

# 201 MA HRM

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# **EMPLOYEE COMPENSATION AND MANAGEMENT**

**M.A (H.R.M), Semester – II, Paper-I**

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## FOREWORD

*Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A' grade from the NAAC in the year 2016, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 443 affiliated colleges spread over the two districts of Guntur and Prakasam.*

*The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the door step of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004 onwards.*

*To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.*

*It is my aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn be part of country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson- writers of the Centre who have helped in these endeavors.*

***Prof. P. Raja Sekhar***  
*Vice-Chancellor (FAC)*  
*Acharya Nagarjuna University*

**EMPLOYEE COMPENSATION AND MANAGEMENT  
SYLLABUS**

**UNIT – I**

**Employee Compensation Management:** Concept, Principles; significance; **Wage Concepts:** Wage and Salary; Minimum Wage; Need-based Minimum Wage; Fair Wage; Living Wage; ; Money and Real Wages: **Wage Theories; Compensation Policy.**

**UNIT –II**

**Wage Determination:** Fringe Benefits, Strategic Compensation Planning, Development as a Base Plan, Compensation as Retention strategy.

**UNIT – III**

**Wage fixation:** Statutory Wage Fixation, Wage Boards, Collective Bargaining, Adjudication, Pay Commissions; Wage fixation in Public Sector Undertakings.

**UNIT- IV**

**Wage Payment Methods:** Time and Piece Rate Systems, Payment by Results (PBR); Payment Methods in Different Countries; **Incentives:** Principles, Procedure for Installing Incentive System: Wage incentive Schemes in India; Linking Wages with Productivity.

**UNIT – V**

**Wage Components:** Significance, Basic Wage; Dearness Allowance; Bonus and General Allowances; Fringe Benefits; Managerial Compensation: Recent Trends in Indian Organizations and MNCs: Role of H.R. Department in Compensation Management.

**Prescribed Books:**

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**LESSON 1**  
**INTRODUCTION TO EMPLOYEE  
COMPENSATION**

**Learning Objectives**

- ✓ To Discuss the Objectives, Principles of Employee compensation
- ✓ To know the significance of Employee Compensation
- ✓ To Study the factors that influencing the compensation Management

**Structure**

**1.0 Introduction**

**1.1 Compensation**

1.1.1 Definition of Compensation

**1.2 Objectives of Compensation**

**1.3 Principles of Compensation**

**1.4 Components of Compensation**

**1.5 Job Evaluation**

1.5.1 Definition of Job Evaluation

1.5.2 Job Evaluation Process

**1.6 Significance of Employee Compensation**

**1.7 Wage and Salary Management**

**1.8 Wage Determination process**

**1.9 Factors Influencing the Compensation Management**

1.9.1 External factors

1.9.2 Internal Factors

**1.10 Criteria for Effective Compensation program**

**1.11 Types of Compensation**

1.11.1 Direct Compensation

1.11.2 Indirect Compensation

**1.12 Summary**

**1.13 Key words**

1.14 Self Assessment Questions

1.15 Suggested Readings

## 1.0 INTRODUCTION

The term compensation represents the exchange between employees and organization, both gives something in return for something else. In the past, the compensation issues were often confidential and govern by individual employer's preferences and choices. However in today's competitive world the compensation policies are more transparent and the employees take their own choices based on the compensation package. Thus, balancing the cost of compensation and retaining the employees have become the most important priority for the organization (Bhattacharyya 2009).

### 1.1.1. COMPENSATION

The compensation is a substitute word of wages and salaries and it has recently originated. The literature of wages and salaries' are enormous but it considers the issues from a legal viewpoint. However, wages have now become very significant as a cost factor (Bhattacharyya 2009).

Compensation is the remuneration received by an employee in returns of their contribution to the organization. The compensation management is an organized practice which is important for balancing the work and employee relationship by providing monetary and non-monetary compensation to employees. Compensation includes all form of pay given to the employees which arise from the employment. The one of the strapping feature of the organizations is compensation management and they used it to attract and retain the most important and worthy assets. The compensation management is considered to be a complex process which requires accuracy and precision and if not carried out properly may lead to employees' dissatisfaction.

An ideal compensation policy motivates the employees to work harder and with more determination. It also helps the organizations to set the standards for job that it is related, realistic and measurable. Compensation policies should have a sound integration with practices of HRM. One of the key functions of compensation management of any company is to create a hearty competition among the employees in order to attain more efficiently and provide growth opportunities to its employees (Khan, Aslam, Lodhi, 2011).

### 1.1.2. Definition of Compensation

According to Cascio (1995) the "Compensation includes direct cash payments and indirect payments in form of employees benefits and incentives to motivate employees to strive for higher levels of productivity".

According to Milkovitch and Newman (2005) the "Compensation is all forms of financial returns, tangible services and benefits employees receive as part of an employment relationship." The phrase "financial returns" refers to an individual's base salary, as well as short- and long-term incentives. "Tangible services and benefits" are such things as insurance, paid vacation and sick days, pension plans, and employee discounts.

### 1.2. Objectives of Compensation

Bhatta charay (2009) had provided the following objectives of compensation or wages as given below:

**Equity**

The first category is equity which may take several forms. It include income distribution through narrowing of inequalities, increasing the income of lowest paid employees, protecting real wages (purchasing power), and the concept of equal pay for work of equal values. Compensation management strives for internal and external equity. Internal equity requires pay related to the worth of similar job so that similar job gets similar pay.

External equity means paying worker what other firms in the labour market pay comparable workers. Compensation differentials, based on differences in skills or contribution, are all to the concept of equity.

**Efficiency**

The objective of efficiency are reflected in attempts to link a part of wages to productivity or profit, group or individual performance, acquisition and application of skills, and so on. Arrangement to achieve efficiency may also be seen as being equitable (if they fairly reward performance) or inequitable (if the reward is viewed as unfair).

**Macro-economic Satiability**

It can be achieved through high employments level and low inflation. For instance, an inordinately high minimum wages would have an adverse impact on levels employment, though at what level these consequences would occur is a matter of debate. Although compensation policies influence macro-economic stability and contribute to the balanced and sustainable economic development.

**Efficient Allocation of Labour**

The efficiency allocation of labour in the labour market implies that employees will move to wherever they receive a net gain. Such movement may be from one geographical location to another or from one job to another (within or outside an enterprise). The provision or availability of financial incentive causes such movement.

**Motivating the Employees**

Employees may have talent but they will not be motivated to use their talent unless they know that they will be rewarded duly for their contribution towards organizational objectives or be punished for not contributing as per the demands of the job.

**Acquire Qualified Employees**

Compensation needs to be high enough to attract applicants. Pay levels must respond to supply and demand of workers in the labour market since employers compete for workers.

**Retain Current Employees**

Employees may quit when compensation levels are not competitive resulting in higher turnover. Therefore, one of the important objectives of Compensation Management is retaining the human capital or talent of the organization.

**Reward Desired Behaviour**

Pay should reinforce desired behaviour and act as incentive for those behaviours to occur in future.

**Control Cost**

A rational compensation system helps the organization obtain and retain workers at reasonable cost.

**Comply with Legal Regulations**

A sound wage and salary system considers the legal challenges imposed by the government and ensures the employers compliance.

**Facilitate Understanding**

The Human Resource specialists, operating managers and employees should easily understand the compensation management.

**Further Administrative Efficiency**

Wages and salary programs should be designed to be managed efficiently, making optimal use of HRIS i.e. Human Resource Information System.

**1.3. Principles of Compensation**

There are following seven principles of Compensation Formulation (Jain, 2014):

- i. The organization should have a unambiguous plan to determine differential paylevels in terms of different job requirements involving varied skills, exertion, responsibility and working conditions.
- ii. An attempt should be made to keep the common level of wages and salaries of the organization in line with that obtained in the labour market.
- iii. Adequate attention should be taken to distinguish people from the jobs. Although people are paid in terms of rate embodied in specific jobs, some exceptions should be allowed in the cases of professional and executive personnel by paying them in terms of their abilities and contributions.
- iv. The care should be taken irrespective of individual considerations to ensure that equal pay for equal work.
- v. There should be a plan to adapt an unbiased measure for identifying individual differences in capacity and contribution in the form of rate ranges within the grade increments, wages incentive schemes and a system of job promotion.
- vi. There should be proper procedure for handling the wage grievances in organization.
- vii. Adequate care should be taken to inform the employees and the union, if any, about the procedure followed in determining wage rates. There were no confidential wages and the employees should have a clear understanding of their wage or salary structure. This will enhance employee satisfaction with wages.

There are certain guiding principles which provide the foundation for effective reward management.

**1.4. Components of Compensation**

The components of a compensation system include (hr-guide, 2014):

**Job Description**

The job description is the written responsibilities, functions, duties, requirements, conditions, environment, location and other facets of jobs.

**Job Analysis**

The process of analyzing the job is job analysis and job descriptions are also developed from it. Job analysis techniques include the use of interviews, questionnaires, and observation.



**Job Evaluation**

It is a process of comparing jobs for the determining adequate compensation for individual jobs or job elements.

**Pay Structures**

The pay structure includes the several grades and each grade containing a minimum salary, increments and grade range.

**Salary Surveys**

It is a collection of survey of salary and market data and also includes inflation indicators, average salaries, cost of living indicators, salary budget averages. Companies may purchase results of surveys conducted by survey vendors or may conduct their own salary surveys.

**Policies and Regulations**

Compensation is supposed to be as fair if it is contained the system of components to develop and maintain internal and external equity in organization.

**1.5. Job Evaluation**

Job evaluation is the output provided by job analysis. Job evaluation uses the information of job analysis to evaluate job and valuing its components and ascertaining relative job worth to formulate proper wages or salary structure (Elcher & David, 1974). So it is a process through which jobs are evaluated in organization (cited in Mamoria & Ganker, 2011).

When job is evaluated then the relative worth of a given collection of duties and responsibilities to the organization is assessed. This process is adopted to help a management to maintain high level of employees' productivity and employees' satisfaction. If job valued is not properly studied, it is very likely that jobs would not be properly priced, i.e. high valued job received less pay than less valued job. When employees' relies this then they will become dissatisfied and they may leave the organization, reduce their efforts or perhaps adopt other modes of behaviour detrimental to the organization. Therefore, in modern society a great deal of attention is paid to the value of a job. In other words, a person is paid for what he brings to a job- his education, training and experience provided that these are related to the requirements of the job which he is assigned (Mamoria & Ganker, 2011).

**1.5.1. Definition of Job Evaluation**

International Labour Organization defines Job Evaluation as "An attempt to determine and compare the demands which the normal performance of particular jobs make on normal workers without taking into account of the individual abilities or performance of the workers concerned." (Mamoria & Ganker, 2011).

The Bureau of Labour Statistics, U.S.A. (1973), says that "Job evaluation is the evaluation or rating of jobs to determine their position in the job hierarchy. The evaluation may be achieved through the assignment of points or the use of some other systematic method for essential job requirements, such as skills experience and responsibility".

According to the French & Wendell (1977), "Job evaluation is a process of determining the relative worth of the various jobs within the organization, so that differential wages may be paid to the jobs of different worth". The relative worth of the job means value produced by such factors as responsibilities and other requirements.

### 1.5.2. The Job Evaluation Process

The basic procedure of job evaluation is to compare the content of jobs in relation one another and also in terms of their skills or responsibility or some other requirement. In India, the National Institute of Personnel Management has laid down the following steps which should be taken to install a job evaluation program: (Mamoria & Ganker, 2011).

#### i. Analyze and Prepare Job Description

This requires the preparation of a job description and also an analysis of job requirements for successful performance.

#### ii. Select and Prepare a Job Evaluation Plan

This means that a job must be broken down into its component parts, i.e., it should involve the selection of factors, elements needed of factors, elements needed for the performance of all jobs for which money is paid, determining their value and preparing written instructions for evaluation.

#### iii. Classify Jobs

It required organizing the jobs in a correct order in terms of value to the firm and relating the job in terms of money to determine their relative worth.

**iv. Install the Program** This involves explaining it to employees and putting it into operation.

**v. Maintain the Program** Jobs cannot continue without updating new jobs and job changes in obedience to changing conditions and situation.

### 1.6 Significance of employee compensation

Compensation includes direct and indirect monetary and non-monetary rewards given to employees on the basis of the value of the job, their personal contributions, and their performance. These rewards must meet both the organization's ability to pay and any governing legal regulations.

As per law, compensation is a pecuniary remedy that is awarded to an individual who has sustained an injury in order to replace the loss caused by said injury, such as workers' compensation. Wages paid to an employee or, generally, fees, salaries, or allowances. The payment a landowner is given to make up for the injury suffered as a result of these injures, when the government through eminent domain takes his or her land.

Compensation basically is the act or state of compensating. The most well known form of compensation is Worker's compensation, which is a type of insurance, which offers compensation for workers who have been injured in the course of employment.

### 1.7 Wage and Salary Management

Though methods vary among jurisdictions, provision can be made for weekly payment in the for of wages, compensation for economic loss, reimbursement and payment of medical bills, general damages for pain and suffering and benefits payable to the family of the employee killed during work.

Cash benefits are recognized according to state formulas like utmost benefit level. These benefits are managed on a state level, mainly by the state department for labour. The

laws of compensation are a characteristic of highly advanced industrial societies, put into practice after long and hard fought struggles made by trade unions.

Compensation has been an extremely important issue for both, the employer and employee. This is because money is a crucial incentive and directly or indirectly related with fulfilment of all human needs. Employees sell their hands and brain in order to fulfil their primary needs and employers hire them to achieve their organisational objectives. Therefore, the employer's and employee's perspectives vary on matters concerning compensation. From a cost perspective alone, effective management of compensation becomes critical because of the total operating costs. Another perspective from employer's point of view is to assess its impact on wide range of employees' attitude, behaviours, and ultimately its effectiveness on organisation's success. Compensation directly influences key outcomes like job satisfaction, attraction, retention, performance, skill acquisition, co-operation and flexibility etc. While employer's objective is concerned with primarily productivity the employee's emphasis may be on higher compensation to offset their increased cost of living and perhaps the price his skill will fetch in the competitive job market.

Compensation, therefore, remains one of the most strategic and important functions of human resource management. Over the years, compensation has become a complicated issue. Not only are the problems of internal equity and external parity important, but also the larger issues of the wider economy and society impinging on the problem of compensation. Therefore, students of management must develop a clear insight into the different facets of management of compensation, as also reward.

Compensation is provided with basically two objectives – as a reward for the past services to the organisation and as stimulus to increase performance in future. The progressive organisations are utilizing compensation and so that they are able to appreciate the problem in its proper perspective. Rewards system as effective tools to develop, build and maintain “human capital” for competitive advantages by the following ways:

Compensation can serve to attract qualified applicants to the organisation. Other things being equal, an organisation offering a higher level of pay can attract larger number of qualified applicants than its competing units.

Compensation helps to retain competent employees in the organisation. Although retaining competent workers is contingent on many factors, compensation policies help by maintaining a fair internal pay structure and by providing attractive benefits. Turnover is thus reduced, along with costs associated with recruiting, selecting, and training replacements.

Compensation serves as an incentive to motivate employees to put forth their best efforts. Manufacturing and sales organisations, for example, use monetary incentives to attain higher levels of production or sales without hiring additional employees.

When employees put forth their best efforts, average productivity of labour increases. With increased productivity, fewer employees are needed to achieve the same level of output. Thus, labour costs are reduced and organisational profitability is increased.

## 1.8 Wage Determination Process

The steps involved in determining wage rates are: (Mamoria & Ganker, 2011)

### i. The process of Job Analysis

Results of job descriptions lead to job specification. A job analysis describes the duties, responsibilities, working conditions and inter-relationships between the jobs as it is and the other jobs with which it is associated. It attempts to record and analyze details

concerning the training, skills, required efforts, qualifications, abilities, experience, and responsibilities expected of an employees. After determining the job specifications, the actual process of grading, rating or evaluating the job occurs. A job is rated in order to determine its values relative to all the other jobs in the organization which are subject to evaluation.

## ii. Wages Surveys

When the worth of job is absolute by job evaluation then the definite amount to be must paid and it is determined by wage or salary surveys in the concerned area. Such survey seek to answer questions like what are other firms paying? What are they doing by way of social insurance? What is the pay level which is offered by other firms of similar occupation? etc., by gathering information about 'benchmark jobs', which are usually known as good indicators. Such wage surveys provide many kinds of useful information about difference in wage level for particular kinds of occupations. This can have great influence on an organization's compensation policy.

## iii. Relevant Organizational Problems

In addition to the results of job analysis and wage surveys, several other variable have to be given due to consideration in establishing wage structure. For example, whether there exists a well-established and well-accepted relationship among certain jobs which can upset job evaluation, whether the organization would recruit new employees after revised wage structure; are the prevailing rate in the industry or community inconsistent with the results of job evaluation? What will be the result of paying lower or higher compensation; and what should be the relationship between the wage structure and the fringe benefit structure? Belcher has listed 108 variables which can affect levels of compensation and the wage structure.

## iv. Preparation of Wage Structure

The next step is to determine the wage structure. For this several decision need to be taken, such as:

- (a) Whether the organization wishes, or is able, to pay amount above, below, or equal to the average in the community or industry;
- (b) Whether wage ranges should provide for merit increases or whether there should be single rates;
- (c) The number and width of the 'pay grade' and the extent of overlap;
- (d) Which jobs are to be placed in each of the pay grade;
- (e) The actual money value to be assigned to various pay grade;
- (f) Differentials between pay plans; and
- (g) What to do with salaries that are out of line once these decisions have been made.

There are though no hard and fast rules for making such decisions, and procedure commonly used is the two-dimensional graph on which job evaluation points for key jobs are plotted against actual paid against actual amounts paid or against desired levels. Plotting the remaining jobs then reveals which jobs seem to be improperly paid with respect to the key jobs and each other.

**1.9. Factor Influencing Compensation management**

According to the Jain the number of factors influences the remuneration payable to employees. They can be categorized into:

- (i) External and
- (ii) Internal factors.

**1.9.1 External Factors**

Followings are external factors which influence compensation:

**i. Labour Market**

Demand and supply of labour influences the fixation of wage and salary. A lower wage fixed when the labour demands were less than the labour supply. A higher wage will have to be paid when the labour demand more than labour supply it happened as in the case of skilled labour. A paradoxical situation is prevailing in our country—excessive unemployment is being juxtaposed with shortage of skilled labour.

**ii. Cost of Living**

Next in importance to labour market is the cost of living. This matters is criterion during periods of rising prices but it is forgotten when prices are stable or falling. When the cost of living is rise and it required to be remunerated by payment of dearness allowance, basic pay to continue uninterrupted.

**iii. Labour Unions**

The presence or absence of labour organizations often determines the substantial wages paid to the employees. Employers of non-unionized organization enjoy the liberty to fix wages and salaries as they want. Because of larger-scale unemployment, these employers hire workers at little or even less than legal minimum wages. An individual nonunionized company may be pay more to its employees if they want to discourage them from forming one. The employees of strongly unionized companies too have no freedom in fixation of wage and salary. They are forced to vintage the pressure of labour representatives in revision and determination of pay scales.

**iv. Union Influences on Compensation Decisions**

Unions and labour relations laws also influence compensation design. The various labour legislations and court decisions were legitimized the labour movement.

**v. Labour Laws**

We have a various labour laws at the central and as well as at the state levels. These legislations are for protection of employees interests.

**vi. Society**

Compensation paid to employees is imitated the prices fixed by an organization for their goods and services. The Supreme Court, from its very inception, has had to adjudicate industrial disputes—particularly disputes relating to wages and allied problems of financial concern to the worker- an ethical and social outlook liberally interpreting the spirit of the Constitution.

**vii. The Economy**

The economy has its impact on wage and salary fixation is the state of the economy. While it is possible for some organizations to thrive in a recession, there is no question that the economy does not affect remuneration decisions.

**1.9.2 Internal Factors**

Following are the internal factors which influence compensation:

**i. Business Strategy**

The overall strategy of a company which pursue the determination of employees compensation. The strategy is to sustain and protect current profit because of the declining fortunes of the company the compensation level were needs to be average or even below average.

**ii. Performance Appraisal**

The Performance appraisal helps to reward, compensation hike for the employees who show better performance.

**iii. The Employee**

Several employee-related factors interact to determine his or her remuneration. These include performance, seniority, experience, potential, and even sheer luck.

**1.10. Criteria of Effective Compensation Program**

There were seven criteria to judge the effectiveness of compensation: [Jain, 2014; Bhattacharay, 2009)

**Adequate:** Minimal governmental, union, and managerial levels should be met.

**Equitable:** Each person should be paid fairly, in line with his or her effort, abilities and training.

**Balanced:** Pay, benefits and other rewards should provide a reasonable in total reward package.

**Cost Effective:** Pay should not be excessive, considering what the organization can afford to pay.

**Secure:** Pay should be enough to help an employee feel secure and aid him or her in satisfying basic needs.

**Acceptable to the Employee:** The employee should understand the pay system and feel it is a reasonable system for the enterprise and himself or herself.

Incentive providing: Pay should motivate effective and productive work.

**1.11. Types of Compensation**

Compensation is of two types Direct Compensation and Indirect Compensation.

**1.11.1. Direct Compensation**

Direct compensation refers to monetary compensation provided to employees in returns of their services to the organization. It includes, TA, DA, HRA, LTA, special

allowances, bonus, etc. They are given at a regular interval at a definite time (naukrihub, 2014).

**i. House Rent Allowance (HRA)**

Company either provides housings facility or they provide house rent allowances to its employees.

**ii. 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.

**iii. Leave Travel Allowance (LTA)**

The employees are given allowances to visit any place they wish with their families.

**iv. City Compensation Allowance**

City compensation allowance is paid to the employees in certain cities to compensate the cost of living. It varies from city to city & it is highest in metropolitan cities.

**v. Incentives**

Incentives and variable compensation can be among the most important drivers of individual performance. An incentive is something that motivates an individual for goodperform.

**vi. Bonus**

Bonus is paid to the employees during festive seasons to motivate them and provide them the social security.

**vii. 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.

**1.11.2 Indirect Compensation**

Indirect compensation are refers to non-monetary compensation provided to employees in return of their services to the organization (naukrihub, 2014).

**i. Leave Policy**

It is the right of employee to get adequate number of leave while working with the organization. The organizations also provide for paid leaves such as, casual leaves, medical leaves (sick leave), maternity leaves and statutory pay, etc.

**ii. Overtime Policy**

Employees were provided with the adequate allowances and facilities during their overtime.

**iii. Medical Benefits**

The employees were provided allowances to get their regular check-ups and also provide medical-claim for their family.



**iv. 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.

**v. Leave Travel Allowances**

The employees are provided with leaves and travel allowances to go for holiday with their families.

**vi. 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.

**vii. 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.

**viii. 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.

**1.12 Summary**

Compensation is the process of providing equitable and fair remuneration to the employees. Compensation Management includes 1)Job evaluation, 2)Wage and Salary Administration 3)Incentives 4) Bonus 5) Fringe benefits and 6)Social security measures, etc. One of the most important factors in Personnel/ Human resource Management is Compensation Management. The soundness of compensation management depends up on the amount of wage and salary paid to the employee for a fair days work. Formulation and administration of sound compensation policy to attract and retain personnel in right position is the prime responsibility of my organization (right person for right job with fair remuneration).The main objective of compensation management is to bring cost-effective structure which attract, motivate and retain competent employees. Compensation System is classified into two types, Direct Compensation and Indirect Compensation.

**1.13 Key words**

**Compensation-** Compensation includes direct cash payments and indirect payments in form of employees benefits and incentives to motivate employees to strive for higher levels of productivity”.

**Job Evaluation-** Job Evaluation as “An attempt to determine and compare the demands which the normal performance of particular jobs make on normal workers without taking into account of the individual abilities or performance of the workers concerned

**Job Description-**The job description is the written responsibilities, functions, duties, requirements, conditions, environment, location and other facets of jobs.

**Job Analysis-**The process of analyzing the job is job analysis and job descriptions are also developed from it. Job analysis techniques include the use of interviews, questionnaires, and observation.



**Wages Surveys-** When the worth of job is resolute by job evaluation then the definite amount to be must paid and it is determined by wage or salary surveys in the concerned area

#### 1.14 Self Assessment Questions

- 1) Define compensation and discuss its importance.
- 2) What is meant by compensation System ? Explain its objectives?.
- 3) Briefly describe factors that influencing the Compensation Management?
- 4) Explain the Types of Compensation?

#### 1.15 Suggested Readings

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## LESSON 2

# WAGE CONCEPTS

### Learning Objectives

- ✓ To study the wage concepts
- ✓ To examine the Impact factors that influence the wages
- ✓ To know the Methods of wage fixation adopted in India
- ✓ To understand the Basic systems of wage Payment

### Structure

#### 2.0 Introduction

#### 2.1 Wages-Definition & Meaning

#### 2.2 Wage Concepts

- 2.2.1 Minimum wage
- 2.2.2 Living wage
- 2.2.3 Fair wage
- 2.2.4 Direct and Indirect Compensation
- 2.2.5 Time Rate and Piece Rate system

#### 2.3 Components of Sound wage system

#### 2.4 Important factors that influencing wages

#### 2.5 Components of Industrial wage structure

#### 2.6 Factors that Determine the Levels of wages to be paid to the employees

#### 2.7 Methods of Wage Fixation adopted in India

#### 2.8 Basic system of wage payment

#### 2.9 Summary

#### 2.10 Key words

#### 2.11 Self Assessment Questions

#### 2.12 Suggested Readings

#### 2.0 Introduction

The term 'wage' can be defined as the payment made to workers for placing their skill and energy at the disposal of an employer, the method of use of that skill and energy being at the employer's discretion and the amount of payment being in accordance with the terms stipulated in a contract of employment of service. Wage forms the basis, for calculation of compensation of an employee.

Wage means economic compensation paid by employers to employees for the services rendered by the latter. The committee on Fair Wages (1948) and the 15th Session of Indian Labour conference (1957) propounded certain wage concepts such as Minimum Wage, Fair Wage, Living Wage and Need-based Minimum Wage.

### 2.1 Wages – Definitions and Meaning

Labour is one of the most important factors of production. Labour expects fair wages for the services it renders to the process of production. The term wages refer to payments for services, whether manual or mental, based on hours of work or quantity of output. Normally, the term wages is used to refer to payment made for services given by manual labour or non-supervisory and non-clerical staff. It refers to the hourly or daily rate paid to production and maintenance employees, i.e., blue collar employees.

According to Berham, “Wages mean the amount paid to the labour for his services to the employer”.

According to P.M. Stohank, “Wages is the labour’s remuneration which creates utility”.

The term salary is defined as the remuneration paid to clerical and managerial personnel employed on a monthly or annual basis. Nowadays, all categories of employees are treated as human resources and the terms wages/salary are used interchangeably. Wages/salary is the direct remuneration paid to an employee compensating his services to an organisation.

Section 2 (vi) of the Payment of Wages Act defines wages as all remuneration capable of being expressed in terms of money which would, if the contract of employment express or implied, were fulfilled, be payable whether conditionally upon the regular attendance, good work or other behaviour of the person employed or otherwise to a person employed in respect of his employment or of work done in such employment and includes any bonus, or other additional remuneration of the nature aforesaid, which would be so on termination of his employment, but does not include-

- a) Value of house accommodation, supply of light, water, medical attendance or other amenity;
- b) Any contribution to pension fund or provident fund;
- c) Any travelling allowance or the value of any travelling concession;
- d) Any sum paid to defray special expenses entailed on him by nature of employment; and
- e) Any gratuity payable on discharge.

The above definition can be split into three portions. Firstly, wage means all remunerations, which would if the terms of the contract of employment express or implied, were fulfilled, be payable to a person employed in respect of his employment. Secondly, wage includes any bonus or other additional remuneration. Thirdly, the term ‘wage’ includes any sum payable to a person by reason of termination of his employment.

The term ‘wage’ can be defined as the payment made to workers for placing their skill and energy at the disposal of an employer, the method of use of that skill and energy being at the employer’s discretion and the amount of payment being in accordance with the terms stipulated in a contract of employment of service.

## 2.2 Wages Concepts: Minimum Wage, Living Wage, Fair Wage, Direct and Indirect Compensation and Time Rate and Piece Rate System

Wage means economic compensation paid by employers to employees for the services rendered by the latter. The committee on Fair Wages (1948) and the 15th Session of Indian Labour conference (1957) propounded certain wage concepts such as Minimum Wage, Fair Wage, Living Wage and Need-based Minimum Wage.

### 2.2.1 Minimum Wage:

A minimum wage is a compensation to be paid by the employer to his employee irrespective of his ability to pay. The minimum wage must provide not only for the bare necessities of life but also for preservation of efficiency of the worker namely education health, other requirements and amenities.

### 2.2.2 Living Wage:

A living wage is a compensation which enables the earner to provide himself and his family with not only the bare necessities of life like food, shelter, and clothing but also a measure of frugal comfort including education for children, protection against ill health, demands of social needs, insurance against misfortunes and old age needs. This wage ensures standard of living.

### 2.2.3 Fair Wage:

It represents the average of minimum wage and living wage. It is above the minimum wage and below the living wage. The wage is linked with the capacity of the industry to pay. It depends on factors like labour productivity, wage prevailing in the same and neighbouring localities, the level of national income and its distribution and the place of industry in the economy of the country.

### 2.2.4 Direct and Indirect Compensation:

Direct compensation refers to monetary benefits offered to the employees for the services rendered by them to the organisation. The monetary benefits include basic salary, HRA, conveyance, leave travel allowance, medical reimbursements, bonus, gratuity, PF, etc. Indirect compensation includes non-monetary benefits such as leave, insurance, holiday homes, hospitalisation, etc.

### 2.2.5 Time Rate and Piece Rate System:

In time rate system, wages are paid based on the time spent by the employees in the factory. The production by workers is not considered. In piece rate system, the payment is related to the output given by the worker. The wage rate is fixed for piece of work or for certain quantity of production.

## 2.3 Wages – Components of a Sound Wage System

The components of a sound wage system are:

1. **Fair standard** – It must be based on a fair standard, after a careful time and motion study.
2. **Fairness to employer and employee** – Both the employer and the employee should feel that the system is fair.
3. **Un-ambiguity** – The wage plan should be clear and unambiguous. Every employee should understand the mechanics of wage calculation.

**4. Equity** – Employees should experience individual, interpersonal and organizational equity. In other words, pay should be so devised that employees experience absolute equity i.e., o/i ratios is equal.

**5. Annual increment** – Annual increment should be part of his pay structure in recognition of his service.

**6. Incentives** – Pay should include an incentive component to reward the extra effort put in by high performers.

**7. Cost of living** – Dearness allowance should be a part of pay which compensates the employee against continuous hike in cost of living.

**8. Prompt payment** – Pay should be released on the stipulated date so that employee's plans are not upset.

**9. Economic stability** – Any wage plan should guarantee stable income for the employee. Piece based pay should guarantee element of a minimum but a fair fixed pay.

#### 2.4 Important Factors Influencing Wages

**1. Wage policy of the company** – The wage policy has a **decisive influence on the structure and wage level**. Example – Policy decisions on salary fixation based on length of service or performance or both, to pay below average or above average rates, to pay more to reduce employee turnover etc.,

**2. Prevailing wages in comparable industries** – Wage rates are related to region and industry base. The organisation has to pay wages at least equal to prevailing rates for similar jobs in similar organisations.

**3. Financial position of the company** – Increase in wages are paid by companies who can afford to pay. Companies having **good sales and profits tend to pay higher wages**. Total cost of labour has to be considered in determining the ability to pay. During period of prosperity, companies pay higher wages and wages are reduced during period of depression.

**4. Demand and supply of labour** – The **demand and supply** of certain skills determine wage rates. Examples – High demand for IT professionals, financial analysts, scientists in pharmacy industry, etc., leads to higher wages. Similarly, oversupply of certain category of employees has resulted in steep fall in wages. Oversupply of management graduates and fall in wages.

**5. Cost of living** – When **cost of living increases**, the **workers and union demand higher wages to offset the erosion of real wages**. Many companies consider inflation rate, while working out salary increments.

**6. Capacity of bargaining** – A strong trade union is able to bargain and obtain higher wages for its members.

**7. Nature of job** – Jobs that require high levels of knowledge and skills, require high pay.

**8. Government policy and intervention influence wage determination**. Example – Payment of Wages Act (1936) and Minimum Wages Act (1948) assure proper payment of wages and avoiding all malpractices like non-payment, delayed payment and underpayment.

**9. Personal traits** of the employee such as education, experience, and training are considered while fixing wages.

**10. Productivity** – Here, worker's wages are linked to their productivity level. Wages are paid based on job performance.

**11. Psychological and social factors** – Psychologically, a person considers level of wages as a measure of success in life. Sociologically, people feel that equal work should carry equal wages and there should not be any discrimination on the basis of religion, caste, gender etc.

**12. The living wage** – The wages should be adequate to enable an employee to maintain himself and family at a reasonable level of existence.

### 2.5 Components of Industrial Wage Structure in India

The industrial wage structure in India consists of various components such as a basic wage, a dearness allowance, an annual statutory bonus, and a host of fringe benefits and incentives.

#### 1. Basic Wage:

The term 'basic wage' is ordinarily understood to mean that part of the price of labour which the employer must pay to all workmen belonging to all categories. The phrase is used ordinarily in contradistinction to allowances, the quantum of which may vary in different contingencies. The revisions in the basic wage have become progressively less frequent and insignificant because of the ever growing dearness allowance component.

#### 2. Dearness Allowance:

The fixation of wage structure also includes within its compass the fixation of rates of dearness allowance. It is an additional payment made by the employer to his employees to compensate them to a certain extent for the rise in the cost of living. In the context of a changing pattern of prices and consumption, real wage 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 important consideration for him. Thus, it serves as a device to protect, to a greater or lesser extent, the real income of wage-earners and salaried employees from the effects of a rise in prices.

The system of payment of dearness allowance varies from centre to centre, industry to industry, and even within the same centre and industry. In most industries it is linked to the consumer price index number. These different systems of dearness allowance have come into existence over a period of time during the last four decades as a result of ad-hoc decision taken either in the process of collective bargaining or awards given by the wage fixing authorities.

Some of the dearness allowance payment systems are as follows:

- i. Flat Rate – Under this method, a fixed amount, says Rs. 200 per month, is paid to all categories of workers, irrespective of their wage scales. The main advantage of this system is that it is simple and it gives greater relief to the low-paid workers.
- ii. Graduated Scale – It is a method of paying dearness allowance on a graduated scale according to slabs. Under this, workers are divided into groups according to different wage slabs. They are paid fixed amounts of dearness allowance 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 of paying dearness allowance is popular because it is convenient and it is also considered to be equitable.

iii. Cost of Living and Consumer Price Index Number – The Consumer Price Index Number is a system of linking dearness allowance with the cost of living index. In this method, dearness allowance automatically increases and decreases with a rise or fall in the value of money.

The adjudicators have generally favoured the payment of uniform dearness allowance to factory operatives and clerical staff when they get the same pay. The method and extent to which neutralisation in the cost of living should be given have been under constant examination by the industrial tribunals and other wage fixing authorities.

The law is thus clear that dearness allowance is intended to neutralise a portion of the increase in the cost of living. Though 100 percent neutralisation is not advisable as it will lead to inflation, full neutralisation may be permissible only in the case of the lowest class of employees. The management is entitled to complain if the neutralisation is more than 100 percent.

The different systems of dearness allowance have created disparities in the dearness allowance payment. The contributing factors are its automatic linkage with the consumer price indices; payment on point-to-point basis; cent-per-cent neutralisation and sometimes even more; absence of any ceiling, wide diversities in the rates prescribed by industrial tribunals or settled in collective agreements.

In the process, the fundamental and sound principles governing wage fixation, viz., productivity of labour; prevailing rates of wages in the same or similar occupations in the neighbouring localities; level of national income and its distribution; place of industry in the economy of the country; and capacity of the industry to pay have been completely ignored.

### 3. Overtime Payment:

Working overtime in industry is possibly as old as the industrial revolution. In the early days, however, due to the then existing social order, perhaps the concept of overtime did not exist as there were no defined hours of work. With the passage of time, the government came out with legislation to restrict excessive working by the employees beyond certain limited hours.

While the need for such legislation was welcome in situations where labour was exploited, another situation started shaping up in which employees started willfully organising work in such a fashion wherein the managements are compelled to give overtime as a means of achieving production. During the post-war period, overtime has become quite a regular feature in many industries. The employer began to supplement production and the employee his wage with overtime working.

The necessity of the management's seeking overtime working from employees becomes inevitable mainly to overcome –

- (a) Inappropriate allocation of manpower and improper scheduling;
- (b) Absenteeism;
- (c) Unforeseen situations created due to genuine difficulties like breakdown of machines;
- (d) Where the work is of a fluctuating nature and it is economical and more convenient to work with existing staff longer hours during peak periods rather than employing extra-staff on a long-term basis;
- (e) Rush jobs during the financial year end



(f) Situation wilfully planned where overtime work is forced as the only answer to obtain production.

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 overtime allowance **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 ordinary rate of wages have been defined as the basic wage plus such allowances, including the cash equivalent of the advantage accruing through the concessional sale to workers of food grains and other articles as the worker is for the time being entitled to, but not including a bonus. Compensatory and house rent allowance as well as the dearness allowance is to be taken into account in computing compensation for overtime work.

#### 4. Annual Bonus:

The Encyclopaedia Britannica has defined bonus as an award in cash or its equivalent by an employer to an employee, for accomplishment being considered desirable and perhaps implied, though not required by the contract of employment. It is usually intended as a stimulus but may also express a desire on the part of the employer to share with the employees the fruits of their joint enterprise.

Bonus is a unique component of India's compensation system. Bonus is regarded as an incentive for regular attendance; as an encouragement for good work or payment for some special or additional service by workers; as an ex-gratia payment depending upon entirely on the goodwill of the employers which cannot be claimed as of right; as a share in the profits which workers may claim as of legal right and also as a deferred wage. Bonus as a deferred wage implies that it is to be paid, irrespective of profit or loss **of the concern.**

**The Payment of Bonus Act** does not deal with customary bonus and is confined to profit-based or productivity-based bonus. The customary bonus does not require calculation of profits or availability of surplus because it is a payment founded on long usage.

The bonus payment under the Act has varied from one industry to another, and within an industry from one unit to another. There has also been a variation in bonus payment from year to year for the bonus-paying organisation.

The bonus disputes between management and unions mainly related to the computation of depreciation, development rebate, direct taxes, interest on capital, and accuracy of data content **in the balance-sheet and the profit and loss account.** Statutory bonus payments have led to the most frequent source of industrial unrest in our country.

#### 5. General Allowances:

The employers pay various sorts of allowances to their workmen depending upon the nature of their duties and other incidents of the employment. Various allowances are also given to the employees under different settlements.

These are special allowance, house rent allowance, leave travel assistance, out station allowance, travelling allowance, washing allowance, conveyance allowance, lunch



allowance/dinner allowance, allowance for working on weekly-off unpaid paid holidays, acting allowance, cash handling allowance, shift allowance, self- development allowance, transport allowance, underground allowance, education allowance, social security allowance, factory allowance, overtime allowance, and so on. Such allowances are innumerable. It is, therefore, not possible to deal with them exhaustively.

However, some such allowances are being discussed as illustrative case under the following heads:

**i. Tiffin Allowance** – Certain commercial and industrial concerns, with a view to ensure efficiency and economise time, provide free tiffin facilities to their employees. In some cases, they have become customary and an implied condition of service.

**ii. Overtime Allowance** – Section 59 of the Factories Act, 1948 prescribes that a worker who works overtime in a factory shall be entitled to twice his ordinary rate of wages in respect of the overtime work. Some States, in their respective Shops and Establishments Acts, have prescribed rates of overtime work and overtime allowance.

**iii. Compensatory Allowance** – Compensatory allowance indicates that it is a compensation for something. For instance, the allowance paid to the workmen for the work done on holidays has been treated as compensatory allowance.

**iv. Acting Allowance** – Acting allowance means the allowance paid to an employee when he is acting in a higher post in the event of an employee holding the higher post proceeding on leave or otherwise being away from his duties.

**v. Special Allowance** – A special allowance may be granted to the workmen in view of certain special circumstances peculiar to a situation or where they have to run some special risk. For instance, a special allowance in banks is paid in terms of Sastri and Desai awards when an employee discharges duties of a supervisory nature or is accorded the status of a person competent to discharge functions of a supervisory character.

**vi. House Rent Allowance** – Under the existing labour laws, there is no provision for payment of any house rent allowance. The problem of getting house accommodation has already become and is becoming very acute and also costly due to insufficient number of houses and high rate of house rent.

In order to give some relief to the industrial workmen on this account, some of the States like West Bengal and Maharashtra have already made laws providing for payment of house- rent allowance by the employer to industrial workmen in their States.

#### 6. Tax Planning:

Tax planning is a conscious and well thought out process of arranging one's financial and economic affairs in a manner that enables him to take advantage of all deductions, exemptions, allowances and rebates available under Income Tax law s with a view to reducing his tax liability to the minimum.

In relation to salary and wages, tax planning is important from the point of view of both the employer and the employee. The basic purpose of tax planning exercise is to minimise the incidence of tax to both the employer and the employee.

Basically, there are three steps in tax planning exercise:

1. Calculation of taxable income from all sources such as salary / pension, interest etc

2. Calculation of tax payable on gross taxable income for whole financial year (i.e., from April 1 to March 31).

3. After calculation of the amount of tax liability, two options are open- (a) payment of tax (no tax planning required), and (b) minimisation of tax through prudent tax planning

Most people prefer option 'b', because of several tax saving schemes and investments which reduces tax liability to "zero" or to "minimum" possible

### 2.6 Factors that Determine the Level of Wages to be Paid to the Employees

The following factors determine the level of wages to be paid to the employees of different categories:

#### a. The Employer and the Policy of the Company:

In the private sector, the employer has been the sole decision maker in fixing wages to be paid to different categories of staff. Even, the minimum wage provisions are not followed for managers in many of the new private organizations.

The position is the same in the unorganized sector also. In progressive organizations like the House of Tatas and others, the payment of wages is determination on the basis of scientifically assessed methods like work measurement, job evaluation, etc. All good employers like Tisco, SAIL, NTPC, Hindustan Lever for instance pay more than others in the country as a matter of policy, and, of course, it depends upon their capacity to pay; progressive employers believe in paying more for attracting the best talents, in the competitive market.

#### b. Wage Fixation through Collective Bargaining:

The history of wage fixation in India is of recent origin. Under the Industrial Disputes Act, 1947, various tribunals have passed awards regulating wages in a number of important industries. Immediately after the Independence, industrial relations climate in the country deteriorated rapidly with rising number of disputes and loss of production. The government was worried to achieve industrial peace that was a prerequisite for industrial and economic growth.

So in 1947 the Union Government convened a tripartite conference with representatives of employers, labourers and the government. The government in its Declaration of Industrial Policy Resolution in 1948 included a spirit of truce. The Statement of Truce Resolution included two statements related to wages- (a) statutory fixation of minimum wages in sweated industries. In this context, the government passed the Minimum Wages Act, 1948, laying norms and procedures for determining the wages in 40 scheduled employments, e.g. china clay mines, fire clay, asbestos, iron ore, agriculture, etc. (b) promotion of fair wages agreement in more organized industries.

In this context the Government of India appointed a tripartite committee on fair wages for determining the principles on which fair wages should be fixed and also to suggest lines on which these principles should be applied.

Collective bargaining is one of the most acceptable and exclusive methods of determining wages in many organized set-ups, especially in engineering, heavy industries, steel-making, auto manufacturing organizations. Besides, industrial wage boards and government appointed commissions of pay and adjudication awards have also been the methods of wage fixation.

Collective bargaining process can take place with:

- i. Employer's representatives and workers' representatives at the enterprise and plant level,
- ii. Group of employers bargaining as a unit,
- iii. Unions and groups of unions, and
- iv. An association of some or all of employers in an industry in an area or region or a nation.

Collective bargaining helps workers to achieve a voice in fixing wages and hours of work, as well as the other conditions of work. It is a direct method of negotiation over the key issues of wages, hours of work and conditions of employment. It is preferred over the process of adjudication.

The central issues in all collective bargains are wages and wage-related matters, besides recognition of mutual rights, responsibilities by the management and the workers, system of wage and payment of dearness allowance, bonus, incentive wage and fringe benefits. Some of the wage agreements arrived through collective bargaining also relate to personnel issues, e.g., recruitment, promotion and transfers, etc.

Once an agreement is achieved it reflects the interplay of many forces like:

- i. Unionism and its bargaining power
- ii. Methods of wage payment
- iii. Various regional and local conditions
- iv. Size of establishment
- v. Technical efficiencies
- vi. General business conditions
- vii. Capacity to pay
- viii. Company's wage policy
- ix. Union wage policy.

In all bargaining processes trade union representatives focus on shortcomings in the following issues:

- i. General level of wage rates
- ii. Structure of wage rates
- iii. Bonus
- iv. Incentives
- v. Fringe benefits
- vi. Administration of wages.

**a. Wage Boards:**

The Government of India had constituted industry wise wage boards in 1957-66 and after. But wage boards are not popular due to its being a time-consuming process. The parties involved also contest wage boards awards. But, wage boards were quite effective in the 1920s, during the British Regime for 'sweated trades/industries', like chain, bidi-making, where workers were not able to bargain effectively with the employers.

**b. Pay Commissions:**

The Government of India has constituted five pay commissions for regulating the salary of civil servants including those in post and telegraph, railways, defense and civil aviation. In case of a dispute arising out of the award of the pay commission for

implementation, the subject is with the Commission of Inquiry, Adjudication by Tribunals and the Joint Consultative machinery.

#### c. Wage Policy:

All progressive employers have their own policy on employees' compensation. They pay higher than their competitors to attract the best talents. They also like to be known as the best pay masters in the region/country. Such organizations create what is termed as 'wage islands', which is not healthy for the community. MNCs pay on an average, higher than the Indian firms.

This causes disparity in wages and if the wages are abnormally higher than those of the others, then it may cause distortion in the economy. A good example, we have in the wage revision of the state-owned PSU, namely BHEL, in 1978-79, when BHEL outfits operating in Bangalore were the highest pay-masters to the workers.

#### d Ability to Pay:

This is the most significant factor. The government also leaves the issue open for each organization in PSUs to pay as per its capacity. But within the ceiling and the norms issued by the BPE.

#### e. Productivity Bargain:

Productivity bargain gained momentum in collective bargain. The keyword in the emphasis, **output per man per hour rather than to productivity**. Productivity bargain provides a new dimension to management, to shape its industrial relations and to aim for better managerial control, for improving organizational effectiveness as also restructuring.

The real outcome of productivity bargain has been in an effective **productivity agreement**. Productivity agreement, being a **systematic attempt at securing greater efficiency and economy in utilization of resources, both physical and human**, it is a package deal.

#### The features of such agreements are as follows:

- i. The agreements are **based on the concept of give and take, self-interest** of both sides protected.
- ii. The agreements lay **down specific and direct contribution of labor towards improving productivity**.
- iii. Agreements are based on cost-benefit analysis, unlike the classical wage agreements.
- iv. The agreement constitutes the package of practices, methods to be followed in exchange for rewards. Thus, it is a rationalized system of wage and incentives.

Productivity bargains are no doubt, short-term methods of implementation of wage payments.

In the long term, there may be problems in case of a change in the climate, and with regard to sharing the gains of productivity. So, it is liable to result into industrial unrest.

What is termed as 'personnel payment' is the most significant factor in the overall profitability of an organization. Expenditure under 'personnel payment' as a percentage of the total cost is higher in labour-intensive organizations as compared to capital intensive outfits or in assembly-type organizations as compared to process outfits.

Accordingly, in mining or heavy industries organizations like BCCL, Coal India or BHEL, the personnel payments to the total cost may be around 60 per cent as compared to the

petro-chemical fertilizers where it is estimated to be 2-3 per cent only. In some manufacturing units this expenditure is limited to 15-16 per cent.

As such, the capital intensive units pay higher than labour intensive organizations and the impact of higher pay on output cost is not as acute as in the case of labour intensive organizations.

In this context, productivity bargain has been an important factor in wage negotiation process in collective bargaining in India ever since, the early 1960s, although the workers' representatives have been opposing this factor. But, settlement of wage based on a given rate of productivity gain is the ideal method to hedge against the rising labour cost. Such bargaining agreements have been practiced in Premier Automobiles, ITC as also in Tisco and BHEL/other PSUs.

The agreements define that attainment of a given rate of productivity will lead to the given rate of wages and more jobs, over and above the period of the tenure of the agreement. Further, high profit is another factor which may result in a quantum jump in wages/benefits to the staff/across the board.

### **2.7 Methods of Wage Fixation Adopted in India: Wage Board, Job Evaluation and Wage Legislation**

In India, several methods of wage fixation are used. These methods include wage boards, job evaluation, collective bargaining and legislation.

#### **a. Wage Boards:**

The government of India, acting upon the recommendations of the First- Five-Year Plan, appointed wage boards for fixing wages. The first wage board was set up in 1957 for the cotton textile industry. The wage boards are tripartite in nature, with independent members and a chairman. It was actually the Committee on Fair Wages that recommended the setting up of wage boards for fixing wages.

Wage boards were set up because workers were not satisfied with the method of compulsory adjudication for wage determination not only because it was a lengthy procedure but also because they had no role to play in determining wages.

The First and Second Five-Year Plans, drawing support from the FWC's recommendation, encouraged the setting up of wage boards to deal with all aspects of the question of wages.

The NCL (1969) had constituted a Committee to study the functioning of the system of wage boards, which suggested that the wage boards were expected to create a climate for harmonious industrial relations; and to safeguard the interests of the community and to represent consumers' interest; and derive standardized wage structure for the concerned industry.

A wage board is tripartite in character and is non-statutory body consisting of representatives of employers and workers and is headed by an independent chairman. The government appoints the representatives of employers and workers in equal number after consulting the concerned organization.

The government nominates the chairman as well as an economist and a consumers' representative both being independent also. The consumers' representative is a Member of Parliament, who is expected to safeguard consumers' interests while the chairman is usually a

judge either serving or retired. The total number of members of wage boards constituted so far varied from 7 to 9.

A wage board issues a detailed questionnaire to collect information from the concerned parties, makes an assessment of the views of the parties, and makes its recommendations regarding wage structure. The wage structure recommended by a wage board is in operation for five years. The management may not always implement the wage structure recommended.

**b. Job Evaluation:**

Job evaluation is another method of wage fixation. Job analysis explains the duties of a job, authority relationships, skills required, conditions of work, and additional relevant information. Job evaluation, on the other hand, uses the information in job analysis to evaluate each job-valuing its components and ascertaining relative job worth.

It involves a formal and systematic comparison of jobs in order to determine the worth of one job relative to another, so that a wage or salary hierarchy results. So this process evaluates the jobs in an organization.

Job evaluation aims to assess the relative worth of a given collection of duties and responsibilities to the organization. It helps the management to maintain high levels of employee productivity and employee satisfaction. In the absence of proper job evaluation, it is very likely that jobs would not be properly priced.

Consequently, high valued jobs may receive less pay than low-valued jobs. The employees realizing this may become dissatisfied, leave the organization, reduce their efforts or may adopt other modes of behaviour detrimental to the organization. Therefore, organizations pay a great deal of attention to the relative worth of jobs so that they are able to determine what a particular job should be paid. A person is paid for what he brings to a job – his education, training and experience.

Job evaluation as a part of compensation system relates to the systematic procedure for creating a wage structure with a view to determining a proper value relationship between several jobs in an enterprise to attract, motivate and maintain effective human resources by adequately compensating them for work performed.

Wendell French defines job evaluation as, “a process of determining the relative worth of the various jobs within the organization, so that differential wages may be paid to jobs of different worth”. Factors such as responsibilities, skill, effort and working conditions determine the relative worth of a job.

Thus, we can define job evaluation as a evaluating – analyzing and describing-positions, grouping them and deciding their relative value by comparing the duties, responsibilities, skill, effort and working conditions of different jobs.

**c. Wage Legislation:**

In India workers have always needed state protection against exploitation. As such, the state has enacted a number of legislations to ensure regular, expeditious, equitable and minimum payment of wages and bonus to workers.

There are four main acts that comprise the legal framework relating to wage legislation:

- (i) The Payment of Wages Act, 1936.



(ii) **The Minimum Wages Act, 1948.**

(iii) **The Equal Remuneration Act, 1976.**

(iv) **The Payment of Bonus Act, 1965.**

(i) **The Payment of Wages Act, 1936:**

The Payment of Wages act, 1936 aims to protect the wage earners against exploitation by the employer, in the form of arbitrary deduction and imposition of fines. It also stipulates the payment for working over time and deduction of wage. Section 3 of the Act makes it obligatory for the employers to make payment of wages, fix the wage period and time of payment.

The Act authorizes the employers to make deductions of fines, for absence from duty, damage or loss of goods, money, house accommodation provided by the employer, deductions for such benefits/amenities and services supplied by the employer, for recovery of advances or for adjustment of over payment of wages, income tax at source, subscription to and for repayment of advances from PF, payment to a co-operative society and deduction for written authorization of the employee.

(ii) **The Minimum Wages Act, 1948:**

**The Minimum Wages Act aims to-**

1. Provide minimum (statutory) wages for scheduled employments.
2. Eliminate chances of exploitation of labour through payment of very low and sweating wages.
3. Provide for maximum daily working hours, weekly rest and over time.
4. The rates fixed under the Act prevail upon the rates fixed under the award or agreement.

The Act, defines wage as all remuneration which are capable of being expressed in Terms of money and, which would, if the terms of the contract of employment, expressed or implied, are fulfilled, be payable to a person employed in respect of his employment or of work done in such employment.

But it does not include value of accommodation, supply of light, water, medical attendance, any other amenity or any service, excluded by general or special order of the government, any contribution by employer towards provident fund or pension fund or under any scheme of social justice, any travel allowance or value of travel concession, any sum to meet special expenses entailed on him by the nature of the employment or, any gratuity payable on discharge from service.

(iii) **The Equal Remuneration Act, 1976:**

This act emphasizes on equal payment of wage to men, women wage earners who are engaged in identical employment. The act attracts punishment to employers for violation of the provisions of the Act.

(iv) **The Payment of Bonus Act, 1965:**

The Payment of Bonus Act, 1965 provides for payment of bonus to workers in all establishments/factories in which 20 or more persons are employed on any day, covered in the related accounting year. The Act lays down a minimum eight and one-third per cent and a

maximum of twenty per cent of pay. The minimum bonus is payable, even though a company has not made profits during the related accounting year.

Although, the act aims to ensure payment of bonus every year to a factory worker, it became a constraint for many good employers like Tatas, who earlier paid much more than the prescribed limit. In reality, many of the then British firms operating in West Bengal paid some kind of bonus in the form of puja bonus that was more than the provisions under the act.

**2.8 Basic Systems of Wage Payment:** Time Rate System, Piece Rate System and Balance or Debt Method (With Advantages and Disadvantages)

There are three basic systems of payment, i.e.:

1. Time Rate System,
2. Piece Rate System and
3. Balance or Debt Method.

**1. Time Rate System:**

Under this system, wages are paid on the basis of time, the employee puts on the work, without considering output of the worker. Wages are calculated on the basis of attendance.

**Advantages of Time Rate System:**

- (i) Wages can be easily calculated by workers and the management.
- (ii) As there is no hurry for completing the work, machine material and instruments are properly handled.
- (iii) Provides regular and stable income to the worker.
- (iv) Requires less administrative attention as the system is based on trust and understanding.
- (v) Quality of production can be maintained as the workers are not under pressure to complete work.
- (vi) Time rate system is preferred by trade union.

**Disadvantages:**

- (i) The wage payment is not linked to production and therefore there is no motivation to increase production.
- (ii) Workers may go slowly at work, leading to low production.
- (iii) There is no distinction between efficient and inefficient workers.
- (iv) As there is no record of individual workers' output, it becomes difficult to determine the relative efficiency of workers for the purpose of promotion.

**2. Piece Rate System:**

The wages are paid on the basis of output of workers without considering the time taken for performing the work. The workers are paid based on quantity of work and this is known as payment by results.



**Advantages of Piece Rate System:**

- (i) It encourages workers to produce more and efficiency of the workers tend to increase.
- (ii) Workers know that they will not be paid for idle time and therefore idle time is minimised.
- (iii) The systems is fair to the management and employee since the employee is paid as per quantum of output and the management gets production in proportion to the wages paid.
- (iv) The workers handle the equipments, machinery, etc., with care as they know that breakage, will reduce the output and the wages.
- (v) The management can distinguish between efficient and inefficient workers based on quantity of output.
- (vi) Labour cost per unit of production remains fixed and constant and it is relatively easy to calculate cost of production while submitting tender quotations.

**Disadvantages:**

- (i) The fixation of piece rate is not done on a scientific basis by management. If the employer finds that the workers are getting higher wages, he puts pressure on the workers to accept lower piece rate.
- (ii) Deterioration in the quality of output since the focus is on quantity of production.
- (iii) Wear and tear of equipment and machinery due to speeding of work.
- (iv) Trade union is opposed to piece rate system.

**3. Balance or Debt Method:**

This is a combination of time and piece rates. The worker is guaranteed an hourly or day rate with an alternative piece rate. If the earnings of a worker calculated at the piece rate exceed the amount which he would have earned if paid on time basis, he gets credit for the balance. If the piece rate earnings are equal to time rate earnings, additional payment is not required.

When piece rate earnings are less than time rate earnings, he is paid on the basis of time rate, but additional amount which he is paid is carried forward as a debt against him to be recovered in future.

The advantage of the system is that an efficient worker has an opportunity to increase his wages and at the same time worker with ordinary ability gets guaranteed time wage.

**2.9 Summary**

The institution and implementation of wage concepts in organizations is crucial and should take utmost care on concepts of wages. Minimum wage, Need based minimum wage, Fair Wage, Living wage and Money and Real wages are regularly practicing by the Personnel /HR executives. The concept of wages includes economic, sociological, psychological and organizational elements. In an industrial society, wage concepts determine the worker's way of life, including his social position.

### 2.10 Key words

**Wage** can be defined as the payment made to workers for placing their skill and energy at the disposal of an employer, the method of use of that skill and energy being at the employer's discretion and the amount of payment being in accordance with the terms stipulated in a contract of employment of service

**Minimum Wage**- A minimum wage is a compensation to be paid by the employer to his employee irrespective of his ability to pay. The minimum wage must provide not only for the bare necessities of life but also for preservation of efficiency of the worker namely education health, other requirements and amenities.

**Living Wage**- A living wage is a compensation which enables the earner to provide himself and his family with not only the bare necessities of life like food, shelter, and clothing but also a measure of frugal comfort including education for children, protection against ill health, demands of social needs, insurance against misfortunes and old age needs.

**Fair Wage**-It represents the average of minimum wage and living wage. It is above the minimum wage and below the living wage.

### 2.11 Self Assessment Questions

1. Briefly Explain the components of Wage Structure
2. Discuss the Important factors that influence the wages
3. Give a detail on the Methods of wage fixation adopted in India
4. Elucidate the Basic system of wage payments

### 2.12 Suggested Readings

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## LESSON 3

# WAGE THEORIES

### Learning objectives

- ✓ To study the Economic theories of wages
- ✓ To understand the Behaviour theories
- ✓ To discuss the content theories

### Structure

- 3.0 Introduction
- 3.1 Economic Theory of wages
- 3.2 Limitations of Economic theories
- 3.3 Behavioural theories
  - 3.3.1 Content theories
  - 3.3.2 Rewards that influence the behaviour process theories
- 3.4 Summary
- 3.5 Key words
- 3.6 Self Assessment Questions
- 3.7 Suggested Readings

### 3.0 Introduction

Wage determination, apart from the statutory aspect, is influenced by different theories. These theories—subsistence theory, wages fund theory, surplus value theory, residual claimant theory, marginal productivity theory, bargaining theory of wages, and behavioural theory of wages are discussed in brief below-

### 3.1 Economic Theory of Wages

(i) **Subsistence Theory-** (David Ricardo): This theory (1817) states that:

“The labourers are paid to enable them to subsist and perpetuate the race without increase or diminution.” The theory was based on the assumption that if the workers were paid more than subsistence wage, their numbers would increase as they would procreate more; resulting in spurt in supply of labour and this would bring down threat of wages. If the wages fall below the subsistence level, the number of workers would decrease - as many would die of hunger, malnutrition, disease, cold, etc. and many would not marry, when that happened the wage rates would go up.

(ii) **Wages Fund Theory-** (Adam Smith):

Adam Smith developed this theory. His basic assumption was that wages are paid out of a pre-determined fund of wealth which lay surplus with wealthy persons - as a result of organisation savings. This fund could be utilized for employing labourers for work. If the fund was large, wages would be high; if it was small, wages would be reduced to the

subsistence level. The demand for labour and the wages that could be paid them were determined by the size of the fund. Francis A. Walker attacked the wage fund theory. He argued that wages were paid out of the product of labour and not from some previously accumulated capital. It is production that furnishes true measure of wages.

