Unit – 1
Overview of Compensation Management

Learning Objectives

After completion of the unit, you should be able to :

- Understand the objective of Compensation Management.
- Describe the Methods of Compensation , Rewards, Compensation Structure and Policy .
- Explain the definition, Meaning and Implications of Compensation
- Know the Framework of a Compensation Policy

Structure

1.1 Introduction

If the abilities of employees have been developed to the point where they meet or exceed job requirements, it is now appropriate that they be equitably compensated for their contributions. The factors affecting the determination of equitable compensation are many, varied and complex. And management must come to some decision concerning the basic wage or salary. To motivate improved performance on the job many systems of variable compensation have been devised and
finally organizations have developed numerous ways of providing supplementary compensation in the form of fringe benefits.

An incentive or reward can be anything that attracts a workers attention and stimulates him to work. An incentive programme is most frequently built on monetary rewards but may also include a variety of non-monetary rewards. The term reward has been used both in the restricted sense of participation and the widest sense of financial motivation. The concept of reward implies the increased wiliness or motivation to work and not the capacity to work.

Compensation and Rewards determination may have one or more objectives, which may often be in conflict with each other. The objectives can be classified under four broad headings.

The first is equity, which may take several forms. They include income distribution through narrowing of inequalities, increasing the wages of the lowest paid employees, protecting real wages (purchasing power), the concept of equal pay for work of equal value compensation management strives for internal and external equity. Internal equity requires that, pay be related to the relative worth of a job so that similar jobs get similar pay. External equity means paying workers what comparable workers are paid by other firms in the labor market. Even compensation differentials based on differences in skills or contribution are all related to the concept of equity.

Efficiency, which is often closely related to equity because the two concepts are not antithetical. Efficiency objectives are reflected in attempts to link to link a part of wages to productivity or profit, group or individual performance, acquisition and application of skills and so on. Arrangements to achieve efficiency may be seen also as being equitable (if they fairly reward performance) or inequitable (if the reward is viewed as unfair).

Macro economic stability through high employment levels and low inflation, of instance, an inordinately high minimum wage would have an adverse impact on levels of employment, though at what level this consequence would occur is a matter of debate. Though compensation and compensation policies are only one of the factors which impinge on macro-economic stability, they do contribute to (or impede) balanced and sustainable economic development.

Efficient allocation of labor in the labor market. This implies that employees would move to wherever they receive a net gain, such movement may be form one geographical location to another or form on job to another (within or outside an enterprise). The provision or availability of financial incentives causes such movement.

For example, workers may move form a labor surplus or low wage area to a high wage area. They may acquire new skills to benefit form the higher wages paid for skills. When an employer's wages are below market rates employee turnover increases. When it is above market rates the employer attracts job applicants. When employees move from declining to growing industries, an efficient allocation of labor due to structural changes takes place.

1.2 Definitions

Compensation is a systematic approach to providing monetary value to employees in exchange for work performed. Compensation may achieve several purposes assisting in recruitment, job performance, and job satisfaction.

Compensation is a tool used by management for a variety of purposes to further the existence of the company. Compensation may be adjusted according the business needs, goals, and available resources.

Compensation may be used to

· Recruit and retain qualified employees.
· Increase or maintain morale/satisfaction.
· Reward and encourage peak performance.
· Achieve internal and external equity.
· Reduce turnover and encourage company loyalty.
· Modify (through negotiations) practices of unions.

Recruitment and retention of qualified employees is a common goal shared by many employers. To some extent, the availability and cost of qualified applicants for open positions is determined by market factors beyond the control of the employer. While an employer may set compensation levels for new hires and advertise those salary ranges, it does so in the context of other employers seeking to hire from the same applicant pool.

Morale and job satisfaction are affected by compensation. Often there is a balance (equity) that must be reached between the monetary value the employer is willing to pay and the sentiments of worth felt be the employee. In an attempt to save money, employers may opt to freeze salaries or salary levels at the expense of satisfaction and morale. Conversely, an employer wishing to reduce employee turnover may seek to increase salaries and salary levels.

Compensation may also be used as a reward for exceptional job performance. Examples of such plans include: bonuses, commissions, stock, profit sharing, gain sharing.

Employee compensation refers to all forms of pay or rewards going to employees and arising from their employment, and it has two main components. There are direct financial payments in the form of wages, salaries, incentives, commissions and bonuses and there are indirect payments in the form of financial benefits like employee paid insurance and vacations.

So in nutshell we can say that employee compensation refers to all the forms of pay or rewards going to employees and arising from their employment.

