituted the higher-order needs. These higher-order needs are generally satisfied internally, i.e., within an individual. Thus, we can conclude that during boom period, the employees lower-order needs are significantly met.

# Implications of Maslow's Hierarchy of Needs Theory for Managers

- As far as the physiological needs are concerned, the managers should give employees appropriate salaries to purchase the basic necessities of life. Breaks and eating opportunities should be given to employees.
- As far as the safety needs are concerned, the managers should provide the employees job security, safe and hygienic work environment, and retirement benefits so as to retain them.
- As far as social needs are concerned, the management should encourage teamwork and organize social events.
- As far as esteem needs are concerned, the managers can appreciate and reward employees on accomplishing and exceeding their targets. The management can give the deserved employee higher job rank / position in the organization.
- As far as self-actualization needs are concerned, the managers can give the employees challenging jobs in which the employees' skills and competencies are fully utilized. Moreover, growth opportunities can be given to them so that they can reach the peak.

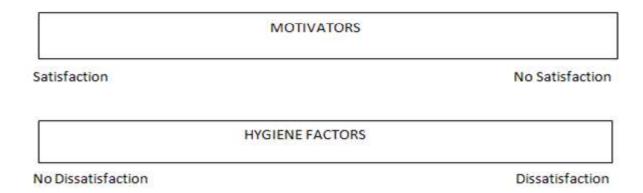
The managers must identify the need level at which the employee is existing and then those needs can be utilized as push for motivation.

# **Limitations of Maslow's Theory**

- ♦ It is essential to note that not all employees are governed by same set of needs. Different individuals may be driven by different needs at same point of time. It is always the **most powerful unsatisfied need that motivates an individual**.
- ♦ The theory is not empirically supported.
- The theory is not applicable in case of starving artist as even if the artist's basic needs are not satisfied, he will still strive for recognition and achievement.

# B. Herzberg's Two-Factor Theory of Motivation

In 1959, Frederick Herzberg, a behavioural scientist proposed a two-factor theory or the motivator-hygiene theory. According to Herzberg, there are some job factors that result in satisfaction while there are other job factors that prevent dissatisfaction. According to Herzberg, the opposite of "Satisfaction" is "No satisfaction" and the opposite of "Dissatisfaction" is "No Dissatisfaction".



# FIGURE: Herzberg's view of satisfaction and dissatisfaction

Herzberg classified these job factors into two categories-

- a. Hygiene factors- Hygiene factors are those job factors which are essential for existence of motivation at workplace. These do not lead to positive satisfaction for long-term. But if these factors are absent / if these factors are non-existant at workplace, then they lead to dissatisfaction. In other words, hygiene factors are those factors which when adequate/reasonable in a job, pacify the employees and do not make them dissatisfied. These factors are extrinsic to work. Hygiene factors are also called as dissatisfires or maintenance factors as they are required to avoid dissatisfaction. These factors describe the job environment/scenario. The hygiene factors symbolized the physiological needs which the individuals wanted and expected to be fulfilled. Hygiene factors include:
- Pay The pay or salary structure should be appropriate and reasonable. It must be equal and competitive to those in the same industry in the same domain.
- Company Policies and administrative policies The company policies should not be too rigid. They should be fair and clear. It should include flexible working hours, dress code, breaks, vacation, etc.
- Fringe benefits The employees should be offered health care plans (mediclaim), benefits for the family members, employee help programmes, etc.
- Physical Working conditions The working conditions should be safe, clean and hygienic.
   The work equipments should be updated and well-maintained.
- ♦ Status The employees' status within the organization should be familiar and retained. Interpersonal relations The relationship of the employees with his peers, superiors and subordinates should be appropriate and acceptable. There should be no conflict or humiliation element present.
- ♦ Job Security The organization must provide job security to the employees.

- **b. Motivational factors-** According to Herzberg, the hygiene factors cannot be regarded as motivators. The motivational factors yield positive satisfaction. These factors are inherent to work. These factors motivate the employees for a superior performance. These factors are called satisfiers. These are factors involved in performing the job. Employees find these factors intrinsically rewarding. The motivators symbolized the psychological needs that were perceived as an additional benefit. Motivational factors include:
- Recognition- The employees should be praised and recognized for their accomplishments by the managers.
- Sense of achievement- The employees must have a sense of achievement. This depends on the job. There must be a fruit of some sort in the job.
- Growth and promotional opportunities- There must be growth and advancement opportunities in an organization to motivate the employees to perform well.
- Responsibility- The employees must hold themselves responsible for the work. The managers should give them ownership of the work. They should minimize control but retain accountability.
- ♦ Meaningfulness of the work- The work itself should be meaningful, interesting and challenging for the employee to perform and to get motivated.

# **Limitations of Two-Factor Theory**

The two factor theory is not free from limitations:

- 1. The two-factor theory overlooks situational variables.
- 2. Herzberg assumed a correlation between satisfaction and productivity. But the research conducted by Herzberg stressed upon satisfaction and ignored productivity.
- 3. The theory's reliability is uncertain. Analysis has to be made by the raters. The raters may spoil the findings by analyzing same response in different manner.
- 4. No comprehensive measure of satisfaction was used. An employee may find his job acceptable despite the fact that he may hate/object part of his job.
- 5. The two factor theory is not free from bias as it is based on the natural reaction of employees when they are enquired the sources of satisfaction and dissatisfaction at work. They will blame dissatisfaction on the external factors such as salary structure, company policies and peer relationship. Also, the employees will give credit to themselves for the satisfaction factor at work.

6. The theory ignores blue-collar workers. Despite these limitations, Herzberg's Two-Factor theory is acceptable broadly.

# **Implications of Two-Factor Theory**

♦ The Two-Factor theory implies that the managers must stress upon guaranteeing the adequacy of the hygiene factors to avoid employee dissatisfaction. Also, the managers must make sure that the work is stimulating and rewarding so that the employees are motivated to work and perform harder and better. This theory emphasize upon job-enrichment so as to motivate the employees. The job must utilize the employee's skills and competencies to the maximum. Focusing on the motivational factors can improve work-quality.

### C. EXPECTANCY THEORY OF MOTIVATION

The expectancy theory was proposed by **Victor Vroom** of Yale School of Management in 1964. Vroom stresses and focuses on outcomes, and not on needs unlike Maslow and Herzberg. The theory states that the intensity of a tendency to perform in a particular manner is dependent on the intensity of an expectation that the performance will be followed by a definite outcome and on the appeal of the outcome to the individual.

The **Expectancy theory** states that employee's motivation is an outcome of how much an individual wants a reward (Valence), the assessment that the likelihood that the effort will lead to expected performance (Expectancy) and the belief that the performance will lead to reward (Instrumentality). In short, **Valence** is the significance associated by an individual about the expected outcome. It is an expected and not the actual satisfaction that an employee expects to receive after achieving the goals. **Expectancy** is the faith that better efforts will result in better performance. Expectancy is influenced by factors such as possession of appropriate skills for performing the job, availability of right resources, availability of crucial information and getting the required support for completing the job.

**Instrumentality** is the faith that if you perform well, then a valid outcome will be there. Instrumentality is affected by factors such as believe in the people who decide who receives what outcome, the simplicity of the process deciding who gets what outcome, and clarity of relationship between performance and outcomes. Thus, the expectancy theory concentrates on the following three relationships:

- Effort-performance relationship: What is the likelihood that the individual's effort be recognized in his performance appraisal?
- Performance-reward relationship: It talks about the extent to which the employee believes that getting a good performance appraisal leads to organizational rewards.

• Rewards-personal goals relationship: It is all about the attractiveness or appeal of the potential reward to the individual.

Vroom was of view that employees consciously decide whether to perform or not at the job. This decision solely depended on the employee's motivation level which in turn depends on three factors of expectancy, valence and instrumentality.

# **Advantages of the Expectancy Theory**

- ♦ It is based on self-interest individual who want to achieve maximum satisfaction and who wants to minimize dissatisfaction.
- ♦ This theory stresses upon the expectations and perception; what is real and actual is immaterial.
- It emphasizes on rewards or pay-offs.
- ♦ It focuses on psychological extravagance where final objective of individual is to attain maximum pleasure and least pain.

# **Limitations of the Expectancy Theory**

- ♦ The expectancy theory seems to be idealistic because quite a few individuals perceive high degree correlation between performance and rewards.
- ♦ The application of this theory is limited as reward is not directly correlated with performance in many organizations. It is related to other parameters also such as position, effort, responsibility, education, etc.

# **Implications of the Expectancy Theory**

- The managers can correlate the preferred outcomes to the aimed performance levels.
- The managers must ensure that the employees can achieve the aimed performance levels.
- The deserving employees must be rewarded for their exceptional performance.
- The reward system must be fair and just in an organization.
- Organizations must design interesting, dynamic and challenging jobs.
- The employee's motivation level should be continually assessed through various techniques such as questionnaire, personal interviews, etc.

# D. EQUITYTHEORY OF MOTIVATION

The core of the equity theory is the principle of balance or equity. As per this motivation theory, an individual's motivation level is correlated to his perception of equity, fairness and justice practiced by the management. Higher is individual's perception of fairness, greater is

the motivation level and vice versa. While evaluating fairness, employee compares the job input (in terms of contribution) to outcome (in terms of compensation) and also compares the same with that of another peer of equal cadre/category. D/I ratio (output-input ratio) is used to make such a comparison.

# **Ratio Comparison Perception**

```
O/I a < O/I b Under-rewarded (Equity Tension)
O/I a = O/I b Equity
O/I a > O/I b Over-rewarded (Equity Tension)
```

**Negative Tension state:** Equity is perceived when this ratio is equal. While if this ratio is unequal, it leads to "equity tension". J.Stacy Adams called this a negative tension state which motivates him to do something right to relieve this tension. A comparison has been made between 2 workers A and B to understand this point.

**Referents:** The four comparisons an employee can make have been termed as "referents" according to Goodman. The referent chosen is a significant variable in equity theory. These referents are as follows:

- Self-inside: An employee's experience in a different position inside his present organization.
- Self-outside: An employee's experience in a situation outside the present organization.
- Other-inside: Another employee or group of employees inside the employee's present organization.
- Other-outside: Another employee or employees outside the employee's present organization.

An employee might compare himself with his peer within the present job in the current organization or with his friend/peer working in some other organization or with the past jobs held by him with others. An employee's choice of the referent will be influenced by the appeal of the referent and the employee's knowledge about the referent.

Moderating Variables: The gender, salary, education and the experience level are moderating variables. Individuals with greater and higher education are more informed. Thus, they are likely to compare themselves with the outsiders. Males and females prefer same sex comparison. It has been observed that females are paid typically less than males in comparable jobs and have less salary expectations than male for the same work. Thus, a women employee that uses another women employee as a referent tends to lead to a lower

comparative standard. Employees with greater experience know their organization very well and compare themselves with their own colleagues, while employees with less experience rely on their personal experiences and knowledge for making comparisons.

**Choices:** The employees who perceive inequity and are under negative tension can make the following choices:

- Change in input (e.g. Don't overexert)
- Change their outcome (Produce quantity output and increasing earning by sacrificing quality when piece rate incentive system exist)
- Choose a different referent
- Quit the job
- Change self perception (For instance I know that I've performed better and harder than everyone else.)
- Change perception of others (For instance Jack's job is not as desirable as I earlier thought it was.)

# **Assumptions of the Equity Theory**

- The theory demonstrates that the individuals are concerned both with their own rewards and also with what others get in their comparison.
- Employees expect a fair and equitable return for their contribution to their jobs.
- Employees decide what their equitable return should be after comparing their inputs and outcomes with those of their colleagues.
- Employees who perceive themselves as being in an inequitable scenario will attempt to reduce the inequity either by distorting inputs and/or outcomes psychologically, by directly altering inputs and/or outputs, or by quitting the organization.

### E. PORTER AND LAWLER MODEL OF MOTIVATION

Lyman Porter and Edward Lawler came up with a comprehensive theory of motivation, combining the various aspects that we have so far been discussing and using two additional variables in their model. Though built in large part on Vroom's expectancy model. Porter and Lawler's model is a more complete model of motivation. This model has been practically applied also in their study of managers. This is a multi variate model which explains the relationship that exists between job attitudes and job performance.

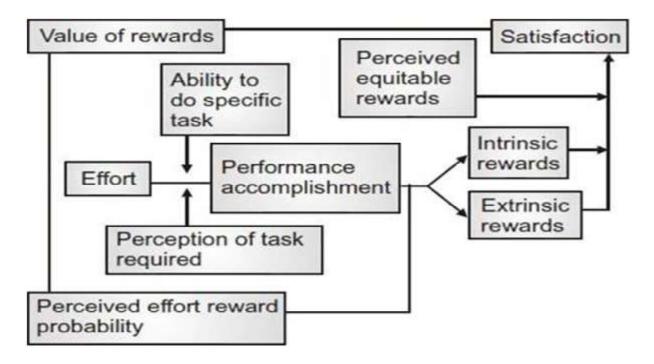
# **Assumptions:**

This model is based on four basic assumptions about human behaviour:

- As mentioned above, it is a multi variate model. According to this model, individual behaviour is determined by a combination of factors in the individual and in the environment.
- Individuals are assumed to be rational human beings who make conscious decisions about their behaviour in the organisations.
- Individuals have different needs, desires and goals.
- On the basis of their expectations, individuals decide between alternate behaviours and such decided behaviour will lead to a desired outcome.

#### **Elements:**

# The various elements of this model are explained in the following figure:



#### 1. Effort:

Effort refers to the amount of energy which a person exerts on a job.

### 2. Value of Reward:

First of all people try to figure out whether the rewards that are likely to be received from doing a job will be attractive to them. This is referred to as valence in Vroom's theory.

A person who is looking for more money, for example, extra vacation time may not be an attractive reward. If the reward to be obtained is attractive or valent then the individual will put extra efforts to perform the job. otherwise he will lower his effort.

# 3. Perceived Effort Reward Probability:

Addition, before people put forth any effort, they will also try to assess the probability of a certain level of effort leading to a desired level of performance and the possibility of that performance leading to certain kinds of rewards. Based on the valence of the reward and the effort reward probability, people can decide to put in certain level of work effort.

#### 4. Performance:

Effort leads to performance. The expected level of performance will depend upon the amount of effort, the abilities and traits of the individual and his role perceptions. Abilities include knowledge, skills and intellectual capacity to perform the job. Traits which are important for many jobs are endurance, pre-servance, and goal directedness. Thus, abilities and traits will moderate the effort- performance relationship.

In addition, people performing the jobs should have accurate role perception which refers to the wav in which people define for the jobs. People may perceive their roles differently. Only those, who perceive their roles as is defined by the organization, will be able to perform well when they put forth the requisite effort.

### 5. Rewards:

Performance leads to certain outcomes in the shape of two types of rewards namely extrinsic rewards and intrinsic rewards. Extrinsic rewards are the external rewards given by others in the organization in the form of money, recognition or praise. Intrinsic rewards are internal feelings of job sell esteem and sense of competence that individuals feel when they do a good job.

#### 6. Satisfaction:

Satisfaction will result from both extrinsic and intrinsic rewards. However, for being satisfied, an individual will compare his actual rewards with the perceived rewards if actual rewards meet or exceed perceived equitable rewards, the individual will feel satisfied and if these are less than the equitable rewards, the individual will feel dissatisfied.

#### SIGNIFICANCE OF THE PORTER AND LAWLER MODEL:

Porter and Lawler model is a departure from the traditional analysis of satisfaction and performance relationship. In practice, we find that motivation is not a simple cause and effect relationship rather it is a complex phenomenon.

This model is of great significance to managers since it sensitises them to focus their attention on the following points to keep their employees motivated:

- 1. Match the abilities and traits of individuals to the requirements of the job by putting the right person on the right job.
- 2. He should carefully explain to the subordinates their roles or what they must do to be rewarded. Then he must make sure that they understand it.
- 3. Prescribe in concrete terms the actual performance levels expected of the individuals and these levels should be made attainable.
- 4. To achieve and maintain motivation, the appropriate reward must be associated with successful performance.
- 5. Make sure that the rewards dispensed are valued by the employees. Thus, he should find out what rewards are attractive to the employee and see if such rewards can be given to him.

Porter and Lawler model has definitely made a significant contribution to the better understanding of work motivation and the relationship between performance and satisfaction. But even then, to date, it has not made much impact on the actual practice of human resource management.

#### 11.4 CASESTUDY

Mr. Alok Banarjee is the Chief Executive of a medium-sized pharmaceutical firm in Calcutta. He holds a Ph D in Pharmacy. However, he has not been involved in research and development of new products for two decades. Though turnover is not a problem for the company, Mr. Banarjee and his senior colleagues noticed that the workers on hourly basis are not working upto their full potential. It is well known fact that they filled their days with unnecessary and unproductive activities and worked only for the sake of a pay cheque. In the recent past the situation has become quite alarming as the organization began to crumble under the weight of uneconomical effort. The situation demanded immediate managerial attention and prompt remedial measures. Mr. Banarjee knew very well that the only way to progress and prosper is to motivate workers to peak performance through various incentive plans. One fine morning, Mr. Banarjee contacted the Personnel Manager and enquired: "What is the problem with the workers on hourly basis? The wage bill shows that we pay them the highest in the industry. Our working conditions are fine. Our fringe benefits are excellent. Still these workers are not motivated. What do they require really?" The Personnel Manager gave the following reply: "I have already informed you a number of times, that money, working conditions and benefits are not enough. Other things are equally important. One of workers in that group recently gave me a clue as to why more and more workers are joining the bandwagon of 'non-performers'. He felt bad that hard work and efficiency go un-noticed and un-rewarded in our organization. Our promotion and benefit plans are tied to length of service. Even the lazy workers, accordingly, enjoy all the benefits in the organization, which, infact according to workers, should go only to those who work hard." Mr. Banarjee then wanted the Personnel Manager to look into the problem more closely and find out a solution to the problem of workers on hourly basis.

# **Questions:**

- 1. Explain the motivational problem in this case by relating to Herzberg's theory.
- 2. What would be your response to Banarjee's statement, if you were the Personnel Manager of the Company?
- 3. If you were the manager, how would you motivate the employees so that they work better?

| 11.5  | NOTES   |        |        |        |        |        |        |        |
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### 11.6 SUMMARY

Motivation is inner burning or passion caused by need want and desire. Stronger the need higher would be efforts on the part of an individual and therefore the performance would also be higher. Performance therefore can be put as under:

Performance= ability × Motivation

Motive can be defined as "an inner state that energises, activates and directs the behaviour of the individuals to achieve goals". Motive is a strong need. When one need gets fulfilled another need arises and again individual attempts to satisfy the same. This is a continuous process. It is the responsibility of a manager to create such environment that individual is motivated to achieve higher goals. Motivation is therefore is a way in which individual strives to fulfill desires, urges and aspirations that explains the individual behaviour. Motivation is inner passion that propels an individual. It is a psychological phenomenon. Motivation should be continuous process. It is caused due to anticipated value. Motivation is intrinsic in nature and therefore caused by non-monetary incentives. A monetary incentive keeps the minimum level of motivation amongst the employees. Motivation is probably is the single most important factor that a manager is required to do in the organization. It may be noted that high motivation leads to greater performance, higher cohesiveness and leads to higher job satisfaction. Employees accept change that leads to increased organizational image low turnover and absenteeism. Abraham Maslow, the pioneer in the studies of motivation has suggested that every individual has a complex set of needs and his behaviour is determined by the strongest need existing at a particular moment. He propagated need hierarchy theory of motivation and classified human needs into five categories namely physiological needs, safety needs, social needs, esteem needs and self-actualisation needs. He states that needs are hierarchal in nature. Only one need is strongest at any one time and that an individual attempts to fulfill the same. Once that need is fulfilled the second need arises as strongest need and individual keeps on fulfilling each need as it arises. Maslow has taken deprivation – gratification approach to need satisfaction. Once one level of needs is gratified, the next level of need will emerge as the deprived need seeking to be gratified. Fredrick Herzberg and his associates developed motivation theory based on two main factors. The theory is therefore called two factor theory. The first factor is "motivation factor" which includes a set of job conditions which primarily operates to build strong motivation and job satisfaction. The other factor is called "maintenance factor or hygiene factor." This include job conditions that dissatisfy when these are absent and do not in any way increase satisfaction when they are present. They however maintain a certain level of job satisfaction. These factors are not intrinsic part of a job. Porter and Lawler have presented a motivational model which is a step

ahead of Vroom's theory of motivation. They have related satisfaction of employees with traits, skills, efforts, performance and its relationship with the reward system. Managers can effectively implement this model in their organizations.

#### 11.7 KEYWORDS

- Hygiene factor
- Dissatisfiers
- Expectancy
- Equity

#### 11.8 SELFASSESSMENT

- 1. Explain the rationale behind motivation.
- 2. Critically examine Maslow's need hierarchy theory.
- 3. Explain the efficiency of two factor theory while motivating employee's.
- 4. Write a critical note on equity theory of motivation.
- 5. Describe Porter and Lowers model of motivation.

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# **UNIT - 12: THEORIES OF WAGES**

# **Structure:**

| 12.0 | Objectives |
|------|------------|
|      |            |

- 12.1 Introduction
- 12.2 Meaning of wage
- 12.3 Types of wages
- 12.4 Concept and meaning of wage payment system
- 12.5 Importance of wage payment system
- 12.6 Essential characteristics of a good wage payment system
- 12.7 Determinations of wages and salary structures
- 12.8 Wage structure in India
- 12.9 Wage theories
- 12.10 Case study
- 12.11 Notes
- 12.12 Summary
- 12.13 Key words
- 12.14 Self assessment questions
- 12.15 References

### 12.0 OBJECTIVES

To After reading this unit, you should be able to:

- Explain the different types of wages
- describe the importance of wage system
- explain the essential characteristics of good wage system
- explain the determinants of wage system
- evaluate the wage theories

### 12.1 INTRODUCTION

The system of wage payment is the method adopted by manufacturing concerns to remunerate workers. It is the way of giving financial compensation to the workers for the time and effort invested by them in converting materials into finished products. It indicates the basis of making payment to the workers, which may be either on time basis or output basis.

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. For instance, there is a wide difference between the pay packages offered by multinational and Indian companies. It is because of this difference that the multinational corporations are able to attract the most talented workforce.

# 12.2 MEANING OF WAGE

- 1. A fixed regular payment earned for work or services, typically paid on a daily or weekly basis.
- 2. A particular amount of money that is paid, usually every week, to an employee, especially one who does work that needs physical skills or strength, rather than a job needing a college education.
- 3. A regular payment, usually on an hourly, daily, or weekly basis, made by an employer to an employee, especially for manual or unskilled work.
- 4. <u>Monetary remuneration</u> computed on hourly, <u>daily</u>, weekly, or piece <u>work</u> basis. A fixed weekly or monthly wage is usually <u>called</u> a <u>salary</u>.

### 12.3 TYPES OF WAGES

The main types of wages are:

- 1. Subsistence wage;
- 2. Minimum wage;
- 3. Fair Wage; and
- 4. Living Wage

**Subsistence Wage:** The wage that can meet only bare physical needs of a worker and his family is called subsistence wage.

**Minimum Wage:** Minimum wage is the wage that is able to provide not only for bare physical needs but also for preservation of efficiency of worker plus some measure of education, health and other things.

**Fair Wage:** Fair wages is an adjustable step that moves up according to the capacity of the industry to pay, and the prevailing rates of wages in the area of industry.

**Living Wage:** Living wage is that which workers can maintain the health and decency, a measure of comfort and some insurance against the more important misfortune of lie. In any even the minimum wage must be paid irrespective of the extent of profits, the financial condition of the establishment or the availability of workmen at lower wages.

The wages must be fair, i.e. sufficiently high to provide standard family with, food, shelter, clothing, medical care and education of children appropriate to the workmen.

A fair wage lies between the minimum wage and the living wage which is the goal.

Wages must be paid on an industry wise and region basis having due regard to the financial capacity of the unit.

# 12.4 CONCEPTAND MEANING OF WAGE PAYMENT SYSTEM

The selection of the system depends on the type and nature of the concern and its products. The wage payment systems can be divided into two main systems as follows.

- 1. Piece rate system
- 2. Time rate system

#### 1. PIECE RATE SYSTEM

The piece rate system is that system of wage payment in which the workers are paid on the basis of the units of output produced. Piece rate system does not consider the time spent by the workers. Piece rate system is the method of remunerating the workers according to the number of unit produced or job completed. It is also known as payment by result or output. Piece rate system pays wages at a fixed piece rate for each unit of output produced. The total wages earned by a worker is calculated by using the following formula.

**Total Wages Earned**= Total units of outputs produced x Wage rate per unit of output.

Or,

Total Wages Earned= Output x Piece Rate

### ADVANTAGES OF PIECE RATE SYSTEM

The following are some important advantages of piece rate system of wage payment.

- Piece rate system pays wages according to the output produced by the workers. It encourages efficient workers.
- Piece rate system helps to reduce idle time.
- Piece rate system gives incentives to the workers to adopt a better method of production for increasing their production and earning.
- Piece rate system helps the management to determine the exact labor cost per unit for submitting quotation.
- Piece rate system reduces per unit cost of production due to increased volume of production.
- Piece rate system requires less supervision cost.

# DISADVANTAGES OF PIECE RATE SYSTEM

The following are the notable disadvantages of piece rate system

- Piece rate system does not help in producing quality output as the workers are concentrated more on quantity instead of quality.
- Piece rate system does not help for a uniform flow of production and makes difficult to regulate the production schedule.
- It is very difficult to fix an acceptable and reasonable piece rate for each item of output or job.
- Piece rate system adversely affects the workers' health as well.
- It requires extra supervision cost for quality output and effective use of materials, tools and equipment.

#### 2. TIME RATE SYSTEM

The time rate system is that system of wage payment in which the workers are paid on the basis of time spent by them in the factory. Under this system, the workers and employees are paid wages on the basis of the time they have worked rather than the volume of output they have produced. Hence, according to this system, wages are paid on hourly, weekly or monthly basis. Under time rate system, the wages earned by a worker is determined by using the following formula.

**Wages Earned** = Time spent (Attended) x Wage rate per hour/day/week/month

#### ADVANTAGES OF TIME RATE SYSTEM

The following are some of the important advantages of time rate system of wage payment:

- Time rate system is simple to understand and easy to calculate.
- Time rate system is quite useful for organizations that use costly inputs for quality outputs.
- Time rate system is beneficial for average and below workers.
- Time rate system assures regular income and creates the feeling of economic security among the workers.
- Time rate system does not discriminate the workers and is preferred by trade unions.

#### DISADVANTAGES OF TIME RATE SYSTEM

The following are some notable disadvantages of time rate system of wage payment.

- ♦ Time rate system does not help in increasing output and improving efficiency as there is no correlation between effort and reward.
- ♦ Time rate system is not justifiable between efficient and inefficient workers and skilled and unskilled workers.
- Time rate system pays for idle time, which increases the cost of production.

Time rate system encourages a g0-slow tendency among workers during working hours and encourages them to work overtime.

- It is difficult to estimate exact labor cost in advance.
- It requires strict supervision to get the required quantity of output.

# 12.5 IMPORTANCE OF WAGE PAYMENT SYSTEM

The amount of wages paid to the workers is one of the major elements of cost. It has a great bearing on the cost of production and profitability of the concern. Hence, every concern is required to adopt a fair system of wage payment.