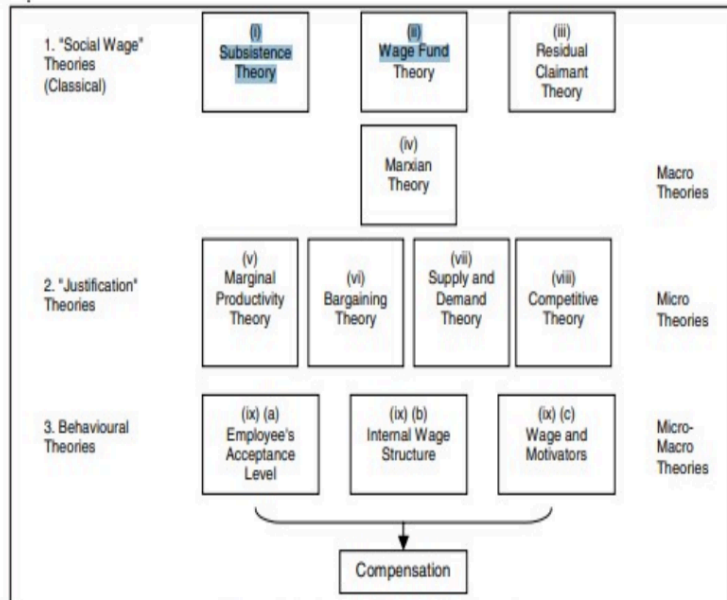


Figure 3.1 Model of Economic theories

**(iii) Residual Claimant Theory (Francis A. Walker):**

According to Walker, there are four factors of production/business activity, viz. land, labour, capital and entrepreneurship. Wages represent the amount of value created in the production, which remains after payment has been made for all these factors of production. In other words, labour is the residual claimant. This theory does not explain how trade unions are able to increase the wages, it does not consider role of labour in productivity.

**(iv) Surplus Value Theory of Wages (Marxian):**

This theory owes its development to Karl Marx (1818-1883). According to this theory, the labour is an article of commerce, which could be purchased on payment of 'subsistence price'. The price of any product is determined by the labour time needed for producing it. The labourer is not paid in proportion to the time spent on work, but much less, and the surplus went over, to be utilized for paying other expenses.

**(v) Marginal Productivity Theory (Philips Henry & Bates Clark)**

This theory was developed by Philips Henry (England) and John Bates Clark (USA). According to this theory, wages are based upon an entrepreneur's estimate of the value that will probably be produced by the last or marginal worker. In other words, it assumes that wages depend upon the demand for, and supply of, labour. Consequently, workers are paid what they are economically worth. The result is that the employer has larger share in profit as has not to pay to the non-marginal workers. As long as each additional worker contributes more to the total value than the cost in wages, it pays the employer to continue hiring; where this becomes uneconomic, the employer may resort to superior technology.

**(vi) Bargaining Theory of Wages (John Davidson )**

According to this theory, wages are determined by the relative bargaining power of workers or trade unions and of employers. When a trade union is 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.

**(vii) Employment Theory (Supply and Demand Theory)**

It is based on the interrelation between wages and employment. According to it, unemployment would disappear, if workers were to accept a voluntary cut in wages, pleaded for wage flexibility for promoting employment at a time of organisation depression. These wage cuts would bring down costs and thereby fall in price. This lowering in prices would cause additional demand, which will increase production. This will increase employment of workers.

**(viii) Competitive Theory:**

The force on which economists have traditionally laid the greatest stress in wage determination is demand and supply. Adam Smith, argued that if wages were fixed in accordance with demand and supply, workers would be attracted by high wages to industries, occupations and localities, where they were most needed and would tend to leave industries and places where the supply of labour was greater than demand. More precisely, the basic assumption of competitive theories of pay is that employers compete among themselves by offering a higher wage to attract employees; while the employees compete with one another for jobs by offering their services for a lower wage. Competition, then, is essentially disequilibrium process by which excess demand and excess supply cause changes in wages.

**(ix) Behavioural Theories:****(a) 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 accompany. 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.

**(b) Internal Wage Structure:**

Social norms, traditions, customs prevalent in the organisation 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 organisation.

### (c) Wage 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, merit increases, bonuses are based on performance. We note, wage theories reveal that each theory contains some truth but none of them is a complete one covering all aspects.

#### 3.2 Limitations of Economic Theories

1. Economic theories assume that wages and prices are either fully fixed (Keynesian paradigm) or fully flexible (neo-classical liberalists). The reality lies somewhere in-between.
2. Most wage theories are based on the assumption of full employment. In most developing countries this is not really the case.
3. Labour is not as mobile as capital and products are. Therefore, wage rates could be influenced by the changes in the demand for and supply of factors other than labour too.
4. In several industries labour costs are less critical than other costs. Also, fluctuations in interest rate and exchange rates as well as relative intensity of capital and technology, influence the demand for, and may cause the substitution of, both the input and the output of labour as well as the proportionate costs of labour in the total cost of production.
5. Wages and benefits reflect industry characteristics and personal characteristics (including skill differentials) as well as societal preferences and prejudices.
6. Interference by government and trade unions could minimize the influence of the market forces organisation demand and supply of labour.
7. Technology and productivity are major determinants. Low wages may not mean low wage costs. Similarly high wage rates may not mean high unit labour costs.
8. With the growing pressure for linking labour standards with international trade, increasingly it will become difficult (for countries, industries and companies) to compete on the basis of comparative advantage of cheap labour.

#### 3.3 Behavioural (Motivational) Theories

Every reward or element of compensation/reward has a behavioural objective and seeks to fulfil a need (physiological or psychological) and achieve a goal. Luthans argues that motivation is a process that starts with a physiological or psychological deficiency or need that activates a behaviour or a drive that is aimed at a goal. Reward systems are aimed at compensating people for their skill, effort, responsibility and working conditions and motivating them for higher performance.

There are two groups of motivation theories. These are:

Content Theories,

Process Theories.

##### 3.3.1. Content Theories

What motivates people at the workplace? Content theories of motivation focus on the needs of individuals and attempts to satisfy and influence various kinds of actions or

behaviours. Non-cognitive theories, sometimes called content theories, include the theory of needs hierarchy, achievement motivation theory, and motivation-hygiene theory

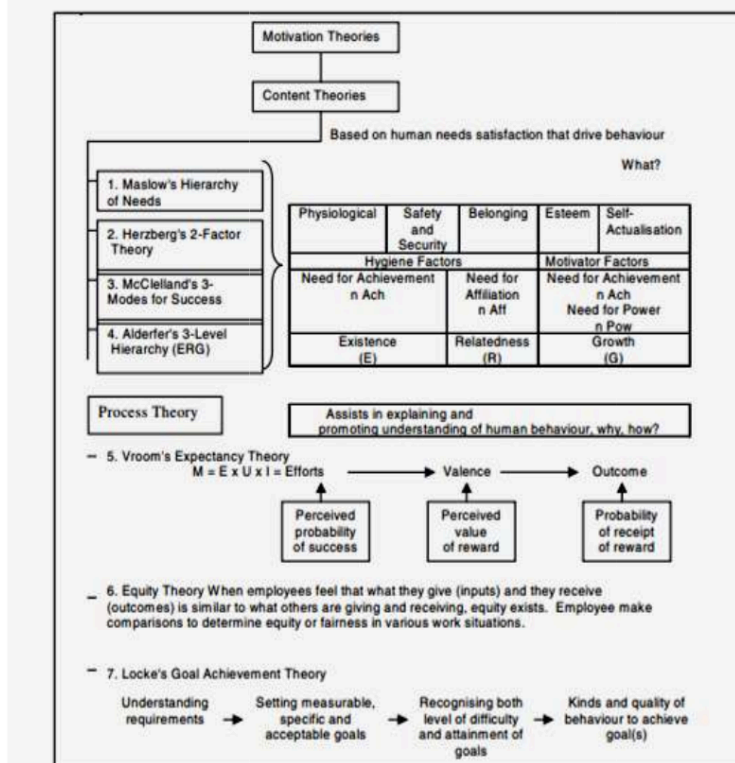


Fig. 3.2 Motivational Theories

- (i) **Maslow's Need Hierarchy:** The Maslow hierarchy of needs theory holds that humans are “wanting” animals motivated to satisfy their want or needs. Once a need has been fulfilled, it is no longer a source of motivation until the need arises again. According to this theory, needs are hierarchical in nature. Dr. Abraham Maslow ranked needs in order of their ascending importance as follows: (a) Physiological (b) Safety (c) Belonging (d) Esteem (e) Self-actualisation As lower-order needs are satisfied, the individual is motivated to satisfy the next level of needs. In American culture, the basic physiological and safety needs are generally fulfilled for the working population; therefore, higher order needs are more closely related to motivation and performance. According to this theory, supervisors of employees with a need for self-esteem should praise and recognise performance. The person with self-actualisation needs may not need such praise;



he or she will be motivated merely by the feeling of accomplishment of a job well done.

- (ii) **Herzberg's Motivation-Hygiene Theory:** Frederick Herzberg developed a motivation-hygiene theory applicable to the work setting. According to Herzberg, factors contributing to job satisfaction are called motivators. They are separate and distinct from factors that may sometimes lead to job dissatisfaction. Job satisfaction may be defined as a favourable reaction or feeling towards work. Good feelings about work result when needs are met by the job. Job satisfaction may come from the job itself, through intrinsic job satisfaction factors (motivators). Factors that are outside the job itself in the work environment and that affect job satisfaction levels are called extrinsic or hygiene factors. Herzberg's research indicates that intrinsic factors lead to job satisfaction, whereas extrinsic factors may or may not contribute to it. Herzberg repackaged Maslow's hierarchy of needs and developed the concepts of hygiene factors and motivators creating the two factory theory of motivation. In conjunction with these efforts, he promoted the idea of intrinsic and extrinsic motivators. Herzberg's hygiene factors related to the first three levels of Maslow's hierarchy, and his motivators related to the upper two levels of the hierarchy. Herzberg developed the hypothesis that positive job satisfaction can occur only when job content makes it possible for the motivator factors to come into play (the job itself promotes employee responsibility, achievement, recognition, growth). The concepts of intrinsic and extrinsic motivators added to the understanding and usefulness of motivators. Intrinsic motivators are those drives, generated from within the individual; extrinsic motivators come from outside the individual. Self-esteem and increased responsibility coming from a well-designed job are intrinsic motivators. Pay that comes from the organisation and the pat on the back from the supervisor in recognition of a job well done are examples of extrinsic motivators, or in Herzberg's terms, hygiene factors.

Intrinsic Factors	Extrinsic Factors
Ability utilization	Company policies and practices
Achievement	Compensation
Activity	Co-workers
Advancement	Recognition
Authority	Security
Creativity	Social service
Independence	Social status
Moral values	Supervision - human relations
Responsibility	Supervision - technical Working conditions

Leadership style may be affected when the supervisor recognises that letting subordinates use their unique job skills or giving them responsibility will increase their job



satisfaction levels. Job design should also take into consideration job satisfaction. Research on job satisfaction supports the proposition that good pay does not guarantee satisfaction.

**(iii) David C. – Mc Celland's Achievement Motivation Theory:** Mc Celland deals primarily with the need for achievement, secondarily with power and affiliation needs. According to this research, a high need for achievement correlates positively with high levels of performance. Mc Celland places a great emphasis on needs and individual differences. He focuses on three needs.

(i) Need for Achievement (n Ach): It is a drive to excel, to achieve in relation to a set of standards, and desire to succeed. Specific characteristics of high achievers are:

(a) Moderate risk taking and they prefer situations where there are 50:50 chances for success or failure.

(b) They prefer activities, which provide immediate and precise feedback information on how they are progressing towards the goal. They are frustrated where feedback on performance is imprecise, vague and long-range.

(c) High achievers derive greater satisfaction with accomplishment from solving complex problem rather than accompanying money rewards.

(d) Preoccupation with tasks and desire for improvement and better performance. They concentrate on goal until successfully completed.

**(iv) Alderfer's ERG Theory:**

Alderfer modified Maslow's five levels of needs to three levels and called them - 'E' for existence; 'R' for relatedness; 'G' for growth. 'Existence' needs comprise Maslow's Physiological as well as safety and security. 'Relatedness' needs affection. 'Growth' needs desire for personal development, i.e. self-actualisation and intrinsic component of Maslow's esteem needs.

(i) ERG needs are not rigidly hierarchical.

(ii) Maslow believes that once need is satisfied, it no longer motivates an individual. 'A' suggests that satisfaction of need may increase its intensity, e.g. if a job affords a great deal. Challenge, autonomy, creativity, the growth needs instead of being fulfilled, might get stronger, necessitating additional autonomy and challenge for satisfaction.

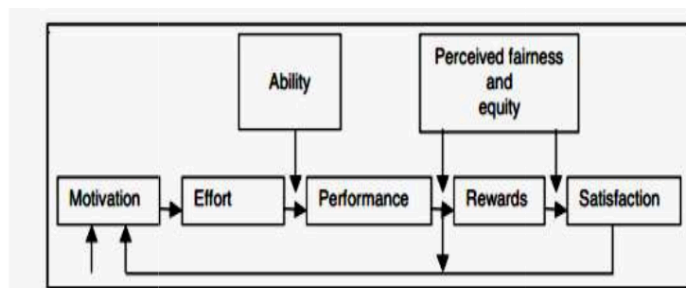
(iii) ERG theory suggests that more than one need may be activated at the same time and may be operating simultaneously. Alderfer's theory is appealing and is seen as directly applicable to motivation of people at work.

(iv) Process Theories: The most recent theories of motivation are based on the assumption that much human behaviour results from conscious, planned, decision-making. Humans are thoughtful and deliberative in their choice of actions. Motivational theories based on this premise are known as cognitive theories. Among them are: equity theory, Expectancy valence theory and Goal-setting theory.

(v) Vroom's Expectancy-Valence Theory: Like equity theory, this theory is based on the assumption that people usually make rational decisions about how to behave. This theory maintains that there are several elements in the motivational process. The level of performance is heavily dependent upon the amount of effort expended. Individuals expect that particular outcomes will occur as a result of their performance, and the importance (valence or value) of those outcomes to

them will in turn influence the degree of effort they expend. Expressed arithmetically, this theory states that effort is equal to expected outcome multiplied by the value of that outcome to the individual. Some illustrations may clarify these theoretical concepts. You, a supervisor in your first management position, feel that by working hard and doing your job well you will be promoted to higher managerial ranks (expectancy), a challenge that is of utmost importance to you (high-valence outcome). Your best operator is a working mother whose job interests are secondary to her family interests. The prospect of required overtime work (expectancy) has a negative motivational effect on her as she anticipates a decrease in the time available for her family (low-valence outcome). Her performance level may decrease. Another operator and his wife are working hard to accumulate funds necessary for a down payment on a house (expectancy). Overtime may be an appealing motivational factor for this individual (high-valence outcome). A person who has a high need for money will be more motivated to perform in a situation that provides monetary rewards. Individuals will behave in a way that will lead to rewards they value and are attractive

- (iii) Expectancy-valence theory explains well, the importance of money as a motivating factor. People are willing to work hard not necessarily because they enjoy their work but because they want monetary rewards that can be used to achieve other important goals. The expectancy theory model suggests the conditions necessary for employee motivation.



**Fig. 3.3 Expectancy Theory Model**

A person's motivation is a function of:

1. Effort to performance expectancies
2. Performance-to-reward expectancies
3. Perceived attractiveness of rewards

(vi) J. Adams Equity Theory: Adams argues that a major input into job Performance and satisfaction is the degree of equity (or enquiry) that people

Perceive in their work situation. Inequity occurs when a person perceives that the ratio of his or her outcomes to inputs and the ratio of a relevant other's outcomes to inputs are unequal.

People feel unhappy not only when they receive less than what they consider they deserve, but also when they receive more than what they consider they deserve. When an employee receives more than what he/she considers is fair, the employee begins to wonder whether others too, are receiving more than what they deserve. If it is indeed the case, the

next question that comes to the mind is compared to what they are getting, whether others are receiving much more than what they deserve.

Adams proposal can be represented as follows:

Person's outcomes < Other's outcomes

Person's inputs > Other's inputs

Person's outcomes < Other's outcomes

Person's inputs > Other's inputs

Equity occurs when

Person's outcomes = Other's outcomes

Person's inputs = Other's inputs

Related Issues: Equity can be internal or external. Internal equity refers to the pay differential between and among the various skills and levels of responsibility. For instance, a skilled worker could get more than the unskilled worker. Whether a blue-collar worker should get less or more than the white-collar depends not only on relative skill differentials and difficulties in working conditions, etc., but also on the demand and supply of those skills and the dominant occupational preferences of people in the society. When in one engineering fabrication industry, gas cutters (welders) were getting less than grass cutters (gardeners) it was perceived by the technical staff that it was glaring instance of a lack of internal equity because in that industry, welding is considered to be a highly rated technical trade and should command higher wage rate. Internal equity is established through job evaluation. Pay satisfaction surveys also provide insights into it. Job evaluation can be done not only for manual jobs, but also for managerial jobs. Collective bargaining pressures have, however, substantially eroded pay differentials based on skill differentials.

In many industries, dearness allowance and other employee benefits constitute bulk of the pay packet and basic pay, which is supposed to be based on job, evaluation constitutes only a small portion of the total pay packet.

External equity refers to concerns how wage/pay levels for similar skill levels in one firm compare with those in other firms in similar or same industry and location/region. For instance, if welders in one firm get the same as welders in the other firms in the industry/region, there is perceived external equity.

External equity is assessed usually through pay surveys and pay satisfaction surveys. Companies, which pay significantly less than the market rates, would find it difficult to attract, retain and motivate people to perform better.

Therefore, it is possible that low wage rates may not always be associated with low wage costs.

Non-discrimination should be an important consideration in pay policies.

International Labour Organisation (ILO) Convention No. 100 concerns equal remuneration for work of equal value. For similar skill, effort, responsibility and working conditions, pay should be similar. It is difficult to translate this principle into action because in reality pay differentials are based not only on these four factors but also on the demand for and supply of labour with relevant skills, the relative power of trade unions in collective bargaining which

varies widely across sectors/industries and regions, the capacity to pay of the firm/industry and the employer policies concerning pay on whether to lead or lag the average pay trends in the industry/location.

Alfred Marshall's iron laws of wages suggest that the relative power of unions is dependent on four factors: (a) the substitutability of the input of labour, (b) the substitutability of the output of labour, (c) the proportionate cost of labour, and (d) the cumulative impact of the preceding three factors. As a result, for instance, the textiles workers power to obtain higher wages could be less than that of, say, airline pilots.

In India, the principle of equal remuneration is upheld, partly through Equal Remuneration Act, 1976. The legislation is aimed at ending discrimination in remuneration based on sex. It does not, however, speak about equal remuneration for equal work. The legislation affords protection against discrimination for women workers, who are covered by the definition of 'workman' under the Industrial Disputes Act, 1947. Numerous judgments by courts limited the application of the concept of non-discrimination only to men and women doing similar work with similar qualifications in the same organisation.

**(vii) Goal-Setting Theory:** Proponents of this theory maintain that all individuals have values and goals. Values reside in emotions and desires, which in turn lead individuals to set goals, to satisfy them. These goals then determine behaviour and performance. The supervisors may recognise the application of this theory in Management by Objectives (MBO) programmes that exist in many organisations. Such programmes have proved motivationally effective, and they may produce even better results when managers involve in establishing them have improved their understanding of criteria for goal setting. For instance, an employee with a high need for achievement may need to set very challenging goals to be motivated, whereas a low achiever could be frustrated by a challenging goal that appears overwhelming. The supervisor who uses goal-setting techniques should be sure that participants accept the idea, that it does not lead to job dissatisfaction, and that it does not become stale as a motivator. **(viii) Agency Theory:** The agency theory focuses on the divergent interests and goals of the organisation's stakeholders and the way that employee remuneration can be used to align these interests and goals. **Employers and employees are the two stakeholders of a business unit, the former assuming the role of principals and the latter the role of agents. The remuneration payable to employees is the agency cost.** It is natural, that the employees expect high agency costs while the employers seek to minimize it. The agency theory says that the principal must choose a contracting scheme that helps align the interest of the agents with the principal's own interest. These contracts can be classified as either behaviour-oriented (e.g. merit pay) or outcome oriented (e.g. stock option schemes, profit-sharing, and commissions). At the first sight, outcome-oriented contracts seem to be obvious solution. As profits go up, rewards also increase. Remuneration falls when profits go down.

**3.3.2 Rewards Influence Behaviour Process theories** seek to explain why and how work behaviour is stated, energized, directed, sustained and stopped. Various process theories – Expectancy, Equity, and Reinforcement – have identified four critical elements to work motivation – 1. Ability, 2. Contingency, 3. Valued and Equitable Reward and 4. Saliency.

Table 3.1 Work Behaviour and Incentives

Conditions	Organisation Incentives
<ul style="list-style-type: none"> <li>• Employees must have the ability, skill to perform at the desired level – otherwise Reward cannot help</li> <li>• Reward must be contingent to Performance (Performance-Linked Reward)</li> <li>• The Reward should be Valued and Equitable</li> <li>• Reward must be Salient in the sense that it must be uppermost in the mind of the employees</li> </ul>	<ul style="list-style-type: none"> <li>• Ensure this through proper Recruitment, Placement &amp; Training.</li> <li>• Performance-based Reward/Promotion systems.</li> <li>• Design and administer employees Rewards which are instrumental in satisfying employees needs. They must be objective, rational and non-arbitrary.</li> <li>• Need-based Rewards based on surveys.</li> </ul>

In order to be effective in influencing behaviour, reward systems should satisfy three key design requirements according to Dr. Naresh C. Agarwal (McMaster University, Canada). These requirements are derived from established behavioural science theories and research.

**(i) Contingency:** The first requirement is that appropriate behaviour-reward contingencies be established i.e. rewards should be made contingent upon specific behaviours that are of importance to the organisation. Reinforcement theory suggests that a response followed by a reward is more likely to occur in the future. Applied to organisational settings, the theory implies that employees learn to behave in ways that get rewarded and avoid behaviour that does not get rewarded (Lawler, 1981). The basis of learning here is, the employee actually experiencing rewards following desired behaviour. Expectancy theory (Lawler, 1973; Vroom, 1995) also emphasises the importance of behaviour-reward relationships as a key motivational factor but it focuses more on expected rather than experienced rewards. The perceived link between behaviour and rewards is called instrumentality in expectancy theory and is often referred to as “line of sight” design requirement in the compensation literature (Gerhart, Minkoff and Oisen, 1995). Many organisations foul-up this design requirement because they fall prey to the “folly of rewarding A, while hoping for B” (Kerr, 1995). Some examples of such incongruence in reward systems are as follows: rewarding employees for attendance but hoping that they will maximise performance; rewarding the team members with best individual performance but hoping for teamwork and collaboration; paying sales staff on straight commissions while hoping that the senior salespersons will mentor and train the newly hired junior sales staff; and, rewarding and recognising university professors almost entirely for their research and publications while hoping that they will not neglect their teaching responsibilities.

**(ii) Equitable:** The second requirement for designing effective reward systems is that employees should perceive their rewards to be equitable. In employment relationship, the

employee provides inputs to the organisation and in return receives outcomes (rewards) from the organisation. According to equity theory (Adams, 1965), the employee judges the fairness of this exchange by comparing the ratio of his/her outcomes to inputs of some other relevant person. If the comparison reveals the two ratios to be equal, the employee experiences equity which in turn contributes to his/her job satisfaction. If the comparison shows the ratios to be unequal, the employee will experience inequity, which will cause him/her to take corrective action. Two possible corrective actions postulated in equity theory are altering inputs (e.g. lowering performance) and leaving the organisation. Research studies show that when individuals perceive underpayment, they tend to lower their inputs which enables them to raise their outcomes-to-inputs ratio to attain equity (Mowday, 1987; Greenberg, 1990; Cowherd and Levine, 1992).

**(iii) Value:** The third requirement for designing effective reward systems is that the rewards provided by the organisation should be of value to the employees. Only then, will rewards satisfy employees and influence their organisation behaviour. The logic of this requirement is derived from need theory (Maslow, 1954) and expectancy theory (Lawle, 1973; Vroom, 1995). These theories argue that individuals engage in behaviours which produce outcomes (rewards) that satisfy their salient needs. Thus, rewards attain their value or attractiveness from their perceived instrumentality to satisfy salient needs. Different needs can be salient for different individuals at the same time and for the same individual over time. Consequently, the value of a given reward can vary from one individual to another and for the same individual over time.

### 3.4 Summary

Wage Theory a highly systematized body of knowledge began to emerge two hundred years ago. A variety of new social ideas, institutional forces and ethical considerations, social, legal, political and economic factors, demands of social justice and equity area work in the establishment of a wage level and a wage structure.

The activity of trade unions and positive interference of the state (government) in the regulation of wages for the benefit of wage-earners has brought to light the inadequate treatment to the supply side of the wage theory.

Various theories of wage determination may be necessary in the scientific study of the problems of wages. Wages when determined are subjected to several theories of wages.

### 3.5 Key words

**Subsistence Theory- (David Ricardo):** This theory (1817) states that: "The labourers are paid to enable them to subsist and perpetuate the race without increase or diminution." The theory was based on the assumption that if the workers were repaid more than subsistence wage, their numbers would increase as they would procreate more.

**Wages Fund Theory- (Adam Smith)-**Adam Smith developed this theory. His basic assumption was that wages are paid out of a pre-determined fund of wealth which lay surplus with wealthy persons - as a result of organisation savings.

**Residual Claimant Theory (Francis A. Walker)-** According to Walker, there are four factors of production/business activity, viz. land, labour, capital and entrepreneurship. Wages represent the amount of value created in the production, which remains after payment has been made for all these factors of production

**Surplus Value Theory of Wages (Marxian)**- This theory owes its development to Karl Marx (1818-1883). According to this theory, the labour is an article of commerce, which could be purchased on payment of 'subsistence price'

### 3.6 Self Assessment Questions

1. Briefly Explain the Economic theories of wages
2. Describe the Rewards that Influence the Behaviour Process theories
3. Elucidate the Limitations of Economic theories

### 3.7 Suggested Readings

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## LESSON 4

# COMPENSATION POLICY

### Learning Objectives

- ✓ To study the Methods of Payments
- ✓ To Understand the Non-financial Compensation system
- ✓ To learn the New Trends in Compensation Management

### Structure

#### 4.0 Introduction

#### 4.1 System of Compensating

#### 4.2 Compensation Dimension

- 4.2.1 Pay for work and Performance
- 4.2.2 Pay for time Not worked
- 4.2.3 Disability Income Continuation
- 4.2.4 Differed Income
- 4.2.5 Spouse Income Continuation
- 4.2.6 Health, Accident, liability Protection
- 4.2.7 Income Equity Payments

#### 4.3 Organisation Develop Compensation Policy

#### 4.4 Methods of Payments

- 4.4.1 Time Rate system
- 4.4.2 Payment by Results system
- 4.4.3 Measured Day work

#### 4.5 Non Financial Compensation System

- 4.5.1 Enhance Dignity Satisfaction from work performed
- 4.5.2 Enhance Psychological, health, Intellectual Growth, Emotional Maturity
- 4.5.3 Promote Constructive Social Relationship
- 4.5.4 Design Job that required adequate Attention and Effort
- 4.5.5 Allocate sufficient Resource to Perform work assignment
- 4.5.6 Grant Sufficient control over the job to meet the personal documents
- 4.5.7 Offer supportive leadership and Management

#### 4.6 New Trends in Compensation Management



#### **4.7 The 3-P Compensation Concept**

#### **4.8 Summary**

#### **4.9 Key words**

#### **4.10 Self Assessment Questions**

#### **4.11 Suggested Readings**

### **4.0 Introduction**

Compensation includes direct and indirect monetary and non-monetary rewards given to employees on the basis of the value of the job, their personal contributions, and their performance. These rewards must meet both the organization's ability to pay and any governing legal regulations.

As per law, compensation is a pecuniary remedy that is awarded to an individual who has sustained an injury in order to replace the loss caused by said injury, such as workers' compensation. Wages paid to an employee or, generally, fees, salaries, or allowances. The payment a landowner is given to make up for the injury suffered as a result of the seizure, when the government through eminent domain takes his or her land.

Compensation basically is the act or state of compensating. The most well known form of compensation is Worker's compensation, which is a type of insurance, which offers compensation for workers who have been injured in the course of employment. Though methods vary among jurisdictions, provision can be made for weekly payment in the wages, compensation for economic loss, reimbursement and payment of medical bills, general damages for pain and suffering and benefits payable to the family of the employee killed during work.

Cash benefits are recognized according to state formulas like utmost benefit level. These benefits are managed on a state level, mainly by the state department for labour. The laws of compensation are a characteristic of highly advanced industrial societies, put into practice after long and hard fought struggles made by trade unions.

Compensation has been an extremely important issue for both, the employer and employee. This is because money is a crucial incentive and directly or indirectly related with fulfilment of all human needs. Employees sell their hands and brain in order to fulfil their primary needs and employers hire them to achieve their organisational objectives. Therefore, the employer's and employee's perspectives vary on matters concerning compensation. From cost perspective alone, effective management of compensation becomes critical because of the total operating costs. Another perspective from employer's point of view is to assess its impact on wide range of employees' attitude, behaviours, and ultimately its effectiveness on organisation's success. Compensation directly influences key outcomes like job satisfaction, attraction, retention, performance, skill acquisition, co-operation, and flexibility, etc. While employer's objective is concerned with primarily productivity, the employee's emphasis may be on higher compensation to offset their increased cost of living and perhaps the price his skill will fetch in the competitive job market.

Compensation, therefore, remains one of the most strategic and important functions of human resource management. Over the years, compensation has become a complicated issue. Not only are the problems of internal equity and external parity important, but also the larger

issues of the wider economy and society impinging on the problem of compensation. Therefore, students of management must develop a clear insight into the different facets of management of compensation, as also reward, so that they are able to appreciate the problem in its proper perspective.

Compensation is provided with basically two objectives – as a reward for the past services to the organisation and as stimulus to increase performance in future. The progressive organisations are utilizing compensation and rewards system as effective tools to develop, build and maintain “human capital” for competitive advantages by the following ways:

Compensation can serve to attract qualified applicants to the organisation. Other things being equal, an organisation offering a higher level of pay can attract larger number of qualified applicants than its competing units.

Compensation helps to retain competent employees in the organisation. Although retaining competent workers is contingent on many factors, compensation policies help by maintaining a fair internal pay structure and by providing attractive benefits. Turnover is thus reduced, along with costs associated with recruiting, selecting, and training replacements.

Compensation serves as an incentive to motivate employees to put forth their best-efforts. Manufacturing and sales organisations, for example, use monetary incentives to attain higher levels of production or sales without hiring additional employees. When employees put forth their best efforts, average productivity of labour increases. With increased productivity, fewer employees are needed to achieve the same level of output. Thus, labour costs are reduced and organisational profitability is increased.

#### 4.1 System of Compensating

Monetary claims on goods and services are wages or salaries paid to an employee in the form of money or a form that is quickly and easily transferable to money at the discretion of the employee. As a medium of exchange, money enables an employee to purchase certain kinds and amounts of a wide variety of goods and services available in the marketplace. The actual kinds and quantity of purchase made depend on the individual mechanisms that motivate choice behaviour. Wages and salaries in the form of money may be subdivided further into payments earned and acquired at the present time and payments earned but not acquired until some future time—deferred payments.

In kind, claims are made on goods and services made available and paid for either totally or in some percentage by the employer. Employees often have little or no opportunity for immediate monetary gain from an in-kind payment. Many employer—provided in-kind payments, however, replace monetary payments of some amount of the employees’ income should the employees obtain similar goods and services elsewhere. Organisations purchase these required and usually desired goods and services for their members to take advantage of (1) economies of scale available through group purchasing (2) the benefits available through tax laws and regulations, and (3) government laws requiring certain services.

The value of any in-kind payment to a specific employee depends directly on the employee’s perception of its worth. Individual perception relates to a range of demographic characteristics (age, gender, marital status, education, number and age of dependents, length of service, level in the organisation, current wealth, other income), as well as to the physical and emotional state of the employee.

The total compensation package may be described in many ways, but the classification scheme used in this book is based on eight dimensions. Each dimension has a number of compensation components. Each component has a variety of features. Because of different features, one component may relate to more than one dimension. The structuring of features, component may relate to more than one dimension. The structuring of features,

components, and dimensions into a compensation system is a job for the compensation specialist.

## 4.2 Compensation Dimensions

### 4.2.1 Pay for Work and Performance

Pay for work and performance includes money that is provided in the short-term (weekly, monthly, and annual bonuses/awards) and that permits employee to pay for and contract for the payment of desired goods and services.

The amount of money payments provided to employees normally depends on specified job requirements; outputs that meet or exceed quantity, quality, or timeliness standards; innovations that might lead to improved productivity; dependability; loyalty; and some combination of these items. Typical components within this dimension are base pay, premiums and differentials, short-term bonuses, merit pay, and certain allowances.

### 4.2.2 Pay for Time not Worked:

Over the years, the number of hours worked per week and the number of days worked per year have decreased. During the past 40 years, workers have enjoyed more days off with pay for holidays, longer paid vacations, and paid time off for a wide variety of personal reasons. These components of pay for time not worked significantly increase labour costs and also enhance quality-of-work-life opportunities for most employees.

### 4.2.3 Disability Income Continuation:

The possibility always exists that a worker will incur health or accident disability. Because of these disabilities, employees are frequently unable to perform their normal assignments. Even so, individual and family living expenses continue, and medical, hospital, and surgical bills create additional burdens. Social security, workers' compensation, sick leave, and short and long-term disability plans are examples of components that provide funds for employees who are unable to work for health related reasons.

### 4.2.4 Differed Income:

Various kinds of programmes, such as social security, employer provided pension plans, savings and thrift plans, annuities, and supplemental income plans provide income after retirement. Tax laws and regulations make deferred income plans more appealing to many employees. Because of tax regulations, employers can often take immediate deductions and employees can defer tax obligations until income tax rates are possibly more favourable. In addition, funds invested in many of these deferred Plans draw tax-free interest, significantly increasing the amount of money available upon retirement. Stock purchase, option, and grant plans are components commonly used to achieve tax deduction, estate building, and deferral goals.

### 4.2.5 Spouse (Family) Income Continuation:

Most employees with family obligations are concerned with what might happen if they are no longer able to provide money that will allow their families to maintain a particular standard of living. Certain plans are designed to provide dependents with income when an employee dies or is unable to work because of total and permanent disability. Specific features within Life Insurance plans, Pension plans, social security, workers' compensation, and other related plans provide income for families of employees when these conditions arise.

#### 4.2.6 Health, Accident and Liability Protection:

When a health problem occurs, employees must be concerned not only with income continuation, but also with payment for the goods and services required in overcoming the illness or disability. Organisations provide wide variety of Insurance plans to assist in paying for these goods and services. In recent years, the cost of medical-related goods and services has increased at a greater rate than almost any other goods or services desired or required by the employees.

#### 4.2.7 Income Equivalent Payments:

A final set of compensation components may be grouped under the title of income equivalent payments. Many of these components are frequently called perquisites, or "perks". Employees usually find them highly desirable, and both employers and employees find certain tax benefits in them. Some perks are tax free to employees and tax deductible to employers. In recent years, the Internal Revenue Service (IRS) has required that employer costs for a specific portion of certain perks be considered earned income to employees. In most cases when this occurs, the earned income charge to employees is significantly less than the amount employees would have been required to pay if they had purchased the goods or services in the market place. Some of the more desirable perks are the use of a company car or a company credit card, payment for expenses to professional meetings, subsidized food services, and child care services.

#### 4.3 Organisations Develop Compensation Policy:

The compensation system hinges on sound principles of compensation administration. Some of them are as under: D.S. Beach in his book, 'The Management of People at Work' provides seven principles of compensation administration.

1. The enterprise should have a clear-cut plan to determine differential pay level in terms of divergent job requirements involving varied skill, effort, and responsibility and working conditions.
2. An attempt should be made to keep the general level of wages and salaries of the enterprise in line with that obtained in the labour market or industry.
3. Adequate care should be taken to distinguish people from the jobs.
4. Irrespective of individual considerations, care should be taken to ensure equal pay for equal work depending upon flexibility of jobs – of course, variations may be permitted within a pay range.
5. There should be a plan to adopt equitable measure for recognizing individual differences in ability and contribution.
6. Attempt should be made to provide some procedure for handling wage grievances.
7. Adequate care should be taken to inform the employees and the union, if any, about the procedure followed in determining wage rates.

#### 4.4 Methods of Payment

Compensation is the price of labour hence it has to be in harmony with other price systems in the economy.

##### 4.4.1 Time Rate System:

Under this system the employees are simply paid a pre determined rate per week, or hour for the actual time they have worked. The basic rate for the job can be fixed by negotiation, by reference to local rates, or by job evaluation. This system is prevalent in the engineering and processing industries and among clerical, supervisory and managerial personnel where there is no rigid standardization of work, and a certain amount of skill is involved. Within the time paid for, a minimum standard of performance is expected.

From the point of view of employees, the advantages of time rates are that earnings are predictable and steady. Moreover, they need not argue with supervision and rate-fixers about piece rate or time allowances. The disadvantage of time rates is that they do not provide the motivation of a direct incentive relating the reward to the effort. You can overcome this problem of incentive by adopting a system of measured day work. Alternatively, you may also use some form of merit award. Merit awards may be in the form of additions to the base rate of so much per hour, usually with an upper limit. They may be awarded on the basis of the purely subjective judgement of a superior, or determined by reference to systematic merit assessment procedures which will review the workers' performance in terms of output, skill, versatility of organisation time keeping.

#### 4.4.2 Payment by Results System

Under this system, the pay or part of the pay is related to the number of items a worker produces or the time he takes to do a certain amount of work. It is applicable to simple manual operations, where the effort of an individual can be measured in terms of quantity or quality. This may be through a straight piecework or a differential piecework system.

**(i) Straight Piecework:** It is payment of a uniform price per unit of production. This is most appropriate where production is repetitive in character and can easily be divided into similar units. In this system, you can pay a worker a flat money price for each piece or operation completed (money piecework), or you can pay him for the time allowed to complete a task (time piecework). In the latter case, if the worker completes the job in less than the allowed time he gains the advantage of time saved.

**(ii) Differential Piecework:** Systems allow you to adjust wage cost per unit in relation to output. In this system, the wages cost per unit of production falls as output increases. At the same time the hourly rate of workers' earnings still increases, although not in proportion to the increased output. This system is possible where it is early to relate effort to production and the work is standardized, repetitive and measurable. You should keep quality in mind while adopting the piece rate system.

#### 4.4.3. Measured Day Work:

In this system, the pay of the employee is fixed on the understanding that he will maintain a specified level of performance. The pay does not fluctuate in the short-term with performance. You can define the required level of performance and monitor the actual level with the help of work measurement methods. What distinguishes this system from the time rate system is the concept of an incentive level of performance. You are putting the employee under an obligation to perform at the effort level required by the guaranteeing the incentive payment in advance.

Measured day work offers enhanced earnings in exchange for an incentive level of performance.

Puffer (1998) lists six dangerous myths about compensation:

Labour costs and labour rates are the same thing. They are not. Labour rates are Straight wages divided by time. Labour costs are a calculation of how much accompany pays. Not necessarily. One must address productivity, not wage rates. Decreasing wage rates may increase wage costs. Labour costs constitute a significant proportion of total costs. This is true sometimes. Labour costs vary widely by industry and company. Low labour costs are a potent and sustainable competitive weapon. Even if it is, it is not sustainable Individual incentive pay, in reality, undermines performance of both the individual and the organisation.

It might undermine teamwork. Pay is not often related to performance. People work for money. But they work even more for meaning in their lives.

#### **4.5 Non-Financial Compensation System**

Non-financial compensation rewards are all situation-related rewards not included in the compensation package. These rewards have an almost-infinite number of components that relate to the work situation and to the physical and psychological well-being of each worker. In fact, any activity that has an **impact on the intellectual, emotional, and physical well-being of the employee** and is not specifically covered by the compensation systemic part of the non-compensation reward system.

The non-compensation system contains many of the reward components that behavioural Scientists have been describing for the past 50 years as critical for improving workplace performance. An in-depth analysis of the seven non-compensation dimensions have been identified in a close interrelation between compensation and non-compensation rewards.

The line between these two major reward categories might at first glance appear to be sharply defined, but it soon blurs as they interact and blend together.

##### **4.5.1 Enhance Dignity and Satisfaction from Work Performed:**

Possibly the **least** costly and one of the most powerful rewards an organisation can offer to an employee is to recognize the person as a useful and valuable contributor. This kind of recognition leads to employee's feelings of self-worth and pride in making a contribution. Few people simply want to be given something. They would much prefer to know that through their own efforts, they have earned and deserved rewards. Every compensation and no compensation reward component should carry with it the message, "we need you and appreciate your efforts."

##### **4.5.2 Enhance Physiological Health, Intellectual Growth and Emotional Maturity:**

Considering the number of hours a person spends on the job, on travel to and from the work site, and off the job in attempting to resolve job-related problems frequently receive minimal attention until a serious problem occurs. Once this happens, however, it overrides all other employee concerns and activities. Modern health practices recognize the direct relationship between the physiological health and intellectual and emotional well-being of each individual.

##### **4.5.3 Promote Constructive Social Relationships with Co-workers:**

An old adage states that "One man is no man." Although there are constant reminders of what one dedicated person can achieve, there are even more reminders that one human alone is weak. However, with concerted action, people can accomplish almost anything. In this world of extreme specialization, people need and rely on other people more than ever. One of the most valued rewards gained from working is the opportunity to interact in a socially constructive manner with other people, to enjoy the comradeship of work-place associates.

##### **4.5.4 Design Jobs that Require Adequate Attention and Effort:**

Over the past 40 years, organisational scientists have discussed at length the problems arising from boredom related to work assignments that were developed in the last quarter of the nineteenth century. Jobs were designed so that workers could be taught quickly how to perform anew highly repetitive tasks. Workers then were required to perform these few tasks



floras long as they remained on the job. What first appeared to be an efficient way of melding human resources with machine technology proved to have serious drawbacks?

#### **4.5.5 Allocate Sufficient Resources to Perform Work Assignments:**

Requiring employees to perform assignments for which they have neither the knowledge nor the skills, opens the door to problems. Not only is the organisation likely to suffer because of outcome failures, but employee job-related interest and satisfaction are apt to break down because of the likelihood or inevitability of failure. Most employees seek a sense of accomplishment from their work. They want some degree of challenge, but they also want to feel reasonably sure that they can succeed.

#### **4.5.6 Grant Sufficient Control over the Jobs to Meet Personal Demands:**

From the 1950s to the present time, behavioural scientists have discussed the need to grant employees greater opportunity to participate in organisational decision-making processes. One problem with this participation concept is that organisations are composed of all types of people with all kinds of decision-making desires. Some people simply want to be told what to do, to be shown what is an acceptable level of performance, and then to be left alone to do their jobs. A few people in every organisation want to tell top management how to run the organisation. Between these two extremes is a wide variety of demands for a greater voice in determining how to perform assignments.

#### **4.5.7 Offer Supportive Leadership and Management:**

This dimension is difficult to separate from all other non-compensation rewards, but it is so important that it must be recognized as a unique dimension of the non-compensation rewards and not just a component of the other factors.

### **4.6 New Trends in Compensation Management**

1. in the contemporary environment characterized by, among others,

- (a) Globalization,
- (b) Disinvestment and privatisation,
- (c) Liberalization,
- (d) Recession in business,
- (e) (Employer) shift from a sellers' market to a buyers' or customer-oriented market,
- (f) Focus on quality,
- (g) Changes in tax policy,
- (h) Stakeholders' expectations, and
- (I) fast changes in technology, the traditional incentive schemes linked to physical productivity or its parameters such as capacity utilization and material utilization are on the wane.

The trend appears to be towards adopting Economic Value Added (EVA) as a measure of organisational and group performance and using it to determine the quantum of performance-based bonus for employees. Individual employees can get their share on the basis of KPA-based performance measurement. In this way, individual, group and company performance, linked to organisational strategy, determines the quantum organisation incentive bonus.

2. The incentive value of fringe benefits needs to be reviewed in the light of tax policies.

Tax saving through tax planning, especially in fringe benefits is possible and can enhance the incentive value. An employee's fringe benefits, for instance, includes attendant allowance, welfare allowance, conveyance reimbursement, academic pursuance allowance,

gift vouchers up to Rs. 5,000, and car washing for senior executives. A detailed exercise needs to be carried out on the tax provisions vis-à-vis fringe benefits to enhance their monetary value to the employees.

3. For the effectiveness of incentives, a change in work culture is necessary

Organisations should identify the extent of the gap between the present and desired work culture and work out policies and practices for reducing the gap. This can be done through a diagnostic exercise with professional help, if necessary.

4. An organisation should adopt a package of monetary and non-monetary incentives based on the motivational needs profile of its employees.

A diagnostic exercise can be carried out to determine the motivational needs profile and the relative strength of different motivational needs. The data thus generated may be used to evolve reward policies and determine a package of monetary and non-monetary incentives within the boundaries of the wage and salary system.

5. Some of the non-monetary incentives in the offering are:

- a. Gift voucher
- b. Dinner with the Chief Executive Officer (CEO)
- c. Quality award
- d. Timeliness award
- e. Best R&D technique award
- f. Sportsman of the year award
- g. Good health award
- h. Long service award
- i. Creativity award

6. There is a need to excel in the fiercely competitive current environment.

In this context, the Excel Award Scheme of Bharat Heavy Electricals Ltd. and its experience in implementing it could be used as a benchmark by organisations for evolving and devising their own award schemes for excellence. Measurement of performance of individual executives based on KPAs linked to Memorandum of Understanding (Mou) parameters may be used as a basis for designing a performance-linked incentive scheme for the individual executives. The performance bonus could be given in cash or ESOPs or in a combination of the two. EVA was, however, perceived as a better measure of organisational performance than the current Mou parameters. EVA has unlimited potential forewarnings, since the additional performance-linked earnings are funded through the value generated by the employees. Also, EVA reflects the true picture of a company's value addition.

7. Variable pay or performance-linked incentive should comprise a sizeable part of the compensation package. Variable pay should be linked to KPAs/EVA.

8. Where possible, a cafeteria approach for compensation to the employees may be opted, within the framework of the wage and salary structure of the organisation.

9. The new compensation strategy should be external market-sensitive based pay and not internal alignments.

10. It should be variable performance-based pay and not annual increments.

11. It should be risk-sharing partnership and not entitlement.

12. It should provide flexible opportunity to contribute, and not tied to a fixed job.

13. It should provide for lateral promotions and not career paths.

14. It should ensure employability and not job security or pay security.

15. It should encourage team working and not individual working



Table 4.1 Best Practices Options

The New Pay*	High Commitment**
<ul style="list-style-type: none"> <li>• External market-sensitive based pay, not internal consistency</li> <li>• Variable performance-based pay, not annual increases</li> <li>• Risk-sharing partnership, not entitlement</li> <li>• Flexible opportunities to contribute, not jobs</li> <li>• Lateral promotions, not career path</li> <li>• Employability, not job security</li> <li>• Teams, not individual contributors</li> </ul>	<ul style="list-style-type: none"> <li>• High wages: You get what you pay for</li> <li>• Apply incentives; share gains, not risks employee ownership</li> <li>• Participation and empowerment</li> <li>• Teams, not individuals, are base units</li> <li>• Smaller pay differences</li> <li>• Promotion from within</li> <li>• Selective recruiting</li> <li>• Enterprise wide information sharing</li> <li>• Training, cross-training and skill development are crucial</li> <li>• Symbolic egalitarianism adds value</li> <li>• Long-term perspective matter</li> <li>• Measurement matters</li> </ul>

\*Source: J.R. Schuster, The New Pay; E. LAWLER, New Pay

\*\*Source: Pfeffer, Competitive Advantage through People.

This new system of compensation works on a very simple premise - "If you measure it, people will do it. If you measure it and pay for it, people will do it in spades. If what you measure matches corporate goals and strategies, the company will be successful." These points to designing appropriate reward programmes linked to performance. Charles Handy - "The new organisation equation for success is that profit and productivity are best created by half of the workforce, paid twice as well and producing three times as much." This can be achieved through performance linked incentive and reward system.

The new concept of compensation emphasizes on high payment to attract, retain and motivate high talents. If you pay peanuts, you can get only monkeys. You get the employee what you pay for.

#### 4.7 The 3-P Compensation Concept-

The concept of paying for the 3 P's consists of three parameters that are considered by management of any organisation while deciding the salary as well as the incentives of employees. It is to pay for the Position, the Person and the Performance.

**Pay for Position**

The focus of the compensation policy translated into the width of the grade, in relation today for Position. The width of the grade is the degree to which jobs of different size are included in the same grade. Therefore, a wide grade, in effect, reduces the emphasis on Position since many jobs of varying job sizes are encompassed in the same grade. In such instances, other factors, such as person's capabilities or competency (i.e. Pay for Person) or an individual's achievement of objectives (i.e. Pay for Performance) will have a much greater impact on the total pay level than the grade level. Broad-banding is an example of this type of approach. By contrast, narrow grades emphasize positions since a small increase in responsibility would lead to a promotion and an increase in grade. A grade width not only determines the overall importance of Position to pay but also can be used to vary the emphasis of the three pay elements—position, person, and performance at different levels of the organisation.

**Creating a grading structure:**

The ranking of positions as a result of position evaluation can be converted into grades based on the unique requirements of each organisation. This process is called the Internal Position Evaluation (IPE). These grades are created from IPE by answering three questions: One, how many employee groups are there in the organisation? Two, how many levels are there within each employee group? Three, how many levels are there within each employee group? The entire organisation is first divided into broad classifications depending on designations or levels. Consistent policies are then designed for each of the groups.

**Pay for Person**

The second P in this model is the "Person"—considered one of the hardest and most subjective part of compensation management. Pay for Person takes into account a person's capabilities and experience in setting a pay level that is both equitable and competitive. It also considers the market demand of a person's unique skills and experience. Pay for Person is most commonly associated with "competency-based pay".

However, it also incorporates a market-based pay approach. The starting point for this approach is the position. An individual's assessment looks at the person's capabilities and experience relative to the position requirements. Thus, the first step in Person for Pay is to determine the position requirements for competencies and experience. This "position competency profile" lays out the experience and competencies (aptitudes, attitudes, skills, and knowledge) that the organisation ideally wants in a person for a given position.

Organisations should be looking for a process that assesses position and people against the same competency criteria within the framework of the organisation's philosophy, image, value, and identity. The 3-P competency profiling forms and process are designed to ensure that competencies are carefully identified, defined and weighted for the specific culture and need of the organisation. Each position and person has their own profile, which enables the organisation to match positions and persons against each other.

The linchpin between Pay for Positions and pay for Person is the Reference salary which is a set based on the market-competitive pay for someone who fulfils the position's requirements for competency and experience. In the 3-P system, the actual salary varies relative to the Reference Salary based on the Position/Person ratio and the number of years that the individual has been in the position. Each grade has its own range of Person for Pay. The minimum pay for each grade is based on the minimum competency acceptable for the position and the corresponding market pay level required attracting a person with that level of competency. On the other hand, the maximum pay for the range of each grade is close to the Reference Salary the logic being that an organisation should pay for only those competencies required to fulfil a position's responsibility.

The Position/Person profile and ratio provides a basis not just to evaluate the Pay for Person (i.e. the actual salary) but also provides guidance in titling, training, and development.

	<b>Position/Person Ratio</b>	<b>Pay for Person</b>	<b>Titling</b>	<b>Training</b>	<b>Development</b>
<b>Maximum</b>	The person demonstrates unique capabilities for the selected criteria.	Pay slightly above the reference salary until promotion	Senior title (for example, senior engineer).	Enrich & broaden the scope capabilities.	Explore promotion options.
<b>Meets Requirement</b>	The person demonstrates the necessary level of competency for the selected criteria.	Pay at or near reference salary	Generic title (for example, engineer).	Focus on new training.	Guide into new development plans.
<b>Minimum</b>	The person demonstrates a need to improve in some or all selected criteria.	Pay at lower end of person pay range.		Train in areas that are far below position requirements.	Identify hidden talents and potential
		Pay below Reference salary but, increasingly closer. Based on position/person Ratio.		Develop capabilities upto position requirements.	

An

organisation can set the titles within a grade based on the person's competencies relative to the position requirements. Companies can arrange training for the person based on the areas where the person's competencies have fallen short of the position requirement and determine the person's development plans and potential for promotion based on a simulation of profile. Pay for Person may also include a market premium in case the competencies related to the position are rare and under market pressure. Usually market pressure is temporary since over time, supply & demand equalizes pay levels for jobs of the same size. Thus, market premiums should be paid separately from salary and adjusted up or down based on changes in market conditions. In the present day market scenario, it is the skills and the talents that matters the most. Companies are paying the least attention towards the sky-rocketing remunerations of the deserving employees. IIM graduated drawing astronomical packages and breaking their own records year after year are perhaps the biggest example of this. There are two exceptions that may warrant a permanent premium incorporated into the Pay for Person. These include permanent shortages of skills, capabilities competencies and experience linked to a specific individual. Permanent shortages of skills and capabilities are usually due to controlled and limited supply. This may be the case when a qualification is required to assume a position and the qualifications are limited regardless of demand. This can happen for positions such as doctors, lawyers, actuaries and certified public 25 Wage and Salary Management accountants. In these cases, an organisation accountants. In these cases, an organisation may pay position holders a salary that incorporates a permanent premium over other jobs in the same grade. At senior levels within an organisation, an individual may possess specific experience and capabilities that uniquely qualify that person for the position. In such cases, an organisation may be willing to pay far above the market to secure and retain the individual.

#### **Pay for Performance**

The third prefers to pay for Performance. In 3-P compensation management, the performance of the individual is not the only consideration in setting the salary or granting salary increase. The logic is that since performance is variable and fluctuates from year to year, so should performance pay be variable and fluctuates from year to year.

Granting a salary increase based on one year's performance is equivalent to repeatedly paying a bonus year after year for performance delivered in a single year. In this new form, an individual's performance is managed through a "performance contract" which comprises the clarification of the role, the setting of objectives, and there view of performance. As an outcome of the performance contract process, a measure of performance at the corporate, unit and individual level becomes the basis for setting the performance pay.

The purpose of Pay for Performance is to define all incentive schemes – short-term or long-term and efficiently reward the employee's contribution to its immediate and long-term results. An efficient scheme implies that it includes agreed-upon, challenging, and realistic targets, that it motivates the employee by linking targets to sizeable rewards, and that it openly and clearly recognizes the employee's contribution.

The management chooses from all possibilities one or several types of plans that are in line with the organisation's activities, the types of objectives assigned to the employees, and the corporate culture. Rules of eligibility should then be established for each plan. It's very important to remember that for whatever plan each category of employee ineligible, the total amount of possible rewards should be equitable from one person to another. In other words, a similar performance evaluation should bear similar amounts or value of rewards, even if the nature of the incentive plan is different. Finally, in assessing who should be eligible for what plan, it is useful to remember how each plan is funded.

#### 4.8 Summary

The compensation policy and the reward system of an organization are viewed by the employees as indicators of the management's attitude and concern for them. Traditionally, pay scales in companies reflected the importance of the work and the responsibility level. Today, organizations try more to assess the worth of an individual in terms of his performance and contribution to the organization. There is importance of a compensation system that is competitive and attractive for the employees and at the same time, profitable for the organization.

#### 4.9 Key words

**Compensation:** Direct and indirect monetary and nonmonetary rewards given to employees on the basis of the value of the job, their personal contributions, and their performance. These rewards must meet both the organization's ability to pay and any governing legal regulations.

**Salary:** Regular wages received by an employee from an employer on a weekly, biweekly, or monthly basis.

**Wages:** Payment received by an employee in exchange for labour. It may be in goods or services but is customarily in money.

**Wage Determination:** A "wage determination" is the listing of wage rates and fringe benefit rates for each classification of labourers and mechanics.

**Straight Piecework:** It is payment of a uniform price per unit of production.

**Differential Piecework:** Systems allow you to adjust wage cost per unit in relation to output.

#### 4.10 Self Assessment Questions

1. Define Compensation? Briefly Explain the System of Compensating?
2. Discuss the Compensation Dimensions
3. Examine the Methods of Payments in Compensation Management
4. Elucidate the Non financial Compensation system
5. Outline the 3-P Compensation Concept

#### 4.11 Suggested Readings

1. B.D. Singh, Compensation and Reward Management, Excel Books, New Delhi.
2. R.S. Dived, Managing Human Resource and P.M. in Indian Enterprise, Golgotha Publishing Company, New Delhi.
3. Wayne Casco, Managing Human Resource, Tata McGraw Hill, New Delhi.
4. Memorial and Gawker, Personnel Management, Himalaya Publication
5. S. Khanka, Human Resource Management, Scand & Company Ltd., New Delhi.
6. Aswathappa, Human Resource Management and Personnel Management, Tata McGraw Hill, New Delhi.

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## LESSON - 5

# WAGE DETERMINATION

### Learning Objectives:

After reading this lesson, the student is able to :

- \* Know the significance of Wage Determination.
- \* Study the Principles of Wage Determination.
- \* Learn the Considerations and Constraints in Wage Determination.
- \* Understand how the factors influencing Wage Determination.

### Structure:

- 5.1 Introduction
- 5.2 Meaning
- 5.3 Principles of Wage Determination
- 5.4 Considerations for Wage Determination
- 5.5 Constraints in Wage Determination
- 5.6 Factors influencing in Wage Determination
- 5.7 Systems for Wage Determination
- 5.8 Compensation/Wage Determinant Methods
- 5.9 Summary
- 5.10 Keywords
- 5.11 Self Assessment Questions
- 5.12 Further Reading.

### 5.1 INTRODUCTION :

Companies usually use more than one way to 'determine' what to pay their employees. They compute what they can afford, based on their projections of revenues, overall costs and the historical share of employee costs. This provides a round ceiling for total compensation costs. They then look at what they have been giving by way of annual increases every year. This is what the employees would normally expect and becomes some sort of a rough floor which must be met, at least for these employees who are considered too valuable to lose. If this is higher than what the companies can afford they think for ways to either link increases to productivity hikes (e.g. as in collective bargaining in unionised sectors) or work out performance based differentiation of compensation to contain the overall bill while rewarding the best. Determining floors and ceilings is not enough though, companies still have to figure out what their scales should be and what they should pay people performing any particular role. Most of the companies address this by benchmarking through compensation surveys and positioning

themselves on a particular percentile in the set of companies being surveyed depending on the extent to which they wish to be seen as compensation leaders.

### 5.2 MEANING :

Compensation/Wage Determination means "the fixation of compensation/wage rates through standard or structured procedure i.e.. Wage theories (Historical), wage surveys, job evaluation, legal enactments, policy making, appointment of committees, commissions, collective bargaining and with economical, political, social and psychological influences.

Compensation/wage determination is purely an economic problem it gives rise to various social, political, ethical, behavioural and economic problem. It is extremely essential to have specific consideration of factors which have some relationship to existing wage levels and thus influence wage and salary administration.

Generally large number of factors influence the salary levels in an organisation. But at the same time all the factors need not be considered in each and every organisation. A combination of factors will be considered at the organisation depending upon the capacity, conditions, traditions and beliefs.

Usually, wage determination having some common steps to determine/fix the wage in the organisations as : performing job analysis, wage surveys, analysis of relevant organisational problems forming wage structure, forming rules of compensation/wage administration, explaining these to employees, assigning grades and price to each job and paying the guaranteed wage.

### 5.3.PRINCIPLES OF WAGE DETERMINATION :

To solve compensation / wage problems, a set of principles are pertaining for wage determination. A clear understanding of the aims of organisation in matters of pay having its own determination principles are as follows :

- 1) Ensure that the organisation's compensation policy is consistent with national/public policy.
- 2) Adjust wages and salaries to changes in the labour market.
- 3) Graduate wage and salary rates in accordance with the difficulty and importance of the jobs.
- 4) Maintain consistency by paying similar jobs to similar rates.
- 5) Provide for flexibility in compensation programs in response to changed conditions.
- 6) Provide incentives for development.
- 7) Protect the owners by seeing that pay is neither too high nor too low in terms of value received.
- 8) Provide not only fairness but employees conviction of fairness in all compensation programs.
- 9) Strive for simplicity in pay programs as an aid to employee understanding.

- 10) Provide all employees with full information on compensation policies and programs of the organisation.