Compensation includes direct cash payments, indirect payments in the form of employee benefits & incentives to motivate employees to strive for higher levels of productivity is a critical component of employment relationship.

Compensation is affected by many factors like labour market factors, collective bargaining, government legislation & top management philosophy regarding pay benefits.

1.3 Nature and Purpose of Compensation Management

Process of compensation management is to establish & maintain an equitable wage & salary structure & an equitable cost structure .it involves job evaluation, wage & salary survey, profit sharing &control of pay costs.

Two important functions of compensation

· Equity function
· Motivation function

Equity is based on past & current performance & motivation with which the work has been performed in the past & current performance.

Nature and Purpose of compensation management

The basic purpose of compensation management is to establish and maintain an equitable reward system. The other aim is the establishment and maintenance of an equitable compensation structure, i. e, an optimal balancing of conflicting personnel interests so that the satisfaction of employees and employers is maximized and conflicts minimized. The compensation management is concerned with the financial aspects of needs, motivation and rewards. Managers, therefore, analyze and interpret the needs of their employees so that reward can be individually designed to satisfy these needs. For it has been rightly said that people do what they do to satisfy some need. Before they do anything, they look for a reward or pay-off.

The reward may be money or promotion, but more likely it will be some pay-off-a smile, acceptance by a peer, receipt of information, a kind word of recognition etc.

From individual standpoint -remuneration is a major source of an individual's purchasing power. It determines his or her status, prestige & worth in society.

From enterprise stand point- compensation is a crucial element in the cost of production, which is expected to permit adequate profits leading to increase in new capital, expansion production,
and capacity.

From national point of view –dissatisfied work force hampers equitable distribution of aggregate real income among various group involved .it causes inflation.

A Sound Compensation Structure Tries to Achieve these Objectives

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

a. For employees

1. Employees are paid according to requirements of their jobs, i.e., highly skilled jobs are paid more compensation than low skilled jobs. This eliminates inequalities.
2. The chances of favoritism (which creep in when wage rates are assigned) are greatly minimized.
3. Job sequences and lines of promotion are established wherever they are applicable.
4. Employees' morale and motivation are increased because of the sound compensation structure.

b. To Employers

1. They can systematically plan for and control the turnover in the organization.
2. A sound compensation structure reduces the likelihood of friction and grievances over remuneration
3. It enhances an employee's morale and motivation because adequate and fairly administered incentives are basic to his wants and needs.
4. It attracts qualified employees by ensuring and adequate payment for all the jobs.

Now we come to the principles of Compensation

· Differences in pay should be based on differences in job requirements.
· Wage & salary level should be in line with those prevailing in the job market.
· Follow the principle of equal pay for equal work.

· Recognize individual differences in ability & contributions.
· The employees & trade unions should be involved in while establishing wage rates.
· The wages should be sufficient to ensure for the worker &his family reasonable standard of living.
· There should be a clearly established procedure for redressal of grievances concerning wages
· The wage & salary structure should be flexible .
· Wages due to employees should be paid correctly & promptly.
· A wage committee should review & revise wages from time to time.

1.4 Components and Types of compensation

Employees as fair if based on systematic components will perceive compensation. Various compensation systems have developed to determine the value of positions. These systems utilize many similar components including job descriptions, salary ranges/structures, and written procedures.

The components of a compensation system include:

· **Job Descriptions:** A critical component of both compensation and selection systems, job descriptions define in writing the responsibilities, requirements, functions, duties, location, environment, conditions, and other aspects of jobs. Descriptions may be developed for jobs individually or for entire job families.
· **Job Analysis:** The process of analyzing jobs from which job descriptions are developed. Job analysis techniques include the use of interviews, questionnaires, and observation.
· **Job Evaluation:** A system for comparing jobs for the purpose of determining appropriate compensation levels for individual jobs or job elements. There are four main techniques: Ranking, Classification, Factor Comparison, and Point Method.
· **Pay Structures:** Useful for standardizing compensation practices. Most pay structures include several grades with each grade containing a minimum salary/wage and either step increments or grade range. Step increments are common with union positions where the pay for each job is pre-determined through collective bargaining.
· **Salary Surveys:** Collections of salary and market data. May include average salaries, inflation indicators, cost of living indicators, salary budget averages. Companies may purchase results of surveys conducted by survey vendors or may conduct their own salary surveys. When purchasing the results of salary surveys conducted by other vendors, note that surveys may be conducted within a specific industry or across industries as well as within one geographical region or across different geographical regions. Know which industry or geographic location the salary results pertain to before comparing the results to your company.