The importance of wage payment system can be summarized as follows:

- Wage payment system facilitates the preparation of wage plan for future.
- Wage payment system helps to determine the cost of production and the profitability of the organization.
- Wage payment system determines the amount of earning of the workers and their living standards.
- Wage payment system affects the interest and attitude of the workers.
- Wage payment system determines the level of satisfaction of the workers and affects the rate of labor turnover.
- Wage payment system helps in recruiting skilled, experienced and trained workers.
- Wage payment system helps to increase the productivity and goodwill of the organization.

### 12.6 ESSENTIAL CHARACTERISTICS OF A GOOD WAGE PAYMENT SYSTEM

A sound system of wage payment is one that satisfies employer and employee by fulfilling following criteria.

- **Simplicity:** The wage system should be easy to understand and simple to operate. A complex system may lead to strikes and agitations and may be a hindrance to a harmonious employer-employee relationship.
- ♦ Fair to Employer and Employee: The system should be satisfactory from the point of view of both employer and employees. In other words, the reward to the employee should be fair and must give low cost per unit to the employer.
- Guaranteed minimum wage: The system should guarantee a minimum wage to every worker irrespective of the work done by them.
- Incentive to work: The system should provide adequate incentives to workers to work hard with great care. Efficient workers should be able to earn more wages as compared to the inefficient workers.

- Quality output: The system should encourage the workers not only to increase the quantum of output but also to improve the quality of output.
- Certainty: The system should not have any element of uncertainty or ambiguity.
- ♦ **Distinction between skilled and unskilled worker:** The system should distinguish between skilled and unskilled workers. Skilled workers should be compensated for the efforts put in by them to acquire the skill.
- **Uniformity:** The system should be common in the same local industry.
- ♦ Conformity with local and national labour laws: The system should to conformity with various labour laws and regulations both local and national.
- ♦ **Minimisation of labour turnover:** The system should minimise la turnover, absenteeism and late attendance.
- ♦ Adjustment to price changes: The system should invariably contain provision for automatic rise in wages as cost of living index nu increases.
- Flexibility: The system should incorporate flexibility to adjust with changing circumstances of the business.

# 12.7 DETERMINATION OF WAGES AND SALARY STRUCTURES

While the objective of wage and salary administration is as simple, the process is not so easy and simple. In fact, it is a complex one, especially since the 'fair wages' is a relative term viewed differently by different parties.

For example, while the employer will be concerned primarily with productivity, the employee's concern will be on wage rates that can offset the effects of inflation. Based on Belcher's classification of the compensation management, we have for the purposes of our analysis considered two broad components of wage and salary administration.

#### These are:

- 1. Determination of Wages and Salary
- 2. Wages/Salary Structures

# 1. Determination of Wages and Salary:

The starting point of wage and salary administration is the determination of wage and salary levels. The wage/salary of employee in the organised sector in India is determined by a variety of factors.

# These all factors are classified into four categories:

- 1. Wage Enactments (both Central and State Governments)
- 2. Prevalent Wage Rates.
- 3. Influence of Trade Unions.
- 4. Corporate Philosophy on Wages

**Lantham** has listed the following five factors that have a bearing on the formulation of wage/salary levels:

- 1. Cost of living
- 2. Productivity
- 3. Prevailing wage rates
- 4. Ability to pay
- 5. Attraction and retention of employees.

### **Cost of Living:**

Workers need to be paid compensation adequate to maintain an acceptable level of living. The concepts of 'minimum wage' are based on the same justification. However, wage/ salary fixed once becomes inadequate to maintain the required level of living due to inflationary spirals increasing the cost of living.

The increase in cost of living calls for fixation of compensation accordingly. In order to offset the increased cost of living, compensation is, then, fixed by increasing dearness allowance based on the cost of living index.

# **Productivity:**

Productivity can be expressed as production in relation to time unit. Productivity increase production and decreases cost. As per the principle of payment by performance productivity of the worker is a high, wage/salary rate will be high. Conversely, it productivity of the worker is low, wage/salary rates tend to be low. Thus, any shift in productivity has its impact on the wage level of the worker.

Here, it is important to mention that productivity increases are not due to the worker efforts alone It may also be due to better organisation and management, technological development etc Se results (profits) of increased productivity available to the employer need to be distributed in a manner acceptable to the employees, the management, and the customers. However, been any productivity index that can measure only me productivity o a

specific factor including worker Therefore. Though theoretically sound criterion, it is operationally complicated one.

# **Prevailing Wage Rate:**

In order to attract and retain workers in the organisation, wage/salary rates are fixed as per the prevailing rate in the region. This is also called the 'going wage rate' which is the most widely used criterion of wage/salary fixation. The prevailing wage rate is, thus, fixed based on inter-firm wage comparisons.

This is because of several reasons. First, various government laws and judicial decisions make the adoption of uniform wage rates Ions accept and encourage this system to ensure equal pay for equal work across the industries regions. Third, all firms functionally related in an industry require essentially the employees with the same or about the same skills and experience. However, if -age/salary are not paid to the employees what are paid by the other organisations (competitors), it will be difficult for organisation to attract and retain employees in a sufficient quantity and quality.

# **Ability to Pay:**

This criterion of wage/salary fixation is based on the dictum. "Cut your coat according to the size of your cloth". Following this, organisations do also fix wages what they can afford to pay. The reason being an increased wage cost, better call it 'wages beyond one's affording capacity' cannot enable the organisation to sustain in a competitive environment specially in the long run Such wage cost only pushes up unit cost, thus, cutting into the market share of the organization.

In such a case, organisations resort to cost cutting and axe may fall on wage and salary levels. It is mainly the ability to pay criterion, organization which earns high profits pay higher wages as compared to those whose profits are low or are incurring losses. Wage differentials between organisations are due to the same reason, i.e. ability to pay.

# **Attraction and Retention of Employees:**

The quantity and quality of employees an organizations needs to employ also determines the levels of wages and salary fixed. For example, wage/salary will be fixed at a higher level if organisation needs quality people to be employed and retained. If the availability of jobs is scarce, the wages and salary levels will be low.

Wage levels may also be low even lower than the prevailing wage rate if the firm's economic situation is such that it cannot afford to pay the prevailing wage rate in the industry or region.

According to Monappa, the following factors determine the level of wage/salary in the organised sector of the Indian industry.



# 2. Wage/Salary Structure:

Jobs offered by an organisation vary in terms of their values. Job value is ascertained by job evaluation. Job evaluation is a systematic method of appraising the value of each job in relation to other jobs in an organisation.

Once all jobs are assigned values, and then these are placed in a grade, or say, a rate per job. These grades are arranged in a hierarchical order starting with lower to higher jobs. Thus wage/salary structure consists of the various salary grades and their different levels of single jobs or group of jobs.

### 12.8 WAGE STRUCTURE IN INDIA

The employee benefit package normally contains apart from basic wage, a dearness allowance, overtime payment, annual bonus, incentive systems, and a host of fringe benefits.

# **Basic Wage**

The concept of basic wage is contained in the report of the Fair Wages Committee. According to this Committee, the floor of the basic pay is the "minimum wage" which provides "not merely for the bare sustenance of life but for the preservation of the efficiency of the workers by providing some measure of education, medical requirements and amenities." The basic wage has been the most stable and fixed as compared to dearness allowance and annual bonus which usually change with movements in the cost of living indices and the performance of the industry.

#### **Dearness Allowance**

The fixation of wage structure also includes within its compass a fixation of rates of dearness allowance. In the context of a changing pattern of prices and consumption, real wages of the workmen are likely to fluctuate greatly. Ultimately, it is the goods and services that a worker buys with the help of wages that are an important consideration for him. The real wages of the workmen thus require to be protected when there is a rise in prices and a consequent increase in the cost of living by suitable adjustments in these wages. In foreign countries, these adjustments in wages are effected automatically with the rise or fall in the cost of living.

In India, the system of dearness allowance is a special feature of the wage system for adjustment of the wages when there are frequent fluctuations in the cost of living. In our country, at present, there are several systems of paying dearness allowance to the employees to meet the changes in the cost of living. In practice, they differ from place to place and industry to industry. One of the methods of paying dearness allowance is by a flat rate, under which a fixed amount is paid to all categories of workers, irrespective of their wage scales. The second method is its linkage with consumer price index numbers published periodically by the government. It indicates the changes in the prices of a fixed basket of goods and services customarily bought by the families of workers. In other words, the indexes show the rise or fall in the cost of living due a rise or fall in consumer prices.

The Consumer Price Index (CPI) is a monthly index published by the Bureau of Labor Statistics. The CPI is compiled by price data collected throughout the country for a fixed set of goods, such as food, clothing, shelter, fuels, prescriptions, transportation fares, and medical fees. The CPI is important as a predictor of wage increases and of employees' need for greater income.

The third method of paying dearness allowance is on a graduated scale according to slabs. Under this method, workers are divided into groups according to the slabs of wage scales to whom fixed amounts of dearness allowance are paid on a graduated scale. After a limit, there will not be any increase in the amount of dearness allowance at all, however high the wage rate may be. This method is popular because it is convenient and also considered to be equitable.

# **Overtime Payment**

Working overtime in industry is possibly as old as the industrial revolution. The necessity of the managements' seeking overtime working from employees becomes inevitable mainly to overcome inappropriate allocation of manpower and improper scheduling,

absenteeism, unforeseen situations created due to genuine difficulties like breakdown of machines. In many companies, overtime is necessary to meet urgent delivery dates, sudden upswings in production schedules, or to give management a degree of flexibility in matching labour capacity to production demands. The payment of overtime allowance to the factory and workshop employees is guaranteed by law. All employees who are deemed to be workers under the Factories Act or under the Minimum Wages Act are entitled to it at twice the ordinary rate of their wages for the work done in excess of 9 hours on any day or for more than 48 hours in any week. The major benefit of overtime working to workers is that it offers an increase in income from work. The Factories Act, 1948.

### **Annual Bonus**

The bonus component of the industrial compensation system, though a quite old one, had assumed a statutory status only with the enactment of the Payment of Bonus Act, 1965. The Act is applicable to factories and other establishments employing 20 or more employees.

**Eligibility:** Every employee not drawing salary/wages beyond Rs. 10,000 per month who has worked for not less than 30 days in an accounting year, shall be eligible for bonus for minimum of 8.33% of the salary/wages even if there is loss in the establishment whereas a maximum of 20% of the employee's salary/wages is payable as bonus in an accounting year. However, in case of the employees whose salary/wages range between Rs. 3500 to Rs. 10,000 per month for the purpose of payment of bonus, their salaries/wages would be deemed to be Rs. 3500. The Payment of Bonus Act, 1965.

### 12.9 WAGE THEORIES

Some of the most important theories of wages are as follows:

- A. Subsistence Theory
- B. Wages Fund Theory
- C. The Surplus Value Theory of Wages
- D. Residual Claimant Theory
- E. Marginal Productivity Theory
- F. The Bargaining Theory of Wages
- G Behavioural Theories of Wages.

How much and on which basis wages should be paid to the workers for services rendered by them has been a subject matter of great concern and debate among economic thinkers for a long time This has given birth to several wage theories, i.e. how wages are determined. Out of them, some important theories of wages are discussed here.

### A. SUBSISTENCE THEORY

Subsistence theory was proposed by Adam Smith, who is regarded as the father of economics. According to Subsistence theory, wages should be at the level where a worker can satisfy his/her own needs as well as the needs of his/her family. This level of wages is termed as Subsistence level.

In case, the level of wages rises beyond the subsistence level, then the size of population would increase as the worker may get married and have children. This increase in population would increase the supply of labor. As a result, the wage level would again come down to the subsistence level.

On the other hand, if the wage level falls below the subsistence level, then the worker may not think of getting married. This would decrease the labor supply. In such a case, the wage level needs to reach back to the subsistence level so that the supply of labor can increased.

The theory of subsistence is also criticized by economists on various grounds, which are as follows;

- Provides a general rule for determination of wages for all countries. However, the subsistence theory is applicable in underdeveloped countries, but not for developed countries.
- Assumes that an increase in the wage level results in increase of population. However, an increase in the wage level may also increase the standard of living of individuals as well as their real wages.
- Focuses on the customs and habits of people for determining the wage level. However, the taste and habits of individuals is subject to change with time.
- Present a general view for all type of works. However, in the real world, the level of wages differs for different types of works.
- Takes into account only the supply of labor not demand for labor, which is major component in determining the wage level.

### **B. WAGES FUND THEORY**

Wages fund theory was developed by J.S. Mills. According to him, "wages depend upon the demand and supply of about, or, as it are often expressed, on the proportion between population and capital. By population is here meant the number only of the labouring classes or rather of those who work for hire, and by capital, only circulating capital and not even the whole of that but the part which is expanded on the direct purchase of labor. Wages not only depend upon the relative amount of capital and population, but cannot, under the rule of competition, be affected by anything else."

As per the wage fund theory, the wage level depends on the quantity of he wage fund and the number of people who are employed. Wage fund refers to the amount of capital that an employer keeps for paying wages to labor.

### The level of wages can be determined with the help of the following formula;

Level of wages= wage fund/number of employees

This equation implies that wages are directly proportional to wage fund and are inversely proportional to number of employees. Therefore, wages increases when wage fund increases or number of employees decreases.

However, according to the wage fund theory, wage fund is constant. Therefore, the wage level would increase only by reducing the number of employees. According to this theory, trade unions do not have any control on the level of wages.

Wage fund theory is also criticised by many economics on the following grounds;

- a. Does not provide a clear view whether the wages are paid through capital reserved or from the revenue generated by selling products. Generally, in short term, wages are paid from the revenue generated by selling products. However, in long term, wages are paid from the capital reserved.
- b. Presents the concept of keeping a certain amount for wage fund, which is not true in the real world. This is because there is no as such fund, which is fixed for providing wages.
- c. Calculates the level of wages by dividing wage fund with number of employees, which is not an appropriate method of determining the wage level.

### C. RESIDUAL CLAIMANT THEORY

According to this theory labour receives what remains after the payment of rent, profits, taxes and interest out of the national income. This theory is offered by American economist **Mr. Walker**. He says, "Wages equal the whole product minus rent interest and profit."

**Jevon** says, "The wages of working man are ultimately coincident with what he produces, after the deduction of rent, taxes and the interest on capital."

This theory has been criticized on the following grounds:

- **a. Supply influence ignored:-** This theory ignores the influence or supply side in the determination of wages.
- **b.** Role trade unions: It fails to explain as to how the trade unions raise their wages.
- **c. Entrepreneur right:** Residual claimant is the right of entrepreneur and not the labour. The labour receives its share during the process of production.
- **d.** Case of loss: If the firms suffers a loss, in that case how labour will bear the loss.

### D. MARGINAL PRODUCTIVITY THEORY

"Marginal productivity means the net addition or net subtraction caused in the total production by employing or withdrawing one unit of production."

A producer always compares the marginal product value with the price of a marginal input unit. This theory states that price of each factor of production tends to be equal to its marginal productivity.

### **Assumptions**

- ♦ Homogeneous units: It has been assumed that all the input units are exactly same. While it is not possible that all units should be same.
- **Perfect competition:** It is assumed in this theory that the <u>law of diminishing</u> return also applies to the business organization.

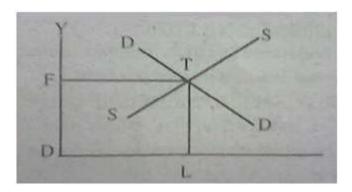
### E. DEMANDAND SUPPLY THEORY

Just as the price of commodity is determined by the interaction of the forces of demand and supply, the rate of wages can also be determined in the same way with help of demand and supply forces.

- Supply of Labour: Supply of labour depends upon the following factors.
- **Size of population:** If the size of population is greater than the supply of labour will also be greater.
- **Mobility of labour:** The supply of labour also depends upon the mobility of labour. Because if any occupation or country supply of labour decreases it can be increased.
- **Social structure:** Supply of labour also depends upon the social set up of a country. If any society allows the women to work, then the supply of labour will be greater.

The wages will be determined at the point where demand and supply both are equal to each other.

We can explain it by following diagram:



According to the above diagram demand curve (DD) and supply curve (SS) both cut each other at the point "T". So it is an equilibrium point. The OF wages will be determined in the market.

**Criticism:-** In this theory it is assumed that there is perfect competition in the market while perfect competition is absent in the market of labour and goods.

### F. THE BARGAINING THEORY

John Davidson propounded this theory. Under this theory, wages are determined by the relative bargaining power if workers or trade unions and of employers. When a trade union involved, basic wages, fringe benefits, job differentials and individual differences tend to be determined by the relative strength of the organisation and the trade union.

### G. BEHAVIOURALTHEORY

Many behavioural scientists- notably industrial psychologists and sociologists like Marsh and Simon, Robert Duvin, Eliot Jacues have presented their views or wage and salaries, on the basis of research studies and action programmes conducted by them. Briefly such theories are:

The Employee's Acceptance of a Wage Level: this type of thinking takes into consideration the factors, which may induce an employee to stay on with a company. The size and prestige of the company, the power of the union, the wages and benefits that the employee receives in proportion to the contribution made by him -all have their impact.

The Internal Wage Structure: Social norms, traditions, customs prevalent in the organization and psychological pressures on the management, the prestige attached to certain jobs in terms of social status, the need to maintain internal consistency in wages at the higher levels, the ratio of the maximum and minimum wage differentials, and the norms of span of control, and demand for specialized labour all affect the internal wage structure of an organization.

Wage and Salaries and Motivators: Money often is looked upon as means of fulfilling the most basic needs of man. Food, clothing, shelter, transportation, insurance, pension plans, education and other physical maintenance and security factors are made available through the purchasing power provided by monetary income - wages and salaries.

Merit increases, bonuses based on performance, and other forms of monetary recognition for achievement are genuine motivators. However, basic pay, cost of living increases, and other wage increases unrelated to an individual's own productivity typically may fall into maintenance category.

### 12.10 CASE STUDY

Ko, a 50- year old former employee of a dot-com in California. Her company proudly instituted a reward program designed to motivate employees. What were the rewards for a job well done? Employees would receive a badge that read "U Done Good" and each year, would receive a T-shirt as a means of annual recognition. Once an employee received 10 "U Done Good" badges, he or she could trade them in for something bigger and better- a paperweight. Ko states that she would have preferred a raise. "it was patronizing. There wasn't any deep thought involved in any of this." To make matters worse, she say the badges were handed out arbitrarily and were not tied performance. And what about those T-shirts? Ko states that he company instilled a strict dress code, so employee couldn't even wear the shirts if they wanted to. Needless to say, the employee recognition program seemed like an empty gesture rather than a motivator. Even programs that provide employees with more expensive rewards can backfire, especially if the rewards are given insincerely. Eric Lange, an employee of a trucking company, recalls a time when one of the companies' vice presidents achieved a major financial goal for the company. The vice president, who worked in an office next to Lange, received a Cadillac Seville as his company car and a new Rolex wrist watch that cost the company \$,10,000. Both were lavish gifts, but the way they were distributed left a sour taste in the vice president's mouth. He entered his office to the Rolex in a cheap cardboard box sitting on his desk, along with a brief letter explaining that he would receiving a 1099 tax form in order to pay taxes on the watch. Lange states of the vice president, he came into office, which was right next door, and said "Can you believe this?" A mere 2 months later, the vice president pawed the watch. Lange explains, "It had absolutely no meaning for him." Such experience resonate with employees who may find more value in a sincere pat on the back than in gifts from management that either are meaningless or aren't conveyed with respect or sincerity. However, sincere pats on the back may be hard to come by. Gallup's poll found that 61% of employees stated that they haven't received a sincere "thank you" from

management in the past year. Findings such as these are troubling, as verbal rewards are not only inexpensive for companies to hand out but also quick and easy to distribute. Of course, verbal rewards do need to be paired sometimes with tangible benefits that employees valueafter all, money talks. In addition, when praising employees for a job well done, managers need to ensure that the praise us given in conjunction with the specific accomplishment. In this way, employees may not only feel valued by their organisation but will also know what actions to take to be rewarded in the future.

### Questions;

- 1. As a manager, what steps would you take to motivate your employees after observing them performed well?
- 2. As a manager, how could you ensure that recognition given to employee is distributed fairly and justly?

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### **12.12 SUMMARY**

Wage and salary, <u>income</u> derived from human <u>labour</u>. Technically, wages and salaries cover all compensation made to <u>employees</u> for either physical or mental <u>work</u>, but they do not represent the income of the self-employed. Labour costs are not identical to wage and salary costs, because total labour costs may include such items as cafeterias or meeting rooms maintained for the convenience of employees. Wages and salaries usually include remuneration such as paid vacations, holidays, and sick leave, as well as <u>fringe benefits</u> and supplements in the form of pensions or health insurance sponsored by the employer. Additional compensation can be paid in the form of bonuses or <u>stock options</u>, many of which are linked to individual or group performance.

### **12.13 KEY WORDS**

- Minimum Wage
- Fair Wage
- Living Wage
- Cost of Living
- Productivity

### 12.14 SELFASSESSMENT QUESTIONS

- 1. Explain the types of wages
- 2. Compare and contrast piece-rate system and time-rate system
- 3. Describe the essential characteristics of good wage system.
- 4. Discuss the determinants of wages and salary structure.

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### DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

### **M.B.A III Semester**

### COURSE - 18 C

# COMPENSATION MANAGEMENT AND PERFORMANCE APPRAISAL

### **BLOCK**

4

### WAGE LEGISLATION AND WAGE PAYMENT SYSTEM

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# BLOCK-4: WAGE LEGISLATION AND WAGE PAYMENT SYSTEM

While fixing wages a manager needs have complete knowledge of various legislations. This block deals with wage legislation and wage payment system. Which is divided into four units.

Unit-13 deals with wage legislation. The unit discusses payment of wages act of 1936 and defines wages according to the act, continous discuss concept wage fixation, deductions allowed from wages and fines. Further, this unit focusses on the concept of minium wage, statutory wage and objectives of the minium wage act. This unit also explains penalties for offences, and payment of bonus act.

Unit-14 focusses on wage survey. Wage survey is powerful compensation and benefit benchmarking tool. The unit at the begenning sheds light on nature of wage survey, and job evaluation. The job evaluation is powerful tool that decides the relative worth of a job, the unit discusses objectives and procedure of job evaluation, Further unit also focused on steps for developing a job evaluation programme, limitation, principles and methods of the job evaluation.

Unit-15 is concerned with wage structure, this unit at the outset discusses steps for framing wage structure, principles of wage fixation. Further the unit also discusses factors affecting wage structure, methods of wage payment and wage payment policies.

Unit-16 deals with wage payment system. This unit focusess on time rate and piece rate systems of wage payment. This unit also throughs light on internal control of wage payment, importance of wage payment system and essential chacteristics of good wage payment system. Further, the unit discusses wage incentive plans, objectives of wage, types of incentive plans and blue collar employees.

# **UNIT-13: WAGE LEGISLATION**

## **Structure:**

| 13.0  | Objectives                                  |
|-------|---|
| 13.1  | Introduction                                |
| 13.2  | Wage legislations                           |
| 13.3  | Payment of wages act of 1936                |
| 13.4  | Definition of wages                         |
| 13.5  | Fixation for wage periods                   |
| 13.6  | Deductions which may be made from the wages |
| 13.7  | Fines                                       |
| 13.8  | The concept of minimum wage                 |
| 13.9  | Statutory minimum wages                     |
| 13.10 | Objectives of the minimum wages act         |
| 13.11 | Penalties for offences                      |
| 13.12 | Payment of bonus act                        |
| 13.13 | Case study                                  |
| 13.14 | Notes                                       |
| 13.15 | Summary                                     |
| 13.16 | Keywords                                    |
| 13.17 | Self assessment Questions                   |
| 13.18 | References                                  |

### 13.0 OBJECTIVES

After studying this unit you should be able to:

- Define the wage legislation
- Describe The Payment of Wages Act
- Discuss the Minimum Wages Act
- Describe Minimum Bonus Act
- Explain the various factors influencing wage fixation in different Act

### 13.1 INTRODUCTION

Wages are considered as one of the important element in factors of production. Wages are the reward which is paid by the employer to the worker for his work for over a period of time. Wages are one of the most important constituent of payment system and it carries too much importance in retaining good workers. Firms over a period of time has been trying to frame various policies in making the skilled labours stay with the company, but the execution of the top policies has been not fulfilled up to its longest extent. Apart from that it has been seen over a period of time that firms payment system in respect of wages has created many confusions and problems in the mind of the workers as the payment is not up to the standard level which is expected from work, To overcome all these problems Govt initiated various Act which are helpful for the firm to fix the wages in best possible manner. In this unit we are discussing various Acts and legislations framed by the Government to overcome these problems.

### 13.2 WAGE LEGISLATION

The workers who devote most of their energies to the service of their employers are nevertheless found living in poverty, there is a strong legislative urge to do something about it. The obvious thing to do is to require employers to pay a "living wage." Such legislation has now been in force in various countries for over a hundred years, and economists have been discussing the issue much longer than that. While recognizing the reduction of poverty as a primary goal of policy, economists have almost uniformly decided to provide their respective guidelines for the removal of poverty in the reduction of wrong policies laid down by employers. Wages legislations are one of the most power tool in ensuring that the workers get fair reward for their respective work. Every country Government has been playing important role in protecting its countries from unfair wage policy of the employer.

The first national minimum wage law was enacted by the government of New Zealand in 1894, followed by Australia in 1896 and the United Kingdom in 1909. In the United States, statutory minimum wages were first introduced nationally in 1938, and reintroduced and expanded in the United Kingdom in 1998. There is now legislation or binding collective bargaining regarding minimum wage in more than 90 percent of all countries. In the European Union, 21 member states currently have national minimum wages. Many countries, such as Sweden, Finland, Denmark, Switzerland, Austria, and Italy have no minimum wage laws, but rely on employer groups and trade unions to set minimum earnings through collective bargaining. India was one of the first developing countries to introduce minimum wage policy. It also has one of the most complicated systems with more than 1200 minimum wage rates. Customs and extra-legal pressures from governments or labor unions can produce a *de facto* minimum wage. International public opinion also plays an important role in fixing the minimum wages by pressuring the MNCs to pay wages according to the international criteria.

To prevent the undue and unfair wages policy the Government has overtime various wages legislations which are as follows

- 1. Factories Act 1928
- 2. Industrial Disputes Act 1947
- 3. Employees State Insurance Act 1948
- 4. Industrial Employment Standing Order Act 1946
- 5. Payment of Wages Act -1936
- 6. Workmens Compensation Act
- 7. Minimum Wages Act 1948

### 13.3 PAYMENT OF WAGES ACT 1936

### **Definitions**

"employed person" [sec 2 (i)] includes the legal representative of a deceased employed person;

"employer" [sec 2 (ia)] includes the legal representative of a deceased employer;

"industrial or other establishment" [sec 2 (i1)] means any –

(a) Tramway service or motor transport service engaged in carrying passengers or goods or both by road for hire or reward;

- (aa) air transport service other than such service belonging to or exclusively employed in the military naval or air forces of the Union or the Civil Aviation Department of the Government of India;
- (b) Dock wharf or jetty;
- (c) Inland vessel mechanically propelled;
- (d) Mine quarry or oil-field;
- (e) Plantation;
- (f) Workshop or other establishment in which articles are produced adapted or manufactured with a view to their use transport or sale;
- (g) establishment in which any work relating to the construction development or maintenance of buildings roads bridges or canals or relating to operations connected with navigation irrigation or to the supply of water or relating to the generation transmission and distribution of electricity or any other form of power is being carried on;
- (h) any other establishment or class of establishments which the Central Government or a State Government may having regard to the nature thereof the need for protection of persons employed therein and other relevant circumstances specify by notification in the Official Gazette.