#### 5.4 CONSIDERATIONS FOR WAGE DETERMINATION :

There are several considerations or criteria which help in determining wages in an organisation. These criteria include law of supply and demand, prevailing wages, ability to pay government role, standard and cost of living, productivity, bargaining power and job requirements.

#### 5.5. CONSTRAINTS IN WAGE DETERMINATION :

Constraints in wage determination can be classified as statutory and non-statutory, economic and technical.

##### i) The Statutory Constraints :

The Minimum Wages Act 1948, the Payment of Wages Act 1936, Equal Remuneration Act 1976, and the Payment of Bonus Act 1965, Adjudication, Tribunals and judgements are statutory constraints of wage determination.

##### ii) Non-statutory Constraints :

Non-statutory constraints exist varied from industry wide arrangements of wages standardisation at national level which lead to mass-scale governmental intervention. Those are wage boards, pay commissions, committees recommendations, and collective bargaining operating in a democratic industrial society.

##### iii) Economic Constraints :

Inflation forms an economic constraint in the determination of wages in an enterprise. It causes divergence between the money or nominal wages of the worker and their real wages or the purchasing power of the money earned.

##### iv) Technological Constraints :

Technology forms a major constraint in the process of wage determination of an enterprise.

#### 5.6. FACTORS INFLUENCING WAGE DETERMINATION :

On the basis of above discussions, we may summarise the factors affecting wage determination as under :

##### a) Demand and supply of labour :

Demand and supply conditions of labour have considerable influence on the determination of wage rates, like the price of a commodity is determined by the demand and supply of that commodity. The wage rates to the workers are also influenced by the demand and supply position of labourers in the labour market. If the labour is in short supply, and the demand for labour is more, the workers will offer their services only if they are paid well. On the other hand labour may be available at cheaper rates if their supply is in plenty and the demand for labour is comparatively less.



**b) Firm's Capacity to Pay :**

One of the principal consideration that weights with the management in fixing the wage rates is its capacity to pay. While fixing wage rates the firm must consider the capacity to pay, because if it pays beyond capacity it no longer survive for a longer period, it may lead to closure after some time.

When capacity to pay of an organisation is a part of profitability, various expenses that the industry bears, certain trends in prices of products/services that are to be charged by the industry should also be taken into account. In addition total cost of employees (salaries, allowances, cost of fringe benefits etc.) should be taken into consideration in determining the ability to pay.

Trade unions demand higher wages when the companies financial position is sound. But they may not accept wage reduction, when the company's financial position is in doldrums. Hence the management has to take decision judiciously. Further, certain incentives are linked to the profitability. Thus, whatever the influence of other factors may be, the organisation can not pay more than its ability to pay in the long run.

**c) Remuneration in Comparable Industries :**

Prevailing rates of remuneration in comparable industries constituted an important factor in determining wage rates. The organisation in long run, must pay at least equal to the prevailing rates for similar jobs in similar organisation. Further, the wage and salary rates for the similar jobs in the firms located in the same geographical region also influence the wage determination. The organisation has to pay wages equal to that paid for similar jobs in comparable industries in order to secure and retain the competent employees.

**d) Cost of Living :**

The cost of living is an other important factor that influences the quantum of wage or 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 the cost of living. Progressive employers take into consideration the cost of living for their employees and try to fix their wages as to ensure at least the same standard of living as before. Where the employers do not show awareness, labour unions come out with a demand of wage adjustment according to the cost of living index number.

In recent years, in advanced countries, "number of labour agreements have 'escalator' clauses, providing for automatic wage and salary increase as cost of living index raises". However in some of the Asian countries the "Dearness Allowance" is an allowance granted to the employees with a view to combination the sloughs of so arising prices.

**e) Labour Productivity :**

An interesting development in wage determination has been the productivity standard. This is based on the fact that productivity increase is also the result of employee satisfaction and contribution to the organisation. But wage, productivity linkage does not appear to be so easy since many problems crop up in respect of the concept and measurement of productivity. Although, the wages are not linked directly to the productivity, in an organisation, changes in productivity have their impact on remuneration. This criteria received consideration of wage

boards, not only, because it constituted a factor in the fixation of 'fair wage' but also because it is directly related to such question as desirability of extending the system of 'payment by result'.

**f) Bargaining Power :**

Wage also depend to a considerable extent on the relative bargaining power of labour/trade unions and employers. The stronger and more powerful trade unions bargain the higher wages. Their bargaining power is often measured in terms of their membership, the financial strength and the nature of leadership.

M. Ross, concluded that 'real hourly earnings have advanced more sharply in highly organised collective bargaining strategies, political tactics and by organising strikes etc. Trade unions influence may be on the grounds that wages in comparable industries, firm's financial position, rising living cost, government regulations etc. Where the wage level is below that of other comparable industries.

**g) Importance of the Industry in the Economy :**

Wages are also influenced by the importance of the industry in the economy/country. For e.g. if we take the industries like Petroleum, Engineering, Ports and Docks, the wages are high because the profits are high and the bargaining power of unions is also high. The wages of the workers in these industries will be high when compared to the wages of workers in industries like jute, cotton textiles, and sugar etc.

**h) Government Role :**

Since the bargaining power of the workers has not ensured fair wages in all industries, the government has to interfere in regulating wage rates to guarantee minimum wage rates in order to cover the essentials in modern civilised society. The role of the government in this regard can be categorised into two; one is legislative and other in non-legislative.

Enactment of different legislations like Minimum Wages Act 1948, Payment of Wages Act 1936, Equal Remuneration Act 1976, and the Payment of Bonus Act 1965, are intended to protect the wages of employees.

The overall objectives of the above said legislations are well summarised as follows :

- i) to abolish malpractices and abuses in wage payment,
- ii) to set minimum wages for workers, whose bargaining position is weak because they are either unorganised or inefficiently organised.

The non-legislative body of the government in influencing wage rates is in the form of wage boards, pay commissions, recommendations of committees, and adjudication.

**i) Good will of the Organisation :**

A few organisations want to establish themselves as good employer in the society. For building such reputation, they fix higher wages for their workers. For E.g. ONGC, NTPC, BHEL, Ingresal-Rand, Wedia India Ltd., TELCO etc.

**j) Job Requirements :**

If a job requires higher skills, effort, greater responsibility and risk, the job holder will naturally get higher wages. Generally, the more difficult the job paid higher the wages.

**k) Socio-Psychological Factors :**

These factors determine to a great extent the importance of the job or the individual to the organisation. They also determine how hard an individual will work for the compensation received or what pressure he will exert to get his compensation increased. Whether the wage is adequate and equitable, depends not only upon the amount that is paid but also the perceptions and the views of the recipients of the wage.

**5.7 SYSTEMS OF WAGE DETERMINATION :**

The following are the systems of wage determination evolved for effectiveness of organisations:

- i) The wages are determined based on clear definition of values / worth of all jobs in relation to each other within the company.
- ii) Ensure fair and suitable earnings to the employees.
- iii) Optimise the earning capacity of the employees.
- iv) Provide employees, a share in the gains of productivity and follow the principles of internal and external consistency for wage determination.

**5.8 COMPENSATION/WAGE DETERMINANT METHODS :**

There are two widely practised methods for determining the compensation (i) Salary/wage surveys, and (ii) Job evaluation.

**(i) Wage/Salary Surveys :**

Wage/salary surveys are quick and less expensive way to determine compensation. It could be used to conduct a survey of what is being paid in similar industries for similar positions. This could be done two levels - organisational and professional consultant levels. As far as organisational level is concerned, the HRM department itself can undertake a study to find out comparable compensation packages in similar industries.

**(ii) Job Evaluation :**

Job evaluation is a technique to establish the relationship between contribution of an employee and compensation for this contribution. Although in reality it is very difficult to get a precise value of the contribution of an employee because of the large number of factors involved in the performance of a job. Job evaluation is the most suitable mechanism to the wage determination.

**5.9. SUMMARY :**

Wage determination is one of the important area of compensation management. A large number of factors are influencing in wage determination. Significant among them are, capacity of the employer to pay, i.e., the wages payable must be within the firms ability to pay. The remuneration in comparable industries shall also be considered because if we pay wages

unilaterally the wages may be either too low or too high, both are problems. Like the prices of a commodity is determined by the demand and supply of the commodity, here the wages are also determined by the demand and supply of labour. Government role in wage determination is in two ways, legislatively and non-legislatively. Whatever may be the factors which influences the wage determination, finally, the wages would be settled by agreements between the management and unions. So collective bargaining is one of the most important in wage determination. The other significant factors that influences wage determination process are; cost of living, labour productivity, importance of industry in the economy, good will of the organisation, job requirements and socio-psychological factors.

#### 5.10 KEYWORDS :

**Wage Determination :** Wage determination is fixing the wage/salary rates with a systematic procedure. **Capacity to pay :** Management fixing the wages based on organisation's ability or capacity.

**Collective Bargaining :** The negotiations between employees and employer is known as collective bargaining.

**Cost of Living :** Cost of living means expenditures of normal employee in the modern society. That can be measured with consumer price index.

#### 5.11 SELF ASSESSMENT QUESTIONS :

1. Define wage determination, explain its principles.
2. What are principles of wage determination ? Discuss its considerations.
3. Various factors influence the wage determination, briefly discuss some important factors
4. In the globalisation, every organisation shall follows the factors to fix their organisation's compensation/wage rates, discuss.

#### 5.12 FURTHER READING :

- Belcher, David. W. : Wage and salary Administration, Prentice-Hall International, London (second edition).
- Dwivedi, R.S. : Managing Human Resources : Personnel Management in Indian Enterprises, Galgotia Publishing Company, New Delhi, 2002.
- Sarma A.M. : Understanding Wage Systems, Himalaya Publishing House; Mumbai, 2004.
- Saiyadain S. Mirza : Human Resources Management, Tata McGraw-Hill Publishing Company Ltd., New Delhi, 2003.

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## LESSON - 6

# JOB EVALUATION

### OBJECTIVES :

After reading this lesson, the student is able to:

- ✓ Know the concept of Job Evaluation
- ✓ Visualise the role of Job Evaluation in Wage Determination
- ✓ Study the Characteristics, objectives and steps in Job Evaluation
- ✓ Understand the Techniques/methods of Job Evaluation.

### STRUCTURE :

- 6.1 Introduction
- 6.2 Meaning and Concept of Job Evaluation
- 6.3 Role of Job Evaluation in Wage Determination
- 6.4 Characteristics of Job Evaluation
- 6.5 Objectives of Job Evaluation
- 6.6 Steps in Job Evaluation
- 6.7 Techniques / Methods of Job Evaluation
- 6.8 Establishing the Pay Structure
- 6.9 Summary
- 6.10 Keywords
- 6.11 Self Assessment Questions
- 6.12. Further Reading

### 6.1 INTRODUCTION :

Job evaluation is a systematic method of appraising the value of each job in relation to other jobs in the organisation. It provides a consistent procedure that sets up and maintains a hierarchy of jobs, attaching to each job a pay rate commensurate with status in the hierarchy

Job evaluation is a method used to describe, analyse, compare and evaluate jobs within a unit, or an industry on the basis of the work content and the job requirements in order to place them under particular wage or salary grades.

## 6.2 MEANING AND CONCEPT OF JOB EVALUATION :

Job evaluation as a part of compensation system relates to the systematic procedure for creating a wage structure with a view to determining a proper value relationship between several production or clerical jobs in an enterprise to attract, motivate and maintain effective human resources by adequately compensating them for work performed.

The International Labour organisation (ILO) defined job evaluation as an "attempt to determine and compare 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".

Windell L.French defined 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".

British Institute of Management (1970) defined job evaluation as "the process of analysing and assessing the content of jobs, in order to place them in an acceptable rank order which can be used as a basis for a remuneration system. Job evaluation, therefore, is simply a techniques designed to assist in the development of new pay structures by defining relatives between jobs on a consistent and systematic basis".

Thus job evaluation may be defined as a process of determining the relative worth of jobs, ranking and grading them by comparing the duties, responsibilities, requirements like skills, knowledge of a job with other jobs with a view to fix compensation payable to the concerned job holder.

## 6.3 ROLE OF JOB EVALUATION IN WAGE DETERMINATION :

Job evaluation is the cornerstone of a formal wage and salary and compensation administration. Specifically the job evaluation process plays a key role in compensation management in the following ways :

1. It is the most effective means of determining internal pay relationships.
2. It can be used as an instrument for effecting the company's basic pay policies.
3. Equitable base-pay relationships set by job evaluation serve as a foundation for incentive of bonus plans or merit increase programmes.
4. Job evaluation provides a reasonable basis for personnel moves like transfer, promotion, or demotion.
5. Useful controls over wage and salary costs can be greatly aided by job evaluation.
6. Job evaluation provides a foundation for gearing company pay scales to the wages paid by competing companies.
7. Job evaluation assists management in meeting day-to-day problems. This in turn contributes to the reduction of employee grievances, improves employee productivity through higher morale, and helps to reduce turnover.

**6.4 CHARACTERISTICS OF JOB EVALUATION :**

1. Job evaluation is a method with a systematic approach
2. It is an attempt to determine the requirements of the work involved for any incumbent.
3. It is a process by which jobs in an organisation are appraised.
4. It is a process of analysing and describing positions, grouping them, and determining their relative value by comparing the duties of different positions in terms of their different responsibilities and other requirements.
5. It is a system to deal exclusively with assessment of the job and not concerned with employees assigned to the job.

**6.4.1 Purpose of Job Evaluation :**

1. Job evaluation can provide a more workable internal wage structure.
2. Job evaluation fixes wage rates for new or changed jobs
3. Job evaluation reduce the grievances over wage and salary rates.
4. Job evaluation can provide incentive values to employees
5. Job evaluation provide the facts for wage negotiations
6. Provide the facts on job relationships for use in selection, training, transfers and promotions.

**6.5 OBJECTIVES AND PRINCIPLES OF JOB EVALUATION :**

The following objectives are derived from the analysis of the above mentioned definitions.

- i) to gather data and information relating to job description, job specification and employee specification of various jobs in an organisation.
- ii) to compare the duties responsibilities and demands of a job with that of other jobs.
- iii) to determine the hierarchy and place of various jobs in an organisation.
- iv) to determine the ranks or grades of various jobs.
- v) to ensure fair and equitable wage on the basis of relative worth or value of jobs. In other words equal wages are fixed to the jobs of equal worth or value.
- vi) To minimise wage discrimination based on sex, age, caste, religion, region etc.

**6.5.1 PRINCIPLES OF JOB EVALUATION :**

Job evaluation programme should be implemented carefully. The following principles help in successful implementation of the programme are :

- i) Rate the job but not employee. Rate the elements on the basis of job demands.
- ii) The elements selected for rating should be easily understood



- iii) The elements should be defined clearly and properly selected.
- iv) Employees concerned and the supervisors should be educated and convinced about the programme.
- v) Supervisors should be encouraged to participating in rating the jobs.
- vi) Secure employee co-operation by encouraging them to participate in the rating programme.
- vii) Discuss with the supervisors and employees about rating but not about assigning money values to the points.
- viii) Do not establish too many occupational wages.

#### 6.6. PROCEDURE/STEPS IN JOB EVALUATION :

National Institute of Personnel Management has evolved the following steps for evaluating jobs.

##### i) Analyse and prepare job description :

Job evaluation is the outcome of job analysis. Job analysis provides information necessary for appraising jobs like skills, knowledge, abilities and aptitudes.

##### ii) Select and prepare job evaluation plan :

Job should be divided into detailed tasks and positions. It also includes selection factors, elements needed for the performance of the jobs, determining the money value of each factor and element and writing instructions for evaluation.

##### iii) Evaluation and Classification of jobs :

Classify the jobs in a sequential order based on their significance and contribution to the organisation. This includes assigning money values to each class.

##### iv) Install the Job evaluation programme :

Educate the employees, with their confidence and then put the programme into operation.

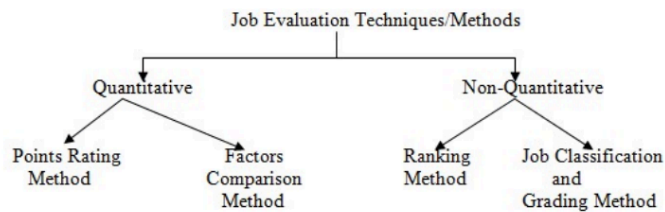
##### v) Maintain the job evaluation programme :

This step involves updating the job evaluation programme, bring modifications based on the changes in the conditions and situations. Make sure from time to time that programme runs smoothly and perfectly.

#### 6.7 TECHNIQUES/METHODS OF JOB EVALUATION :

Jobs are evaluated on the basis of various techniques. These techniques are grouped into two classes, viz., 'quantitative and non-quantitative' techniques. Non-quantitative techniques include ranking, (simple ranking and paired comparison ranking), job classification and grading methods. Quantitative techniques include points rating and factor comparison methods (see fig. 6.1).

Figure 6.1



### 6.7.1 NON-QUANTITATIVE TECHNIQUES OR METHODS :

Conventionally, non-quantitative, simple and crude techniques were developed. They are ranking and job classification methods.

#### (i) Ranking Method :

This is a simplest method of job evaluation, in this method four stages or steps are there.

**(a) Simple Ranking :** This is the simplest and administratively the most easiest technique. The evaluator compares one job with other jobs based on duties, responsibilities and demands made by the jobs on the incumbent and the degree of importance of the job to the organisation and ranks all the jobs from the most important to the least important. The evaluator has to appraise and rank the jobs but not the job incumbents.

**(b) Ranking the Key jobs :** Ranking all the jobs at a stretch under simple ranking methods is difficult. The evaluator, in order to minimise this problem, has to identify the key or representative jobs at the first stage, rank the key jobs at the second stage, identify and rank all other jobs at the third stage.

**(c) Paired Comparison :** In this method the evaluator ranks each job in turn against all other jobs to be appraised, so that a series of paired rankings is produced. This method is more comprehensive, logical and reliable compared to the simple ranking method.

**(d) Single Factor Ranking Method :** 'Goldenberg' has suggested a single factor ranking scheme. The single factor considered is the discretionary contents present in each job related to other jobs. The single most important task to be performed in a job is identified and compared with the single most important task to be performed in other jobs. Thus, pure ranking does not cover these refinements.

The jobs are to be priced after they are ranked. In other words, money value should be assigned to each job. Key jobs with known monetary values will be used as the basis to determine the money value of jobs. Generally, there is agreement about the rates of key jobs.

**Advantages :**

(i) This method is the simplest, quickest and least costly from the viewpoint of time and money, (ii) This method is most appropriate in small organisations, (iii) It is also appropriate for ranking the top managerial personnel in large organisations and (iv) It is useful as a first and basic step of job evaluation.

**Disadvantages :**

(i) This method provides no yardstick for measuring the relative worth of one job against the other, (ii) Job requirements, job specifications and employee specifications are not considered in evaluation, (iii) It does not indicate the extent or degree to which one job is worthy than the other and (iv) It is not a comprehensive and systematic technique.

**(ii) Job Classification and Grading Method :**

Class and grade are used differently in this method. A grade is a group of different jobs of similar difficulty or requiring similar knowledge and skill to perform. A class is a subdivision of a given occupation. For example, Class I Clerk, Class II Clerk, Class III Clerk, Class IV Clerk and Class V Clerk. The jobs with in a class have fairly similar tasks to be performed whilst the jobs with in a grade may be different as far as tasks are concerned. However, classes and grades are designed for the similar jobs and thus receive similar pay.

Under this method, jobs at different levels in the organisational hierarchy are divided into various grades with a clear cut definition of each grade. Grades are formulated on the basis of nature of tasks, requirements of skill, knowledge, responsibilities and authority of various jobs. There are several steps in the mechanism of this method. The important among them are:

- (i) Determine the shape and size of organisational structure, i.e. tall or flat organisation, geographical or functional organisation etc.
- (ii) Preparation of job descriptions,
- (iii) Preparation of grade descriptions based on various components.
- (iv) Establishment of a number of job grades and division of the organisation into various grades like Grade-I, Grade-II . . .Grade-VI.
- (v) Discussion and negotiation with trade union representatives regarding the number of grades, grade descriptions.
- (vi) Selection of key jobs and grading them.
- (vii) Grading the entire jobs.
- (viii) Classifying the jobs of each grade and
- (ix) Assigning the money value to the key grades first and then to all other grades.

**Advantages :**

(i) It is simple and easy to understand and operate, (ii) It provides an opportunity for a systematic organisation structure, (iii) Pay grades are better and appropriate for comparison with those of other organisations. (iv) It is more elaborate than ranking method.

**Limitations :**

(i) It sometimes seems to be arbitrary though it takes the view of the representation of the trade unions. (ii) Writing grade descriptions is not easy in this method. However, classification and gradation represent a link in the historical development of job evaluation between ranking and points system.

**6.7.2 QUANTITATIVE TECHNIQUES OR METHODS :**

These are two methods under conventional quantitative techniques, viz., points rating and factor comparison system.

**(i) Points Rating Method :**

This method was introduced by Merrill R. Lott . This was one of the earliest approaches for evaluating jobs based on quantitative values. This method is analytical in the sense that jobs are broken into components for purposes of comparison. This method is quantitative as each component of the job is assigned a numerical value. Thus, characteristics of factors considered to have a bearing on all jobs in the programme like skill, knowledge, responsibility, working conditions etc., are selected under this method. Each factor is divided into degrees or levels and point value is assigned to each level. The total of point values assigned to each factor given the total point values for each job which can be compared.

This method of job evaluation should be developed systematically and applied methodically in order to avoid the anomalies. The important steps in the process of developing this technique are:

- (i) Constituting a representative committee of members from various departments for job evaluation.
- (ii) Selecting a sample of jobs and preparing job descriptions, job specifications and employee specifications.
- (iii) Selecting and defining those factors which are related to all jobs and are considered to be most critical in determining the relative degrees of difficulty and responsibility between jobs.
  - (a) **Skill:** Education, Training, judgement, analysis, mental complexity, mental dexterity, adaptability etc.
  - (b) **Effort:** Physical demand, visual effort, concentration, mental effort, alertness etc.
  - (c) **Responsibility:** For preventing monetary loss, machines, materials, safety, policy etc.
  - (d) **Job Conditions:** Working conditions, hazards etc.
- (iv) Determining the weight of each factor according to its relative importance.
- (v) Defining each factor, specifying the scope and elements of each factor.
- (vi) Dividing each factor into levels and defining each level.
- (vii) Determining relative value of each level within factors. Factors can be divided into point values by arithmetic or geometric progression.

- (viii) **Testing the mechanism:** Get the total points for a few sample jobs and compare them with the results obtained through other methods. Proceed further, if the system produces acceptable results.
- (ix) Appraise all the jobs and arrive at a composite numerical value for each job.
- (x) Price the points in order to arrive at the wage structure with the help of organisational hierarchy of jobs and salary policy.

**Advantages :**

- (i) Almost the same pay scale can be arrived at for the same jobs because agreement among rates on the same is very close.
- (ii) Definitions are written in applicable terms to the jobs.
- (iii) Assigning monetary values is very easy.
- (iv) Prejudice, bias and error of human judgement are minimised in this technique.
- (v) Once the score is assigned to a particular job, it is long standing.
- (vi) Wage differentials would be systematic and according to the content of the job under this method.

**Disadvantages :**

- (i) It is difficult to determine factor levels and assign point values.
- (ii) It would be somewhat difficult to explain the mechanism and operation of this method to employees, supervisors and trade union leaders.
- (iii) Operation of this method involves heavy expenditure, spending of much time and clerical work.

**(ii) The Point Factor or Factor Comparison Method**

This method is based both on the principles of points rating and principle of ranking. This method is analytical as jobs are broken into sub-factors and components. Under this method, first the components and sub-factors are ranked under various factors headings. The next step is assigning the monetary values to the components or sub-factors of each job. Thus, each job is ranked a number of times (i.e., number of compensable components of sub-factors).

The mechanism or modus operandi of this method involves the following steps :

(i) Developing job descriptions, job specifications of job requirements covering physical requirements covering physical requirements, skill requirements, training and experience, responsibility and authority, working conditions etc.

(ii) **Selecting a number of key jobs:** This step is more critical and useful from the point of final evaluation as the other jobs are assigned monetary values based on the fixed wage rates arrived for the key jobs on the basis of negotiations. A key job must be clearly divisible into sub-factors and components. This step also involves dividing the job into sub-factors and components.

(iii) **Ranking key jobs:** The sub-factors of each key job must be given relative ranks based on their individual contribution to the total job.

(iv) The fourth step involves valuing the sub-factors of each of the key jobs. This step is known as factor evaluation. Money worth of each sub-factor of the key jobs is ascertained in order to know the royal money value (or salary) of each of the key jobs.

(v) The fifth step integrating the monetary value of sub-factors arrived through factor evaluation with those of ranking of factors. It is to find out whether the difference among factors as per the ranking and factor evaluation is one and the same or not.

(vi) The sixth step is comparing all the jobs (factor by factor) of the same grade or level with related key job and establishing monetary value to the sub-factor of various jobs based on the monetary value of sub-factors of key jobs. There are certain advantages to this technique over others.

Point score or monetary values cannot be manipulated very easily.

(vi) Assignment of point score of money value is consistent and accurate.

**Advantages :**

- (i) It is analytical and quantitative method.
- (ii) This method is a combination of two techniques, i.e., ranking and factor comparison.
- (iii) Since the modus operandi of this system is relatively easy to understand, it can be operated and explained to supervisors, employees and trade union leaders.
- (iv) This technique is more reliable and valid compared to other techniques as each is compared with all other jobs from respects, i.e., factor rank order comparison.
- (v) This technique assigns money value more or less fairly and objectively as there is cross checking of money value with rank order.

**Disadvantages**

- (i) It is costly and difficult to operate compared to the conventional non-quantitative techniques.
- (ii) Factors evaluation in this method is not that much objective as that of point rating technique.
- (iii) This technique does not consider all the sub-factors as the operation of the system.

**6.7.3 Advantages of job Evaluation :**

Job evaluation has certain advantages over techniques of pay fixation. They are:

- (i) It is **logical and to a certain extent an objective method of ranking** and grading the **jobs**.
- (ii) It helps **to** fit the newly created jobs in the existing structure.
- (iii) Employee grievances, doubts and complaints would be at the lower ebb as it is a systematic and objective method of wage fixation.

- (iv) It eliminates some undesirable factors like capacities of employee and employers, fluctuations in market rates etc.
- (v) It satisfies the principles of fair wage, wage equity, uniformity in wages etc.
- (vi) It helps to redesign the jobs for minimising wide wage differentials.
- (vii) It ensures employee satisfaction about wage level and wage equity.
- (viii) It also helps to redesign the jobs by reallocating the easy and difficult tasks equally among various jobs.

#### **6.8 ESTABLISHING PAY STRUCTURE :**

Once the job evaluation is complete, its data become the nuclear for the development of the organisations pay structure. This means establishing pay rates or ranges that are compatible with the ranks, classifications, or points arrived through job evaluation.

##### **Wage Surveys :**

Most organisations use surveys to gather factual information on pay practices within specific communities and among firms in their industry. This information is used for comparison purposes. It can tell management if the organisations wages are in line with those of other employees and in cases where there is a short supply of individuals to fill certain positions, may be used to actually set wage levels.

##### **Wage Curves :**

When management arrives at point totals from job evaluation and obtains survey data on what comparable organisations are paying for similar jobs, then a wage curve can be fitted to the data.

#### **6.8.1 PROBLEMS OF JOB EVALUATION**

Though **there are** certain advantages **of job evaluation**, it suffers from some problems. They are:

- (i) Job evaluations is not exactly scientific.
- (ii) Modus operandi of most of the techniques is difficult to understand even to the supervisors.
- (iii) The factor taken by the programme are not exhaustive.
- (iv) There may be wide fluctuations in compensable factor in view of changes in technology, values and aspirations of employers etc.
- (v) Employees, trade union leaders, management and the programme operators may perceive differently in selecting the compensable factors, in giving weightages or degrees etc.
- (vi) The results of job evaluation may not exactly coincide with social evaluations which in turn result in employee dissatisfaction.
- (vii) Job evaluation is only one among several factors in determining the wage level. Sometimes, other factors like government policy may dominate the job evaluation.
- (viii) Job of equal contact or grade may not attract the workers equally.



- (ix) Job evaluation programme once structured may not be useful for the next time. Despite these limitations or problems, job evaluations is the most appropriate technique for fixing and revising the wages as it is a systematic and objective method of wage fixation.

### 6.8.2 MERIT RATING :

James Lundy defines merit ratings as “the process of evaluating an employee’s performance on the job” Merit rating is concerned with employee appraisal. It is a systematic and impartial procedure for determining the excellence with which an individual is performing a job.

Kimball and Kimball define merit rating as “the evaluation of any given worker as to his fitness for given terms of assigned factors by which he may be intelligently appraised.”

#### Objectives of Merit Rating :

- (i) to furnish a periodic record of the relative value of each employee as judged by his superiors.
- (ii) to determine and justify wage differentials existing for the same job.
- (iii) to provide more accurate information for the purpose of promotions, transfers and demotions.
- (iv) to provide a means of evaluating the selection and training techniques.
- (vi) to ensure congenial superior-subordinate relationship.

Job evaluation and merit rating are not one and the same. These two are different. The differences between job evaluation and merit rating are presented in exhibit 6.1.

#### *Exhibit 6.1*

#### DIFFERENCES BETWEEN JOB EVALUATION AND MERIT RATING

<i>Job Evaluation</i>	<i>Merit Rating</i>
1. Job evaluation is determining the relative worth of jobs,	Merit rating is appraising/evaluating the employee against the job description.
2. Job evaluation is the basis for designing a satisfactory wage structure.	Merit rating is used for determining promotions/transfers.
3. Job evaluation explains the relative wage rates of the jobs,	Merit rating provides guidelines to employees for better performance/promotions.

### 6.9. SUMMARY :

Job evaluation is a systematic attempt which provides a basis of comparing jobs and determines the relevant worth of different jobs in an organisation. It has two basic objectives: (1) to compare jobs and determine their level within each occupational group; and (2) to compare jobs between occupational groups. Achieving the first objectives is important for promotions, career planning and personnel development. Achieving the second objective is of interest because of wage comparisons. Job evaluation attempts to achieve both objectives by determining the rank order of all the jobs. It is thus a systematic and orderly process of determining the value of each job in relation to other jobs in the organisation. It is the job that is

be rated and not the man. It is an important tool of personnel administration and has an important role to play in wage decisions. It provides a systematic framework which may serve as the basis for wage determination, but does not entirely solve the problem.

#### 6.10 KEY WORDS :

**Job Analysis :** It is the process of a study and collection of information relating to the operations and responsibilities of a specific job.

**Job Evaluation :** It is the process of determining relative worth of jobs.

#### 6.11 SELF ASSESSMENT QUESTIONS :

1. What is job evaluation? Explain the objective of job evaluation. How do you prepare the ground for evaluating jobs?
2. What are the conventional and non-conventional techniques of job evaluation? What type of technique do you adopt to evaluate the jobs of an Engineer (Maintenance), Engineer (Operations), Engineer (Marketing), and Chief Engineer in a large Machine Tools Industry?
3. What are the quantitative and non-quantitative techniques of job evaluation? Which type of techniques do you adopt to evaluate jobs of an officer (AgOfficer (Small Scale Industry), Economic Officer and General Officer in a large Commercial Bank.
4. "Job evaluation does not usually price jobs" Discuss.
5. Explain the advantages and limitations of job evaluation as a basis for fixing and revising wages and salaries.
6. Explain different techniques of job evaluation. What are the advantages and disadvantages of each technique.

#### 6.12 FURTHER READING :

- Belcher, David.W : Wage and Salary Administration, Prentice-Hall International, London, 1965.
- Chatterjee, N.N. : Management of Personnel in Indian Enterprises, Allied Book Agency, Calcutta, 1978.
- Dwivedi, R.S : Managing Human Resources / Personnel Management in Indian Enterprises, Galgotia Publishing Company, New Delhi, 2003.
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## LESSON - 7

# WAGE DIFFERENTIALS

### OBJECTIVES :

- After reading this lesson, the student is able to :
- Know why the Wage Differentials in an Industry.
  - Study various factors influence the Wage Differentials.
  - Study the different types of Wage Differentials.
  - Understand Recommendations or Opinions of various Committees in India.

### STRUCTURE :

- 7.1 Introduction
- 7.2 Importance of Wage Differentials
- 7.3 Significance of Wage Differentials
- 7.4 Factors causing Wage Differentials
- 7.5 Inevitability of Wage Differentials
- 7.6 Types of Wage Differentials
- 7.7 Desirability of Wage Differentials
- 7.8 Wage Differentials in India
- 7.9 Summary
- 7.10 Keywords
- 7.11 Self Assessment Questions
- 7.12 Further Reading.

### 7.1 INTRODUCTION :

Payment of wages differ in different occupations, localities and grades. One therefore comes across such terms as occupational wage differentials, inter-industry, inter-firm, inter-area or geographical differentials and personal differentials.

The causes of difference in wages in different occupations, localities and grades of employment needed to be analysed. Wages everywhere tend to approximate to the marginal productivity of labour which is different in different occupations and grades. It varies with the degree of scarcity of labour in relation to the demand for it, or ultimately in relation to the demand for the products produced by labour.

The wage differentials that can be attributed to imperfections in the employment markets, such as the limited knowledge of workers in regard to alternative job opportunities available elsewhere, obstacles to geographical, occupational or inter-firm mobility of workers; or time lags in the adjustment of resources distribution and changes in the scope and structure of economic activities. Examples of such wage differential are inter industry, inter-firm, and geographical wage differentials.

The wage differentials which originate due to social values, and prejudices which are deeper and more persistent than economic factors. Wage differentials by age, sex, status or ethnic origin. The occupational wage differentials, which would exist even if employment markets were perfect and social prejudices, were absent.

## 7.2 IMPORTANCE OF WAGE DIFFERENTIALS :

The importance of proper wage differentials has been stressed by 'Harry Ober' in his book "Occupational wage differentials in Industry".

The study of wage differentials is important both from academic as well as practical point of view. Wage differentials are a necessary concomitant of the wage system in the modern industrial organisation and have been recognised as such in all countries, irrespective of their political and economic background. Wage differentials are directly related to the allocation of the economic resources of a country - including manpower, growth of national income, and the pace of economic development. Economic and social welfare activity depends, in a large measure on such wage differentials.

## 7.3 SIGNIFICANCE OF WAGE DIFFERENTIALS :

Wage differentials have a great economic and social significance, for they are directly related to the allocation of the economic resources of a country.

Wage differentials reflect differences in physical and mental abilities of workers, in productivity and efficiency of management, and consumer preferences. By providing an important incentive for labour mobility, they bring about a reallocation of the labour force under changing circumstances. Wage differentials act as an incentive to work hard, to develop requisite skills and improve productivity. Different levels of wages exist mainly to fulfil the objectives of efficiency and justice in wage payment.

The wage differentials must be based on certain sound principles and rationalism, namely:

- a) Wages should be commensurate with work.
- b) Equal wages should be paid for equal work.
- c) Differentials should be such as to provide a sufficient incentive for acquiring skill and improving productivity; and
- d) Wage differentials should be sufficient to attract workers to jobs in industries in which there is a shortage of labour.

## 7.4 FACTORS CAUSING WAGE DIFFERENTIALS :

### 7.4.1. Considerations to Wage Differentials:

The Committee on Fair Wages recommended that wage differentials should be established on the basis of certain considerations.

- i) The degree of skill.
- ii) The strain of work.
- iii) The experience involved.
- iv) The training required.
- v) The responsibility undertaken.
- vi) The mental and physical requirements.
- vii) The disagreeableness of the task.

- viii) The hazard attendant on the work.
- ix) The fatigue involved.

According to the Planning Commission, wage differentials for various jobs should be maintained at the minimum levels justified by the criteria which had been suggested by the Fair Wages Committee.

#### 7.4.2 Factors influence the Wage Differentials :

Robert E. Sibson has presented a useful list of factors to explain wage diversity:

- 1) The wide difference in the earning of employees.
- 2) The personnel policy of employees.
- 3) Imperfections of the labour market.
- 4) Job security.
- 5) Regularity of employment.
- 6) The relative bargaining strength of individual employers and local unions.
- 7) The value of labour to an individual employer.
- 8) The proposition of total costs represented by labour costs.
- 9) The market conditions of the employers product.
- 10) Variation in individual performance.
- 11) The growing importance of fringe benefits in employee compensation.
- 12) Job disutility's connected with the work and with specific jobs and hazards inherent in the occupation.

#### Wage differentials may be due to any one or combination of factors such as :

- a) Degree of skill and training period needed for discharging and assigned job.
- b) State and nature of the work to be performed.
- c) Mental and physical exertions and risk in doing job.
- d) Disagreeableness or unpleasantness of the assigned task.
- e) Differences in the efficiency of labour, which may be due to in born quality, education and conditions of work.
- f) Demand and supply of particular type of labour service.
- g) Existence of non-competing groups due to difficulties in the way of labour mobility from low paid to high paid employment.
- h) Differences in agreeableness or social esteem of employment.

#### 7.5 INEVITABILITY OF WAGE DIFFERENTIALS :

The question of wage differentials has a profound economic and social significance as it is directly related to the allocation of economic resources of a country including manpower, growth of national dividend and the pace of economic development. According to an L.O. Publication (Wage - General Report, P. 82), the attainment of maximum economic and social welfare depends, in a large part on establishing such wage differentials as will :

- (a) Cause labour to be allocated among different occupations, industries and geographical areas in the economy in such a manner as to maximise the national products

- (b) Enable full employment of the resources of the economy to be attained and
- (c) Facilitate the most desirable rate of economic progress. Efforts towards the achievement of these aims are universally desirable irrespective of the type of the economy.

#### 7.6 TYPES OF WAGE DIFFERENTIALS :

The common types of prevalent wage differentials are occupational or skill differentials, inter-plant wage differentials inter-industry wage differentials, regional or geographic wage differentials and differentials based on the age or sex.

##### 7.6.1 Occupational Wage Differentials:

These indicate that 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. The basic functions of such differentials are :

- a) to include workers of undertake "more demanding more agreeable or dangerous" jobs, or those involving a great chance of unemployment or wide uncertainty of earnings.
- b) to provide an incentive to young persons to incur the cost of training and education and encourage workers to develop skills in anticipation of higher earnings in future.
- c) to perform a social function by way of determining the social status of workers.

In countries adopting a course of planned economic development, skill differentials play an important role in manpower and employment programmes, for they considerably help in bringing about an adequate supply of labour with skills corresponding to the requirements of product plans.

##### Inter - Occupational Differentials :

Inter-occupational differentials may comprise skilled, unskilled and manual wage differentials; non-manual and manual (white and blue collar); and general skill differentials occupational wage differentials generally follow the changes in the relative supplied of labour to various occupations.

##### 7.6.2. Inter-firm differentials :

Inter-firm differentials reflect the relative wage levels of workers in different plants in the same area and occupation. The main cause of inter-firm wage differentials are :

- a) Differences in the quality of labour employed by different firms;
- b) Imperfections in the labour market ; and
- c) Differences in the efficiency of equipment, supervision and other Non - labour factors.

Differences in technological advance, managerial efficiency, financial capacity, age and size of the firm, relative advantages and disadvantages of supply of raw materials, power and availability of transport facilities these also account for considerable disparities in inter firm wage rates. Lack of co-ordination among adjudication authorities, too, are responsible for such anomalies.

### 7.6.3. Inter - area or Regional Differentials :

Inter area or regional wage differentials arise when workers in the same industry and the same occupational group, but living in different geographical areas, are paid different wages. Regional wage differentials may be conceived in two senses. In the first sense, they are nearly a part of inter-industry differentials in a particular region. "The industry mix varies from one area to another, and for this reason alone, the general average of wages would be expected to vary. In the second sense, they may represent real geographical differentials, resulting in the payment of different rates for the same type of work. In both cases, regional differentials affect the supply of manpower for various plants in different regions.

Such differentials are the result of living and working conditions, such as unsatisfactory or irksome climate, isolation, sub-standard housing, disparities in the cost of living and the availability of manpower. In some cases, regional differentials are also used to encourage planned mobility of labour.

### 7.6.4 Inter - industry Differentials :

Inter - industry wage differentials arise when workers in the same occupation and the same area but in different industries are paid different wages. Inter - industry differentials are skill differentials. The industries paying higher wages have mostly been industries with a large number of skilled workers.

While those paying less have been industries with a large proportion of unskilled and semi skilled workers. Other factors influencing inter - industry differentials are the extent of unionisation, the structure of product markets, the ability to pay, labour - capital ratio and the stage of development of an industry.

### 7.6.5. Sector Differentials :

Wage differentials between agricultural sector and industrial sector is generally a characteristic of developing economies like India. The main reason for such sectoral differences in wage rates are the nature of the workers groups whether they are an organised group or unorganised group, and the level of economic development of sector.

### 7.6.6 Sex or Gender Differentials :

Personal wage differentials arise because of differences in the personal characteristics (age or sex) of worker who work in the same plant and the same occupation. "Equal pay for equal work" has been recommended by the I.C.O. convention (No. 100), as also by Industrial courts, labour tribunals, the minimum wages committee, and fair wages committee. But in practice this principle has not been fully implemented because in occupation which involve strenuous muscular work, women workers, if employed are paid less than men employees, less mobility among them, their lower subsistence and their weak constitution are other reasons which bring them lower wages than their male counterparts receive.

To give effect of article 39 of India constitution, the Government of India passed the Equal Remuneration Act, 1976. The act provides for the payment of equal remuneration for men and women workers and for the prevention of discrimination on the ground of sex against women in the matter of employment and for other incidental matters connected herewith. It also seeks to provide for increasing opportunities for women in the specified employments.



### 7.7 DESIRABILITY OF WAGE DIFFERENTIALS :

Wage differentials perform a very important and useful economic function in that "they provide an important incentive for labour - mobility and bring about a reallocation of labour force under changed conditions, however imperfect the market mechanism may be". In a communist society there is a forcible direction of labour in accordance with the needs of the society but in a capitalist society the same objective is achieved on a voluntary basis through the instrumentality of wage differentials. In a planned economy where wage cannot and should not be determined by the market forces of demand and supply, wage differentials have an important role to play in the regulation of wages and development of a national wages policy. An under developed or a developing economy requires the development of new skills and creation of new occupations. Shortage of workers skilled as well as unskilled in the basic and key industries and in backward and underdeveloped regions may create serious bottlenecks that might impair the efficiency of planning and check the growth of the economy. The maintenance of proper wage differentials therefore, becomes an essential aspect of the national wage policy.

Further, wage differentials are desirable within certain limitations to provide a strong incentive to the low paid workers to work hard and produce more with a view to enhance their earnings. This is the specific advantage of piece rates. Though the workers may exert themselves for noneconomic motives as well, the economic motive - reward in terms of money is very important.

### 7.8 WAGE DIFFERENTIALS IN INDIA :

Due to the paucity of relevant data on wage differentials, it is not possible to analyse them in India; yet the main features of the Indian wage structure may be stated thus : "As a characteristic the unorganised labour market, personal differentials because of job selling, individual bargaining and wage discrimination have tended to persist in India, especially in the unorganised sector of the economy, and even in the organised and unorganised sections in industry.

The tendency appears to be towards the elimination of wage differentials because of government interference through the fixation of the minimum wages and of late, through the appointment of wage Boards and pressures from trade unions. Wage differentials by sex are more in India. Both economic and social reasons account for this phenomenon. Despite the fact the constitution of India enjoins upon the state to direct its policy towards securing "equal pay for equal work for men and women, awards of some Industrial Tribunals provide for "different wages for men and women workers, not on the ground that the wages of women workers support a smaller family than the cost of employing women workers is higher".

As regards inter-firm and inter-industry differentials in India, the former were quite important and frequent in the past, particularly in the jute industry. Of late, however, there has been a tendency towards the elimination of inter-firm differentials. The forces which tend to eliminate inter-firm differentials in the country operate in this case as well.

### 7.9 SUMMARY :

Wage differentials are inevitable in any type of economy. Whether capitalist or socialist. They are necessary both in the interests of efficiency and in the interests of justice. But wide disparities in wage levels and consequent exploitation of low wage earners belonging to a particular section of society are not to be justified under any circumstance. Wage differentials for various jobs should be maintained at the minimum levels justified by the criteria which had been suggested by the committee on fair wages. It is heartening to note

that over a period time, various influences such as trade unionism, government intervention by compulsory adjudication, minimum wage enactments and the process of standardisation of occupation, have helped to reduce the wage differentials in our country. There is no doubt that workers' expectations are such that the Indian society of the future will move towards much lower disparities in income than is at present keeping this in view, there is a general need to evolve a policy on wage differentials.

#### 7.10. KEY WORDS :

**Wage Differentials :** Wage are differentiate with several factors i.e. skill, occupation, industry, region.

**Inter - Industry Wage Differentials :** Inter - industry wage differentials arise when workers in the same occupation and the same area but in different industries are paid different wages.

**Regional Wage Differentials :** Inter - area or geographical wage differential arise when works in the same industry and in the same occupational group, but living in different geographical areas, are paid different wages.

#### 7.11. SELF ASSESSMENT QUESTIONS :

1. Wage differentials are essential, discuss.
2. Wage differentials have considerable economic and social significance for an industry discuss.
3. Briefly discuss the principals of wage differentials and write various factors causing wage differentials.
4. What do you mean by wage differentials ? Explain briefly the various types of wage differentials.
5. Indicate an account of disparity in wage rates in different industries in India.
6. Examine the principle of "Equal pay for Equal work" in the context of its implementation in India.

#### 7.12. FURTHER READING :

**Bhagoliwal T.N. :** Economics of Labour and Industrial Relations, Sahitya Bhavan Publications, Agra, 1968.

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## LESSON - 8

# METHODS OF WAGE FIXATION IN INDIA

### OBJECTIVES:

After reading this lesson, the student is able to:

- Know the Need for Wage Fixation.
- Study the Principles of Wage Fixation.
- Understand the Methods of Wage Fixation.
- Visualise the Wage Fixation Practices in Indian Industries.

### LESSON STRUCTURE :

- 8.1 Introduction**
- 8.2 Need for Wage Fixation**
- 8.3 Principles of Wage Fixation**
- 8.4 Norms and Procedures for the Fixation of Wages**
- 8.5 Institutions / Methods for Wage Fixation.**
  - 8.5.1 Statutory Fixation / Legislations
  - 8.5.2 Collective Bargaining
  - 8.5.3 Wage Boards
  - 8.5.4 Pay Commissions
  - 8.5.5 Adjudication
- 8.6 Wage Fixation Practices in Public Sector**
- 8.7 Summary**
- 8.8 Keywords.**
- 8.9 Self Assessment Questions**
- 8.10 Further Reading.**

### 8.1 INTRODUCTION :

The history of wage fixation in India is of a recent phenomenon. There was practically no effective machinery until the Second World War for the settlement of disputes for the fixation of wages. Under the Industrial Disputes Act 1947, various tribunals have passed awards resulting wages in a number of important industries. Immediately after attainment of Independence, industrial relations in our country started deteriorating rapidly. There was a phenomenal increase in the number of industrial disputes, mostly over wages, leading to a substantial loss of production. Realising that industrial peace was a sine-qua-non for progress on

the industrial as well as economic front, the Central Government convened in 1947 a tripartite conference consisting of the representatives of the employers, labour and government.

## 8.2 NEED FOR WAGE FIXATION :

The spirit of truce was incorporated by the Government of India in its declaration of Industrial Policy Resolution of 1948. In the statement embodied in the Resolution, the Government included two items which have bearing on wages namely;

- i) Statutory fixation of minimum wages in sweated industries; and
- ii) Promotion of fair wages agreement in more organised industries.

To fulfil the first objective, the Minimum Wages Act, 1948 was passed to lay down certain norms and procedures for the determination and fixation of wages by the Central and State Governments in sweated scheduled employments.

To fulfil the second objective, the Government of India appointed in 1949 a tripartite committee on fair wages to determine the principles on which fair wage should be fixed and to suggest lines on which these principles should applied.

## 8.3 PRINCIPLES OF WAGE FIXATION :

A set of principles of wage fixation have emerged over the last few years as guidelines for the adjudicating authorities on wage demands. The fair wage committee in its report observed that "any attempt to evolve principles for governing the fixation of wages must be made against the background of general economic conditions of the country and the level of national income".

The principles laid down by the Fair wage committee were discussed at length by the Supreme Court in the case of Crown Aluminium Works v/s their workmen (1958 1 LLJ 1), and were expounded in detail in the case of Express Newspapers v/s Union of India and others (1961-1 LLJ 339). In the case of Crown Aluminium works, the Supreme Court made the following well known and off quoted observation : "There is, however, one principle which admits of no exceptions. No industry has a right to exist unless it is able to pay its workmen at least a bare minimum wage. It is quite likely that in developing countries, where unemployment prevails on a very large scale, unorganised labour may be available on starvation wages. but the employment of labour on starvation wage cannot be encouraged or favoured in a modern democratic welfare state. If an employer cannot maintain his enterprise without cutting down the wages of his employees below even a bare subsistence or minimum wage, he would have no right to conduct his enterprise on such terms".

In the case of express News papers, it was held that the upper limit of wages must be set by capacity to pay, not of a particular unit then of but on an industry - cum - region basis. Another principle which the Supreme Court has stressed is that, while fixing the wage - scales the total emoluments, including the basic wages and dearness allowance, have to be taken into consideration.

#### 8.4 NORMS AND PROCEDURES FOR THE FIXATION OF WAGES:

The wage fixation policy should ensure prevention of exploitation of labour through the payments of unduly low wages, particularly in those employments where sweated conditions exist and where the workers are vulnerable because of lack of organisation. It is a step in the direction of realising the objectives of wage in the direction of realising the objectives of wage policy in a developing country like India; namely, the abolition of malpractices and abuses in wage payment, and fixation of minimum wage for workers whose bargaining position is weak because they are unorganised wages can not be left to be determined entirely by the market forces and the government has a positive role play in ameliorating the conditions of the low paid workers. The following norms shall be followed while fixation of wages.

1. The wages have to be fixed on an industry-cum-region basis.
2. Uniformity shall be maintained in the wage levels of different concerns of the same industry working in the same region.
3. Wages prevailing in an establishment must be comparable with those given to workmen on similar grade and scale by similar establishment in the same industry.
4. Employees getting the same wages should get the same dearness allowance, irrespective of whether they are working as clerks or members of subordinate staff of factory workmen.

#### 8.5 INSTITUTIONS/METHODS OF WAGE FIXATION IN INDIA :

Wage and salary incomes in India determined through several institutions. There are five methods of wage fixation in India: 1) Statutory Fixation, 2) Collective Bargaining, 3) Wage Boards, 4) Government Appointed Pay Commissions, 5) Adjudication and Tribunals.

##### 8.5.1 STATUTORY FIXATION / LEGISLATIONS:

The major wage laws include the Payment of Wages Act, 1936 and its subsequent amendments, the Minimum Wages Act, 1948 and the Equal Remuneration Act, 1976.

##### 1) The Payment of Wages Act, 1936:

Except Sikkim, The Payment of Wages Act, 1936, extends to the whole of India and applies to persons employed in any factory as defined in the Factories Act, 1948 and in the railways, receiving wages and salaries below Rs. 1,600 a month. Neither employers can withhold the wages earned by workers nor can they make any unauthorised deductions. Payments must be made prior to the expiry of a specified day after the last day of the wage period. While there is a provision to impose fines for only those acts of omission which have been approved by the appropriate government, the fines cannot exceed an amount equal to three paise in a rupee of the wage payable. If the payment of wages is delayed or wrongful deductions are made, the workers or their trade unions can file a claim.

## 2) **The Minimum Wages Act, 1948 :**

The Minimum Wages Act, 1948 relates to the employment situations embodied in part I and II of the Schedule to the Act. The appropriate governments are empowered to include other employment situations in the schedule and fix or revise the minimum wage rates. It is obligatory on the part of the employer to pay the minimum rates of wages fixed in terms of the procedures prescribed by law, irrespective of employer's capacity to pay. The Act provides for fixing minimum wages in certain employment situations where sweated labour prevails or where there exists possibility of exploitation of labour. However, minimum wages are not to be fixed in an industry which employs less than 1,000 employees in the entire state, although this condition has been relaxed in a subsequent amendment of the Act. Thus, the Act empowers the central and state governments to fix minimum rates of wages in woollen, carpet-making or shawl-weaving establishments, rice, flour or dall mills, tobacco or bidi-making industry, plantations, oil mills, road seed or insufficiently organised. In a developing economy, with severe unemployment, construction or building operations, stone breaking or stone crushing, lac manufactories, mica works, public motor transport, tanneries and leather manufactories and agriculture. The Act provides for the fixation of a minimum time-rate, a minimum piece-rate, a guaranteed time-rate, and an overtime rate suitable for various occupations and classes of workers. A minimum wage rate incorporates a basic rate of wage and a cost of living allowance or a basic rate with or without a cost of living allowance, and the cash value of the concessions regarding supplies of essential commodities at normal rates. The Act further prescribes for the payment of wages in cash, although the appropriate government is empowered to pay in wholly or partly in kind. The Act further provides for the appointment of committees, subcommittees, advisory board for assisting the appropriate government in fixing and revising the wages. The Act also provides for revision of minimum rates fixing at suitable intervals, not exceeding five years. Accordingly, wage revisions are done by different state governments and union territory authorities. The facts taken into account for initial fixation of wages as well as for the subsequent revisions under the Act include minimum wage rates fixed by other states in similar industries, prevailing wage rates in adjacent areas/industries, increases in the cost of living since the last fixation, etc.

The Act, however, does not provide any guidance to the wage fixation authorities with respect to the content of minimum wages, factors to be taken into account while fixing the minimum rates of wages, size of the family unit for which minimum wage rates have to be fixed, weight age to be assigned to different factors such as cost of living, needs of workers, etc. Therefore, it is left to the individual committee or the government to determine their own standards and arrive at conclusions. Historically, the first to lay down the guidelines for fixation of minimum wages was the fifteenth session of the Indian Labour Conference held in July 1957. It passed a resolution stressing that the minimum wage should be need-based to meet the minimum requirements of the workers. The resolution embodies several norms for the fixation of such wages in industry.

The one-man committee headed by K.I. Vidysagar, in his report dated 19th December 1966, suggested a number of norms which must be taken into account while fixing/revising minimum wages. Likewise, the National Commission on Labour (1969) provided a number of recommendations with regard to the statutory minimum wage. A committee of secretaries belonging to six states with additional secretary of the Ministry of Labour as chairman was formed in 1981. The committee made a number of recommendations with respect to the criteria

for fixation of minimum wages and evolve a formula for variable dearness allowance to be attached thereto.

Although the Minimum Wages Act originally included 13 industries/employments, the minimum rates of wages have been fixed in 197 employments till 30 June 1985. During July 1995 to June 1996, minimum wages were revised in 426 employments.

#### **Viewpoint of National Labour Law Association on the Minimum Wages Act, 1948:**

In the opinion of National Labour Law Association, while significant progress has been made in extending the coverage of the Act, the effort has neither been systematic nor uniform. There is also no means to verify or to ensure that all the employments for which minimum wages need to be fixed are actually included in the schedule, and minimum wage have been fixed in respect of all of them.

Fixation of minimum wages is a kind of "safety net" to protect workers from exploitation by payment of unduly low wages. This protection should be available to every worker who needs it. There is no justification to deny this protection to those employed in employments which are not included in the schedule to the Act unless there is proper arrangement for regulation of their wages by collective agreement or otherwise. It is, therefore, proposed to make law applicable to all employees with the provision that where the minimum was fixed or revised under this code is less than the wage fixed through collective bargaining, arbitration, adjudication, wage board or otherwise the employee shall be entitled to be paid the wages at the higher rate applicable to him.

Finally, there is limitation in the Act as it does not define the term minimum wages. While several states consider that the concept of minimum wage as currently applied to sweated industries needs no change, trade unions have urged that to avoid differences in interpretation by wage fixing authorities, "minimum wage" should be spelt out in precise terms. Accordingly, the minimum wages vary from region to region and even within the same region from time to time depending upon particular situations. It has been recommended by the National Labour Law Association that the minimum wage be defined as "a wage which is fixed with reference to the basic needs of an employee so as to provide him and his family consisting of his spouse and two children adequate means of livelihood and a decent standard of living".

#### **3) The Equal Remuneration Act, 1976 :**

The Equal Remuneration Act, 1976 provides for payment of equal remuneration to men and women workers for the same work or work of similar nature. It prevents discrimination on the ground of sex against women in the matter of employment and for matter connected therewith except where the employment of women in such work is prohibited or restricted by under any law for the time being in force. The Act has been enforced in several spheres such as plantations, local authorities, central and state governments, banks, educational institutions, mines, hospitals, hotels and restaurants, manufacture or textiles and textile products, wholesale and retail trade, construction, agriculture and air transport industry. In June 1978, it was extended to community, social and personal services.



### 8.5.2 COLLECTIVE BARGAINING :

The phrase 'Collective Bargaining' originated in the writings of 'Sydney' and 'Beatrice Webb'. This term relates to those arrangements under which ways and condition of employment generally are decided by agreements negotiated between the parties.

Collective bargaining is a process of joint decision - making and basically represents a democratic way of life in industry. It establishes a culture of bipartism and joint consultation in industry and a flexible method of adjustment to economic and technical changes in an industry. It helps in establishing industrial peace without disrupting either the existing arrangements or the production activities.

Bargaining may also take place at enterprise level and plant level. It may be conducted through a union (or a group unions) and an association representing wages, hours at work and other conditions of employment. Broadly speaking the following factors affect the wage determination by collective bargaining process :

1. Alternate choice and demands;
2. Institutional necessities, e.g. if ratification of an agreement requires a majority vote of employees, the character of wage settlement would have to be such as would be acceptable to major
3. The right and capacity to strike.

'Joseph Shister has opined that collective bargaining can best be analysed by listing its principles characteristics. He lists five characteristics : 1) Collective bargaining involves group relationships; 2) it is both continuous and evolutionary; 3) it interacts with the socioeconomic climate; 4) it is private, but at times involves government action; and 5) it varies from setting to setting.

'John Dunlop and Derek Bok' have listed five important function of collective bargaining : i) establishing the rules of the work place; ii) determining the form of compensation; iii) standardising compensation; iv) determining priorities on each side; and v) redesigning the machinery of bargaining.

Employers federation of India shows that collective bargaining system has been adopted in almost all industries.

The Bureau of public enterprise has increasingly exerted unifying influence on collective bargaining in public sector undertakings.

In a modern democratic society wages are determined by collective bargaining in contrast to individual bargaining by workers in the part. When wages are determined by individual worker bargaining separately with his employer.

### 8.5.3 WAGE BOARDS :

The establishment of tripartite (non-statutory) wage boards was recommended by the Fair Wages Committee with a view to determining wages on an industry-cum-region wise basis. In March 1957 the first Wage Board was established for the textile industry (followed by the second formed in 1964). Thereafter, several wage boards were established for sugar (1957, 1965, 1985), cement (158, 1964), jute (1960), tea plantations (1960), rubber plantations (1961),



coffee plantations (1961), iron and steel (1962), iron ore mining (1962), limestone and dolomite mining (1963), coal mining (1962), working journalists (1963, 1985), nonworking journalists (1964, 1985), ports and docks (1964), engineering (1964), heavy chemicals and fertilizer (1964), leather and leather goods (1966), electricity undertaking (1966) and road transport (1966). The composition of wage boards is tripartite in character and thus, involves the representatives of employees and workers and an independent chairman. An equal number of representatives of the employers and workers are appointed by the government in consultation with them. The chairman and two other independent members (including consumers' representative) are nominated by the government. Usually, the chairman is a judge serving or retired, while the consumers' representative is a member of Parliament. The total number of members of the wage boards formed hitherto, vary from seven to nine. Although the wage structure recommended by a wage board remains in operation for five years, it may not be necessarily implemented by the management.

#### **Working of Wage Boards :**

The objectives of wage boards include more durable results, improved climate for industrial relations, promotion of interests of consumers and the community, standardisation of wage structure and support to social and economic policies of the government. Explicitly, wage boards have not succeeded in accomplishing these objectives largely. Specifically they have failed to tackle the problem of wage differentials and payment by results. There are several drawbacks in the system of wage structures. Despite several inadequacies, it is admitted that the system has provided a rity; machinery to pay for bipartite collective bargaining on wages and allied issues on an industry wise basis at the national level. It has been suggested that wage boards should be provided statutory support to make them effective. However, as Subramanian observes, if wage boards are made statutory and their recommendations made legal binding, they will be inseparable from industrial tribunals and lose whatever advantage they have under a voluntary system of being a convenient forum for collective bargaining. Moreover, wage determination on all India basis is inconsistent with the requirements of a developing country involving uneven levels of development in various regions and industries. Indeed, collective bargaining of wage claims is likely to be effective when limited to an industry in a small area or region than when embracing the national level.