Different Types of Compensation?

Different types of compensation include:

· Base Pay
· Commissions
· Overtime Pay
· Bonuses, Profit Sharing, Merit Pay
· Stock Options
· Travel/Meal/Housing Allowance

Benefits including: dental, insurance, medical, vacation, leaves, retirement, taxes...
In a layman's language the word Compensation means something, such as money, given or received as payment or reparation, as for a service or loss. On the other hand, the word
Reward means something given or received in recompense for worthy behavior or in retribution for evil acts.

Now students let us try to demarcate between compensation and rewards

In a layman's language the word Compensation means something, such as money, given or received as payment or reparation, as for a service or loss.

On the other hand, the word Reward means something given or received in recompense for worthy behavior or in retribution for evil acts.

The word Compensation may be defined as money received in the performance of work, plus the many kinds of benefits and services that organizations provide their employees.

On the other hand, the word Reward or Incentive means anything that attracts an employees' attention and stimulates him to work. An incentive scheme is a plan or a programme to motivate individual or group performance.

An incentive programme is most frequently built on monetary rewards (incentive pay or monetary bonus), but may also include a variety of non-monetary rewards or prizes.

Compensation or rewards (incentives) can be classified into

1. Direct compensation and
2. Indirect compensation.

Money is included under direct compensation (popularly known as basic salary or wage, i.e. gross pay) where the individual is entitled to for his job, overtime-work and holiday premium, bonuses based on performance, profit sharing and opportunities to purchase stock options.

While benefits come under indirect compensation, and may consist of life, accident, and health insurance, the employer's contribution to retirement (pensions), pay for vacation or illness, and employer's required payments for employee welfare as social security.

While French says, the term " Incentive system" has a limited meaning that excludes many kinds of inducements offered to people to perform work, or to work up to or beyond acceptable standards. It does not include:

1. Wage and salary payments and merit pay;
2. Over-time payments, pay for holiday work or differential according to shift, i.e. all payments which could be considered incentives to perform work at undesirable times; and
3. Premium pay for performing danger tasks.

It is related with wage payment plans which tie wages directly or indirectly to standards of productivity or to the profitability of the organization or to both criteria. Compensation represents by far the most important and contentious element in the employment relationship, and is of equal interest to the employer, employee and government.

1. To the employer because it represents a significant part of his costs, is increasingly important to his employee's performance and to competitiveness, and affects his ability to recruit and retain a labor force of quality.
2. To the employee because it is fundamental to his standard of living and is a measure of the value of his services or performance.
3. To the government because it affects aspects of macroeconomic stability such as employment, inflation, purchasing power and socio – economic development in general.

While the basic wage or pay is the main component of compensation, fringe benefits and cash and non-cash benefits influence the level of wages or pay because the employer is concerned more about labor costs than wage rates per se. The tendency now is towards an increasing mix of pay element of executive compensation has substantially increased in recent years.

Basic Purpose for Establishment of a Sound Compensation and Reward Administration

The basic purpose of establishment of a sound compensation and reward administration is to establish and maintain an equitable compensation structure.

Its secondary objective is the establishment and maintenance of an equitable labor-cost structure, an optimal balancing of conflicting personnel interests so that the satisfaction of employees and employers is maximized and conflicts minimized.
A sound wage and salary administration tries to achieve these objectives

a. **For employees**

1. Employees are paid according to requirements of their jobs, i.e., highly skilled jobs are paid more compensation than low skilled jobs. This eliminates inequalities.

2. The chances of favoritism (which creep in when wage rates are assigned) are greatly minimized.

3. Job sequences and lines of promotion are established wherever they are applicable.

4. Employees' morale and motivation are increased because a wage programme can be explained and is based upon facts.

b. To Employers

1. They can systematically plan for and control their labor costs.
2. In dealing with a trade union, they can explain the basis of their wage programme because it is based upon a systematic analysis of job and wage facts.
3. A wage and salary administration reduces the likelihood of friction and grievances over wage inequities.
4. It enhances an employee's morale and motivation because adequate and fairly administered wages are basic to his wants and needs.
5. It attracts qualified employees by ensuring and adequate payment for all the jobs.

1.5 Objectives of Compensation and Rewards

The first is equity, which may take several forms. They include income distribution through narrowing of inequalities, increasing the wages of the lowest paid employees, protecting real wages (purchasing power), the concept of equal pay for work of equal value compensation management strives for internal and external equity. Internal equity requires that, pay be related to the relative worth of a job so that similar jobs get similar pay. External equity means paying workers what comparable workers are paid by other firms in the labor market. Even compensation differentials based on differences in skills or contribution are all related to the concept of equity.