### 13.4 DEFINITION OF WAGES

wages" [sec 2 (iv)] means all remuneration (whether by way of salary allowances or otherwise) expressed in terms of money or capable of being so expressed which would if the terms of employment express or implied were fulfilled by payable to a person employed in respect of his employment or of work done in such employment and includes –

- (a) Any remuneration payable under any award or settlement between the parties or order of a court;
- (b) Any remuneration to which the person employed is entitled in respect of overtime work or holidays or any leave period
- (c) Any additional remuneration payable under the terms of employment (whether called a bonus or by any other name)
- (d) Any sum which by reason of the termination of employment of the person employed is payable under any law contract or instrument which provides for the payment of such sum whether with or without deductions but does not provide for the time within which the payment is to be made

(e) Any sum to which the person employed is entitled under any scheme framed under any law for the time being in force

### But does not include -

- (1) Any bonus (whether under a scheme of profit sharing or otherwise) which does not form part of the remuneration payable under the terms of employment or which is not payable under any award or settlement between the parties or order of a court
- (2) The value of any house-accommodation or of the supply of light water medical attendance or other amenity or of any service excluded from the computation of wages by a general or special order of the State Government
- (3) Any contribution paid by the employer to any pension or provident fund and the interest which may have accrued thereon
- (4) Any travelling allowance or the value of any travelling concession
- (5) Any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment
- (6) Any gratuity payable on the termination of employment in cases other than those specified in sub-clause

### Responsibility for payment of wages

Every employer shall be responsible for the payment to persons employed by him of all wages required to be paid.

- In the case of the factory, manager of that factory shall be liable to pay the wages to employees employed by him.
- In the case of industrial or other establishments, persons responsibility of supervision shall be liable for the payment of the wage to employees employed by him.
- In the case of railways, a person nominated by the railway administration for specified area shall be liable for the payment of the wage to the employees.
- In the case of contractor, a person designated by such contractor who is directly under his charge shall be liable for the payment of the wage to the employees. If he fails to pay wages to employees, person who employed the employees shall be liable for the payment of the wages.

### 13.5 FIXATION FOR WAGE PERIODS

Every person responsible for the payment of wages under section 3 shall fix periods in respect of which such wages shall be payable. No wage-period shall exceed one month. That means wage can be paid on daily, weekly, fortnightly (for every 15 days) and monthly only. Wage period for payment of wages to employees by employer should not exceed 30 days i.e. one month according to this act.

### Time Of Payment Of Wages.

- In railway factory or industrial or other establishment, if there are less than 1000 employees, wages of employees should be paid before the expiry of the 7th day after the last day of the wage period. (ex:- wages should be paid on starting of present month within 7 days i.e. before 7th date if wage is paid on 1st in previous month)
- In other railway factory or industrial or other establishment, if there are more than 1000 employees, wages of employees should be paid before the expiry of the 10th day after the last day of the wage period. (ex:- wages should be paid on starting of present month within 10 days i.e. before 10th date if wage is paid on 1st in previous month)
- For employees of port area, mines, wharf or jetty, wages of employees should be paid before the expiry of the 7h day after the last day of the wage period.

### 13.6 DEDUCTIONS WHICH MAY BE MADE FROM THE WAGES

At the time of payment of the wage to employees, employer should make deductions according to this act only. Employer should not make deductions as he like. Every amount paid by the employee to his employer is called as deductions. The following are said to be the deductions and which are acceptable according to this act

- Fines,
- Deductions for absence from duty,
- Deductions for damage to or loss of goods made by the employee due to his negligence,
- Deductions for house-accommodation supplied by the employer or by government or any housing board,
- Deductions for such amenities and services supplied by the employer as the State Government or any officer,

- Deductions for recovery of advances connected with the excess payments or advance payments of wages,
- Deductions for recovery of loans made from welfare labour fund,
- Deductions for recovery of loans granted for house-building or other purposes,
- Deductions of income-tax payable by the employed person,
- Deductions by order of a court,
- Deduction for payment of provident fund,
- Deductions for payments to co-operative societies approved by the State Government,
- Deductions for payments to a scheme of insurance maintained by the Indian Post Office
- Deductions made if any payment of any premium on his life insurance policy to the Life Insurance Corporation with the acceptance of employee,
- Deduction made if any contribution made as fund to trade union with the acceptance of employee,
- Deductions, for payment of insurance premia on Fidelity Guarantee Bonds with the acceptance of employee,
- Deductions for recovery of losses sustained by a railway administration on account of acceptance by the employee of fake currency,
- Deductions for recovery of losses sustained by a railway administration on account of failure by the employee in collections of fares and charges,
- Deduction made if any contribution to the Prime Minister's National Relief Fund with the acceptance of employee,
- Deductions for contributions to any insurance scheme framed by the Central Government for the benefit of its employees with the acceptance of employee.

### **13.7 FINES**

Fine should be imposed by the employer on employee with the approval of the state government or prescribed authority. Employer should follow the rules mentioned below for and before imposing of fine on the employee.

1. Notice board of fines on employee should be displayed in the work premises and it should contain activities that should not be made by employee.

- 2. Fine should not be imposed on the employee until he gives the explanation and cause for the act or omission he made.
- 3. Total amount of fine should not exceed 3% of his wage.
- 4. Fine should not be imposed on any employee who is under the age of 15 years.
- 5. Fine should be imposed for one time only on the wage of the employee for the act or omission he made.
- 6. Fines should not be recovered in the way of installments from the employee.
- 7. Fine should be recovered within 60 days from the date on which fine were imposed.
- 8. Fine should be imposed on day act or omission made by the employee.
- 9. All fines collected from the employee should be credited to common fund and utilize for the benefit of the employees.

### **INSPECTORS**

The state government may appoint an inspector for purpose of this act. Every Inspector shall be deemed to be a public servant within the meaning of the Indian Penal Code, 1860 [Sec 14(5)]. The inspector of this act is having powers mentioned below

- Inspector can make enquiry and examination whether the employers are properly obeying the rules mentioned under this act.
- Inspector with such assistance, if any, as he thinks fit, enter, inspect and search any premises of any railway, factory or industrial or other establishment at any reasonable time for the purpose of carrying out the objects of this Act.
- Inspector can supervise the payment of wages to persons employed upon any railway or in any factory or industrial or other establishment.
- Seize or take copies of such registers or documents or portions thereof as he may consider relevant in respect of an offence under this Act which he has reason to believe has been committed by an employer.

# CLAIMS ARISING OUT OF DEDUCTIONS FROM WAGES OR DELAY IN PAYMENT OF WAGES

To hear and decide all claims arising out of deductions from the wages, or delay in payment of the wages, of persons employed or paid, including all matters, incidental to such claims, there will be a officer mentioned below appointed by the appropriate government.

- a.) Any Commissioner for Workmens Compensation or
- b) Any officer of the Central Government exercising functions as –

### a.) Regional Labour Commissioner

- (b) a presiding officer of any Labour Court or Industrial Tribunal, constituted under the Industrial Disputes Act, 1947 (14 of 1947) or under any corresponding law relating to the investigation and settlement of industrial disputes in force in the State; or
- (c) any other officer with experience as a Judge of a Civil Court or a Judicial Magistrate, as the authority to hear and decide for any specified area all claims arising out of deductions from the wages, or delay in payment of the wages, of persons employed or paid in that area,
- (d.) Appropriate Government considers it necessary so to do, it may appoint more than one authority for any specified area and may, by general or special order, provide for the distribution or allocation of work to be performed by them under this Act.

If any employer does opposite to the provisions of this act, any unreasonable deduction has been made from the wages of an employed person, or any payment of wages has been delayed, in such case any lawyer or any Inspector under this Act or official of a registered trade union authorized to write an application to the authority appointed by government for direction of payment of wages according to this act. Every such application shall be presented within 12 months from the date on which the deduction from the wages was made or from the date on which the payment of the wages was due to be made. Time of making an application can be accepted if that is reasonable

e)After receiving of the application the authority shall give an opportunity to hear the applicant and the employer or other person responsible for the payment of wages and conducts the enquiry if necessary. It is found that there is mistake with employer; authority shall order the employer for payment of the wage or refund to the employee of the amount deducted unreasonably or the payment of the delayed wages, together with the payment of such compensation as the authority may think fit. There will not be any compensation payable by employer if there is a reasonable and genuine cause in delay in the payment of wages.

### PENALTY FOR OFFENCES UNDER THE ACT

### **Penalty**

- Delay in payment of wages
- Unreasonable deductions
- Excess deduction for absence of duty
- Excess deduction for damage or loss to employer
- Excess deduction for house-accommodation amenity or service

# Punishable with fine which shall not be less than 1000/- rupees but which may extend to 7500/- rupees.

If Wage period exceed one month. Failure in payments of wages on a working day. Wages not paid in form of current coin or currency notes or in both.

- Failure to maintain record for collected fines from employee.
- Improper usage of fine collected from employees.
- Failure of employee to display notice containing such abstracts of this Act and of the rules made.

### Punishable with fine which may extend 3000/- rupees

- Whoever obstructs an Inspector in the discharge of his duties under this Act
- Whoever willfully refuses to produce on the demand of an Inspector any register or other document?
- Whoever refuses or willfully neglects to afford an Inspector any reasonable facility for making any entry, inspection, examination, supervision, or inquiry authorized by or under this Act

### **Minimum Wages Act**

In a free competitive market forces of demand and supply determine the level of wages payable to workers. In a welfare State the protection of the interests of workers is one to the aims of any legislation that is enacted in the labor field. The Indian labor class besides being illiterate is by and large not organized to protect its interests in a competitive market where supply of labor is always in excess of demand. Under such conditions, the labor class left to it is unable to protect its legitimate interests. In a country, which is still underdeveloped, the exploitation of labor in certain industries is a common feature due to the reasons that unemployment even on starvation wages.

The Act was enacted to secure the welfare of the workers in a competitive market by providing for a minimum limit of wages in certain employment. To achieve the first objective of the industrial policy resolution, the minimum wages act, 1948 was passed. It laid down certain norms and procedures forth determination and fixation of wages by the central and state government authorities in the sweated scheduled employment. The whole philosophy under the act was to prevent the exploitation of labor through the payment of unduly low wages

The provisions of the Act are intended to achieve the object of doing social justice to workers employed in scheduled employments by prescribing minimum rates of wages for them. Therefore the legislature intended to apply this Act not to all industries but to those industries only where by reason of unorganized labour or want of proper arrangement for effective regulation of wages or other causes the wages are very low. The concept of locus stand has also been enlarged with a view to ensure the application of the law.

The act contemplates that minimum wages rates must ensure not the mere physically need of the worker which would keep him just above starvation but ensures for him not only his subsistence and that of his family but also preserve his efficacy as a workman. It should, therefore, provide not merely the bare subsistence of life but the preservation of the workers health and for some measure of education, medical requirement and amenities. The Minimum Wages Act was enacted to fulfill the aspiration of the workers as contained in the resolution based on Geneva Convention held in 1928.

### 13.8 THE CONCEPT OF MINIMUM WAGE

The Act does not define the minimum wages presumably it would not be possible to lay down a uniform minimum for all industries throughout the country on account of different and varying conditions prevailing from industry to industry and form one part of the country to another

### **Definition**

Wages as defined in the Act means all remuneration, capable of being expressed in terms of money which would, if the terms of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or work done in such employment and includes house rent allowance, but wages do not include

- 1. The value of any house accommodation, supply of light, water medical attendance
- 2. The value of any other amenity or may service excluded by general or special order of the appropriate government
- 3. Any contribution paid by employer to any pension fuc or provident fund orundr any scheme of social insurance
- 4. Any traveling allowance or the value of any traveling concession
- 5. Any sum paid to the persons employed to defy special expenses entailed on him by the nature of his employment

### 13.9 STATUTORY MINIMUM WAGES

Statutory minimum wages mainly includes

Any minimum rate of wages fixed or revised by the appropriate government in respect of scheduled employments may consist of

- A basic rate of wages and a special allowance at a rate to be adjusted at such intervals and in such manner as the appropriate government may direct to accord as nearly as possible with the variation of cost of living index number applicable to such workers
- A basic rate of wages with or without the cost of living allowance, and the cash value of allowance in respect of essential commodities at a concession rate where so authorized.
- An all inclusive rate allowing for the basic are, the cost of living allowance and the cash value of the concession, if any
- Minimum wages, as the name itself implies, represent the level below which wages cannot be allowed to drop it is prescribed in order to check the evil of sweating and for the benefits of workers who are not in a position to bargain with their employers.

### 13.10 OBJECTIVES OF THE MINIMUM WAGES ACT

- 1. To prevent exploitation of workers
- 2. Aims at fixation of minimum wages, which the employer must pay
- 3. To ensure minimum statutory wages for scheduled employments and to avoid the chances of exploitation by paying very low wages
- 4. The act also provides for maximum daily working hours, weekly and rest of day and overtime
- 5. Minimum wages fixed by the State Government under the Act prevailed over the rates if fixed under/agreement

### **Applicability of Act**

The Act is called the Minimum Wages Act, 1948 .IT came into force from 15<sup>th</sup> MARCH 1948.The Act was amended in 1954,1957,1961,1982,1983,1987,1990 and 1993.It extends the whole of India. Under this Act,the Central Government is empowered to fix minimum wage for employment detail in Schedule 1 of the Act, and carried on by or under the authority of the Central Government ,by a railway administration or in relation to a mine oil field, or any corporation established by a Central Act and by the State Governments for other

employments covered by the Schedule of the Act. The appropriate government is empowered to extend that act to any category of employment

### Minimum rate of Wages

Any minimum rate of wages fixed or revised by the appropriate government in respect of scheduled employments under section 3 may consist of

- 1. A basic rate of wages and a special allowance at a rate to be adjusted, at such intervals and in such manner as the appropriate government may direct to accord as nearly as practicable with the variation in the cost of living index number applicable to such workers
- 2. A basic rate of wages with or without the cost of living allowance and the cash value of the concessions in respect supplies essential commodities a a concession rate.
- 3. The cost of living allowance and the cash value of the concessions in respect of supplies of essential commodities at concessional rate shall be compared by the competitor authority at such intervals and in accordance with such directions as may be specified or given by the appropriate Government.

### Procedure for fixing and revising minimum wages

- (1) In fixing minimum rates of wages in respect of any scheduled employment for the first time under this Act or in revising minimum rates of wages so fixed the appropriate government shall either –
- (a) appoint as many committees and sub-committees as it considers necessary to hold enquiries and advise it in respect of such fixation or revision as the case may be or
- (b) by notification in the Official Gazette publish its proposals for the information of persons likely to be affected thereby and specify a date not less than two months from the date of the notification on which the proposals will be taken into consideration.
- (2) After considering the advice of the committee or committee appointed under clause (a) of sub-section (1) or as the case may be all representations received by it before the date specified in the notification under clause (b) of that sub-section the appropriate government shall by notification in the Official Gazette fix or as the case may be revise the minimum rates of wages in respect of each scheduled employment and unless such notification otherwise provides it shall come into force on the expiry of three months from the date of its issue:

**Provided** that where the appropriate government proposes to revise the minimum rates of wages by the mode specified in clause (b) of sub-section (1) the appropriate government shall consult the Advisory Board also.

### **Provisions**

- 1. The Act lays down that the employer shall pay wages to employees engaged in scheduled employments, wages at a rate not less than the minimum rates as notified by the government
- 2. The wages of a worker in any scheduled employment shall be paid on a working day. In the case of establishments in which less than one thousand person are employed, the wages shall be paid before the expiry of the seventh day after the wage period in respect of which the wages are payable. In all other factories, wages must be paid before the expiry of the tenth day from the wages period aforesaid
- 3. When the employment of any person is terminated, the wages shall be paid before the expiry of the second working day after the termination of the employment. All wages shall be paid in current coin or currency notes or both
- 4. The wages shall be paid without deductions of any kind except those allowed by rules and notifications
- 5. The appropriate Government may fix the number of hours which shall constitute a normal working day inclusive of one or more specified intervals, provide for a day of rest in every period of seven days which shall be allowed to all employees or to any specified class employees and for payment of remuneration in respect of such days of rest, and provide for payment for work on a day of rest at a rate not less than the over time rate.
- 6. In a scheduled employment where minimum rates of wages have been fixed, the rest day shall be Sunday but the employer can fix any other day of the week as rest day for an employee. The number of hours, which shall constitute a normal working day, shall be none hours in he case of adults and four and half hours in the case of children
- 7. When an employee works for more than prescribed hours of work, he shall entitle to overtime wages.

### 13.11 PENALTIES FOR OFFENCES

- 1. An employer, who pays to any employee less than the prescribed minimum rate of wages or infringes any order or rule, may be punished up to six months and or with a fine up to Rs 500 or both. Further an employer who fails to maintain a register a record required to be maintained under the Act is punishable with a fine which may extend to fine of Rs 500
- 2. Any employer pays to any employee less than the minimum rate of was fixed for that employees class of work or less that the amount due to him under the provisions of their

act or contravenes any rule or order made under section 13 shall be punishable in imprisonment for a term which any extend to six months or with fine which extend to tie hundred rupees or with both provided that in imposing any fine for an offence under the section the court shall take into consideration the amount of any compensation already awarded again the accused in any proceedings taken under section 20

- 3. Any employee who contravenes any provision of the Act of if any rule or under made thre under shall if no other penalty is provided for such contravention by this Act be punishable with fine which extend to Rs 500
- 4. No court shall be take cognizance of a complaint again any person for an offence (a) of section 22 unless an application in respect of the facts consisting such offence has been presented under section 20 and has been granted wholly in part and the appropriate government or an officer authorized by and its behalf has sanctioned the making of the complaint (b) under section 22A except on a complaint made by or with the sanction of an Inspector
- 5. No court shall take cognizance of an offence (a) under clause 22 unless complaint there of is made within one month of the grant of sanction under this section.(b) under section 22A unless complaint thereof is made within six months of the date on which the offence is alleged to have been committed.

### 13.12 PAYMENT OF BONUS ACT

The Payment of Bonus Act, 1965 is the principal act for the payment of bonus to the employees which was formed with an objective for rewarding employees for their good work for the organization. It is a step forward to share the prosperity of the establishment reflected by the profits earned by the contributions made by capital, management and labour with the employees.

### **Objective**

- 1. To improve statutory liability to pay bonus [reward for good work] in case of profits or losses. 2. To prescribe formula for calculating bonus
- 3. To prescribe Minimum & Maximum percentage bonus
- 4. To provide of set off/set on mechanism
- 5. To provide redressal mechanism

### 13.12.1 Definitions

- (i) in relation to a corporation, the year ending on the day on which the books and accounts of the corporation
- (ii) in relation to a company, the period in respect of which any profit and loss account of the company laid before it in annual general meeting is made up, whether that period is a year or not;
- (iii) in any other case-

(a) if the accounts of an establishment maintained by the employer thereof are closed and balanced on any day other than the 31st day of March, then, at the option of the employer, the year ending on the day on which its accounts are so closed and balanced "employee" means any person (other than an apprentice) employed on a salary or wage not exceeding 10,000/- rupees per month in any industry to do any skilled or unskilled manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied; (2007 amendment)

### 13.12.2 Payment of Bonus Act not to apply to certain classes of employees.

- Life Insurance Corporation,
- The Indian Red Cross Society or any other institution of a like nature,
- Universities and other educational institutions,
- Institutions (including hospitals, chambers of commerce and society welfare institutions) established not for purposes of profit,
- Employees employed by the Reserve Bank of India,
- The Industrial Finance Corporation of India,
- Financial Corporations,
- National Bank for Agriculture and Rural Development,
- Unit Trust of India,
- Industrial Development Bank of India,

### **Provision Regarding Payment of minimum bonus**

- Bonus should be paid along with the salary
- Every year, every employer shall be bound to pay bonus to every employee.

- a minimum bonus which shall be 8.33% cent of the salary or wage earned by the employee during the accounting year or 100/- rupees, whichever is higher.
- Bonus shall be payable in case of profits or losses in the accounting year.

### 13.12.3 Power of exemption of bonus payment by government

In certain circumstances payment of minimum bonus can be exempted by the appropriate government by taking consideration into relevant circumstances of concern factory or establishment which is in losses. Payment of bonus exemption by the appropriate government may be given for a certain period only.

### **Payment of Maximum Bonus**

- 1. In case the allocable surplus amount [Section 2(4)] exceeds the minimum bonus (8.33%) payable amount to employees, the employer is bound to pay extra percentage of bonus.
- 2. But maximum of 20% of bonus is payable to the every employee on the wage or salary earned during the year.

### **Inspectors**

The Government may, by notification in the official Gazette, appoint such persons as it thinks fit to be Inspectors for the purpose of this Act

### **Powers**

- Inspector can any reasonable time can enter in the premises and inspect or examine the records, accounts, books, registers and any other documents.
- Employer is having duty to furnish any information asked by the inspector.

### **Offences and Penalties**

- For contravention of the provisions of the Act or rules the penalty is imprisonment upto 6 months or fine up to Rs.1000, or both.
- In case of offences by companies, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly: any such person liable to any punishment if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

### 13.13 CASE STUDY

For right or wrong reasons, Bata India Limited (Bata) always made the headlines in the financial dailies and business magazines during the late 1990s. The company was headed by the 60 year old managing director William Keith Weston (Weston). He was popularly known as a 'turnaround specialist' and had successfully turned around many sick companies within the Bata Shoe Organization (BSO) group. By the end of financial year 1999, Bata managed to report rising profits for four consecutive years after incurring its first ever loss of Rs 420 million in 1995. However, by the third quarter ended September 30, 2000, Weston was a worried man. Bata was once again on the downward path. The company's nine months net profits of Rs 105.5 million in 2000 was substantially lower than the Rs 209.8 million recorded in 1999. Its staff costs of Rs 1.29 million (23% of net sales) was also higher as compared to Rs 1.18 million incurred in the previous year. In September 2000, Bata was heading towards a major labour dispute as Bata Mazdoor Union (BMU) had requested West Bengal government to intervene in what it considered to be a major downsizing exercise. Throughout its history, Bata was facing too huge labor problems with frequent strikes and lockouts at its manufacturing facilities. The company incurred huge employee expenses (22%) of net sales in 1999). Competitors like Liberty Shoes were far more cost-effective with salaries of its 5,000 strong workforce comprising just 5% of its turnover.

### **Assault Case**

More than half of Bata's production came from the Batanagar factory in West Bengal, a state notorious for its militant trade unions, who derived their strength from the dominant political parties, especially the left parties. Notwithstanding the giant conglomerate's grip on the shoe market in India, Bata's equally large reputation for corruption within, created the perception that Weston would have a difficult time. When the new management team weeded out irregularities and turned the company around within a couple of years, tackling the politicized trade unions proved to be the hardest of all tasks. On March 8, 2000, a lockout was declared at Bata's Peenya factory in Bangalore, following a strike by its employee union. The new leadership of the union had refused to abide by the wage agreement, which was to expire in August 2001. Following the failure of its negotiations with the union, the management decided to go for a lock out. Bata management was of the view that though it would have to bear the cost of maintaining an idle plant (Rs. 3 million), the effect of the closures on sales and production would be minimal as the footwear manufactured in the factory could be shifted to the company's other factories and associate manufacturers. The factory had 300 workers on its rolls and manufactured canvas and PVC footwear. In July 2000, Bata lifted the lockout at the Peenya factory. However, some of the workers opposed

the company's move to get an undertaking from the factory employees to resume work. The employees demanded revocation of suspension against 20 of their fellow employees. They also demanded that conditions such as maintaining normal production schedule, conforming to standing orders and the settlement in force should not be insisted upon.

In September 2000, Bata was again headed for a labour dispute when the BMU asked the West Bengal government to intervene in what it perceived to be a downsizing exercise being undertaken by the management. BMU justified this move by alleging that the management has increased outsourcing of products and also due to perceived declining importance of the Batanagar unit. The union said that Bata has started outsourcing the Power range of fully manufactured shoes from China, compared to the earlier outsourcing of only assembly and sewing line job. The company's production of Hawai chappals at the Batanagar unit too had come down by 58% from the weekly capacity of 0.144 million pairs. These steps had resulted in lower income for the workers forcing them to approach the government for saving their interests

### Questions

- 1. Do you think claim of workers to abide by the wage agreement after its expiry was legally accepted
- 2. Do you think workers claim for lower wages was justified?
- 3. If you were the HR Manager what would have been your stand on the issue relating to outsourcing of job due to low demand?

| 13.14NOTES                              |  |
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### **13.15 SUMMARY**

Wages legislation is one of the important instruments in ensuring that the overall management runs in a well shaped manner as wages are key to any development or growth of the business area. The firm can develop better when it is equipped with the best human resource and skilled labor which can provide answers to the organizational problems whenever the firm faces problem of any sort. This has laid down the basis for effective wage legislation and steps are taken to ensure that every worker is paid proportionate wages to the proportion of their works. Hence wages legislation has been considered up as one of the most instrument act in ensuring that proper wages are provided for the work undertaken by the workers.

### 13.16 KEY WORDS

Wages, Legislation, Act, Human Resource, Development, Entitled

### 13.17 SELF ASSESSMENT QUESTIONS

- 1. What do you mean by wage legislation and explain how they are framed?
- 2. Define Inspector and explain its role in Minimum Bonus Act.
- 3. Define Bonus and explain the objective of Minimum Bonus Act.

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# **UNIT - 14 : WAGE SURVEY**

### **Structure:**

- 14.0 Objectives
- 14.1 Introduction
- 14.2 Nature of Wage Surveys
- 14.3 Concept of job evaluation
- 14.4 Advantages of Job Evaluation
- 14.5 Objectives of job evaluation
- 14.6 Procedure of job evaluation
- 14.7 Steps for Developing a Job Evaluation Programme
- 14.8 Limitations of job evaluation
- 14.9 Principles of Job Evaluation
- 14.10 Methods of the Evaluation
- 14.11 Case Study
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- 14.13 Summary
- 14.14 Key words
- 14.15 Self assessment Questions
- 14.16 References

#### 14.0 OBJECTIVES

#### After studying this unit you should be able to:

- describe the wage survey and its content
- analyze the meaning and principal of Job Evaluation
- explain the methods of Job Evaluation
- analyze various steps in developing Job Evaluation Programme
- estimate the advantages and disadvantages of Job Evaluation Techniques
- identify the various factors influencing wage fixation in different Act

#### 14.1 INTRODUCTION

The wage survey is extremely powerful compensation and benefits benchmarking tool. They are important for the setting right compensation strategy and for following and monitoring the desired pay market. The wages survey is provided by the external compensation consultant, who gather the compensation information and wages details about the individuals, match the information and provides feedback about the pay market and pay structures back to the participating organizations. Wage Surveys are tools used to determine the median or average compensation paid to employees in one or more jobs. Compensation data, collected from several employers, is analyzed to develop an understanding of the amount of compensation paid. Surveys may focus on one or more job titles, geographic regions, employer size, and or industries. Wages surveys may be conducted by employer associations (e.g., SHRM), survey vendors, or by individual employers.

Wages data is often time sensitive and may become out-of-date quickly because of the time sensitive information, surveys are often identified by the year or quarter in which the data was collected.

# Types of data gathered in a wages survey

Wages Surveys are analyses of compensation data. This data may include quantifiable aspects of compensation such as:

- 1. Base salaries
- 2. Increase percentages or amounts
- 3. Merit Increases
- 4. Wages Ranges

- 5. Starting Wages
- 6. Incentives/Bonuses
- 7. Allowances and Benefits
- 8. Working Hours

#### 14.2 NATURE OF WAGE SURVEYS

#### ♦ Jobs

Wages Surveys collect compensation data for one or more jobs (job titles). The jobs may vary depending on industry and or size of employer. For example, some surveys for printing companies may include titles such as: Press Operator, Binding Machine Operator, or Lithographic Press Operator. Job titles specific to the banking industry include: Teller, Cashier, Account Manager, or Investment Manager. Job titles should be have little overlap and should unique titles that describe the job. For example the following job titles: Secretary A, Secretary B, and Secretary C do not adequately describe the hierarchical relationship between the three job titles.