#### **Viewpoint of National Labour Law Association :**

Although India has a long experience of Wage Boards, observes National Labour Law Association, the spirit of cooperation among parties evaporated and each started mistrusting the other. Accordingly, there was inordinate delay in completing the work and even when completed the recommendations came to be challenged in the courts stalling their implementation. The practice of setting up wage boards has, therefore, gradually been discontinued. Currently, the law requires wage boards to be set up for the newspaper industry under the Working Journalists and other Newspaper Employees (conditions of services) and Miscellaneous Provisions Act, 1955. The only other wage board set up recently was for the sugar industry. In order to minimise litigation on the awards of the wage boards, the Association proposed to make them final and binding subject only to an appeal to National Labour Relations Commission. It is also proposed to keep the awards in operation for a minimum of three years which may extended by mutual agreement between the parties. It is also suggested that there should be an enabling provision in

the law for setting up wage boards for any activity when necessary in consultation with the most representative organisations of employees and employers concerned.

#### 8.5.4 PAY COMMISSIONS :

##### **The First Central Pay Commission :**

The First Central Pay Commission (1947) Justice Varadachariar asserts that “the state must now take some steps forward in the direction of giving effect to the living wage principle”. Thus, the commission stresses that the “living wage” should form the basis for determining the minimum wage which should not be too low to cause under nourishment. Accordingly, the minimum wage was fixed at Rs. 30 per month in the lowest grade of class IV employees. It asserted that a state should not attempt to be a model employer and accordingly “it will not be fair to the country to encourage a claim by civil servants to be treated better than their fellow countrymen”. However, the commission recognises that “the lower grades of Government servants with fixed incomes of small amounts have been hard hit, they must be relieved, at least to some persisting”. Notwithstanding this observation, it did not limit its recommendations regarding dearness allowance to “the most vulnerable section” of the employees but also allowed it to higher salaried employees. Obviously, it allowed more than 100 per cent neutralisation in instances where the basic salary was below Rs. 46.25. Thus, it considered Rs. 55 as an appropriate minimum wage for January 1947 at consumer price index of 80.

##### **The Second Central Pay Commission :**

The Second Central Pay Commission was constituted in August 1957 and submitted its report in August 1959. Regarding principles of pay fixation, the commission observed, “We have reached the conclusion that the minimum wage or salary not be determined merely on economic considerations, but should satisfy also a social test—both because of its intrinsic validity and because of its bearing on efficiency”. It recommended that minimum wage should be fixed at Rs. 80 per month corresponding to consumer price index of 115 obtained at the time of reporting. The commission visualised dearness allowance as “a device to protect to a greater or lesser extent, the real income of wage earners and salaried employees allowance to those drawing a salary of less than Rs. 300 per month. Accordingly, for others it asserts, “As it is, we consider that it would be appropriate to fix the entire remuneration for such staff in the form of salaries which appear reasonable in the present conditions”. The commission further states, “If the Government were to function as a model employer in the sense that they paid higher wages and salaries than other good employers for comparable work.. the community would be required to pay a price which the efficiency of the public service did not demand and which should not in fairness, be asked of the community. The Government cannot, therefore, in our opinion be a model employer in this sense”.

##### **The Third Central Pay Commission:**

The Third Central Pay Commission submitted its report in 1973. It stressed on the reduction of prevailing numerous pay scales by compiling the posts of several different categories and occupational groups in one single grade. Regarding the fixation of the minimum wage, the commission observes, “we are, therefore, of the view that the starting salary need not be fixed higher than Rs. 185 per month”. Accordingly, the minimum scale devised by the commission was Rs. 185-2-193-3-220 based on the consumer price index of 200 obtained in 1972. It asserts, “we not consider it practicable to recommend more than one level for the

semiskilled category within the pay range available” and thus, six scales were board-banded into one scale of Rs. 200-280 incorporating dearness allowance and interim relief. Likewise, 13 existing scales for skilled categories of working staff were board were broad banded into three new scales of Rs. 260-350, Rs. 260-400 and Rs. 320-400. Again the grades of highly skilled workers were devised as Rs. 330-480 and Rs. 380-560, while that of master craftsman as Rs. 425-640. The grades of lower division clerks and upper division clerks were revised to be Rs. 260-400 and Rs. 330-560, respectively. The commission recommended payment of dearness allowance to all employees drawing pay not exceeding Rs. 2,250 per month. However, the report of the commission recommended by the commission raising the minimum wage for the lowest category of class IV from Rs. 185 to Rs. 196. The commission denied the role of the model employer to the government. It observes, “ We would be labouring under a delusion if we were to suggest that the Central Governments should now take upon itself the responsibility of being a pace-setter, and of bettering the wages paid by reputable concerns in the private sector”.

#### **The Fourth Central Pay Commission :**

The Fourth Central Pay Commission, appointed under the chairmanship of Justice P N Singhal on September 1, 1983, submitted its report on June 30, 1986. It was specifically asked to examine the variety of allowances and benefits in kind which are currently available to the employees in addition to pay and to suggest their rationalisation and simplification to promote efficiency in administration. The commission's report is divided into two parts.

Part I relates to structure of emoluments, conditions of service of central government employees including union territories, members of all India services and personnel belonging to armed forces. Part II deals with the pension structure for pensioners including both past and future and the death-cum-retirement benefits for all categories of employees.

It has been felt with the pension structure for pensioners including both past and employees with those of public sector undertakings was not based on sound reasoning. There is also need to rationalise transfer / travelling allowance rules to resolve various problems and hardships which the transferred employee is subjected to. The commission has been appreciated for providing a new dearness allowance formula, liberalisation of HRA and withdrawal of overtime allowance for nonindustrial employees.

#### **The Fifth Central Pay Commission :**

The Fifth pay Commission was formed on April 9, 1994 under the Chairmanship of S R Pandian, a retired Supreme Court Judge, The other members were Suresh Tendulkar and M K Kaw. The Commission's report has caused immense contradictions and resentment. It has proposed a total annual increase of Rs. 9,500 crore (as compared to Rs. 5,000 crore provision in the current year) in the central government's expenses towards:

	Rs. (in crore)
Transport allowance	: 522
Housing	: 2,000
Salaries (civil and defence)	: 2,333
Exemption of allowances from income tax	: 132

Increase in pension : 9,000

Other expenses (servant allowance, LTA,  
entertainment allowance, medical cover, etc.) : 3,646

There is recommendation for increasing the pay of lower level employees by 20 to 40 percent and that of senior level bureaucrats by almost 130 per cent. There is also proposal to reduce hiring, abolish currently vacant posts, and restructure government department. It has made several recommendations to improve productivity These include:

A six-day week instead for five, which will increase the number of working days by 40. the number of gazetted holidays be reduced from 17 to three (Republic Day, Independence Day and Mahatma Gandhi's Birthday); a holiday be declared only on the death of an incumbent Prime Minister or President and on no other deaths.

All payment of overtime allowance to employees should be discontinued. Instead, staff deployed on weekly off-days may be given compensatory leave.

The payment of a time-punching machine, to ensure punctuality in every office-applicable even to the Cabinet Secretary.

Top executives (secretary-level officers) should be entitled to T class or AC first class train travel; senior executives (above the post of deputy secretaries) be entitled to 'Y' class air travel and AC first class train-travel; executives (below the level of deputy secretary) be entitled to economy class air travel and AC second class train travel; and supervisory staff be entitled to AC second class train travel.

Government should phase out staff cars by attaching such cars only to top executives. beginning common pool of private vehicles; freezing the cadre of staff car drivers; and abolishing vacant posts of drivers.

Increase timings of government-run service institutions like banks, hospitals, dispensaries and shopping centres by introducing a shift-system in these places.

All adhoc bonus schemes should be made productivity-related and a performance-related increment scheme should be introduced.

#### **SIXTH CENTRAL PAY COMMISSION**

In July 2006, the Cabinet approved setting up of the sixth pay commission. This commission has been set up under Justice B.N.Srikrishna with a timeframe of 18 months. The cost of hikes in salaries is anticipated to be about Rs. 20,000 crore for a total of 5.5 million government employees as per media speculation on the 6th Pay Commission, the report of which is expected to be handed over in late March/early April 2008. The employees had threatened to go on a nationwide strike if the government failed to hike their salaries. Reasons for the demand of hikes include rising inflation and rising pay in the private sector due to the forces of Globalization. The Class I officers in India are grossly underpaid with an IAS officer with 25 years of work experience earning just Rs.55,000 as his take home pay. Pay arrears are due from January 2006 till September 2008. Almost all the Government employees received 40% of the pay arrears in 2008 and balance 60% arrears (as promised by Government) has also been credited in Government employees account in 2009. The Sixth Pay Commission mainly focused on

removing ambiguity in respect of various pay scales and mainly focused on reducing number of pay scales and bring the idea of pay bands. It recommended for removal of Group-D cadre.

#### SEVENTH CENTRAL PAY COMMISSION

The Government of India has initiated the process to constitute the 7th Central Pay Commission along with finalization of its Terms of Reference, the composition and the possible timeframe for submission of its Report. On September 25, 2013 the finance minister P Chidambaram announced that the Prime Minister Manmohan Singh has approved the constitution of the 7th Pay Commission. Its recommendations are likely to be implemented with effect from January 1, 2016. Justice A.K Mathur will be heading the Seventh Pay commission, announcement of which was done on 4 February 2014

#### 8.5.5 ADJUDICATION:

Since, Independence, adjudication has become one of the main instruments for settlement of wage disputes, improvement in wage scales, standardisation of wages and allowances. Though Courts and tribunals were primarily intended to deal with the settlement of industrial disputes, in practice, wage fixation has become an important element in their working and functioning. This is because of a large number of disputes concerning wages and allowances. The Industrial Disputes Act 1947 which replaced the Trade Disputes Act 1929, enables the government to intervene in matters involving disputes between workers and employers. The act also provides the compulsory adjudication in the case of failure of conciliation proceedings. Numerous wage disputes in many industries have been guided by the reference for adjudication to labour courts and tribunals during the past four decades. In this exercise they have been guided by the Fair Wages Committee. The High Courts and Supreme Court have also adjudicated upon such disputes. The awards given by these authorities not only helped in the formulation of a body of principle governing wage fixation but laid down the foundation for the present wage structure in many of the major industries.

#### 8.6 WAGE FIXATION PRACTICES IN PUBLIC SECTOR:

In the beginning, compensation plans for the public enterprises were mainly borrowed from the Government. In some organisations these were based on a comparison of similar industries in private enterprises. In case of public sector steel plants, the pay scales and allowances were a mixture of Government, TISCO, IISCO and Railways. In 1962, the minimum wage and wage structure was suitably modified in line with the recommendations of the Second Pay Commission for Central Government employees. For the first time, a composite Central Wage Board for Iron and Steel Industry was set up in January, 1962 which finalised its report in 1965. This was, as it were, the foundation for determination of wages on industry basis both for public, private as well as joint enterprise. The Wage Board produced an extensive document describing the history of Iron and Steel Industry and the Wage Fixation machinery therein besides dealing with the question of principles of Wage Fixation and allied matters.

The experiment of bipartism which thus started successfully in 1970 in steel was emulated throughout the country. In BHEL, it started in 1973, Coal India Ltd. in 1974 and in other public enterprises later. The history of wage settlements in other enterprises is much the same. In most of the central public sector undertakings today, bilateral committees consisting of

representatives of labour and management determine wages and allied fringe benefits, on an industry basis or even enterprise basis, through a process of collective bargaining.

The department of public enterprises issued guidelines for new wage settlements. Under the guidelines, managements are free to negotiate wage structure consistent with generation of resources / profits by individual enterprises / units. Wage increases are to be met from internal resource generation. The period of wage settlements is to be normally five years and there should be no increase in labour cost per unit of output.

#### 8.7 SUMMARY:

The methods generally followed in India with regard to wage determination are collective bargaining, wage boards, governments appointed pay commissions and adjudication by courts and tribunals. Collective bargaining is one of the important methods of wage determination process in India. Its practice vary in accordance with such factors as the economic characteristics of the industry. Single plant or company bargaining is more widespread as compared to industry - wide bargaining.

The minimum wages Act was passed in 1948 to provide for machinery for statutory fixation and revision of minimum wages in the scheduled employments, including plantations and agriculture it is a piece of social legislation which provides protection to workers in employments who are exploited on account of the lack of organisation and bargaining power. The main object of the Act is to prevent the payment of unduly low wage to workers employed in scheduled employments and to secure certain basic conditions of work and employment. The setting up of tripartite wage boards for the fixation of fair wages on an industry - region basis was one of the recommendations made by the Fair Wages Committee. The fifteenth session of Indian Labour Conference reiterated that wage boards should be appropriate machinery for the fixation of wage rates. One more institution which is giving recommendations for the fixation and revision of wages and allowances of Government employees is the Pay commissions. Adjudication has become one of the main instruments for settling wage disputes, improvement in wage scales and standardisation of wages and allowances. Though courts and tribunals were primarily intended to deal with the settlement of industrial disputes, in practice, wage fixation has become an important element in their working and functioning.

#### 8.8 KEY WORDS:

**Wage Fixation:** Wage and Salaries are determined through several institutions i.e. collective bargaining, legislations, wage boards, pay commission and adjudication.

**Wage Boards:** The term "Wage Board" covers (i) a voluntary body set up by discussions between organised employers and workers to regulate wages, working hours and related conditions of employment by collective bargaining. (ii) a body set up by law or with 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.

**Pay Commission:** The Commission appointed by the Central / State Government for the fixation and recommendation on wages, salaries, Dearness allowance, H.R.A. and benefits.



**Adjudication:** Adjudication is one of the main instruments for settlement of disputes on wages allowances etc.

**Tribunals:** The Government shall constitute or setup the tribunals where the dispute or problem is for a state or whole.

**8.9. SELF ASSESSMENT QUESTIONS:**

- 1) What are the principles of wage fixation?
- 2) What are the mechanisms of wage and salary fixation in Industrial Sectors?
- 3) Any system of wage fixation must be judged by how it works in practice, Discuss.
- 4) Elaborately discuss the statutory methods of wage fixation.
- 5) Enumerate the role of pay Commissions and wage boards for the fixation of wage and salaries.
- 6) Define collective bargaining and explain its importance in wage fixation.

**8.10 FURTHER READING :**

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## LESSON - 9

# WAGE FIXATION

### Learning Objectives

- ✓ To study the wage concepts
- ✓ To narrate wage components
- ✓ To examine the wage structure
- ✓ To know the determine wage factors

### Structure

#### 9.0 Introduction

#### 9.1 Wages – Definitions and Meaning

#### 9.2 Wages – Concepts

#### 9.3 Wages – Components

#### 9.4 Important Factors Influencing Wages

#### 9.5 Components of Industrial Wage Structure in India

#### 9.6 Factors that determine the level of Wages to be paid to the Employees

#### 9.7 Collective Bargaining

#### 9.8 Summary

#### 9.9 Key Words

#### 9.10 Self – Assessment Questions

#### 9.11 Further Readings

### 9.0 Introduction

The fixation of wage structure also includes within its compass the fixation of rates of dearness allowance. It is an additional payment made by the employer to his employees to compensate them to a certain extent for the rise in the cost of living.

The term 'wage' can be defined as the payment made to workers for placing their skill and energy at the disposal of an employer, the method of use of that skill and energy being at the employer's discretion and the amount of payment being in accordance with the terms stipulated in a contract of employment of service. Wage forms the basis for the calculation of the compensation of an employee.



Wage means economic compensation paid by employers to employees for the services rendered by the latter. The committee on Fair Wages (1948) and the 15th Session of Indian Labour conference (1957) propounded certain wage concepts such as Minimum Wage, Fair Wage, Living Wage and Need-based Minimum Wage.

Learn about:- 1. Definitions of Wages 2. Concepts of Wages 3. Components 4. Factors Influencing 5. Components of Industrial Wage Structure in India 6. Factors that Determine the Level of Wages to be Paid to the Employees 7. Methods of Wage Fixation in India 8. Systems 9. Theories.

### 9.1 Wages – Definitions and Meaning

Labour is one of the most important factors of production. Labour expects fair wages for the services it renders to the process of production. The term wages refer to payments for services, whether manual or mental, based on hours of work or quantity of output. Normally, the term wages is used to refer to payment made for services given by manual labour or non-supervisory and non-clerical staff. It refers to the hourly or daily rate paid to production and maintenance employees, i.e., blue collar employees.

According to Berham, “Wages mean the amount paid to the labour for his services to the employer”.

According to P.M. Stohank, “Wages is the labour’s remuneration which creates utility”.

The term salary is defined as the remuneration paid to clerical and managerial personnel employed on a monthly or annual basis. Nowadays, all categories of employees are treated as human resources and the terms wages/salary are used interchangeably. Wages/salary is the direct remuneration paid to an employee compensating his services to an organization.

Section 2 (vi) of the Payment of Wages Act defines wages as all remuneration capable of being expressed in terms of money which would, if the contract of employment express or implied, were fulfilled, be payable whether conditionally upon the regular attendance, good work or other behavior of the person employed or otherwise to a person employed in respect of his employment or of work done in such employment and includes any bonus, or other additional remuneration of the nature aforesaid, which would be so on termination of his employment, but does not include-

- a) Value of house accommodation, supply of light, water, medical attendance or other amenity;
- b) Any contribution to pension fund or provident fund;
- c) Any travelling allowance or the value of any travelling concession;
- d) Any sum paid to defray special expenses entailed on him by nature of employment; and
- e) Any gratuity payable on discharge.

The above definition can be split into three portions. Firstly, wage means all remunerations, which would if the terms of the contract of employment express or implied, were fulfilled, be payable to a person employed in respect of his employment. Secondly, wage includes any bonus or other additional remuneration. Thirdly, the term 'wage' includes any sum payable to a person by reason of termination of his employment.

The term 'wage' can be defined as the payment made to workers for placing their skill and energy at the disposal of an employer, the method of use of that skill and energy being at the employer's discretion and the amount of payment being in accordance with the terms stipulated in a contract of employment of service.

## 9.2 Wages – Concepts

Wage means economic compensation paid by employers to employees for the services rendered by the latter. The committee on Fair Wages (1948) and the 15th Session of Indian Labour conference (1957) propounded certain wage concepts such as Minimum Wage, Fair Wage, Living Wage and Need-based Minimum Wage.

### A) Minimum Wage

A minimum wage is a compensation to be paid by the employer to his employee irrespective of his ability to pay. The minimum wage must provide not only for the bare necessities of life but also for preservation of efficiency of the worker namely education health, other requirements and amenities.

### B) Living Wage

A living wage is a compensation which enables the earner to provide himself and his family with not only the bare necessities of life like food, shelter, and clothing but also a measure of frugal comfort including education for children, protection against ill health, demands of social needs, insurance against misfortunes and old age needs. This wage ensures standard of living.

### C) Fair Wage

It represents the average of minimum wage and living wage. It is above the minimum wage and below the living wage. The wage is linked with the capacity of the industry to pay. It depends on factors like labour productivity, wage prevailing in the same and neighboring localities, the level of national income and its distribution and the place of industry in the economy of the country.

### D) Direct and Indirect Compensation

Direct compensation refers to monetary benefits offered to the employees for the services rendered by them to the organization. The monetary benefits include basic salary, HRA, conveyance, leave travel allowance, medical reimbursements, bonus, gratuity, PF, etc. Indirect

compensation includes non-monetary benefits such as leave, insurance, holiday homes, hospitalization, etc.

### E) Time Rate and Piece Rate System

In time rate system, wages are paid based on the time spent by the employees in the factory. The production by workers is not considered. In piece rate system, the payment is related to the output given by the worker. The wage rate is fixed for piece of work or for certain quantity of production.

### 9.3 Wages – Components

The components of a sound wage system are

1. Fair standard – It must be based on a fair standard, after a careful time and motion study.
2. Fairness to employer and employee – Both the employer and the employee should feel that the system is fair.
3. Un-ambiguity – The wage plan should be clear and unambiguous. Every employee should understand the mechanics of wage calculation.
4. Equity – Employees should experience individual, interpersonal and organizational equity. In other words, pay should be so devised that employees experience absolute equity i.e., o/i ratios is equal.
5. Annual increment – Annual increment should be part of his pay structure in recognition of his service.
6. Incentives – Pay should include an incentive component to reward the extra effort put in by high performers.
7. Cost of living – Dearness allowance should be a part of pay which compensates the employee against continuous hike in cost of living.
8. Prompt payment – Pay should be released on the stipulated date so that employee's plans are not upset.
9. Economic stability – Any wage plan should guarantee stable income for the employee. Piece based pay should guarantee element of a minimum but a fair fixed pay.

### 9.4 Important Factors Influencing Wages

1. Wage policy of the company – The wage policy has a decisive influence on the structure and wage level. Example – Policy decisions on salary fixation based on length of service or performance or both, to pay below average or above average rates, to pay more to reduce employee turnover etc.
2. Prevailing wages in comparable industries – Wage rates are related to region and industry base. The organization has to pay wages at least equal to prevailing rates for similar jobs in similar organizations.

3. Financial position of the company – Increase in wages are paid by companies who can afford to pay. Companies having good sales and profits tend to pay higher wages. Total cost of labour has to be considered in determining the ability to pay. During period of prosperity, companies pay higher wages and wages are reduced during period of depression.
4. Demand and supply of labour – The demand and supply of certain skills determine wage rates. Examples – High demand for IT professionals, financial analysts, scientists in pharma industry, etc., leads to higher wages. Similarly, oversupply of certain category of employees has resulted in steep fall in wages. Oversupply of management graduates and fall in wages.
5. Cost of living – When cost of living increases, the workers and union demand higher wages to offset the erosion of real wages. Many companies consider inflation rate, while working out salary increments.
6. Capacity of bargaining – A strong trade union is able to bargain and obtain higher wages for its members.
7. Nature of job – Jobs that require high levels of knowledge and skills, require high pay.
8. Government policy and intervention influence wage determination. Example – Payment of Wages Act (1936) and Minimum Wages Act (1948) assure proper payment of wages and avoiding all malpractices like non-payment, delayed payment and underpayment.
9. Personal traits of the employee such as education, experience, and training are considered while fixing wages.
10. Productivity – Here, worker's wages are linked to their productivity level. Wages are paid based on job performance.
11. Psychological and social factors – Psychologically, a person considers level of wages as a measure of success in life. Sociologically, people feel that equal work should carry equal wages and there should not be any discrimination on the basis of religion, caste, gender etc.
12. The living wage – The wages should be adequate to enable an employee to maintain himself and family at a reasonable level of existence.

### 9.5 Components of Industrial Wage Structure in India

The industrial wage structure in India consists of various components such as a basic wage, a dearness allowance, an annual statutory bonus, and a host of fringe benefits and incentives.

#### 1. Basic Wage:

The term 'basic wage' is ordinarily understood to mean that part of the price of labour which the employer must pay to all workmen belonging to all categories. The phrase is used ordinarily in

contradistinction to allowances, the quantum of which may vary in different contingencies. The revisions in the basic wage has become progressively less frequent and insignificant because of the ever growing dearness allowance component.

## 2. Dearness Allowance:

The fixation of wage structure also includes within its compass the fixation of rates of dearness allowance. It is an additional payment made by the employer to his employees to compensate them to a certain extent for the rise in the cost of living. In the context of a changing pattern of prices and consumption, real wage 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 important consideration for him. Thus, it serves as a device to protect, to a greater or lesser extent, the real income of wage-earners and salaried employees from the effects of a rise in prices.

The system of payment of dearness allowance varies from centre to centre, industry to industry, and even within the same centre and industry. In most industries it is linked to the consumer price index number. These different systems of dearness allowance have come into existence over a period of time during the last four decades as a result of ad-hoc decision taken either in the process of collective bargaining or awards given by the wage fixing authorities.

Some of the dearness allowance payment systems are as follows:

- i. Flat Rate – Under this method, a fixed amount, says Rs. 200 per month, is paid to all categories of workers, irrespective of their wage scales. The main advantage of this system is that it is simple and it gives greater relief to the low-paid workers.
- ii. Graduated Scale – It is a method of paying dearness allowance on a graduated scale according to slabs. Under this, workers are divided into groups according to different wage slabs. They are paid fixed amounts of dearness allowance 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 of paying dearness allowance is popular because it is convenient and it is also considered to be equitable.
- iii. Cost of Living and Consumer Price Index Number – The Consumer Price Index Number is a system of linking dearness allowance with the cost of living index. In this method, dearness allowance automatically increases and decreases with a rise or fall in the value of money.

The adjudicators have generally favoured the payment of uniform dearness allowance to factory operatives and clerical staff when they get the same pay. The method and extent to which neutralization in the cost of living should be given have been under constant examination by the industrial tribunals and other wage fixing authorities.

The law is thus clear that dearness allowance is intended to neutralize a portion of the increase in the cost of living. Though 100 percent neutralization is not advisable as it will lead to inflation, full neutralization may be permissible only in the case of the lowest class of employees. The management is entitled to complain if the neutralization is more than 100 percent.

The different systems of dearness allowance have created disparities in the dearness allowance payment. The contributing factors are its automatic linkage with the consumer price indices; payment on point-to-point basis; cent-per-cent neutralization and sometimes even more; absence of any ceiling, wide diversities in the rates prescribed by industrial tribunals or settled in collective agreements.

In the process, the fundamental and sound principles governing wage fixation, viz., productivity of labour; prevailing rates of wages in the same or similar occupations in the neighboring localities; level of national income and its distribution; place of industry in the economy of the country; and capacity of the industry to pay have been completely ignored.

### 3. Overtime Payment:

Working overtime in industry is possibly as old as the industrial revolution. In the early days, however, due to the then existing social order, perhaps the concept of overtime did not exist as there were no defined hours of work. With the passage of time, the government came out with legislation to restrict excessive working by the employees beyond certain limited hours.

While the need for such legislation was welcome in situations where labor was exploited, another situation started shaping up in which employees started willfully organizing work in such a fashion wherein the managements are compelled to give overtime as a means of achieving production. During the post-war period, overtime has become quite a regular feature in many industries. The employer began to supplement production and the employee his wage with overtime working.

The necessity of the management's seeking overtime working from employees becomes inevitable mainly to overcome –

- (a) Inappropriate allocation of manpower and improper scheduling;
- (b) Absenteeism;
- (c) Unforeseen situations created due to genuine difficulties like breakdown of machines;
- (d) Where the work is of a fluctuating nature and it is economical and more convenient to work with existing staff longer hours during peak periods rather than employing extra-staff on a long-term basis;
- (e) Rush jobs during the financial year end; and

(f) Situation willfully planned where overtime work is forced as the only answer to obtain production.

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 overtime allowance 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 ordinary rate of wages have been defined as the basic wage plus such allowances, including the cash equivalent of the advantage accruing through the concessional sale to workers of food grains and other articles as the worker is for the time being entitled to, but not including a bonus. Compensatory and house rent allowance as well as the dearness allowance are to be taken into account in computing compensation for overtime work.

#### 4. Annual Bonus:

The Encyclopedia Britannica has defined bonus as an award in cash or its equivalent by an employer to an employee, for accomplishment being considered desirable and perhaps implied, though not required by the contract of employment. It is usually intended as a stimulus but may also express a desire on the part of the employer to share with the employees the fruits of their joint enterprise.

Bonus is a unique component of India's compensation system. Bonus is regarded as an incentive for regular attendance; as an encouragement for good work or payment for some special or additional service by workers; as an ex-gratia payment depending upon entirely on the goodwill of the employers which cannot be claimed as of right; as a share in the profits which workers may claim as of legal right and also as a deferred wage. Bonus as a deferred wage implies that it is to be paid, irrespective of profit or loss of the concern.

The Payment of Bonus Act does not deal with customary bonus and is confined to profit-based or productivity-based bonus. The customary bonus does not require calculation of profits or availability of surplus because it is a payment founded on long usage.

The bonus payment under the Act has varied from one industry to another, and within an industry from one unit to another. There has also been a variation in bonus payment from year to year for the bonus-paying organization.

The bonus disputes between management and unions mainly related to the computation of depreciation, development rebate, direct taxes, interest on capital, and accuracy of data content in



**the balance-sheet and the profit and loss account.** Statutory bonus payments have led to the most frequent source of industrial unrest in our country.

#### **5. General Allowances:**

The employers pay various sorts of allowances to their workmen depending upon the nature of their duties and other incidents of the employment. Various allowances are also given to the employees under different settlements.

These are special allowance, house rent allowance, leave travel assistance, out station allowance, travelling allowance, washing allowance, conveyance allowance, lunch allowance/dinner allowance, allowance for working on weekly-off unpaid paid holidays, acting allowance, cash handling allowance, shift allowance, self- development allowance, transport allowance, underground allowance, education allowance, social security allowance, factory allowance, overtime allowance, and so on. Such allowances are innumerable. It is, therefore, not possible to deal with them exhaustively.

However, some such allowances are being discussed as illustrative case under the following heads:

- i. Tiffin Allowance – Certain commercial and industrial concerns, with a view to ensure efficiency and economies time, provide free tiffin facilities to their employees. In some cases, they have become customary and an implied condition of service.
- ii. Overtime Allowance – Section 59 of the Factories Act, 1948 prescribes that a worker who works overtime in a factory shall be entitled to twice his ordinary rate of wages in respect of the overtime work. Some States, in their respective Shops and Establishments Acts, have prescribed rates of overtime work and overtime allowance.
- iii. Compensatory Allowance – Compensatory allowance indicates that it is a compensation for something. For instance, the allowance paid to the workmen for the work done on holidays has been treated as compensatory allowance.
- iv. Acting Allowance – Acting allowance means the allowance paid to an employee when he is acting in a higher post in the event of an employee holding the higher post proceeding on leave or otherwise being away from his duties.
- v. Special Allowance – A special allowance may be granted to the workmen in view of certain special circumstances peculiar to a situation or where they have to run some special risk. For instance, a special allowance in banks is paid in terms of Sastri and Desai awards when an employee discharges duties of a supervisory nature or is accorded the status of a person competent to discharge functions of a supervisory character.



vi. House Rent Allowance – Under the existing labour laws, there is no provision for payment of any house rent allowance. The problem of getting house accommodation has already become and is becoming very acute and also costly due to insufficient number of houses and high rate of house rent.

In order to give some relief to the industrial workmen on this account, some of the States like West Bengal and Maharashtra have already made laws providing for payment of house- rent allowance by the employer to industrial workmen in their States.

#### **6. Tax Planning:**

Tax planning is a conscious and well thought out process of arranging one's financial and economic affairs in a manner that enables him to take advantage of all deductions, exemptions, allowances and rebates available under Income Tax law s with a view to reducing his tax liability to the minimum. In relation to salary and wages, tax planning is important from the point of view of both the employer and the employee. The basic purpose of tax planning exercise is to minimize the incidence of tax to both the employer and the employee.

The compensation package generally consists of the following components:

##### **(a) Salary:**

Salary, according to its ordinary meaning is a fixed payment made periodically to a person as compensation for regular work or remuneration for services rendered. The definition of salary includes wages and conceptually there is no difference between the two. However, the term salary is used in the context of services of non-manual type of work, and services of a higher class. On the other hand, wages are confined to earnings of laborers and artisans.

##### **(b) Allowances:**

All payments made by the employer by way of allowances to the employees for the personal benefit of the latter will form part of the salary and hence will be chargeable to income tax.

If, however, such payments are made to meet expenses that are wholly, necessarily and exclusively incurred in the performance of duties of an office, the same will not form a part of the salary and will, therefore, be exempt from income tax. Such allowances will also be permissible deductions as business expenses for calculating the taxable income of the employer.

##### **(c) Perquisites:**

The third component of employee's remuneration is perquisite. A perquisite is defined as a gain or profit incidentally made from employment in addition to regular salary or wages, especially of a kind expected or promised. It signifies such benefits in addition to the amount that may be legally due by way of contract for rendering service.

Perquisites are normally in the nature of voluntary payments attached to an office or employment. The main characteristic is that they are payable only during the continuance of employment and are directly dependent on the service. When employment comes to an end, perquisites cease to be payable. The normal meaning of the word denotes something that benefits an employee by going directly to his pocket.

It therefore does not apply to reimbursement of expenses actually incurred in interest of official work. In order to come within the meaning of perquisites, it ought to be a benefit, fee or profit attached to an office or position or an addition to salary or wages. What is important is the nature of benefits given and the name given to a particular payment is not conclusive.

The provisions which have implications to the employer in respect of various components of compensation package should be kept in view while deciding on compensation package. Income tax makes certain provisions for deductions in respect of employee remuneration. Apart from complying tax deduction provisions, employer has also to ensure that tax is deducted at source.

In short, proper tax planning is a basic duty of every person, which should be carried out religiously.

Basically, there are three steps in tax planning exercise:

1. Calculation of taxable income from all sources such as salary / pension, interest etc.
2. Calculation of tax payable on gross taxable income for whole financial year (i.e., from April 1 to March 31).
3. After calculation of the amount of tax liability, two options are open- (a) payment of tax (no tax planning required), and (b) minimization of tax through prudent tax planning

Most people prefer option 'b', because of several tax saving schemes and investments which reduces tax liability to "zero" or to "minimum" possible.

#### **9.6 Factors that Determine the Level of Wages to be Paid to the Employees**

The following factors determine the level of wages to be paid to the employees of different categories:

- a. The Employer and the Policy of the Company:

In the private sector, the employer has been the sole decision maker in fixing wages to be paid to different categories of staff. Even, the minimum wage provisions are not followed for managers in many of the new private organizations.

The position is the same in the unorganized sector also. In progressive organizations like the House of Tatas and others, the payment of wages is determination on the basis of scientifically assessed methods like work measurement, job evaluation, etc. All good employers like Tisco, SAIL, NTPC, Hindustan Lever for instance pay more than others in the country as a matter of policy, and, of course, it depends upon their capacity to pay; progressive employers believe in paying more for attracting the best talents, in the competitive market.

b. Wage Fixation through Collective Bargaining:

The history of wage fixation in India is of recent origin. Under the Industrial Disputes Act, 1947, various tribunals have passed awards regulating wages in a number of important industries. Immediately after the Independence, industrial relations climate in the country deteriorated rapidly with rising number of disputes and loss of production. The government was worried to achieve industrial peace that was a prerequisite for industrial and economic growth.

So in 1947 the Union Government convened a tripartite conference with representatives of employers, labourers and the government. The government in its Declaration of Industrial Policy Resolution in 1948 included a spirit of truce. The Statement of Truce Resolution included two statements related to wages- (a) statutory fixation of minimum wages in sweated industries. In this context, the government passed the Minimum Wages Act, 1948, laying norms and procedures for determining the wages in 40 scheduled employments, e.g. china clay mines, fire clay, asbestos, iron ore, agriculture, etc. (b) promotion of fair wages agreement in more organized industries.

In this context the Government of India appointed a tripartite committee on fair wages for determining the principles on which fair wages should be fixed and also to suggest lines on which these principles should be applied. Collective bargaining is one of the most acceptable and exclusive methods of determining wages in many organized set-ups, especially in engineering, heavy industries, steel-making, auto manufacturing organizations. Besides, industrial wage boards and government appointed commissions of pay and adjudication awards have also been the methods of wage fixation.

### 9.7 Collective Bargaining

Collective bargaining helps workers to achieve a voice in fixing wages and hours of work, as well as the other conditions of work. It is a direct method of negotiation over the key issues of wages, hours of work and conditions of employment. It is preferred over the process of adjudication.

- i. Employer's representatives and workers' representatives at the enterprise and plant level,
- ii. Group of employers bargaining as a unit,
- iii. Unions and groups of unions, and
- iv. An association of some or all of employers in an industry in an area or region or a nation.

The central issues in all collective bargaining are wages and wage-related matters, besides recognition of mutual rights, responsibilities by the management and the workers, system of wage and payment of dearness allowance, bonus, incentive wage and fringe benefits. Some of the wage agreements arrived through collective bargaining also relate to personnel issues, e.g., recruitment, promotion and transfers, etc.

Once an agreement is achieved it reflects the interplay of many forces like:

- i. Unionism and its bargaining power
- ii. Methods of wage payment
- iii. Various regional and local conditions
- iv. Size of establishment
- v. Technical efficiencies
- vi. General business conditions
- vii. Capacity to pay
- viii. Company's wage policy
- ix. Union wage policy.

In all bargaining processes trade union representatives focus on shortcomings in the following issues:

- i. General level of wage rates
- ii. Structure of wage rates
- iii. Bonus
- iv. Incentives
- v. Fringe benefits
- vi. Administration of wages.

Wage Boards:

The Government of India had constituted industry wise wage boards in 1957-66 and after. But wage boards are not popular due to its being a time-consuming process. The parties involved also contest wage boards awards. But, wage boards were quite effective in the 1920s, during the British Regime for 'sweated trades/industries', like chain, bidi-making, where workers were not able to bargain effectively with the employers.

d. Pay Commissions:

The Government of India has constituted five pay commissions for regulating the salary of civil servants including those in post and telegraph, railways, defense and civil aviation. In case of a dispute arising out of the award of the pay commission for implementation, the subject is with the Commission of Inquiry, Adjudication by Tribunals and the Joint Consultative machinery.

e. Wage Policy:

All progressive employers have their own policy on employees' compensation. They pay higher than their competitors to attract the best talents. They also like to be known as the best pay

masters in the region/country. Such organizations create what is termed as 'wage islands', which is not healthy for the community. MNCs pay on an average, higher than the Indian firms.

This causes disparity in wages and if the wages are abnormally higher than those of the others, then it may cause distortion in the economy. A good example, we have in the wage revision of the state-owned PSU, namely BHEL, in 1978-79, when BHEL outfits operating in Bangalore were the highest pay-masters to the workers.

f. Ability to Pay:

This is the most significant factor. The government also leaves the issue open for each organization in PSUs to pay as per its capacity. But within the ceiling and the norms issued by the BPE.

g. Productivity Bargain:

Productivity bargain gained momentum in collective bargain. The keyword in the emphasis, **output per man per hour rather than to productivity**. Productivity bargain provides a new dimension to management, to shape its industrial relations and to aim for better managerial control, for improving organizational effectiveness as also restructuring.

The real outcome of productivity bargain has been in an effective **productivity agreement**. **Productivity agreement**, being **a systematic attempt at securing greater efficiency and economy in utilization of resources, both physical and human**, it is a package deal.

The features of such agreements are as follows:

- i. The agreements are **based on the concept of give and take, self-interest** of both sides protected.
- ii. The agreements lay **down specific and direct contribution of labour towards improving productivity**.
- iii. Agreements are based on cost-benefit analysis, unlike the classical wage agreements.
- iv. The agreement constitutes the package of practices, methods to be followed in exchange for rewards. Thus, it is a rationalized system of wage and incentives.

Productivity bargains are no doubt, short-term methods of implementation of wage payments.

In the long term, there may be problems in case of a change in the climate, and with regard to sharing the gains of productivity. So, it is liable to result into industrial unrest. What is termed as 'personnel payment' is the most significant factor in the overall profitability of an organization. Expenditure under 'personnel payment' as a percentage of the total cost is higher in labour-

intensive organizations as compared to capital intensive outfits or in assembly-type organizations as compared to process outfits.

Accordingly, in mining or heavy industries organizations like BCCL, Coal India or BHEL, the personnel payments to the total cost may be around 60 per cent as compared to the petro-chemical fertilizers where it is estimated to be 2-3 per cent only. In some manufacturing units this expenditure is limited to 15-16 per cent.

As such, the capital intensive units pay higher than labour intensive organizations and the impact of higher pay on output cost is not as acute as in the case of labour intensive organizations.

In this context, productivity bargain has been an important factor in wage negotiation process in collective bargaining in India ever since, the early 1960s, although the workers' representatives have been opposing this factor. But, settlement of wage based on a given rate of productivity gain is the ideal method to hedge against the rising labour cost. Such bargaining agreements have been practiced in Premier Automobiles, ITC as also in Tisco and BHEL/other PSUs.

The agreements define that attainment of a given rate of productivity will lead to the given rate of wages and more jobs, over and above the period of the tenure of the agreement. Further, high profit is another factor which may result in a quantum jump in wages/benefits to the staff/across the board.

#### **9.8 Summary**

The wage is the monetary measure corresponding to the standard units of working time (or to a standard amount of accomplished work, defined as a piece rate). The earliest such unit of time, still frequently used, is the day of work. Wages are part of the expenses that are involved in running a business. It is an obligation to the employee regardless of the profitability of the company.

Payment by wage contrasts with salaried work, in which the employer pays an arranged amount at steady intervals (such as a week or month) regardless of hours worked, with commission which conditions pay on individual performance, and with compensation based on the performance of the company as a whole. Waged employees may also receive tips or gratuity paid directly by clients and employee benefits which are non-monetary forms of compensation. Since wage labour is the predominant form of work, the term "wage" sometimes refers to all forms (or all monetary forms) of employee compensation.

### 9.9 Key Words

**Wage** - pay, payment, remuneration, salary, emolument, stipend, fee, allowance, honorarium. income, revenue. Yield, profit, gain, reward. compensation, recompense, reimbursement. earnings, takings, proceeds.

**Basic Wage** - basic wage is ordinarily understood to mean that part of the price of labour which the employer must pay to all workmen belonging to all categories.

**Minimum Wage** - A minimum wage is a compensation to be paid by the employer to his employee irrespective of his ability to pay.

### 9.10 Self – Assessment Questions

1. Define wage? What are the factors influencing wage?
2. Discuss the different wage components?
3. Explain the components of Industrial Wage Structure in India?
4. Examine different allowances in wages?

### 9.11 Further Readings

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**LESSON – 10**

**STATUTORY WAGE FIXATION AND  
COLLECTIVE BARGAINING**

**Learning Objectives**

- ✓ To know the statutory wage
- ✓ To examine the wage boards
- ✓ To study the collective bargaining
- ✓ To observe the types of collective bargaining

**Structure**

**10.0 Introduction**

**10.1 History of Minimum Wages**

**10.2 Minimum Wages Regulations in Andhra Pradesh**

**10.3 Regular Pay in Andhra Pradesh**

**10.4 Wage Boards in India**

**10.5 The main objectives of wage boards**

**10.6 Evaluation of the Wage Boards**

**10.7 Collective Bargaining**

**10.8 How Collective Bargaining Works**

**10.9 Collective Bargaining Steps**

**10.10 Types of Collective Bargaining**

**10.11 Advantages of Collective Bargaining**

**10.12 Disadvantages of Collective Bargaining**

**10.13 Criticisms of Collective Bargaining**

**10.14 Summary**

**10.15 Key Words**

**10.16 Self Assessment Questions**

**10.17 Further Readings**



### 10.0 Introduction

As is generally the case in the economic literature, the term statutory minimum wage is used here to designate all minimum wage fixing mechanisms other than through collective agreements. This may include minimum wages set through the decision of a competent authority; decisions of wage boards or councils; or industrial or labour courts or tribunals. This differs from the more narrow legal definition of the term "statutory" that refers to a legislative process.

In statutory systems, the most frequent way of ensuring consultation and participation of social partners and independent experts is through institutions such as tripartite or bi-partite wage commissions, wage boards, or other bodies with general competence for economic and social affairs.

However other forms of consultations are possible, including written communications or separate ad hoc bilateral consultations. Although most wage commissions are consultative, some countries have delegated decision-making authority to them, such as in the Republic of Korea.

As a matter of principle, social partners should be involved on a basis of equality. Membership in wage boards or commissions should include employers' and workers' representative organizations.

India introduced the Minimum Wages Act in 1948, giving both the Central government and State government jurisdiction in fixing wages. The act is legally non-binding, but statutory. Payment of wages below the minimum wage rate amounts to forced labour. Wage boards are set up to review the industry's capacity to pay and fix minimum wages such that they at least cover a family of four's requirements of calories, shelter, clothing, education, medical assistance, and entertainment. Under the law, wage rates in scheduled employments differ across states, sectors, skills, regions and occupations owing to difference in costs of living, regional industries' capacity to pay, consumption patterns, etc. Hence, there is no single uniform minimum wage rate across the country and the structure has become overly complex. The highest minimum wage rate as updated in 2012 was Rs. 322/day in Andaman and Nicobar and the lowest was Rs. 38/day in Tripura. In Mumbai, as of 2017, the minimum wage was Rs. 348/day for a safai karmachari (sewage cleaner and sweeper), but this was rarely paid.

The Minimum Wages Act 1948 is an Act of Parliament concerning Indian labour law that sets the minimum wages that must be paid to skilled and unskilled labours.

The Indian Constitution has defined a 'living wage' that is the level of income for a worker which will ensure a basic standard of living including good health, dignity, comfort, education and provide for any contingency. However, to keep in mind an industry's capacity to pay the constitution has defined a 'fair wage'. Fair wage is that level of wage that not just maintains a level of employment, but seeks to increase it keeping in perspective the industry's capacity to pay. Due to an unjust attention towards the decades old law it is now exploited by

major businesses to underpay their employees, In public opinion government must set an yearly wage change just like countries internationally do.

### 10.1 History of Minimum Wages

To achieve this in its first session during November 1948, the Central Advisory Council appointed a Tripartite Committee of Fair Wage. This committee came up with the concept of a minimum wage, which not only guarantees bare subsistence and preserves efficiency but also provides for education, medical requirements and some level of comfort.

1920: K.G.R. Choudhary recommended **setting up boards for** determining **minimum wages** for **each industry**.

1928: **International Labour Conference** implemented system to fix wages for different trades. However, the practice was not put into legislation in India.

1943: Standing Labour Committee, a Labour Investigation Committee was appointed on the recommendation of Indian Labour Conference (ILC), 1943 to look into conditions of labour in terms of their wages, housing, social conditions, and employment.

1945: The first bill on minimum wages was drafted in ILC.

1946: A bill on **minimum wages was introduced in** Central Legislative assembly on the recommendations of 8th Standing Labour Committee. **The 8th meeting of the Standing Labour Committee, 1946[8]** also **recommended** that a separate legislation that specified working hours, minimum wages and paid holidays of un-organized sector be enacted.

1947: Post-independence representatives of labour, employers, and government attended a government-organized conference. They defined minimum wages to be such that they should not only provide for subsistence but should also be enough for education, medical requirements and other amenities and should sustain efficiency.

1948: The Minimum Wages Act was eventually passed and was effective from 15 March. Under the act a **tripartite committee "The Tripartite Committee of Fair Wage"** was appointed that **set** definitions and guidelines for formulating a wage structure in India. The **Committee of fair wage** definition of minimum wage as: "The minimum wages must be provided **not merely for the bare subsistence of life but also for the preservation of efficiency of the workers by providing for some measures of education, medical requirement and amenities**". Recommendations of this committee have now set the foundations of wage fixation.

1957: The 15th Labor conference added some norms in the fixation of minimum wages such that revision and fixation of wage rates are need-based. The recommendations were.

The cost of three consumption units- husband, wife and two children for one earner. Income from women and children should be ignored

Satisfy the minimum food requirement of 2700 calories per person

Clothing requirement of 72 yards for a family annually

Rent of the minimum area as specified by Government's Industrial Housing Scheme

20% of minimum wage should be the cost of fuel and miscellaneous items of expenditure

1987: Parliamentary sub-committee on unorganized labour concluded that minimum wages fail to ensure a livelihood above the government defined poverty line for the unorganized sector. It also revealed some flaws in implementation of the act. The committee noted that wages are not fixed or revised regularly in some states.[11] The committee recommended that factors such as nutrition requirements, poverty line, shelter, clothing, fuel, light, medical and educational expenses should be taken into account while fixing and revising minimum wages.[12]

1988: Labour Minister's Conference recommend the necessity of an allowance that safeguards wages against inflation, called Variable Dearness Allowance (VDA).[13]

1991: Hon'ble Supreme court's judgment in the case of Reptakas & Co. specified that 25% of the minimum wages should also account for Children's education, required medical expenses, recreation in festivals/ceremonies and provision for old age and marriage. National Commission on Rural Labour (NCRL) recommended the government to introduce a national minimum wage floor level for uniformity.

VDA became effective. It is revised twice in a year, on 1 April and 1 October.

1992: Thirtieth session of ILC observed the ineffectiveness of states' implementation machinery and labour administration. It urged the civil society especially NGOs and workers' organizations to inspect and ensure payment of minimum wages.[1] The thirtieth session also discussed that officials should be wary of fixing minimum wage rates to impracticable high levels.

1994: The 9th Centre of Indian Trade Unions conference along with insisting a minimum wage floor of Rs. 78.50, raised the following demands

The family should be taken as five units instead of three.

The Minimum Wages Act should cover all employments.

There should be full neutralization of cost of living with automatic linkage with the consumer prices index and revision after every six months or 50-point rise in the CPI, whichever is earlier.

1996: Government fixed the national minimum wage floor at INR 35/day as per the recommendations of NCRL. Since 2009 it stands at INR 100/day.

2007: The Tamil Nadu state government announced that it has fixed minimum wages for 90% of all occupations.

The Indian National Trade Union Congress appeals for a "national decent minimum wage" for all industries that would be based on workers' needs.

2008: Working Women in Houses Union marched in Salem demanding statutory fixation of minimum wages for house maids and servants.

2009: The Central government de-linked MGNREGA's wage rates from minimum wages through notification under Section 6(1). Wage rates that were initially aligned with respective states' minimum wages were now fixed at a uniform wage rate of Rs. 100/- under the scheme.

On 12 August, the Andhra Pradesh wrote to the Ministry of Rural Development that workers under the MGNREGA scheme are being paid less than the Minimum wage rate and this could attract "contempt of court". There was no response to this.

On 10 July, the Labour Department responded to the notification of wage rate in MGNREGA scheme as against the minimum wage rate: "Minimum Wages Act, 1948 guarantees minimum wages to workers and there cannot be a wage rate less than the minimum wage rate in any circumstances.

2010: Andhra Pradesh's government says that any payment including that under the MGNREGA scheme, below minimum wage rate is unconstitutional.

2011: As per Karnataka High Court's interim order MGNREGA's wage rates are to be aligned with the Minimum Wage rates of the state.

National Human Right Commission convened a zonal workshop on fixation, revision and enforcement of minimum wage is Brick kiln industry.

2012: Mazdoor Kisan Shakti Sangathan urges the Supreme Court to withdraw the SLP to the PM to rediscuss Karnataka High Court and Andhra Pradesh high Court's judgments.

Supreme Court asks the Central Government to consider respective states' minimum wages to bring parity between them.

The Labour Department decides to make revisions in minimum wage rates mandatory within three years.

2015: From 1 July 2015 the National Floor Level of Minimum Wage was raised to Rs 160 per day.

2015: On 1 September 2015 labours in unorganized sector extended their support to one-day nationwide general strike<sup>[21]</sup> called by central trade unions (CTUs). Later than Shri Bandaru Dattatreya, the Minister of State(IC) for Labour and Employment, elaborated on the initiatives and continuing efforts of the Government to address the issues and concerns of the Trade Unions

for the welfare of workers. If the norms are implemented then the minimum wage would be not less than Rs 273 per day which is currently Rs 160 per day.

### 10.2 Minimum Wages Regulations in Andhra Pradesh

Employees of establishments under the Shops and Establishments Act are entitled to payments without any deductions other than those authorized. No fine can be imposed on any employee unless they have made certain acts or omissions that were specified by the employer with previous approval from the government. These acts and omissions should be mentioned to a worker by notice.

Similarly, no fine can be imposed on any employee without giving them an opportunity of explaining against the fines unless specified by law. The total amount of fine which may be imposed in any one wage period on any employee cannot exceed 3% of the wage payable. A fine cannot be imposed on a worker under 15. Law also states that the fines imposed on an employee cannot be recovered after the expiry of sixty days from the day on which it was imposed.

Deductions on account of absence are allowed however the deduction should match the days of absence during a wage period. The deduction for damage of goods cannot exceed 50 per cent of the amount of damaged goods. A notice must be served to the workers, with an opportunity to explain, prior to any such deduction. Deductions for recovery of an advance of money given before employment began can be made from the first payment of wages. However, no recovery can be made of such advance given for travelling expenses.

### 10.3 Regular Pay in Andhra Pradesh

Every employer is responsible for the payment by him to employees of all wages and sums, required to be paid under this Act. Every employer must fix periods in which wages are payable. No wage period can be more than one month. The wages of every employee must be paid before the end of the fifth day after the last day of the wage period. Where the service of any employee is terminated by the employer, the employee should receive their wage before the expiration of two days from termination.

In organizations with less than 1000 workers, contract labourers should be paid their wages within 7 days after their wage cycle. In other organizations, this payment should be paid before the 10th day. All payments of wages must be made on a working day at the work premises and during the working time. This date and time should be notified to the workers in advance. In case the work ends before the average wage period, contract workers should be paid within 48 hours of the last working day.

Wages due to every worker must be paid to such workers directly or to another person authorized by the worker. Wages must be paid without any deductions of any kind except those specified by the State Government by general or special order. Employers are supposed to

display a notice with all the payable wages at a visible place at the establishment. A representative of the principal employer should be present every time the contractor is giving out the wages. The contractor should ensure that such an authorized representative is present. The principal employer may also ensure written slips of all disbursed wages.

Source: Section 63-73 of Andhra Pradesh Contract Labour (Regulation and Abolition) Rules, 1971; Section 35, 36, 38, Andhra Pradesh Shops and Establishments Act, 1988

#### 10.4 Wage Boards in India

The Wage Boards in India consists of three parts which simultaneously works in union with workers, employers and independent members. Apart from the Wage Boards for journalists and news-agency employees, all other Wage Boards are non-statutory in nature. The wage board is, as a rule, tripartite body representing the interest of labor, management and the public. Labor and management representatives are nominated in equal numbers by the government, after consultation with and with the consent of major central organizations.

Wage boards are set up by the Government, but in selection of members of wages boards, the government cannot appoint members arbitrarily. Members to wage boards can be appointed only with the consent of employers and employees. The representatives of employers on the wage boards are the nominees of employers' organization and the workers' representatives are the nominees of the national center of trade unions of the industry concerned.

The composition of wage boards is as a rule tripartite, representing the interests of labor, Management and Public. Labor and management representatives are nominated in equal numbers by the government, with consultation and consent of major Central Organizations. These boards are chaired by government nominated members representing the public. Wage board function industry-wise with broad terms of reference, which include recommending the minimum wage differential, cost of living, compensation, regional wage differentials, gratuity, hours of work etc.

#### 10.5 The main objectives of wage boards are;

1. To work out wage structure based on the principles of fair wages as formulated by the Committee on Fair Wages.
2. To work out a system of payment by results.
3. To evolve a wage structure based on the requirements of social justice.
4. To evolve a wage structure based on the need for adjusting wage differentials in a manner to provide incentives to workers for advancing their skill.

#### A) Composition and Functions of Wage Boards

The wage board is, as a rule, tripartite body representing the interest of labor, management and the public. Labor and management representatives are nominated in equal numbers by the government, after consultation with and with the consent of major central

organizations. Generally, the labor and management representatives are selected from the particular industry which is investigated. These boards are chaired by government – nominated members representing the public. They function industry – wise with broad terms of reference, which include recommending the minimum wage, differential cost of living compensation, regional wage differentials, gratuity hours of work, etc.

**B) Wage boards are required to:**

1. Determine which categories of employees (manual, clerical supervisory, etc.) are to be brought within the scope of wage fixation.
2. Work out a wage structure based on the principles of fair wages formulated by the committee on fair wages.
3. Suggest a system of payment by results.
4. Work out the principles that should govern bonus to workers in industries.

In addition to these common items, some wage boards may be asked to deal with the question of Bonus (like that of the wage boards for cement, sugar and jute industries); gratuity (like that of the wage boards for iron ore mining, limestone and dolomite mining industries) and the second wage board on cotton textile industry; demands for payments other than wages (wage boards for jute and iron and steel industry); hours of work (rubber plantation industry); interim relief (wage boards for jute industry and post and dock workers). Some wage boards (Wage boards for sugar, jute, iron ore, rubber, tea and coffee plantations, limestone and dolomite mining industries) have been required to take into account the 'special features of the industry'.

1. Thus, wage boards have had to deal with a large number of subjects. Of these, the fixation of wage – scales on an industry – wise basis constitutes the biggest of all the issues before them. In evolving a wage structure, the board takes into account:
2. The needs of the industry in a developing economy including the need for maintaining and promoting exports:
3. The requirements of social justice, which ensures that the workman who produces the goods has a fair deal, is paid sufficiently well to be able at least to sustain himself and his family in a reasonable degree of comfort, and that he is not exploited;
4. The need for adjusting wage differentials (which is in relation to occupational differentials; inter-firm differentials; regional or inter-area differentials; inter-industry differentials and differentials based on sex) in such a manner as to provide incentives to workers for improving their skills.

For the determination of fair wages, the board has to take into consideration such factors as the degree of skill required for his work, the fatigue involved, the training and experience of the worker, the responsibility under-taken, the mental and physical requirements for work, the disagreeableness or otherwise of the work and the hazards involved in it. The board is required to



make due allowances for a fair return on capital, remuneration to management and fair allocation to reserve and depreciation.

### C) Working of Wage Boards

Although wage boards are set up by the government, the basic reason for their establishment is the pressure brought to bear on the government, by the trade unions, industrial federations and national organizations on the one hand after the employers' formal or informal consent on the other. Pressure has been used for the appointment of wage boards for the jute industry by the jute workers association and for the coal mining industry by their trade union. The formation of wage boards in other industries has been the result of similar demands and pressures on the part of trade unions – such as plantations, iron and steel, engineering, sugar and electricity.

The government cannot appoint members of the wage boards in an arbitrary way. Independent members can be appointed only with the consent of employers and employees. The representatives of employers on wage boards are the nominees of the employer's organization and the workers representatives are the nominees of the national organization of trade unions of the industry concerned. However, before their actual appointment, a great deal of negotiations takes place not only between the two main recalcitrant interests but also among different groups representing particular interests.

Item to be included for the consideration of the wage boards are the outcome of the negotiations between the parties. The issues are unanimously determined by trade unions and employers; but these invariably relate to gratuity, bonus, hours of work and grant of interim relief. The quantum of interim relief is also decided by negotiations and bargaining which have sometimes resulted in temporary deadlocks.

### D) The wage boards functions in three steps:

1. The first step is to prepare a comprehensive questionnaire designed to collect information on the prevailing wage rates and skill differentials, means of assessing an industry's paying capacity and workloads, prospects for industry in the immediate future, and regional variations in the prices of widely consumed consumer goods. The questionnaire is sent out to labor unions, employers associations, interested individuals, academic organizations and government agencies.
2. The second step is to give a public hearing at which leaders of labor unions and employers associations, not represented on the board, as well as others interested in the industry in question are given a verbal or oral bearing on issues dealing with wages, working conditions and other items.
3. The third step is to convene secret sessions at which members of the board make proposals and counter – proposals regarding the items covered under the terms of reference.

In the case of failure to reach a unanimous decision on the issues, each party has the right to veto the others decision.

The role of independent members on the board is limited to conciliation and mediation; they try to prevent deadlocks by promoting communication between labour and management representatives. They also offer advice and suggestions to the parties, but the final decision must result from the parties give – and – take attitudes and compromises.

The main reasons for the delay in the completion of wage boards work have been :

1. Routine delays in the recruitment of staff; preparation and printing of questionnaires;
2. Getting replies to questionnaires
3. Time involved in public hearings and
4. Lack of accord among members in arriving at a decision.

#### 10.6 Evaluation of the Wage Boards

The boards have been successful in fulfilling their primary object of promoting industry – wise negotiations and active participation by the parties in the determination of wages and other conditions of employment. The board's deliberations and awards have contributed significantly towards the development of a national and 'development oriented' outlook on questions pertaining to particular areas and sectors. They have given serious attention to the impact (of wage increase) on factors like prices, employment and the profitability of the industry.

The committee setup by the National Commission on Labour identified three major problems from which the wage boards suffer:

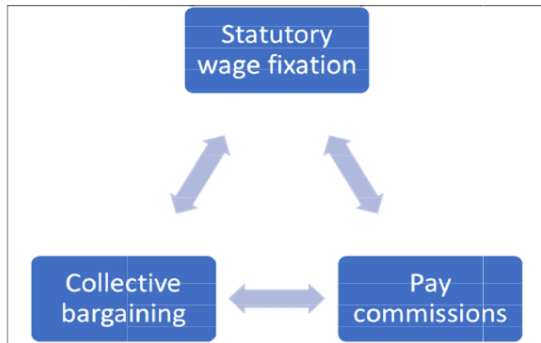
1. A majority of the recommendations of the wage boards are not unanimous.
2. The time taken by the wage boards to complete their task has been rather unduly long and
3. The implementation of the recommendations of the wage boards has been difficult.

