Compensation Management

Compensation means recovery of the losses. Dictionary meaning of the compensation is, 'something, typically money, awarded to someone in recognition of loss, suffering, or injury'. Thus, compensation can be discussed in two ways.

1. Compensation for the injury form industrial accidents.
2. Compensation for the loss of working hours.

Compensation for the injury form industrial accidents can be dealt with The Workman's compensation Act 1923 or The Employee Sate Insurance Act 1948. In the case of injury or death compensation is given to the employees.

Another aspect of the employee compensation is loss of working hours of the employees. Employees help to the employer for achieving their organizational objectives. For the contribution in the form of labour employers compensate the loss of working hours of the employees in the form of wages or salaries.

In this chapter we will be discussing about the later type of compensation i.e. wages and salaries.

Meaning

According to **The Payment of Wages Act 1936**, Wage can be defined as, "wages" 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, be 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 1[the appropriate 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; or
(6) any gratuity payable on the termination of employment in cases other than those specified in sub-clause (d).

Objectives of compensation

There are various objectives of the compensation, some are as following

1. To attract the potential and capable employees.
2. To retain talented human resource in the organization.
3. To motivate the employees to work towards achieving the organizational goal.
4. To maintain market competitiveness in order to reduce or control employee attrition.
5. To reward employees for their productive contributions in the form of incentives.
6. To establish a good image in the labour market.
7. To help employee meet their economic, personal, social and psychological needs.
8. To encourage employees to develop their skills and competencies so that they can reach at higher level in the hierarchy.
9. To encourage employees to show desired behaviour.
10. To comply with various Labour legislations.

Developing Pay Structures

Play structures system is a system determine that how much compensation should be paid to any employee. Compensation is paid to the employees in the form of wages and salaries according to their position in the organization chart. Higher and important position in the organization means higher compensation.

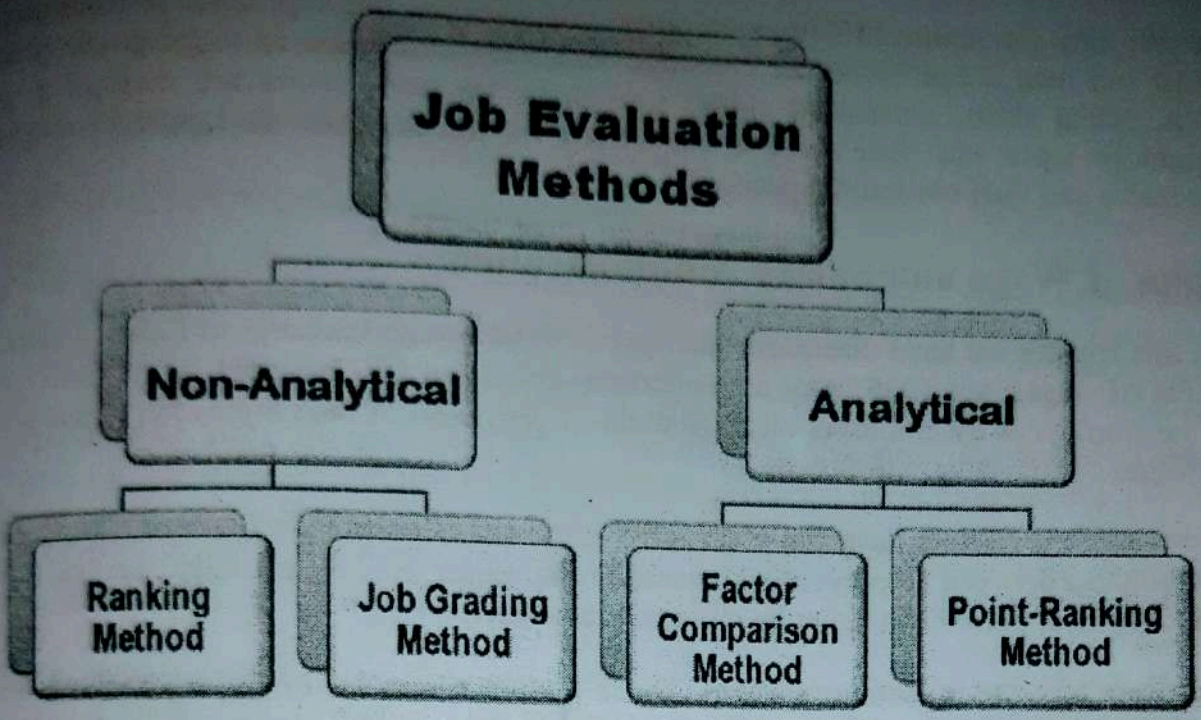
Value of the job in the organization can be estimated with the help of job evaluation. With the help of job evaluation two jobs are compared with each other. Based on this comparison level of compensation is determined by the management of the organization.