Efficiency, which is often closely related to equity because the two concepts are not antithetical. Efficiency objectives are reflected in attempts to link to link a part of wages to productivity or profit, group or individual performance, acquisition and application of skills and so on. Arrangements to achieve efficiency may be seen also as being equitable (if they fairly reward performance) or inequitable (if the reward is viewed as unfair).

Macro economic stability through high employment levels and low inflation, of instance, an inordinately high minimum wage would have an adverse impact on levels of employment, though at what level this consequence would occur is a matter of debate. Though compensation and compensation policies are only one of the factors which impinge on macro-economic stability, they do contribute to (or impede) balanced and sustainable economic development.

Efficient allocation of labor in the labor market. This implies that employees would move to wherever they receive a net gain, such movement may be form one geographical location to another or form on job to another (within or outside an enterprise). The provision or availability of financial incentives causes such movement.

For example, workers may move form a labor surplus or low wage area to a high wage area. They may acquire new skills to benefit form the higher wages paid for skills. When an employer's wages are below market rates employee turnover increases. When it is above market rates the employer attracts job applicants. When employees move from declining to growing industries, an efficient allocation of labor due to structural changes takes place.

Other Objectives of Compensation

1. Acquire qualified personnel – compensation needs to be high enough to attract applicants. Pay levels must respond to the supply and demand of workers in the labor market since employers compete for workers. Premium wages are sometimes needed to attract applicants already working for others.
2. Retain current employees- Employees may quit when compensation levels are not competitive, resulting in higher turnover.
3. Reward desired behaviour- pay should reinforce desired behaviors and act as an incentive for those behaviors to occur in the future. Effective compensation plans reward performance, loyalty, experience, responsibility, and other behaviors.

Control Costs

a rational compensation system helps the organization obtain and retain workers at a reasonable cost. Without effective compensation management, workers could be over paid or under paid.

4. Comply with legal regulations- a sound wage and salary system considers the legal challenges imposed by the government and ensures the employer's compliance.

Facilitate understanding- the compensation management system should be easily understood buy human resource specialists, operating managers and employees.

5. Further administrative efficiency- wage and salary programs should be designed to be managed efficiently, making optimal use of the HRIS , although this objective should be a secondary consideration compared with other objectives.

Rewards

The use of Incentives or Rewards assumes that people's actions are related to their skills and ability to achieve important longer-run goals. Even though many organizations, by choice, or tradition or contract, allocate rewards on non-performance criteria, rewards should be regarded as a "payoff " for performance.

An Incentive Plan has The Following Important Objectives

1. An incentive plan may consist of both 'monetary' and 'nonmonetary' elements.
2. Mixed elements can provide the diversity needed to match the needs of individual employees.

3. the timing, accuracy and frequency of incentives are the very basis of a successful incentive plans.
4. The plan requires that it should be properly communicated to the employees to encourage individual performance, provide feedback and encourage redirection.

Determinants of Incentives
These feature are contingencies, which affect the suitability and design of incentives to varying degrees. The effective use of incentives depends on three variables-the individual, work situation, and incentive plan.

i.(I and Ill) The Individual and the Incentives
Different people value things differently. Enlightened managers realize that all people do not attach the same value to monetary incentives, bonuses, prizes or trips. Employees view these things differently because of age, marital status, economic need and future objectives.

However, even though employee reaction to incentives vary greatly, incentives must have some redeeming merits. For example, there might be a number of monetary and nonmonetary incentive programmes to motivate employees. Money, gift certificates, praises, or merit pay are of the continuous parade of promotion.

ii. The Work Situation
This is made up of four important elements:
A. Technology machine or work system, if speed of equipment operation can be varied, it can establish range of the incentive.
b. Satisfying job assignments, a workers' job may incorporate a number of activities that he finds satisfying. Incentives may take the form of earned time-off, greater flexibility in hours worked, extended vacation time and other privileges that an individual values.
Feedback, a worker needs to be able to see the connection between his work and rewards. These responses provide important reinforcement.
Equity, worker considers fairness or reasonableness as part of the exchange (or his work, Incentives, in general, are important motivators. Their effectiveness depends upon three factors: drives, preference value, and. satisfying value of the goal objects.