A) The committee made some important recommendations. These have been given below:

1. The chairman of the wage should selected by common consent of the organizations of employers and employees in the industry concerned.
2. In future, the wage board should function essentially as machinery for collective bargaining and should strive for unity.
3. Wage boards should be assisted by technical assessors and experts.
4. The terms of reference of wage boards should be decided by the government in consultation with the organizations of employers and the workers concerned.
5. A central wage board should be set up in the Union Ministry of Labour on a permanent basis to serve all wage boards through the supply of statistical and together material and lending of the necessary staff.

6. Unanimous recommendations of wage boards should be accepted and in case of non – unanimous recommendations, the government should hold consultations with the organizations of employers and employees before taking a final decision.
7. Wage boards should not be set up under any statues, but their recommendations, as finally accepted by the government, should be made statutorily binding on the parties.
8. For the industries covered by wage boards, permanent machinery should be created for follow-up action.
9. Wage boards should complete their work in one years time and the operation of its recommendation should be between two or three years, after which the need for a subsequent wage boards should be considered on merit.

If these recommendations are accepted, the working of wage boards may be made more affective.



### 10.7 Collective Bargaining

Collective bargaining is the process in which working people, through their unions, negotiate contracts with their employers to determine their terms of employment, including pay, benefits, hours, leave, job health and safety policies, ways to balance work and family, and more. Collective bargaining is a way to solve workplace problems. It is also the best means for raising wages in America. Indeed, through collective bargaining, working people in unions have higher wages, better benefits and safer workplaces.

The term collective bargaining refers to the negotiation of employment terms between an employer and a group of workers. Employees are normally represented by a labor union during collective bargaining. The terms negotiated during collective bargaining can include working conditions, salaries and compensation, working hours, and benefits. The goal is to come up with

a collective bargaining agreement through a written contract. According to the International Labour Organization, collective bargaining is a fundamental right for all employees.

### **10.8 How Collective Bargaining Works**

As noted above, the International Labour Organization (ILO) states that collective bargaining is a fundamental right available to all workers. This means that all employees are entitled to present their grievances to their employers and to be able to negotiate them. According to the ILO, collective bargaining helps reduce inequalities in the workplace while providing workers with labor protection.

Collective bargaining normally takes place between members of corporate management and labor union leaders, who are elected by workers to represent them and their interests. Collective bargaining is initiated when employee contracts are up for renewal or when employers make changes to the workplace or contracts. These changes include, but aren't limited to:

- a) Employment conditions
- b) Working conditions and other workplace rules
- c) Base pay, wages, and overtime pay
- d) Work hours and shift length
- e) Holidays, sick leave, and vacation time
- f) Benefits related to issues such as retirement and healthcare

These issues fall into three different categories, which are referred to as mandatory subjects, voluntary subjects, and illegal subjects. Mandatory subjects include anything that the law requires of the employer, such as salary, overtime, and workplace safety. Voluntary subjects include negotiable things the law doesn't require like union issues and decisions about employer board members. Illegal subjects involve anything that violates laws, such as workplace discrimination. The goal of collective bargaining is called a collective bargaining agreement. This agreement is meant to establish rules of employment for a set number of years. Union members pay for the cost of this representation in the form of union dues. The collective bargaining process may involve antagonistic labor strikes or employee lockouts if the two sides have trouble reaching an agreement.

### **10.9 Collective Bargaining Steps**

Collective bargaining can be an intense process that can be stressful and difficult for all parties involved. It often involves a lot of back-and-forths, with offers and counteroffers. But the end goal is to reach an agreement.

The process goes through a number of stages. These steps can be summed up as follows:

- a) Identifying the issues and preparing the demands
- b) Negotiating

- c) Coming to a tentative agreement
- d) Accepting and ratifying the agreement
- e) Administering the agreement

There are instances, though, where the parties involved can't come to an agreement. If the negotiation period expires without a collective bargaining agreement in place, union representatives may suggest that workers go on strike until their demands are met.

Employers, on the other hand, may decide to lock out their employees until a suitable agreement is reached. If they are locked out, employees have the right to picket. In most cases, neither party wants to reach these points, which are considered drastic measures that are used as a last resort.

#### 10.10 Types of Collective Bargaining

Not all types of collective bargaining are the same. In fact, collective bargaining can be divided into several categories. We've noted some of the most common types below.



##### A) Composite Bargaining

Composite bargaining has nothing to do with compensation. Instead, it focuses on other issues, such as working conditions, job security, and other corporate policies. These may include hiring and firing practices as well as workplace discipline. The goal of composite bargaining is to come up with a suitable agreement leading to a lasting and harmonious relationship between employers and their employees.

##### B) Concessionary Bargaining

As its name implies, concessionary bargaining focuses on union leaders making concessions in exchange for job security. This is common during an economic downturn or recession. Union leaders may agree to give up certain benefits in order to guarantee the survival of the employee pool and, ultimately, of the business.

### C) Distributive Bargaining

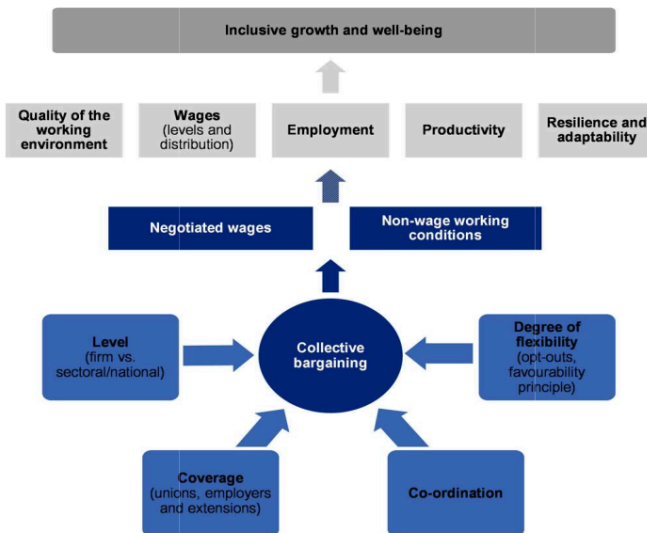
This process is characterized as benefitting one party financially at the expense of the other. This can come through increased bonuses, salaries, or any other financial benefits. Distributive bargaining normally favors workers over employers. Unions must have a higher degree of power in order for distributive bargaining to work. Higher membership means more power. If an employer refuses to accept a union's demands, it can call a strike.

### D) Integrative Bargaining

Each party tries to benefit through integrative bargaining, which is why it's often referred to as a form of win-win bargaining. Each side tries to consider the other's position and bring issues to the table that aim to benefit both parties. As such, employees and employers both stand to lose and gain with integrative bargaining.

### E) Productivity Bargaining

This type of bargaining revolves around compensation and the productivity of employees. Labor union leaders often use higher salaries and compensation as a way to boost employee productivity, which leads to higher profits and value for the employer. In order for this kind of bargaining to work, both parties need to agree to financial terms in order to increase productivity.



### 10.11 Advantages of Collective Bargaining

As the name implies, workers have a larger voice through collective bargaining. Being in a group with the same goal(s) gives employees more power to negotiate demands with their employers. Companies may be able to shut out the voices of one or two employees but can't necessarily do the same with a larger group of unified individuals. Workplace conditions can see significant improvements and guarantee all workers with the same protections under collective bargaining. This includes the implementation of health and safety checks as well as suitable salaries, overtime pay, and vacation time. Employers and employees are fully aware of their rights and responsibilities under a collective bargaining agreement. Once employment terms are negotiated, a contract is drawn up. Both parties agree to the terms, which are clearly defined.

### 10.12 Disadvantages of Collective Bargaining

As mentioned above, collective bargaining is often a long, drawn-out process that can take weeks or even months. Employers and labor union leaders may have to go back and forth with employment terms. Union leaders are required to update employees and must put the terms to a vote. If employees vote to reject a contract, the negotiating process begins again. Collective bargaining often comes at a high cost. Employees and employers may have to take time off from work in order to negotiate. This means less time on the job and, therefore, a drop in productivity. Lengthy negotiations can affect a company's bottom line. The process is often considered biased. Because employees are able to band together under a single union, employers may be forced to negotiate and accept unfavorable terms in order to keep their businesses running without much disruption.

### 10.13 Criticisms of Collective Bargaining

Collective bargaining is a controversial subject, particularly when it comes to public-sector workers. Because tax revenues fund wages for public-sector employees, opponents allege that the practice leads to excessive pay that places an undue burden on taxpayers. Supporters argue that any worries about runaway pay are unfounded and that public-sector employees covered by collective bargaining agreements earn, at most, 5% more than their nonunion peers. Former Governors Chris Christie of New Jersey and Scott Walker of Wisconsin fought high-profile battles with public-sector unions. Christie drew fire from the New Jersey Education Association (NJEA) for restructuring teacher pensions to rein in state spending. Walker's initiative to limit teachers' collective bargaining rights in Wisconsin proved so controversial that its opponents succeeded in collecting enough signatures to force a recall election against Walker in June 2012. The governor prevailed in the election.

### 10.14 Summary

The main conclusion to be drawn from this analysis is that, historically, it was very often the minimum wage that triggered the development of collective. The wage is the monetary

measure corresponding to the standard units of working time (or to a standard amount of accomplished work, defined as a piece rate). The earliest such unit of time, still frequently used, is the day of work. Collective Bargaining and Labor Relations is a college-level text which explores the history and current practice of union-management relations, and collective bargaining. Collective Bargaining and Labor Relations will be of interest to those who seek a better understanding of contemporary labor relations, and of the role of unions in collective bargaining. This work is divided into eighteen chapters grouped into eight parts. Each chapter ends with discussion questions and exercises.

#### 10.15 Key Words

- Collective bargaining is the process of negotiating the employment terms between an employer and a group of workers.
- The process takes place between company management and a labor union.
- Concerns and issues that may come up during collective bargaining include working conditions, salaries and compensation, working hours, and benefits.
- The goal of collective bargaining is to come up with a collective bargaining agreement or contract.
- There are several types of collective bargaining, including composite concessionary, distributive, integrative, and productivity bargaining.

#### 10.16 Self Assessment Questions

1. Define the term wage? What are the statutory provisions of wages?
2. Discuss the system of wage boards in India ?
3. What is collective bargaining? Role of ILO in collective bargaining?
4. Critically examine the advantages and disadvantages of collective bargaining?

#### 10.17 Further Readings

1. Wage and Salary Administration, by Radha Gupta, December 2017, Anmol Publisher, ISBN-10 9788126131082
2. OECD (2019), "Education at a glance: Educational attainment and labour-force status", OECD Education Statistics (database), <https://dx.doi.org/10.1787/889e8641-en> (accessed on 31 October 2019).
3. OECD (2019), OECD Employment Outlook 2019: The Future of Work, OECD Publishing, Paris, <https://dx.doi.org/10.1787/9ee00155-en>.
4. OECD (2018), Good Jobs for All in a Changing World of Work: The OECD Jobs Strategy, OECD Publishing, Paris, <https://dx.doi.org/10.1787/9789264308817-en>.

**Dr.K. Madhu Babu**



**LESSON - 11**  
**ADJUDICATION**

**Learning Objectives**

- ✓ To study the adjudication
- ✓ To understand the adjudication
- ✓ To know the process of adjudication
- ✓ To discern the problems of adjudication

**Structure**

- 11.01 Understanding Adjudication**
- 11.00 Introduction**
- 11.02 Administrative Adjudication**
- 11.03 Need for Administrative Adjudication**
- 11.04 Problems in Adjudication by Administrative**
- 11.05 Rules of Natural Justice applicable in Administrative Adjudication**
- 11.06 Reasons for the growth of Administrative Adjudication**
- 11.07 Administrative Tribunal**
- 11.08 Adjudication Process**
- 11.09 Deciding the Adjudication**
- 11.10 Informal Adjudication**
- 11.11 Arbitration and Adjudication**
- 11.12 Summary**
- 11.13 Key Words**
- 11.14 Self – Assessment Questions**
- 11.15 Further Readings**

**11.00 Introduction**

Adjudication refers to the legal process of resolving a dispute or deciding a case. When a claim is brought, courts identify the rights of the parties at that particular moment by analyzing what were, in law, the rights and wrongs of their actions when they occurred.

An adjudication is a legal ruling or judgment, usually final, but can also refer to the process of settling a legal case or claim through the court or justice system, such as a decree in the bankruptcy process between the defendant and the creditors.

Normally, an adjudication represents the final judgment or pronouncement in a case that will determine the course of action taken regarding the issue presented. Outside of a legal process, adjudication can also more generally refer to other formal processes of judgment or ruling that render a final decision, such as the process of validating an insurance claim.

#### **11.01 Understanding Adjudication**

Adjudication describes the legal process that helps expedite and deliver a court's resolution regarding an issue between two parties. The result of the process is a judgment and court opinion that is legally binding. Most adjudication hearings center on disputes that involve money or nonviolent infractions and result in the distribution of rights and obligations for all parties involved.

Adjudication specifically refers to the process and decision issued by a government-appointed (or elected) judge, as opposed to a decision issued by an arbitrator in a private proceeding or arbitration. While both judges and arbitrators are expected and required to follow the law, judges' adjudications also must take into account the interests of the government and general public interest. Arbitration, meanwhile, only needs to consider the interests of the parties involved.

This legal process differs from other justice-seeking or evidence-based court cases. It is instead used to settle disputes between private parties, political officials and a private party, and public bodies and public officials. In the healthcare industry, for example, adjudication can determine a carrier's liability for monetary claims submitted by an insured person.

#### **11.02 Administrative Adjudication**

'Administrative decision-making' or 'Administrative Adjudication' is a by-product of an intensive form of government, and consequential socialization of law (thus causes for the evolution of administrative adjudication and delegated legislation are same); the traditional judicial system cannot give to the people that quantity and quality of justice which is required in a welfare state, because it is the highly individualistic and ritualistic approach.

Natural justice is the common law doctrine that provides important procedural rights in administrative decisions- making. The doctrine now has a wide application and is presumed by the courts to apply the exercise of virtually all statutory powers. But the courts have also accepted that natural justice can be excluded by legislation that is expressed in sufficiently clear terms. The doctrine (natural justice) is now termed as a synonym of fairness in the concept of justice and stands as the most accepted methodology of governmental action.

It is a settled position of law that the rules of natural justice have many facets and cannot be put in a straitjacket formula; in other words, they are flexible. Rules of natural justice are synonymous to fairness in the backdrop of common sense. Natural justice is another name for common-sense justice.

Administrative decision-making' or 'Administrative Adjudication' is a by-product of an intensive form of government, and consequential socialization of law (thus causes for the evolution of administrative adjudication and delegated legislation are same); the traditional judicial system cannot give to the people that quantity and quality of justice which is required in a welfare state, because it is the highly individualistic and ritualistic approach.

#### **11.03 Need for Administrative Adjudication**

(i) It provides a system of adjudication which is informal, cheap, and rapid, unlike the traditional courts.

(ii) It explores new public law standards based on moral and social principles away from the highly individualistic norms developed by courts. For example, the Employees' State Insurance Scheme in India required a new standard of medical service and treatment to which all the insured population and doctors must conform. The setting up of new standards requires expertise, specialization, and experimentation which can be provided by the administration.

(iii) Nowadays, there is a growing emphasis on preventive justice rather than punitive. This can be done only by administrative agencies exercising adjudicatory powers.

However, it is being said that strategy of administrative adjudication was developed not as a result of public necessity but for governmental convenience and expediency. People doubt the independence of administrators as judges and also fear their anti-legal approach.

#### **11.04 Problems in Adjudication by Administrative**

Administrative justice has been a host of controversies in India. A few common problems the adjudicative process occurs are as follows:

(i) Number and complexity— A large number of adjudicative bodies have come up in recent times; every statutory scheme contains its own machinery for decision-making. A large number of parallel bodies adjudicating on the same kind of disputes give diverse decisions and adopt a variety of procedures. Because the principles of natural justice are not rigid and do not apply uniformly in all situations, the consequent results at times in arbitrary actions.

(ii) Unsystematic system of appeal: No uniform system of appeal is there. Sometimes, decisions are made appealable before an independent tribunal as in tax cases, and sometimes before a higher administrative agency. Some acts do not provide for any appeal.

(iii) Invisibility and anonymity of decisions: Not all the administrative agencies exercising judicial power publish their decisions; their decisions thus go beyond the Pale of public criticism. Also, often the decisions are made in a 'hole and the corner' fashion. No one knows where the decision comes.

(iv) Unpredictability and anonymity of decisions: Administrative agencies do not follow the doctrine of precedent, hence they are not bound to follow their decisions. This ad hocism not only makes the development of law incoherent but also violates the principles of the rule of law.

(v) Combination of functions: Except in the case of civil servants, in all disciplinary proceedings, the functions of a prosecutor and the judge are either combined in one person or in the same department, in such a situation bias is inevitable.

(vi) No evidence rule: In India, the technical rules of the Evidence Act do not apply to administrative adjudications. The gap is filled, true inadequately, by the judge-made rule of 'No Evidence'.

(vii) Official perspective and official bias: In administrative justice, an official perspective is inherent. In any disciplinary proceedings of presumption is of guilt rather than innocence. The actions are taken on the basis of expediency and various other extra-legal considerations. Official or departmental bias is very common e.g. Strong and sincere conviction as to public policy or bias results due to pecuniary interest.

(viii) Plea bargaining: It means the bargaining of 'plea of guilt' with lesser charges and punishment. A poor employee is bullied by an overbearing superior to accept the charge against him on a promise that a lesser punishment will be awarded.

(ix) Political interference: Instrumentalities of Administrative justice are, by their very nature, subject to some more manner of political interference.

(x) Reasoned decisions: Generally there is no requirement for the administrative authority to give reasons, which undermines the faith in administrative justice.

(xi) Legal representation and cross-examination: There is no general requirement for administrative authority to allow legal representation and cross-examination in every case.

In order to create confidence among the people in administrative justice, a code prescribing a minimum procedure of Administrative agencies must be adopted; till this is done, judicial review must be enlarged by using the test of reasonableness of Administrative findings of the fact and law.

#### **11.05 Rules of Natural Justice applicable in Administrative Adjudication**

The principles of natural justice, in brief, are as follows:

1. That every person whose rights are affected must have reasonable notice of the matter that he has to meet.

2. That he must have a reasonable opportunity of being heard in his' defense.

That the hearing must be an impartial person i.e. A person who is neither directly or indirectly a party to the case. One who has an interest in the litigation is already biased against the party concerned.

4. That the authority of hearing the case must act in good faith and not arbitrarily but reasonably.

Salient features of Natural Justice

The salient features of natural justice are summed up as follows:

1. The allegation should be specific and precise and ought to be produced in writing. The charges framed against the workman on the basis of allegations should be such as are qualitative and specific provisions of the service rules or the notified standing orders applicable to the establishment.

2. Reasonable time should be given to the delinquent the employee to reply to the charge-sheet and prepare for his defense, inquiry is to be conducted.

3. Inquiry officer appointed for conducting domestic inquiry should be totally unbiased and not connected with the incident. He should not appear as the prosecution witness himself.

4. All prosecution witnesses should be examined individually in the presence of a delinquent employee and their statements recorded. Pre-recorded should not be on the record of the inquiry proceedings.

5. The delinquent employee or his Defense Representative should be given ample opportunity to cross-examine the witness and the replies of the witness should be recorded by the inquiry officer.

#### **11.06 Reasons for the growth of Administrative Adjudication**

Administrative Adjudication protect the rights of citizens at the cost of the state authority. Following mentioned are some of the reasons contributing to the growth of Administrative Adjudication:

Administrative authorities can help in taking various preventive and cautionary measures. As it has been observed that the disputing parties approach the courts of law for redressal, however, the same is not the case with Administrative authorities as herein, the preventive actions are already taken which then prove to be more effective and useful than what happens in regular courts i.e. punishing the perpetrator after he has committed a breach of law.

Administrative authorities endure effective measures for the enforcement of the aforesaid preventive measures e.g. suspension, revocation and cancellation of license, destruction of contaminated articles etc., which are not generally available through regular courts of law.

The judicial system of India is considered to be inadequate in deciding and settling all kinds of disputes, for the reasons it being, slow, incompetent, costly, complex and formal. The Indian court are already overloaded with number of cases and it becomes impossible to expect speedy disposal of even very important matters. Thus, the development of administrative authorities such as industrial tribunals and labour courts have led to bring a relief in the number of cases. Lastly, these tribunals had updated techniques and expertise to handle such complex issues.

The legislative process followed in our country is considered to be quite inappropriate. The lengthy proceedings and obsolete techniques followed in the Indian courts make the process of delivering justice delayed. Even having detailed provisions in some legislations made by the legislature, they are considered to be defective. Therefore, it the need of the hour to delegate some powers to the administrative authorities.

### **11.07 Administrative Tribunal**

In administrative law, tribunal is a body that practices power to adjudicate. 'Tribunals' are not termed as ordinary courts. Article 136 of the Constitution[1] recognizes the status of tribunals which gives power to the Honourable Supreme Court of India (hereinafter, 'the Apex Court') to give a special leave to appeal from any judgment, decree, order, determination or sentence by any Tribunal in India. Similarly, Article 227[2] gives power to the High Court to be superior over every Tribunal within their jurisdiction.

By the 42nd Constitutional Amendment, Articles 323A[3] and 323B[4] have been added in the Constitution vide which the Parliament was authorised to include an administrative tribunal for the matters that arise from service and adjudication of the matter mentioned therein.

#### **A) Need For Administrative Tribunals**

There are various reasons that lead to formation of administrative tribunals. These are:

The inadequacy of judicial system: Traditional judicial system has proved to be inadequate in presiding over every conflict that needs to be resolved. Also, it is slow, complex, costly, lacks expertise and is very formal. It has been burdened excessively and one cannot expect a fast execution in all matters. For instance, conflicts between employees and employers comprising of strikes and lockouts among other disputes is an issue that cannot be settled only through stern interpretation of law. Various other factors need to be taken into consideration and for that one needs a body of experts. This comes in the form of Industrial Tribunal and Labour courts

The judicial system is conservative, rigid and technical: This is one of main reasons for establishment of tribunals. The conventional judicial system is out-dated, stern and technical.

Always by the book. Administrative authorities on the other hand can do away with technicalities. Tribunals are not held by stern rules of evidence and procedure. They make use of practical aspects to settle practical issues.

**i)Provisions for preventive measures:** Unlike ordinary courts, administrative authorities can take preventive measures such as licensing and rate-fixing even before the parties in dispute appear.

**ii)Effective enforcement:** Administrative authorities can undertake such processes to enforce the preventive measures that were mentioned earlier which may include suspension, cancellation or revocation of licenses and destruction of contaminated articles among others. The conventional courts usually don't have these solutions.

**iii)Need for expertise:** Disputes are naturally technical sometimes. It is not expected of the judicial system to preside over such technicalities and decide them. Administrative tribunals are handled by experts and thus are able enough to cater to and solve such issues.

**iv)Others:** To add to all of it, administrative adjudication is inexpensive, fast and flexible

#### **11.08 Adjudication Process**

The first and most important step in the proceeding is service by the claimant of the notice of adjudication. Adjudication is initiated by a claimant serving written notice of the claimant's intention to refer a dispute to adjudication on the other party or parties to the construction contract, and the owner of the construction site if a determination of an owner's liability is sought under section 30(a) of the Construction Contracts Act (the Act) and approval of a charging order is sought under section 30(b) of the Act.

The requirements for a notice of adjudication are set out in section 28(2) of the Act. The requirements are mandatory. There is very little discretion regarding compliance with section 28(2) afforded the adjudicator under section 64, in the event of a failure on the part of the claimant to include the required information.

The notice of adjudication must state:

- a) the date of the notice;
- b) the nature and a brief description of the dispute and of the parties involved;
- c) details of where and when the dispute arose;
- d) the relief or remedy that is sought;
- e) whether approval for the issue of a charging order under section 29 is being sought;
- f) whether a determination of the owner's liability under section 30(a) and an approval for the issue of a charging order under section 30(b) are being sought;

details sufficient to identify the construction contract to which the dispute relates including: the names and addresses of the parties to the contract and, if available, the addresses that the parties have specified for service of the notices.

A notice of adjudication must also set out prominently, in the prescribed form, a statement of the respondent's rights and obligations in the adjudication and a brief explanation of the process.

As with formal rulemaking, parties must receive notice of a pending adjudication. The notice must contain information regarding the time and place of the hearing, the legal authority under which the adjudication will be held and the substance of the facts and law at stake in the adjudication. The notice also must contain instructions for the party regarding any required submissions to respond to claims to be adjudicated in the hearing.

Federal law does not require prehearing discovery. Instead, fact finding is accomplished through the mandatory disclosure of information by agency officials.

Parties to the adjudication can also compel witnesses to appear at the hearing through the issuance of subpoenas and may compel the witnesses to present documents at the hearing. Some agencies require the party requesting a subpoena to demonstrate that the evidence being sought is relevant and the scope of the subpoena is reasonable. Some governmental information is also available through the use of Freedom of Information Act requests.

Parties have the right to cross-examine witnesses at adjudication proceedings. The courts, however, have upheld agency decisions limiting cross examination to cases in which a party has made sufficient showing that they are necessary.

The rules of evidence for an agency hearing differ from those of a trial. The general rule for an agency hearing is that any relevant evidence is admissible. Rules limiting the admissibility of evidence in civil litigation, such as the rule against admission of hearsay, do not apply to agency adjudications. Administrative Law Judges may, however, exclude evidence on the grounds that it is immaterial or repetitious.

Generally, the agency may only rely on evidence that is part of the official record when deciding an adjudication. The record consists of testimony transcripts, exhibits and documentation filed over the course of the hearing.[24] If an agency relies on evidence, such as scientific data, which is not part of the official record, this may constitute a violation of due process.[25] However, agency officials may utilize expertise they have gained while serving as adjudicators for specific policy areas to weigh the evidence before them. This may include rejecting the findings of expert testimony as presented in the hearing.

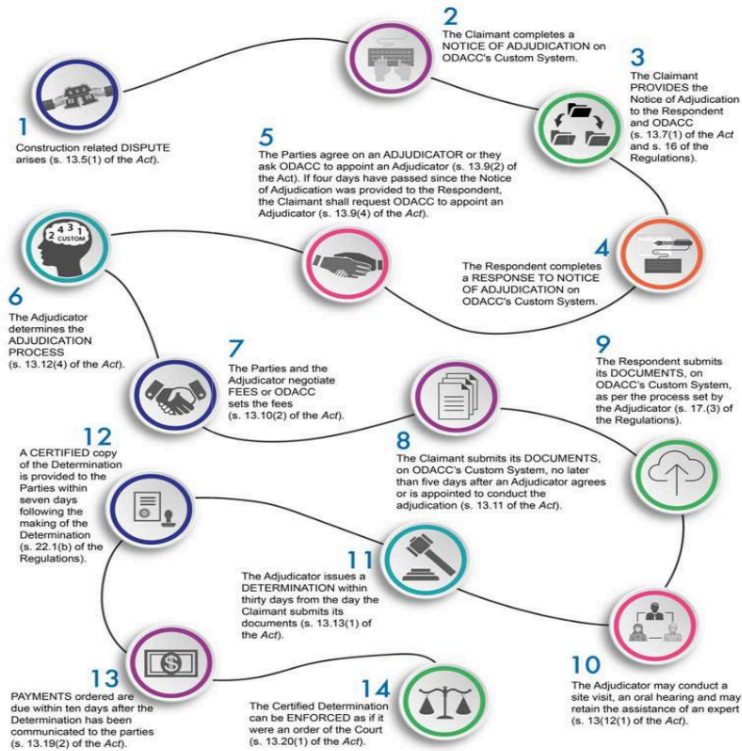


### A) Commencement of adjudication:

The adjudication process commences when the Claimant provides the Respondent with a Notice of Adjudication (and sends ODACC an electronic copy). For further information on how to commence an adjudication, please refer to Commencing an Adjudication.

### B) Response:

The Respondent may then provide the Claimant (and ODACC) with a Response to Notice of Adjudication. For further information on how to respond to a Notice of Adjudication, please refer to Response to Notice of Adjudication.



**C)Adjudicator Selection**

After the Respondent receives the Notice of Adjudication, the Claimant and the Respondent have four days to select an Adjudicator and obtain the Adjudicator's consent to act as the Adjudicator. Adjudicators have the right to refuse to conduct an adjudication. For an Adjudicator to be officially appointed to an adjudication, the Adjudicator must agree to conduct the adjudication (s. 13.9(6) of the Construction Act). If the Parties cannot agree on an Adjudicator, either Party can ask ODACC to appoint an Adjudicator. ODACC will appoint an Adjudicator within seven days of receiving the appointment request. For further information on the Adjudicator selection process, please refer to Selecting an Adjudicator.

**D)Adjudication Process:**

The Adjudicator will conduct the adjudication in the manner he or she determines appropriate in the circumstances, in accordance with s. 13.12(4) of the Construction Act. Some adjudications may include a hearing by videoconference, some may have an in-person hearing, some may require a site visit, and some may proceed only with documents. For further information about the adjudication process, please refer to Adjudication Process.

**E)Negotiating Fees:**

After an Adjudicator consents to adjudicate a dispute, the Adjudicator will contact the Parties to negotiate the Adjudication Fee. The Adjudication Fee may consist of a flat fee, or an hourly rate (plus disbursements). If the Adjudicator and the Parties cannot agree on an Adjudication Fee, the Adjudicator may ask ODACC to set the fee. ODACC will set the fee in accordance with the Schedule of Fees approved by the Attorney General for Ontario. For further information on fees, please refer to the Schedule of Fees and Fees, Retainers and Payments.

FAQ: Who is responsible for paying the cost of adjudications? The Parties to an adjudication are responsible for an equal share of the adjudication fees unless the Adjudicator orders otherwise (s. 13.10(3) of the Construction Act). Each Party to an adjudication will be responsible for their own costs, regardless of the outcome (s. 13.16 of the Construction Act). Pursuant to s. 13.17 of the Construction Act, an Adjudicator has the discretion to order a party to pay all or a portion of the other Party's costs where the Party acted in a manner that was "frivolous, vexatious, an abuse of process or other than in good faith".

**F)Parties Submit Documents:**

When the Adjudicator communicates the adjudication process to the Parties, the Adjudicator will specify the supporting documents (and number of pages) that each Party may submit to the Adjudicator for consideration. The Claimant's supporting documents are due within five days of the appointment of the Adjudicator. The Adjudicator will notify the Respondent as to when it

must submit its supporting documents. For further information on supporting documents, please refer to Supporting Documents.

**G) Determination Due Date:**

The Adjudicator will make a Determination within thirty days from the day the Claimant submits its documents (the "Due Date"). The Due Date may be extended with the consent of all the Parties and the Adjudicator. For further information on Determinations, please refer to Determinations.

**11.09 Deciding the Adjudication**

A decision issued by an agency conducting an adjudication, including an initial or final decision, must state the findings and conclusions of the decision-maker regarding all matters of law and fact, as well as the basis for the decision. The decision itself may take the form of an order, a sanction, a grant of relief or a denial of any of these. The requisite statement of findings and reasons provides a basis for a petitioner to decide on the grounds for an appeal for judicial review of the agency's actions. It can also serve as the basis for the courts to review the decision, should the case be subject to judicial review. The Administrative Procedures Act also provides an opportunity for a party to submit a proposed statement of finding and reasons, and the decision-maker must address the proposed statement in its statement of findings and reasons.

Note that when agency heads simply affirm the initial decision of an administrative law judge, they need not issue a separate statement of findings and reasons.

The courts have imposed a requirement that the agency head, or whoever makes the final determination, be sufficiently familiar with the evidence and arguments presented at trial in order to render a valid decision. This requirement stemmed from a case in which the Secretary of Agriculture made a determination regarding stockyard rates without reading the evidence or arguments presented at the adjudication hearing at which a subordinate presided. The court held that the inattention to the record constituted a denial of the right of the parties to a "full hearing."

In practice, however, it is difficult to establish a violation of this familiarity requirement to a degree necessary to vacate an agency decision.

Agencies generally follow previously decided matters of law based on the principle of precedent and consistency of policy. However, agencies may overturn prior agency precedent based on new considerations or shifts in policy priorities. When agencies depart from precedent, they must explain the reasons for choosing not to follow previous rulings. The standard of proof by which a decision-maker decides a case is the preponderance of the evidence standard. This is the standard most often employed in civil litigation, and is generally understood to mean that the weight of the evidence leans more towards one side than the other or that it is more likely than not that the claim presented to the court is meritorious. This standard is in contrast with those requiring more

exacting levels of evidence such as “clear and convincing evidence,” which applies to some civil matter, or “evidence beyond a reasonable doubt,” which applies to criminal cases.

The Administrative Procedures Act places the burden of proof on the party seeking the issuance of a rule or order from the presiding decision-maker. So, for example, if the government seeks to impose a civil penalty on a party for violating pollution regulations, the burden would be on the government to prove that the violation took place by a preponderance of the evidence. Conversely, one who seeks an order to have welfare benefits reinstated after the government cut them off bears the burden of proving that he meets the relevant statutory criteria.

### **11.10 Informal Adjudication**

Not all agency adjudicatory hearings require the agency to apply all Administrative Procedures Act provisions governing the formal adjudication proceedings. The Act recognizes a class of agency actions known as informal adjudications, which are agency enforcement decisions that are not required to be “on the record.” Since this definition covers a wide array of governmental actions, the category of informal adjudication applies to many more cases than formal adjudication. These cases do not involve trial-type hearings, and the Act requires only minimal procedures and protections for the agency decision-making process. These include the right to personally appear before the agency and to be represented by counsel. They also include the requirement of a timely conclusion of the matter, an explanation of a denial of an application or request when relevant and the enforcement of subpoenas when required by law.

In addition, when an informal adjudication involves the revocation or suspension of a license, the Act requires the agency to issue a warning and provide an opportunity for the target to correct the underlying conduct at issue. Note that this warning provision does not apply in cases of willful misconduct or if it involves public health or safety.

Even when the requirements of formal adjudication do not apply, the agency must keep a basic record containing the final order along with agency considerations in making the determination. The record is needed because informal adjudication is subject to judicial review, and the reviewing court needs a basis on which to assess the agency decision. Note that while courts may not impose additional procedures on agencies conducting adjudications, the agencies themselves may decide to provide formal adjudication procedures even when not required to do so by law.

Finally, since orders or decisions under informal adjudications are government actions which may deprive people of liberty or property rights, the adjudications may be subject to due process protections, including sufficient notice of an adjudication and the guarantee of a neutral decision-maker.

In our last module, we’ll look at judicial review of administrative actions and the extent to which people can sue administrative actors in their capacities as agents of state and federal governments.

### 11.11 Arbitration and Adjudication

The actual process of arbitration and adjudication is much the same. The primary difference between them is the person or entity that makes the decision in a legal dispute. In arbitration, the disputing parties agree on an impartial third party—an individual or a group—to hear both sides and resolve the issue. In adjudication, the decision is the responsibility of a judge, magistrate, or other legally-appointed or elected official.

Arbitration is often used as a way to settle contract disputes. Parties signing a contract often agree to the use of arbitration to decide if a contract has been breached or whether it can be terminated. By choosing arbitration to settle disputes, the parties agree not to pursue their complaints in a court of law. If arbitration is not chosen, the parties' only recourse is typically adjudication. Contracts usually include a clause that the parties agree to comply with the arbiter's decision, especially if it is a case of 'binding arbitration'. The Industrial Truce Resolution, 1962, emphasized voluntary arbitration and specified certain items which could be analyzed in critical way. These include complaints pertaining to dismissal, discharge, victimization and retrenchment of individual workmen. Indian Labour Conference in 1962 held, "Whenever conciliation fails, arbitration will be the next normal step, except in cases where the employer feels that for some reasons he would prefer adjudication, such reasons being creation of new rights having wide repercussions or those involving large financial stakes.

Mediation through an arbitration hearing is similar to a court hearing. Each party brings evidence and witnesses before the agreed-upon arbiter and makes his or her case. The arbiter weighs the evidence and draws a conclusion, either deciding for one of the parties or proposing a unique solution. After the "Arbitrator" has given his (or her) decision, usually it cannot be challenged in court unless the decision has violated the principle of natural justice. Adjudication is the process of settling disputes compulsorily through the intervention of a third party appointed by the Govt. When wage disputes persist, government refers them for adjudication. The adjudicative process is governed by formal rules of evidence and procedure. Its objective is to reach a reasonable settlement of the controversy at hand. A decision is rendered by an impartial, passive fact finder, usually a judge, jury, or administrative tribunal.

The Industrial Disputes Act provides for a 3 tier adjudication system which is: - i) Labour Court  
ii) Industrial Tribunal & iii) National Tribunal

Since independence adjudication has been one of the main instruments for settlement of disputes, improvement in wage scales and standardization of wages and allowances. Though courts and tribunals were primarily intended to deal with settlement of industrial disputes, in practice, wage fixation has become an important element in their work and functioning. This is because of large number of disputes concerning of wages and allowances have been referred to such courts. The High Courts and Supreme Court have also adjudicated upon such disputes. The awards given by

these authorities not only helped in formulation of a body of principles governing wage fixation but laid foundation for present wage structure in many of major industries.

#### 11.12 Summary

Tribunals are needed for a specialized and effective hearing of technical matters that may at times miss the eye of law in the conventional courts. The procedural simplicity and speedy justice that is guaranteed by a tribunal reduces the burden of the constitutional courts and thus its importance cannot be undermined. However, the issues that are being faced by these tribunals need to be resolved to effectuate speedy justice.

#### 11.13 Key Words

Adjudication is the process by which a court judge resolves issues between two parties.

Adjudication hearings are similar to the arbitration hearing process.

Generally, adjudication hearings involve money or nonviolent infractions that result in a distribution of rights and obligations for all parties involved.

#### 11.14 Self – Assessment Questions

1. What is adjudication? Discuss the importance of adjudication?
2. Explain the importance of adjudication?
3. Describe the process of adjudication in India?
4. Explain the arbitration and adjudication?

#### 11.15 Further Readings

1. Construction Adjudication Hardcover – Import, 13 December 2007, by Mr Justice Coulson, OUP Oxford Publisher, ISBN – 10 0199235503.
2. Good Practice Guide: Adjudication, By Mair Coombes-Davis, ISBN 9781859463956, Published October 1, 2011 by RIBA Publishing.
3. A Practical Guide to Construction Adjudication ; Editor(s): James Pickavance, ; First published:21 October 2015 ; Print ISBN:9781118717950, Online ISBN: 9781118717912
4. Adjudication of Companies Act matters under NCLT, by Rajender Kumar, January 2021, Urmila Publication House, ISBN- 10 9353619084,
5. Supreme Court on Arbitration (1950 to 2018) (In 3 Volumes), by Surendra Malik and Sudeep Malik, Edition: 2019.
6. Arbitration and Conciliation, A Commentary, by Saurabh Bindal and RV Prabhat, Edition: 1st Edition, 2021.

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## LESSON - 12

# PAY COMMISSIONS AND WAGE FIXATION IN PUBLIC SECTOR UNDERTAKINGS

### Learning Objectives

- ✓ To know the wage fixation
- ✓ To study the industrial wage boards
- ✓ To learn the pay commissions
- ✓ To discover the wage fixation in PSUs

### Structure

- 12.0 Introduction
- 12.1 Industrial Wage Boards
- 12.2 Pay Commissions
- 12.3 7th Pay Commission
- 12.4 Wage fixation in Public Sector Undertakings
- 12.5 11th Pay Revision Commission Andhra Pradesh 2020
- 12.6 Full Time Contingent Employees and Contract Employees
- 12.7 Automatic Advancement Scheme
- 12.8 Human Resources to Meet Contemporary Requirements of Governance
- 12.9 Summary
- 12.10 Keywords
- 12.11 Self - Assessment Questions
- 12.12 Further Readings

### 12.0 Introduction

**Pay Commission** is set up by Government of India, and gives its recommendations regarding changes in salary structure of its employees set up in 1947. Since India's Independence, seven pay commissions have been set up on a regular basis to review and make recommendations on the work and pay structure of all civil and military divisions of the Government of India.

Headquartered in Delhi (India), the commission is given 18 months from date of its constitution to make its recommendations.

#### A) Purpose

A pay commission examines and reviews the existing pay structure recommends changes in the salary, allowances, and other facilities for civil employees as well as for the military forces. In addition, it reviews the norms of bonuses, keeping in view the performance and productivity of the employees. A pay commission examines and reviews the existing pay structure recommends changes in the salary, allowances, and other facilities for civil employees as well as for the military forces. In addition, it reviews the norms of bonuses, keeping in view the performance and productivity of the employees.

Fixation of wages is a recent phenomenon in India. There was no effective machinery until the Second World War for settlement of disputes for fixation of wages. After independence, industrial relations become a major issue and there was phenomena increase in industrial dispute mostly over wages leading to substantial loss of production. Realizing that industrial peace was essential for progress on industrial as well as economic front, the central govt. convened in 1947 a tripartite conference consisting of representatives of employers, labour and Government of India formulated Industrial Policy Resolution in 1948 where the Government of India has mentioned two items which has bearing on wage, which are:-

- i) Statutory fixation of Minimum Wages and
- ii) Promotion of Fair Wages.

To achieve 1st objective, the Minimum Wages Act, 1948 was passed to lay down certain norms and procedures for determination and fixation of wages by central and state govt.

To achieve 2nd objective Government of India appointed in 1949, a tripartite committee on fair wages to determine the principles on which fair wages should be fixed. As of now, India does not have a formal national wage policy, though the issue has been discussed several times. The government has direct and indirect control over wage levels, which has been exercised through different institutions.

#### 12.1 Industrial Wage Boards

Concept of wage board was first enunciated by Committee on Fair Wages on determination of minimum wages in country. Wage Boards in India are of two types

- i) Statutory Wage Board
- ii) Tripartite Wage Board



a) Statutory Wage Board means a body set up by law or with legal authority to establish minimum wages and other standards of employment which are then legally enforceable in the particular trade or industry to which board's decision relate.

b) Tripartite Wage Board means a voluntary negotiating body set up by discussions between organized employers, workers and govt. to regulate wages, working hours and related conditions of employment.

**A) Criticism of Wage Boards-** A major criticism of the Wage Boards is the delay in submitting the report to the government and in implementing the Board's recommendations. These delays result in worker dissatisfaction and agitation by Unions. Moreover, by the time the report is submitted, it is so late that the recommendations are outdated. Also there were problems in the implementation of the recommendations as they were non-statutory in nature and the government can only give moral pressure to the parties concerned to accept it. For example in 1969, the unanimous recommendation of the Wage Board on coal mines was accepted by the government but the employers refused to implement the recommendations on the grounds of inability to pay. This precipitated a strike of coal miners. The tripartite Wage Boards have come to be widely accepted in our country as a viable wage-setting mechanism and therefore the system may be more effective by removing the lacunae in the system.

## 12.2 Pay Commissions

The Wage Boards were set-up to deal with the pay structure in different industries outside the government whereas the pay structure of the government employees is based on the recommendations of the Pay Commission. So the ambit of the Pay commission is much wider as it covers all the employees in the government sector including the Public Sector employees. Whereas the workmen of the private sector have access to methods like Collective Bargaining, Conciliation, Adjudication or Arbitration, for settlement of disputes, for the government employees, the Pay Commission is the only effective method. Pay Commissions are set-up at regular intervals by the government and functions non-statutorily in the sense that they submit their report to the government and it is up to the government to modify, reject or accept it.

Pay Commission	Year	Chairman
First Pay Commission	1947 - 1957	Srinivasa Varadachariar
Second Pay Commission	1959 - 1973	Jaganath Das
Third Pay Commission	1973 - 1987	Raghubir Dayal
Fourth Pay Commission	1987 - 1996	P N Singhal
Fifth Pay Commission	1996 - 2006	Justice Ratnavel Pandian
Sixth Pay Commission	2006 - 2016	Justice B NKrishna
Seventh Pay Commission	2016 - 2026	Justice Ashok Kumar Mathu

The First Pay Commission was appointed by the Government of India under the Chairmanship of Justice Vardachariar to enquire into the conditions of service of Central Govt. employees. The Commission in its report said that in no case a man's pay should be less than the Living Wage.

The 2nd Pay Commission was appointed in Aug. 1957, and the commission submitted its report in 1959. It examined the norms for fixing a need based minimum wage set up 15th session of Indian Labour Conference and came to the conclusion that the daily diet of an average Indian male should be a little more than 2600 calories as against 2700 calories as suggested by Dr. Arkroyd. The money value corresponding to this calorie level worked out to Rs. 80 which was considered by the workmen's organizations as too conservative and unrealistic and they demanded Rs 110 - 135 depending upon the region.

Govt. of India appointed the Third Pay Commissions in 1970's which submitted its report in April 1973. In this report commission express its support for a system in which pay adjustments will occur automatically upon an upward movement in consumer price index. The Commission recommended a pay of Rs. 185 as minimum remuneration to a Class IV staff upon entry but this was contested by the Workmen's organizations and the Government later revised this rate to Rs. 196.

After thirteen years, Government appointed the Fourth Central Pay Commission under chairmanship of Justice P.N. Singhal on July 26, 1983 to examine the structure of emoluments of all Central Govt. employees, including those of union territories, officers belong to All India service and armed forces personnel. Commission submitted its report on July 30, 1986 and made several recommendation like drastic reduction in pay scales, increasing the lowest level and highest level of pay, increasing HRA, increasing the scope for leave accumulation and its encashment upon retirement. It also advocated a better work culture among the employees and recommended discontinuation of overtime allowance. The Fifth Pay Commission (1992-1996) made certain recommendation regarding a) raising retirement age to 60 years b) hike in HRA c) an enhanced minimum and maximum salary d) abolition of OT e) drastic cut in holidays (from 17 to 3) along with a six-day working week. Since these recommendations generated a lot of controversy the Government decided not to implement this report and keep it in abeyance.

The Sixth Central Pay Commissions was established on 2006 and this committee submitted its report on March 2008. The Commission recommended linking pay with performance and suggested a scheme of revised pay bands, reduction of the total number of grades, continuance of the five-day week and only three national holidays. It also put forward novel ideas like staggered working hours, special leave for childcare, enhanced maternity leave and provision for setting-up of "working women's hostels".

### 12.3 7th Pay Commission

Central government employees unions have been demanding for a long time to increase the minimum wage from Rs 18,000 to Rs 26,000. We have a piece of good news for Central

government employees! Centre might soon increase the fitment factor of employees and a decision regarding the same might be taken soon.

Central government employees unions have been demanding for a long time to increase the minimum wage from Rs 18,000 to Rs 26,000 and increase the fitment factor from 2.57 times to 3.68 times. If the government announces an increase in the fitment factor of central employees, then their salary will increase.

Pay Commission	Highlights
First Pay Commission	<ul style="list-style-type: none"> <li>Chaired by Shri Srinivasa Varadacharia was set up in January 1946 and report submitted in May 1947.</li> <li>This is based on the idea of 'living wages' to the employees</li> <li>The Commission had fixed Rs 55 as minimum wage (Rs 30 plus Rs 25 as Dearness Allowance (DA))</li> </ul>
Second Pay Commission	<ul style="list-style-type: none"> <li>Chaired by Shri Jagannath Das was set up in August 1957 and report submitted after two years</li> <li>Pay scales revised by merging 50% of the Dearness Allowance with basic Pay and it recommended Rs 80 as the minimum remuneration (Basic Pay of Rs 70 and DA of Rs 10)</li> </ul>
Third Pay Commission	<ul style="list-style-type: none"> <li>Chaired by Shri Raghubir Dayal was set up in April 1970 and report submitted in March 1973</li> <li>Minimum remuneration of Rs 185 per month was recommended</li> <li>However, Government modified few recommendations post taking into consideration the employee's views and minimum wage was raised from Rs 185 per month to Rs 196 per month.</li> </ul>
Fourth Pay Commission	<ul style="list-style-type: none"> <li>Chaired by Shri P N Singhal was set up in June 1983 and report submitted in three phases within a period of 4 years</li> <li>Recommended the government to constitute a permanent machinery to undertake periodical review of pay and allowances of Central Government employees which was not implemented</li> </ul>
Fifth Pay Commission	<ul style="list-style-type: none"> <li>Chaired by Justice S Ratnavel Pandian was set up in June 1994 and report submitted in January 1997</li> <li>Recommended reduction in the number of pay scales and increased the minimum pay from Rs 750 to Rs 2550</li> </ul>
Sixth Pay Commission	<ul style="list-style-type: none"> <li>Chaired by Justice B N Srikrishna was set up in July 2006 and report submitted in March 2008</li> <li>To remove stagnation, running pay bands were introduced.</li> <li>Minimum salary at entry level pay band was fixed at Rs 7000 and maximum salary at secretariat/equivalent level was Rs 80,000</li> </ul>

**A) The formula of 7th Pay Commission**

The salary is calculated by multiplying the current basic pay by a factor of 2.57, then adding all relevant benefits such as Transport Allowance (TA), House Rent Allowance (HRA), Medical Allowance, and so on to arrive at the final amount.

**B) The Minimum wage will increase by Rs 8,000**

Increasing the fitment factor will also increase the minimum wage. At present, the employees are getting salary under the fitment factor based on 2.57 percent, which when increased to 3.68 percent, will increase the minimum wage of the employees by Rs 8,000. This means that the minimum wage of central government employees will be increased from Rs 18,000 to Rs 26,000.

If the fitment factor is increased to 3.68, then the basic pay of the employees will be Rs 26,000. Right now if your minimum salary is Rs 18,000, then excluding allowances, you will get Rs 46,260 ( $18,000 \times 2.57 = 46,260$ ) as per 2.57 fitment factor. Now if the fitment factor is 3.68 then your salary will be Rs 95,680 ( $26,000 \times 3.68 = 95,680$ ).

**C) Earlier Pay Commission**

The Union Cabinet had approved the recommendations of the 7th Pay Commission in June 2017 with 34 amendments. The entry-level basic pay was increased from Rs 7,000 per month to Rs 18,000, while the highest level i.e. secretary was increased from Rs 90,000 to Rs 2.5 lakh. For Class 1 officers, the starting salary was Rs 56,100.

**D) Highlights of the Seventh Pay Commission**

- **Minimum pay:** Minimum pay at entry level is increased from Rs 7,000 to Rs 18,000 per month. For a newly recruited Class I Officer, the minimum salary is now Rs 56,100 per month.
- **Maximum pay:** Maximum pay at the level of secretariat/equivalent is increased to Rs 2,25,000 per month for Apex Scale and Rs 2,50,000 per month for Cabinet Secretary and others presently at the same pay level
- **Annual increment:** The rate of annual increment is retained at 3%
- **New Structure:** Present system of pay bands and grade pay has been dispensed with and a new pay matrix has been designed. Grade Pay has been subsumed in the pay matrix. The status of the employee, hitherto determined by grade pay, will now be determined by the level in the pay matrix.
- **Fitment factor:** A fitment factor of 2.57 is being proposed to be applied uniformly for all employees.
- **Military Service Pay:** Unlike earlier where Military Service Pay (MSP) was payable to all ranks upto and inclusive of Brigadiers and their equivalents will now be admissible

only to Defence forces personnel. MSP is a compensation for military service and it is recommended to enhance MSP for various categories

- **Modified Assured Career Progression (MACP):** Performance benchmarks for MACP is set at 'very good' and also proposed that no annual increment to employees who do not meet the benchmark either for MACP or for a regular promotion in the first 20 years of their service

#### **Additional benefit to Short Service Commissioned Officers**

- **Cadre review:** Systemic change in the process of Cadre Review for Group A officers recommended
- **Allowance:** The Commission has recommended abolishing 52 allowances altogether. Another 36 allowances have been abolished as separate identities, but subsumed either in an existing allowance or in newly proposed allowances. It was recommended to increase the House Rent Allowance (HRA) as there is an increase in the basic pay and further increase based on change in DA
- **Advance:** Non-interest bearing advance and other interest bearing advances except Personal computer advance and House Building Advance (HBA) is abolished and HBA ceiling revised to Rs 25 lakhs from Rs 7.5 lakhs
- **Central Government Employee Group Insurance Scheme (CGEGIS):** Rates of contribution and insurance coverage under CGEGIS
- **Medical facility:** Introduction of a Health Insurance Scheme for Central Government employees and pensioners, covering postal pensioners under CGHS and merging of postal dispensaries with CGHS
- **Pension:** Revised pension formulation for civil employees including Central Armed Police Forces (CAPF) personnel and defence personnel retired before 1 January 2016
- **Gratuity:** Ceiling of gratuity enhanced from Rs 10 lakhs to Rs 20 lakhs. The ceiling on gratuity may be raised by 25% when DA rises by 50%
- **New Pension System (NPS):** Pursuant to receiving many grievances relating to NPS, recommended a number of steps to improve the functioning of NPS and also establishment of a strong grievance redressal mechanism.
- **Pay based on performance:** Introduction of the Performance Related Pay (PRP) which will subsume the existing bonus scheme for all categories of Central Government employees, based on quality Results Framework Documents, reformed Annual Performance Appraisal Reports and some other broad Guidelines was recommended.
- **Disability pension for armed forces:** Slab based system for disability pension regime is recommended to existing percentile based disability pension regime.

Government implemented the recommendations of the 7th Pay Commission including those affecting the armed forces with minor modifications on 5 September 2016. For eg: Increase in the contribution to CGEGIS was not accepted, however, cabinet has asked the ministry to work

out a customized group insurance scheme for Central Government Employees with low premium and high risk cover.

Government increased dearness allowance of Central Government by 2% on 7 March 2018 in accordance with the accepted formula based on the recommendation of 7th Pay Commission. There has been expectations that the Government will hike the salary and fitment factor beyond 7th Pay Commission's recommendation. Employees are demanding hike in fitment factor to 3 times as against recommended 2.57 times which will increase the minimum basic pay to Rs 21,000 from recommended Rs 18,000.

#### **12.4 Wage fixation in Public Sector Undertakings**

Since independence the government has striven to adopt wage fixation policies with regard to public sector organized labour. Initially the role was discharged by the judiciary and a while later by a tripartite machinery - the wage boards. However, the setting up of the Bureau of Public Enterprises in the early 1960s signaled a shift to greater centralization. Despite the bureau's existence as a 'supra-bureaucracy', its attempts to impose wage standardization and salary restraints, but for a brief period during the emergency years, proved by and large ineffectual.

Reference is invited to this Department's OMS No. 1211188-Pay-I dated 7.8.89 and 1211196-Pay-I dated 10.7.98, whereby guidelines for fixation of pay of candidates working in Public Sector Undertakings etc., recommended for appointment by the Commission by the method of recruitment by selection through interview only, were issued. Subsequent to the implementation of the recommendations of the 6th CPC and the issue of CCS(RP) Rules 2008, the system of Running Pay Bands and Grade Pays has been introduced. Accordingly, in partial modification of this Department's OM dated 7.8.89 and 10.7.98 referred to above, the method of pay fixation in respect of those appointed on or after 1.1.2006 will be as under:

"In case of candidates working in Public Sector Undertakings, Universities, Semi Government Institutions or Autonomous Bodies, who are appointed as direct recruits on or after 1.1.2006 on selection through interview by a properly constituted agency including Departmental Authorities making recruitment directly, their initial pay may be fixed by granting them the Grade Pay attached to the post.

Further, their pay in the Pay Band may be fixed at a stage so that the pay in the Pay Band +Grade Pay and DA as admissible in the government, protects the pay +DA already being drawn by them in their parent organizations. The pay in the Pay Band fixed under this formulation will not be fixed at a stage lower than Entry Pay in the Revised Pay Structure (corresponding to the Grade Pay applicable to the post) for direct recruits on or after 1.1.2006 as notified vide Section 11, Part A of First Schedule to CCS(RP) Rules, 2008. The pay in the Pay Band fixed under this formulation will not exceed Rs. 67000, the maximum of the Pay Band PB-4."

**12.5 11th PAY REVISION COMMISSION ANDHRA PRADESH 2020****1. Pay Scale**

- a) The Master Scale concept is retained with 32 Grades and 83 stages (increased from 81 stages). The Master scale is formulated with the following features:
- Annual increment to range from 3% of the pay in initial stages to 2.34% at the end.
  - Periodicity of increase in increment is recommended to be 3 years up to stage 72 in the Master Scale, 4 years for stage 73-80 and 2 years thereafter.
- b) The New Pay Scale is evolved by merging 100% of Dearness Allowance (as on 01.07. 2018) with Basic Pay and adding the fitment benefit.
- c) The 'Minimum Pay' for the lowest paid employee is to be ₹.20,000/- per month.
- d) The 'Maximum Pay' in the Master scale is worked out to Rs1,79,000/- p.m. which represents a Maximum to Minimum ratio of 8.95.
- e) In the event of stagnation in pay scale, grant of up to 5 stagnation increments is recommended.

**2. Fitment**

The Commission recommends a fitment benefit of 27 % on Basic Pay.

**3. Date of Effect of New Pay Scale**

The new pay scales may come into effect from the concern date . Government may however take a view regarding the date from which the monetary benefit would accrue keeping in view its resource position and the various demands thereon.

**4. Dearness Allowance as per latest**

- a) The existing practice of revising the Dearness Allowance (DA) twice a year, on 1st January and 1st July, in tandem with the sanction of DA by the Government of India may be continued.
- b) Since the Central rates of DA are based on the DA merged scales of 1.1.2016 while in the State DA is recommended to be fully merged on 1.7.2018, the Commission recommends a conversion factor of 0.91 for sanction of DA from 1.1.2019. It means that for every 1 % increase in DA sanctioned by the Government of India, the DA to be sanctioned by the State to its employees would be 0.91% starting from 1.1.2019.

**5. House Rent Allowance**

- a) HRA may be allowed at the following rates
- @ 30% of basic pay subject to a ceiling of ₹.26,000/- p.m. for employees shifting from Hyderabad on bifurcation of State.

ii) @ 22% of pay basic pay subject to a ceiling of ₹.22,500/- p.m. in cities with population above 10 lakh (iii) @ 20% of pay basic pay subject to a ceiling of ₹.20,000/- p.m. in cities with population of above 2 lakh and up to 10 lakh.

(iv) @ 14.5% of pay basic pay subject to a ceiling of ₹.20,000/- p.m. in cities with population of above 50,000 and up to 2 lakh

(v) Rest of the employees @12% subject to a limit of ₹.17,000 p.m. b) Additional HRA in lieu of rent free accommodation is retained at 8 % of basic pay, but the monetary ceiling is recommended to be increased from ₹.2,000/- to ₹.2,600/- p.m.

#### **6. City Compensatory Allowance**

For the purpose of grant of City Compensatory Allowance, the Commission has recommended two slab rates, one for Visakhapatnam and Vijayawada and the second for the 12 other Municipal Corporations . The quantum of allowance is increased for all the pay ranges (Municipal Corporations of Visakhapatnam and Vijayawada ₹400-1000 and other Municipal Corporations ₹,300-750).

#### **7. Advance Increments**

The Commission has recommended not granting in the normal course any special increment for possessing higher qualifications.

#### **8. Loans and Advances**

a) The Commission has recommended that the Government tie-up with financial institutions for grant of House Building/Personal Conveyance loans and link up repayment to salary disbursement. Back-ended subsidy of 2.5% has been recommended on such loans;

b) Pending such tie up, revised eligibilities, amounts and floating rate of interest linked to Repo Rate have been recommended in respect of all types of advances;

c) It is recommended that the eligibility for 'Advance for purchase of Personal Computer' may be increased to a maximum of 3 times during the entire service career subject to a minimum gap of 7 years between the purchase of two successive computers and complete repayment of previous computer advance.

#### **9. Leave Benefits**

a) Additional 5 days Casual Leave has been recommended in favor of non-teaching women employees on par with the teaching women employees;

b) Child Adoption Leave up to 180 days is recommended for woman employee having less than two surviving children if she legally adopts a child up to one year of age. Subject to the same



conditions, paternity leave up to 15 days may be extended to 'single' male employees (unmarried/ widower/divorcee) within a period of 6 months of child adoption;

c) Child Care Leave has been recommended to be increased to 180 days in a maximum of three spells. It may also be extended to 'single' male employees (unmarried/widower/divorcee);

d) **Special Casual Leave** of up to 7 days in a year is recommended for orthopedically challenged employees needing to change prosthetic aides. Same duration of Special Casual Leave has also been recommended for Nursing staff working in high risk ward;

e) Revised rates have been prescribed for Ex-gratia Allowance payable to the employees who are granted extra-ordinary leave for the treatment of certain diseases.

#### **10. Medical Benefits**

a) In order to ensure financial sustainability of EHS, the quantum of employees' contribution should be increased in steps over a period of time along with similar step-up in the Government contribution;

b) The pending claims of the network hospitals should be settled expeditiously by releasing additional funds to the Arogyasri Trust;

c) The facility of Annual Health check-up may be extended to the Pensioner and his/her spouse;

d) The Dr. YSR Arogyasri Trust may hold talks with a few hospitals in Hyderabad, Bangalore and Chennai, empanelled by the concerned State Governments, for inclusion under the EHS;

e) Medical Allowance to Service Pensioners / Family Pensioners is recommended to be enhanced to ₹.500/- p.m.