Job Evaluation:

The Job Evaluation is the procedure of assessing and evaluating the relative worth of the jobs in an organization. Job are evaluated based on the complexity, skills required, supply of manpower etc. There are various methods of job evaluation.

Methods of Job Evaluation

There are two main methods of job evaluation. One is Non analytical, and another is analytical method.



(*Figure: methods of job evaluation*)

A. **Non-analytical Job Evaluation Methods:** Non analytical methods are qualitative in nature. There are two types of non-analytical methods of job evaluation as following.

1. **Ranking Method:** This is the easiest and an inexpensive job evaluation method, wherein the jobs are ranked from the highest to the lowest based on their importance in the organization. In this method, the overall job is compared with the other jobs and then job is given a rank based on its nature and complexity in performing it. This method is easy to understand and les complex.
2. **Job Grading Method:** within this method various grades are formed by the administration and then various jobs are created as per the grades. Higher grade job is more important and require more skills in comparison to the lower level jobs. Thus, compensation is decided as per the level of grades.
   This method is more acceptable in the organizations. Managers also can decide the level of compensation as per the levels or grades without any biasness.

B. **Analytical Job Evaluation Methods:** These methods are more quantitative & analytical in nature.

1. **Factor-Comparison Method:** This method is used to evaluate the job, and the ranks are given based on a series of factors like Mental effort, physical effort, skills required supervisory responsibilities, working conditions, and other relevant factors. These factors are believed to be constant for each set of jobs. Thus, each job is compared against each other based on factor comparison and is ranked accordingly. However, it is the complex, expensive and time taking method.
2. **Point-Ranking Method:** Point raking method is used with the help of weightage system. First factors are identified of a job. Some sub factor can be identified as well. After identifying the crucial factors of the job, weightage is assigned to each factor and then these based on these

factors, jobs are compared with each other. For example, the key factor to perform a job is skills, and then it can be further classified into sub-factors such as training, communication skills, social skills, persuasion skills, etc. scores of each factors are multiplied with the weightage score and final score is considered for the analysis. This method is also more expensive and time-consuming process.

Principles of Wage and Salary Administration

Earlier in this chapter we have discussed that how to define wage specially in Indian context as per the payment of wages Act 1936. Any remuneration which can be expressed in the form of money given to the employees by employer on fulfillment of provision of the employment contract can be called as wage.

Wages are calculated on hour basis but practically wages are calculated and paid on daily basis. With the mutual consent between employees and management wages can be paid daily, weekly, fortnightly or monthly. Payment period can never be more than a month.

Another concept of wage is minimum wages. The minimum wages act 1948 deals with the minimum wages in India. Minimum wages may differ for different sates in India. Most of the time it depends on the cost of living in any state. Minimum wages are divided among various categories. These categories are;

a. Skilled workers
b. Semi-skilled workers
c. Unskilled workers

Minimum wages are revised twice in a year. Once it is received with starting of the financial year in April and again in the month of October.

Minimum wages can vary for different industries as well. But it is observed that minimum wages remain same for many industries and it only varies as per the skill level only. No employer can pay below this level of minimum wages to their employees.

Types of wages

We can further divide the wages in to three categories.

Minimum wage – This wage is given to the employees with the view to cover the basic necessities of life like food, cloths, shelter etc. this wage is statutory in nature and determined by the appropriate authority.

Fair wage – This type of wage remains equal to that received by employees for performing equal or similar work. Equal work is to be considered not only in the same job but also work in similar and comparable jobs. This type of wage is deiced by the employer only. Benchmarking technique is used to determine the wage i.e. what is being paid in the industry by other employer for the similar work.

Living wage - This is the wage which can be offered to an employee which remains higher than the minimum wages so that employees can maintain a good standard of life. This type of wage is again is

employers and are not statutory in nature. This type of wages is offered by the to attract the best talent form the labour market.