## **♦** Summary

Wages Survey results should contain a summary of the data analysis. This summary is useful for understanding trends that are occurring the labor market.

## Methodology

is there a minimum number of responses needed before reporting results? Data should not be reported for too few incumbents. Need to report median wages as well as averages. The mean is the average of all numbers divided by the number of responses. The 'mean' can be affected by extreme values. The median is the midpoint with half of the responses is above that number and half fall below. Please note that in wages data, the median tends to be lower than the mean due to the fact that there is no upper limit to the rates that can be paid for a job. However, the lower limit is zero. Therefore, the distribution of salaries tends to be skewed with a few salaries at the extreme high end of the range. Fact: In wages data, the median will almost always be lower than the mean. Explanation.

#### **♦** Tabulations

At a minimum, survey results must be tabulated by Job Title. This means that the average or median wages should be reported separately for each job in the survey (assuming that there were sufficient numbers of participants to make the analysis meaningful). If the

survey includes data from a large number of participants, the value of the survey results will be increased if the results can be tabulated by other employer demographics such as: funding type (public/private), industry, geographic region, size (number of employees or financial measure).

#### 14.3 CONCEPT OF JOB EVALUATION

In simple words, job evaluation is the rating of jobs in an organisation. This is the process of establishing the value or worth of jobs in a job hierarchy. It attempts to compare the relative intrinsic value or worth of jobs within an organisation. Thus, job evaluation is a comparative process.

## Below are given some important definitions of job evaluation:

According to the International Labour Office (ILO) "Job evaluation is an attempt to determine and compare the demands which the normal performance of a particular job makes on normal workers, without taking into account the individual abilities or performance of the workers concerned".

The British Institute of Management defines job evaluation as "the process of analysis and assessment of jobs to ascertain reliably their negative worth using the assessment as the basis for a balanced wage structure". In the words of Kimball and Kimball "Job evaluation is an effort to determine the relative value of every job in a plant to determine what the fair basic wage for such a job should be".

Wendell French defines job evaluation as "a process of determining the relative worth of the various jobs within the organisation, so that differential wages may be paid to jobs of different worth. The relative worth of a job means relative value produced. The variables which are assumed to be related to value produced are such factors as responsibility, skill, effort and working conditions".

Now, we may define job evaluation as a process used to establish the relative worth of jobs in a job hierarchy. This is important to note that job evaluation is ranking of job, not job holder. Job holders are rated through performance appraisal. Job evaluation assumes normal performance of the job by a worker. Thus, the process ignores individual abilities of the job holder.

Job evaluation provides basis for developing job hierarchy and fixing a pay structure. It must be remembered that job evaluation is about relationships and not absolutes. That is why job evaluation cannot be the sole determining factor for deciding pay structures.

External factors like labour market conditions, collective bargaining and individual differences do also affect the levels of wages it, organisations. Nonetheless, job evaluation can certainly provide an objective standard from which modifications can be made in fixing wage structure.

#### 14.4 ADVANTAGES OF JOB EVALUATION

- 1. Reduction in inequalities in salary structure It is found that people and their motivation is dependent upon how well they are being paid. Therefore the main objective of job evaluation is to have external and internal consistency in salary structure so that inequalities in salaries are reduced.
- 2. Specialization Because of division of labour and thereby specialization, a large number of enterprises have got hundred jobs and many employees to perform them. Therefore, an attempt should be made to define a job and thereby fix salaries for it. This is possible only through job evaluation.
- **3. Helps in selection of employees -** The job evaluation information can be helpful at the time of selection of candidates. The factors that are determined for job evaluation can be taken into account while selecting the employees.
- 4. Harmonious relationship between employees and manager Through job evaluation, harmonious and congenial relations can be maintained between employees and management, so that all kinds of salaries controversies can be minimized.
- 5. Standardization The process of determining the salary differentials for different jobs become standardized through job evaluation. This helps in bringing uniformity into salary structure.
- **6. Relevance of new jobs -** Through job evaluation, one can understand the relative value of new jobs in a concern.

#### 14.5 OBJECTIVES OF JOB EVALUATION

The main objective of job evaluation is to determine relative worth of different jobs in an organization to serve as a basis for developing equitable salary structure. States an ILO Report the aim of the majority of systems of job evaluation is to establish, on agreed logical basis, the relative values of different jobs in a given plant or machinery i.e. it aims at determining the relative worth of a job. The principle upon which all job evaluation schemes are based is that of describing and assessing the value of all jobs in the firms in terms of a

number of factors, the relative importance of which varies from job to job. **The objectives** of job evaluation, to put in a more orderly manner are to:

- 1. Provide a standard procedure for determining the relative worth of each job in a plant.
- 2. Determine equitable wage differentials between different jobs in the organisation.
- 3. Eliminate wage inequalities.
- 4. Ensure that like wages are paid to all qualified employees for like work.
- 5. Form a basis for fixing incentives and different bonus plans.
- 6. Serve as a useful reference for setting individual grievances regarding wage rates.
- 7. Provide information for work organisation, employees' selection, placement, training and numerous other similar problems.
- 8. Provide a benchmark for making career planning for the employees in the organisation.

#### 14.6 PROCEDURE OF JOB EVALUATION

Though the common objective of job evaluation is to establish the relative worth of jobs in a job hierarchy, there is no common procedure of job evaluation followed by all organisations. As such, the procedure of job evaluation varies from organisation to organisation.

#### 1. Preliminary Stage:

This is the stage setting for job evaluation programme. In this stage, the required information's obtained about present arrangements, decisions are made on the need for a new programme or revision of an existing one and a clear cut choice is made of the type of programme is to be used by the organisation.

#### 2. Planning Stage:

In this stage, the evaluation programme is drawn up and the job holders to be affected are informed. Due arrangements are made for setting up joint working parties and the sample of jobs to be evaluated is selected.

#### 3. Analysis Stage:

This is the stage when required information about the sample of jobs is collected. This information serves as a basis for the internal and external evaluation of jobs.

## 4. Internal Evaluation Stage:

Next to analysis stage is internal evaluation stage. In the internal evaluation stage, the sample of bench-mark jobs are ranked by means of the chosen evaluation scheme as drawn up at the planning stage. Jobs are then graded on the basis of data pending the collection of market rate data. Relative worth of jobs is ascertained by comparing grades between the jobs.

# 5. External Evaluation Stage:

In this stage, information is collected on market rates at that time.

#### 6. Design Stage:

Having ascertained grades for jobs, salary structure is designed in this stage.

#### 7. Grading Stage:

This is the stage in which different jobs are slotted into the salary structure as designed in the preceding stage 6.

#### 8. Developing and Maintaining Stage:

This is the final stage in a job evaluation programme. In this stage, procedures for maintaining the salary structure are developed with a view to accommodate inflationary pressures in the salary levels, grading new jobs into the structure and regarding the existing jobs in the light of changes in their responsibilities and market rates.

#### 14.7 STEPS FOR DEVELOPING A JOB EVALUATION PROGRAMME

- 1. Analyse and Prepare Job Description
- 2. Select and Prepare a Job Evaluation Programme/Plan
- 3. Classify Jobs
- 4. Install the Programme
- 5. Maintain the Programme

#### 14.8 LIMITATIONS OF JOB EVALUATION

1. Job evaluation is susceptible because of human error and subjective judgment. While there is no standard list of factors to be considered for job evaluation, there are some factors that cannot be measured accurately.

- 2. There is a variation between wages fixed through job evaluation and market forces. Say Kerr and Fisher, the jobs which tend to rate high as compared with the market are those of junior, nurse and typist, while craft rates are relatively low. Weaker groups are better served by an evaluation plan than by the market, the former places the emphasis not on force but on equity".
- 3. When job evaluation is applied for the first time in an organisation, it creates doubts in the minds of workers whose jobs are evaluated and trade unions that it may do away with collective bargaining for fixing wage rates.
- 4. Job evaluation methods being lacking in scientific basis are often looked upon as suspicious about the efficacy of methods of job evaluation.
- 5. Job evaluation is a time-consuming process requiring specialised technical personnel to undertake it and, thus, is likely to be costly also.
- 6. Job evaluation is not found suitable for establishing the relative worth of the managerial jobs which are skill-oriented. But, these skills cannot be measured in quantitative terms.
- 7. Given the changes in job contents and work conditions, frequent evaluation of jobs is essential. This is not always so easy and simple.
- 8. Job evaluation leads to frequent and substantial changes in wage and salary structures. This, in turn, creates financial burden on organisation.

#### 14.9 PRINCIPLES OF JOB EVALUATION

#### The principles of job evaluation are as follows:

- (a) Job evaluation must attempt to rate the job and not the man.
- (b) Elements of job selected for the job must be common to most of the jobs, few in number and simple to identify and easy to understand.
- (c) Clean definition of elements and consistency of degrees of such elements, improve accuracy of job evaluation.
- (d) Secure willing co-operation and support of supervisors on job evaluation. This is obtained by selling this idea among them and obtains this participation in the process.
- (e) Secure co-operation and participation from employees.
- (f) Minimise number of wage rate within each grade.

#### 14.10 METHODS OF THE EVALUATION

There are different methods of job evaluation.

# They can be classified as:

#### 1. Non-Quantitative Methods:

- (a) Ranking or job comparison
- (b) Grading or job classification.

# 2. Quantitative Methods:

- (a) Point rating
- (b) Factor comparison.

# 1. Non-Quantitative Methods:

Non quantitative job refers to

#### (a) Ranking or Job Comparison:

Ranking of job is normally done by an "expert committee" formed by the organisation. This committee consists of representatives from management and employees. This committee may also consist of a certain number of experts either as permanent members or co-opted members on as required basis. Here the jobs are ranked as a "whole job" instead of breaking them into parts.

Three techniques can be used for ranking jobs.

#### They are as follows:

#### (i) Job Description:

In this technique a written jobs description is prepared for every job. The job descriptions are then studied and analysed. The differences between them in terms of duties, responsibilities, skill requirements etc, are noted. Each job is assigned a rank depending upon its relative significance. Several raters may independently rank each job

# (ii) Paired Comparison:

In this technique each job is paired with every other job in the series. The more difficult job in each pair is identified. Rank is then assigned on the basis of the number of times a job is rated more difficult

#### (iii) Ranking along a Number Line:

In this technique ranks obtained through job descriptions and paired comparisons are spread along a number line. Each job is then placed along the line on the basis of its closeness to the highest ranked job.

# Advantages of Ranking Method Are:

- 1. Simple and easy to understand.
- 2. Faster and inexpensive.

#### **Disadvantages:**

- 1. Subjective and influenced by personal bias.
- 2. Specific job requirements are not taken into account.
- 3. Ranking does not give indications of actual differences between jobs; in terms of difficulties or responsibilities.

# (b) Grading Method:

This method is made popular by civil services used mostly for administrative jobs. Here different "grades" or "classes" of jobs are predetermined based on certain criteria such as skill, knowledge, responsibility etc. Even though, initially grading method is envisaged by civil service for administrative and clerical jobs, later this concept became popular and extended to defense services, marketing, sales and managerial cadre jobs. This method is applicable for workers, supervisors and managerial jobs. In India, the following classification methods are used.

# **Government Departments:**

Class I, II, III... for officers in descending order.

#### **Public Sector Units (Psu):**

Grade 1, 2, 3... for officers in ascending orders.

#### Civil Services:

Group A, B, C... non-officers.

#### The steps involved in this method are as follows:

- (i) Prefix the grade/classification.
- (ii) Prepare job description.

- (iii) Identify key jobs in each grade/class
- (iv) Allocate all jobs in each grade/class based on criteria.

## **Advantages:**

- (i) This method is easy to understand and simple to operate.
- (ii) It is more accurate and systematic than the ranking method.
- (iii) It is economical and therefore suitable for small concerns.
- (iv) It provides an opportunity to develop a systematic organisation structure.
- (v) This method is used in government offices.

## Disadvantages:

- (i) It is very difficult to write accurate and precise description of job grades.
- (ii) Some job may involve tasks which overlap more than one grade. It is difficult to classify such jobs in a particular grade.
- (iii) The system is rigid and personal judgment is involved in deciding job classes and assigning jobs to specific classes.

#### 2. Quantitative Methods:

In quantitative methods key factors of the job are selected and measured.

### (a) Point Rating:

It is the most widely used method of job evaluation. Under it, jobs are divided into component factors. Points or weightage are assigned to each factor depending on the degree of its importance in a particular job. The total points for a job indicate its relative worth or value. The procedure involved is as follows:

#### Steps 1:

#### Job Cluster:

Group jobs into similar families having common nature and characteristics. This arrangement assists realistic assessment of factors and comparison of jobs.

#### Steps 2:

#### **Identification of Factors:**

Based on the cluster of jobs, identify relevant factors which are common to these jobs. Unlike factors comparison, there is no restriction on the number of factors. Normally number of factors does not exceed 15.

#### **Step 3:**

## **Assigning Degrees to Factors:**

For the purpose of fine tuning the edifices between jobs, each factor is subdivided into various degrees like, "illiterate", "High school level", "graduate", "Post-graduate" etc.

#### Step 4:

# Fixing Relative Weightages:

All factors will not carry same weightages. This weightage varies from cluster to cluster, committee of experts assign weightages. For e.g., a manual job carry higher weightage of "physical ability" compared to "mental ability" and so on.

These weightages are then converted to percentages. These percentages are counted as points for first degree. Points for higher degrees for the same factor are obtained by multiplying the first degree points by the corresponding number 2, 3, 4 etc.

### **Step 5:**

#### **Assign Money Value to Points:**

Expert committee work out money values in terms of rupees per hour for a range of points having grouped them into different classes/grades.

# Step 6:

#### **Prepare Job Evaluation Manual:**

Job evaluation manual is prepared by selecting a number of "key jobs" in each Department/cluster. For each key job, identify the relevant factors, their degrees and points.

Key jobs in job-evaluation manual serve an example for future evaluation of all other jobs. Job evaluation manual become more effective if "Job description" and Job specification can be redrafted in terms of factors identified for each cluster.

#### **Step 7:**

#### **Rating Jobs:**

With the help of job-evaluation manual and formula pre-determined for conversion of points to money value, we can now prepare the rating for all jobs by comparing term with key jobs.

#### **Advantages:**

(i) This method is the most comprehensive and accurate method of job evaluation. Factors are divided into sub factors and different degrees of a factor are considered.

- (ii) Assignment of point scores and money values is consistent thereby minimizing bias and human judgment.
- (iii) Systematic wage differentials according to content of the job can be determined.

# **Disadvantages:**

- (i) It is expensive and time consuming.
- (ii) Point method is complicated and an average worker cannot understand it easily.
- (iii) Errors may occur if assigned point values are not realistic. It is difficult to determine factor levels and assigns point values.
- (iv) It is difficult to apply this method to managerial jobs wherein the work content is not measurable in quantitative terms.

# (B) Factor Comparison:

Under this method, a few key jobs are selected and compared in terms of common factors. The procedure involved is as follows.

## (i) Select And Define The Factors:

The factors common to all jobs are selected and defined clearly. Skill, physical and mental effort, responsibility and working conditions are the main factors used.

# (ii) Select Key Jobs:

Key jobs serve as standards against which other jobs can be compared. A key job is one having standardised contents and well accepted pay rate, key jobs should be a cross-section of all jobs in the organisation representing all levels of pay.

#### (iii) Rank Key Jobs by Factors:

Job descriptions are carefully analysed and the key jobs are rated in terms of the selected factors.

#### (iv) Decide Rates For Key Job:

A fair and equitable wage rate (hourly and daily) is dimensioned for each key job.

#### (v) Apportion the Wage Rate:

The wage rate for a job is allocated among the identified and ranked factors. The ranked factors are fixed by considering the various preferred factors in appropriate matter.

#### (vi) Evaluate The Remaining Jobs:

The remaining jobs are compared with the key jobs in terms of each factor. Suppose, 'carpenter job is to be similar to tool maker in skill (Rs. 25), machinist in physical effort (Rs. -7), welder in mental requirements (Rs. 14), painter in responsibility (Rs. 12), and painters in working condition (Rs. 18). Then, the wage rate for this job would be Rs. 76.

#### **Advantages:**

- 1. Method is scientific being analytical and quantifiable.
- 2. Limited of factors makes this method simple and easy.
- 3. Jobs are compared with each other to obtain relative value.
- 4. Job pricing is directly obtained without intermediary point's weightage.

#### **Disadvantages:**

- 1. Using just five factors are not realistic.
- 2. Direct determination of rating shift the focus of job evaluation from "job worth" to "job wage" in money value. This creates bias.

#### 14.11 CASE STUDY

XYZ was established in 1985 as a joint venture between various foreign companies. The company has grown from a capacity of 15,000 AC units in 1985 comprising of largely an assembly operation, into the largest and only integrated manufacturing unit in India for Auto Air Conditioning systems. The company has the capability to manufacture compressors, condensers, heat exchangers and all the connecting elements that are required to complete the AC Loop. The company has three plants in Noida, one in Manesar and one in Pune. It also has a R&D centre and Tool room in Noida. The HR department of the company has its well developed training and development process but wants to move one step ahead with the training effectiveness evaluation process and make it more competitive. For the same they have implemented a policy wherein the employees are asked to take up a project based on the training which they had undergone and should have the practical application of learning in training. The employees are then to be evaluated for 'On-the-job training effectiveness evaluation' on their performance accordingly. In simple words, to show how they are applying their learning in their job. They give employees a duration of three months to evaluate themselves and for doing a project on the basis of his/her learning. Then employees rate themselves as per their learning. After that the employee is rated by his/her HOD (Head of the department) on the basis of the project and his learning and on the basis of application of that learning. Finally HOD rates his employees against the rating given by the employees themselves. HOD then writes remarks and provides recommendations to the HR department, which gives the HR dept. information to check whether there is any requirement of re-training or if their investment on the training of the employee is successful or not. This is how HR dept. conducts on the job evaluation of training effectiveness. But the problem which the HR dept. faces is that the employee takes this project work as a burden on their daily routine work and they escape from it. They do not understand the importance of the filling of the Training Effectiveness Form and taking up a project. Till the date of HR Audit the HR people keep on running after the employee to collect the Training Effectiveness forms. Finally when those forms are compiled it is observed that the employees just do it for formality sake. After a lot of discussion on this topic, the AGM (HR) of the company conveys that if the company keeps on changing policies then it will create a wrong impression among employees. This wrong impression implies that the HR department will change the policies as and when a problem arises. AGM follows a school of thought that policies are not meant to be changed frequently. On the contrary the surprising fact is, while employee interacts with the HR Dept. The issue is never raised, even after being probed, AGM says that today if only 10-12% employees take this exercise seriously then in future then only he will be on motivating his employees and make this policy successful, ignoring the fact that majority of employees escape from this exercise.

#### Questions

- 1. Is the stand taken by the HR manager of not changing the policy is justified?
- 2. What would be your course of action had you been in the place of the HR manager?
- **3.** Is the method implemented by the HR dept. to evaluate on-the-job training effectiveness proper? If 'NO', then what is the alternative as per your perception?

| 14.12 NOTES                             |       |        |  |
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#### **14.13 SUMMARY**

Job evaluation is an important technique to evaluate the job and based on job evaluation the relative worth of the job is estimated and on the same the firm places salaries and incentives to the employees. Both the quantitative and qualitative method plays an important role in job evaluation. Job evaluation helps the firms to pay right money for right job and hence ensures that skills are employed up to its best level. Job evaluation has its own significance in the growing competitiveness as every firm tries to minimize the cost and maximize the benefit from it.

#### 14.14 KEYWORDS

Job Evaluation, Quantitative, Qualitative, Salaries, Incentives, Employees, Worth

# 14.15 SELF ASSESSMENT QUESTIONS

- 1. Define job evaluation. What its advantages?
- 2. Describe the procedure of job evaluation.
- 3. Explain the various steps in job evaluation programme.
- 4. What are the principles of job evaluation?

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# **UNIT -15: WAGE STRUCTURE**

# **Structure:**

| 15.0  | Objectives                       |
|-------|----------------------------------|
| 15.1  | Introduction                     |
| 15.2  | Steps for framing wage structure |
| 15.3  | Principles of wages fixation     |
| 15.4  | Factors affecting wage structure |
| 15.5  | Methods of wage payment          |
| 15.6  | Wage payment policies            |
| 15.7  | Case study                       |
| 15.8  | Notes                            |
| 15.9  | Summary                          |
| 15.10 | Key words                        |
| 15.11 | Self assessment questions        |
| 15 12 | References                       |

#### 15.0 OBJECTIVES

After studying this unit, you should be able to:

- define wage structure
- analyze the various steps for framing wage structure
- describe the principals of wages fixation
- analyze various wage payment methods
- identify the factors affecting wage structure
- explain requirement of various wage policies

#### 15.1 INTRODUCTION

Jobs offered by an organisation vary in terms of their values. Job value is ascertained by job evaluation. Job evaluation is a systematic method of appraising the value of each job in relation to other jobs in an organisation. Once all jobs are assigned values, and then these are placed in a grade, or say, a rate per job. These grades are arranged in a hierarchical order starting with lower to higher jobs. Thus wage/salary structure consists of the various salary grades and their different levels of single jobs or group of jobs.

After the relative worth of jobs has determined by job evaluation, the actual amounts to be paid must be determined .A major factor in taking such decisions is the survey of wages and salaries in other enterprises in the same region and in the same industry. The purpose of wage survey is to determine the extent to which the organizations pay scales are like those of other enterprises in the region

The crucial question is to be determined for carrying out a survey are

- 1. The jobs to covered
- 2. The employees to be contracted
- 3. The method to be used in gathering the data.

The entire job should not be covered in the job survey because it is not possible to obtain data in regard to each. Only the crucial jobs should be covered by the job survey because these cover all ranges. The second key questions concern the organization to be surveyed. The organization to be surveyed. The organization to be cover by the survey must be collected by great care. The organizations so chosen must be selected from same region . Finally the method of survey must be decided. Personal interviews would be most the most

expensive one. That is why mailed questionnaire are probable the most frequently used method as it is one of the most cheapest method. But the fear in the case is that the response may be very poor. The questionnaires should be designed very carefully so that it may derive maximum information and information so collected can afterwards be processed to determine the average rate of wages for important jobs in the countries.

#### 15.2 STEPS FOR FRAMING WAGE STRUCTURE

- 1. Ascertain and establish, on the basis of market rate surveys and studies of existing salary structures, the most senior and most junior jobs to be covered by the salary structure.
- 2. Based on above, draw up salary grade structure ranging from the lowest, limit along with the width of salary gaps between jobs and the size of overlap between different grades.
- 3. Make a job evaluation exercise. This can be done by any method of job evaluation. However, job evaluation by means of a simple ranking scheme is preferable.
- 4. Procure market rate data keeping in mind that there is likely to be a range of market rates in existence in the labour market.
- 5. Finally, based on the results of job evaluation and market rate surveys and studies arrange 'all jobs in the grades in an hierarchical order. In fact, it is the stage where a good judgment is required.

#### There are two more elements involved in a Wage structure:

- 1, Salary Progression
- 2. Broad banding

A brief description of these follows:

#### **Salary Progression:**

As the term itself implies, it refers to a sequence of progress in salary. In other words, salary progression relates to increases in salary to merit. It relates compensation/salary to performance on a consistent and equitable manner.

#### The procedure of wages progression is characterized by the following key features:

(i) The salary grades are divided into defined areas or zones. An employee will pass through these stages or zones as he/she progresses in experience. For example a Professor in a University starts with a basic pay of Rs. 13,400 and touches Rs. 20,900 after 10 years experience and Rs. 22,400 after 13 years' experience.

(ii) There is an incremental rate at which an employee progresses along with the salary grade. In the above example, the incremental system consists of a rate of Rs. 450 per year during the first 10years- period and Rs. 500 per year during the last 03 years period of experience.

# **Broad banding:**

Broad banding means a process reducing salary grades to a words broad banding means collapsing salary grades and ranges into a few broad and wide levels or 'bands' each consisting of a relatively wide range of jobs and salary levels. As mentioned earlier, in a University. For example, all teaching jobs are reduced to three broad grades namely, Professor, Reader and Lecture. This broad banding of grades is more popular in industrial organisations employing huge number of employees. For example, Toyota has broad banded it's all jobs into just five grades or bands. Similarly, General Electricals has been able to restructure its all jobs into three job classifications, viz., Division I: Production Members, Division II: General. Maintenance Team Managers; and Division III: All Tie and Dye Members.

The main advantage of broad banding is that it injects greater flexibility into employee compensa-tion. It is especially sensible where firms flatten their hierarchies and organise around self-managing teams.

#### 15.3 PRINCIPLES OF WAGES FIXATION

Salary or wage" means all remuneration (other than remuneration in respect of over-time work) capable of being expressed in terms of money. Wages are defined broadly as any economic compensation paid by the employer to his labourers under some contract for the services rendered by them. In its actual sense which is prevalent in the practice, wages are paid to workers which include basic wages and other allowances which are linked with the wages like dearness allowances, etc., but does not include

- (i) Any other allowance which the employee is for the time being entitled to;
- (ii) The value of any house accommodation or supply of light, water, medical attendance or other amenity or of any service or of any concessional supply of food grains or other articles;
- (iii) Any traveling concession;
- (iv) Any Bonus (including incentive, production and attendance bonus);
- (v) Any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the employee under any law for the time being in force;

- (vi) Any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex gratia payment made to him;
- (vii) Any commission payable to the employee.

The basic principle of wage and salary fixation is that it should be based on the relative contributions of different jobs and not on the basis of who the job holders are. If this principle is adopted, the first requirement is to identify the likely contributions of different jobs. This is what job evaluation precisely does. It provides the information about what is the worth of a job in terms of its contributions to the achievement of organizational effectiveness.

# **Overcoming Problems**

Job evaluation, if carried on periodically and objectively, helps in overcoming various problems which may develop in an organization over the period of time with regard to compensation management. Knowles and Thompson have identified that there are following anomalies and evils which may develop in an organization and may be overcome by job evaluation:

- 1. Payment of high wages and salaries to persons who hold jobs and positions not requiring great skill, effort and responsibility;
- 2. Paying beginners less than that they are entitled to receive in terms of what is required of them?
- 3. Giving a raise to persons whose performance does not justify the raise;
- 4. Deciding rates of pay on the basis of seniority rather than ability;
- 5. Payment of widely varied wages and salaries for the same or closely related jobs and positions
- 6. Payment of unequal wages and salaries on the basis of race, sex, religion or political differences.

As the major production cost, wages affect profits, business investment, competitiveness, and are a cost push inflationary factor. As the major income in the economy, wages affect standard of living, income distribution and poverty, and demand pull inflation. As the source of wage disputes is the employer treating wages as their major **cost**, and the employee viewing wages as their major income.