#### **11. Special Pays**

The quantum/rate of Special Pay for the existing category of employees has been recommended to be suitably enhanced. In respect of a few categories we have recommended its discontinuance.

#### **12. Other Allowances**

a) Mileage Allowance is recommended to be increased to ₹.15.50 per k.m. for petrol driven vehicles, ₹.11.50 per k.m. for diesel driven vehicles and ₹.6.40 per k.m. for motor cycles/ scooters.

b) Rates of Daily Allowance and Lodging Charges may be enhanced by 33 % to ₹.300- 600 per day for tours inside the State and ₹.400-800 per day for tours outside the State

- c) For the purpose of payment of lodging charges a fresh classification of places, inside and outside the State, has been drawn up and lodging charges have been fixed from ₹.300/- to ₹.1700/- per day.
- d) Conveyance charges to Court Masters and Personal Secretaries to Hon'ble Judges of A.P. High Court/ APAT has been increased to a maximum of ₹.5000/- per month.
- e) Fixed Travelling Allowance enhanced to a maximum of ₹.1700/- per month from the existing ₹.1200/- per month. The rates applicable for minimum 20 days touring in a month have been rationalized pro rata compared to the rates fixed for minimum 15 days touring in a month. Several new categories of employees from the Departments of Animal Husbandry, Cooperation, Sericulture, School Education and Panchayatiraj/Tribal Welfare Engineering have been recommended to be added to the list to get FTA.
- f) The limit for Tuition Fee reimbursement has been enhanced to ₹.2500/- per annum per child, subject to a maximum of two children.
- g) Funeral Charges of deceased employee has been recommended for increase to ₹.20,000/-.
- h) Special Compensatory Allowance payable for working in the Tribal areas has been increased from the existing minimum and maximum of ₹.500/- per month and ₹.1275/- per month respectively to ₹. 700/- per month and ₹.1800/- per month.
- i) Substantial increases have been suggested in Uniform Allowance, Uniform Maintenance Allowance and Stitching Charges.
- j) Enhanced admissibility of Risk Allowance has been suggested and new categories have been added to the existing list of employees eligible for 'Risk Allowance' in the Departments of Animal Husbandry and Forest.
- k) 'Ration Allowance' has been recommended at enhanced rates. New categories have been suggested for inclusion in the Insurance Medical Service and HM&FW departments.
- l) Increases have been recommended in 'Emergency Health Care Allowance', PG Degree and Diploma Allowance, Non Private Practice Allowance, Tribal Allowance and Rural Allowance for several categories of employees in Medical related Departments.
- m) 'Readers Allowance' to Visually Challenged teacher and lecturers is recommended to be enhanced by 33 percent, up to a maximum of ₹. 1200/- per month.
- n) 'Delhi Allowance' / 'Special Compensatory Allowance', to the staff working in the Andhra Pradesh Bhavan at New Delhi, has been recommended to be enhanced to 15% of Basic Pay subject to a maximum of ₹.5000/- per month.

o) 'Special Gratuity Allowance' to drivers of AP Bhavan has been recommended to be increased to ₹.30/- per hour subject to a ceiling of 100 hours in a month.

p) 'Conveyance Allowance' to physically challenged employees has been enhanced to 10% of Basic Pay subject to a maximum of ₹.2000/- per month.

### 13. Pensionary Benefits

In respect of pensionary benefits our recommendations are the following:

a. To consolidate pension/family pension with dearness relief as on 1.7.2018. 27% of the basic pension/family pension is to be treated as fitment benefit.

b. To continue the existing provision of full pension after 33 years of qualifying service with 5 years of service weight age. Similarly no change is recommended in the formula for fixation of pension/family pension.

c. A revised scale of additional quantum of pension starting from 70 years of age has been suggested

d. If a government servant dies while in service, enhanced family pension is recommended to be paid to his dependants for a period of up to 10 years without any upper age limit. In case of death after retirement the enhanced family pension should be payable for a period of seven years or up to the date on which he would have attained 67 years, had he survived, whichever is earlier.

e. The conditions of 45 years age limit in respect of unmarried/widowed/divorced daughter of family pensioners may be rescinded and the stipulation regarding having children may be altered so as to exclude widowed/divorced daughter having a child who has attained 25 years of age or started earning.

f. To allow Dearness Relief on both the basic pensions (Service and Family) received by the same pensioner.

g. The quantum of minimum pension/ family pension is recommended to be increased to ₹.10000/- p.m.

h. The maximum amount of Gratuity payable at the time of retirement is recommended to be enhanced from ₹.12 lakh to ₹.16 lakh.

i. The maximum limit for Death Relief amount on the death of a service pensioner/ family pensioner is recommended to be enhanced to ₹.20,000/-.

j. The financial assistance is recommended to be increased to the level of minimum service pension/family pension (₹.10,000 per month) with dearness relief thereon after 1.7.2018.

k. The existing ceiling limit of commutation at 40% of basic pension and provision regarding restoration of commuted portion of pension after 15 years should be continued.

#### **14. Work Charged Establishment**

The scales of pay of Work Charged establishment have been rationalized keeping in view the qualifications prescribed at the entry level and the service conditions.

#### **12.06 Full Time Contingent Employees and Contract Employees**

i. The Commission recommends a remuneration of ₹.20,000/- p.m. (i.e. the minimum pay of Last Grade Employees in the proposed RPS) plus DA to the Fulltime Contingent/Daily Wage/ Consolidated Pay/NMR employees whose services have not been regularized and who are already drawing a remuneration of ₹.13,000/- p.m. + DA in the 2015 RPS.

ii. In respect of Contract employees also the remunerations may be fixed at the minimum of the time scale, in the now revised pay scale, of the equivalent category in regular employment in the Government.

iii. The revision in remuneration in respect of these employees may be given effect to simultaneously (with effect from the same date) with the regular Government employees.

#### **12.7 Automatic Advancement Scheme**

The existing scheme of AAS may continue with the following modifications:

(1) The present SPP Scale -II/SAPP Scale-II, eligible after 24 years of service in the same post, may be rechristened as SPP Scale -IIA/SAPP Scale-IIA

(2) An employee, on completion of 30 years of service in a particular post, may be granted one increment in the SPP Scale IIA/ SAPP Scale IIA, as the case may be, which shall be called the Special Promotion Post Scale II-B/ Special Adhoc Promotion Post Scale II-B.

(3) The benefit of Automatic Advancement Scheme may be continued up to and inclusive of Grade-25 in the revised scales i.e., ₹.76730-162780.

#### **12.8 Human Resources to Meet Contemporary Requirements of Governance**

a. Each department should draw up a Recruitment Plan, updated on annual basis, containing details of existing vacancies in staff and officers, vacancies likely to arise in future due to retirement/ promotion etc. and phase wise recruitment to be made through APPSC / DSC or through Contract.

b. In future Contract staff may be appointed only against positions which are temporary in nature and not against permanent positions. Those of the qualified Contract employees, who have been

appointed on merit after following transparent and competitive recruitment process, may be regularized in service against available vacancies in permanent posts.

c. Outsourcing should be only of services such as cleaning and maintenance, security/ watch and ward, bill collection, managing reception desks, supply of vehicles/drivers etc. These functions should be outsourced to Agencies on competitive tendering and in future no individual personnel should be hired on outsourcing basis.

d. Gaps in training should be identified, department wise, by a Committee constituted under the auspices of the Andhra Pradesh HRD Institute, Bapatla and budgetary support provided for planning and conducting induction/ refresher training programmes for different categories of employees.

e. General Administration (Services) Department may constitute a Committee to review, in a time bound manner, the Service Rules of all the departments in consultation with the respective Heads of Departments. While doing so adequate attention should be given to the aspect of career planning.

f. Executive staff at the field level may be provided with mobile phones with CUG connectivity to quicken the process of decision making, problem solving and to monitor progress.

g. Increasing number of 'Government to Citizen' (G2C) services should be brought under the umbrella of 'Mee Seva'.

### 12.9 Summary

**Minimum Pay:** After considering all relevant factors and based on the Aykroyd formula the minimum pay in government is recommended to be set at ₹18000 per month.

**New Pay Structure:** The present system of pay bands and grade pay has been dispensed with and a new pay matrix has been designed. The status of the employee, hitherto determined by grade pay, will now be determined by the level in the pay matrix. Separate pay matrices have been drawn up for civilians, defense personnel and for military nursing service. All existing levels have been subsumed in the new structure; no new levels have been introduced nor has any level been dispensed with.

### 12.10 Keywords

A **Pay Commission** is an administrative system and mechanism of the Central Government that reviews and examines existing salary structure and recommends changes (in pay, allowances, benefits, bonuses and other facilities) for civil employees and military forces.

Commission is a payment based on the amount of sales an employee makes and is usually based on a percentage of total sales, so the more sales made, the more money the employee takes home.

**The minimum wage fixing** procedures in the countries covered by the database. Four categories have been identified, based on the considerations mentioned above: the actors involved and the number of minimum wage rates.

1. One base rate for the whole country or per region, with the State as the key decision-maker.
2. Multiple rates that vary by sector and/or occupation, with the State as the key decision-maker.
3. One base rate for the whole country or per region, determined by collective bargaining.
4. Multiple rates that vary by sector and/or occupation, determined by collective bargaining.

#### **12.11 Self - Assessment Questions**

1. What is Wage fixation? Explain methods of wage fixation?
2. Describe pay commission in India?
3. Examine the highlights of latest pay commission?
4. Discuss the public sector undertaking pay commissions?

#### **12.12 Further Readings**

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## **LESSON-13**

# **WAGE PAYMENT METHODS**

### **Learning Objectives**

- ✓ To Study the Time wage and piece wage system
- ✓ To Understand the Methods of wage payment
- ✓ To identify Incentive Rate

### **Structure**

#### **13.0 Introduction**

#### **13.1 Time wage**

#### **13.2 Piece wage**

#### **13.3 Payment by results**

#### **13.4 Balance or Debt Method**

#### **13.5 Incentive Rate**

#### **13.6 Methods of wage Payment**

13.6(i) Flat time rate

13.6(ii) High Pay rate

13.6(iii) Measured by pay rate

13.6(iv) Graduated Time rate

13.6 (v) Differential Time rate

#### **13.6.2 Piece Rate system**

13.6.2(i) Straight Piece Rate system

13.6.2(ii) Taylor Differential Piece rate system

13.6.2(iii) Merrick Multiple Piece Rate system

13.6.3(iv) Gantt Task & Bonus Plan

#### **13.7 Summary**

#### **13.8 Key words**

#### **13.9 Self Assessment Questions**

#### **13.10 Suggested Readings**

**13.0 Introduction**

Wage payment system consists of the pay structures and the methods used to motivate and reward work force for their contribution to the goals of the organization. Various systems of the wage payments have been developed in different industries and in different countries.

All of these systems may, however, be regarded as variants or combinations of different principles of time-rate system, piece-rate system, payment by results system, balance or debt system, and incentive rate system. These systems reflect the basic philosophy of a company and its management.

There are mainly two system of paying wages to employees viz., **Time wage system and Piece wage system which** are explained below:

**13.1. Time Wage:**

Time wage system is also called day wage system is a system in which wages **are paid on the basis of time spent by the** worker like per day, week or month instead of output produced or amount of work done. Here presence of employee is more important than performance of employee. The wage rate is determined by negotiation considering prevailing local wage rate or job evaluation.

**Merits or Advantages:**

- (i) Simple and easy – This method is simple and easy to calculate remuneration by both workers and employers as unit of output produced need not be counted and recorded.
- (ii) Improves quality of work – This method ensures improved quality of work as there is no pressure on workers to speed-up production and there is every scope for the workers to show their talent and skill.
- (iii) Economical – Clerical work in computation of wages is minimum and there is no necessary of keeping records for the units produced and hence it is less expensive.
- (iv) It assures fixed remuneration to workers – As remuneration is paid on the basis of time spent rather than unit produced, workers get fixed remuneration for the number of days they have attended irrespective of the amount of work done.
- (v) Encourages beginners – It encourages beginner or learner to learn best method of doing work as their earnings are not related to unit produced.

**Demerits or Disadvantage:**

**Time wage system suffers from the following demerits:**

- (i) **No** distinction between efficient and inefficient employees – **This system does not** make any difference **between efficient and inefficient** employees as efficient and hardworking employees receive the same remuneration at par with inefficient employees.



(ii) This system is a punishment to efficient employees – Efficient and hardworking employees do not get extra remuneration in spite of their extra effort and performance. Therefore, this system does not attract and encourage hardworking and efficient employees.

(iii) No increase in production – Under this system remuneration is paid on the basis of time spent by the workers rather than unit produced and hence there is no pressure to speed up production which in turn may result decrease in production.

(iv) Difficult to calculate labor cost – As remuneration is paid on the basis of time spent and not on the basis of unit produced, calculation of labor cost per unit is difficult.

(v) Low productivity and high supervision cost – As the system does not offer any incentive to efficient and hardworking employees, productivity of labor becomes low unless close supervision is used which in turn increases cost of supervision.

(vi) Difficult to ascertain the merit – As all employees are treated at par, there is no basis for finding the merit of different employees.

(vii) Difficult to fix the basis of promotion – As it is difficult to find out the merit of employees, it is also difficult to fix the basis of promotion. If the employees are promoted on the basis of seniority, it may affect on the morale and efficiency of young and hardworking employees.

#### **Suitability of Time Wage System**

Time wage system is suitable under the following circumstances:

- i. Where quality of work is important rather than quantity to be produced. E.g. Jeweler, furniture etc.
- ii. Where workers are new, learner or beginner.
- iii. Where output cannot be measured in terms of individual unit produced by each employee.
- iv. Where machinery and equipment used in the process of production are sophisticated, expensive and need special care.
- v. Where employees have little or no control over quantity of output to be produced.

#### **13.2. Piece Wage**

In this system of wage payment, remuneration is paid to the employees on the basis of unit produced or amount of work done. Unit of output produced or amount of work done is the basis of payment of wages. Therefore, greater is the number of unit produced, higher is the remuneration of employees and vice-versa, hence this method is called payment by result. Under this system efficient and hardworking employees get higher remuneration whereas learner or beginner gets lower amount of remuneration.

#### **Merits or Advantages of Piece Wage System**

- (i) Attracts efficient and hardworking employees – As remuneration is paid on the basis of units produced or amount of work done, efficient and hardworking employees work more and show better performance that in turn get higher remuneration.

(ii) Increase in production and productivity – As workers are paid remuneration on the basis of their performance, workers are forced to work more and to show better performance which in turn increase production and may also increase productivity.

(iii) Low cost of production – Increase in productivity and production may result in lower cost of production per unit.

(iv) Simple and easy to calculate wages – As wages are paid directly in proportion to the number of unit produced, calculation of wage or remuneration is easy. Even employees themselves can calculate their remuneration on the basis of unit produced and rate per unit.

(v) Increase in standard of living of employees – Efficient and hardworking employees have opportunity to show their talent and increase their earnings which in turn help them to improve their standard of living.

(vi) Helps in fixing the basis of promotion – Piece wage system helps the management in distinguishing efficient and inefficient employees which help them in giving the promotion to employees.

**Demerits or Disadvantages:**

Piece wage system suffers from the following drawback:

(i) Effect on quality of output – In the race to earn more wages, workers may work fast and may not give importance to the quality, which may affect on image of the business.

(ii) Variation in the earnings of the workers – Workers earnings depend on their working performance. Higher is the performance, better will the remuneration and vice-versa. In view of variation in earnings workers may feel insecure and dissatisfied.

(iii) Difficult to fix wage rate – Unless scientific basis is made available to fix the wage rate, employers may find it difficult to fix suitable piece rate. Piece rate, if fixed arbitrarily, may be harmful either to employer or to employees.

(iv) Expensive and time consuming – Detailed record of production, involves clerical work. Continuous production requires continuous recording of work for calculation of piece wage which is both expensive and time consuming.

(v) No guarantee of minimum wage – This method does not guarantee minimum wage and hence Trade Union may not accept this method of wage payment.

(vi) Disparity between employees – This method makes difference between efficient and inefficient workers as efficient workers work more and earn more income as compared to inexperienced and in-efficient workers. Therefore, this method may create jealousy among the workers and may spoil the industrial relation also.

**Suitability of the Method:**

Piece wage system is suitable under the following circumstances:

(i) Where there is an urgency to increase the production and quality is not that much important.

(ii) Where it is possible to measure the units produced by an individual worker separately.

(iii) Where the quality of the output depends on skill and judgment of the employees.

(iv) Where there is regularity in flow of work and interruptions are minimum.

(v) Where method of production is standardized and the job is of a repetitive nature.

### 13.3. Payment by Results (PBR):

There are many different systems of wage payment under which the worker's earnings are related directly to some measurement of the work done either by himself or by the group or working unit to which he belongs. Such systems, known as payment by results, can be classified in four main groups such as- (i) in the same proportion as output; (ii) proportionately less than output; (iii) proportionately more than output; or (iv) in proportions which differ at different levels of output.

Payment by results is a payment system under which money rewards vary with the measured changes in performance according to predetermined rules. The PBR system relates the pay or a part of the pay received by the worker to a number of items he produces or the time he takes to do a certain amount of work.

Under this system, the worker is paid a wage which bears some fairly direct and continuous relation to his output or performance, or to the average output of the group of workers to which he belongs. Under this plan, the worker working in a given condition and with the given machinery, is paid exactly in proportion to his physical output.

Under PBR, the workers' pay during a given period is directly related to the levels of measured performance. The essential difference between PBR and time rate system is how performance is related to reward. The basic alternative to PBR is time payment. The PBR system varies with the variation in individual and group performance at the plant or enterprise as a whole.

The most common scheme of payment by results which is purely individual in character what is called straight piece work. A worker's earning can be calculated on the basis of the number of pieces produced and the rate per piece. This means payment of a uniform price per unit of production, and it is most appropriate where production is repetitive in character and can easily be divided into similar units.

There is also the differential piece work system where the wage cost per unit is adjusted in relation to output. Under this scheme, two piece rates may be fixed – one considerably higher than the going time wage for the job and the other somewhat lower than the time wage. The lower rate is paid when the workers fail to achieve the standard level of performance.

The main idea behind establishing two differential piece rates has been to reward high production and to discourage low production. This system has been used mainly by firms with heavy non-labour costs. The main problem in applying this system is the difficulty of setting the standard and the amount of difference between the two piece rates. Further, it may lead to excessive speeding by some workers, who then get much higher earnings than others.

The PBR may be introduced with certain safeguards such as:

- (a) Quality of output is to be controlled through strict supervision;
- (b) Wastage of material is to be prevented;
- (c) Health of the worker is to be protected;
- (d) Supply of raw materials, maintenance of plant and efficiency of management are to be assured;
- (e) Workers are to be guaranteed job security or continued employment; and
- (f) Work-load is to be fixed by impartial aspects.

Rates once fixed should not be cut by management without justification. The design of an appropriate PBR scheme involves basically three different types of decisions. The first concerns the safeguards and the procedures to be incorporated in the scheme to make it acceptable and effective; the second concerns the amount of bonus, or incentive potential that the scheme should provide; and the third concerns the precise way in which increased productivity should be shared between the worker and the employer.

When a system of payment by results is applied in a particular undertaking the interest of employers and workers may be seriously affected. The employees, in a desire to raise their earnings, may attempt to increase their output to a level at which quality is adversely affected. Such deterioration of quality is, of course, not in the interest of the employers nor of the workers.

The safeguards needed to ensure the equitable operation of any system of payment by results include- (1) safeguards relating to the introduction of the system, (2) safeguards relating to the operation of the system.

Systems of payment by results are to be applied in an equitable and reasonable manner. The health and safety of the workers may suffer if the task is set too high. Again, inequities may result if some workers are able to earn considerably more than their colleagues. Further, workers may be tempted to neglect security regulations while on piece work.

When such a system is applied the interest of both employers and employees require to be protected by suitable provisions in collective agreements. Unless a system of payment by results is applied equitably from both the management's and the workers' points of view, good industrial relations will be difficult to secure or maintain.

Distrust between management and workers and friction among the workers themselves may prevent the system from functioning properly, may lead to wasteful strikes, or may even force the complete abandonment of the system.

The PBR has many advantages:

- (a) It pays the workmen according to their efficiency as reflected in the amount of work turned out by them;
- (b) It involves less supervision as the workers are not likely to while away their time;

(c) Being interested in the continuity of his work, a workman is likely to take greater care in the maintenance of the machine.

**The demerits of this system are:**

- (a) A piece rate worker in his anxiety to produce more may neglect the quality of output;
- (b) He may, in his desire to earn more, may work so hard as to impair his health, unmindful of the fact that this would ultimately reduce his earning power;
- (c) Under this system, the worker's earning may suffer because of causes beyond his control, such as inadequate supply of raw materials, failure of machinery, lack of demand in the market for the goods produced;
- (d) Trade unions are often opposed to this system as they are of the opinion that such a system encourages rivalry among workers and endangers their solidarity in labour disputes.

The success of any system of payment by results depends in a large measure on the way in which it is introduced and applied. First, the requirement for the success of a system of payment by results is that it should be developed and applied with the agreement of the workers concerned and in an atmosphere of good industrial relations.

Second, wherever possible the methods to be followed in the introduction and application of systems of payment by results should be settled by collective bargaining between the employers and workers concerned.

**13.4. Balance or Debt Method**

This is a combination of time and piece rate. The worker is guaranteed an hourly or a day rate with an alternative piece rate. If the earnings of a worker calculated at the piece rate exceeds the amount which he would have earned if paid on the time basis, he gets credit for the balance, namely, the excess piece rate earnings over the time rate earnings.

If the piece rate earnings are equal to his time rate earnings, the question of excess payment does not arise. Where piece rate earnings are less than time rate earnings, he is paid on the basis of the time rate; but the excess paid is carried forward as a debt against him to be recovered from any future balance of piece work earnings over time work earnings. This system pre-supposes the fixation of time and piece rates on a scientific basis. The obvious merit of this system is that an efficient worker gets an opportunity to improve his earning.

**13.5. Incentive Rate**

Incentive Rates can be used more effectively in a production situation where output is measurable in homogeneous units, where product specifications do not change frequently, and where worker's effort can directly influence output. Incentives are difficult to employ where output is fixed substantially by the requirements of production process and cannot be controlled by the workers.

The most common type of incentive system is straight piece work, which simply means a constant rate of pay per unit of output. Bonus plans represent another method of incentive pay

and involve, in general, the determination of standard tasks. Bonuses are paid for production above standard.

A great many problems arise in connection with incentive plans. Of basic importance is the way in which production standards are determined under either straight piece work or bonus systems. Under bonus plans, the extent to which increased production will be rewarded must be decided. The question of incentive rate adjustment in the light of technical changes is also important. Another crucial area is the guarantee of minimum earnings under the incentive systems.

A substantial amount of controversy between labour and management has arisen over the use of incentive pay methods. Organized labour does not, however, have a uniform position in the matter. Some unions are opposed in principle to the incentive plans; others accept wage incentives and are concerned primarily with the equitable determination of rates and prevention of abuses.

### 13.6 Methods of wage payments

Wages can be paid to the employees either on the basis of time or on the basis of production done by them.

Thus, there are two system of wage payment:

1. Time rate System.
2. Piece rate System.

#### 13.6.1. Time Rate System:

Time rate system is the oldest method of wage payment. Under this method the employee is paid on the basis of time worked i.e. a day, a week, a fortnight or a month irrespective of quantity produced. It must be remembered here that wages are paid after the time fixed for work is completed irrespective of output or completion of the work.

Every worker knows how much wages he will get after specific period as an arrangement regarding wages is reached between employees and management regarding the wage rate.

Formula:

Wages = Number of hours worked × Rate per hour

For example, A worker is paid at the rate of Rs.10 per hour and he spent 100 hours at work.

So his wages will be:

Wages = Number of hours worked × Rate per hour

= 100 × 10 = Rs.1000

Types of Time Rate System:

**13.6.1(i) Flat Time Rate:**

It is the oldest and simple method of wage payment. Under this system workers are paid at the flat rate on the basis of time they are employed. The flat rate may be per hour, per day, per week, per month etc.

**13.6.1 (ii) High Pay Rate**

One of the basic drawbacks of the time rate system is that it does not attract the highly skilled workers. High pay rate system suits to highly skilled workers. Under this method overtime is not allowed and workers are required to achieve the target within time. The success of the system depends on the cooperation of efficient workers. It also requires proper setting of standards.

**13.6.1 (iii) Measured Pay Rate**

Under this workers are given a specified work and rate is fixed according to the level of performance. Higher wages will be given for higher performance. This method is criticised on the ground that additional remuneration is given for any improvement in the performance.

**13.6.1 (iv) Graduated Time Rate**

Under this method the wage rate is fixed with cost of living index changes. This method is the choice of workers as they get additional wages when cost of living index changes.

**13.6.1 (v) Differential Time Rate**

Under this system different wages are fixed for different workers as per their personal abilities. Higher wages are paid to meritorious workers and incentives are given to workers for their performance.

**Advantages of Time Rate System:**

Following are the advantages of time rate system:

(i) Simple – The very first advantage of time rate system is that it is simple to understand and easy to use. The workers can easily understand this method and compute their earnings.

(ii) Regularity – Regularity is another feature of this method. Earnings are regular and fixed, there being no uncertainty of any type. So workers get regular earnings and plan their expenditures in advance on the basis of their earnings.

(iii) Clerical Work – Workload of clerks and other officials also gets reduced. In this method, the clerical work in the wage calculations is minimum because no records of output are required.

(iv) Amount of Wages – In this method, the employees can predict the wages in advance, similarly for the employer i.e., employer can predict his liability for the payment of wages in future with accuracy which makes the arrangements of funds very easy.



(v) Quality – There is no restriction regarding the quantity of output, employees try to maintain the top quality of goods. The employees work with ease and patience. So it can be said that the output in this system is of good quality.

(vi) Protection – Workers are sure to get certain amount of wage so they can plan their expenditures and also can make their family budget. This method protects the wages of trainees, aged and other employees who temporarily fall sick.

(vii) No Wastage – There is no consideration of quantity, workers make the production by giving more importance to quality, which avoids wasteful handling of material, machines and tools.

(viii) Preference – Since time rate system of wage payment does not differentiate between efficient and inefficient workers, so it is preferred by workers and trade unions.

(ix) Popular Method – This is the most popular method. It is favored and practiced by most of employers and employees.

(x) Lesser Administrative Expenses – Every worker takes his job and his duty sincerely and honestly and as such lesser inspection and supervision is required which reduces the administrative expenses.

#### **Disadvantages of Time Rate System:**

Following are the disadvantages of the time rate system of wage payment:

(i) Lack of Incentive for Efficiency – The major disadvantage of this method is the lack of incentives i.e., both efficient and inefficient workers get equal remuneration on the same job, as such there is no incentive for efficient workers.

(ii) Need for More Supervision – The workers become careless, as no specific amount of work is required to be performed. This is why more supervision is required.

(iii) Loss of Efficiency – There is no discrimination in this method between the efficient and inefficient workers. So efficient workers have no incentives to work better in terms of quality and quantity, which decreases the morale and efficiency of the efficient workers.

(iv) Difficult Assessment of Work – As there is no record of individual's performance or output. So in this method it is very difficult to assess the workers' efficiency.

(v) Loss of Production – Carelessness and slackness of both workers and management results in loss of production.

(vi) Reduced Morale – This method destroys the morale of the workers, and even efficient workers come to the level of inefficient workers. Sometimes competition takes the negative side.

#### **Suitability of Time Rate System:**

The time rate system is suitable in the following situations:

(i) Work is of varied nature and standards of performance are difficult to set.



(ii) Where quality of goods is more important.

(iii) Where mental work is involved such as administration, management policy making.

(iv) Trade union is very strong and is opposed to output-related payment.

(v) Highly skilled and competent manpower is employed which does not require to be closely supervised.

(vi) When it is difficult to fix the standard time for doing the job.

(vii) When the job relates to office or is clerical work.

(viii) When collective effort of group of persons necessary to perform the job.

### 13.6.2. Piece Rate System

Under this system the worker is paid on the basis of output i.e., amount of work done. The earnings of the workers are governed by the production quantities and wage rate per piece. The rate of wages is fixed in advance. Though the time is not important in this system, it is assumed that the worker will not take more than the average time to complete a job. The earnings of the worker depend upon the speed of his work and his own individual skill and efficiency.

As against the time rate system where every employee is paid the same wage, under this system the wage varies according to the worker. A superior worker will earn more than the inferior worker. The higher the output of the worker, the greater are his wages.

Formula:

Wages = Number of units produced x Rate per unit

For example, Suppose piece rate prescribed is Rs.20 per unit produced.

If a worker produces 10 units, his wages will be as follows:

Wages = Number of units produced x Rate per unit

Wages = 10 x 20

Wages = Rs.200

Types of Piece Rate System:

There are four types of piece rate system:

#### 13.6.2 (i) Straight Piece Rate System

It is the simple method of payment under which payment is made to workers according to the units produced at fixed rate. Another type of this method is piece rate with guaranteed time rate with additional advantage of piece rate.

**13.6.2 (ii) Taylor Differential Piece Rate System**

The differential piece rate system makes the correlation between the increase in the efficiency of the worker and the increase in wage rates. With this an efficient worker gets more wages in comparison to the inefficient one. The two wage rates are determined in this system i.e. higher wage rate for the worker who produces more than the standard output and lower wage rate for the worker who produces standard or less than standard output.

**13.6.3 (iii) Merrick Multiple Piece Rate System:**

Under this system three piece rates are applied to workers with different levels of performance.

These are:

**13.6.3 (iv) Gantt's Task and Bonus Plan**

Under this the standard time is fixed for doing particular task and then workers' actual performance is compared with the standard time. If worker takes more time than the standard time then he is given wage for the time taken by him.

(a) If worker takes the standard time then he is given wages for the standard time + 20% as the bonus on the wages earned.

(b) If worker takes time less than the standard time then he is given wages equal to the standard time + 20% of the wages for the standard time.

**Advantages of Piece Rate System:**

The following are the advantages of piece rate system:

(i) **Increased Production** – Production increases as every worker tries to produce more and more. Efforts on the part of every worker results in the amount of output.

(ii) **Simple** – Wages are based on the number of units produced by workers so both management and workers can calculate their wages in advance. On the basis of this they can plan their expenditures.

(iii) **Better Employer Employee Relations** – The relations between employer and employees improve as rate of wages is decided in advance and there are no chances of conflict.

(iv) **Proper Use of Tools and Equipments** – Every worker tries to produce more and more so it makes the efficient use of tools and equipments.

(v) **Benefits to Consumers** – The large-scale increased output reduces the cost of production and also the prices of the products. The customers get these products at cheaper rates.

(vi) **Easy Determination of Quotation Price** – The employer is able to know the exact labor cost per unit. This will help to make quotations confidently and accurately.

**(vii) Less Supervision** – As compared with the time rate system, the supervision costs under this system are not high, because the workers are to be paid on the basis of performance. The very attraction of greater reward for greater effort drives them to work hard.

**(viii) Reduction of Idle Time** – The quantum of idle time is minimized as workers know that they will not be paid for idle time. Thus it persuades them not to waste their time.

**(ix) Minimization of Loss due to Breakage** – The workers handle the machines, tools and implements with great care which helps in minimization of loss resulting from breakage. They know that the breakage will reduce their output which results in reduced wages.

**Disadvantages of Piece Rate System:**

Some important disadvantages of the system are given below:

**(i) Difficulty in Fixation of Standard Piece Rate** – Setting of a standard rate involves a lot of difficulties and a considerable amount of expense has to be incurred. If high piece rate is established, it is very difficult to reduce it subsequently.

**(ii) Ignores Quality** – As more output means more wages, the workers are always in a hurry to produce more. This results in production of substandard items, high rate of rejection and ultimately increased production cost per unit.

**(iii) Insecurity** – The system does not provide guarantee of minimum wages to the workers. They feel insecure since they would get less wages during the period when their efficiency may get reduced due to factors beyond their control. Thus, at times, workers may be earning even below the subsistence level.

**(iv) Conflict** – The system may lead to conflict between the management and the workers, if the output is low due to some fault of the management, such as bad quality of raw material, frequent break downs failure of machinery etc.

**(v) Expensive Control Systems** – Management is compelled to install expensive control systems of supervision and inspection for maintaining quality of output.

**(vi) Speeding** – Workers may speed up the work to produce more which causes great injury to their health. Speeding also causes undue wastage of raw materials and wear and tear to machines.

**(vii) Effect on Production Schedule** – Workers may work at a speed for a day, earn more wages and then absent themselves for a few days, which may affect the uniform flow of production and the production as such may be disturbed.

**(viii) Increased Cost of Production** – Cost of production may increase due to more wastage of materials, high cost of supervision and inspection, and wear and tear of machines.

**(ix) Frustration among Less Efficient Workers** – The system will frustrate the less efficient workers and their efficiency may further decrease because of discontentment.

**Suitability of Piece Rate System:**

**Piece rate system** of payment of wages is considered suitable where:

- (i) The quantity of work done can be precisely measured and standardized.
- (ii) The work is of repetitive nature;
- (iii) It is possible to fix a fair and acceptable piece rate;
- (iv) The productivity is closely related to skill and efforts;
- (v) The quality of goods can be controlled;
- (vi) Timecards are maintained for ensuring regularity and punctuality of workers and uninterrupted flow of production; and
- (vii) Materials, tools and machines are readily available to cope with the possible increase in production.

**13.7 Summary**

A Wage Payment System is a method used to calculate the wages of workers in the organization. It includes different types of wage payment system methods according to companies requirements like Time basis, per product or piece basis, Incentive basis etc. It varies upon the types and nature of business. Wage system that rewards a worker for productivity above an established standard, incentives by way of bonus etc are offered to efficient workers for the time saved. The incentives given by summit bank are bonus, commission, refreshment package gifts to their employees.

**13.8 Key words**

**Time wage system-** Time wage system is also called day wage system is a system in which wages are paid on the basis of time spent by the worker like per day, week or month instead of output produced or amount of work done.

**Piece Wage-** In this system of wage payment, remuneration is paid to the employees on the basis of unit produced or amount of work done.

**Payment by Results-** Payment by results is a payment system under which money rewards vary with the measured changes in performance according to predetermined rules.

**Balance or Debt Method-** This is a combination of time and piece rate. The worker is guaranteed an hourly or a day rate with an alternative piece rate. If the earnings of a worker calculated at the piece rate exceeds the amount which he would have earned if paid on the time basis, he gets credit for the balance, namely, the excess piece rate earnings over the time rate earnings.

**Gantt's Task and Bonus Plan-** Under this the standard time is fixed for doing particular task and then workers' actual performance is compared with the standard time

**13.9 Self Assessment Questions**

**1. Define** a) Time wage b) Piece wage c) Payment by Results d) Gantt Task and bonus plan e) Merrick Multiple Piece rate system

2. Describe the Methods of wage Payments?

**13.10 Suggested Readings**

1. Strategic Compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010

2. Compensation Management Mosumi S.Bhattacharya Nilanjan Sengupta, Excel Books , 2010

3. Compensation Reward Management B.D Singh Excel books, 2012.

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## LESSON-14

# INCENTIVE SYSTEM

### Learning Objectives

- ✓ To understand the Importance and variables of Individual and work
- ✓ To Learn the incentive program guidelines
- ✓ To study the classification of Incentives

### Structure

14.0 Introduction

14.1 Meaning

14.2 Importance

14.3 variables – Individual and work situation

14.3.1 The Individual

14.3.2 The work situation

14.4 Incentive Program Guidelines

14.4.1 Tie to performance

14.4.2 Recognize Individual Difference

14.4.3 Recognize Organizational factors

14.5 Types of Incentives

14.5.1 Individual difference

14.5.2 Piece Rate system

14.5.3 Differential Piece rate system

14.6 Incentive to employees

14.6.1 Financial Incentives

14.6.2 Non Financial Incentives

14.7 Classification of incentives

14.7.1 Long term Incentives

14.7.2 short term Incentives

14.8 Incentive system

14.8.1 Group Incentives

14.8.2 Organizational Incentives

**14.9 Summary****14.10 Key words****14.11 Self Assessment questions****14.12 Suggested Readings****14.0 Introduction**

An incentive provides additional compensation for those employees who perform well. It attempts to tie additional compensation as directly as possible to employee productivity.

Further incentives are monetary benefits paid to workmen in recognition of their outstanding performance. They are defined as “variable reward granted according to variations in the achievement of specific results”.

Incentive systems should be tied as much as possible to performance. If an incentive is actually to spur increased performance and effort, employees must see a direct relationship between their efforts and then- rewards.

Incentives can be short-term and/or long-term, which can be tied up with the performance of an individual employee or a group/unit’s productivity.

Performance through incentives may be defined as cost saving, quantity produced, standards met or quality improved, revenue generated, return on investment or increased profit.

**14.1 Meaning**

The main purpose of incentive is to tie employees’ rewards closely to their achievements. This tie is done by providing more compensation for better performance. Individual will generally strive for additional rewards by higher production and their performance depends upon higher efforts. Some people may prefer some extra time off rather than more money.

An incentive provides additional compensation for those employees who perform well. It attempts to tie additional compensation as directly as possible to employee productivity.

Further incentives are monetary benefits paid to workmen in recognition of their outstanding performance. They are defined as “variable reward granted according to variations in the achievement of specific results”.

The international labour office refers to incentives as payment by results. But it is appropriate to call them Incentive systems of payment’. ‘Emphasizing the motivation i.e., the imparting of incentives to workers for higher production and productivity’.

**14.2 Importance**

1. The primary advantage of incentive is the inducement and motivation of workers for higher efficiency and greater output,

2. Fixed remuneration removes fear of insecurity in the minds of employ-ees (as incentive as a part of total remuneration)

3. Earnings of employees would be enhance due to incentive.

4. Reduction in the total as well as unit cost of production through incentives (because of higher productivity)

5. Production capacity is also likely to increase.

6. Incentive payments reduce supervision, better utilization of equipment, reduce scrap, reduce loss time, and reduce absenteeism and turnover.

### 14.3 Variables-The Individuals and Work Situation

The effective use of incentives depends on two variables:

1. The individual,
2. Work situation, and

#### 14.3.1. The Individual

Different people value things differently. Enlightened managers realize that all people do not attach the same value to monetary incentives, bonuses, prizes or tips. Employees view these things differently because of age, marital status, economic need and future objectives.

#### 14.3.2. The Work Situation

This is made up of four important elements:

(a) Technology – The operation of a machine or work system which can establish a range of incentives;

(b) Satisfying job assignments – A worker’s 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;

(c) Feedback – A worker needs to be able to see the connection between his work and rewards. These responses provide important reinforcement; and

(d) Equity – A worker considers fairness or reasonableness as part of the exchange for his work.

### 14.4 Incentive Program Guidelines

#### 14.4.1. Tie to Performance

Incentive systems should be tied as much as possible to performance. If an incentive is actually to spur increased performance and effort, employees must see a direct relationship between their efforts and then- rewards. Further, both workers and managers must see the



rewards as equitable and desirable. If a group incentive system is to be used, it clearly should reflect employees' effort as a group of individuals.

#### **14.4.2. Recognize Individual Difference**

Incentive plans should provide for individual differences. Recognition of the complex view of personnel management means that a variety of incentive systems may have to be developed to appeal to various organizational groups and individuals. Not everybody will want the same type of incentive rewards.

#### **14.4.3. Recognize Organizational Factors**

The incentive system chosen should be consistent with the climate and constraints of an organization. For example, it is inconsistent to devise an incentive plan requiring a high degree of employee participation for an organization that adheres to traditional procedures and rules. The incentive plan also should be compatible with organizational resources and be developed in close consultation with the firm's financial officers to determine how much incentive compensation an organization can afford.

#### **14.4.4. Continue to Monitor**

An incentive system should consistently reflect current technological and organizational conditions. Offering an incentive for clothing sales clerks to sell outdated merchandise would be more appropriate than offering incentives to sell only current fashion items that are already in high demand. Incentive systems should be reviewed continually to determine whether they are operating as designed.

### **14.5 Types of Incentives (With Different Incentives for Employees and Agents)**

Organizations perform use a combination of incentive system. This incentive plans can be setup as individual, group or organizational in nature. Performance can be measured un-productivity, cost effective, and superiors rating.

#### **14.5.1. Individual Incentives**

Individual incentive systems may have to be tailored to individual desires for instant salary plus commission basis, only commission or worker wants additional time up instead of additional take home pay. An individual incentive system may also be used as a means of measuring individual capabilities and initiatives.

#### **14.5.2. Piece Rate Systems**

The most basic individual incentive system is the Peace Rate System. Under the State Peace Work system wages are determined by multiplying the number of units produce by the Peace Rate for 1 unit.

#### **14.5.3. Differential Peace Rate**

The differential Peace Rate System pays employees at one peace rate, if they produce less than a standard output and at a higher peace rate if they produce more than the standard,

developed by Frederick Taylor in the late 1800s. The system is to design to stimulate employees to achieve or exceed established standard of production.

Peace Rate System is difficult to use, because of determination standards.

#### **14.6 Incentives for Employees:**

The following are the different incentives for employees which the company can use:

##### **14.6.1 Financial Incentives**

The various financial incentives are:

- (i) Pay and allowances
- (ii) Productivity linked wage incentive
- (iii) Bonus
- (iv) Co-partnership/stock option
- (v) Retirement benefits
- (vi) Perquisites

##### **14.6.2 Non-Financial Incentives**

The various non-financial incentives are:

- (i) Employee recognition programmes
- (ii) Employee empowerment
- (iii) Job security
- (iv) Status
- (v) Employee participation
- (vi) Organizational climate

Incentives for Agents:

The following are the different incentives for agents which the company can use:

##### **a. Financial Incentives:**

The various financial incentives are:

- (i) Commission
- (ii) Profit sharing

**b. Non-Financial Incentives:**

The various non-financial incentives are:

- (i) Recognition programmes like certificate of merit etc.
- (ii) Organizational climate
- (iii) Job enrichment
- (iv) Career advancement opportunity

Benefits derived by the company from the above steps are:

- (a) Loyalty and dedication of agents.
- (b) Increased business due to enhanced motivational level.

**14.7 Classification of Incentive Plans**

Incentives can be short-term and/or long-term, which can be tied up with the performance of an individual employee or a group/unit's productivity. Performance through incentives may be defined as cost saving, quantity produced, standards met or quality improved, revenue generated, return on investment or increased profit. This means that there are endless possibilities.

**14.7.1. Long-Term Incentives**

Long-term incentives are focused on an employee's efforts on multi-layered results, such as innovations, strategic suggestions to increase the return on investments and increasing the market share or multi-layered contributions to develop the organization's competitiveness. These could be indirect financial support to tax payee employees, social security plans, pension plans, stock ownership, etc.

**14.7.2. Short-Term Incentives**

They are in addition to the basic pay provided within the current operating year which could be supplemented to pay cheques or a separate amount on a monthly, half yearly or yearly basis. This added income relates to the employee's achievement or special performance to benefit the organization, such as 100% attendance, overtime, reduction in cost, suggestion for improvement, long-term association with the organization, etc.

These could be classified as:

**(a) Individual Bonus:**

Punctuality, specialized contribution affecting quality or productivity, increasing productivity and reducing cost with modified suggestions are generally covered here, which encourages an individual to earn more, and the organization is benefited by the increased productivity and profit.

**(b) Length of Service Award:**

In a competitive environment, the retention of knowledgeable workers or knowledge bank has become essential and the recognition of long service may also make an employee feel proud. The organization may also feel pride in the retention of the competent employee.

They, therefore, offers service awards such as 10 years service awards, 20 years service awards, 25 years' service awards, etc. annually and give recognition to the employee in annual functions. These incentives could be in cash or kind.

**(c) Referral Award:**

Sometimes when the labour market is tight and the management prefers to have loyal and reliable employees, by seeking referrals from old employees, they would like to pay a cash award to that employee as it has helped the organization to have a reliable and loyal employee through him/her.

**(d) Suggestion Award:**

This is the most common and simple incentive plan to motivate the employees to use their creativity and earn recognition.

**(e) Intellectual Contribution Award:**

This is more applicable to the executive class which can be motivated to contribute intellectually in suggesting or implementing creative strategies, and to improve the performance or excellence in performing a job. The awards can be calculated based on the total financial improvement achieved by the company and the share can be worked out according to the proportion of the individual contribution.

**(f) Special Achievement Award:**

This is also very common to boost up the morale of the executives to get recognition in achieving something special by taking initiatives and putting in more efforts.

**(g) Special Behavioral Award:**

In discharging duties, behavior plays an important role. Behavioral theory also indicates that an employee's performance is dependent on wage/salary acceptance and satisfaction of worth. To encourage the employees to change their behavior as desired, this incentive has been found advantageous.

However, the management, depending upon the size, type, financial strength and business nature, may have different values or types of these awards.

**(h) Productivity Bonus:**

It is a very common incentive in any organization as pay for performance. It is the main motto. There are various productivity bonus awards applicable in all the organizations

**14.8 Incentive Systems**

A group or organization incentive systems provides rewards to all employees in a work unit, department, division or organization. These incentives are designed to promote cooperation and coordinated effort within the group or organization.

**14.8.1. Group Incentives**

A group incentive system may be useful in overcoming some of the problems associated with individual incentives. However it may not lead to higher productivity than individual incentive system because individual effort is not as directly tied to rewards. One critical factor in the group incentive system is the size of the group. If it becomes too large employees may feel their individual effort will have little or no effect on the total performance of the group and the resulting reward.

Small Group Plans may encourage team work in groups. Groups may restrict output, resist revision of standards and seek to gain at the expense of groups.

**14.8.2. Organizational Incentives**

An organization wise incentive system compensate all employees in the organization based upon how well the organization as a whole, does during the year.

The basic concept behind organization wide incentive plans is that overall efficiency depends on organization as a whole.

Common Organizational Incentive System includes Scanlon plans and various profit sharing plans.

Scanlon plans a unique type of organization wise incentive plan. Since its development in 1927 the Scanlon plan has been implemented in many companies. The basic concept underlying the plan is that efficiency depends on team work and plant wide cooperation.

The plan has two main features:

- i. A system of departmental committees and a plant screening committee to evaluate all cost saving suggestion.
- ii. A direct incentive to all employees to improve efficiency.

**14.9 Summary**

Incentive pay refers to giving employees bonuses or other forms of compensation in exchange for going above and beyond their normal duties. It is used as a way to incentivize employees to continue doing excellent work. Incentive compensation programs are primarily used to promote efficiency and productivity of the workforce, but organizations can also use them to enhance employee recruitment, engagement, retention and employer branding. Incentive compensation programs stem from the theory that rewards drive behavior. Applied to the corporate setting, incentive compensation programs enable organizations to produce targeted results by rewarding employees who are responsible for those results.

**14.10 Keywords**

**Incentives** - Incentives are monetary benefits paid to workmen in recognition of their outstanding performance. They are defined as “variable reward granted according to variations in the achievement of specific results”.

**Individual incentive**- Individual incentive systems may have to be tailored to individual desires for instant salary plus commission basis, only commission or worker wants additional time up instead of additional take home pay.

**Piece Rate Systems**- The most basic individual incentive system is the Piece Rate System. Under the State Piece Work system wages are determined by multiplying the number of units produce by the Piece Rate for 1 unit.

**Differential Piece Rate**- The differential Piece Rate System pays employees at one piece rate, if they produce less than a standard output and at a higher piece rate if they produce more than the standard, developed by Frederick Taylor in the late 1800s

**14.11 Self Assessment Questions**

1. Discuss the Importance of Incentive system?
2. Describe the Incentive Program Guidelines and Types of Incentives?
3. Explain the Financial and Non Financial Incentives?

**14.12 Suggested Readings**

1. Strategic Compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010
2. Compensation Management Mosumi S. Bhattacharya Nilanjan Sengupta, Excel Books , 2010
3. Compensation Reward Management B.D Singh Excel books, 2012.
4. Performance Appraisal Management A Modern Approach Second Edition, Dewakar Goel, PHI Learning Private Limited, 2012.
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## LESSON-15

# WAGE INCENTIVE SCHEMES IN INDIA

### Learning Objectives

- ✓ To study the Classification of Incentives
- ✓ To Understand the Motivation and Incentives
- ✓ To Know the Justification of Incentives

### Structure

#### 15.0 Introduction

#### 15.1 Classification of Incentives

- 15.2.1 Hasley Incentive Plan
- 15.2.2 Rowan Plan
- 15.2.3 Emerson Efficiency plan
- 15.2.4 Output Based Plan

#### 15.3 Motivation and Incentives

#### 15.4 Justification of Incentives

#### 15.4.1 Incentive Plan

#### 15.4.2 Merit Plan

#### 15.4.3 Group Incentive plan

#### 15.4.4 Profit sharing Plan

#### 15.5 Social Security

#### 15.6 Summary

#### 15.7 Key words

#### 15.8 Self Assessment questions

#### 15.9 Suggested readings

#### 15.0 Introduction

The term incentive has been used both in the restricted sense of participation and in the widest sense of financial motivation. The concept of incentive implies increased willingness or motivation to work and not the capacity to work. It refers to all the plans that provide extra pay for extra performance in addition to regular wages for a job. Under this programme, 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 productive output. 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. Basically, the wage incentive implies a system of payment under which the amount payable to a person is linked with his output. Such a payment may also be called payment by results.

### 15.1 Meaning and Definition

Incentives are monetary benefits paid to workmen in recognition of their outstanding performance. An incentive scheme is a plan or 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. The International Labour Organization (ILO) refers to incentives as payment by results. But it is appropriate to call them incentive systems of payment emphasizing the point of motivation, that is the imparting of incentives to workers for higher production and productivity. Unlike wages and salaries which are relatively fixed, incentives generally vary from individual to individual, and from period to period for the same individual.

### 15.2 Classification of Incentives

Incentives can be classified into: (i) direct compensation, and (ii) indirect compensation. Direct compensation includes the basic salary or wage that 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, etc. Indirect compensation includes protection programmes (insurance plans, pensions), pay for time not worked, services and perquisites.

Also incentives may broadly be classified into monetary and non-monetary. Monetary incentives have an important contribution to make within the total motivation pattern. They provide extra-financial motivation, by rewarding the worker over and above his regular remuneration for performing more than the targeted work. Some of the financial motivations are overtime wages, higher basic wages, incentive bonus, merit increments, suggestion rewards; various allowances, promotion and fringe benefits.

Some of the non-financial incentives are good human relations, self-respect, recognition, status, sense of belonging, appreciation, higher responsibility, greater authority, job satisfaction, improved working conditions, greater leisure, etc. All these motivate workers to raise their productivity.

ILO classifies incentive schemes into four categories: (i) schemes in which earnings vary in proportion to output, (ii) schemes where earnings vary proportionately less than output, (iii) schemes where earnings vary proportionately more than output, and (iv) schemes where earnings differ at different levels of output.

Incentives have also been classified into individual, group and organisation-wide. In an individual incentive plan, the rewards of incentives are based solely on individual performance. It is the extra compensation paid to an individual over a specified amount for his production effort. Such a system is feasible only where an individual can increase the quantity and quality of his output by his own individual efforts and where his output can be measured. The payment is normally on a monthly basis, though in a few cases it may be quarterly or other convenient periods. The standards of performance have been set by a qualified industrial engineering analyst, using technically sound work measurement procedures. The rewards under this plan are almost always immediate, that is, paid daily or weekly.



The advantages of individual wage incentive plans are relatively obvious and straightforward. First and foremost, the individual incentive plan rewards the individual for his or her production. The more the worker produces, the more, the worker earns.

Second, the individual incentives appeal to the basic need for money found in most people. Almost everyone will work harder, up to a point, when there is a justifiable reason to believe that increased productivity will bring about a personal gain. Although individual wage incentives have advantages, there are also limitations. Individual wage incentives work best with jobs that are primarily operator-controlled. They may also lead to labour problems. Incentives, because they reward production levels, can lead to quality problems. Safeguards must be taken to ensure that quality is not sacrificed for quantity. It is the output of the group rather than that of each individual member of the group that can be measured most conveniently or accurately.

Group or area incentive schemes provide for the payment of a bonus either equally or proportionately to individuals within a group or area. The bonus is related to the output achieved over an agreed standard or to the time saved on the job - the difference between allowed time and actual time. Such schemes may be most appropriate:

- (a) where people have to work together and team work has to be encouraged; and
- (b) where high levels of production depend a great deal on the co-operation existing among a team of workers as compared with the individual efforts of team members. Group bonuses are calculated on the basis of the output of the team and are divided among the members either equally or in specified proportions, with more being given to skilled employees than to those who are unskilled.

Group incentives are usually applied to small teams and the rewards are based on the performance of the entire group. The bonuses are often much larger than individual wage incentives. Group incentive plans, since they evaluate overall performance, are **applicable to** a wide variety of tasks.

#### 15.2.1 Halsey Incentive Plan

In this method a standard time is fixed for the completion of the job. A minimum base-wage is guaranteed to every worker. If a worker completes his job in just the standard time, he will not be given any incentive. If a worker performs his job in less than standard time, he is given incentive. The incentive will be equal to 50% of the time saved by the worker.

$$W=TR+(S-T)$$

Where

W=Total Wages

S=Standard time

T=Time taken to complete the job

%=Percentage of wages of time saved to be given as incentive

R=Rate;

For example, if rate hour is Rs.3 standard time for completion of job is 10 hours.

**A worker completes the job in 8 hours, his total wages will be:**

$$W = 8 \times 3 + (10-8)3 \times 1/2 = \text{Rs.}27$$

In the above example, worker is given an incentive of 50% (1/2) of time saved

#### Advantages

- It is simple.
- Each worker is guaranteed a minimum wage.
- This is beneficial to efficient worker.
- Causes no harm to new worker, trainee, or slow workers.

#### Disadvantages

- Workers get only a percentage of return on their over-achievement.
- The quality of production may suffer as workers may do work in hurry,
- There may be difficulties in setting standard time for different jobs

#### 15.2.2 Rowan Plan

This plan is quite similar to Halsey plan. It differs only in terms of calculation of incentive for time saved. The worker gets the guaranteed minimum wages. The incentive for completing the job in time lesser than standard time is paid on the basis of a ratio, which is time saved over standard time per unit standard time.

Incentive is calculated as:

$$\begin{aligned} \text{Incentive or Bonus} &= S - 1/SX T \times R \\ \text{Total wages} &= T \times R + \text{incentive} \\ &= T \times R(S-T)/S \times T \times R \\ \text{Where, } W &= \text{Total wages} \\ S &= \text{Standard time} \\ T &= \text{Time taken to complete the job} \\ R &= \text{Rate.} \end{aligned}$$

For example, if rate per hour is Rs.3 and standard time for completion of job is 10 hours.

**A worker completes the job in 8 hours, his total wages will be:**

$$W = 8 \times 3 + (10-8)/10 \times 8 \times 3 =$$

$$\text{ANS} = \text{Rs.}28.4$$

#### 15.2.3 Emerson's Efficiency Plan

In this plan, a minimum wage is guaranteed to every worker on time basis and incentive is given on the basis of efficiency. Efficiency is determined by the ratio of time taken to standard time. Payment of bonus/incentive is related to efficiency of the workers. Incentive will be given to those workers who attain more than  $2/3^{\text{rd}}$  i.e. 66.67% of efficiency. No incentive will be given at 66.67% efficiency. At 100% efficiency incentive is 20% of the hourly rate. For efficiency exceeding 100%, 1% incentive/bonus is paid for every 1% increase in efficiency.

For example, if standard time for a job is 6 hours and hourly rate is Rs.3. If a worker completes a job in 6 hours, the efficiency of worker is 100%. His wages will be  $6 \times 3 + \text{bonus @20\%}$  i.e.  $\text{Rs.}18 + 20\% \text{ of } 18 = \text{Rs.}21.6$

**Advantages**

- a. Minimum wages are guaranteed.
- b. It is simple to understand.

**Disadvantages**

Incentive after attaining standard is very low.

**15.2.4 Output-Based Plans****Taylor's Differential Piece Rate System**

This system was introduced by Taylor, the father of scientific management. The main characteristics of this system are that two rates of wage one lower and one higher are fixed. A lower rate for those workers who are not able to attain the standard output within the standard time; and a higher rate for those who are in a position to produce the standard output within or less than the standard time.

For example, if standard production in 8 hours is fixed at 10 units. The lower piece rate is Rs.3 and higher piece rate is Rs.3.5. If a worker produces 9 units, his wages =  $9 \times 3 = \text{Rs.}27$ . In case a worker produces 10 units, his wages =  $10 \times 3.5 = \text{Rs.}35$ .

**Advantages:**

- a. Provides incentives to efficient worker.
- b. Inefficient worker is penalized.
- c. This system is simple and easy to implement.

**Disadvantages:**

- a. Minimum wage is not assured,
- b. There are chances that quality of work may suffer,
- c. This system is not liked by below average workers, as they do not get any incentive

**Merrick's Multiple Piece Rate Plan:**

To overcome the limitations of Taylor's differential piece rate system, Merrick suggested a modified plan in which, three-piece rates are applied for workers with different levels of performance.

**These are:**

- a. Workers producing less than 83% of the standard output are paid at basic rate.
- b. Workers producing between 83% and 100% of standard output will be paid 110% of basic piece rate.

c. Those producing more than 100% of the standard output will be paid 120% of basic piece rate.

**Advantages:**

- a. Efficient workers are rewarded handsomely.
- b. Minimum wages are guaranteed.

**Disadvantages:**

- a. There is wide gap in slabs of differential wage rate.
- b. Over emphasis on high production rate.

Meggison (1967) defines incentive wages as the extra-compensation paid to an individual for production over a specified magnitude which stems from exercise of more than the normal skill, effort or concentration when accomplished in a pre-determined way involving standard tools, facilities and materials.

Currently, the emphasis in payment by results schemes is on team work more than individual effort.

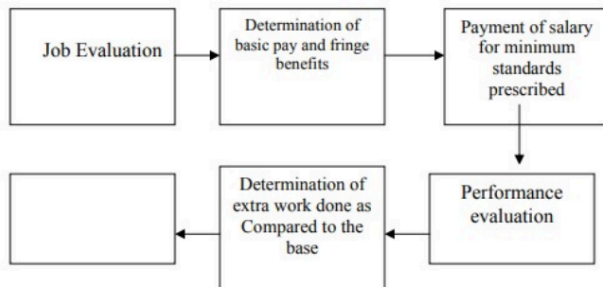


Figure 15.1 Schematic diagram below depicts the process of incentive, offering financial inducements above and beyond basic wages and salaries

### 15.3 Motivation and Incentives

Reiterating the importance of motivation, E.F.L. Breh states, "the problem of motivation is the key to management action; and in its executive form it is among the chief tasks of the General Manager. We may safely say that the working of an organization is a reflection of motivation from the top".

On the basis of above definitions, it can be said that motivation is a tendency, which keeps a person attentively and purposefully engaged in achieving goals. Motivation arises from

obvious and tacit factors that form employee psychology. It involves interactions and relationships in employee personal and work life referring to his existence as an individual, a member of society and a member of both the formal and the informal group of the organization he works for. From a management perspective, motivation constitutes the base for management activities covering POSDCoRB functions. One of the biggest challenges to modern organizations is how to sustain productivity or efficiency standards while maintaining competitive advantage in the market place with emphasis on cost competitiveness. There is a danger of workers losing interest in work if they realize that extra interest or labour could not make any difference to them. Paul Rigors (1973) has rightly posed this challenge when he states, "a continuing challenge for management is how to share the gains from higher productivity in ways that will stimulate the interest of employees in improving their performance on-the-job and the productivity of the organization as a whole." One of the challenges of motivation theory is investigation into pathological phenomenon.

Questions like, why some employees feel alienated in an organization? Why some resist their own skills and capabilities? Do they encounter emotional blockages? What can the management do? Is retrenchment the only solution? Or, is the best? Why is there inertia in hierarchy? Why employees of one organization work more efficiently than others?; and what makes certain employees achievement oriented and disciplined arise?;

These and such other questions have to be inquired into, if we have to grasp fully the meaning, nature and scope of motivation for both social and utilitarian purposes. It is obvious that mere possession of knowledge, skill and ability do not ensure best results as performance also depends on intangibles like human relations at work, motivation or will to perform. Empirical investigation into behavioral phenomenon is required to answer many of the questions addressed above to solve the perennial dilemma of motivation in management theory and practice. The most important task of the personnel department is to put across the point most emphatically and continually that personnel in an organization are most important and also the key to development.