Beyond subsistence level, becoming needs (self-actualization needs) possess greater preference value and are more satisfying than deficiency needs (which are necessary for survival). Below the subsistence level, however, the reverse holds true." He makes the following generalizations:

i. Incentives, whether they are monetary or non-monetary, tend to increase the level of motivation in a person.
ii. Financial incentives relate more effectively with basic motivation or deficiency needs.
iii. Non-financial incentives are linked more closely with higher motivation, or becoming needs.
iv. The higher the position of a person in an organization's hierarchy, the greater is his vulnerability to non-financial incentives.

“While budgetary restrictions and’ temporary improvements in performance place a limit on the potency of money as a motivator, non-financial incentives involve only human ingenuity as investment and also insure a relatively stable acceleration in output.

Monetary incentive imply’ external motivation, non-monetary incentives involve internal motivation. Both are important. It is a judicious mix-up of the two that tends to cement incentives with motivation.

1.6 Methods of Compensation

The operating companies need to develop a compensation package for their employees depending on the size and type of business, employers may choose to compensate their employees in a number of different ways.
Below is given the different methods of compensation:

1. Wages and Salaries

Although we use the terms wages and salaries interchangeably, in payroll accounting, the two terms have different definitions. Wages refers to the earnings of employees whose pay is calculated on an hourly basis.

Salary refers to the earnings of employees whose pay is calculated on a weekly, bi-weekly, semi-monthly, or monthly basis.

3. Commissions

Sales commission plans vary greatly from company to company, but are generally based on the dollar amount of sales made during a payroll period. Commission income is considered the same as wages or salaries for withholding and reporting purposes. Commissions are usually computed on a certain percentage or commission rate.

Some commissioned employees may not be exempt from the minimum wage requirement. The employer must determine the regular, hourly rate for each non-exempt salesperson during the week and make sure this rate is at least equal to the current minimum wage.

4. Piece-Rate Plan

Workers paid on a piece-rate plan receive a certain amount for each item produced. Gross earnings equal the rate per item multiplied by the number of items produced during the payroll period.

5. Combination Plan

Many businesses pay sales people both a salary and a commission. Such a combination plan provides some regular income and offers an incentive for superior sales.

6. Draws

Draws are often given to salespeople who work only for commission. A draw is an advance given to a salesperson that will be collected when future sales transactions are closed. Draws will be subtracted from a salesperson’s commissions after any applicable taxes and deductions have been withheld. The draw is subject to all payroll withholding taxes.

Other Types of Earnings

7. **Bonuses**

Businesses offer bonuses in many different ways. Some bonuses are based on profitable operations of the business and are paid at year-end. A common type of bonus may be offered to salespeople for selling a specific item. Another type of bonus plan, one that may be part of an employment agreement, pays managers if the yearly sales or profits reach a certain level.

8. **Profit Sharing Payments**

A profit sharing plan, like a bonus plan, can be structured in a number of different ways. An employer may elect to pay cash to employees, give them stock in the business, or set up a deferred compensation fund for retirement.

9. **Other Taxable Forms of Compensation**

Sometimes other payments to employees are required that are equivalent to wages. These include non-cash fringe benefits, reimbursed expenses, sick pay, supplemental unemployment payments are subject to federal taxes.

10. **Non-Cash Fringe Benefits**

Non-cash fringe benefits must be included in an employee's gross earnings.
Fringe benefits include the following:
· Personal use of company cars
· Free or discounted airline flights
· Vacations
· Discounts on property or services
· Memberships in country clubs or other social clubs
· Tickets to entertainment or sporting events

11. **Reimbursed Expenses**

Payments made to employees for travel and other necessary business expenses are taxable only if: The employee does not have to substantiate those expenses with receipts or other documentation. The employer advances an amount to the employee for business expenses and the employee does not return any unused amount.

Travel and entertainment reimbursements, or other expense allowances, paid to an employee under a non-accountable plan are also included as wages. Under a non-accountable plan, the employee is given a certain amount of money toward expenses, but does not have to substantiate them or return any excess cash.

Under an accountable plan, travel advances paid to the employee prior to travel in excess of substantiated expenses must be repaid to the employer within a reasonable and specified period
of time.

12. Sick Pay

In general, sick pay is any amount paid to an employee because of illness or injury under a plan providing for such benefits. The amounts are disbursed by the insurance company or the employee's trust, and are referenced as third party payments.

13. Tips

In certain businesses, employees receive compensation in the form of gratuities or tips. A tip is an additional amount from a customer for services rendered. Bartenders and restaurant servers usually receive tips in addition to wages. Hair stylists and taxi drivers also depend on tips as a major source of income.