Principle of wage determination

There are two main principles of wage determination;

1. Capacity to pay
2. Industry based
3. Individual worth

1. **Capacity to pay/ Internal Equality**– According to this principle wages are determined according to the capacity of employer to pay. Though no employer can pay below the minimum wages. How much should be paid to the workers above the level of minimum wages depends on the financial condition of the organization. Following factor can affect while determining the wages.

a. Adjustment of total productivity and wages
b. Selling price of the products in the market
c. Cost of material
d. Annual turnover and profit
e. Job evaluation

2. **Industry basis/ External Equality** – As per this principle external factor or industry norms are responsible for determining the wages of the employees in an organization. Rate of pay should be judge on industry basis after taking a fair cross-section of the industry. Following factors should be considered under this principle;

a. Demand & supply in labour market
b. Wages being paid by the competitors
c. Image of the organization in the market
d. Difficulties in the job

Individual worth- According to this principle every individual should be paid as per his performance, qualifications and experience.

Theories on wages -

1. **Subsistence theory** – This theory is based on assumption that labor like any other commodity is purchased and sold in the market. In the long run the value of labor tends to be equal to the cost of production of that labor. With the increase in population supply of the labors will increase and level of wages will decrease and vice versa in the case of decreasing population.
2. **Wage fund theory** - According to this theory a fixed amount of wage fund remains available in the organization for distribution. Thus, there exists a direct relationship between wage rate and wages fund and inverse relationship between wage rate and number of labourers. If the supply of human resource remains low wage rate would be higher to attract the workers and more wage fund would be required by the management.

3. **Marginal productive theory** - According to this theory, wage for labour should be equal to the value of the marginal product. Marginal product is the addition made to total product by the employment of one unit of labour. The value of the marginal product of labour remains equal to the price at which the marginal product can be sold.
4. **The bargaining theory** - This theory states that the determination of wage rate depends upon the relative bargaining power for employer and employees. This theory gives equal importance and recognition to parts played by trade union. Collective bargaining can be the best example for this theory.
5. **Residual claimants' theory** – This theory entails that wages are determined based on the amount left after payment of rent, profit and interest. This amount is also known as the labour cost of production.

The amount of wage = production value - (rent+ profit + interest)

Compensation Planning

Planning compensation is crucial part of wage determination and distribution. While planning for compensation following points should be considered.

Develop a program outline: In the first step objectives should be identified and then these objectives should be merged and compared with the organizational objectives.

Develop a compensation philosophy: Under this step a committee should be formed. This committee would determine the demand & supply of the manpower in the market and what should be the salary of wages at different level.

Conduct a job analysis of all positions: Job analysis is important and crucial step while determining the compensation. There are two elements of the job analysis; one is job description, and another is job specification. These elements help the management while conducting the job evaluation and finding out the worth of a job.

Evaluate jobs: With the help of information collected in the process of job analysis various jobs are compared with each other qualitatively and quantitatively. As we discussed earlier that job evaluation helps in determining the worth of any job compared to other similar jobs.

Determine grades: Job evaluation and job analysis helps the management deciding the various levels and grades in the organization. By comparing the salary structure of the competitors and benchmarking wages and salaries for each grade or level can be determined.

Develop a salary administration policy: Under this step wage period, mode of payment, types of allowances are decided by the managers. Future increase in the level of wages should be decided under this stage only.

Obtain top executives' approval of the basic salary program: Once a blueprint regarding the wage and salary structure is prepared, same should be shared with the top management or leaders of the organization for further approval.

Communicate the final program to employees and managers: Once top management approves the compensation structure; it should be shared with the employees. It is the responsibility of the managers to explain in most simple manner about the wage structure and elements of wages to the employees.

Monitor the program: It is also very crucial to monitor the wage structure time to time to eliminate errors and shortcomings of the wage structure as current requirement.

Determinants of wage structure

Factors which help in determining the wage structure are known as determinants of wage structure. Some determinants are as following-

Cost of living – Cost of living depends on the geographical existence of the job. Cities with higher cost of living should get more wages in comparison to the cities with lesser cost of living.

Prevailing wage rates - By considering this wage rate employer may come reasonably close to the wage level of competitors and this would enable them to retain and attract the qualified workers.

Demand and supply of labor- If there is short supply of labor the wages may be high whereas if there is no shortage of labor wages tend to be low.

Job requirement- Job requiring specialized knowledge and much mental efforts are needed higher payment of wages.

Labor union - If the laborer is well organized due to strong trade union, there barraging power would be higher and they can demand higher rate of wages.

Competition - If there is perfect completion the level of wages may be at par with the value of the net addition of the total output. But if there is imperfect completion the wages may or may not reach at this level.