#### 15.4 Justification of Incentives

The economic theory of motivation is based upon the argument that people feel motivated when rewarded with money. This gives a utilitarian orientation to incentive management. There is an assumption of direct correlation between monetary reward and performance. Dale Yoder, (1969) rightly remarks, "However, fascinating the individual's job assignment in a public agency or private firm, the employee expects to be paid. His wage may (and it is generally assumed that it does) affect the way he works how much and how well." Guellerman (1963) too regards money as an important motivator when he states, "money may well turn out to be the costliest motivator of them all, but money may also prove to be the most potent motivator of all, at least in certain circumstances, and when used on a sufficient scale." Executives in organizations must look after material welfare of employees because despite human relations and behavioral assumptions, money is regarded as a potent motivator.

However to assume that financial rewards are the only sources of motivation would be an exercise in oversimplification. A positive incentive can be either financial or nonfinancial. Financial incentives satisfy primarily, employees' lower order needs viz., physiological, security, as per Abraham Maslow's (1954) theory and wins his calculative involvement, that is,

the person feels committed only to the extent of doing a fair day's work for a fair day's pay. On the other hand, non-financial incentives for example, praise, competitions, participation, etc., provide higher order need satisfaction, catering to social and psychological needs of a person, which make him more committed to organizational goals. As a result, a person realizes his full potential. To quote

Barnard,(1938) "material rewards are ineffective beyond the subsistence level excepting to a very limited proportion of men; that most men neither work harder for material things, nor can be induced thereby to devote more than a fraction of their possible contribution to organized efforts. The opportunity for distinction, prestige, personal power, and the attainment of dominating position are much more important than material rewards in the development of organizations including commercial organizations."

It has, therefore, been conceded that economic gain may not be sufficient incentive. In this vein Allport (1943) observes, "Employees in an organization are 'not economic men' so much as they are 'ego-men'. What they want, above all else, is credit for work done, interesting tasks, appreciation, approval and congenial relations with their employers and fellow workers. These satisfactions they want even more than high wages or job security."

Non-material incentives take the form of recognition of good work through appreciation letters, merit certificates, medals, more meaningful involvement in decision making, opportunity for self growth('associational attractiveness' and 'ideal benefactions' by Barnard's terminology). Such awards benefit employees indirectly that is, aiding promotion or nomination to higher posts. However, this comparison is rather meaningless because management needs both types of incentives. The real question, therefore, is not what type of incentives is required, but rather how to integrate the two types of incentives successfully. What is needed is a contingency approach that considers needs of workers, type of jobs, and requirements in the organizational environment. Only then can an optimum balance between financial and non-financial incentives be attained. (Tripathi, 2003)

R.K. Misra (1973) favors the judicious use of both monetary and non-monetary incentives to achieve productivity. While budgetary restrictions and temporary improvements in performance place a limit on the potency of financial incentives as motivators, non-financial incentives demand only human ingenuity as investment and also ensure relatively stable acceleration in output. Both are important and judicious mix of the two enriches organizational practice. The Administrative Reforms Commission (1968) has advocated the use of incentives to promote efficiency in organization.

1. Incentives for timely completion of a specific project may be provided through suitable awards such as a rolling cup or a shield. In individual cases, commendatory certificates may be issued;

2. Cash awards or one or two advance increments may be given to those who give valuable suggestions for simplifications of work leading to economy in expenditure or otherwise increase efficiency; and

3. Any exemplary or special achievement may be recognized by grant of medals as is practiced at present in the police department. It may now be in order to discuss incentive plans separately.

### 15.4.1 Incentive Plans

The incentive plans are discussed under two types, that is, material incentives and nonmaterial incentives.

A. Material Incentives: Individual Incentive Plans These plans award individuals or group of individuals, extra payment for the extra work performed. In order to encourage employees, different incentive plans have been designed. Some are recounted as; Taylor's Differential Piece Rate Plan, Gantt Bonus Plan, Halsey Plan, Emerson Efficiency Plan, Rowan Plan, etc. In these schemes minimum, daily or weekly rates of pay are guaranteed and personal effort and efficiency are linked with rewards.

Modern innovation metrics such as Return on Innovation Investment (ROI) aid in evaluating and rewarding new product teams and establishing a credible link between new product performance and corporate incentives

According to Louden, "the purpose of individual incentive plans is to offer financial incentive for a worker or group of workers to produce work of an acceptable quality over and above a specified quantity." According to Wolfe, "their primary purpose is to aid in obtaining minimum unit costs thereby contributing to enterprise profits." These individual incentive plans can be categorized into piece rate plans and production bonus plans. There are, however, problems in instituting individual incentive plans. The most pressing is the criteria by which work performance standards are to be set. It has also to be kept in mind that differential payment schemes might adversely affect social capital and lower group morale. It can also potentially affect the quality of work. Differential annual payout may be determined by a subjective evaluation of each person's performance.

Advantage is that differential criteria is adopted to reward performance which is just to more meritorious employees and individual performance is given recognition apart from group. There may also be a significant one-time payout if an employee has an extraordinary accomplishment for a year.

Disadvantages are that the payout may be subjective. It can be divisive and adversely affect the working of the informal organization. Suggestion proffered to get around the problem is to encourage employees to make suggestions through a suggestion box for promotion of productivity and reduction of cost. This would also encourage employee participation in decision making in an organization. Suggestions given by employees would be effective as they are expected to understand the functioning of the organization better than supervisory personnel. However, care should be taken that suggestion plans do not lead to unsavory interference or dilution with respect to the management function specifically policy making. Supervisory and professional employees are excluded from such plans as this forms part of their job profile.

### 15.4.2 Merit Pay

The merit increase program is implemented when funds are designated for that purpose by the institution's administration, dependent upon the availability of funds and other constraints. Its major advantages are that it allows administration of differential pay to high



performers, allows estimation of individual and company performance separately with a view to judge impact fairly, and allows compensation for outstanding achievements. Main disadvantage is that assessment criteria employed may be subjective.

Robert and Masvin (1966) observe that there are several specific common-sense considerations in establishing any such plan:

1. Ensure that effort and rewards are directly related. The incentive plan should compensate employees in direct proportion to their increased productivity. Employees must also perceive that they can actually do the tasks required. Thus, the standards have to be attainable, and the employer has to provide the necessary tools equipment and training;
2. Make the plan understandable and easily calculable by the employees. Employee should be able to calculate easily the rewards they will receive for various levels of efforts;
3. Set effective standards: This requires several things. The standards should be viewed as fair by subordinates. They should be set high but reasonable and there should be about a 50/50 chance of success. And the goal should be specific – this is much more effective than telling someone to “do your best” Guarantee standards: View the standards as a contract with your employees.

Once the plan is operational, great caution is to be used before decreasing the size of the incentive in any way. Rate cuts have long been the nemesis of incentive plan;

5. Guarantee an hourly base rate: Particularly for plant personnel, it is usually advisable to guarantee employees base rate. Therefore, they will know that no matter what happens they can at least earn a minimum guaranteed base rate; and
6. Get support for the plan: Group restrictions can undermine the plan; get the work group's support for the plan before starting it.

#### 15.4.3 Group Incentive Plans

Because of the pressure of unions, these incentive plans often become unpopular. Group incentive plans are increasingly put into use, for example, bonus schemes, profit sharing, etc. The purpose of group-incentive plans is the same as that of individual incentive plans except that incentives are paid to a group rather than individuals engaged in a particular plan or aspect of organizational work.

#### 15.4.4 Profit-sharing Plans

Profit-sharing plans are the most widely used incentive-pay programs. The purpose of profit-sharing is to distribute additional profit among employees as incentives in the form of bonus, which may be paid in cash or transferred to their account. The company contributes a portion of its pre-tax profits to a pool that is to be distributed among eligible employees. The amount distributed to each employee may be weighted by the employee's base salary so that employees with higher base salaries receive a slightly higher amount of the shared pool of profits. This is done generally on an annual basis. The amount credited to their account can be withdrawn only if the employees have worked for a minimum period of time. Profit plans work



best at more established firms with relatively steady earnings. Large corporations widely employ profit sharing.

Advantages of a profit-sharing plan include, fostering team work, focus on profitability and sustainability to the enterprise. For smaller companies with erratic earnings, profit sharing plans can frustrate and irritate employees by creating expectations that are not fulfilled. Criteria adopted for administering profit plans differs from organization to organization and need to be carefully defined in advance.

Wages received by employees are supplemented by payment of an annual lump sum called bonus, which is a type of profit sharing. Over the years, the concept of bonus has changed from one of profit sharing to one of deferred wage, so that a minimum amount is payable irrespective of the profits. Bonus is regulated in India by the Payment of Bonus Act 1965, which is applicable to every factory and other establishments employing twenty (20) or more persons on any day during an accounting year. Newly set up establishments are not required to pay a bonus until they derive profits or for five accounting years following the year when they start selling their products on a regular basis, whichever is earlier.

The Payment of Bonus Act specifies a detailed method for computation of the bonus. Only employees drawing up to Rs 3,500 per month are entitled to a bonus under the act, but the bonus is calculated on the maximum salary of Rs 2,500 per month for a salary between Rs 2,500 and Rs 3,500. The amount payable varies from 8 percent (minimum) to 20 percent (maximum) of annual salary. However, the normal practice is to pay, ex gratia, some amount to employees drawing above Rs 3,500 per month also.

In addition to profit sharing and bonuses, some other incentive options are:

- Salary-at-risk plans; where employees receive their full base pay only if performance meets minimum goals, but a larger payout is possible; and

- Gain sharing, popular at some manufacturing firms, provides for a portion of increases in efficiency to be shared with employees. Gains are measured and distributions are made through predetermined formula. For example difference between actual and expected hours of work put in give hours gained. Since this pay comes into act only when gains are achieved, gain sharing plans do not entail extra cost burden.

- Stock Options entail the 'right' to purchase stock at a given price at some time in the future. An option is created that specifies that the owner of the option may 'exercise' the 'right' to purchase a company's stock at a certain price (the 'grant' price) by a certain (expiration) date in the future. Usually, the price of the option (the 'grant' price) is set to the market price of the stock at the time the option was sold. If the underlying stock increases in value, the option becomes more valuable. If the underlying stock decreases below the 'grant' price or stays the same in value as the 'grant' price, then the option becomes worthless. Stock options provide employees the right, but not the obligation, to purchase shares of their employer's stock at a certain price for a certain period of time. Options are usually granted at the current market price of the stock and last for up to 10 years. To encourage employees to stick around and help the company grow, options typically carry a four to five year vesting period, but each company sets its own parameters.

**Stock Options are of two types:**

1. Incentive stock options; (ISOs) in which the employee is able to defer taxation until the shares bought with the option are sold. The company does not receive a tax deduction for this type of option.

2. Nonqualified stock options; (NSOs) in which the employee must pay income tax on the 'spread' between the value of the stock and the amount paid for the option. The company may receive a tax deduction on the 'spread'.

The advantages of stock options are that they allow a company to share ownership with employees. Employees consequently feel more involved in organizational functioning.

The disadvantage is that stocks are speculative with attendant risks, employee interference increases in the name of participation and their attention diverts to pecuniary matters rather than performance at work

Stock options are considered most suitable for small companies where future growth is expected and for publicly owned companies that want to diversify ownership.

Besides aforementioned schemes, other forms of incentives could be recounted as (HR Guide, 2005):

- i. Paid holidays
- ii. Paid vacation
- iii. Medical care
- iv. Paid sick leave
- v. Life insurance
- vi. Retirement plans
- vii. Educational assistance
- viii. Accident insurance
- ix. Family benefits
- x. Paid personal leave
- xi. Paid maternity leave

In addition to monthly salary or wages, various fringe benefits are also available to employees. Fringe benefits contribute significantly to the cost of hiring an employee. In general, it may be said that they represent approximately 50 percent of the monthly salary. The compulsory fringe benefits are as follows.

- 1 Annual bonus
- 2 Monthly contribution to a provident fund
- 3 Terminal gratuity
4. Contribution toward the employees' state insurance scheme.
5. House rent allowance to workmen.

**(B) Non-material Incentive Plans**

Non material incentive plans may take the form of appreciation letters, award of medals, certificates, etc. These incentive plans can be of great use in organizations where the service aspect is stressed more than the business or commercial aspect. In organizations, with welfare activities or law and order or defense functions, it may be difficult to compensate the hard work of employees with money. Here, one can make use of nonfinancial incentives, which sustain the morale of particularly hard-working employees.

### 15.5 Social Security

According to P.C. Tripathi (2003), the connotation of the term 'social security' varies from country to country along with changing political ideologies. In socialist countries, the avowed goal is complete protection of every citizen from the cradle to the grave. In other nations, with less controlled economies, a measure of protection is afforded to all citizens with schemes evolved through the democratic process consistent with the resources of the state. According to the social security (minimum standards) convention number 102, adopted by the International Labour Organization in 1952, following are the nine identified components of social security:

- (i) Medical care
- (ii) Sickness benefit
- (iii) Unemployment benefit
- (iv) Old-age benefit
- (v) Employment injury benefit
- (vi) Family benefit
- (vii) Maternity benefit
- (viii) Invalidity benefit
- (ix) Survivor's benefit

### Shortcomings of Incentive Schemes

Incentive schemes, if not properly implemented can create problems, for example, (i) there is a tendency amongst employees to improve quantity at the cost of quality; (ii) there is a danger that safety regulations might be disregarded by workers which result in higher accident rates; and (iii) there is a danger that workers undermine their health under strain of work; finally such schemes potentially generate misunderstandings and jealousy among workers because of differential earnings. Therefore:

- (1) Employees must be taken into confidence in design the rewards and incentive plans so that they are aware of all parameters by which to avail of benefits.
- (2) The plan should be simple and intelligible to all
- (3) The plan should be equitable and flexible.

(4) The amount of rewards and incentives should be substantial so as to suit the stature of the person concerned.

(5) A feedback of incentive audit must be obtained to assess the benefits of the Scheme

### 15.6 Summary

The crux of the discussion is;

1. Rewards and Incentives are important to motivate employees towards excellence.
2. Rewards can be both material and non-material.
3. Non-material awards are easy to administer.
4. Awards and incentives must be based on well- defined principles.
5. Awards and incentives may be given only to deserving employees

### 15.7 Key Terms

**Incentive-** Incentives are offered to motivate employees towards better work performance and improved commitment towards the organizational purpose. Incentives are both material and non material incentives. Examples of non material incentives include meaningful participation in work, recognition, team work and identification with the purpose of the organization etc.

**Motivation-**“Goal directed behavior” is motivated behavior. Motivation study analyses human needs, motives and drives which create an achievement orientation in an employee. As part of management strategy it implies positive reinforcement of desired organizational behavior.

**Halsey Incentive Plan-** In this method a standard time is fixed for the completion of the job. A minimum base-wage is guaranteed to every worker

**Rowan Plan-** This plan is quite similar to Halsey plan. It differs only in terms of calculation of incentive for time saved

**Emerson's Efficiency Plan-** In this plan, a minimum wage is guaranteed to every worker on time basis and incentive is given on the basis of efficiency. Efficiency is determined by the ratio of time taken to standard time

### 15.8 Self Assessment questions

1. Define Meaning and definition of Incentives? Discuss the Classification of Incentives?
2. Give a brief note on Justification of Plan
3. Define a) Halsey Incentive Plan b) Rowan Plan C) Emerson efficiency plan

**15.9 Suggested Readings**

1. Strategic Compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010
2. Compensation Management Mosumi S. Bhattacharya Nilanjan Sengupta, Excel Books , 2010
3. Compensation Reward Management B.D Singh Excel books, 2012.
4. Performance Appraisal Management A Modern Approach Second Edition, Dewakar Goel, PHI Learning Private Limited, 2012.
5. Compensation Management, Dipak kumar Bhattacharya Second Edition, OUP Higher Education, Division, 2014.
6. Compensation, Burry Gerhart, George T.M.Kolvich Jerry M.Newman, Mc Graw Hills Edition, 2016
7. Compensation Management R.C. Sharma, Sulabh Sharma Sage Publications, 2019.

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## **LESSON-16**

# **LINKING WAGES WITH LABOR PRODUCTIVITY**

### **Learning Objectives**

- ✓ To understand the Linking wage with labor productivity
- ✓ To Know the unit of Analysis
- ✓ To Learn Issues of Particular relevance to LDC

### **Structure**

- 16.0 Introduction**
- 16.1 Numerator value added or Output**
  - 16.1.1 Physical Output**
  - 16.1.2 Gross Output**
  - 16.1.3 Value Added**
  - 16.1.4 Adjust for Prices**
- 16.2 Denominator – Labor Inputs**
  - 16.2.1 Quantity of work**
  - 16.2.2 Quality weighting**
- 16.3 Unit of Analysis**
  - 16.3.1 Individual**
  - 16.3.2 Plant or firm**
  - 16.3.3 Sector**
  - 16.3.4 Country**
- 16.4 Issues of Particular relevance to LDC**
  - 16.4.2 Informal sector**
  - 16.4.3 Other Measurement of Problem**
- 16.5 Summary**
- 16.6 Key words**
- 16.7 Self Assessment Questions**
- 16.8 Suggested Readings**

## 16.0 Introduction

Labor productivity is a widely used measure. It is defined as the value of output that a worker, a firm, an industry, or a country has produced per unit of labor input. To calculate labor productivity, one simply divides output by labor input. It can be measured in levels or in growth rates. Usually it is put in a comparative context, i.e. one firm is 5% more productive than another or productivity is 2% higher today than it was last year, but it also has an absolute interpretation. The output per worker that a group of workers has produced will be the total value available for consumption and also the maximum total income available to each worker. At an aggregate level, the total number of workers is the one exogenously given input for the economy. Other inputs, such as intermediates and capital, tend to be outputs of particular production processes in the economy. As such, over the long run labor productivity growth will measure the absolute output potential of an economy (Hulten, 1978).

### 16.1 Numerator: value added or output

#### 16.1.1 Physical output

The most straightforward way to quantify output is as physical output or production volume, as in the number of specific widgets produced. The relationship with the production process that uses the labor input is most transparent and the resulting labor productivity measure is very intuitive. However, its use in economic studies is only appropriate when two conditions are met.

First, the units of observation must be highly comparable, both in terms of the technology used and the type of good produced. An example is Van Biese broeck (2003) who uses the number of vehicles produced as the output measure for productivity at automobile assembly plants. This works well for a particular production stage in the industry, but would not be appropriate at the firm level as different firms differ in their degree of vertical integration. The similarity of the different assembly plants in a single country (the United States) for a limited time period leads to only small variations in capital-labor ratio, which shows up as small and insignificant output elasticities for capital in a production function. Even in such a situation, it is a good idea to control for product differences in any subsequent analysis of the productivity numbers. For example,

Van Biesebroeck (2007a) uses hours of labor input per vehicle as labor productivity measure, but includes dummy variables for vehicle segments (compact cars, intermediate cars, pick-up trucks) as controls when explaining the productivity differences.

Second, physical output is only appropriate for a micro-level analysis, at the level of individual workers or at most for plants as units of observation. Moreover, output must be clearly attributable to the unit of observation for the productivity measure to be informative. The presence of multiple outputs also makes the use of physical output problematic as aggregation across products will be ad-hoc, except when revenue shares are used (see next section). He uses the number of automobile glasses installed by workers at one particular company to study the

impact of compensation—piece rates versus hourly wage—on productivity. In this case, all workers use the same technology they are individually responsible for their output, and they have no responsibility overpricing.

Physical output facilitates comparisons across countries and across time as currency differences and price changes do not influence measured output. The work at the OECD on Regulatory Reform has constructed national labor productivity statistics for several narrowly defined service sectors (often dominated by a single incumbent producer) using physical output measures: the number of landlines (in telecommunications), kWh of electric power generation (in electricity supply), or total passenger-kilometers (in air transport). Several of these studies appeared in a special issue in June 2001 of the OECD journal *Economic Studies*; see Gönenç, Maher, and Nicoletti (2001) for an overview.

Output price variation across firms is considered to be the result of existing differences in demand and when the objective is to compare (physical) output we should filter out those sources of variation. In this view, the extent to which firms can exercise market power and sell their output at higher prices should not be considered a productivity advantage. The same holds on the input side, where a firm's advantage in commanding lower input prices should be stripped out of a TFP estimate. These adjustments will bring the results for productivity measures that use a value concept of output closer to those using a physical output concept. Whether this improves the accuracy of the estimates depends on what one wants to include in the productivity measurement. If one is convinced that performance is solely the result of efficiency differences in production, it is the right approach. One has to realize that approaches that use physical output or that adjust the value of output for firm-specific price differential ignore the value added that is created in the sales or in the purchasing department.

#### 16.1.2 Gross output

The most straightforward alternative to physical output is total sales or revenue. To make the measure comparable over time it is usually deflated with an industry price deflator and called gross output. For production units with a single output, it is simply the physical output multiplied by the final good selling price. If there are multiple outputs, gross output is the sum of the price times quantity over all goods produced. For aggregate units of observation, e.g. sectors, the summation is additionally over all active plants or firms.

Gross output is frequently used to construct a “total factor” measure of productivity, where it is adjusted for all inputs used. The EU KLEMS Growth and Productivity Accounts (<http://www.euklems.net>) make such an analysis possible at the sectoral level for a variety of countries. In addition to labor (L), output can be adjusted for the use of capital (K), energy (E), and material inputs (M). When material input is explicitly included in a production function, the analysis allows for different output elasticity with respect to intermediates by sector. When gross output is used in the numerator of labor productivity and only normalized by labor input, it leads to a measure that is often not comparable across different observations. Small differences in the intensity of intermediate input use, for example because of differences in the extent of vertical integration or in the use of higher quality intermediates, easily lead to widely varying results. The reason is that in manufacturing on average two thirds to three quarters of the value of output is accounted for by intermediate input use. Neglecting an adjustment for capital intensity, which



is always the case for labor productivity, is much less problematic as the importance of capital services in total output is an order of magnitude smaller than intermediates.

Gross output is generally only used in the numerator of labor productivity when the necessary information to calculate value added is not available (see next section). This is often the case in analyses of the service sectors, but fortunately this sector of the economy also tends to use intermediate inputs less intensively. One example is Foster, Haltiwanger, and Krizan (2006) who use total deflated sales by store as the numerator in labor productivity of retail establishments.

### 16.1.3 Value added

For an analysis at a more broad level, for example the sectoral level, or when comparing firms that operate in different sectors, it is unavoidable to convert physical output into a value concept to make it comparable. Multiplying with a market price is the only way to make measures like “vehicles per worker” and “landlines per worker” comparable. For units with multiple outputs, multi-product firms or sectors, Caves,

Christensen, and Diewert (1982) illustrate that revenue shares are the optimal weights to aggregate outputs. When comparing production units that operate with varying degrees of vertical integration, it is equally important to adjust for the intensity of intermediate input use. While some firms purchase only raw materials and add most of the value themselves, other firms purchase processed and more costly intermediates which allows them to produce more output with fewer workers. Such an adjustment is also necessary to compare between firms at different stages in the vertical production chain. Firms operating further downstream will tend to pass on a lot of value that is generated upstream when they sell their output. As their workers are only responsible for the slice of value that was added in their particular step in the production process, an adjustment is needed.

The most straightforward approach is to simply subtract purchased materials and intermediate inputs from gross output to obtain value added as output measure. When necessary, further adjustments are made for indirect taxes or subsidies. When information on sales is collected at the retail level, distribution margins need to be subtracted as well.

An alternative way to construct value added is to calculate it from the ground up by adding up its components. Its three components are total labor expenditures, capital depreciation, and operating profit. The first element is the sum of the wage bill and the cost of all other employment benefits. The second element represents the cost of the capital that is consumed as capital services in the production process. In principle, this is a straightforward element in total cost, but in practice it is hard to disentangle from changes in the valuation of the capital stock and from expenditures related to the way the capital stock is financed. The company accounts will record interest payments associated appreciations or depreciations of the capital stock. All of these are only indirectly related to the gross consumption of capital. Operating profit, the third element, is also tricky to calculate as the accounting entries are influenced more by tax policy than by economic profits. Moreover, accounting profit will include a risk premium to compensate capital providers, but some of this will already be counted in the disbursed dividend stream.

#### 16.1.4 Adjust for prices: across units or over time

To make value added or gross output comparable over time, the nominal values need to be deflated to control for the average evolution of the price level. The objective is to measure how real output evolves. For gross output, the producer price index is usually used, ideally defined for an industry classification that is as narrow as possible. For value added, it is preferable to separately deflate the output and the material inputs before subtracting the latter from the former. When the price index for output and inputs evolve differently, it is misleading to subtract the nominal values in each year and only deflate the difference as it will make the evolution of value added a function of the difference in the growth rate of the two price indices.

This is achieved by imputing an appropriate reduction in the price index to reflect that because of quality improvement each unit of output has become more valuable to consumers. National statistical agencies quantify the value of quality changes using two statistical techniques. Hedonic price regressions decompose the price of all goods into the valuation that consumers implicitly attach to the observable characteristics. The estimates can then be used to predict the added value generated from a set of improved characteristics. Matched model indices are an alternative approach. They exploit the observed price decline or the loss in market share experienced by unchanged goods that are sold in consecutive years when they face new and improved products in the market place.

While price deflators control for the general evolution in the price level, an individual firm's price can also rise because it exploits market power. Comparisons overtime are likely to be rather insensitive to this, but comparisons across firms are strongly influenced by firm-specific price differentials.

They reach this conclusion using estimates for only a few homogenous product sectors, but it could be a general phenomenon. In general, there is no good solution as it is not straightforward to define a unit of output in many differentiated goods sectors and detailed price information is not available either. At a minimum it is good to keep in mind that measured productivity willing corporate anything a firm has done to boost the demand for its products. Finally, when comparing productivity in different countries, output valued indifferent currencies needs to be converted to a common unit. For country-level comparisons, purchasing power parities (PPP) as constructed by the International

### 16.2 Denominator: labor input

#### 16.2.1 Quantity of work

The denominator of labor productivity measures the total amount of labor input that went into the production of the value created in the numerator. The most straight forward concept to use is the number of workers. At the national level, aggregate labor productivity only differs from GDP per capita by the extent that the active workforce only represents a fraction of the total population.

The number of workers is a stock concept, a onetime snapshot, while output is inherently a flow over a time period. Hence, the total number of hours worked by all employees is a more appropriate labor input concept. Only when the average number of hours worked per employee

fluctuates or differs between firms that are being compared will the two concepts produce different results. In the Longitudinal Research Database, the firm-level data set for the U.S. manufacturing sector maintained by the U.S. Bureau of the Census, hours worked is only available for production (blue-collar) workers. For productivity analysis, most researchers impute the hours for non-production (white collar) workers which are on monthly wage contracts using a fixed annual average.

The same stock-flow mismatch also plagues the calculation of productivity for firms that newly enter the industry. Output produced will be roughly proportional to the fraction of the year the firm has been in operation. In contrast, the number of employees is independent of the starting date and might be similar in subsequent years even if the firm only operated for a fraction of the initial year. Without adjustment productivity will be underestimated in the entry year and productivity growth will be overestimated. The problem might not be detected as one might plausibly interpret the strong growth as a result of learning-by-doing.

Similarly, when information on both production (output) and sales is available, it is better to use the first variable as the latter might include sales from inventory, i.e. from past production. With information on sales and end-of-year inventory of finished goods it is possible to adjust output for inventory changes to approximate production for the year.

If a firm makes a significant fraction of its revenue from the re-selling of own purchases and employees in its sales and purchasing division are not reported separately, it might be best to include total sales and total employment, as long as it is possible to subtract intermediate inputs and measure value added. The general idea is straightforward: as much as possible, make sure the labor input concept used in the denominator is representative for the period over which the output in the numerator was produced.

In the absence of information on the number of hours worked, it is sometimes possible to adjust for the fraction of part-time workers; see for example Each full-time and part-time worker is assigned a fixed number of hours—based on a national or sectoral average—before aggregating to a number of full-time equivalent workers. If available, the fraction of the wage bill for different worker categories could also be used to construct a weighted average, but care is needed as there is often a wage discount for part-time workers. In addition, part-time workers are disproportionately women and they also tend to be paid less per hour.

Adjustments for hours worked are more important in some sectors than others. Retailing or hotels & restaurants are sectors that typically employ many part-time workers. On the other hand, manufacturing industries of durable goods are notoriously cyclical with reduced work hours in cyclical downturns. Bresnahan and Ramey (1994) illustrate the different margins of adjustment for labor input in the automobile industry, but such detailed information is almost never available. An adjustment using sectoral capacity utilization can be used to verify the sensitivity of results to the business cycle.

Finally, sectors like agriculture and tourism are very seasonal and tend to employ many temporary workers. Given that most firm-level data sets measure the number of employees at

one particular point in time, using the same reference date for all firms, care is needed to make sure the labor input stock is representative.

### 16.2.2 Quality weighting

The contribution of labor services to the production process has not only a quantity, but also a quality dimension. To increase output, a firm can use more workers or employ more productive workers. To express labor productivity in efficiency units, the output value created by a benchmark worker, differences in the composition of the workforce need to be controlled for. When we measure productivity growth, we want to know how much the output of a typical or average worker has increased. If a firm has adjusted the type of workers it employs, for example by employing a more educated workforce, we may want to filter out the contribution of the human capital and only identify the output increase that a comparable workforce would have generated. Similarly, when comparing two firms, we may want to adjust their workforce to make them comparable and identify output differences that are tied to the firm. In the growth accounting framework that underlies the calculation of TFP, the human capital embedded in workers is treated as a source of capital and subtracted from output using appropriate weights.

Griliches and Jorgenson (1967) decomposed total labor input growth additively into the growth rate for the number of workers, growth in hours worked per employee, and a Growth rate of human capital. The latter is a weighted average (using relative wages) of the growth rate of employment shares in each worker category. If employment increases more rapidly than average in a worker category that has above average wages, this increase will be counted as an increase in the use of human capital and be deducted from output in the calculation of TFP. When input use is so accounted for, both in terms of utilization rates and quality improvements, they show that it explains the majority of output growth, leaving only a relatively small fraction of output growth (approximately one fifth) as a TFP residual.

## 16.3 Unit of analysis

### 16.3.1 Individual

The simplicity of the labor productivity concept, both in terms of the calculation and the interpretation, implies that it can be used at all levels of aggregation. As long as it is possible to identify an output flow that is plausibly under control or the result of action taken by the workers included in the denominator, the ratio will be informative. It means that in some situations it can even be calculated at the individual level. A straightforward application is to single-person firms. In some countries, the limited accounts that small firms need to file with the business registry or a government agency contain sufficient information to calculate value added and employment. Under the value added tax system operated in most European countries, for example, administrative data exists on annual sales and total input purchases for all firms that meet (sometimes low) sales threshold. Single household farms are common in agriculture and using survey evidence it is sometimes feasible to estimate labor productivity at the individual-level if

individuals are assigned personal responsibility for a plot of land. Some applications exist studying productivity of self-employed individuals;

In some situations, the work of employees of larger firms is sufficiently self contained that one can identify the output that a single individual is responsible for. The example of workers installing automobile glass in the Satellite Glass Corporation in Lazear (2000) has already been mentioned. A similar example is Seiler (1984) who studies the individual output of 100,000 workers that are employed in 500 different firms in the footwear and clothing industries.

These applications are not limited to manual laborers. The vast literature that investigates whether CEO compensation is excessive or not has developed more involved output measures to evaluate the performance of company executives. It provides an overview of the recent literature and calculates (marginal) productivity statistics for CEOs, using their impact on a firm's market capitalization as output measure. Event studies have similarly exploited movements in the stock price of a company to evaluate successor announcements. The productivity of individual researchers is also studied in detail in the vast literature on the sources of innovation. For example, Dietz and Bozeman study the performance of scientists working in academia as well as the private sector, using both published papers and patents granted as output measures.

### 16.3.2 Plant or firm

The most extensive and intuitive use for labor productivity is to compare the performance between plants or firms or the evolution of their performance over time. One benefit of labor productivity over TFP when comparing between firms is that comparisons are automatically multilateral because the absolute level of labor productivity has a direct interpretation. In contrast, for TFP one has to assume a particular functional form and impose the same production technology on all firms, or one has to compare each unit to a hypothetical average firm, or one is limited to only bilateral comparisons.

The most important measurement problems have already been mentioned above. One difficulty that is particularly relevant at the firm or plant level of aggregation is worth discussing. Even if we know employment, output, and material inputs for a particular production site, if the establishment belongs to a multi-unit firm it will generally consume some headquarter services that are not performed locally. These might include support services such as human resources and finance, but also the work of sales, purchasing, and marketing departments. In contrast, single-plant firms will perform all activities locally on site. As the internal organization of firms is bound to vary and head quarter services are generally not observed, the number of employees might not be comparable across observations.

One research area where this is particularly troublesome is when comparing the productivity level between domestic and foreign-owned firms. At one extreme are small single-plant firms that perform all activities in a single location; at the other extreme are large domestic firms that have national headquarters in the vicinity where most office work is performed. Foreign-owned subsidiaries tend to be intermediary, with some services performed at

headquarters, but not the entire range because regulations differ across countries and headquarters are likely to be located further away.

In the application to automotive assembly plants in Van Biesebroeck (2007), the full range of activities performed at each production location is observed. To make the labor productivity calculation, hours-per-vehicle, more comparable, a set of core activities which are performed everywhere is selected and only workers performing those activities are counted. But, in general, such detailed information is not available.

A new survey piloted by the U.S. Bureau of Labor Statistics holds some potential. Establishments—production plants or any other location where economic activities take place—receive a form that lists around 40 economic activities—business functions. These include production, purchasing, sales, R&D, human resources, etc. Firms are asked to indicate which activity is performed on site and how many workers are employed in each division. A similar project exists at Eurostat to collect information on employment by business function at the establishment level. The European project focuses specifically on international sourcing

### 16.3.3 Sector

Naturally, labor productivity can also be calculated at the sectoral level. An interesting property is that when firm-level statistics are aggregated using labor weights, .e. the employment share of each firm in the sector, the average of the micro-level estimates exactly replicates the ratio of aggregate output to aggregate input. This is not the case for TFP.

An important drawback is that capital-labor ratios tend to differ a lot across sectors. For example, the mining industry in virtually every country has an average level of labor productivity that is far higher than the economy average. Similarly, within the manufacturing industry the chemical sector also tends to have a higher than average level labor productivity. Such differences seem to suggest that large output gains could be had by reallocating workers between sectors. Such a comparison is misleading, though, as workers in those sectors need a lot of complementary inputs, notably capital. The labor productivity we calculate is not the contribution of the marginal worker, keeping everything else fixed, but the average contribution.

Given that technologies and capital-labor ratios are relatively stable over time, labor productivity growth rates are more comparable across sectors. However, in some situations even here caution is warranted. Brandt et al. (2012) study the manufacturing sector in China between 1998 and 2007. The extremely low interest rates that the government imposed in order to channel investment into the manufacturing sector lead to rapidly growing capital-labor ratios. As a result, labor productivity growth rates were substantially higher than TFP growth, but this was true to a different extent by sector. Not each sector was able to increase the capital-labor ratio as easily and not each sector received the same easy credit.

Technologies are also relatively comparable across countries, this is even an explicit assumption of the standard Heckscher-Ohlin theory of international trade. As a result, comparisons of the labor productivity level of individual sectors across countries are also

feasible. Especially if the countries are of similar level of development and the factor price ratio, the wage rate relative to the cost of capital, is likely to be similar. Converting the output to a common currency, while accounting for international differences in relative prices is the greater challenge here, as discussed earlier.

#### 16.3.4 Country

At the national level, GDP (or GVA) per capita is the most widely used measure to compare countries. The currency conversion is usually done with PPP, as mentioned earlier, to account for cross-country differences in price levels. The measure has an income interpretation—how rich is a country?—but GDP is equally well calculated from the production side. It measures the total value added of all economic activities performed in the country. GDP per capita can be divided by the activity ratio of a country—the fraction of the population that is in the workforce—to obtain output per worker. However, cross-country differences in output tend to be so large that they swamp this adjustment. Moreover, the activity ratio is endogenous and it reflects a country's ability to recruit people into the workforce. It depends on the application whether one wants to exclude this effect from the performance comparison or not.

### 16.4 Issues of particular relevance to LDCs

#### 16.4.1 Informal sector

Many of the insights in terms of firm dynamics in the manufacturing sector of developing countries have been surveyed. A few of the unique features of firms in developing countries they highlight have implications for the measurement of labor productivity.

A first feature that is impossible to ignore is the importance of the informal sector. Especially in sectors outside manufacturing, informal firms are responsible for an important share of economic activity. It demonstrates that there is a very steep productivity premium related to size in the manufacturing sectors of seven sub-Saharan countries. The formal sector systematically attracts more productive firms which will bias measured productivity differences obtained from any administrative dataset upwards. Brandt et al. (2012) illustrate that in 2004 in China 91% of manufacturing output is produced by above-scale firms (with annual sales above 5 mio. RMB) even though smaller firms are responsible for 29% of employment in the manufacturing sector.

Rather than relying on self-registration by firms into an official business registry, a large number of interviewers exhaustively surveyed all houses in a well-defined geographical area to find out whether any 'businesses' (broadly defined) were operating in that location. The resulting sample shows that there are a very large number of very small firms, often with only one or two employees.

It was used this sampling method more recently for India. They not only find a large number of micro-firms, but find moreover that these firms often stay small. It is not uncommon for firms to have only a few employees, basically still be a household firm, even after being in operation for thirty years. This is in sharp contrast with evidence for the United States where young firms either grow rapidly or exit relatively quickly with the distribution of entry cohorts rapidly converging to the industry average. Given that a lot of the productivity growth comes with scale, often through the greater capital-intensity of operations and the technical progress

embodied in equipment, the prevalence of small informal firms is hampering (productivity) growth in developing countries.

A different manifestation of the importance of the informal sector can be seen in delays in updating the national firm registry. This is especially true in fast growing economies as most statistical agencies use a minimum size threshold before firms are surveyed. When the size threshold is related to employment and the firm collects income tax, it is not too difficult for the statistical agencies to know when to start surveying a firm. However, in some countries the size threshold is related to revenue.

#### **16.4.2 Undercounting of inputs**

Just as firms are missed, administrative records in development countries are likely to undercount labor input if firms rely on family workers and casual employment, even day laborers. If the firm's output measurement is not affected, it will lead to upwardly biased labor productivity estimates. Surveys can account for this by explicitly asking for employment in different categories. For example, the RPED surveys underlying their view of Bigsten and Söderbom (2006) explicitly questioned firms on the employment of family members and asked to report casual, seasonal, or part-time workers.

Even when workers are counted, the actual labor input is likely to be more variable than in developed countries. Unmeasured overtime work is widespread in larger firms, while underemployment of the existing staff is widespread in smaller firms. Unmeasured weather inputs, which tend to be important in agriculture, are also likely to introduce measurement error. Other inputs—raw materials, energy, intermediates—are sometimes measured for institutional reasons. Examples are sales tax evasion or because they entered the country through parallel import channels to avoid high import tariffs. Given that these inputs are subtracted from sales to construct value added, omitting some of them will lead to an over estimate of labor productivity. The effects could go both ways depending on the exact institutions.

In China, for example, the cost of imported inputs subject to import tariffs might be understated as duty-free inputs originally destined for the export processing sector leak into the wider economy. In contrast, the value added tax that firms have to pay on final output will be partially rebated if the output is exported, and this rebate is not always counted in output.

#### **16.4.3 Other measurement problems**

As measured earlier, prices need to be deflated to make productivity comparison over time. The more detailed the definition of sectors, the smaller is the scope of firm specific price differences to distort real output measurement. In several studies, especially for smaller developing countries, the only price deflator available is an economy-wide purchasing price index or even only the national consumer price index.

#### **16.5 Summary**

A Wage Payment System is a method used to calculate the wages of workers in the organization. It includes different types of wage payment system methods according to



companies requirements like Time basis, per product or piece basis, Incentive basis etc. It varies upon the types and nature of business. Wage system that rewards a worker for productivity above an established standard, incentives by way of bonus etc are offered to efficient workers for the time saved. The incentives given by summit bank are bonus, commission, refreshment package gifts to their employees.

#### **16.6 Key words**

**Physical output-** The most straightforward way to quantify output is as physical output or production volume, as in the number of specific widgets produced

**Gross Output-**The most straightforward alternative to physical output is total sales or revenue. To make the measure comparable over time it is usually deflated with an industry price deflator and called gross output.

**Quality weighting-** The contribution of labor services to the production process has not only a quantity ,but also a quality dimension

#### **16.7 Self Assessment questions**

1. Discuss the Numerator value added and Denominator labor input for the Productivity?
2. Explain the issues that are particular relevance to LDC

#### **16.8 Suggested readings**

1. Strategic Compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010
2. Compensation Management Mosumi S. Bhattacharya Nilanjan Sengupta, Excel Books , 2010
3. Compensation Reward Management B.D Singh Excel books, 2012.
4. Performance Appraisal Management A Modern Approach Second Edition, Dewakar Goel, PHI Learning Private Limited, 2012.
5. Compensation Management, Dipak Kumar Bhattacharya Second Edition, OUP Higher Education, Division, 2014.
6. Compensation, Burry Gerhart, George T.M.Kolvich Jerry M.Newman, Mc Graw Hills Edition, 2016
7. Compensation Management R.C. Sharma, Sulabh Sharma Sage Publications, 2019.

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**LESSON-17**  
**WAGE COMPONENTS**

**Learning Objectives**

- ✓ To study the Wage Components
- ✓ To Understand the Important System for fixing the salary
- ✓ To Learn the wage and Salary Administration
- ✓ To Outline the wage and salary problems

**Structure**

**17.0 Introduction**

**17.1 Wage Components**

- 17.1.1 Basic Wage
- 17.1.2 Dearness Allowance
- 17.1.3 Allowances
- 17.1.4 Fringe Benefits

**17.2 Important system for fixing salary**

- 17.2.1 Wage Theories
- 17.2.2 Job Evaluation
- 17.2.3 Wage/salary survey
- 17.2.4 Factors affecting wage/salary levels
- 17.2.5 Wage Fixation institutions in India

**17.3 How to control wage and salary Administration**

**17.4 Wage and salary Problem**

- 17.4.1 Wage and Salary Level
- 17.4.2 wage and salary structure
- 17.4.3 Wage fixation for individual employee
- 17.4.4 Methods of wage payment
- 17.4.5 Compensation for Executive & Managerial Personnel
- 17.4.6 Control

**17.5 Summary**

**17.6 key words**

**17.7 Self Assessment Questions**

**17.8 Suggested Readings**

### 17.0 Introduction

In simple language, a salary and wage structure is a series of wage rates/grades that obtain in an organization for compensating labour. According to Prof. Dunlop, a wage structure 'is the complex of rates within firms differentiated by occupation and employees and the complex of inter-firm rate structure'.

A wage structure of a plant or an office or more broadly, of a national economy, can be viewed as a series of wage rates designed to compensate workers for varying skills and abilities required in the production process. The most significant aspect of a wage structure is not only the number of workers or staff at each rate in the scale of pay, but also the relative importance of each rate. Each rate/grade is designed to pay the workers/staff for his/her skilled performance on the respective job. The rate is for the given job/designation-wise. In PSUs, there is a well-defined wage structure for artisans, supervisors and managers. The wage structure is designed and reviewed every five years or so, as per the terms of the wage agreement/contract in vogue/decided through the process of collective bargaining. Progressive employers like the Tatas, the Aditya Birla Group, Wipro and others have well designed wage structure as per their wage policy.

### 17.1 Wage Components

- (a) Basic wage,
- (b) Dearness allowance,
- (c) Allowances, and
- (d) Fringe benefits.

#### 17.1.1 Basic Wage

A basic wage is the base rate in the respective grade/scale of the wage structure developed as a result of the agreement reached after the collective bargaining process, or on the basis of the recommendations made by the Fair Wages Committee, 1948 as also the 15th Indian Labour Conference, 1957 and the various rulings of tribunals and courts in the post-independence period.

The basic wage is fixed reviewed and bargained in the wage negotiation or awards, Wage Boards or Pay Commissions. In the industry, especially in large manufacturing organizations there are normally eight to ten wage grades applicable to workers/artisans and supervisors, with each grade having its base rate. Likewise, there are Executive grades/scales of pay ranging between E 1 to E 8, each scale applicable to given designations or hierarchy of executives. In fact, each organization has its own scale of pay.

In PSUs usually, there are systematically defined grades and scales of pay, ranging between E 1 to E 8 for executives and similarly some eight or nine grades for artisans, etc. In non-executive scale, the first scale is applicable to the lowest level of wage earner, e.g., attendant, peon or an auxiliary worker/helper (unskilled categories). In executive grades, E 1 refers to an Executive entrance grade and E 8 refers to General Manager's grade. Each scale has a different basic rate, so the question is, what is the basis of the differential in the wage structure?

**To summarize, the following factors are taken into consideration in working out the wage differential:**

- i. Level of skill required on the job
- ii. Level of training required on the job
- iii. Physical and mental effort needed
- iv. Level of experience needed on the job
- v. Fatigue arising out of stress/strain on the job
- vi. Level of responsibility the job demands.

Likewise, there are different wage grades of pay for workers/artisans operating at different levels, as say unskilled, or semi-skilled or skilled or highly skilled categories. As of now, in PSUs, there are around ten grades. Workers/artisans are placed in the respective grades as per the job specification/their merits.

#### **17.1.2 Dearness Allowance**

**Dearness allowance (DA)** is a part of the negotiated wage/pay agreement in an organization. The objective for paying dearness allowance is to neutralize the rise in prices of essential commodities. **Dearness allowance is linked to the All-India Consumer Price/index AICPI.** Every point rise or fall in the index is linked to money value. And, so the dearness allowance varies according to the index.

During the course of wage negotiations, following the process of collective bargaining, the management on behalf of the employer, and the union on behalf of the workers agree to merge a part of the existing DA to the basic rate, thus upgrading the wage scales/grades level which provides for incremental retirement and other benefits related to the rate/basic pay, e.g., entitlement for company housing, travel, PF contribution, etc.

DA reduces the impact of inflation in the economy on the wage earner. As per the formula, the cost of living index takes the given year as a base year, which relates to the ongoing fluctuations in prices, in terms of essentials to a series of numbers and index. The numbers are translated to monetary wage terms to by the HR experts. DA is, thus, paid to neutralize the rise in prices.

#### **17.1.3 Allowances**

Allowances are another form of compensation to a wage earner, which are negotiated as a part of wage revision in the collective bargaining process.

**Today there are a large number of allowances paid in the variety of organizations:**

- i. Car allowance/conveyance reimbursement
- ii. City compensatory allowance
- iii. Transport allowance/subsidy for outstation workers
- iv. Deputation allowance for staff on deputation
- v. Education, servant, mail and cook allowance
- vi. Cash allowance for staff of accounts dept. on cash disbursement
- vii. Book allowance
- viii. Milk allowance
- ix. Hazard allowance for working in a hazardous workplace

- x. Acting allowance to executives
- xi. Family allowance to non-family stations
- xii. Site working allowance.

#### 17.1.4 Fringe Benefits

A fringe benefit is an indirect benefit and constitutes a major part of the wage and the benefit is not merely fringe or peripheral. Some define fringe benefits as a wage cost, not directly linked to employees' productive efforts, sacrifice, service /performance. Fringe benefits no doubt, are non-wage benefits offered to staff/employees in an organization. These benefits are effective methods of attracting and retaining talent in the company. This is a supplementary compensation to employees. It boosts the real earnings and provides extra spending money to employees. It is also termed as an economic security to the workers/staff.

#### Fringe benefits also known as perks or perquisites include:

- i. Providing status to an executive by giving entitlement to use company's car with/without chauffeur, allowing entertainment facilities, holidays, foreign travel, telephone facility at home, mobile phone, etc.,
- ii. Providing security through insurance coverage and the employee medical facilities for himself, family and his dependants, children's education facilities/subsidies; and work benefits like air conditioner in office and residence, secretarial services, training for development in India/abroad, company scholarship for higher education, and
- iii. Key benefits are provided which includes share scheme, profit sharing, retirement counselling and loan for housing at nominal rates of interest.

The extent of benefits under (a), (b) and (c), provided to the employees, depend upon the company's ability to spend on fringe benefits. Attendance bonus, service bonus are the other fringe benefits. Most of these benefits are non-statutory but in the case of statutory benefits, the same have to be provided by the employer. Such benefits are under the Employees' Provident Fund Act for all employees and ESI are good examples. Profit sharing bonus is another statutory benefit in vogue, and the Gratuity payment scheme under the Gratuity Payment Act are all statutory benefits for the employees. Fringe benefits are also bargainable in the collective bargaining process.

#### 17.2 Important System for fixing the salary

Salary is structured, fixed, adjusted on the basis of several systems.

#### The important among them are:

- (1) Wage Theories;
- (2) Job Evaluation;
- (3) Wage/Salary Survey;
- (4) Various Factors Affecting Wage and Salary Levels.
- (5) Wage Fixation Institutions in India

##### 17.2.1. Wage Theories

There are a number of theories on wages.

**Important among them are discussed hereunder:**

**The Just Wage Theory** – This was the first theory on wages advocated during medieval period. The essence of this theory is that the worker should be paid on the level of maintaining himself and his family.

**Subsistence Theory** -According to Ricardo “the labourers are paid to enable them to subsist and perpetuate the race without increase or diminution.”

**(iii) Standard of Living Theory**

Karl Marx pointed out that the “Wage of labour is determined by a traditional standard of living, which, in turn, is determined by the mode of production of the country concerned.”

**(iv) The Wage Fund Theory**

According to J.S. Mill, the wages are determined on the basis of the relationship between the amount of fund allocated for the purpose of wage payment and number of workers in a country.

$$\text{Wage} = \frac{\text{Amount of fund allocated for wage payment}}{\text{Number of workers}}$$

**(v) Residual Claimant Theory**

According to Walker, the wages are determined on the basis of the amount left after the payment of rent, profits and interest to land, entrepreneur and capital respectively out of the production value.

The amount of wages = Production value – (Rent + Profits + Interest).

**(vi) Marginal Productivity Theory**

According to J.B. Clark, the wages are determined on the basis of marginal contributions of the worker to the production. The employer stops employing further workers where the contributions of the most recently employed worker are equal to his wages.

**(vii) The Bargaining Theory of Wages**

According to this theory the wages and other terms of employment are determined on the basis of the relative bargaining strength of the two parties, viz., the employer and the employees. Webbs stated that, “the conditions of the market which under a system of free competition and individual bargaining determines the conditions of employment.”

**(viii) Contribution of Behavioural Scientists to the Wage Theories –**

According to behavioural scientists, wages are determined on the basis of several factors like the size, nature, prestige of the organisation, strength of the union, social norms, traditions, customs, prestige of certain jobs in terms of authority, responsibility and status,

level of job satisfaction, morale, desired lines of employee behaviour and level of performance.

Thus, the first five wage theories influenced the wage determination until 19th century. But the influence of these theories had been reduced to a greater extent during the 20th century. The bargaining theory of wages and the behaviour theory of wages influence much the determination during the present century. The modern and important system of salary administration is job evaluation.

#### 17.2.2. Job Evaluation

Job evaluation determines the relative worth or money value of jobs. It may be defined as a process of determining the relative worth of jobs, ranking and grading them by comparing the duties, responsibilities, requirements like skill, knowledge of a job with other jobs, with a view to fixing compensation payable to concerned job holder. Jobs can be evaluated on the basis of various methods/techniques. Thus, job evaluation is a part of pay fixation machinery along with other concepts like wage theories, seniority, performance, career progression, wage survey and other factors influencing wage determination.

#### 17.2.3. Wage/Salary Survey

Survey is an investigation of current position. Salary survey is one of the techniques useful in salary administration. The purpose of this survey is to collect competitive salary data regarding various jobs in the labour market and provide the same for salary administration. A salary survey enables an organisation to find out what other organisations pay for specific jobs and the basis for payment of the existing salary level. The going rate or the market rate in that particular region influences the wage rate of the organisation. Mostly, the organisations are forced to pay the wage equivalent to the going rate.

#### 17.2.4 Factors affecting wage/salary levels

Generally, a large number of factors influence the salary levels in an organisation. Significant among them are-

- (i) Remuneration in Comparable Industries;
- (ii) Firm's Ability to Pay;
- (iii) Cost of Living; (iv) Productivity;
- (iv) Union Pressure and Strategies; and
- (v) Government Legislations.

##### (i) Remuneration in Comparable Industries

Prevailing rates of remuneration in comparable industries constituted an important factor in determining salary levels. The organisation, in the long-run, must pay at least equal to the going rate for similar jobs in similar organisations. Further, the salary rates for the similar jobs in the firms located in the same geographical region also influence the wage rate in the organisation. The organisation has to pay the wages equal to that paid for similar jobs in comparable industries in order to secure and retain the competent employees, to follow the directive of courts of law, to meet the trade union's demands, to satisfy the employee need for the same social status as that of the same categories of employees in comparable organisations.

Comparable industries constitute the organisations engaged in the same or similar activities, of the same size, in the similar type of management, i.e., public sector or under the management of the same owners, organisations located in the same geographical region etc.

#### **(ii) Firm's Ability to Pay**

One of the principal considerations that weighs with the management in fixing the salary levels is its ability to pay. But **in the short-run, the influence of ability to pay may be practically nil**. However, in the long-run, it is quite an influential factor. In examining the paying capacity of an organisation, apart from profitability, various expenses that the industry has to bear, certain trends in prices of products/services that are to be charged by the industry should also be taken into account. In addition, total cost of employees (salaries, allowances, cost of fringe benefits etc.) should be taken into consideration in determining the ability to pay. Trade Unions demand higher wages when the company's financial position is sound. But they may not accept wage reduction, when the company's financial position is in doldrums.

Hence, the management has to take decision judiciously. Further, certain incentives are linked to the profitability. Thus, whatever the influence of other factors may be, the organisation cannot pay more than its ability to pay in the long-run.

#### **(iii) Cost of Living**

**The cost of living is** another important factor that influences 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. In fact, in recent years, in advanced countries, "a number of labour agreements have 'escalator' clauses, providing for automatic wage and salary increase as cost of living index rises."<sup>18</sup> Dearness allowance is an allowance granted to the employees with a view to combating onslaughts of soaring prices.

#### **(iv) Productivity**

An interesting development in wage determination has been productivity standard. This is based on the fact that productivity increase is also the result of employee satisfaction and contribution to the organisation. But wage productivity linkage does not appear to be so easy since many problems crop up in respect of the concept and measurement of productivity.

But, although the wages are not linked directly to the productivity, in an organisation, changes in productivity have their impact on remuneration. This criterion received consideration of wage boards, "not only because it constituted a factor in the fixation of 'fair wage' but also because it was directly related to such questions as desirability of extending the system of payment by result."

#### **(v) Union Pressure and Strategies**

The wages are also often influenced by the strength of unions, their bargaining capacity and their strategies. Arthur M. Ross, concluded that "real hourly earnings have advanced more sharply in highly organised industries than in less unionized industries." Unions pressurise management through their collective bargaining strategies, political tactics and by organising strikes etc.



Trade unions influence may be on the grounds of wages in comparable industries, firm's financial position, rising living cost, government regulations, etc. It may be noted here that the unions may have the wage raised particularly in those industries where the wage level is below that of other comparable industries."

#### (vi) Government Legislations

Government legislations influence wage determination. The two important legislations which affect wage fixation are- The Payment of Wages Act, 1936 and The Minimum Wages Act, 1948. The important provisions of The Payment of Wages Act, 1936 are- ensuring proper payment of wages and avoiding all malpractices like non-payment, under payment, delayed and irregular payment, and payment in kind and under-measurement of work. The Act covers all employees drawing the wage up to Rs 1,000 per month. The Act stipulates that the organisations with less than hundred workers should pay the wage by the seventh and the organisations with more than 100 employees should pay by the tenth of next month.

The Act also stipulates time for payment of dues to the discharged employees. Under the Act, fines can be levied but after due notice to the employees and the fine deductions are restricted to 1/32nd of the wage. The important provisions of The Minimum Wages Act, 1948 are- The Act seeks to protect the workers from underpayment of wages for their efforts. It presented the guidelines for the fixation of minimum wages which is just sufficient to meet the basic needs of workers and to keep a man's 'body and soul' together.

Statutory minimum wage is determined according to the procedure prescribed by the relevant provisions of the Act. The Act provides for fixing of-

- (i) Minimum wage in certain employments;
- (ii) Minimum time rate;
- (iii) Minimum piece rate;
- (iv) Guaranteed time rate;
- (v) Overtime rate; and
- (vi) Basic pay and D.A. The Act also provides for revisions of minimum wage at fixed intervals.

#### 17.2.5 Wage Fixation Institutions in India

Wages are fixed by the following institutions in India. They are-

- (i) Collective Bargaining and Adjudication;
- (ii) Wage Boards; and
- (iii) Pay Commissions.

##### (i) Collective Bargaining and Adjudication

Collective bargaining is a procedure in which compromise is reached through balancing of opposed strengths. It is a means through which employee problems relating to various issues including wages are settled. If these problems are not settled through collective bargaining, they may be settled through voluntary arbitration or adjudication. The awards given or reached by or through the arbitrator or adjudicator or collective bargaining agreements form the basis for fixing wages in various organisations.

**(ii) Wage Boards**

This is one of the important institutions set-up by the Government of India for fixation and revision of wages. Separate wage boards are set-up for separate industries. Government of India started instituting Wage Boards in accordance with the recommendations of Second Five Year Plan, which were reiterated by the Third Five Year Plan. Wage Boards are not governed by any legislation but are appointed on ad-hoc basis by the Government.

Each Wage Board consists of one neutral Chairman, two independent members and two or three representatives of workers and management each. The Wage Boards have to study various factors before making its recommendations. The recommendations of the Wage Board are first referred to the Government for its acceptance. The Government may accept with or without modification or reject the recommendations of the Wage Board. The recommendations accepted by the Government are enforceable by the parties concerned.

**The Wage Boards take the following factors into consideration for fixing or revising the wages in various industries:**

- (a) Job evaluation.
- (b) Wage rates for similar jobs in comparable industries.
- (c) Employees' productivity.
- (d) Firm's ability to pay.
- (e) Various wage legislations.
- (f) Existing level of wage differentials and their desirability.
- (g) Government's objectives regarding social justice, social equality, economic justice and economic quality.
- (h) Place of industry in the economy and society of the country and the region.
- (i) Need for incentives, improvement in productivity etc.

The Wage Boards fix and revise various components of wages like basic pay, dearness allowance, incentive earnings, overtime pay, house rent allowance and all other allowances.

**(iii) Pay Commissions:**

This is another institution which fixes and revises the wages and allowances to the employees working in government and government departments. Pay Commissions are separately constituted by Central and State Governments. Central Government so far has appointed four Pay Commissions.

**17.3 How to Control Wage and Salary Administration**

Wage and salary administration should be controlled by some proper agency. This responsibility may be entrusted to the personnel department or to some job executive. Since the problem of wages and salary is very delicate and complicated, it is usually entrusted to a Committee composed of high-ranking executives representing major fine organisations.

**The major functions of such Committee are:**

- (i) Approval and/or recommendation to management on job evaluation methods and findings;
- (ii) Review and recommendation of basic wage and salary structure;
- (iii) Help in the formulation of wage policies; from time to time;
- (iv) Co-ordination and review of relative departmental rates to ensure conformity; and
- (v) Review of budget estimates for wage and salary adjustments and increases.

This Committee should be supported by the advice of the technical staff. Such staff committees may be for job evaluation, job description, merit rating, wage and salary surveys in an industry, and for a review of present wage rates, procedure and policies.

Alternatively, the over-all plan is first prepared by the Personnel Manager in consultation and discussions with senior members of other departments. It is then submitted for final approval of the top executive. Once he has given his approval, for the wage and salary structure and the rules for administration, its implementation becomes a joint effort of all heads of the departments. The actual appraisal of the performance of subordinates is carried out by the various managers, who in turn submit their recommendations to higher authority and the latter, in turn, to the personnel department.

The personnel department ordinarily reviews recommendations to ensure compliance with established rules of administration. In unusual cases of serious disagreement, the president makes the final decision.

#### **17.4 Wage and Salary Problems**

Wage and salary administration involves consideration of various interests such as those of employers, employees, government and society at large. The employer is interested in securing a satisfactory level of output in tune with the remuneration paid to his employees, establishing standard wages for standard occupations, adjusting wages to changes in the market, maintaining equity in wage relativities, rewarding efficient employees through incentives or performance-based remuneration and providing effective arrangements for dealing with compensation issues.

A sound compensation policy may also contribute to achieving certain social objectives by ensuring more equitable compensation, reduction of wage exploitation and satisfying employees' ambitions. The interests of the employer may not be in conformity with those of the employees and their union. Difficulties may also have to be encountered in ensuring compliance with governmental policy in the field.

In balancing the many conflicting considerations, organisational goals may appear controlling, but over any significant period they probably cannot be allowed to conflict with socially prescribed objectives. These problems of establishing a balance between employer's interests and those of others are manifested in various areas of compensation; the more notable of these are described below.