#### 15.4 FACTORS AFFECTING WAGE STRUCTURE

The wage structure of different organizations vary somewhat. Small units pay the Minimum necessary to attract the required number and kind of labor. Often, these units pay only the minimum wage rates required by labor legislation, and recruit marginal labor. At the other extreme, some units pay well above the going rates in the labor market. They do so to attract and retain the highest caliber of the labor market. They do so to attract and retain the highest caliber of the labor force. But a large number of them seek to be competitive in their wage program, i.e., they aim at paying somewhere near the going rate in the labor market for the various classes of labor they employee. Most units give greater weight to two wage criteria, viz., job requirements and the prevailing rates of wages in the labor market. In the short run, the economic influence on the ability to pay is practically nil. All employers, irrespective of their profits or losses, must pay no less than their competitors and need pay no more if they wish to attract and keep workers. In the long run, the ability to pay is very important.

During the time of prosperity, employers pay high wages to carry on profitable operations and because of their increased ability to pay. But during a period of depression, wages are cut because funds are not available. Small firms and non-profit organizations (like hospitals and educational institutions) pay relatively low wages because of low or no profit. Following are the factors which influences the wage structure

1. The Organization's Ability to Pay - Banks, insurance companies, department stores, and restaurants are organizations with primarily market-oriented wage structures. Professionals are groups of employees whose jobs have been designed largely by the educational process they have been through. This makes for a commonality between organizations in the design of professional jobs.

Organizations having many specialized jobs, dealing in labor markets too disorganized to provide adequate grading and pricing, and lacking unionization have primarily internally determined wage structures. Product markets may influence such wage structures, but only if labor cost is high relative to total cost. Internally determined wage structures result from management decisions and may range from highly rational structures flowing from job evaluation to a system of personal rates.

Organizations in small towns, isolated locations, or nonunion communities provide examples, as do unique organizations in -larger communities, and government employment. Most large, unionized organizations have what might be called union-and-product-oriented wage structures.

Cost-price relationships and the product market compel the organization to resist this upward push and to make changes in jobs and job relationships in line with such resistance. Low ratios of labor cost to total cost and inelastic product demand, however, reduce competitive pressures on organizations. Professional employees (such as engineers) have salary structures that combine market orientation and internal determination, regardless of the major activity of the organization. Managerial salary structures are primarily internally determined except in very tight labor markets, without regard to organization type.

- 2. Supply and Demand of Labor The labor market conditions or supply and demand forces operate at the national, regional and local levels, and determine organizational wage structure and level. If the demand for certain skills is high and the supply is low, the result is a rise in the price to be paid for these skills. When prolonged and acute, these labor-market pressures probably force most organizations to "reclassify hard-to-fill jobs at a higher level" than that suggested by the job evaluation. The other alternative is to pay higher wages if the labor supply is scarce; and lower wages when it is excessive. Similarly, if there is great demand for labor expertise, wages rise; but if the demand for manpower skill is minimal, the wages will be relatively low. "The supply and demand compensation criterion is very closely related to the prevailing pay, comparable wage and on-going wage concepts since, in essence, all of these remuneration standards are determined by immediate market forces and factors."
- 3. Prevailing Market Rate- This is also known as the 'comparable wage' or 'gain wage rate', and is the most widely used criterion. An organization's compensation policies generally tend to conform to the wage rates payable by the industry and the community. This is done for several reasons:

**First**, competition demands that competitors adhere to the same relative wage level.

**Second,** various government laws and judicial decisions make the adoption of uniform wage rates an attractive proposition.

**Third,** trade unions encourage this practice so that their members can have equal pay, equal work and geographical differences may be eliminated.

**Fourth,** functionally related firms in the same industry require essentially the same quality of employees, with the same skills and experience. This results in a considerable uniformity in wage and salary rates.

**Finally,** if the same or about the same general rates of wages are not paid to the employees as are paid by the organization's competitors, it will not be able to attract and maintain a sufficient quantity and quality of manpower.

- **4. The Cost of Living-** The cost-of living pay criterion is usually regarded as an Auto **minimum equity pay criterion**. This criterion calls for pay adjustments based on increases or decreases in an acceptable cost of living index. In recognition of the influence of the cost of living, "escalator clauses" are written into labor contracts. When the cost of living increases, workers and trade unions demand adjusted wages to offset the erosion of real wages. However, when living costs are stable or decline the management does not resort to this argument as a reason for wage reductions.
- 5. The Living Wage- This criterion states that wages paid should be adequate to enable-an employee to maintain himself and his family at a reasonable level of existence However, employers do not generally favor using the concept of a living wage as a guide to wage determination because they prefer to base the wages of an employee on his contribution rather than on his need. Also, they feel that the level of living prescribed in a worker's budget is open to argument since it is based on subjective opinion.
- **6. Productivity-** It is a criterion, and is measured in terms of output per man hour. It is not due to labor efforts alone. Technological improvements, better organization and management, the development of better methods of production by labor and management, greater ingenuity and skill by labor are all responsible for the increase in productivity. Actually, productivity measures the contribution. Of all the resource factors men, machines, methods, materials and management. No productivity index can be devised which will measure only the productivity of a specific factor of production.
- 7. Trade Union's Bargaining Power- Trade unions do affect rate of wages. Generally, the stronger and more powerful the trade union, the higher the wages. A trade union's bargaining power is often measured in terms of its membership, its financial strength and the nature of its leadership. A strike or a threat of a strike is the most powerful weapon used by it. Sometimes trade unions force wages up faster than increases in productivity would allow and become responsible for unemployment or higher prices and inflation. However, for those remaining on the pay roll, a real gain is often achieved as a consequence of a trade union's stronger bargaining power. Unions affect wage structure, but the differential effects of craft and industrial unionism and the type of bargaining relationship are considerable. Craft unions tend to determine craft rates as well as the design of craft jobs for all organizations employing members of the craft. Other unions, most of them craft unions, seek to preserve customary relationships and job security, resist changes in job content and structure, and are uninterested in the employer's problems of maintaining economic efficiency.
- **8. Job Requirements-** Generally, the more difficult a job, the higher are the wages Measures of job difficulty are frequently used when the relative value of one job to another

in an organization is to be ascertained. Jobs are graded according to the relative skill, effort, responsibility, and job conditions required.

- **9. Managerial Attitudes-** These have a decisive influence on the wage structure and wage level since judgment is exercised in many areas of wage and salary administration including whether the firm should pay below average, or above average rates, what job factors should be' used to reflect job worth, the weight to be given for performance or length of service, and so forth, both the structure and level- of wages are bound to bound to be affected accordingly. These matters require the approval of the top executives. Lester observes, "Top management's desire to maintain or enhance the company's prestige has been a major factor in the wage policy of a number of firms.
- 10. Psychological and Social Factors: These determine in a significant measure how hard a person will work for the compensation received or what pressures he will exert to get his compensation increased. Psychologically, persons perceive the level of wages as a measure of success in life; people may feel care have an inferiority complex, seem inadequate or feel the reverse of all these. They may not take pride in their work, or in the wages get. Therefore, the management in establishing wage rates should not overlook these things. Sociologically and ethically, people feel that "equal work should carry equal wages" that "wages should be commensurate with their efforts, "that" they are not exploited, and that no distinction is made on the basis of caste, color, sex or religion." To satisfy the conditions of equity, famines and justice, a management should take these factors into consideration.
- 11. Skill Levels Available in the Market- With the rapid growth of industries, business trade, there is shortage of skilled resources. The technological development, automation has been affecting the skill levels at faster rates. Thus the wage levels of skilled employees are constantly changing and an organization has to keep its level up to suit the market needs.

#### 15.5 METHODS OF WAGE PAYMENT

Wage payment concept is not only important for the employees but also for the employers as they are interesting in paying fewer wages. But paying low wages are not economical as they can prove to be costly for the employer. Employer is morally responsible to pay fair wages to his employees. Following are the wage payment types

#### 15.5.1 Methods of Wage Payment

1. Flat Time Rate: It is the oldest method of wage payment. Under this method, workers are paid at a flat rate on the basis of time they are employed. The flat rate may be per hour,

day, week or month. The flat rate is usually fixed keeping in view the rate prevailing in similar trades in the same locality for the same grade and skill. The earnings of workers depend on the time put in by them. This method of wage payment is most suitable for the highly skilled and the unskilled workers including apprentices.

# This method is also suitable for the following types of work:

- 1. Where quality of goods produced is of extreme importance e.g., artistic goods.
- 2. Where the speed of production is beyond the control or energy of the worker e.g., when production is automatic or it depends on heat treatment or a chemical reaction.
- 3. Where output cannot be measured e.g., maintenance and repair work.
- 4. Where close supervision of work is possible.
- 5. Where work delays are frequent and beyond control of employees.
- 6. Where incentive schemes would be difficult or impossible to follow, e.g., indirect labour, clerical works etc:

Flat rate time wage method is easy and simple to follow and the worker is assured of payment for the time spent by him.

# **Disadvantages of Flat Rate Method**

1. Workers are not paid according to their merits because no distinction is made between efficient and inefficient workers. Payment is made according to the time spent and not according to the output of workers.

Thus, the method gives no incentive to produce more. But this drawback of the method can be removed by following a method of differential time rates; under this method, payment to workers is made at time rates adjusted to different personal qualities in the worker. Time wages under this method vary with the personal qualities of the workers.

- 2. Workers will get payment for idle time because they are to get wages for the time spent irrespective of the units produced.
- 3. Efficient workers will become inefficient workers because they notice that inefficient workers also get the same wages. But this drawback can be overcome to some extent by attracting the highest quality of workers by giving them the higher time rate than that normally paid in the industry or locality.
- 4. The employer is not able to ascertain his exact labour cost per unit because it will change if output falls or rises. Therefore, a difficulty is experienced while sending quotations for tenders.

- 5. Strict supervision is necessary to get the required amount of work done from the workers.
- 6. Inefficiency results in upsetting of production schedule and increases the cost per unit.
- 7. It will encourage a tendency among workers to go slow so as to earn overtime wages.

# **Merit Rating**

Merit-rating of an employee is the process of evaluating the employee's performance on the job in terms of the requirements of the job". It is a technique of assessing the worth of an employee with reference to job requirements. Merit Rating is also known as performance appraisal or performance evaluation. It is a systematic process for measuring the performance of the employees in terms of job requirements. It utilizes various rating techniques for comparing individual employees in a work group in terms of personal qualities or deficiencies and the requirements of their respective jobs. It is an established fact that people differ in their abilities and aptitudes. These differences are natural to a great extent and cannot be eliminated even by providing same training and education facilities to them. There will be some differences in the quality and quantity of work done by different workers even on the same job. Therefore it is essential for the management to know these differentials so that employees having better abilities may be rewarded and the wrong selection and placement maybe restricted or avoided

#### Main objectives of merit rating are as follows:

- 1. To assess the work of employees in relation to their job requirements.
- 2. To consider employees/workers for promotions, transfer, layoffs etc.
- 3. To assess the good and bad points in working of employees and then making suggestions for improvement.
- 4. To help in wage and salary administrations and taking decisions about incentives and increments to be given to the workers.
- 5. To evaluate skill and training capabilities of employees and helping in planning suitable training and development programmes for workers.
- 6. To know the problems faced by workers while doing various jobs.
- 7. To provide a basis for comparison to segregate efficient and inefficient workers.
- 8. To help management in placement/transfer to workers according to their capacity, interest, aptitude and qualifications.
- 9. To help supervisors to know their subordinates more closely for increasing their efficiency and improving productivity.

Advantages of merit rating are as follows:

- (a) It provides a scientific basis for judging the worth of employees. They try to improve upon their performance if it is not up to the satisfaction of the employer.
- (b) It provides a basis for decisions like promotion, demotion, transfer or termination of employees. Better persons are selected for promotion. The systematic evaluation of employees is also kept as a permanent record.
- (c) It helps in distinguishing between efficient and inefficient workers. In this way, it reveals the defects in the selection procedure. Those employees who are misfits may be spotted and appropriate action taken against them.
- (d) Workers may be given increase in pay if their performance is good. It helps the management in avoiding spot judgments and replaces it with planned decisions.
- (e) Objective merit rating develops confidence among the employees if the methods of evaluation are systematic and impartial. Among the workers, a sense of competition is developed resulting into increased output or better performance.
- (f) It helps in creating a congenial working environment in which employer-employee relations are improved. Subordinates get motivated and work hard for getting favorable rating.
- (g) It also helps in stimulating and development of an employee as it points out the weakness of the employees. The training needs of employees can be known and training programmes can be accordingly drawn.
- (h) A systematic evaluation also develops better supervisors and executives. On the basis of merit-rating report, the top management can judge the ability of executives who are writing such reports.

However, formal merit-rating may not take place in case of a small concern since the informal rating can provide all the desired information. In case of a large scale concern, both employer and employee stand benefited from a systematic performance appraisal.

# Limitations of merit rating:

#### 1. Halo Effect:

There is a tendency to rate the employee on the basis of one factor only. It is also known as 'blending tendency'. If the rater finds that the man is good in one factor he may rate him good in all other factors.

#### 2. Clarity in Standards:

Each rater may apply his own standards with the result that final ratings simply cannot be compared. For example, a rater may think that 'satisfactory' rating is better than 'excellent'.

# 3. Leniency or Strictness:

Lenient raters give high ratings whereas strict raters always give low ratings. Hence, there is a big difference of ratings between two raters. A supervisor may feel that low ratings may reflect his own weakness in dealing with workers.

# 4. Central Tendency:

Generally the raters evaluate employees by keeping them in the average category though some may be falling in the extreme ends of the scale viz., excellent or poor.

#### 5. Influence of Higher-Paid Jobs:

Usually there is a tendency to give high rating to a person who is doing the highly paid job. Merit rating has nothing to do with the worth of the job (which is the subject matter of job evaluation).

# 6. Differing Perceptions:

Even if a person tries to be a fairest rater in performance evaluation, he cannot eliminate bias because of differing perceptions. Certain unconscious factors such as race, caste, and creed etc., effect merit rating. If a manager, who is less qualified, evaluates his subordinate who is more or better qualified, merit rating may not be fair.

#### 15.6 WAGE PAYMENT POLICIES

The following guidelines should be followed in the payment of wages,

- Wage policy should be developed keeping in view the interests of the employer, the employees, the consumers and the community.
- Wage policy should be stated clearly in writing to ensure uniform and consistent application.
- Wage and salary administration should be consistent with the overall plans of the company. Compensation planning should be an integral part of the financial planning.
- Wage and salary plans should be sufficiently flexible or responsive to changes internal and external conditions of the organization.
- Management should ensure that employees know and understand the wage policy of the company.

- ♦ All wages and salary decisions should be checked against the standards set in advance in the wage policy.
- Wage and salary plans should simplify and expedite administrative process.
- ♦ An adequate database and proper organizational setup should be developed for compensation determination and administration.
- Wage policy and programme should be reviewed and revised periodically in conformity with changing needs.

# 15.7 CASE STUDY

A financial institution has just decided to open a Branch at Bhimunipatanam, an exclusive resort located about 20 miles from Waitair, a large city. There is no bank at present in Bhimunipatnam. The financial institution is anxious to determine the appropriate wage for the clerical staff as it expects to hire. Clerk in the city office at Qaltair receive a starting wage of Rs 1000 per month .As a matter of company policy, these wage rates have been set at midpoint of the range for financial institutions in Waltair. A survey at local business at Bhimunipatnam indicators that the going rate for qualified clerical personnel varies between Rs 1200-1400 a month. This higher rate in Bhimunipatnam may be attributed, in part, to the substantially higher cost of living in this resort town, the limited number of young people seeking employment and the fact that there is no other financial institutions in the city. Banks in Waltair have traditionally paid lower wages other than business, on the ground that banks offer better working conditions and higher prestige

#### Questions

| 15. | 8 NOTES  |
|-----|--|
|     | rate for the clerical staff?   |
|     | •  |
| l.  | Explain the factors which the firm should take into consideration in fixing the hiring |

| 13.0 NOTES |  |  |
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#### 15.9 SUMMARY

Wage payment is one of the most significant tool in ensuring that the firm is paid the right wages to right person with in the right time. Wages are paid up to the most optimum manner through which the firm incurs less cost and most benefit in the best phased manner. Wage payment is paid after considering all the aspects from all the dimensions and skilled workers can be retained to its best level. Ensuring eminent labour force is the prime requirement for all the firms to keep its operation running in smooth manner.

#### **15.10 KEY WORD**

Wage, Skilled Workers, Labor, Payment System

# 15.11 SELF ASSESSMENT QUESTIONS

- 1. What are the steps in framing wage structure?
- 2. Describe the principles of wage fixation.
- 3. Explain the various factors affecting the wage structure.
- 4. Explain different methods of wage payment.

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# **UNIT - 16 : WAGE PAYMENT SYSTEM**

# **Structure:**

| 16.0  | Objectives   |
|-------|--|
| 16.1  | Introduction   |
| 16.2  | Concept and Meaning of Time Rate System of Wage Payment                    |
| 16.3  | Concept and Meaning of Piece Rate System of Wage Payment                   |
| 16.4  | Differences between Piece Rate System and Time Rate System of Wage Payment |
| 16.5  | Internal Control of Wage Payment   |
| 16.6  | Importance of Wage Payment System  |
| 16.7  | Essential Characteristics of a Good Wage Payment System                    |
| 16.8  | Wage Incentive Plans   |
| 16.9  | Objectives of Wage Incentive Plans   |
| 16.10 | Types of Wage Incentive Plans  |
| 16.11 | Blue collar Employees  |
| 16.12 | Case Study   |
| 16.13 | Notes  |
| 16.14 | Summary  |
| 16.15 | Keywords   |
| 16.16 | Self assessment Questions  |
| 16.17 | References   |

#### 16.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the wage payment system
- identify the types of wage payment system
- differentiate between time rate system and piece rate of system
- analyze the importance and characteristics of good wage payment system
- explain various wage incentive plans and its methods.
- analyze the meaning of blue collar employees.

# 16.1 INTRODUCTION

The system of wage payment is the method adopted by manufacturing concerns to remunerate workers. It is the way of giving financial compensation to the workers for the time and effort invested by them in converting materials into finished products. It indicates the basis of making payment to the workers, which may be either on time basis or output basis. The selection of the system depends on the type and nature of the concern and its products. The wage payment systems can be divided into two main systems as follows.

- 1. Piece rate of time
- 2. Time rate system

#### 16.2 CONCEPT AND MEANING OF TIME RATE SYSTEM OF WAGE PAYMENT

The time rate system is that system of wage payment in which the workers are paid on the basis of time spent by them in the factory. Under this system, the workers and employees are paid wages on the basis of the time they have worked rather than the volume of output they have produced. Hence, according to this system, wages are paid on hourly, weekly or monthly basis. Under time rate system, the wages earned by a worker is determined by using the following formula.

Wages Earned = Time spent (Attended) x Wage rate per hour/day/week/month

# Advantages of Time Rate System

- 1. The following are some of the important advantages of time rate system of wage payment
- 2. Time rate system is simple to understand and easy to calculate.
- 3. Time rate system is quite useful for organizations that use costly inputs for quality outputs.

4. Time rate system is beneficial for average and below workers..

# Disadvantages of Time Rate System

The following are some notable disadvantages of time rate system of wage payment.

- 1. Time rate system does not help in increasing output and improving efficiency as there is no correlation between effort and reward
- 2. Time rate system is not justifiable between efficient and inefficient workers and skilled and unskilled workers
- 3. Time rate system pays for idle time, which increases the cost of production.

Time rate system encourages a g0-slow tendency among workers during working hours and encourages them to work overtime.

- 4. It is difficult to estimate exact labor cost in advance.
- 5. It requires strict supervision to get the required quantity of output.

# 16.3 CONCEPT AND MEANING OF PIECE RATE SYSTEM OF WAGE PAYMENT

The piece rate system is that system of wage payment in which the workers are paid on the basis of the units of output produced. Piece rate system does not consider the time spent by the workers. Piece rate system is the method of remunerating the workers according to the number of unit produced or job completed. It is also known as payment by result or output. Piece rate system pays wages at a fixed piece rate for each unit of output produced. The total wages earned by a worker is calculated by using the following formula.

Total Wages Earned= Total units of outputs produced x Wage rate per unit of output.

OR, Total Wages Earned= Output x Piece Rate.

#### Advantages Of Piece Rate System

The following are some important advantages of piece rate system of wage payment.

- \* Piece rate system pays wages according to the output produced by the workers. It encourages efficient workers.
- \* Piece rate system gives incentives to the workers to adopt a better method of production for increasing their production and earning.
- \* Piece rate system helps the management to determine the exact labor cost per unit for submitting quotation.

- \* Piece rate system reduces per unit cost of production due to increased volume of production.
  - \* Piece rate system requires less supervision cost. Entrepreneurship

# **Disadvantages of Piece Rate System**

- 1. Piece rate system does not help in producing quality output as the workers are concentrated more on quantity instead of quality.
- 2. Piece rate system does not help for a uniform flow of production and makes difficult to regulate the production schedule.
- 3. It is very difficult to fix an acceptable and reasonable piece rate for each item of output or job
- 4. Piece rate system adversely affects the workers' health as well.
- 5. It requires extra supervision cost for quality output and effective use of materials, tools and equipment.

# 16.4 DIFFERENCES BETWEEN PIECE RATE SYSTEM AND TIME RATE SYSTEM OF WAGE PAYMENT

Following are the main differences between piece rate system and time rate system.

- 1. **Meaning**: Piece rate system is a method of wage payment to workers based on the quantity of output they have produced. Time rate system is a method of wage payment to workers based on time spent by them for the production of output.
- 2. **Nature of Payment:** Piece rate system pays the workers according to the units of output produced. Time rate system pays the workers according to the time spent in the factory.
- 3. *Emphasis*: Piece rate system gives emphasis on larger quantity of output. Time rate system emphasis on better quality of output.
- **4. Discrimination**: Piece rate system discriminates the workers and pays more wages to efficient and skilled workers. Time rate system does not discriminate the workers and pays the same wages to efficient and inefficient workers.
- 5. Supervision: Piece rate system requires strict supervision to get the required quality output. Time rate system requires strict supervision to get required quantity of output.
- 6. **Determination Of Labor Cost:** Piece rate system helps to fix per unit labor cost in advance. Time rate system does not help to fix labor cost per unit in advance.

7. Flow Of Production: Piece rate system does not bring uniformity in the flow of production and causes an excessive wastage of inputs. Time rate system helps maintain a uniform flow of production and ensures an efficient use of materials, tools and equipments.

## 16.5 INTERNAL CONTROL OF WAGE PAYMENT

Wages are one of the major portions in the total cost of production. There is always a chance of fraud in wage payment. Therefore, an effective administrative and accounting control system must be implemented by the management to minimize fraud and to keep the labor cost minimum. As already stated a number of departments are set up for the effective utilization of labor force and its proper accounting and controlling. These departments are required to work in a coordinated manner and to support the management in controlling labor cost by recording and reporting their activities on regular basis. The management should evaluate and revise its controlling system to find out leakages and to stop such leakages in time. Fraud in wage payment may result in various ways like inclusion of dummy worker in pay-roll, manipulating hours, recording extra overtime, using a wrong wage rate and registering absent workers.

## 16.6 IMPORTANCE OF WAGE PAYMENT SYSTEM

The amount of wages paid to the workers is one of the major elements of cost. It has a great bearing on the cost of production and profitability of the concern. Hence, every concern is required to adopt a fair system of wage payment.

The importance of wage payment system can be summarized as follows

- 1. Wage payment system facilitates the preparation of wage plan for future.
- 2. Wage payment system helps to determine the cost of production and the profitability of the organization.
- 3. Wage payment system determines the amount of earning of the workers and their living standards.
- 4. Wage payment system affects the interest and attitude of the workers.
- 5. Wage payment system determines the level of satisfaction of the workers and affects the rate of labor turnover.
- 6. Wage payment system helps in recruiting skilled, experienced and trained workers.
- 7. Wage payment system helps to increase the productivity and goodwill of the organization.

## 16.7 ESSENTIAL CHARACTERISTICS OF A GOOD WAGE PAYMENT SYSTEM

A sound system of wage payment is one that satisfies employer and employee by fulfilling following criteria.

- 1. Wage payment system should be fair and justifiable to the workers and organization.
- 2. Wage payment system should help in maximizing workers' satisfaction and minimizing labor turnover.
- Wage payment systems should assure minimum guaranteed wages to all workers.
- 4. Wage payment system should assure equal pay for equal work.
- 5. Wage payment system should provide more wages to efficient and skilled workers.
- 6. Wage payment system should follow government policy and trade union's norms.
- 7. Wage payment system should be simple and understandable to all the workers.
- 8. Wage payment system should help in improving performance and productivity of the workers.
- 9. Wage payment system should be flexible enough to suit the needs of the organization.

### 16.8 WAGE INCENTIVE PLANS

Wage incentive refers to performance linked compensation paid to improve motivation and productivity. It is the monetary inducements offered to employees to make them perform beyond the acceptance standards. According to the National Commission of Labour "wage incentives are extra financial motivation. They are designed to stimulate human effort by rewarding the person over and above the time rated remuneration, for improvements in the present or targeted results". Scott defines it as "any formal and announced programme under which the income of an individual, a small group, a plant work force or all the employees of a firm are partially or wholly related to some measure of productivity output". Human and Nickerson define it in simple terms as "all the plans that provide extra pay for extra performance in addition to regular wages for a job".

## 16.9 OBJECTIVES OF WAGE INCENTIVE PLANS

(i) To use wage incentives as a useful tool for securing a better utilization of manpower, better productivity scheduling and performance control, and a more effective personnel policy.

- (ii) To improve the profit of a firm through a reduction in the unit costs of labour and materials or both.
- (iii) To increase a worker's earning without dragging the firm into a higher wage rate structure regardless of productivity.
- (iv) To avoid additional capital investment for the expansions of production capacity.

## **Advantages of Wage Incentive Plans:**

- 1. Wage incentive plans provide an opportunity for hardworking and ambitious workers to earn more.
- 2. It encourages employees to be innovative. They come out with more efficient ways of doing work by overcoming the problems related to productivity and wasteful practice.
- 3. Incentive plans help to improve discipline and industrial relations. Effective incentive plan helps in minimizing absenteeism, accidents etc.
- 4. The self motivation on the part of the workers to work hard and improve performance so as to earn monetary rewards will reduce the cost of supervision.
- 5. The scientific work study undertaken before introducing the incentive plans helps in improving work flow, work methods etc.
- 6. The employees are encouraged to work as a team with mutual co-operation as their activities is interdependent, and any obstruction on the part of a worker can affect the output and rewards.
- 7. According to the National Commission on Labour, "wage incentive is the cheapest, quickest and surest means of increasing productivity."

#### **Limitations:**

- a. Jealousy and conflicts among workers may arise when some workers earn more than others.
- b. Unless strict check and inspections are maintained, quality may come under stake in the enthusiasm among workers to increase productivity.
- c. In the absence of a ceiling on incentive earnings, some workers may spoil their health.
- d. Strict vigilance becomes necessary to ensure that workers do not disregard safety regulation.
- e. The cost and time of clerical work increases in introducing and administrating the incentive plans.

f. Whenever production flow is disrupted due to the fault of management, workers insist on compensation.

### 16.10 TYPES OF WAGE INCENTIVE PLANS

Following are the types of wage incentive plans.:

1. **Straight Piece Rate Plan**: Under the straight piece rate plan workers are paid based on their output. For example, if the piece rate is Rs. 4 per piece of the product, then a worker who turns out 40 pieces/day earns Rs. 130 (Rs. 4 x 40) as his wage for that day. Whereas another employee who produces 32 pieces/ day earns Rs. 128 (Rs. 4 x 32 pieces). Hence a fast worker earns more compared to the slow worker.

## **Advantages:**

- i. Motivates the workers to increase their output.
- ii. Simple and easy to understand.
- iii. Improve productivity.