14. Supplemental Wages

Supplemental wages differ from regular wages only in that they may be based on a different payroll period, computed on a different compensation plan or rate, or paid at a different time than regular wages.

In addition, certain payments are, by their nature or timing, supplemental wages. Such payments include retroactive pay increases, severance pay, bonuses, commissions, taxable fringe benefits, awards and vacation pay on termination.

The distinction between regular and supplemental wages is important because special rules apply to withholding on supplemental wages.

15. Exempt Payments:

Compensation not considered wages includes sickness and injury payments under a workers' compensation law, and other payments that are likely to be tax deductible such as qualified moving expense reimbursements.

1.7 Compensation Structure

As it has been discussed that compensation is the act of compensating or the state of being compensated or something, such as money, given or received as payment or reparation, as for a service or loss.

What is Compensation Structure?

A Histogram of what people earn. Although money isn't everything, it certainly is one of the top issues potential employees look at when interviewing new companies. (Yes, face it, they are interviewing YOU.) Whether you're offering a straight basic salary structure or an incentive-based pay structure may make or break you in the eyes of top job candidates.

Compensation structure consists of the various salary grades and their different levels of single jobs or groups of jobs. The term wage structure' is used to describe wage/salary relationships' within a particular grouping. The grouping can be according to occupation, or organization, such as wage structure of craftsman (carpenters, mechanics, bricklayers, etc.)

The wage structure or 'grade' is comprised of jobs of approximately equal difficulty or importance as determined by' job evaluation. If the 'point' method of job evaluation is used, the 'pay-grade' consists .of jobs falling within a range of points.

If the 'factor comparison' plan is used, the grade consists of a range of evaluated wage rates (or points, if the wage rates are converted to points). If the 'ranking' plan is used, the grade consists of a specific number of ranks. If 'classification' system is used, the jobs are already categorized into 'class' or 'grades.

So the term Compensation structure means the pattern or the break up of the salary paid to the employees in their respective organization.
Please remember that while determining the compensation structure of employees, it is not only the mathematics but other subjects such as biology and psychology play a major role in compensation determination.

Biology, the increase in size or activity of one part of an organism or organ that makes up for the loss or dysfunction of another. Psychology, behavior that develops either consciously or unconsciously to offset a real or imagined deficiency, as in personality or physical ability.

Hence we can realize that compensation management is an integral part of the labor market characteristics in order to attract capable employees by respective organizations.

Determinants of the wage structure
Before discussing the wage determination process in detail let us first discuss the determinants of wage structure.

1. **Economic Determinants**

In the labor market there commonly exists, known as Occupational Wage Differentials. The reason for it's existence is that in different occupations require different qualifications, different wages of skill and carry different degrees of responsibility, wages are usually fixed on the basis of the differences in occupations and various degrees of skills.
Adam Smith explains occupational wage differentials in terms of :

1. Hardship,
2. Difficulty of learning the job,
3. Stability of employment,
4. Responsibility of the job, and
5. Chance for success or failure in the work.

This is a theory of wage structure. But his standards of worth are equally useful in explaining the complexity of wage structure decisions. The market value of an item is the price it brings in a market where demand and supply are

equal. Use value is the value an individual buyer or seller anticipates through use of the item.
Use value obviously varies among individuals and over time.

2. **Job worth**

These two concepts of worth and the concept of internal labor markets combine to explain important differences among employers in wage structure decisions. Organizations with relatively open internal labor Markets (organizations in which most jobs are filled from outside) make much use of market value. They also make much use of wage and salary surveys in wage structure decisions.

Conversely, organizations with relatively closed internal labor markets (most jobs are filled from inside) emphasize use value. Their analysis of job worth relies more heavily on perceptions of organization members of the relative value of jobs.

3. **Training**

Some other wage structure determinants derived from economic analysis may be noted. Training requirements of jobs in terms of length, difficulty, and whether the training is provided by society, employers, or individuals constitute a primary factor in human-capital analysis and thus job worth. The interaction of ability requirements with training requirements can yield different job values depending on the scarcity of the ability required and the number of people who try to make it in the occupation and fail.

4. **Employee Tastes**

Employee tastes and preferences are another economic factor. People differ in the occupations they like and dislike. In like manner, occupations have non-monetary advantages and disadvantages of many kinds.

1.8 Framework of a Compensation Policy

Employee motivation and performance management depend on good systems that offer both financial and non-financial rewards (non-monetary rewards). This performance management article applies to all organizations.

