

COMPENSATION PLANNING (BASICS)

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MEANING & CONCEPT

In today's world very few of us offer our services free of cost or do charity. Whenever we use our mental and physical labour, in return we expect some kind of monetary gain. This is what is called as 'compensation'. In simple words, compensation is the reward paid by the employer to the employee for availing his services. It is also considered as a reward for the loyalty and experience of the employees. Most of the time a lot of time and effort is put in by the organizations to develop and plan various pay strategies. A proper compensation package is indeed an important criterion to attract and retain some of the best talents in the organizations. The efficiency and effectiveness is highly affected by the compensation paid to him or her. Therefore, if a company requires good efforts on part of the worker then a good compensation and reward system must be developed.

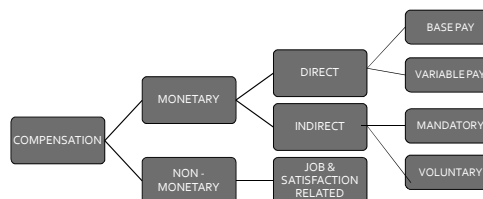
It is generally paid in the form of wages, salaries, incentives, and employee benefits like insurance, pension, maternity benefits, LTCs, etc.

"Compensation refers to the various financial and non-financial rewards to the employees for their services rendered to the organisation."

OBJECTIVES OF COMPENSATION PLANNING

- The important objective of any pay system is fairness or equity – internal equity, external equity and individual equity.
- For attracting the best talent.
- Retention of top or key performers.
- Motivating and building morale the employees
- Get the desired behaviour from the employees
- Compliance with legal rules and regulations
- Building the corporate image
- To maximize the return on investment (RoI)
- Facilitating operative and administrative efficiency

COMPONENTS OF PAY STRUCTURE



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- **Basic Pay:** It depends upon the salary scale or pay scale of the job depending upon the government regulations, demand and supply of labour, bargaining power of unions.
- **Dearness allowances:** It is an allowance which is paid to meet the increasing price levels of the essentials and inflation.
- **House Rent Allowances (HRA):** An allowance provided to meet the cost of accommodation of the employee. It varies from city to city.
- **Variable pay or incentives:** It is paid on the basis of performance like bonuses, group incentives.
- **Mandatory financial incentives:** It is compulsorily provided to the workers like provident fund, Gratuity, maternity benefits, pensions
- **Voluntary financial incentives:** educational allowances, medical benefits, uniform allowances, holidays, club facilities, etc.

FACTORS AFFECTING COMPENSATION/WAGES:

- 1) **Demand and supply of labour** – the demand and supply of the labour in the economy plays an important role in determination of the wages payable. A high demand and low supply increases the wage rates and vice-versa.
- 2) **Organization's capacity to pay** – the compensation to be paid depends upon the companies earning capacity and profitability. If the companies don't have enough financial resources, they may not be in a position to provide high rate of wages and salaries.
- 3) **Performance of workers** – the compensation is directly related to the efforts and performance of the worker. Better the performance, better wages.
- 4) **Government requirements** – to keep a track on the exploitation of the workers by the employees, certain minimum levels of wages have been fixed by the state and the centre. These levels have to be adhered to when deciding on the payment strategies.
- 5) **Prevailing wage rates** – the existing wage rates in the economy and industry have to be considered while designing of the compensation plan. If this is not done, chances of employee turnover increases.
- 6) **Labour union's bargaining power** – the bargaining position of the labour unions exerts all kind of pressures on the company to provide fair or higher wages to the workers.
- 7) **Nature of jobs** – Depending upon the knowledge, skills, expertise required to perform the jobs, the wages should be designed. Similar kind of jobs shall have similar level of payments.

COMPENSATION ADMINISTRATION

Compensation administration is an important consideration for the companies. Wages or salaries to be paid are huge costs on the part of the organisations. Every company has to carefully decide and frame out the compensation policies and programmes as any fault in such a decision may bring a lot of burden on the company. Thus, while deciding on the salaries, wages, incentives, benefits to be provided, the companies should carry out a thorough analysis of various factors that may affect the compensation plans. Efforts must be made to reduce the labour costs in every possible sense. However, they should remember that productivity of the employee is directly related to the compensation.

Employee compensation is divided into two types:

- (a) **Base Compensation:** It refers to the monetary payments made in form of wages and salaries.
- (b) **Supplementary compensation:** It refers to the payments made based on actual performance of individuals or groups.

PRINCIPLES OF WAGES & SALARY ADMINISTRATION

- ☐ Flexibility and adaptability of wage and salary plans
- ☐ Should be uniform and consistent with the overall objective of the organisation
- ☐ Should be easy, quick and simple to implement
- ☐ Must be adhering the social and economic objectives of the nation.
- ☐ Must aim at equity and fairness i.e., protection of interests
- ☐ Must be scrutinized as per the pre-set standards.

Some Terminologies:

- **WAGES:** The aggregate earnings of a worker for a day, a week, a fortnight or a month for his efforts. It is associated with workers working in plants, factories or manufacturing concerns.
- **SALARIES:** An amount payable to the employees on monthly or annual basis for the services provided. It is used for people engaged in office work, supervisors, teachers, managers, etc.
- **WAGE RATES:** the wages received per unit of production or time taken to produce a product.
- **NOMINAL WAGES:** Wages expressed in monetary terms.
- **REAL WAGES:** The amount of goods and services that can be purchased by the monetary wages.
- **FAIR WAGES:** Fair wages is something more than the living wages and is adjusted according to the capacity of the industry.
- **LIVING WAGES:** The minimum income or wage required to meet the basic necessities of food, clothing and shelter.
- **MINIMUM WAGES:** Wages that must be paid invariably irrespective of the size of the company, decided under the Minimum wages Act.