## **Disadvantages:**

- i. No guaranteed minimum wage. This makes workers insecure.
- ii. Great disparity of earning between slow and fast workers.
- iii. Wastage might increase.
- iv. Quality of production may suffer as the workers concentrate on quantity.
- v. Interpersonal relationship suffers due to jealousy and competition to earn more.
- vi. Enforced idleness like electricity failure or machine breakdown, adversely affect earning of workers.

### 2. Standard Piece Rate with Guaranteed Minimum Wage:

Here the minimum guaranteed wage is fixed on hourly basis. A worker gets the minimum fixed wage/day plus the incentive for the number of pieces produced.

#### **Advantages:**

- i. Min. guarantee improves sense of security.
- ii. Disparity between slow and faster workers is reduced.

### **Disadvantages:**

- i. Demotivate faster worker.
- ii. Slow workers get higher piece rate viz Rs. 5.12 (128/25).

#### 3. Differential Piece Rates:

The shortcoming of the above mentioned incentive plans have given way Differential piece rates. The differential piece rates are classified under two heads viz. Individual incentive plans and Group incentive plans.

### 4. Individual Incentive Plans:

## The different plans here are discussed below:

## (a) Halsey Plan:

## The features of this plan are:

- a. Min. wage is guaranteed.
- b. Additional bonus is provided to workers who complete the job in less than the "standard time". Bonus is a certain proportion to the time saved. This proportion is fixed at 50% in this plan.

## **Advantages:**

- i. Guaranteed min. wage exists.
- ii. Simple and easy.
- iii. Dispensed with time consuming and costly process of work study.
- iv. Management share a part of bonus on time saved.

## **Disadvantages:**

- i. Workers get only half of the benefit of their efficiency.
- ii. If the worker's rush through the job to save time, the quality may suffer.
- iii. Workers object management in sharing bonus on time saved.
- iv. Sufficient incentive is not provided to fast workers.
- **(b)** Rowan Plan: This is a modified form of Hasley Plan, developed by James Rowen of England. The Rowan Plan pays more than the Halsey Plan. This is possible if a worker completes the task in half the standard time of the task. If more than 50% time is saved then the bonus he earns decreases. **Advantages:**
- i. Minimum guaranteed wage exists.
- ii. Both the employees and the workers share the benefits of time saved.
- iii. The efficient workers get bonus at diminishing rate if they save more than 50% of the standard time. This checks over-speeding.

## **Disadvantages:**

- i. Incentive provided for fast worker is not sufficient.
- ii. Workers dislike management sharing bonus of time saved.
- (c) Gantt plan: This plan was developed by Henry L. Gantt. Here standard time for every task is fixed through time and motion study. Minimum time wage is guaranteed to all workers. A worker who fails to complete the task within the standard time receives wages for actual time spent at the specified rate. Workers who achieve or exceed the standard get extra bonus varying between 20% to 50% of the hourly rate for the time allowed for the task.

## **Advantages:**

- i. Minimum guarantee exists.
- ii. Fast worker is paid bonus at higher rate proportional to their output.
- iii. Standard worker is paid 20% bonus.
- iv. Part of bonus is shared by the organisation.

## **Disadvantages:**

- i. Sharing of bonus by organisation is resentment.
- ii. Disunity among the slow and the fast workers.
- (d) Bedeaux Plan: This plan is developed by Charles E. Bedeaux in 1911. Here the minimum time wage is guaranteed to all workers. The workers who complete the job within or more than the standard time are paid at the normal time rate. Workers who complete the job in less than the standard time are paid bonus, generally 75% of the wage for the time saved and 25% to the foreman.

### **Advantages:**

- i. Min. wage is guaranteed to all the workers.
- ii. The foreman is motivated to the productivity as 25% of time saved is paid to him.
- iii. This plan is suitable in factories wherein a worker is expected to perform different types of jobs.

### **Disadvantages:**

- i. Workers may resent sharing the bonus with foreman.
- ii. Workers may find it difficult to understand the complete calculation involved in this method.

(e) Emerson's Efficiency Plan: This plan was developed by Harrington Emerson. Here minimum wage is guaranteed. Workers are paid different bonus rates as per their efficiency level. Bonus is given at an increasing percentage beyond the prescribed level of efficiency (usually 66.67%). Efficiency is measured by comparing the actual time taken with the standard time.

## **Advantages:**

- i. Guaranteed time wage provides a sense of security to all the workers.
- ii. It encourages healthy competition among workers.
- iii. Bonus begins at 66.67% efficiency which is within the reach of many workers.

## **Disadvantages:**

- i. There is little incentive after 100% efficiency level.
- ii. The plan is not very flexible or selective.
- iii. Employer may fix the standard time at a low level making it impossible for most of the workers to earn bonus.

**Group Incentive Plan:** In some cases like an assembly line production it is not possible to determine the performance of an individual worker as several workers jointly perform a single operation. In such cases it is desirable to introduce a group incentive scheme. Here the bonus is calculated for a group of workers and the total amount is distributed among the group members in proportion to the wage earned by each.

- (a) The Scalar Plan: This is a group plan where the productivity of the entire work force is taken into account. In this plan bonus is paid at the rate of 1 % for every 1% rise in productivity. Workers are not paid the full amount of bonus earned by them in the same month. A certain percentage is set aside as a "Resource Fund" to take care of fluctuation. At the end of the year, the balance remaining in the "Reserve Fund" is also distributed.
- **(b) Priest Man Bonus Plan:** Here a committee of workers and management set the standard of performance. A minimum wage is guaranteed to each worker. The group gets bonus when actual output exceeds the standard. The group supervisor also gets a share on the group bonus. This plan promotes team spirit among employees.

**Other Forms of Incentives:** Apart from the above mentioned incentive plans; there are also other forms of incentives, especially for the white collared workers. They are briefly discussed below.

**Employee Stock Option Plan:** This is popularly known as ESOP. This is a form of incentive where the employees are allotted the company share at a price below the market price. When the company achieve better results, the market price of its shares and the value of the employees' shareholding rise. This form of incentive plan is relatively new in India and is becoming popular of late. IT is motivating to the employee, as (it enhances a sense of belongingness to the organisation) shareholders are the owners of the organisation.

**Profit Sharing:** Prof. Seager defines profit sharing as "an arrangement by which employees receive a share, fixed in advance of the profits". Profit sharing usually involves the determination of an organisation profits at the end of the fiscal, year and the distribution of a percentage of the profits to the workers qualified to share in the earnings. The main objectives of profits sharing are to create unity of interest and the spirit of co-operation. The theory behind profit sharing is that management should feel its workers will fulfill their responsibilities more diligently if they realize that their efforts may result in higher profits which will be returned to the workers through profit sharing. In India this incentive scheme is not well received by both the management and the workers. Committee appointed by the Govt. of India suggested profit sharing as a method of ensuring industrial peace and a step towards workers' participation in management and also suggested that 50% of the profit be shared among the workers. Both the employers and the trade unions rejected this. The trade unions prefer bonus to profits sharing as bonus is payable irrespective of profit or loss under the Bonus Act 1965.

Fringe Benefits: ILO describes fringe benefits as wages are often augmented by special cash benefits, by the provision of medical and other services or by payment in kind that form part of the cost for expenditure on the goods in services. In addition workers commonly receive such benefits as holidays with pay low cost meals, low rent housing etc. such additions to the wage proper are sometimes referred to as fringe benefits. Fringe benefits involve a labour cost for the employer and are not meant directly to improve efficiency. These add to the workers standard of living. Hence benefits may be statutory or voluntary. They improve motivation and morale of workers by satisfying their needs and develops a sense of belonging and loyalty among workers. They also improve the public image of the organisation.

### 16.11 BLUE COLLAR EMPLOYEES

Blue-Collar employees is a working class person who performs manual labour. Blue-collar work may involve skilled or unskilled manufacturing, mining, sanitation, custodian work, oil field, construction, mechanical maintenance, warehousing, firefighting, technical installation and many other types of physical work. Often something is physically being built or maintained. Blue-collar work is often paid hourly wage-labor, although some professionals may be paid by the project or salaried. There is a wide range of opportunities for such work depending upon field of specialty and experience. The term *blue collar* was first used in reference to trades jobs in 1924. Blue-collar workers perform labor jobs and typically work with their hands. The skills necessary for blue-collar work vary by occupation. Some blue-collar occupations require highly skilled personnel who are formally trained and certified. These workers include aircraft mechanics, plumbers, electricians and structural workers. Many blue-collar employers hire unskilled and low-skilled workers to perform simple tasks such as cleaning, maintenance and assembly line work.

## 16.12 CASE STUDY

Amrit Electrical is a family owned company of approximately 250 employees. Mr. Rajesh Khaitan recently took over as president of the company. A short time after joining the company, he, began to following a discussion with the HR director that the pay of the salaried employees was very much a matter of individual bargaining. Factory workers were not a part of the problem because they were unionized and their wages were set by collective bargaining. An examination of the salaried payroll showed that there were 75 employees ranging in pay from that of the president to that of receptionist. A closer examination showed that 20 of the salaried employees were females. Five of these were front time factory superiviors and one was the HR director. The other fourteen were non-management. This examination also showed that the HR director was underpaid and that the five female supervisors were paid somewhat less than any of the male supervisors. However, there were no similar supervisory jobs in which there were both male and female supervisors. When questioned, the HR director said that she thought that the female supervisors were paid at a lower rate mainly because they were women and because they supervised less skilled employees than did the male supervisors. However, Mr. Khaitan was not convinced that this was true. He decided to hire a compensation consultant to help him. Together they decided that all 75 salaried jobs should be in the same job evaluation cluster, that a modified job evaluation method should be used and that the job descriptions recently completed by the HR director were correct and usable in the study, the job evaluation also showed that the HR director and the five female supervisors were being underpaid in comparison with the male employees.

Mr. Khaitan was not sure, what to do. If he gave these four female employees an immediate salary increase which may large enough to bring them upto where they should be, he was afraid the male supervisors could be upset and the female supervisors might comprehend the situation and demand arrears of pay. The Hr director agreed to take a sizeable salary increase with the no arrears of pay. So this part of the problem was solved. Mr. Khaitan believed that he had three choices relative to the female supervisors: 1) To gradually increase their salaries (ii) to increase their salaries immediately (iii) to do nothing

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| 1. What would you do if you were Mr. Khaitan?                                      |
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| 2. How do you think the company got into a situation like this in the first place? |
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## **16.14 SUMMARY**

Wage payment system is one of the challenging area of whole business area as the firm has to make choices among the various alternatives plans. Firms try to create a balance between the wages paid and the workers undertaken. Firms try to make best use of there available resources to make sure that they retain the best talent by paying them in appropriate manner. A skilled labour is not an alternative for any of the other factors. Different wage plans are laid down in respect to make a worker motivated and keep his services best to the efforts.

### 16.15 KEYWORDS

Wage, Blue collar, Employees, Incentives, Plans

## 16.16 SELF ASSESSMENT QUESTIONS

- 1. What is time rate system of wages? What are its advantages?
- 2. What is piece rate wage system? Distinguish between the time rate and piece rate
- 3. What the essential characteristics of good wage payment system?
- 4. Explain various wage incentive plans.

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## MUKTHAGANGOTHRI, MYSURU-570 006.

# DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

## **M.B.A III Semester**

## COURSE - 18 C

# COMPENSATION MANAGEMENT AND PERFORMANCE APPRAISAL

## **BLOCK**

5

## **EXECUTIVE COMPENSATION**

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## **BLOCK-5: EXECUTIVE COMPENSATION**

Executive compensation always attract the attention of all the stakeholder due many reasons. For example "why executives are paid more?", is the topic of debate in both corporate and academia for a long time. This block focusses on executive compensation. Which is divided into four units.

Unit-17 deals with introduction to executive compensation. This unit discusses basic issues of executive compensation, such of meaning, features and objectives of executive compensation. This unit also discusses role of executive compensation.

Unit-18 is concerned with executive compens\ation plan. This unit focused on compensation plan and mode of compensation. Further, this unit deals with reasons of exectuives are paid more and challenge of compensation.

Unit-19 focusses on mode of executive compensation. This unit deals with topic like performance based compensation, skill based and job based pay. Further, it throughs light on pay review, pay secracy and comparable worth.

Unit -20 deals with compensation management in India. This unit discusses concept of compensation management. This unit also discusses scenario of compensation management and compensation management in organised and unorganised sectors.

# **UNIT-17: INTRODUCTION TO EXECUTIVE COMPENSATION**

## **Structure:**

| 17.0  | Objective                            |
|-------|--------------------------------------|
| 17.1  | Introduction                         |
| 17.2  | Meaning of executive compensation    |
| 17.3  | Features of executive compensation   |
| 17.4  | Objectives of executive Compensation |
| 17.5  | Role of executives' compensation     |
| 17.6  | Case Study                           |
| 17.7  | Notes                                |
| 17.8  | Summary                              |
| 17.9  | Key Words                            |
| 17.10 | Self Assessment Questions            |
| 17 11 | References                           |

#### 17.0 OBJECTIVES

After studying this unit, you shoul be able to:

- define executive compensation
- discuss features of executive compensation and
- enumerute the objectives and role of executive compensation

### 17.1 INTRODUCTION

Executive compensation is a part of human resources development and it is most important function of human resources management. Since the executives are plays dominant role in any organization, hence, it is very essential to ensure adequate monetary and non monetary value to executives. Executive compensation is complex and also significant for organization and executives view points, because it influence on job satisfaction, attraction, retention, performance, skill acquisition, cooperation, and flexibility.

## 17.2 MEANING OF EXECUTIVE COMPENSATION

Executive compensation is the total remuneration or financial compensation a top executive receives within a corporation. This includes a basic salary, any and all bonuses, shares, options, and any other company benefit.

Compensation for executive managers is different from compensation for other employees in most organizations. Executive compensation covers employees that include company presidents, chief executive officers(CEOs), chief financial officers (CFOs), vice presidents, occasionally directors, and other upper-level managers. These high level employees are paid executive compensation.

Further the executive compensation can be define in managerial perspective, the compensation package offered a firm's to executives are important not only because it costs, but it's likely to be the primary reason the employees work for the firm. Compensation packages with good pay and benefits can help attract and retain the best executives.

Thus it is clear that compensation refers to a wide range of financial and non financial rewards to employees for their services rendered to the organization. It is paid in the form of wages, salaries and employee benefits such as paid vacations, insurance maternity leave, free travel facility, retirement benefits etc., Monetary payments are a direct form of compensating the employees and have a great impact in motivating employees.

## 17.3 FEATURES OF EXECUTIVE COMPENSATION

- Executive compensation included both fixed and variable elements that are easily managed by the company and quickly understood by executives.
- It is a financial compensation awarded by organization to their executives and it is designed by a company's Board of Directors,
- Executive pay arrangements typically consist of different compensation components viz., salary, annual incentives, long-term incentives, benefits and, perquisites.
- Most of executive pay packages come in the form of company stock.
- Executive compensation builds to meet the executive objectives and company profit.
- Executive compensation focus on motivating the executive's to meet both tactical and strategic company needs viz., profit, growth, market share, volume, etc.
- Executive compensation distinguishes between performing tasks and achieving results.
- Executive pay is financial compensation received by an officer of a firm, often as a mixture of salary, bonuses, shares of and call options on the company stock, etc

## 17.4 OBJECTIVES OF EXECUTIVE COMPENSATION

The aim of executive compensation program is to provide an attractive, flexible, and market-based total compensation program tied to performance and aligned with the interests of our shareholders. However, the executive compensation package should be designed to motivate the executive to perform in accordance with the company's objectives and risk tolerance. However, the followings are the important objectives of executive compensation.

- **Retain and hire top-caliber executives-** Executive officers should have base salaries and employee benefits that are market competitive and that permit us to hire and retain high-caliber individuals at all levels.
- Pay for performance- A significant portion of the annual compensation of our executive officers should vary with annual business performance and each individual's contribution to that performance.
- **Reward long-term growth and profitability** Executive officers should be rewarded for achieving long-term results.
- **Tie compensation to business performance** A significant portion of our executive officers' compensation should be tied to measures of performance of our businesses.

- Align compensation with shareholder interests- The interests of our executive officers should be linked with those of our shareholders through the risks and rewards of the ownership of our Common Stock and
- **Reinforce succession planning process** The overall compensation program for our executive officers should reinforce our robust succession planning process.

## 17.5 ROLE OF EXECUTIVE COMPENSATION

The executive compensation and reward system plays vital role in a business organization to utilize men, material, machine and money, men has been most important factor, it is impossible to imagine a business process without Men. However, the executive compensation have different role viz., impact on productivity and performance, have positive impact on the efficiency and results produced by executives, encourage the executives to perform better, it solve disputes between the organization and executives, creating a healthy competition among them and encourages executives to work hard and efficiently. In addition to above the executive compensation have other role like it executives are happy with their work, develop the commitment among executives, attract executives who are qualified, experienced and interested in services and boost the morality and work ethics of executives.

## 17.6 CASE STUDY

Joe Black was trying to figure out what to do about a problem salary situation he had in his plant. Black recently took over as president of Acme Manufacturing. The founder and former president, Bill George, had been president for 35 years. The company was family owned and located in a small eastern Arkansas town. It had approximately 250 employees and was the largest employer in the community. Black was the member of the family that owned Acme, but he had never worked for the company prior to becoming the president. He had an MBA and a law degree, plus five years of management experience with a large manufacturing organization, where he was senior vice president for human resources before making his move to Acme.

A short time after joining Acme, Black started to notice that there was considerable inequity in the pay structure for salaried employees. A discussion with the human resources director led him to believe that salaried employees pay was very much a matter of individual bargaining with the past president. Hourly paid factory employees were not part of this problem because they were unionized and their wages were set by collective bargaining. An examination of the salaried payroll showed that there were 25 employees, ranging in pay from that of the president to that of the receptionist. A closer examination showed that 14 of

the salaried employees were female. Three of these were front-line factory supervisors and one was the human resources director. The other 10 were non management

This examination also showed that the human resources director appeared to be underpaid, and that the three female supervisors were paid somewhat less than any of the male supervisors. However, there were no similar supervisory jobs in which there were both male and female job incumbents. When asked, the Hr director said she thought the female supervisors may have been paid at a lower rate mainly because they were women, and perhaps George, the former president, did not think that women needed as much money because they had working husbands. However, she added she personally thought that they were paid less because they supervised less-skilled employees than did the male supervisors. Black was not sure that this was true.

The company from which Black had moved had a good job evaluation system. Although he was thoroughly familiar with and capable in this compensation tool, Black did not have time to make a job evaluation study at Acme. Therefore, he decided to hire a compensation consultant from a nearby university to help him. Together, they decided that all 25 salaried jobs should be in the same job evaluation cluster, that a modified ranking method of job evaluation should be used, and that the job descriptions recently completed by the HR director were current, accurate and usable in the study.

The job evaluation showed that the HR director and the three female supervisors were being underpaid relative to comparable male salaried employees.

Black was not sure what to do. He knew that if the underpaid female supervisors took the case to the local EEOC office, the company could be found guilty of sex discrimination and then have to pay considerable back wages. He was afraid that if he gave these women an immediate salary increase large enough to bring them up to where they should be, the male supervisors would be upset and the female supervisors might comprehend the total situation and want back pay. The HR director told Black that the female supervisors had never complained about pay differences.

The HR director agreed to take a sizable salary increase with no back pay, so this part of the problem was solved. Black believed he had for choices relative to the female supervisors.

- To do nothing.
- To gradually increase the female supervisors salaries.
- To increase their salaries immediately.

| •     | To call the three supervisors into his office, discuss the situation with them, and jointly decide what to do. |
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| 17.7  | NOTES  |
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The executive compensation is the total amount executives can expect to receive when working for an organization. There are many different types of *compensation* packages that an employer will offer employees. However, this unit attempted to give brief information about various aspects relating to executive compensation viz., Introduction, meaning of executive compensation, features of executive compensation, and objectives of executive compensation and role of executive compensation.

## 17.9 KEY WORDS

Executive, compensation, role, features and objectives

## 17.10 ASSESSMENT QUESTIONS

- 1. What are the features of executive compensation? Explain
- 2. What are the objectives of executive compensation?
- 3. Write an analytical note on role of executive compensation
- 4. Write a brief note on executive compensation

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# **UNIT-18: EXECUTIVE COMPENSATION PLAN**

# **Structure:**

| 18.0  | Objectives                           |
|-------|--------------------------------------|
| 18.1  | Introduction                         |
| 18.2  | Compensation Plan                    |
| 18.3  | Basis and Mode of Compensation       |
| 18.4  | Reasons for Executives are paid more |
| 18.5  | Challenges of compensation           |
| 18.6  | Case Study                           |
| 18.7  | Notes                                |
| 18.8  | Summary                              |
| 18.9  | Keywords                             |
| 18.10 | Self Assessment Questions            |
| 18 11 | References                           |

### 18.0 OBJECTIVES

After studying this unit, you shoul be able to:

- define compensation plan
- explain basis and mode of compensation
- analyse reasons for executives are paid more
- Tdiscuss the challenges of compensation

### 18.1 INTRODUCTION

A business executive's area person who is responsible for running an organization and the role varies depending on the organization. They create plans to help their organizations grow. Executives' duties depend on how many people are on their staff. Some executives oversee general managers in different areas. In larger organizations, they may direct one area, such as marketing, finance, or legal services. For example, in the financial area, executives may direct the buying or selling of land or other investments. Other executives get more involved. They may hire and train new staff. They may direct staff in what tasks need to be done. They may choose computer systems to record data, such as budgets. When complaints arise, executives may direct investigations to resolve what occurred in the agency or between staff members. In addition to above the executives plays other role viz., advises the board, advocates / promotes organization and stakeholder change related to organization mission supports motivation of employees in organization products/programs and operations, ensures, staff and board have sufficient and up-to-date information, looks to the future for change opportunities, interfaces between board and employees, interfaces between organization and community, formulates policies and planning recommendations to the Board, Decides or guides courses of action in operations by staff, Oversees operations of organization and Implements plans. However, executives require adequate compensation for their work. It is the responsibility of the compensation committee of the board of directors to design executive compensation contracts. The "right" amount to pay an executive is the minimum amount it takes to attract and retain a qualified individual. In addition, the compensation package should be designed so that it motivates the executive to perform in accordance with the company's objectives and risk tolerance. Executive compensation packages generally include a mix of short-term incentives and long-term incentives. The package may also include guarantees such as a severance agreement and change in control provision.

### 18.2 COMPENSATION PLAN

- **Develop a program outline:** Set an objective for the program, establish target dates for implementation and completion and determine a budget.
- Designate an individual to oversee designing the compensation program:

  Determine whether this position will be permanent or temporary, determine who will oversee the program once it is established, determine the cost of going outside versus looking inside, and determine the cost of a consultant's review.
- **Develop a compensation philosophy**. Form a compensation committee (presumably consisting of officers or at least including one officer of the company, decide what, if any, differences should exist in pay structures for executives, professional employees, sales employees, and so on (e.g., hourly versus salaried rates, incentive-based versus non contingent pay, determine whether the company should set salaries at, above, or below market and Decide the extent to which employee benefits should replace or supplement cash compensation.
- Conduct a job analysis of all positions: Conduct a general task analysis by major departments. What tasks must be accomplished by whom, get input from senior vice presidents of marketing, finance, sales, administration, production, and other appropriate departments to determine the organizational structure and primary functions of each, Interview department managers and key employees, as necessary, to determine their specific job functions, decide which job classifications should be exempt and which should be nonexempt, develop model job descriptions for exempt and nonexempt positions and distribute the models to incumbents for review and comment; adjust job descriptions if necessary, develop a final draft of job descriptions and meet with department managers, as necessary, to review job descriptions.
- Evaluate jobs: Rank the jobs within each senior vice presidents and manager's department, and then rank jobs between and among departments, verify ranking by comparing it to industry market data concerning the ranking, and adjust if necessary, prepare a matrix organizational review, on the basis of required tasks and forecasted business plans, develop a matrix of jobs crossing lines and departments, compare the matrix with data from both the company structure and the industry wise market, prepare flow charts of all ranks for each department for ease of interpretation and assessment and present data and charts to the compensation committee for review and adjustment.
- **Determine grades.** Establish the number of levels senior, junior, intermediate, and beginner for each job family and assign a grade to each level and, determine the number

- of pay grades, or monetary range of a position at a particular level, within each department.
- Establish grade pricing and salary range: Establish benchmark key jobs, review the market price of benchmark jobs within the industry and establish a trend line in accordance with company philosophy.
- **Determine an appropriate salary structure:** Determine the difference between each salary step, determine a minimum and a maximum percent spread, slot the remaining jobs, Review job descriptions, verify the purpose, necessity, or other reasons for maintaining a position, meet with the compensation committee for review, adjustments, and approval.
- **Develop a salary administration policy:** Develop and document the general company policy, develop and document specific policies for selected groups, develop and document a strategy for merit raises and other pay increases, such as cost-of-living adjustments, bonuses, annual reviews, and promotions, develop and document procedures to justify the policy and meet with the compensation committee for review, adjustments, and approval.
- Obtain top executives' approval of the basic salary program: Develop and present cost impact studies that project the expense of bringing the present staff up to the proposed levels, present data to the compensation committee for review, adjustment, and approval, and present data to the executive operating committee (senior managers and officers) for review and approval.
- Communicate the final program to employees and managers: Present the plan to the compensation committee for feedback, adjustments, review, and approval, Make a presentation to executive staff managers for approval or change, and incorporate necessary changes, develop a plan for communicating the new program to employees, using slide shows or movies, literature, handouts, etc., make presentations to managers and employees. Implement the program, design and develop detailed systems, procedures, and forms, work with HR information systems staff to establish effective implementation procedures, to develop appropriate data input forms, and to create effective monitoring reports for senior managers, have the necessary forms printed, develop and determine format specifications for all reports and execute test runs on the human resources information system.
- **Monitor the program.** Monitor feedback from managers, make changes where necessary. Find flaws or problems in the program and adjust or modify where necessary.

### 18.3 BASIS AND MODE OF COMPENSATION

Here an effort is made to study the various aspects about compensations viz, basis of payment, basis payments, fringe benefits, retirement benefits, cafeteria fringe benefits why executives are paid more, Challenges of compensation, performance based compensation, skill–based pay etc

Basis of Payment: Generally the payment provide by public and private organization to their employees on the basis of nature of job, qualifications of job, experience of the employees, knowledge and necessity of employees for organization and expected contribution of the employees. Apart from the above, other basis of compensation is work performed in most private, public, and nonprofit an organization has tra-ditionally been compensated on an hourly basis. It is referred to as hourly or day work, in contrast to piecework, in which employees are paid according to the number of units they produce. Hourly work, however, is far more prevalent than piecework as a basis for compensating employees.