State regulation - State assumes responsibility for safeguarding the interest of our citizen, it must step in to regulating wage rate of laborers through legislative measure.

Components of compensation

There are various head under the wages and salaries. Some are as following which may reflect in salary slips provided by the employers to the employees.

A. **Income:** It is mostly placed on the left side of the salary slip. It includes the basic salary or wage, allowances, perquisites and other incomes or gains related to salary. These incomes are as following-

Basic Salary: Basic salary makes of 40% to 50 % of the salary received by the employee. Basic is used in deciding the various calculation like house rent allowance, PF amount, accommodation perquisite and other such perquisites.

Dearness allowance: It is also a basic component of income. This allowance is given to the employees to cope up with the inflation rate.

Performance & Statutory bonus: For better performance employees can avail the bonus in the form of incentive. Statutory bonus is given to the employees who have worked not less than 30 days in the organization and their per month basic salary or wage remains below 21,000/-

Commission: Certain percentage of the turnover of business is paid to the employee for his contribution in increasing the sales. This amount is identified as a commission.

Arrears: If any arrears of preceding months are paid in that month, then that amount is also shown on the salary slip.

Overtime Compensation: Overtimes is known as extra work done by the employees apart from the regular working hours. Payment depends on the type of workers and organizational policies. As per the factories Act 1948, there is a provision for double payment as overtime.

House Rent Allowance: If employee takes house on rent or lease, many organizations pay HRA to them. This allowance is also not statutory.

Leave Travel Allowance: Railway, roadways or airways expenses are reimbursed by the organization for authorised travels.

City Compensatory allowance: To cope up with the costly cost of living in the metro and A Grade city, organizations provide CCA.

Meals: If meals are provided by the employer to the employee, it is known as meal allowance. Some employers add this cost in the income side, and some provide meals as welfare measures.

Special Allowances and Perquisites: Any other allowances given by the employer or any other perquisites like accommodation, motor car allowance etc. if paid to the employee will be mentioned in the salary slip.

B. Deductions

These are located on the right side of the salary slip.

Provident Fund: This is statutory contribution of employees and employer. 12% of the basic and DA is contributed by the employees and employer contribute the same amount as well. Employers contribution is added at income side of salary slip to increase the CTC (cost to company) by some employers.

Professional Tax: The state government levies tax on salaried individuals. The states which levy the professional tax are Odisha, Tripura, Madhya Pradesh, Andhra Pradesh, Telangana, Maharashtra, Tamil Nadu, Gujarat, Bihar, West Bengal, Assam, Karnataka, Meghalaya, Chhattisgarh, Kerala, and Sikkim. It differs from state to state.

Tax deducted at source: Employer deduct the income tax form the monthly salary or wages if it falls under the certain criteria. Employers issue Form 16 against the deducted taxes at source.

Other deductions: Other deductions like any contribution to charity, fine, Recovery for sabotage etc are shown at the deduction side of the salary slip.

Performance linked compensation

The practice of linking compensation or remuneration with output of the performance of the employee is known as performance linked compensation. Sometimes this concept is also known as variable payment system which is based on the performance of the employees. for an example if a fund manager manages the mutual fund effectively then as per the performance of the mutual funds in the market compensation would be given to the manager.

There may be different categories to link the performance with the compensation, like;

a. Individual performance
b. Divisional/ departmental performance
c. Organizational performance

Wage payment system/ Methods of Remuneration

There are various types of methods of payment of remuneration, but two types of remuneration are widely accepted;

1. Piece rate system
2. Time rate system

1. Piece rate system:

Under this method, the payment is made on the number of units produced by a worker irrespective of the time taken on the job. In other words, a fixed rate is given for each unit produced, i.e. the payment is made based on quantity of work done and time taken to produce such unit is not the matter of concern.

Under this system, an efficient/skilled worker will be rewarded but inefficient/unskilled worker will be punished with low payment of wages. So, earning of the worker will be equal to the number of units produced multiplied by the rate per unit.

Earning = No. of Units x Rate per Unit

E = NU x RU.

a. Straight Piece Rate:

Under this method, a fixed rate is given for each unit produced without considering the time factor.

b. Differential Piece Rate:

Under this method at various level of output, earnings of workers vary, i.e. sometimes in proportion to output, sometimes more or sometimes less. It is introduced to reward the efficient skilled workers and motivate the less skilled workers.