Constant change and high expectations are taking their toll in some organisations, as well as in industry and government generally. Sometimes this is shown in employee turnover.

Sometimes it is hidden because of job insecurity. Many employees make a New Year's resolution to seek other employment. Many are also seeking more balance in their life.

Rewards and remuneration must be scrutinized. Employee motivation and performance are critical. Non-monetary rewards can be as important as monetary rewards.

In some organisations, a multitude of different salary and pay arrangements exist. It is time to bring these different systems into a new framework.

Employees at all levels need to have confidence in the salary administration system. Employees want the rewards to be shared fairly and equitably. If they are not, dissatisfaction can cause severe morale and performance problems.
If they haven't done so already, leading organisations will need to establish an improved salary administration structure.

It is possible to develop a simple structure that overcomes the difficulties of the past, yet is simple enough for everyone in the organisation to understand. This structure can be tied to a completely new performance management approach, including better performance appraisal mechanisms.

Some industry's remuneration systems have been dominated by the industrial relations system. Enterprise bargaining and local area work agreements, individual performance based contracts,
and the effect of competition on organizational structures, have had a big impact.

A good rewards and remuneration system ensures that each person receives appropriate financial and nonfinancial recognition to account for the personal contribution they are making and the overall value of their position to the organisation.

This includes

· Creating and maintaining an organizational structure and culture that facilitates both employee and organizational performance.

· Recognizing and rewarding individual and team performance, financially and otherwise, in relation to the overall contribution made.

· Implementing compensation systems that fairly treat and recognise all employees, regardless of their level within the organisation. This is the equity issue. It involves matching remuneration with the contribution made, particularly where job requirements can change rapidly.

The best performance appraisal system in the world will not work if it is linked to a rewards and remuneration system that employees do not trust or support.

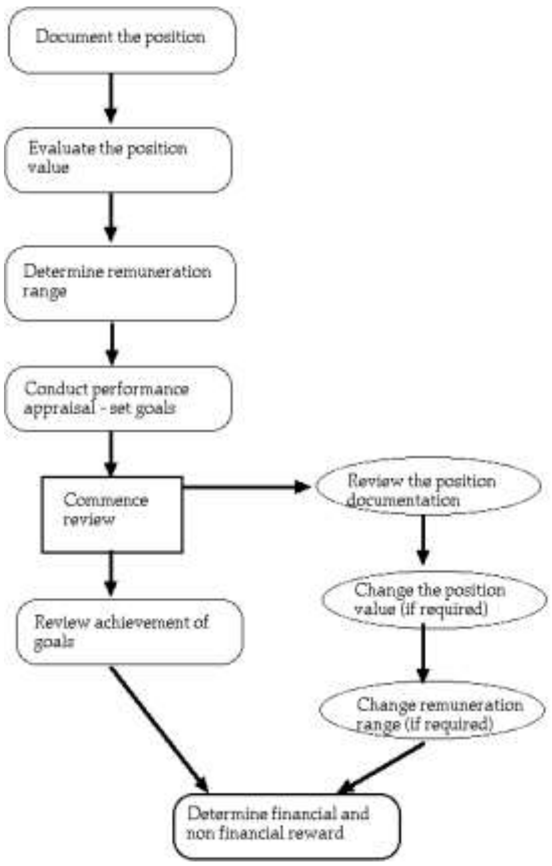
A motivated employee will achieve a great deal. A demotivated employee will be slow, prone to error and not likely to achieve.

Motivation influences performance. It also suggests that the 'lack of ', 'promise of', or receipt of either financial or nonfinancial rewards may also influence motivation. A feedback loop between motivation and performance exists, with each potentially impacting the other.

Remuneration is a component of both financial and nonfinancial reward; financially, in terms of cash and benefits received; non-financially in terms of recognition, status and esteem, e.g. the status of full private use of a motor vehicle. Job evaluation is a process to determine the contribution of a position to an organisation. It needs to be seen by both the employee and organisation as fair and equitable.

Good salary administration requires that employees should receive financial recognition for the contribution that they make, and that positions of equal value should be entitled to equal compensation. If organisations handle this incorrectly, or manipulate it in some way, the impact on the employee is significant.

Past pay systems often paid little attention to incentives. It is only in recent years that some systems have provided for differentiation based on performance. The concept of fair incentives should be on the agenda. An integrated system is required such as the following diagram represents. Perception is the reality. If the current system is not working as intended, then the organisation has a real problem.