Employees compensated on an hourly basis are classified as hourly employees, or wage earners. Those whose compensation is computed on the basis of weekly, biweekly, or monthly pay periods are classified as salaried employees. Hourly em-ployees are normally paid only for the time they work. Salaried employees, by contrast, are generally paid the same for each pay period, even though they occa-sionally may work more hours or fewer than the regular number of hours in a pe-riod. They also usually receive certain benefits not provided to hourly employees. In addition to that other the compensation fix by organization on the basis of nature of job, qualifications of the job, experience and talent of the employees,

## **Basics of compensation**

The followings are the important mode of compensation

- ♦ Salaries: The Company strives to provide base salaries commensurate with comparable executives and private consultants. In consideration of their responsibilities for both managing the Company and/or providing direct consulting services which generate significant Company revenue, the Human Resources Committee believes the officers' salaries are comparable with those earned by executives and consultants of similar background, capability and technical expertise.
- ♦ Equity Compensation: The majority of compensation of most executive pay packages comes in the form of equity, typically company stock or a derivative form of company stock. Equity compensation provides a strong incentive because it is based on the relationship between the value of the award and the performance of a company's stock price. As the value of the company increases, the value of the equity increases, providing

an incentive for the executive to strive to increase the company's success and boost its market value. There are three primary types of Equity which are used in Executive Compensation

- ♦ Stock Options: A stock option gives the holder the right to purchase a share of company stock at a particular price for a set period of time, usually 10 years. The price at which the options may be "exercised" is usually the price of the company's stock on the date the options are granted. If the company performs well, the stock price will increase over the exercise price, giving the options value and rewarding the executive for his role in the company's success. Typically, such options may not be exercised for a period of time, usually between one and five years, before they "vest," or can be exercised.
- Restricted Stock: Shares of company stock which, despite being awarded as compensation, are not sellable by the recipient until a vesting schedule is completed. Although unable to sell shares of Restricted Stock before the vesting schedule is complete, owners enjoy all the other benefits of stock ownership, such as voting rights and dividends. If the executive leaves before the stock vests, the stock is forfeited. Restricted Stock is taxed on the amount received on the vesting date based on the closing market value of stock price.

## **Fringe Benefits**

Fringe benefit plays vital role viz., it creates and improve sound industrial relations, it boost up employee morale, it motivate the employees by identifying and satisfying their unsatisfied needs, it provide qualitative work environment and work life, it provide security to the employees against social risks like old age benefits and maternity benefits, it protect the health of the employees and it provide safety to the employees against accidents, it promote employee's welfare by providing welfare measures like recreation facilities etc. However, Fringe benefit is a payment to employees in addition to salary or wage. It may provide in the form of cash, goods or services and may include items like health insurance, pension plans, and paid vacations etc. In other words fringe benefits are indirect form of compensation given to employees in addition to the various forms of cash pay- base pay, dearness allowance and inventive pay. According to the International Encyclopedia of social sciences a fringe benefit has to meet two tests, it must provide a specific benefit to an employee and it must represent a cost to the employer. Thus it's clear that from the above it is a payments and benefits to an employee by his employer in addition to his normal earnings, it linked to performance of any employee, it may be statutory or voluntary in nature, and it is paid to all the employees to motivate them for better work or performance.

## **Retirement Benefits**

It is a pension plan in which an employer/sponsor promises a specified monthly benefit on retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age, rather than depending directly on individual investment returns. In other words retirement is the point in time when an employee chooses to leave his or her employment permanently. Retirement generally coincides with the employee's eligibility to collect retirement resources such as Social Security, a company pension and another retirement plan. Eligibility for public and private retirement resources varies from country to country as does the retirement age. In the US, the retirement age is gradually increasing, all over the world. An employee may choose retirement for reasons other than the wish to stop working. Employees may suffer ill health or debilitating physical problems that require retirement. Family problems and responsibilities may require retirement. An employer may require employees to take early retirement in order to cut costs and preserve the business. Whatever the reason, retirement from employment marks the start of the next chapter of an employee's life.

## **Types of Retirement Benefits**

The followings are important types of retirement benefits in India

## **Pension**

Pension is a periodic payment made to public servants who have completed their service. The pension rules provide for various kinds of pension based on the nature of retirement, duration of service, and mode of retirement under statutory rules. The pension scheme may be differ from public undertaking to private undertaking. However, the minimum eligibility period for receipt of pension is 10 years. A Central Government servant retiring in accordance with the Pension Rules is entitled to receive superannuation pension on completion of at least 10 years of qualifying service. In the case of Family Pension the widow is eligible to receive pension on death of her spouse after completion of one year of continuous service or before even completion of one year if the Government servant had been examined by the appropriate Medical Authority and declared fit for Government service. W.e.f 1.1.2006, Pension is calculated with reference to average emoluments namely, the average of the basic pay drawn during the last 10 months of the service or last basic pay drawn whichever is beneficial. Full pension with 20 years of qualifying service (10 years in special cases) is 50% of the average emoluments or last basic pay drawn whichever is beneficial.

## **Superannuation Pension**

A Government employee is retired on superannuation on the afternoon of the last day of the month in which he or she attained the age of 58 years in case of superior service and 60 years in case of basic service, and the pension sanctioned is called superannuation pension.

## **Retirement Gratuity**

Retirement Gratuity is admissible to all employees who retire after completion of 5 years of qualifying service at the rate of 'one-fourth of emoluments for each completed six monthly period of qualifying service subject to maximum of 16 1/2 times' the emoluments' or Rs. 3.50 lakh, whichever is less. Emoluments for the purpose of gratuity means: basic pay, stagnation increment, dearness pay, non-practicing allowance and dearness allowance on the date of cessation of service.

### **Commutation of Pension**

Every pensioner is eligible to commute a portion of his monthly pension for a lump sum payment which is the commuted value of that portion of pension. An employee or pensioner against whom departmental or judicial proceedings are pending is not eligible to commute a portion of his pension till completion of such proceedings. Amount admissible up to 40% of monthly pension

#### **Encashment of Earned leaves**

Lump sum cash equivalent of leave salary admissible for the number of days of earned leave at the credit of the employee on the last day of his service, subject to a maximum of 300 days including the number of days for which encashment was availed along with LTC, is granted by the authority competent to sanction leave. The amount of leave encashment payable is worked out in the following manner.

### **General Provident Fund**

The amount standing to the credit shall become payable when the quits service; dismissed/removed from service; proceeds on leave preparatory to retirement, and retires from service/permitted to retire or declared by a Competent Medical Authority to be unfit for further service.

## Cafeteria Fringe Benefits

A cafeteria plan is a separate written plan maintained by an employer for employees that meets the specific requirements of and regulations. It provides participants an opportunity to receive certain benefits on a pretax basis.

A cafeteria plan is an employer fringe benefit plan that permits participating employees to choose from two or more benefits consisting of cash and qualified benefits. The cafeteria plan must offer both cash and at least one qualifies benefit. A plan which offers only two qualified benefits or only two cash benefits is not a cafeteria plan. The cash may result from contributions by the employer to the plan, or may be the result of a voluntary salary reduction by the employee.

A cafeteria plan, also called a flexible benefit plan, allows employees to choose from a menu of optional benefits the ones that best fit their individual needs. Cafeteria plans earn their nickname from the flexibility they give employees in customizing their benefits from this menu. In a cafeteria plan, benefits required by law (e.g., Social Security, unemployment compensation, workers' compensation) and those mandated by company policies or labor agreements are supplemented by a list of other benefits to which employees can subscribe. Employees' choices of optional benefits are limited only by the total benefit dollars available and the variety of benefits offered by the employer. Optional benefits that are often part of cafeteria plans include dental insurance, vision care, group-term life insurance, child care, and disability insurance. Many companies offer some form of cafeteria benefit plan to their employees, although smaller companies are less likely than larger companies to offer flexible benefits. However, there are largest problem with cafeteria plans, as opposed to one-sizefits-all benefit plans, is that cafeteria plans are more complicated to administer. Since employees choose individualized benefit packages, the company must take care to record and maintain each employee's benefit package accurately. The company must maintain adequate communication with employees about changes in the cost of benefits, their coverage, and their use of benefits. Employees must also be offered the opportunity to revisit their benefit choices and make new selections as their needs and life situations change.

## 18.4 REASONS FOR EXECUTIVES ARE PAID MORE

Chief executive officers (CEOs) get paid lots of money for being the top employees in the company. Why do they get paid so much? Like athletes and actors, CEOs provide a level of talent that is required to produce the desired product - in this case, a strongly performing company. The skills and responsibilities that come with the job of CEO are extreme and the number of people who can fill these roles is limited. That is why the market has determined that people with these skills are worth a lot of money to their companies, only about 20 percent of a CEO's pay is base salary; the rest is made up of incentives based on the company's performance. The rationale is that if the company is performing well and the shareholders are making money, then the CEO should share in that success.

- Chief executives are more qualified and they are expecting more from the organization
- They are actively involved in policy formulation and implementation
- ♦ They are like kings in decision making is concern
- They are co-coordinating all affairs of the business
- The performance of organization based on the chief executives
- They are actively involved in policy formulation and implementation
- They are performing core role and responsibilities of the day-to-day running of the organization.
- ♦ CEOs make most of their money through incentives
- o As a general rule, base salary accounts for just 20 percent of a CEO's pay. The other 80 percent comes from performance-based pay.
- o Base pay for the core role and responsibilities of the day-to-day running of the organization. This amount is very often less than \$1 million because the IRS has imposed tax restrictions on "excessive" compensation.
- o Long-term incentive payments for meeting performance objectives to be achieved for a two- to five-year period. These awards are sometimes described as performance shares, performance units, or long-term cash incentives.
- o Restricted stock awards as an incentive to assure the executives are strongly aligned with the interests of shareholders.

## 18.5 CHALLENGES OF COMPENSATION

Human Resource is the most important resource for any organization to get success. In modern world many organizations are operating globally and to keep them on the competitive position they need to uses their human resources effectively and reasonably to achieve optimal business results .The success of any company highly depends upon how efficiently its work force performs and how they are motivated to do so. This can be achieved by providing adequate wage for their work and compensation as per the industry standards.

However, Compensation, particularly monetary compensation is an integral part of an organization's reward system and it is a way of telling the employ that their interests are being looked after by the organization in return for their hard work and efforts. With many organizations turning global and having operations in multiple countries and cultures, the challenges to compensation becomes of a dimension far more complex than if they were

dealing with one country alone. To complicate matters more, the transfer of employees from one location to another can lead to even more challenges in what and how much to compensate as now much of big MNCS organization have workers all over world.

As the HR compensation and administration landscape continues to become more complex, organizations will more and more often find themselves in need of answers that are increasingly difficult to find. Frequently, locating the necessary data will result in opening an entirely new set of questions and issues to be addressed. What begins as a simple local-national salary benchmarking request can rapidly evolve into more significant structural, policy, or practice concerns. To keep up with the rapid movement of our clients as they expand to locations around the globe and meet the needs of our clients and their unique circum. In addition to above the following challenges facing HR department in relation to compensation such as addressing risk with long-term incentives, aligning long-term incentives to transformation-of-care goals, setting the right balance of performance criteria to drive change, Effectively using pay-for-performance analytics and Developing leadership teams for the future.

## 18.6 CASE STUDY

Fortune Furnitech is a state-of-art modular furniture manufacturer, started with an initial '500 crores investment, by raising a term loan from different financial institution and about 65 percent contribution from the traditional family business. The group has a traditional family history of woodcraft manufacturing. Leveraging the family trend, the present owner Asim singh and his wife Ragini ventured into this business. Asim Singh has toured extensively all over the world with his father, right from his childhood. According to Mr.singh, India has top quality berg woods in its North-eastern states, which are imported by countries such as the USA. However, Indian use them as firewood, because of lack of awareness. The company launched an ambitious plan to manufacture and sell hardwood furniture worldwide, as their study indicated that the Indian market for furniture is still unorganized, and the affluent class used imported furniture made out of concentrated wood dust or waste products. To achieve this goal, the company recruited the best designers, business heads, and production people worldwide. Many designers were either Italian-born or trained in Italy. The biggest challenge the company faced was in designing managerial compensation. Management compensation received attention primarily because of its performance implication and strategic fit in Fortune Furnitech. The HR manager claimed that it had a positive effect on the company's financial performance and recommended the appropriateness of different compensation for specific strategic situations. However, he could not convince the top management of the need to formulate an executive compensation package accordingly. Asim Singh only considered such alignment for executives on the board, arguing that their achievements was traceable. The HR manager argued that compensation cost in the company was the second largest expense category, the first being the cost of raw materials and other implements (excepting labour). Hence, it has to be managed strategically, aligning with the performance of the organization and its fit with overall organizational strategy. He supplied extensive literature to sell his argument. He complained that the organization did not have a well-documented compensation philosophy, despite this evidence. Some incentives were also counterproductive. He argued that it is time to develop executive compensation, de-emphasizing the immediate financial gains and tagging it with long range strategy of the organization. After listening to the HR head's argument, the CEO directed him to develop a model that may work in the organization.

## Question

- 1. What are the factors need to be considered by HR Manager to develop the appropriate compensation model?
- 2. You assumed as HR manager and to designing the appropriate pay model for executives of the organization.

| 18.7  | NOTES                                   |
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#### 18.8 SUMMARY

From the above analysis it is clear that executive compensation is a broad term for the financial compensation awarded to a firm's executives. Executive Compensation packages are designed by a company's Board of Directors, typically by the Compensation Committee consisting of independent directors, with the purpose of incentivizing the executive team, who have a significant impact on company strategy, decision-making, and value creation as well as enhancing executive retention to help accomplish these goals, executive compensation has four distinct characteristics. However, this unit covered aspects like brief introduction about compensation, compensation plan, meaning of executive compensation, basis and mode of compensation, reasons for executives are paid more and challenges of compensation etc.

#### 18.9 KEY WORDS

Evaluate jobs, Determine grades, salary structure, salary administration policy, basic salary program, executive compensation, Gratuity, Commutation of Pension, Earned leaves, Fringe Benefits and Challenges of compensation.

# 18.10 SELF ASSESSMENT QUESTIONS

- What are the factors needed to consider while preparing the compensation plan?
   Explain
- 2. Write detail an analytical note on executive compensation
- 3. What are the basics and mode of compensation? Describe
- 4. What are the reasons responsible for higher executive pay? Explain
- 5. Describe in detail the challenges of compensation.

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# **UNIT - 19 : MODE OF EXECUTIVE COMPENSATION**

# **Structure:**

| 19.0  | Objectives                     |
|-------|--------------------------------|
| 19.1  | Introduction                   |
| 19.2  | Performance based compensation |
| 19.3  | Skill based pay                |
| 19.4  | Job based Pay                  |
| 19.5  | Pay Review                     |
| 19.6  | Pay Secrecy                    |
| 19.7  | Comparable Worth               |
| 19.8  | Case Study                     |
| 19.9  | Notes                          |
| 19.10 | Summary                        |
| 19.11 | Keywords                       |
| 19.12 | Self Assessment Questions      |
| 19.13 | References                     |

# 19.0 OBJECTIVES

After studying this unit, you will be able to:

- define the performance base compensation
- elaborate skill and job based compensation
- discuss the pay review and pay secrecy
- analyse comparable worth

# 19.1 INTRODUCTION

The executives are viz., Chief Executive Officer, President, Chief Operating Officer, Chief Financial Officer, And other Chief Officers, such as Chief Information Officer or Chief Marketing and Sales Officer. The role of the chief executive office and other executives to oversee the company's strategy and operations. Obviously, these individuals require compensation for their work. It is the responsibility of the compensation committee of the board of directors to design executive compensation contracts. The "right" amount to pay an executive is the minimum amount it takes to attract and retain a qualified individual. In addition, the compensation package should be designed so that it motivates the executive to perform in accordance with the company's objectives and risk tolerance. pay are more numerous and more complex. they include, but are not limited to base salary, incentive pay, with a short-term focus, usually in the form of a bonus, incentive pay, with a long-term focus, usually in some combination of stock awards, option awards, non-equity incentive plan compensation, enhanced benefits package that usually includes a supplemental executive retirement plan, extra benefits and perquisites, such as cars and club memberships deferred compensation earnings. However, Compensation and Reward system plays vital role in a business organization. Since, among four Ms, i.e. Men, Material, Machine and Money, Men has been most important factor, it is impossible to imagine a business process without Men. Every factor contributes to the process of production/business. It expects return from the business process such as rent is the return expected by the landlord, capitalist expects interest and organizer i.e. entrepreneur expects profits. Similarly the labour expects wages from the process.

#### 19.2 PERFORMANCE BASED COMPENSATION

Performance-related pay is a salary or wages paid based on how well the employee works. Car salesmen or production line workers, for example, may be paid in this way, or through commission. Many employers use this standards-based system for evaluating employees and for setting salaries.

The objectives of a particular performance-related pay scheme will determine the selection of the criteria to assess performance. The criteria may be based on individual, group or organizational performance, or on a mixture of them. Individual-based criteria would require individual goal- setting and an appropriate performance appraisal system; individual training to increase job knowledge and skills because training makes up the difference between abilities needed on the job and the abilities brought to the job; and the individual should have a large measure of control over his/her own performance. Individual performance criteria are not appropriate where the objective is to promote better overall performance through teamwork, cooperation, and the sharing of information and knowledge, or where individual performance is not measurable.

# **Types of Performance compensation**

There are different types of performance compensation following by MNCs, it is based on policies and practices of organization. The followings are the important methods of performance compensation.

#### **Merit Pay**

A common method which has long been in existence is pay increases - in the form of increments to individual performance. Its workability and effectiveness depend on the existence of a suitable performance appraisal system, which has often been found to be lacking. Due to its integration into the salary, it is not lost due to poor performance later, and therefore may cease to be an incentive.

#### **Incentive Payments**

Lump sum payments are another traditional method. It is not added to base pay. Usually the formula and the relationship between performance and the payment of the lump sum are known beforehand. Sales commissions may often have little to do with performance because factors such as product quality, brand name and price may contribute more to sales than the ability of the salesman to convince the buyers. Appraisals are less significant to this category since the criteria are statistical and no further measurement is needed. Another traditional method of rewarding performance is piece rates. Unless related to a reasonable time frame

within which the production should be completed, such rates would not be related to performance.

#### **Performance Bonus**

This type of bonus can be based on individual or group performance. Where it is individual based, the payment would depend on performance ratings. Since the 1980s there has been in many countries performance bonuses are commonest for executive staff. It is estimated that in the U.S.A. about 97% of the large and 86% of the medium sized companies pay such bonuses to their executives. In Western Europe the estimate is about 70% and in Singapore about 66%. As a percentage of base pay, the figure is highest in the U.S.A., though the variations are also large. Some of the criteria for the success of such bonus payments are group over individual performance, the existence of objective criteria for distribution, and the fact that such criteria are capable of measurement to ensure that what is paid is related to it.

### **Group Incentives and Productivity Gain-Sharing**

Group incentive schemes are of three types. Gain-sharing refers to a compensation system which divides between the employer and employees the results of improved performance consequent upon the better use of human resources resulting in productivity gains. Sharing is according to an agreed, pre-determined formula. A second type, namely, profit-sharing, gives employees a share of the profits. A third type is employee stock ownership plans (ESOPS). Sometimes bonuses are paid to individuals based on their own performance appraisal ratings. In the case of group incentives, the criteria could be either group or enterprise performance. The necessity for objective criteria for distribution of the performance component of pay, and a clear relationship between what is paid and the criteria are important. Productivity gain-sharing is practiced by the larger Japanese companies. Their system is based on the premise that basic to successful productivity enhancement in the long term is sharing productivity gains with employees by linking a part of earnings to productivity.

#### 19.3 SKILL BASED PAY

Skill-based pay is a compensation system that rewards employees with additional pay in exchange for formal certification of the employee's mastery of skills, knowledge, and competencies. Skill is acquired and observable expertise in performing tasks.

Skill-based pay systems are based on the idea that employees will be proactive in obtaining new, job-related skills if they are compensated for such efforts. This is a basic principle of behavioral psychology: Actions that lead to rewards will be repeated. The

underlying concept behind a skill-based pay system is relatively simple: increase an employee's compensation as he or she acquires and becomes more proficient with job-related skills. Newly implemented skill-based pay systems can be met with resistance, especially from long-tenured incumbents who have continuously received pay increases based on tenure. This can be challenging to overcome, but in most cases the tenured employees have a great deal of job-related skills, allowing them to enter into the new pay system with a high level of compensation. To correctly implement a skill-based pay system, it is important for the skills in the system to be job-related. For example, a welder being rewarded for learning to use a larger, more powerful welding machine is appropriate, but the same individual should not be compensated for learning to fix a plumbing system. Another important aspect of a well thought out skill-based pay system is that the amount of compensation increase should be relevant to the difficulty of the skill: Learning to construct a basic spreadsheet in Excel is not as difficult as learning to write macros in Visual Basic, so the former should not be associated with as large of a pay increase as the latter. The final important characteristic of an effective skill-based pay system is regular testing of skill proficiency. When incumbents initially learn skills, they should be tested for proficiency. In most cases an incumbent will not be as proficient with a newly acquired skill as with a skill they have possessed for an extended period of time. Additionally, employees who do not use a skill for a long period of time may lose proficiency. In light of both of these factors, it is important for skill proficiency to be tested at least every year. This will allow for the pay system to more accurately reflect skill proficiency.

#### **Effectiveness of Skill-Based Pay Systems**

Skill increases at the individual and workforce level result from the implementation of a skill-based pay system, both of which lead to a more productive workforce. However, some changes to the structure of skill-based pay systems can allow for greater effectiveness. Some of these changes include: Skills learned early in the system should be easier to learn .Employees that have early success with skill-based pay systems are more likely to continue gaining new skills.

Larger rewards early in the pay system motivate employees to continue working hard to obtain more skills, which is the ultimate goal of skill-based pay systems. Put simply, the first skill learned, regardless of difficulty level, should be compensated at a high level, and every skill learned after that should be compensated based on the difficulty level of the skill. While this may seem contradictory to the earlier mentioned rule about making sure the size of the pay increase is related to the difficulty of the skill, the two ideas are mutually exclusive. If every employee received the same bonus after obtaining his or her first skill, it will not seem unfair that an easier skill is rewarded at a greater level.

Skill-based pay systems put the responsibility of earning pay increases in the hands of the incumbents. Some employees, especially those new to skill-based pay systems, may not work as hard to obtain new skills. As such, it is important for management to be supportive in giving employees the time, encouragement, and resources necessary to obtain new skills.

Skill-based pay systems, as with any compensation management strategy, can be ineffective if used incorrectly. It is important to consider the suggestions outlined in this article before implementing a skill-based pay system. Ultimately, the implementation of a skill-based pay system can lead to greater profits as employees become more skilled and more proficient, allowing for them to perform their jobs more effectively.

# Pay structure based on Employees skills

One major trend in wage systems in recent years is to base pay on what workers can do the skills, knowledge, and talents they bring to the company — and not the nature of the positions they fill. To do so, the company adopts a pay structure that best supports the compensation philosophy and job valuation method used.

# Variable pay system

Variable pay systems link a percentage of a position's pay to defined performance and accomplishment targets. It usually works by establish a base pay rate and define group and individual objectives as a variable salary component. Some systems set base pay at about 80 percent of the possible compensation under the variable system. You can base proportions of the variable component on the attainment of departmental or company objectives and on individual achievement

#### **Broad Banding**

The broad banding is type of pay structure it reduce a lengthy series of narrowly defined base-pay categories to a few broad ranges. It works usually boil down a cluster of related jobs into one pay band. For example, you currently have six different job titles and pay groups for your administrative staff like office assistant, office manager, receptionist, executive assistant, administrative assistant, and senior administrative assistant.

#### Skill-based and competency-based pay

Under a skill-based pay system; have set pay scales by skill level and not by job title. Although skill-based pay is still an option, few companies use this approach today, partly because, if a firm's required skill sets change rapidly, it must continuously reinvent the system.

Competency-based pay systems base compensation on an employee's traits or characteristics rather than on specific skills. This method is used by only a few employers today because it's very tricky to develop and administer.

#### 19.4 JOB BASED PAY

A job based pay structure is a structure of salary payments that is built on compensable factors determined by the job. In other words the salary for a job is determined by its responsibilities, and sometimes its work conditions. Job-based pay, employee salaries are established based on job analysis and the requirements of a given position. With knowledge-based pay, more emphasis is placed on the ability of the employee to do the job. It is a more traditional pay structure in which jobs are slotted into salary schedules. Each position is assigned a pay range based on job duties and the only variance in pay is based on education and seniority. This offers employees a more predictable method of pay, making it easier to budget and plan for raises each year. It also rewards employees who stay with the employer for a long time. There is less room for unfairness within job titles since pay is structured by the job. This reduces the potential for discriminatory pay practices.

Job-based pay offers little room for upward pay mobility. For employees who have no desire for promotion, there is little incentive to gain new skills. Some people also get frustrated when they perform at a higher level and see colleagues get similar pay. In some organizations, senior employees struggle for motivation because they are at the high end of the pay schedule and can go no further regardless of performance. This system also contributes to sometimes contentious office politics because employees feel the only way to get ahead is to work their way up the company ladder.

A job-based compensation structure typically contrasts a skill-based structure in that you are paid based on the responsibilities of a position rather than your personal skills. While you might prefer the opportunity to optimize your earnings to match your abilities, job-based pay does offer some benefits that are especially important to women.

# **Advantages of Job Pay**

- ♦ It is based on a hierarchical organizational structure, which is the organizational structure for most organizations.
- It is simpler than a person based system as more work is required to define knowledge, skills and competencies required for a person based pay structure.
- Most companies' pay structures are job based pay structures. This means comparison is possible between companies.

• The hierarchical order of the job structure created the illusion that there are some career paths and possibilities for promotions.

#### **Disadvantages of Job Pay**

- It reinforces hierarchy and bureaucracy. It is less compatible with team based structures and incentives.
- ♦ The hierarchical organizational structure that it is based on has fundamental weakness.
- The job holder may not be competent in the job.
- The job at the top is over paid and the job at the bottom is too paid low. It increases the overall business operating costs.
- It encourages compromise of honesty in job descriptions and job valuations.
- It does not reward employees directly for their knowledge, abilities and individual strengths.
- It does not encourage development of a flexible organizational structure in terms of flatter structure; T-shaped employees and job rotation.

# 19.5 PAY REVIEW

Compensation is a key element of the employment relationship and, in addition to being the single greatest operating cost for many organizations; it has been advocated by some recently as a tool for enhancing organizational performance and sustained competitiveness. Contemporary approaches to compensation emphasize the importance of aligning employee behaviors to the strategic direction of the organization. In order to achieve the said things, the pay review plays vital role.

### **Definition of Pay Review**

Pay review is that its process to set an overall pay bill budget and to determine individual ay rises within that budget, typically on annual basis.

However, the amount of money spent on pay and employee benefits can often account for the largest part of organizational expenditure. In service, knowledge and innovation-based organizations the pay bill can account for most of the total expenditure.

Therefore, given the significance of the reward bill, it is surprising that there has less research around the pay or salary review process, arguably for many employers one of their most important business processes.

Instead, research in this area has tended to focus on the outcomes of the pay review, such as how much salaries have increased by or the size of the bonuses, rather than on how these decisions were arrived at. This study attempts to rectify this deficit by examining the various stages of this business process within various organizational and business contexts to help HR and reward professionals plan their pay review process or examine their existing approach.

The pay review can be crucial in helping the organization create and sustain a culture that is resilient and agile. However, the extent to which it can will depend on reward and HR professionals developing insight and foresight around what possible business, organizational and contextual developments are on the horizon and how best they can take advantage of these. The danger is that if insight and foresight are not developed then the organization will focus on doing what it is already doing and the only insight it gains will be the hindsight of failure.

# **Process of Pay Review**

- Planning /setting a pay bill budget
- ♦ Determining individual pay rises within the overall budget which may be based on internal factors
- Communicating outcomes to employees reviewing and evaluating the outcomes of the process.

#### 19.6 PAY SECRECY

Pay secrecy is a workplace policy that prohibits employees from discussing how much money they make. These policies are sometimes written down in employee handbooks. In some cases, those policies are implied, and managers simply urge employees not to talk about their salaries. Pay secrecy is a contentious issue in many organizations and a controversial one in our society.