F.W. Tylor introduced such type of wage payment system which can be understood with the help of following charge

= 200 + (50/100) (20 x `2.50)

= 200 + `25

= `225

Normal earning = Number of hours worked X Rape per hours

= 80 X ` 2.5 = ` 200

Incentive = Earning – Normal earning

= `225 - ` 200 = `25

B. Halsey-Weir Scheme:

In the year of 1900, G and J Weir Ltd. in Glasgow introduced this scheme. Under this method, bonus is calculated 33% (1/3) of time saved instead of 50% in case of Halsey Premium Scheme.

Except to that percentage of bonus, there is no difference between the Halsey Premium Plan and Halsey-Weir scheme.

It is represented as:

E = HW x RH + (1/3) (TS x RH)

Earnings = Hours Worked x Rate per Hour + (1/3) (Time Saved x Rate per Hour)

Illustration:

A worker takes 80 hours to do a job for which the time allowed is 110 hours and hourly rate is Rs. 3 per hour. Calculate the earnings of the worker under Halsey-Weir Scheme.

Solution:

Earnings = Hours Worked x Rate per Hour + (1/3) (Time Saved x Rate per Hour)

= 80 x `3 + (1/3) (20 x `3)

= `240 + `20

= `260

Normal earning = Number of hours worked X Rape per hours

= 80 X ` 3 = ` 240

Incentive = Earning – Normal earning

= `260 - ` 240 = `20

C. Rowan Premium Scheme:

In the year of 1898, Rowan introduced this scheme. Under this method, working period and wage rate is fixed and bonus is paid based on time saved. Amount of bonus will depend on the percentage of hourly rate which will be in proportion to the time saved.

It is represented as:

= HW x RH + (TS/TA) x (HW x RH)

Earnings = Hours Worked x Rate per Hour + (Time Saved/Time Allowed) x (Hours Worked x Rate per Hour)

Illustration:

Consider the previous illustration and ascertain the amount of wages payable to workers under Rowan Premium Scheme.

Solution:

Earnings = Hours Worked x Rate per Hour + (Time Saved/Time Allowed) x (Hours Worked x Rate per Hour)

= 80 x `3 + (20/100) x (80 x `3)

= `240 + `48

= `288

Normal earning = Number of hours worked X Rape per hours

= 80 X ` 3 = ` 240

Incentive = Earning – Normal earning

= `288 - ` 240 = `48

Overtime

As per the factories Act 1948, section 59, overtime can be explained as, where a worker works in a factory for more than nine hours in a day or forty eight hours in any week, he shall, in respect of overtime work, be entitled to wages at the rate of twice his ordinary rate of wages.

Further section 64 (4) prescribes that maximum daily working hours in the case of overtime can be ten hours.

Method of OT calculation The Factories Act 1948, Sec 59			
Days	**Hr. worked**	**Over Time**	
		Single Rate	**Double Rate**
Monday	9	1	0
Tuesday	8	0	0
Wednesday	8	0	0
Thursday	10	1	1
Friday	10	1	1
Saturday	8	0	0
Total Hr.	53		
Weekly OT	5		
Daily OT		3	2
Wage rate	` 100		
Method 1: on weekly basis			
	Week Pay	48Hr X `100	` 4,800
	OT	5Hr X `200	` 1,000
	Total Pay		` 5,800
Method 2 : on daily Basis			
	Week Pay	48Hr X `100	` 4,800
	OT on Sig. Rate	3Hr. X `100	` 300
	OT on Dob. Rate	2Hr. X `200	` 400
	Total Pay		` 5,500

Illustration of a Salary Slip

Avengers Pvt. Ltd. Pune, Maharashtra				
Salary Slip			Month	Jul-18
Employee Name	Steve Rogers	Date of Joining	1st April 2015	
Employee Code	77245	Total working days	26	
Designation	Asst. Manager	Number of working days attended	26	
PAN	DOITR8972C	Leaves	P	S
Bank account Number	12479573999	Leaves taken	0	0
		Balance Leaves	17	10

Income		Deductions	
Description	Amount (Rs.)	Description	Amount (Rs.)
Basic Salary	16500	PF deducted	250
Dearness allowance	6600	Professional tax	210
HRA	2000	TDS	2500
Tiffin allowance	1250		
City compensatory allowance	120		
Assistant allowance	1500		
Washing allowance	200		
Medical allowance	500		
TOTAL	28670	TOTAL	2960

Net Salary Payable	25710
Employee Signature	Employer Signature