· Is the review process conducted fairly and within agreed time limits? As well as checking goal achievement, does the review reconsider the job and changes that may have occurred?
· Are non-financial rewards considered along with financial rewards?
The system should not be bureaucratic, but it has to be perceived as fair. It also has to be actually administered fairly.
Where do you rate your system on a scale of 1 to 10?
1. Employees are showing their total disenchantment by leaving as quickly as they can. Morale and motivation are non-existent.
2 Employees are unhappy and grumble frequently about the non-existence of a remuneration system. They openly talk about the problems instead of getting on with their work.

3. Employees are unhappy and comment frequently about the remuneration system that is supposed to be in place but doesn't work. However, a work ethic exists and they do some work.
4. Employees believe that 'management' controls and manipulates the system. They continue on regardless, but they do not like it.
5. Employees are aware of a remuneration system but do not see it working for them. It causes some dissatisfaction.
6. Employees believe the remuneration system only works for 'management'.
7. Some employees believe the remuneration system is working, others believe it could be better targeted to their particular situation.
8. A comprehensive system is in place. Position value and remuneration is fairly evaluated and most are well compensated. Areas for improvement are recognizing individual and team contributions fairly. The system is reviewed regularly.
9. A comprehensive system is in place. Position value and remuneration is fairly evaluated and nearly all are well compensated. Individual and team contributions are recognised. Higher achievement will come from better implementation.
10.Everyone from the CEO down believes that the remuneration system is working well and being equitably administered. Individual and team contributions are recognized and rewarded accordingly. Although some would like more pay, no one is unhappy with the system. They are motivated and productive.

General Policy Guidelines

This also provides a framework by which interested parties may gauge the quality of company specific executive compensation programs and practices.

General Policy Guidelines

Executive compensation programs should be designed and implemented to ensure alignment of interest of management with the long-term interest of shareowners.

Executive compensation should be comprised of a combination of cash and equity-based compensation. Direct ownership should be strongly encouraged.

Executive compensation policies should be transparent to shareowners. The policies should contain, at a minimum, compensation philosophy, the targeted mix of base compensation and "at risk" compensation, key methodologies to ensure alignment of interest, and parameters for guidance of employment contract provisions, including severance packages. Companies under new SEC guidelines must provide shareowners the opportunity to vote on any material revisions to these plans.

Executive contracts should be fully disclosed, with adequate information to judge the "drivers" of incentive components of compensation packages.

Executive Compensation Policies

In particular, executive compensation policies should contain, at a minimum, the following components:

1. The company’s desired mix of base, bonus and long-term incentive compensation This section should include adequate detail to shareowners regarding the company’s philosophy of base pay components versus “pay at risk” components of the program. Details should include reasonable ranges based on total compensation within which the company will target base salary as well as other components of total compensation. Overall targets of total compensation should also be provided.
This section should also provide an overview of how the company intends to structure the compensation program, such as how much of overall compensation is based on peer relative analysis and how much of it is based on other criteria. The policy should clearly articulate how the company ensures optimal alignment of interests with shareowners through the design and implementation of its executive compensation program.
2. The company’s intended forms of incentive and bonus compensation, including what types of measures will be used to drive incentive compensation. In addition to the relative mix of base salary and any form of incentive compensation, the company should provide a breakdown of the types of incentive compensation and reasonable ranges based on total compensation targets for
each type of incentive compensation within the program. The policy should include the company’s philosophy related to the major components of incentive compensation, including the strengths and weaknesses of each and how the overall incentive component of the plan provides optimal alignment of interests with shareowners.

1.9 Let’s Sum-up

From the perspective of the employers, the money that they pay to the employees in return for the work that they do is something that they need to plan for in an elaborate and systematic manner. Unless the employer and the employee are in broad agreement (We use the term broad agreement as in many cases, significant differences in perception about the employee’s worth exist between the two sides), the net result is dissatisfaction from the employee’s perspective and friction in the relationship.

It can be said that compensation is the “glue” that binds the employee and the employer together and in the organized sector, this is further codified in the form of a contract or a mutually binding legal document that spells out exactly how much should be paid to the employee and the components of the compensation package. Since, this article is intended to be an introduction to compensation management, the art and science of arriving at the right compensation makes all the difference between a satisfied employee and a disgruntled employee.

Though Maslow’s Need Hierarchy Theory talks about compensation being at the middle to lower rung of the pyramid and the other factors like job satisfaction and fulfilment being at the top, for a majority of employees, getting the right compensation is by itself a motivating factor. Hence, employers need to quantify the employee’s contribution in a proper manner if they are to get the best out of the employee. The provision of monetary value