Thus it is clear that pay secrecy, it can simply be viewed as a restriction of the amount of information employees are provided about what others are paid. In practice, however, pay secrecy can become quite complex. First, there is the issue of availability of information. An employer may keep pay information secret by never providing for its publication or release. Second, the employer may restrict the type of pay information made available. For example, it may choose to provide certain aggregate information about pay, such as pay ranges and/or average pay raises, but fail to give precise individual-level information about employees. Third, the employer may restrict the manner in which pay information is disseminated. For

example, the employer may encourage strong norms against discussing pay, even if pay information is technically publicly available. In this case the employer may actually threaten to impose heavy sanctions against employees who disclose pay or engage in discussions about it.

# **Disadvantages of Pay Secrecy**

- Employee judgments about fairness and their perceptions of trust may be sacrificed.
- Employee performance motivation can be expected to decrease.
- Economics perspective, the labor market may be less efficient because employees will not move to their highest valued use.
- Organization not obtained best employees
- ◆ Pay secrecy is about lack of information, thus producing uncertainty for employees and an asymmetrical information status between employees and the organization

# **Benefits of Pay Secrecy**

- One benefit of pay secrecy would be that it appears to enhance efforts at organizational control. One major way in which organizations economic system, prefer some level of cooperation among employees and like to maintain competition in the workplace at a healthy or otherwise non deleterious level.
- It serve as a form of organizational control is by being a form of organizational paternalism a way of treating employees as children and limiting their autonomy, supposedly for their own benefit
- Pay secrecy can be viewed as a paternalistic policy when managers argue that pay should be kept secret for the benefit of their employees.
- It is a form of paternalistic control would be a benefit of pay secrecy. It would allow the organization to control its employees, but at the same time would let the employers feel good about it, since they were supposedly acting in the best interest of their employees
- Pay secrecy can actually benefit organizations with respect to labor market immobility. Although the labor market inefficiency resulting from pay secrecy may be a cost to society as a whole and some employers in particular, as mentioned above, other employers can profit from this inefficiency by reducing the mobility of their productive workers.

# 19.7 COMPARABLE WORTH

Comparable worth is shorthand for "equal pay for work of equal value" or "equal pay for work of comparable worth." The doctrine of "comparable worth" is an attempt to remedy the inequities of pay which result from a long history of sex-segregated jobs and different pay scales for female and male jobs. Market rates, in this view, reflect past discriminatory practices, and cannot be the only basis of deciding current pay equity. Comparable worth systems seek to compensate jobs held primarily by women or men more equitably by comparing the educational and skill requirements, task activities, and responsibility in different jobs, and attempting to compensate each job in relation to such factors rather than the traditional pay history of the jobs.

Thus, the job of a licensed practical nurse might compare more equally to the job of an electrician and compensation adjusted accordingly. In most actual implementations of comparable worth, the pay of the lower-paid group is adjusted upwards, and the pay of the higher-paid group is allowed to grow more slowly than it would have without the comparable worth system in place

Comparable worth as a social issue is fairly straightforward. The legal side of comparable worth, however, is much less clear. As a legal concept, comparable worth is evolving through a plethora of court cases, appeals, reversals, affirmations, and administrative rulings dealing with related wage disparity issues, but not comparable worth per se. Further complicating the question are the ancillary issues surrounding comparable worth, such as "equal pay for equal work," "equal pay for similar work," and "pay parity," which although sounding similar are quite different from comparable worth. The issue is even further complicated by an oftentimes bewildering barrage of statistical claims, counterclaims, and counter-counterclaims put out by advocates and opponents alike.

#### 19.8 CASE STUDY

A company that created a successful incentive plan for its sales force. One of our clients, a food ingredient manufacturer, decided to change its long-held business strategy of emphasizing profitability to one designed to increase market share. By diversifying its product lines and venturing into new markets, the manufacturer believed it could increase growth and eventually profitability when it achieved economies of scale. The company knew that to drive business growth, it had to change its short-term incentive plan.

Under the old plan, sales people were rewarded for all products they sold individually and received a percentage of their territory's gross margin. Consequently, most reps sold

mature product lines that had the highest gross margins. The manufacturer quickly realized that although the incentive plan maximized profitability, it was not helping the company gain market share with its new product offerings. Clearly, the incentive plan had to change to support the new strategy.

The company revised its incentive plan and based incentives on units sold rather than gross margins. It also divided its products into three categories: Develop, Maintain, and Harvest. Develop products had the highest per-unit incentive, while the Maintain and Harvest categories had a lower and lowest per-unit incentive, respectively. With the new incentive plan in place, top management was able to communicate clearly its new strategic direction and performance expectations. Rewards were made substantial enough to drive change. The company set its annual target awards at 25% of base pay for achieving goal; however, the award could increase to as much as 40% of base pay for superior performance. This was a significant increase over the old plan which had a maximum award of 30% of base pay. Incentives were paid quarterly or semi-annually, so that the sales force would almost immediately see the connection between their efforts and their rewards.

The manufacturer also focused its more seasoned sales people on Develop products, while assigning the less experienced sales people to the Maintain and Harvest products. This approach freed experienced sales people to devote more time to the new products, and provided a better training opportunity to less experienced personnel. Although the Maintain and Harvest products had lower per-unit incentives, the products were easier to sell in an already established marketplace. **The company trained employees to sell its new products and to recognize the characteristics of the customers most likely to buy them.** Through the training program, management communicated to the sales forces the new products' potential and convinced them of the probability of success.

#### **Issues**

- ♦ As this company's experience illustrates, performance-based awards can be powerful tools to create and reinforce change in an organization.
- If what gets rewarded is indeed what gets done, companies need to make sure their performance-based rewards programs are aligned with overall business strategy.

| 19.9  | NOTES |
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#### **19.10 SUMMARY**

Compensation is payment an employee receives for services rendered. Payment typically happens as hourly wages or salaries, but can also occur as variable pay, such as commissions and bonuses. Benefits are usually extras you offer your employees, such as health insurance and 401(k) plans. However, this unit suited mode of compensation like Performance based compensation, Skill based pay, Job based Pay, Pay Review, Pay Secrecy and Comparable Worth.

#### 19.11 KEY WORDS

Performance, merit pay, incentives, bonus, gain, sharing, skills, efficiency, structure, broad, competency, job, secrecy and comparability.

# 19.12 SELF ASSESSMENT QUESTIONS

- 1. What are the managerial benefits of performance pay compensation? Explain
- 2. Explain prose and cones of skilled based pay
- 3. Write a detail note on skilled based pay
- 4. What are the advantages and disadvantages of pay secrecy? Explain
- 5. Describe detail on Comparable Worth.

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# **UNIT -20: COMPENSATION MANAGEMENT IN INDIA**

# **Structure:**

| 20.0  | Objectives   |
|-------|--|
| 20.1  | Introduction   |
| 20.2  | Concept of Compensation Management                           |
| 20.3  | Significance of Compensation Management                      |
| 20.4  | Scenario of compensation management in India                 |
| 20.5  | Global perspectives of compensation management               |
| 20.6  | Compensation management in organized and un organized sector |
| 20.7  | Case Study   |
| 20.8  | Notes  |
| 20.9  | Summary  |
| 20.10 | Keywords   |
| 20.11 | Self Assessment Questions                                    |
| 20.12 | References   |

#### 20. 0 OBJECTIVES

After studying this unit, you shoul be able to:

- write a note on compensation management
- discuss the significance of compensation management
- explain the Scenario of compensation management in India
- analyse the Global perspectives of compensation management
- discuss the compensation management in organized and un organized sector

# 20.1 INTRODUCTION

Compensation administration is one of the key element of HRM . Today, compensation and employee benefits contribute to 40-50% of the total costs. Compensation is strategically reported and monitored at the broad – levels and with the investors to assess the health of the organization. It is an effective and efficient process of managing the earnings – financial and non financial rewards of the employees in an organization based on their performance towards organizational goal is called compensation management. International Compensation is an internal rate of return monetary or non monetary rewards / package and also including base salary, benefits, perquisites and long term & short term incentives that valued by employee's in accordance with their relative contributions to performance towards achieving the desired goal of an organization. However, here an attempt is to study the various aspects of compensation management.

#### 20.2 CONCEPT OF COMPENSATION MANAGEMENT

According to Armstrong - Compensation Management is concerned with the formulation and implementation of strategies and Policies that aim to compensate people fairly, equitably and consistently in accordance with their value to the organization.

According to Hewitt - Compensation Management as the name suggests, implies having a compensation structure in which the employees who perform better are paid more than the average performing employees. This encourages top-performers to work harder and helps to build a competitive atmosphere in the organization. In the world of Armstrong and Brown - postulate that compensation management is an integral part of HRM approach to managing people and as such it supports the achievement of business objectives and it is strategic in the sense that it addresses longer term issues relating to how people should be valued for what they want to achieve; It is therefore integrated with other HRM functions,

especially those concerned with human resources development. Thus it is clear that, compensation Management is an organized practice that involves balancing the work-employee relation by providing monetary and non-monetary benefits to employees. Compensation includes payments such as bonuses, profit sharing, overtime pay, recognition rewards and sales commission.

# **Components of Compensation**

- 1. Basic Pay. The main part of pay package is basic pay. For blue-collar workers basic wage may be based on work done (price wage system) but for white-collar employees, supervisory staff and managers, basic salary is generally time bound. Basic pay is generally determined through job evaluation which is the process of systematically ascertaining the relative worth of a job.
- **2. Allowances.** Several allowances are paid in addition to basic pay. Some of these allowances are given below:
- o **Dearness Allowance:** This allowance is given to protect real income against inflation. Generally, dearness allowance (DA) is paid as a percentage of basic pay.
- o **House Rent Allowance:** Employers who do not provide living accommodation and pay house rent allowance (HRA) to employees. This allowance is calculated as a percentage of basic pay (Percentage varies according to Class of city from 10% to 35% of basic pay in case of government employees).
- o **City Compensatory Allowance:** This allowance is paid generally to employees in metros and other big cities where cost of living is comparatively high. City compensatory allowance (CCA) is generally a fixed amount per month.
- o **Transport Allowance/Conveyance Allowance:** Some employers pay transport allowance (TA) to their employees. A fixed sum is paid every month to cover a part of traveling charges.

In some cases, medical allowance, education allowance for children, Tiffin allowance are also paid.

- **3. Incentives:** Incentive compensation is performance-linked remuneration paid with the aim to encourage employees to work more and perform better. Both individual incentives and group incentives are used. Bonus, profit-sharing, commissions on sales are some examples of incentive compensation.
- **4. Fringe Benefits/Perquisites:** Different types of benefits are paid particularly to senior managers. Provident funds, pensions, gratuity, encashment of earned leave, company

house, company car, leave travel concession (LTC), medical aid, interest free loan, holiday homes, entertainment, stock options, etc. are examples of such benefits.

#### 20.3 SIGNIFICANCE OF COMPENSATION MANAGEMENT

- Compensation management and benefits is vital function of human resource managing team of companies who operate at international level.
- It is very important to compensate employees for their contribution in business process of company.
- Compensation is explained as all forms of financial rewards received by employees.
- It occupies a significant position in the employee's personal and official life.
- ♦ Compensation is major human resource tools that organizations utilize to manage their employees.
- It is important for firm to link compensation to its general goals and strategies as well as its compensation system to align with its HR strategy.
- ♦ Compensation Management is an organized practice that involves balancing the workemployee relation by providing monetary and non-monetary benefits to employees.
- ♦ Compensation assists to motivate the employees and enhances organizational effectiveness.
- ♦ Compensation or reward system of the organization is most influencing factor for employee motivation.
- If we observe history of causes of industrial disputes, employee compensation a reward system issues were the main reason in most cases.
- Good compensation system of rewards system in the organization will minimize industrial disputes and helps in maintaining peace and harmony within the organization.
- Compensation system plays a key role in employee attrition.
- Compensation system mostly influences retention of employee in the organization.
- Most of employee satisfaction depends upon compensation a reward system of organization.
- Effective compensation system builds employer brand, which plays a key role in attracting talent.

- Effective compensation system makes employee to put his full efforts for achievement of organization's goals and objectives.
- Effective compensation system builds initiative towards work, which in turn enhances the productivity of organization.
- Effective compensation makes employees feel belongingness towards the organization.

#### 20.4 SCENARIO OF COMPENSATION MANAGEMENT IN INDIA

The evolution of the management compensation system for the larger organizations came mostly from the pre-independence British companies, or from the Indian government system - which too was initiated by the British, and was generally paternalistic & protective. The system provided a 20-30 year grade scale of Basic Salary for each grade or level of employees - generally linked to age, with other fixed Allowances - differing for each grade. It was felt that with increasing age & the family size, their needs increased, which required consideration in the compensation. Annual increments were provided with increasing steps as one progressed through the Salary scale, even though the increases were often adhoc. Festival, Puja or Annual Bonus was paid to meet the social needs - usually once a year, and was often linked to the profits of the Company. To meet the inflationary trends, a Dearness Allowance system was introduced during the World War II days - in the early forties, but this was generally not applicable to management staff - Basic Salary remained the main component of compensation for them. Benefits frequently included housing - often furnished partially or fully - or an allowance in lieu, annual leave travel expenses, generally quantum linked to the family size & fares to hometown or nearest hill station, use of Company transport or cars (from limited use to extensive, with or without driver - grade related), medical coverage or assistance, and retrial benefits. To encourage Managers in social & sporting activities, either Company clubs existed, or financial assistance was given to join or use local clubs - depending on the level. Overall compensation increased with grade, age & service, with only very limited linkage to performance, and which was often ad-hoc at the discretion or pleasure of the boss. The Company was usually quite actively concerned and involved with the manager's family life & style of living, and strongly believed that the Company's image demanded this conforming discipline from the family members as well.

Most multinational Companies operating in India had a fair number of expatriate staff - even as late as in the sixties - having vastly different terms & conditions of service as compared to the local staff at the same level. This continued partially out of necessity to attract them to overseas postings, and also due to past colonial & historical reasons. Excellent

furnished housing was provided to them, and many other personal or social needs for them and their family members were mostly taken care of by the Company, including overseas education for their children, home leave & travel expenses etc., as well as protection of benefits available at the home country to their compatriots. Class distinctions existed even amongst the expatriates - they were generally separated as 'blue blood' at top positions, and 'commoners' at middle management positions! The local Indian Covenanted cadre managers identified for senior positions were often higher in hierarchy than the expatriate middle managers in rank, but their gross terms were generally lower. The junior management local staff were a class apart, and their terms were substantially lower, but were in line with the above philosophy, and therefore, while the cash component may have been low, the benefits of furnished housing, leave travel expenses, use of Company vehicles etc. enabled the overall living standards during the service period remain at a good level. With limited opportunities, retention of management staff was not an issue at all those days. Revisions in overall terms were usually done after 3 to 5 years. The Management salaries were considered to be a highly confidential topic, and any discussion on this subject was seriously frowned upon by the top brass. The management style did not inspire openness, and the lower levels were expected to follow orders obediently. Participative style was not practiced or encouraged generally. Employee & Managerial costs were a small part of the total expenses, and profits were easily made by most of these large corporations having little competition in near monopoly conditions in India.

From the sixties onwards the salaries of bargain able workers increased phenomenally due to the successes of the Unions in negotiations - at times by pressure tactics. At the same time, the Government statutorily limited the Directors maximum Basic salary at a very low level - in line with the socialistic philosophy. This resulted in the need for creating other indirect compensation mainly through perquisites for the management staff due to the salary compression. These perquisites & benefits given to the management staff gradually started being valued by the authorities, and had to be included for tax purposes, thereby further compressing the "in hand post tax" compensation range drastically - with the junior or middle managers being affected most adversely, while the top management were "taken good care of" by the Company. The marginal tax rates had also risen to very high levels, and so was the inflationary trend, requiring much larger increases to meet the employee expectations. The earlier 'taboo' regarding management salaries being a close subject for discussions was also disappearing and the top management started recognizing disparities that needed urgent attention. It started dawning on most progressive organizations that the compensation governance needed clear cut philosophy and policy, instead of the ad-hoc solutions of the

past, and that motivation & retention of capable managers was getting to be a very crucial need in the growing scenario in India. Some of the Personnel directors or Heads of major companies informally discussed these issues at regular intervals, and shared data & policies with each other.

#### 20.5 GLOBAL PERSPECTIVES OF COMPENSATION MANAGEMENT

Employee compensation and rewards play a critical role in the ability for large and complex global organizations to attract, motivate and retain the talent they need to be successful. When planned strategically and done well, rewards can be used to differentiate a company from its competitors, drive cultural and operational consistency or emphasize key cultural and operational differences within a company and/or from country-to-country. However, employees on international assignment present a challenge to HR and payroll functions in organizations. There is increasing scrutiny and enforcement from tax authorities, the length and structure of assignments are changing, and businesses continue to demand a return on their investment in talent. This report brings together the views of internal mobility functions working across 17 industry sectors. Combined, they manage over 20,000 international assignees worldwide, and in common, they face various challenges to achieve robust, compliant and cost- effective assignee compensation processes. It provides a timely refresh of our report. The following are the research findings relating to global perspective of compensation management.

- ♦ The results of the 2008 update to the Worldat Work Global Compensation Practices survey reveal that large, U.S. multinational companies remain fairly evenly split with regard to how they approach their global compensation structure: centralized (53%) and decentralized (47%).
- ♦ In a follow-up question, 49% of all respondents see more momentum toward greater centralization of their organization's comp structure in the next two years, while 42% do not anticipate any shift either toward greater or less centralization. Only 9% see more decentralization occurring.
- As in 2004, the 2008 respondents who self-reported a globally centralized compensation tructure for their company said that the primary objectives for having this type of structure are: 1) to establish a consistent link between rewards and results, 2) to have a consistent position vis-à-vis market and 3) for internal equity purposes.
- ♦ Among those self-reporting a decentralized global compensation structure, the most common unit of compensation organization is country-specific, followed by a region

- and a combination of business unit and country-specific. Less common structures for those with a decentralized compensation structure is local (city orsub-country), or bus
- Nearly half (47%) of those with a decentralized global compensation structure give it a mixed review in terms of effectiveness, but an additional 42% say it is either a mostly or very effective structure.
- ♦ While 53% of respondents characterize their company's global compensation structure as "centralized," a slightly larger percent (59%) said that their organization has a "global compensation strategy that is, policies and strategies that are applied uniformly in all operations around the world unless individual country compliance dictates otherwise.
- ♦ Three out of five (60%) respondents indicated that their organization uses a global leveling approach, such as whole job slotting, while 40% said they do not perform global leveling.
- ♦ When cross-tabbed by whether the organization had a centralized or decentralized global compensation structure, centralized organizations were far more likely to perform global leveling (75%), versus decentralized organizations (43%).
- ♦ A 56% majority of respondents indicated that their organization uses either global grades, or global bands, or both. All told, 31% of organizations use global grades but not global bands, 14% use global bands but not global grades, and 11% use both global grades and global bands.
- A strong majority of respondents in 2008 say their organization's global base-salary target and total cash compensation target is the 50th percentile.

# 20.6 COMPENSATION MANAGEMENT IN ORGANIZED SECTOR AND UNORGANISED SECTOR

Individuals and organization should develop and progress simultaneously for their survival and attainment of mutual goals, so every modern management has to develop the organization through administration of compensation. Compensation may be defined as money received in performance of work and much kind of services and benefits that an organization provides to employees. Thus it is obvious that compensation management is one of the most complex and dynamic issues in the field of human resource management. For an organized organization to achieve its stated objectives there is needed to effectively manage the human resources. The ability of human resources to achieve its stated objectives to a large extent depends on the effective implementation of compensational packages in order to motivate the subordinates and employees within and beyond their expectation. Compensation Management plays a crucial and functional role because it is the heart beat of human resource

management. However, the following explanation speak about compensation management practices in organized sector

**Direct Compensation** is typically made up of salary payments and health benefits. The creation of salary ranges and pay scales for different positions within the company are the central responsibility of compensation management staff. Direct compensation that is in line with industry standards provides employees with the assurance that they are getting paid fairly. This helps the employer avoid the costly loss of trained staff to a competitor.

Indirect Compensation focuses on the personal motivations of each person to work. Although salary is important, people are most productive in jobs where they share the company's values and priorities. These benefits can include things like free staff development courses, subsidized day care, the opportunity for promotion or transfer within the company, public recognition, the ability to effect change in the workplace, and service to others.

#### Organized sectors compensation management components

- Wages and Salary- Wages represent hourly rates of pay, and salary refers to the monthly rate of pay, irrespective of the number of hours put in by an employee. These are subject to annual increments.
- Allowances- Several allowances are paid in addition to basic pay. Some of these allowance are given below:
- ◆ Dearness Allowance-This allowance is given to protect real income against inflation. Generally, dearness allowance (DA) is paid as a percentage of basic pay.
- ♦ House Rent Allowance- Employers who do not provide living accommodation pay house rent allowance (HRA) to employees. This allowance is calculated as a percentage of basic pay.
- City Compensatory Allowance- This allowance is paid generally to employees in metros and other big cities where cost of living is comparatively high. City compensatory allowance (CCA) is generally a fixed amount per month (30 per cent of basic pay in case of government employees).
- ◆ Transport Allowance/Conveyance Allowance-Some employers pay transport allowance (TA) to their employees. A fixed sum is paid every month to cover a part of traveling charges
- Incentives- Incentive compensation is performance-linked remuneration paid with a view to inspire employees to work hard and do better. Both individual incentives and group

- incentives are used. Bonus, profit-sharing, commissions on sales are some examples of incentive compensation
- Fringe Benefits/Perquisites- These include employee benefits such as provident fund, gratuity, medical care, hospitalization, accident relief, health and group insurance, canteen, uniform, recreation and the likes.

### Compensation management in unorganized sectors

The term unorganized sector when used in the Indian context is defined by National commission for enterprise in the unorganized sector in their Report on Conditions of Work and Promotion of Livelihoods in the Unorganized Sector as consisting of all unincorporated private enterprises owned by individuals or households engaged in the sale or production of goods and services operated on a proprietary or partnership basis and with less than ten total works. Amongst the characteristic features of this sector are ease of entry, smaller scale of operation, local ownership, uncertain legal status, labour- intensive and operating using lower technology based methods, flexible pricing, less sophisticated packing, absence of a brand name, unavailability of good storage facilities and an effective distribution network, inadequate access to government schemes, finance and government aid, lower entry barriers for employees, a higher proportion of migrants with a lower rate of compensation.

However, compensation or remuneration in general terms means direct wages, salaries, or allowances given to the work force of the business organization. Compensation management or wage and Salary administration refer to establishment and implementation of sound policies and practices of employee compensation considering the worth of concerned employee and concerned job. It Includes such areas as job evaluation, surveys of wage and salaries, analysis of relevant Organizational problems, development and maintenance of wage structure, establishing rules for Administering wages, wage payments, incentives, profit sharing, wage changes and adjustments, Supplementary payments, control of compensation.

In addition to above, the unorganized sector accounts for over 90 per cent of our work force. Their percentage is likely to increase. They are as entitled to protection and welfare/security as workers in the organized sector, who are often described today as the privileged sector of the work force. The laws that exist today hardly touch the work force in the Unorganized Sector. It is therefore necessary to enact new legislation to cover workers in this sector. There is a wide variety of employments in this sector. Conditions vary, levels of organization very. The natures of the relations with employers vary. There is an expanding sector of those who are self-employed, or are on contract, and work from homes. It is difficult to have separate laws for each employment. This will only result in endless multiplication of laws. Hence the need for one umbrella legislation that covers whatever is basic and common,

and leaves room for supplementary legislation that covers whatever is basic and common, and leaves room for supplementary legislation or rules where specific areas demand special attention. But we cannot overlook the fact that all such legislation is enacted with the twin purposes of extending protection, and welfare/security. Protection includes security of employment, identification of minimum ages or fair wages, making the minimum known to workers, ensuring the full payment of these wages without unauthorized deductions, and a machinery at the threshold of his/her work place to enforce the law on minimum wages and working conditions. Welfare/security has to include medical services, compensation for injury, insurance, provident fund and pensioner benefit etc. We have also tried to keep in view the need to ensure that the machinery proposed for enforcement of benefits is not vitiated by distance, centralization, top heavy structure, inaccessibility, multiplication of administrative set-ups etc.

According to the NLC, the Social Security measures for the Unorganized Works should include:

- a. Health Care
- b. Maternity and early Child Care
- c. Provident Fund Benefits
- d. Family Benefits
- e. Amenities/Benefits including Housing, Drinking Water, Sanitation, etc.
- f. Compensation of employment Injury benefits (including invalidity benefits and survivor's or dependent's benefits)
- g. Retirement and post-retirement benefits (Gratuity, Pension and Family Pension)
- h. Some cover in cases of loss of earning or the capacity to earn.

#### 20.7 CASE STUDY

SAS Pvt Ltd is probably the least-well known major software company, in India. The company makes statistical analysis software (hence the acronym SAS). And the company is growing very rapidly from 1900 employees five years ago, it now has 5400 employees. But SAS is not your typical software company. It is not your typical 'anything' company. At its headquarters, just outside Bangalore, there is a 36,000 square-foot gym for employees. There is a full-length basketball court, pool tables, a private sky-lighted yoga room and workout areas. Outside, there are soccer and cricket fields. Massages are available several times a week and classes are offered in dance and tennis. The company also operates the largest day-

care facility in India. To encourage families to eat lunch together, the SAS cafeteria supplies baby seats and high chairs. To encourage families to eat dinner together, the company has a seven-hour work day, five days a week. Unlike many work-obsessive software firms, most SAS employees leave the office by 5pm. Management likes to call its work place culture "relaxed". The list of employee amenities at SAS goes on and on. Unlimited tea, coffee and juice. One week paid vacation during Diwali. An on-site health clinic staffed with six nurses and two doctors. Zero cost to employees for health insurance. Casual dress every day.

Is this any way to run a business? Management thinks so. SAS's strategy is to make it impossible for people not to do their work. Even though the company provides no stock option plans and salaries no better than the competition, the company has built an unbelievably loyal workforce. Whereas competitors typically have turnover rates above 30 percent, SAS's rate has never been higher than 5 percent. Management claims that it saves Rs. 75 lakhs a year just in employee replacement-related costs such as recruitment, interviews, moving costs for new hires and lost work time. Just in case any one wonders if the company makes any money, we'll add the following. SAS is owned by just two people – Rahul Sharma and Deepak Ahuja. They were recently listed as being in the top 100 richest people in India.

#### **Questions**

- 1. List the important facts in the case.
- 2. Are progressive HR practices like those at SAS, a cause or a result of high profits? Discuss
- 3. What possible problems could the management at SAS face (from employees) due to the benefits offered?
- 4. If you are appointed as the HR manager at SAS, what changes would you recommend in the compensation structure?

| 20.8  | NOTES                                   |       |       |       |   |
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#### 20.9 SUMMARY

Compensation Management is an organized practice that involves balancing the workemployee relation by providing monetary and non-monetary benefits to employees. Compensation includes payments such as bonuses, profit sharing, overtime pay, recognition rewards and sales commission. However, concept of compensation management, significance of compensation management, scenario of compensation management in India, global perspectives of compensation management and compensation management in organized and un organized sector

#### 20.9 KEY WORDS

Compensation, management, basic pay, allowances, dearness allowance: house rent allowance, incentives, global perspectives of compensation management, organized sector and unorganized.

# 20.10 SELF ASSESSMENT QUESTIONS

- 1. What is compensation management? Explain its role in modern business
- 2. What are the components of compensation management? Describe
- 3. Write a note on scenario on compensation management in India
- 4. Explain status of compensation management in organized sector
- 5. Describe detail on compensation management in unorganized sector

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