##### **17.4.1. Wage and Salary Level**

An important field of compensation is the wage and salary level. Problems in this area are directly related to the conditions of labour market. If the level of wages and salaries is too low, there will be the problem of attracting and maintaining a competent workforce. There may also be difficulties in complying with statutory rates of wages or those awarded by tribunals and courts, and also the rates arrived at as a result of bargaining. On the contrary, if the level of wages and salaries is too high, the competitive position of the undertaking in the product market will deteriorate.

The setting of an appropriate level of wages and salaries calls for a careful consideration of several factors such as –

- (i) market conditions,
- (ii) governmental policy and regulation,

- (iii) prevailing level of wages in comparable employments,
- (iv) collective bargaining and union wage policy and
- (v) management's approach towards proper wage and salary level.

#### 17.4.2. Wage and Salary Structure

Wages and salaries paid to employees on different jobs within an organisation constitute an important field of compensation. Many organisations work out the wage structure on the basis of "job evaluation." The main concern of the management is to prevent wage inequities and correct anomalies wherever necessary.

During more recent years, especially after the advent of globalisation and emergence of highly competitive product markets, managements have to give serious attention to remunerating different categories of employees on the basis of their performance and productivity. Setting of wage and salary structure by the management also involves the problem of strategic decisions regarding various components of wages.

In many organisations, the wage structure is based on collective agreements, industrial awards, court decisions or wage board recommendations. In these cases, the freedom of management to work out the wage structure for its organisation is severely curtailed.

#### 17.4.3. Wage Fixation for Individual Employees:

The setting of wage structure and determination of the level of wages involve pricing of various jobs. Very often, problem arises as to whether all the employees employed on the same job should be paid the same wage. Payment of the same wages to all employees employed on the same job may lead to dissatisfaction among efficient and senior employees. The problem is generally sought to be solved in two ways.

The first is the adoption of incentive system or performance-based remuneration. Another method is that of setting up wage ranges—a starting rate, a standard rate and a maximum rate for individuals on the same job. In such a case, procedures have to be devised for enabling individuals to move through the ranges. One such procedure may be automatic increases based on length of service. Another may be to allow increases on the basis of merit rating or performance appraisal. The third may be a combination of both.

#### 17.4.4. Methods of Wage Payment

Generally, there are two principal methods of wage payment. These are as follows – (i) payment on the basis of time such as by hour, day, week or month (time rate), and (ii) payment on the basis of output that is by piece produced (piece rate). In a particular organisation, either or both may be used depending on the arrangement of work and consent of the parties. Where incentive schemes are in operation, there is a problem of selecting the most suitable of these or a system combining both may be adopted.

#### 17.4.5. Compensation for Executives and Managerial Personnel

The problem of remuneration of executives and managerial and professional personnel is not generally tackled in a planned and systematic manner. This has been in contrast to more or less careful attention to the pay problems of workers. Efforts have been

made to design pay plans for them in such a way so as to offset the effects of progressive income tax. One way for satisfying this group has been providing them with substantial fringe benefits not coming under the purview of income tax law.

However, in India, recent amendments to income tax law have brought a number of fringe benefits under the coverage of taxation. As a result, the advantages available to this class of personnel through the availability of fringe benefits have materially declined. Despite these limitations, lucrative schemes of performance-based remuneration and rewards for these categories of personnel have been adopted in most of the competing industrial organisations.

#### 17.4.6. Control

To the management, control constitutes the central problem in **wage and salary administration**. Control in **wage and salary administration** involves the evaluation of the sufficiency and efficiency of the solutions reached on the total compensation problem. The management has to control both payroll and labour cost, and also has to realise that the value in return of wage bill is more important than the wage bill itself.

**More specifically, control in wage and salary administration involves evaluation of achievements in many areas including the following:**

- (i) Whether the total wage bill constitutes a specified proportion of sales;
- (ii) Whether the pay for jobs is within the ranges set up for them;
- (iii) Whether efficient employees on the payroll are being maintained;
- (iv) Whether the general level of wages is in tune with the conditions of labour market;
- (v) Whether individual wages and salaries are worked out on a consistent basis.

Control also demands creation of standards for comparing the efficacy of the practices in every phase of wage and salary administration, including wage bill, forecast, basic rates, rate-ranges and wage and salary data in the community and the industries.

#### 17.5 Summary

Production of goods and provision of services constitute the cornerstone of any economy, and its labour is the driving force behind the provision of such goods and services. Therefore, it is crucial for an employer to ensure that labour is being compensated adequately for services rendered, in order to maintain a cordial relationship at the workplace and ensure employee satisfaction. Its purpose is to protect workers against exploitation due to disproportionality of the payment to the amount and character of the work done. Minimum wages are a key element of any government's wage policy and generally operate to find a balance between socio-economic objectives and industrial growth. In addition to the prevention of exploitation, a minimum wage policy should also aim to regularize employment and shift unorganized classes of the workforce into more formal modes of employment

### 17.6 Key words

**Basic wage** - A basic wage is the base rate in the respective grade/scale of the wage structure developed as a result of the agreement reached after the collective bargaining process, or on the basis of the recommendations made by the Fair Wages Committee

**Dearness allowance**-Dearness allowance (DA) is a part of the negotiated wage/pay agreement in an organization

**Fringe Benefits** - A fringe benefit is an indirect benefit and constitutes a major part of the wage and the benefit is not merely fringe or peripheral.

**Allowances**- Allowances are another form of compensation to a wage earner, which are negotiated as a part of wage revision in the collective bargaining process

**Job Evaluation**-Job evaluation determines the relative worth or money value of jobs. It may be defined as a process of determining the relative worth of jobs, ranking and grading them by comparing the duties, responsibilities, requirements like skill, knowledge of a job with other jobs, with a view to fixing compensation payable to concerned job holder.

**Collective Bargaining**-Collective bargaining is a procedure in which compromise is reached through balancing of opposed strengths. It is a means through which employee problems relating to various issues including wages are settled

### 17.7 Self Assessment Questions

1. Define Wage? Discuss the Wage components?
2. Describe the Important System for Fixing the salary
3. Explain the Wage theories?
4. Give a detailed list on the Wage Fixation Institutions in India

### 17.8 Suggested Readings

1. Strategic compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010
2. Compensation Management Mosumi Bhattacharya Nilanjan Sengupta, Excel Books , 2010
3. Compensation Reward Management B.D Singh Excel books, 2012.
4. Performance Appraisal Management A Modern Approach Second Edition, Diwakar Goel, PHI Learning Private Limited, 2012.
5. Compensation Management, Dipak Kumar Bhattacharya Second Edition, OUP Higher Education, Division, 2014.
6. Compensation, Burry Gerhart, George T.M.Kolvich Jerry M. Newman, Mc Graw Hills Edition, 2016
7. Compensation Management R.C. Sharma, Sulabh Sharma Sage Publications, 2019.

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## LESSON-18

# FRINGE BENEFITS

### **Learning objectives**

- ✓ To study the Objective and Characteristics of Fringe Benefits
- ✓ To Understand the Principle of Fringe Benefits in social and organisational context
- ✓ To Learn the Statutory Fringe Benefits

### **Structure**

#### **18.0 Introduction**

#### **18.1 Meaning**

#### **18.2 Definition**

#### **18.3 Objectives of Fringe Benefits**

#### **18.4 Characteristics of Fringe Benefits**

#### **18.5 Importance to Employees/Employer**

18.5.1 Importance for Employees

18.5.2 Importance for employer

#### **18.6 Principle of Fringe Benefits in Social and Organisational context**

18.6.1 Social Context

18.6.2 Organisational context

#### **18.7 Statutory Fringe Benefits**

18.7.1 Gratuity

18.7.2 Provident Fund

18.7.3 Deposit Linked Insurance

18.7.4 Pension

18.7.5 The ESI act 1948

#### **18.8 Problems of Fringe Benefits**

#### **18.9 steps for Fringe Benefits**

#### **18.10 Fringe benefits offered by various organisation in India**

#### **18.11 Summary**

#### **18.12 Key words**

#### **18.13 Self Assessment Questions**

#### **18.14 Suggested Readings**



### 18.0 Introduction

Fringe benefits are supplementary compensation made in addition to wages, the object being to stimulate the interest of the workers and to make the job more attractive and conducive. They are, as a matter of fact, indirect benefits. As to their nature, we can say, they are neither mere “fringes” nor peripheral “wage trimmings” but a substantial part of the wage and salary structure.

To quote Belcher, these benefits are “any wage cost not directly connected with employee’s productive effort, performance, service or sacrifice”. Webster defines “fringe” as “an ornamental border, an edging, trimming or a margin”. However, these benefits are aimed at attracting and retaining efficient and contented workforce through boosting up of their real earnings.

There are wide variations in opinions as to the benefits covered by the term “fringe benefits”. We quote here Fisher and Chapman according to whom the classification of fringe benefits are – (a) premiums for time worked, (b) pay for time not worked (c) employee benefits, and (d) employee activities.

In India, the government has prescribed certain minimum amenities to be provided by employers to workers. Indirect benefits are fringe benefits but it is very difficult to distinguish between direct wages and indirect benefits. For instance, conducive working conditions benefit the employer directly, overtime wage paid for work done cannot be described as indirect benefit.

Cockman defines employee benefits as “those benefits supplied by an employer, to or for, the benefit of an employee which are not in the form of wages, salaries and time-related payments”. According to him, benefits are basically of two types – fringe and key.

Fringe benefits include status (cars, entertainment facilities, holidays, foreign travel, telephone); security (insurance, medical facilities, children’s education), and work benefits (office accommodation, secretarial services, management training, company scholarships etc.). Key benefits are benefits such as share schemes, profit sharing, and retirement counselling house purchase.

Fringe benefits afford better living standard to the employees and offer opportunities to the employer to have more productivity and production. So, they are relevant and useful for an organisation provided it can afford to extend fringe benefits. In terms of cost, these benefits constitute “the real total cost to the company of employing the employee” (Beath & Rands). It cannot be denied that fringe benefits are regarded as a “bonus” and, as such, they create a favourable attitude towards the particular job and company.

Benefits that have no relation to employment or wages should not be regarded as fringe benefits, even though they may constitute a significant part of the worker’s total income. This is fairly obvious in the case of public parks, sanitation services, and public and fire protection.

Examples of fringe benefit:

(a) Statutory benefits – The Employees Provident Fund Scheme, Gratuity or Pension Schemes and Employees State Insurance Scheme.



(b) Non--statutory benefits – Payments towards Employees Provident Fund Scheme, Gratuity and Pension Fund contribution, medical facilities, canteens, uniform and recreational facilities.

Fringe benefits also cover profit and other kinds of bonus such as attendance bonus, service bonus and gratuities, loans for house purchases, leave travel concession, children's free education, fair price shops for essential commodities, loans for purchase of car.

Fringe benefits, in spite of some of these drawbacks, have come to stay. They have now become an important part of compensation plans.

So far as the corporate management is concerned, it is necessary to take several broad policy decisions regarding wages. One fundamental issue is the break-up of the compensation package. Several options are available – (a) high/low basic wage (b) high/low fringe benefit package, and (c) high/low retirement benefits.

The management has to consider whether to pay just above or below or at par with “the going wage rate” in the area. The Bonus Act is a matter for consideration by the corporate management. “To a large extent, such issues are decided by the value system and managerial style of the corporate management and how they view wages as contributing to the organisation’s mission” (Monappa and Saiyadain).

### 18.1 Meaning

The word “fringes” with reference to remuneration or compensation came into usage primarily during the Second World War period in the U.S.A. The War Labour Board, which was entrusted with the responsibility of controlling wage increases with a view to prevent inflationary pressure, permitted provision of non-cash benefits.

The board adopted this policy on the premise that these benefits were at the fringe of usual wages and salaries, and could not immediately affect the purchasing power of the employees and were not related to consumer demands. Initially, fringe benefits constituted only a minor portion of the total compensation.

However, the term “fringe benefits” in the sense of all non-monetary benefits and services came to be widely used in spite of its limited value in describing the actual practices. David W. Belcher says, “The large proportion of total compensation that such benefits represent appears inadequately accounted for by a name implying trimming or frills.”

In spite of some obvious limitations in the use of the term, it came to be variously interpreted. The National Industrial Conference Board (U.S.A.) has defined “fringe benefits” as “payments to workers over and above the wages paid on the basis of time worked or production completed.”

Some subsequent interpretations emphasised such elements as follows – (i) employer’s labour costs beyond wages and salaries, (ii) compensation beyond wages and salaries requiring no additional productivity and (iii) compensation, benefits or services not related to employee performance. Despite these differences in approaches, the term has continued to be in wide usage even today.

However, more recent scholars and practitioners have preferred to use in its place such terms as “indirect compensation” (Belcher) “employee benefits” (Mortocchio), “employee benefits and services” (Dessler and Varkkey), denoting all non-monetary benefits, services and facilities made available to employees over and above monetary payments.

Thus, "fringe/employee benefits" may be defined as all non-monetary benefits, services or facilities and some fringe monetary benefits made available to employees in addition to their usual and established monetary compensation such as regular wages, salaries, cash allowances, incentive payments and bonuses. These benefits may take various forms and in varying dimensions, and made available to employees under varying conditions.

### 18.2 Definition

The term 'fringe benefits' refers to various extra benefits provided by employers to their employees, in addition to wages and salaries paid to them. They are also known as 'sub-wages' or 'social charges' or 'perquisites other than wages' etc. There is therefore no unanimous opinion about the meaning of the term 'fringe benefits'. Some have expressed doubt whether the benefits given according to the provisions of law should be considered as fringe benefits.

The term 'fringe benefits' perhaps came into use in the 1950's and can be credited to the regional chairman of the National War La-bour Board in the United States.

In the words of Cockmar, "Fringe benefits are those benefits which are provided by an employer to or for the benefit of an employee and which are not in the form of wages, salaries and time-related payments."

The ILO has described fringe benefits as follows:

"Wages are often augmented by special cash benefits, by the provisions of medical and other services or payments in kind that form part of the wage for expenditure on the goods and services. In addition, workers commonly receive such benefits and holiday with pay, low cost meals, low rent housing etc. Such additions to the wage proper are sometimes referred to as fringe benefits. Ben-efits that have no relation to employment or wages should not be regarded as fringe benefits even though they may constitute a sig-nificant part of the worker's total income."

D. W. Balcher defines fringe benefits as "any wage cost not di-rectly connected with the employee's productive effort, performance service or sacrifice".

According to the Employer's Federation of India, Fringe benefits include payments for non-working time, profits and bonus, legally sanctioned payments on social security schemes, workmen's compensation, welfare Ness, and the contributions made by employer under such voluntary schemes as cater for the post-retirement, medical, educational, cultural and recreational needs of workmen. The term also includes the monetary equivalent of free lighting, water, fuel etc. which are provided for workers, and subsidized housing and related services.

Thus, fringe benefits include both monetary and non-monetary ben-efits given to the employees during as well as post-employment period. These benefits are connected with the employment but not to the em-ployees' contributions to the organisation.

### 18.3 Objectives of Fringe Benefits

Many years ago, benefits and services were labelled "fringe" benefits because they were relatively insignificant or fringe components of compensation. However, the situation now is different, as these have, more or less, become important part of a comprehensive compensation package offered by employers to employees.

The main purpose of fringe benefits is to increase the financial position of the employees. They include items which are over and above the normal earnings.

Considering the above point of view in mind the important objectives of fringe benefits are:

1. To recruit and retain the talented personnel in the organisation.
2. To maintain sound industrial relations and avoid unrest in the organisation.
3. To identify unsatisfied needs of the employees and convert those into satisfying needs by utilizing appropriate steps.
4. To protect social security of the employees during old age by providing provident fund, gratuity and pension.

As per Article 43 of the constitution of India, "All workers should be given a living wage condition of work ensuring decent standard of life and fuller enjoyment to ensure social and cultural opportunities." Therefore, fringe benefits act as a social level to the employees because worker is not a commodity. He is an active participant in programme of economic development and social reconstruction.

5. To develop a sense of belongingness among employees of the organisation.
6. To comply various legislations related with fringe benefits which are formulated by central and state Government
7. To ensure cooperation, loyalty and faithfulness among employees of the organisation.
8. To develop Brand Image of the organisation in the eyes of public.

#### **18.4 The special characteristics of fringe benefits are as follows:**

- i. Fringe benefits are supplementary forms of compensation.
- ii. Such benefits are paid not as incentives but based on membership of the employees with the organization.
- iii. Benefits are linked to performance; these are extended as a condition of employment.
- iv. Such benefits raise the standards of living of employees, therefore, contributes to enrichment of quality of work life (QWL).
- v. Some of the benefits may be statutory while others may be voluntary.
- vi. Payment of fringe benefits in India are primarily made for reasons like, employee demands, presence of trade union, employers' preference to motivate employees, as social security measures and finally to create a motivating environment.

#### **18.5 Importance to Employees and Employer**

Fringe/employee benefits are important not only for the employers and employees, but also for the community. A brief mention of these will be appropriate for discerning their importance. Some of the popular employee benefits comprise the following – medical and sickness benefits, workmen's compensation, insurance, provident fund, pension, maternity benefit, housing accommodation with ancillary facilities, transport facility, leave travel facility and education facilities for the children of the employees.

These benefits may be provided under the company policy or under the agreement with the union or as a result of legislation.

#### **18.5.1. Importance for Employees:**

The benefits are important to the employees for the following main reasons:

- (i) They enhance the real earnings of the employees and enable them to save money, which they would, otherwise, have spent in the absence of these benefits.
- (ii) Money value of these benefits has, for long, not been taxable under income tax law, thus enhancing employees' living standards. However, during more recent years, the value of these benefits is adjusted in the income tax payable by individual employees, but many of these still do not come into the ambit of income tax deductions.
- (iii) Availability of the social security benefits in the event of such contingences as unemployment, sickness, disability, old age, maternity and so on mitigates the worries of the employees regarding apprehended insecurity.
- (iv) Many benefits, particularly medical and refreshment facilities, are conducive to the protection of health of employees and enhancement of their efficiency.
- (v) Housing accommodation with ancillary amenities and transport facilities result in saving of time and add to employees' convenience.
- (vi) Many benefits are made available to the employees' family members, which promote congenial family life and strengthen employees' motivation.
- (vii) Many companies make available to their employees plots for construction of houses or flats on lease basis, and also bear a part of the burden of interests on house loans. Thus, a major item of worry of the employees is mitigated.
- (viii) Some companies advance loans to their employees on liberal terms for the purchase of vehicles and household appliances. This facility also raises the living standards of employees.

#### **18.5.2. Importance for Employers:**

Fringe/employee benefits are advantageous to the employers for the following main reasons:

- (i) Employers have, for long, been enjoying substantial rebate on these benefits under income tax law. This advantage has, however, increasingly diminished during more recent years. Nonetheless, employers still receive rebates for expenditure on many of these benefits.
- (ii) In establishments facing chronic problems of unstable workforce and absenteeism, long-term social security benefits such as life insurance cover, provident fund and pension and housing accommodation have proved effective in reducing their incidence.
- (iii) These benefits generally tend to strengthen employees' motivation and efficiency resulting in higher production and reduction of labour cost.
- (iv) Many companies have experienced establishment of sound employee and industrial relations as a result of provision of these benefits, especially when these benefits have emanated from agreement with the union.

(v) In some cases, the companies have been able to keep wage-rates at a low level on the ground of providing substantial benefits to their employees.

(vi) Provision of these benefits also enhances the prestige of the company in the community and enables competent workers to be attracted towards the company.

Fringe/employee benefits are also significant for the community and economy. It was during the Second World War period in the USA that the concept of "fringes" emerged in the context of compensation. The War Labour Board, which was entrusted with the responsibility of controlling wage increases, allowed fringe benefits holding that these would not stand in the way of measures intended to prevent inflation.

Even today, such a premise holds well in the situation of inflationary pressure under which "wages chasing prices and prices changing wages" is a usual phenomenon. Availability of fringe benefits diminishes pressures for wage increases which is helpful in fight against inflation.

Besides, many big companies have created infrastructure near workplaces in the form of housing colonies, roads, parks, lighting arrangements and community, educational and recreational centres. These benefit not only the residents of the locality, but also many others in the community. The facilities in the hospitals and dispensaries established and maintained by companies are generally made available to the public in the vicinity.

Marketing centres established by companies are similarly open to the public. Many other examples may be easily cited to show that the community derives advantages from the benefits intended to be provided for the employees.

### 18.6 Principle of Benefits in Social and Organizational Context

Fringe benefits act as a maintenance factor in terms of motivation theories. It implies that provisions of benefits and services work as dissatisfies if not provided but do not stimulate employees for higher performance if provided. Therefore, the question arises- what is the rationale behind providing benefits and services?

The answer of this question involves the analysis in a much wider context than merely the organizational context; it has to be analysed both in social as well as organizational contexts.

#### 18.6.1. Social Context:

Every society takes care of its members by providing some kinds of benefits. The value and form of benefits depend on the economic conditions of the society. The basic logic behind such benefits is that members of the society will enjoy comparatively better lives as compared to what they can enjoy in the absence of these benefits. The objective is not necessarily to make them more efficient to work.

Therefore, every country adopts the concept of benefits in its framework which governs the country. For example, Constitution of India provides in its Article 43 that "all workers should be given living wage, conditions of work ensuring decent standard of life and fuller enjoyment to social and cultural opportunities." Various benefits and services provided to the employees serve this purpose.

**18.6.2 . Organizational Context:**

Since every organization of a society is not similar to others, each organization adopts its own approach in providing the benefits to employees. The organizations which adopt philanthropic approach provide more generous benefits and services.

In general, from the organization's point of view, the objectives of benefits and services are as follows:

1. To maintain parity with the general practices adopted by other organizations in the same geographical area or industry sector.
2. To provide community and commonly shared services which employees cannot provide individually.
3. To create better image of the organization so as to attract and retain competent employees.
4. To increase morale and work life of employees so that they can concentrate on their jobs.
5. To satisfy the trade unions by providing benefits and services to employees.

**Employment Security; Health Protection; Old Age and Retirement; Personnel Identification; Participation and Stimulation & Miscellaneous**

Organizations provide a variety of fringe benefits.

The fringe benefits are classified under five heads as given here:

**1. Employment Security:**

Benefits under this head include unemployment, insurance, technological adjustment pay, leave travel pay, overtime pay, level for negotiation, leave for maternity, leave for grievances, holidays, cost of living bonus, call-back pay, lay-off, retiring rooms, jobs to the sons/daughters of the employees and the like.

**2. Health Protection:**

Benefits under this head include accident insurance, disability insurance, health insurance, hospitalization, life insurance, medical care, sick benefits, sick leave, etc.

**3. Old Age and Retirement:**

Benefits under this category include deferred income plans, pension, gratuity, provident fund, old age assistance, old age counselling, and medical benefits for retired employees, travelling concession to retired employees, jobs to sons/daughters of the deceased employee and the like.

**4. Personnel Identification, Participation and Stimulation:**

This category covers the benefits like anniversary awards, attendance bonus, canteen, cooperative credit societies, educational facilities, beauty parlor services, housing, income tax aid, counselling, quality bonus, recreational programs, stress counselling, safety measures, etc.

Other Miscellaneous Categories:

**i. Payment for Time Not Worked:**

Benefits under this category include sick leave with pay, vacation pay, paid rest and relief time, paid lunch periods, grievance time, bargaining time, travel time, etc.

**ii. Extra Pay for Time Worked:**

This category covers the benefits such as premium pay, incentive bonus, shift premium, old age insurance, profit sharing, unemployment compensation, Christmas bonus, Deepali or Pooja bonus, food cost subsidy, housing subsidy, recreation.

**iii. Retrenchment Compensation:**

The Industrial Disputes Act, 1947 provides for the payment of compensation in case of lay-off and retrenchment. The non-seasonal industrial establishments employing 50 or more workers have to give one month's notice or one month's wages to all the workers who are retrenched after one year's continuous service.

The compensation is paid at the rate of 15 days wage for every completed year of service with a maximum of 45 days wage in a year. Workers are eligible for compensation as stated above even in case of closing down of undertakings.

**iv. Lay-Off Compensation:**

Layoff is the temporary suspension or permanent termination of employment of an employee or a group of employees for business reasons, such as the decision that certain positions are no longer necessary or business slow-down or interruption in work.

Originally the term 'layoff' referred exclusively to a temporary interruption in work, as when factory work cyclically falls off. In case of lay-off, employees are entitled to lay-off compensation at the rate to 50% of the total of the basic wage and dearness allowance for the period of their lay-off except for weekly holidays. Lay-off compensation can normally be paid up to 45 days in a year.

Fringe Benefits in HRM – Statutory Benefits: Applicable to the Employees after Retirement and during Old Age

These benefits are related to the social security of employees because the economic and saving conditions of the employees are very poor due to the low wages and high living cost.

With a view to develop social security feeling after retirement and during old age the following statutory fringe benefits are applicable to the employees:

**18.7 Statutory fringe Benefits****18.7.1. Gratuity**

As per the Payment of Gratuity Act, 1972, the gratuity is payable to all the employees who render a minimum continuous service of five year with the present employer or at the age of superannuation or death or disablement due to accident or disease. The maximum limit of gratuity payable to an employee shall not exceed Rs.3.5 Lakhs and the rate for the purpose of calculation is that the 15 days wages for every completed year of service.



**18.7.2. Provident Fund**

The Employee's Provident Fund and Miscellaneous Provisions Act, 1952 provides provident fund and deposit linked insurance to the employees. Both employer and employees contribute to the fund. The rate of contribution is the 12% of the Basic Pay and Dearness Allowance in case of contribution to provident fund scheme and only 12% of the Basic Pay in case of provident fund scheme where the contribution from the employer side is not applicable.

Generally the organizations pay this fund amount with interest to the employee on superannuation or separation from the organisation by any means or to the dependents of the employee, in case of death.

**18.7.3. Deposit Linked Insurance**

This scheme was introduced in 1976 in the Provident Fund Act. If a member of Employees Provident Fund dies during in service then his dependents will be paid an additional amount equal to the average balance during last three years in his account. The maximum amount payable is Rs.10000 under this scheme.

**18.7.4. Pension**

The Government of India introduced a pension scheme in the year 1995 where the contributory provident fund scheme is applicable.

**18.7.5. The Employee State Insurance Act, 1948**

The Workmen Compensation Act, 1923 and Maternity Benefit Act, 1961 are another statutory benefit schemes related to the health of employees comes under fringe benefits category.

The Human Resource Department is generally responsible for administration of the organisation. These are one of the means to ensure welfare of employees and to develop a sense of belongingness among employees towards organisation. Some of the organisations may provide even more than the aforementioned various fringe benefits programmes or may not provide all the benefits described due to the financial ability of the organizations.

**18.8 Problems of Fringe Benefits**

Fringe benefits and services are very useful for the employees. These provide help to the employees and fulfil their needs. It contributes to maintain the satisfied workforce. For this, it is required that the benefits and services must be managed properly. But in many organisations management does not pay proper attention towards administration of benefits and services.

**Following are the problems faced in administration of benefits and services:**

- (a) Workers have different interest in benefits and services.
- (b) Trade unions oppose such schemes.
- (c) Workers and managers do not have knowledge about benefit policy of the company.
- (d) Managers are overloaded with work. Hence they are not able to pay proper attention towards administration of benefits and services.
- (e) Lack of training in administration of benefits and services.



Administration of benefits and services must be proper; otherwise it will lead to confusion.

**18.9 Following steps must be taken for effective management of benefits and services:**

- (a) Study of environmental factors.
- (b) Study of competitor's schemes and their administration.
- (c) Formulation of benefit and service objectives.
- (d) Fixing responsibility of administration of benefits and services.
- (e) Communications of scheme to the employees and trade unions.
- (f) Control of costs of benefits and services.
- (g) Review of existing schemes.

Types of Benefits Offered by Various Organisation in India: Hours of Work, Rest Period, Holidays, Shift Premium and a Few More

The provision of fringe benefits in Indian industries has not been very remarkable. There has been diversity in nature and quantum of these benefits in various industries. There are two types of fringe benefits being provided by Indian employers, some are legal, and some are voluntary.

The contribution to the provident fund of the employees, pension schemes, gratuity, contribution to employees, states insurance fund, lay off compensation, leave travel concession; maternity benefits are some examples of legal fringe benefits, which cost on an average equal to 21.3% of the annual wages.

On the other hand, in many industrial houses, various schemes are being operated for the benefit of their employees voluntarily. Their values range from 10% to 21% of the annual wages in different industries. Public sector enterprises have taken a lead in providing such benefits to their employees.

In spite of such high percentage, the provision of fringe benefits in India cannot be said to be adequate and satisfactory. The cost of fringe benefits is by no means significant as compared to other countries.

**18.10 The fringe benefits offered by various organisation in India may be following types:**

1. **Hours of Work** – As per Section 15 of the Factories Act, 1948, that no adult worker shall be allowed to work in a Factory for more than 48 hours in a week and more than 9 hours in a day.
2. **Rest Period** – Tea break or coffee break are allowed during the day to allow the worker to rest.
3. **Holidays** – As per the Factories Act, 1948, an adult worker shall have weekly paid holiday in general on Sunday or any other day in a week.
4. **Shift Premium** – Shift premium to the workers who are required to work during second and third shifts in a day.
5. **Paid Vacation** – Workers are eligible for paid vacation from 15 days to 30 days in a calendar year

**6. Holidays Pay** – Independence Day, Republic Day, Gandhi Jayanti, Deepawali, Dusshera, Holi, Id and Christmas are gazetted paid holidays. Generally organizations after double the normal rate of the salary if the workers worked during these holidays.

**7. Sick Leave** – The employees are entitled to get full day when he is out of work due to sick for a 10 days in a calendar year.

**8. Maternity Benefit** – The Women are entitled to maternity leave for 12 weeks (six weeks before the delivery and six weeks after the delivery) in addition to cash benefit of 75 paise per day or twice of sickness benefit, whichever is higher.

**9. Disable Benefit** – The employees are entitled to get the benefit under Workmen's Compensation Act 1923, if he is disabled temporarily or permanently (partial or total) during employment injury or occupational diseases.

**10. Absence Leave** – The pay is provided to an employee if he is absent from the work place due to the participating in training and development programmes.

**11. Canteens** – Fully or partially subsidized food and refreshments is provided to the employees during working hours.

**12. Transport Facilities** – Many organizations are providing conveyance facilities to employees from their residence to work place and back.

**13. Housing Facilities** – The big houses are providing company owners housing or subsidized housing facilities to their employees.

**14. Purchasing Facilities** – Many of the large organizations has set up the consumer stores in the employee's colonies and supply all essential goods and services at fair prices.

**15. Educational Service** – Educational services include tuition fees refunds, scholarships, setting up of schools and colleges, libraries and many more. These facilities not only provide to the employees of the organisation but also to their family members.

**16. Medical Facilities** – These include clinics, hospitals and counselling services. It reduces tiredness, absenteeism and employee turnover.

**17. Financial and Legal Aid** – Many organizations are provided loan funds, income-tax service, assistance in legal matters and group insurance plans to their employees.

**18. Recreational Facilities** – Organisations provide social clubs, arrange parties and picnics, reading rooms, libraries and entertainment programmes for their employees.

**19. Travel Concessions** – Many organizations are providing leave and travel concessions one time in a financial year to their employees.

**20. Miscellaneous** – Many organisations are providing other benefits to their employees such as Dipawali gifts, birthday gifts, pooja gifts and productivity or performance rewards, etc.

### 18.11 Summary

Fringe benefits include status (cars, entertainment facilities, holidays, foreign travel, telephone); security (insurance, medical facilities, children's education), and work benefits (office accommodation, secretarial services, management training, company scholarships etc.). Key benefits are benefits such as share schemes, profit sharing, and retirement counselling house purchase. According to ILO fringe benefits has been described as – "Wages are often augmented by special cash benefits, by the provisions of medical and other

services or payments in kind that form part of the wage for expenditure on the goods and services. In addition, workers commonly receive such benefits and holiday with pay, low cost meals, low rent housing etc. Such additions to the wage proper are sometimes referred to as fringe benefits. Benefits that have no relation to employment or wages should not be regarded as fringe benefits even though they may constitute a significant part of the worker's total income.

#### 18.12 Key words

**Fringe benefits-** Fringe benefits also cover profit and other kinds of bonus such as attendance bonus, service bonus and gratuities, loans for house purchases, leave travel concession, children's free education, fair price shops for essential commodities, loans for purchase of car.

**Lay off Compensation** -Layoff is the temporary suspension or permanent termination of employment of an employee or a group of employees for business reasons, such as the decision that certain positions are no longer necessary or business slow-down or interruption in work.

**Employment Security-** Benefits under this head include unemployment, insurance, technological adjustment pay, leave travel pay, overtime pay, level for negotiation, leave for maternity, leave for grievances, holidays, cost of living bonus, call-back pay, lay-off, retiring rooms, jobs to the sons/daughters of the employees and the like.

#### 18.13 Self Assessment Questions

1. Define Fringe Benefits? Discuss the Objectives and characteristics of Fringe benefits?
2. Explain the Principle of fringe Benefits for the Organisational and Social context?
3. Discuss the problems and steps in Fringe Benefits
4. Explain the Fringe Benefits offered by various organisations in India.

#### 18.14 Suggested Readings

1. Strategic compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010
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## LESSON-19 RECENT TRENDS IN INDIAN ORGANISATIONS AND MNC

### **Learning Objectives**

- ✓ To study the Objectives of International compensation
- ✓ To Understand the components of Management
- ✓ To Learn the Approaches of International Compensation

### **Structure**

#### **19.0 Introduction**

#### **19.1 Objectives of International compensation**

#### **19.2 Components of Management or System**

19.2.1 PCNs

19.2.2 TCNs

19.2.3 HCNs

#### **19.3 Components of MNC**

19.3.1 Base Salary

19.3.2 Allowances

19.3.3 Benefits

#### **19.4 Additional payments and Services**

#### **19.5 Approaches to International Compensation**

19.5(a) The Going Rate Approach

19.5(b) The Balance sheet Approach

#### **19.6 Compensation issues in International Scenario**

#### **19.7 Management challenges concerning International Benefits and Compensation**

#### **19.8 Summary**

#### **19.9 Key words**

#### **19.10 Self-assessment questions**

#### **19.11 Suggested Readings**

#### **19.0 Introduction**

The literal meaning of compensation is to counter—balance. In the case of human resource management, compensation is referred to as money and other benefits received by an employee for providing services to his employer. Money and benefits received may be in

different forms — base compensation in money form and various benefits, which may be associated with employees services to the to the employer like provident fund, gratuity insurance scheme and any other payment which the employee receives or benefits he enjoys in lieu of such payment. Cascio has defined compensation as follows; "compensation includes direct cash payments, indirect payments in the form of employees to strive for higher levels of productivity."

Designing and developing a better compensation package for HR professionals for the international assignments requires knowledge of taxation, employment laws, and foreign currency fluctuation by the HR professionals. Moreover, the socio-economic conditions of the country have to be taken into consideration while developing a compensation package. It is easy to develop the compensation package for the parent country national but difficult to manage the host and third country nationals. When a firm develops international compensation policies, it tries to fulfill some broad objectives:

1. The compensation policy should be in line with the structure, business needs and overall strategy of the organization.
2. The policy should aim at attracting and retaining the best talent.
3. It should enhance employee satisfaction.
4. It should be clear in terms of understanding of the employees and also convenient to administer.

The employee also has a number of objectives that he wishes to achieve from the compensation policy of the firm

- a) He expects proper compensation against his competency and performance level.
- b) He expects substantial financial gain for his own comfort and for his family also.
- c) He expects his present and future needs to be taken care of including children's education, medical protection and housing facilities.
- d) The policy should be progressive in nature.

Global compensation managers that is, everyone involved at any level in pay-related decisions increasingly deal with two areas of focus. They must manage highly complex and turbulent local details while concurrently building and maintaining a unified, strategic pattern of compensation policies, practices and values. For multinationals successfully to manage compensation and benefits requires knowledge of employment and taxation law, customs, environment and employment practices of many foreign countries, familiarity with currency fluctuations and the effect of inflation on compensation and an understanding of why and when special allowances must be supplied and which allowances are necessary in what countries – all within the context of shifting political, economic and social conditions.

**Difference Between Multi National Corporation (MNC) and Trans National Corporation (TNC)**

The both multinationals' corporations and transnational corporations operate internationally and their compensation or reward system is also similar, but some differences exist between two, which are:

MNCs operate in several different countries while transnational implies "just across the border" as in the US and Canada. Obviously, both operate internationally

A MNC has a centralized headquarters & is a corporation with extensive ties international operations in more than one foreign country. Examples are Coke, Pepsi, General Electric, Exxon, Wal-Mart, and Mitsubishi. A transnational company has no "head office" and moves whatever base of operations it has fluidly between its national offices. It is a MNC that operates worldwide without being identified with a national home base i.e., it is said to operate on a borderless basis. Examples are Daewoo, Saint Gobain, Sony, Samsung Group, Shell Oil etc.

To prepare employees for cross-cultural assignments, companies need to provide cross-cultural training. Most U.S. companies send employees overseas without any preparation. As a result, the number of employees who return home before completing their assignments is higher for U.S. companies than for European and Japanese companies. U.S. companies lose more than \$2 billion a year as a result of failed overseas assignments.

To succeed overseas, expatriates (employees on foreign assignments) need to be.

1. Competent in their areas of expertise.
2. Able to communicate verbally and nonverbally in the host country.
3. Flexible, tolerant of ambiguity, and sensitive to cultural differences
4. Motivated to succeed, able to enjoy the challenge of working in other countries and willing to learn about the host country's culture, language and customs.
5. Supported by their families.

### 19.1 Objectives of International Compensation

When developing international compensation policies, a firm seeks to satisfy several objectives.

The policy should be consistent with the overall strategy, structure and business needs of the multinational. The policy must work to attract and retain staff in the areas where the multinational has the greatest needs and opportunities. Hence the policy must be competitive and recognize factors such as incentive for Foreign Service, tax equalization and reimbursement for reasonable costs. The policy should facilitate the transfer of international employees in the most cost-effective manner for the firm. The policy must give due consideration to equity and ease of administration.

The international employee will also have a number of objectives that need to be achieved from the firm's compensation policy. First, the employee will expect the policy to offer financial protection in terms of benefits, social security and living costs in the foreign location. Second, the employee will expect a foreign assignment to offer opportunities for financial advancement through income and/or savings. Third, the employee will expect issues such as housing, education of children and recreation to be addressed in the policy.

If we contrast the objectives of the multinational and the employee, we see, of course, the potential for many complexities and possible problems, as some of these objectives cannot be maximized on both sides. Firms must rethink the traditional view that local conditions dominate international compensation strategy.

### 19.2 Compensation Management or System

The type and amount of compensation necessary to attract technically and culturally qualified international managers and technical professionals to the three nationals or country

categories involved international human resource management activities from which employees are selected whether the people are:

PCNs (parent country nationals)

TCNs (third country nationals)

HCNs (host country nationals)

An expatriate is an employee working in a country other than their country of origin.

### 19.2.1 PCNs (Parent Country Nationals)

Those personnel who are of the same nationality as the contracting government or personnel from headquarters

They come from the home country of the operation.

The policy of using PCNs is usually employed when one or more of the following situations exist:

- (1) the host country cannot readily supply desired managerial personnel.
- (2) Efficient communication with headquarters is required, and
- (3) the company adopts a centralized approach to globalization.

### 19.2.2 TCNs (Third Country Nationals)

Those personnel of a separate nationality to both the contracting government and the area of operations i.e. whose nation of residence is neither the host country nor the home country.

Such an employee normally is recruited from outside the host country and relocated from the point of recruitment to the host country.

### 19.2.3 HCNs (Host Country Nationals)

These are Indigos (Indigenous Personnel) / Nationals / Locals – those personnel who are indigenous to the area of operations

Whose basic residence or home is the host nation.

Local colleagues of the expatriate, they are valuable socializing agents, sources of social support, assistance, and friendship to expatriates. Expatriates are more likely to adjust when HCNs engage in this behaviour.

HR managers focus on their strategic objectives to develop a comprehensive compensation plan, in terms of considering base pay, short and long-term incentives, benefits and growth opportunities. The objective of this kind of strategy is to ensure that both TNC/MNCs' long and short-term objectives coexist in the compensation system without overlap, which would duplicate a single pay plan for the same objectives. The purpose of the planning is also designed to ensure that the compensation system attracts and retains the desired employees and that it motivates them to do those things that support the business plan. The area of international compensation is complex primarily because multinationals must cater to three categories of employees: PCNs, TCNs and HCNs.

**19.3 Components of MNC's Compensation****19.3.1. Base Salary**

In a domestic context, base salary denotes the amount of cash compensation serving as a benchmark for other compensation elements (such as bonuses and benefits).

For expatriates, it is the primary component of a package of allowances, many of which are directly related to base salary (e.g. Foreign Service premium, cost-of-living allowance, housing allowance) and also the basis for in-service benefits and pension contributions. It may be paid in home or local-country currency. The base salary is the foundation block for international compensation whether the employee is a PCN or TCN. Major differences can occur in the employee's package depending on whether the base salary is linked to the home country of the PCN or TCN, or whether an international rate is paid.

**Foreign Service inducement/hardship premium**

Parent-country nationals often receive a salary premium as an inducement to accept a foreign assignment or as compensation for any hardship caused by the transfer.

The definition of hardship, eligibility for the premium and amount and timing of payment must be addressed. In cases in which hardship is determined, US firms often refer to the US Department of State's Hardship Post Differentials Guidelines to determine an appropriate level of payment. Making international comparisons of the cost of living is problematic. These payments are more commonly paid to PCNs than TCNs. Foreign service inducements, if used, are usually made in the form of a percentage of salary, usually 5-40 per cent of base pay. Such payments vary, depending upon the assignment, actual hardship, tax consequences and length of assignment.

**19.3.2. Allowances**

Issues concerning allowances can be very challenging to a firm establishing an overall compensation policy, partly because of the various forms of allowances that exist.

(a) The cost-of-living allowance (COLA), which typically receives the most attention, involves a payment to compensate for differences in expenditures between the home country and the foreign country (to account for inflation differentials, for example). The COLA may also include payments for housing and utilities, personal income tax or discretionary items.

(b) The provision of a housing allowance implies that employees should be entitled to maintain their home-country living standards (or, in some cases, receive accommodation that is equivalent to that provided for similar foreign employees and peers). Other alternatives include company-provided housing, either mandatory or optional, a fixed housing allowance or assessment of a portion of income, out of which actual housing costs are paid. As a firm internationalizes, formal policies become more necessary and efficient.

(c) There is also a provision for home leave allowances. Many employers cover the expense of one or more trips back to the home country each year. Firms allowing use of home leave allowances for foreign travel need to be aware that expatriate employees with limited international experience who opt for foreign travel rather than returning home may become more homesick than other expatriates who return home for a 'reality check' with fellow employees and friends.

(d) Education allowances for expatriates' children are also an integral part of any international compensation policy. Allowances for education can cover items such as tuition, language



class tuition, enrolment fees, books and supplies, transportation, room and board and uniforms. PCNs and TCNs usually receive the same treatment concerning educational expenses.

(e) Relocation allowances usually cover moving, shipping and storage charges, temporary living expenses, subsidies regarding appliance or car purchases (or sales) and down payments or lease-related charges. Allowances regarding perquisites (cars, club memberships, servants<sup>10</sup> and so on) may also need to be considered (usually for more senior positions, but this varies according to location). These allowances are often contingent upon tax-equalization policies and practices in both the home and the host countries.

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(f) Spouse assistance to help guard against or offset income lost by an expatriate's spouse as a result of relocating abroad. Although some firms may pay an allowance to make up for a spouse's lost income, US firms are beginning to focus on providing spouses with employment opportunities abroad, either by offering job-search assistance or employment in the firm's foreign office (subject to a work visa being available).

(g) Multinationals generally pay allowances in order to encourage employees to take international assignments and to keep employees 'whole' relative to home standards. In terms of housing, companies usually pay a tax-equalized housing allowance in order to discourage the purchase of housing and/or to compensate for higher housing costs. This allowance is adjusted periodically based on estimates of both local and foreign housing costs.

### 19.3.3. Benefits

The complexity inherent in international benefits often brings more difficulties than when dealing with compensation.

Pension plans are very difficult to deal with country-to-country, as national practices vary considerably.

Transportability of pension plans, medical coverage and social security benefits are very difficult to normalize.

Firms need to address many issues when considering benefits, including:

Whether or not to maintain expatriates in home-country programs, particularly if the firm does not receive a tax deduction for it.

Whether firms have the option of enrolling expatriates in host-country benefit programs and/or making up any difference in coverage.

Whether expatriates should receive home-country or host-country social security benefits.

In some countries, expatriates cannot opt out of local social security programs. In such circumstances, the firm normally pays for these additional costs.

Laws governing private benefit practices differ from country to country, and firm practices also vary. Multinationals have generally done a good job of planning for the retirement needs of their PCN employees, but this is generally less the case for TCNs.

TCNs may have little or no home-country social security coverage;

They may have spent many years in countries that do not permit currency transfers of accrued benefit payments;

Or they may spend their final year or two of employment in a country where final average salary is in a currency that relates unfavourably to their home-country currency.

In addition to the already discussed benefits, multinationals also provide vacations and special leave. Included as part of the employee's regular vacation, annual home leave usually provides airfares for families to return to their home countries. Rest and rehabilitation leave, based on the conditions of the host country, also provides the employee's family with free airfares to a more comfortable location near the host country. Emergency provisions are available in case of a death or illness in the family. Employees in hardship locations often receive additional leave expense payments and rest and rehabilitation periods.

#### 19.4 Additional Payments and Services

- i. Lifestyle enhancement services
- ii. Provision for employee & family to learn the local language
- iii. Education & training of employee & family on local culture, customs and social expectations
- iv. Counselling services for employee & family
- v. Assistance in finding a home at the foreign work site / school & suitable education programmes for children & dependents
- vi. Company car, driver, domestic staff, and child care
- vii. Use of Fitness facilities / subsidized health care services
- viii. Assistance in joining local civic, social, professional organizations
- ix. Allowances & Premiums
- x. Foreign Service premium & tax equalization allowance
- xi. Temporary living allowance
- xii. Currency protection
- xiii. Mobility premium
- xiv. Stopover allowance
- xv. Completion of assignment bonus
- xvi. Assignment extension bonus
- xvii. Emergency loan
- xviii. Extended work-week payment

#### 19.5 Approaches to International Compensation

There are two main approaches in the area of international compensation –

The Going Rate Approach (also referred to as the Market Rate Approach)

The Balance Sheet Approach (also known as the Build-up Approach).

##### 19.5. (a) The Going Rate Approach

With this approach, the base salary for international transfer is linked to the salary structure in the host country. The multinational usually obtains information from local compensation surveys and must decide whether local nationals (HCNs), expatriates of the same nationality or expatriates of all nationalities will be the reference point in terms of benchmarking. For example, a Japanese bank operating in New York would need to decide

whether its reference point would be local US salaries, other Japanese competitors in New York or all foreign banks operating in New York.

With the Going Rate Approach, if the location is in a low-pay county, the multinational usually supplements base pay with additional benefits and payments.

#### 19.5.(b) The Balance Sheet Approach

The basic objective is to 'keep the expatriate whole' (that is, maintaining relativity to PCN colleagues and compensating for the costs of an international assignment) through maintenance of home-country living standard plus a financial inducement to make the package attractive. The approach links the base salary for PCNs and TCNs to the salary structure of the relevant home country. For example, a US executive taking up an international position would have his or her compensation package built upon the US base-salary level rather than that applicable to the host country.

The key assumption of this approach is that foreign assignees should not suffer a material loss due to their transfer, and this is accomplished through the utilization of what is generally referred to as the Balance-sheet Approach.

#### 19.6 Compensation Issues in International Scenario

- a) Incentives provided to stimulate movement or expatriation to a foreign location/ host country
- b) Allowances for repatriation to home country
- c) Additional tax burdens placed on employees working in a foreign location
- d) Labour regulations in home and host country
- e) Cost-of-living allowances in the host country
- f) Home country and host country currency fluctuation
- g) Formal and informal compensation practices unique to the host country
- h) Determining home country for setting base pay of TCNs

#### 19.7 Management Challenges Concerning International Benefits & Compensation

Compensation is one of the most complex areas of international human resource management

Pay systems must conform to local laws and customs for employee compensation while also fitting into global MNC policies

Managers face diverse political systems, laws & regulations; confront different economic climates, economic development, tax policies, diverse culture, customs, the role of labour unions, standard of living

It is also important for MNCs to consider carefully the motivational use of incentives and rewards among the employees drawn from three national or country categories

The traditional function of pay to attract, retain and motivate employees has not changed – The emphasis has shifted from the attraction and retention functions to the motivation function.

TNC/MNCs must ensure that those skilled employees are compensated for achieving goals that make the international business operations succeed

**19.8 Summary**

HR managers focus on their strategic objectives to develop a comprehensive compensation plan, in terms of considering base pay, short and long-term incentives, benefits and growth opportunities. The objective of this kind of strategy is to ensure that both TNC/MNCs' long and short-term objectives coexist in the compensation system without overlap, which would duplicate a single pay plan for the same objectives. The purpose of the planning is also designed to ensure that the compensation system attracts and retains the desired employees and that it motivates them to do those things that support the business plan. The compensation costs of a family with children are shifted to hardship allowance for schooling, childcare, increased residence cost and all fringe benefits associated with supporting a family life cycle. It may be that international compensation administration is more complex than its domestic counterpart, but not radically different in pattern or form.

**19.9 Key words**

**MNC-** A MNC has a centralized headquarters & is a corporation with extensive ties international operations in more than one foreign country

**PCNs (Parent Country Nationals)-** Those personnel who are of the same nationality as the contracting government or personnel from headquarters

**TCNs (Third Country Nationals)-** Those personnel of a separate nationality to both the contracting government and the area of operations i.e. whose nation of residence is neither the host country nor the home country.

**HCNs (Host Country Nationals)-** These are Indigs (Indigenous Personnel) / Nationals / Locals – those personnel who are indigenous to the area of operations

**Transnational Company-** A transnational company has no "head office" and moves whatever base of operations it has fluidly between its national office

**19.10 Self Assessment Questions**

1. What is international compensation system? Explain its objectives.
2. Explain the parties involved in international compensation system?
3. List the components of an international compensation program.
4. Explain the approaches to international compensation system.
5. What are different challenges faced by the management concerned to various benefits in international compensation program.

**19.11 Suggested Readings**

1. Strategic compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010
2. Compensation Management Mosumi Bhattacharya Nilanjan Sengupta, Excel Books , 2010
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**LESSON-20**  
**ROLE OF HR DEPARTMENT IN COMPENSATION**  
**MANAGEMENT**

**Learning Objectives**

- ✓ To study the wage and salary survey
- ✓ To understand the components of pay structure in India
- ✓ To Learn the Methods and systems of Job Evaluation

**Structure**

**20.0 Introduction**

**20.1 Job Evaluation**

**20.2 Wage and Salary Survey**

**20.3 Group Similar job into pay grade**

**20.4 Pay grades-wage curves**

**20.5 Fine Tune Pay rates**

**20.6 Components of Pay structure in India**

- 20.6.1 Categorizing of jobs
- 20.6.2 Comparison of Employee pay to local labor market
- 20.6.3 Management of Internal Pay equity
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### **20.17 key words**

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### **20.0 Introduction**

Compensation is what employees receive in exchange for their contribution to the organization. Generally employee offer their services for receiving three types of rewards: Pay refers to base wages and salaries employee normally receive. Another form of compensation like bonus, commissions, & profit-sharing plans are incentives designed to encourage employee to perform beyond expectations. Benefits such as insurance, medical, recreational, retirement, etc represents a more indirect type of compensation. Thus, there term compensation is comprehensive which include pay, incentive so offered by employer while hiring employees. Besides that, management have to observe legal formalities that offer physical as well as financial security to employees.

### **20.1 Job Evaluation**

Job analysis provide valuable information for developing the compensation system by providing information about the duties and responsibilities that are to be undertaken by the employees. The worth of the job is ascertained by the job evaluation. A committee is appointed to collect information and come up with hierarchy Of jobs according to their

### 20.2 Wage & Salary Surveys

Job evaluation ensures internal equity, wage and salary surveys ensure external equity. A wage and salary surveys provide information as to what other organization that compete for employees are paying. Formal & informal surveys could be done to collect data, published sources also provide valuable information regarding industry wise trends in salary structure in and round the county.

### 20.3 Group Similar jobs into Pay Grades

In this step similar jobs items of their ranking or number points as ascertained by the job evaluation committee, are grouped into grades for pay purposes Price each

### 20.4 Pay Grades – Wage Curves

In the next step pay rates are assigned to pay grades through a wage curves. The wage curve shows graphically the pay rates currently paid for jobs in each pay grade relative to the points or rankings given to each job or grade.

### 20.5 Fine Tune Pay rates & Determine Wage Structure

Here the employees fix a pay range for each grade (Officer grade I,II & III for e.g. in Govt Sector) The wages structure of company is nothing but a pay scale showing ranges of pay within each grade.

### 20.6 Components of Pay Structure In India

The pay structure a company depends on several factors such as labour market conditions, company's paying capacity and legal provisions.

#### 20.6.1. Categorizing of jobs

Not all employees do the same work, and the result is that employee pay differences do exist. It is also true that most employees will readily accept this rationale as the reason for pay variations. It is easy for most employees to understand, for example, employees will undoubtedly understand that a fine – dining operation's executive chef would be paid more than that operation's sous chef. When employees understand real differences in job responsibilities, they can better understand the reasons for differences in pay.

HR managers can add flexibility and enhance employees 'understanding of their compensation programs by creating several categories within the same job, each of which may have its own pay range. For example, desk agents in a hotel may be classified as trainee, intermediate, senior, and so on to designate different experience or skill levels.

Each classification would, under this system, have its own pay range. Employees can also routinely be made aware of the skills or experience needed to advance to higher levels and of any opportunities offered by the employer to help them become trained or eligible for these higher positions.

**20.6.2. Comparison of employee pay to the local labour market**

Compensation is based on prevailing local wage rates , each based on the individual community and labor market in which the operation is located.HR managers can stay abreast of local wage rates by conducting periodic salary survey. You can easily conduct your own salary surveys by talking to your counterparts working at other hospitality operations in your area. They will usually be happy to share such information, because they want to have the benefit of your data just as much as you desire access to their numbers. In addition, managers may be able to purchase commercial salary surveys in some locations. Salary surveys can tell you a lot. First, they provide a way to establish pay ranges for various jobs. Second, they can tell how your wages or salaries compare with the labor market. Third, surveys can give you an idea of how many job categories should be established for each job group. Managers need not follow the local market conditions by matching the wage rates found in a salary survey.

**20.6.3. Management of Internal pay equity**

Most HR managers agree that managing internal pay equity is more important than ensuring external equity. This is so because employees are much more likely to know the hourly pay or salary of the persons they work with than the amount paid to a person in another operation. Also, many employees realize that it is difficult to compare, for example, the pay at two different restaurants because each may offer differing benefit packages that help explain the pay differences.

Employees typically feel that they can make comparisons about co-workers within their own operation. Also, employees will have a better foundation for pay comparisons because they have a better idea of what their co-workers actually do on the job and how well they do it. All of these factors create a much higher potential for morale problems and turnover if pay rates are not seen as equitable.

**20.6.4. Linkage of pay to job performance**

Most managers and employees agree that workers who perform their jobs better should receive greater pay and larger. Pay increases than their peers who do not. At the same time, they may not believe that their own companies do a good job of rewarding superior effort

**20.6.5. Maintenance of open communications**

While some HR managers find it uncomfortable to talk to employees about pay, it is a topic that every employee talks or thinks about on an ongoing basis. The amount of pay - related communication that is appropriate will vary between operations. Many companies do not effectively communicate the mechanics of compensation plans in the organization

**20.7 Cafeteria Approach**

In Cafeteria benefit plan the employees could spend their benefits, allowances on a choice of benefits options. The idea is to allow the employee to put together his/her own benefit package subject to two constraints. The employer must carefully limit total cost for each total benefit package.

2. Each benefit plan must include certain non-optional items.



**Advantages of Cafeteria approach**

1. Employees choose packages that best satisfy their unique needs.
2. Flexible benefits, help firms need the changing needs of a changing workforce.
3. Increased involvement of employees and families improves understanding of benefits.
4. Flexible plans make introduction of new benefits less costly. The new option is added merely as one among a wide variety of elements from which to choose.
5. Cost containment- the organization sets the dollar maximum. Employee chooses within the constraint.

**Disadvantages of Cafeteria style**

1. Employees made bad choices and find themselves not covered for predictable emergencies.
2. Administrative burdens and expenses increase.
3. Adverse selection- employees pick only benefits they will use. The subsequent high benefit utilization increases its cost.

**20.8 Job evaluation (internal equity)****Meaning**

Job Evaluation is a systematic (Quantitative and qualitative) method, for determining the relative worth of a job in comparison within and outside organisation . It helps to eliminate wage inequities and to establish a basis for sound salary and wage-structure.

**Definition**

British standard Institution (1969) Job Evaluation is "A generic term covering methods of determining the relative worth (Equity) of jobs."

Job Evaluation consists the following:

1. Job analysis: the process of examining the content of a job, breaking it down into it's task, functions, processes, operation& elements.
2. Job Description: description of a job based on job analysis.
3. Job Specification: the statement of the content of job based on job description and job grading.
4. Job Grading: ranking of job as a result of job analysis
5. Job Classification: grouping jobs according to their worth
6. Job Assessment: the ascription of a monetary value on the basis of job.

**20.9 Grading****20.9.1 Primary Objectives**

1. To establish wage level of a plant
2. To establish relative wage level in a plant.
3. To bring new jobs to their proper relative parity with existing jobs
4. To facilitate wage negotiations

**20.9.2 Secondary Objectives**

1. To determine qualities (Job-Specification) for new Jobs for employee selection

2. To determine criterion for merit rating & promotions
3. To analyse wage rates.
4. To find scope of automation & improvement
5. To train new supervisors
6. To improve working condition as better compensation

#### **20.10 Job Evaluation Procedure**

**1. Select the group of jobs** Such as workmen category, office staff, supervisory or managerial as distinct groups.

#### **2. Study the Job (Job analysis)**

The jobs are studied by (a) setting information from the employee about his work, (b) Observing the work, and (c) Consulting the supervisors of the employees.

#### **3. Prepare Job Descriptions - approval.**

On the basis of detailed information, recorded in the Job Analysis Sheet, Job descriptions are prepared. These job descriptions state simply and clearly a comprehensive picture of the job.

#### **4. Devise an evaluation plan - common characteristics/traits**

A set of key factors such as education, experience, responsibilities and working conditions are selected and weight ages given to all these factors. Each factor is generally divided into degrees which indicates the extent to which the factor is required for successful performance of the job. This constitutes the job evaluation plan. It is known as the point plan as it involves giving points to each of the jobs to indicate their relative values.

#### **5. Establish a committee of raters and Rate/Evaluate**

A committee of rater jointly rate the jobs by applying the point plan to the job description. In case of any difference of opinion among the raters, efforts are made to arrive at a conclusion by referring to facts stated in the job description, the job analysis, and in some cases by going back to the work spot.

#### **6. Establish a Committee of raters and Rate/Evaluate**

A committee of raters jointly rate the jobs by applying the point plan to the job description. In case of any difference of opinion among the raters, efforts are made to arrive at a conclusion by referring to facts stated in the job description, the job analysis, and in some cases by going back to the work spot.

#### **7. Group or Classify the jobs**

The point values given to the job on various factors are totalled up and the total points secured by different jobs are classified into grades. The number of grades into which they can be classified depends upon the policies of the organisation, the view of management and union, and the experience and judgement of the raters.

#### **8. Convert job grades to money value (Wage Survey)**

The point values of the jobs are converted into money values on the basis of wage survey results and finances available for establishing a more equitable wage differential in the organisation.

**9. Obtain approval from Union & Management****10. Establish a suitable grievance Procedure**

A report on the job evaluation containing full details regarding the work done and a set of recommendations is prepared for use, at the time of implementation and in dealing with any appeals from the employees.

**20.11 Methods and Systems of Job Evaluation****A. Conventional:**

A variety of job evaluation systems are in use and all of them are modifications of four basic systems. These are the ranking system, the grading system, the factor comparison system, and the point system. All of them are similar to each other in certain respects and are applicable to all types of jobs at all levels.

**I. Non quantitative****a.. Ranking method****b. Classification method****II. Quantitative****a. Points Rating method****b. Factor Comparison method****B. Innovative/Non-Conventional:**

These systems are quite innovative and use concepts of management- decisionmaking and related aspects as factors for establishing internal equity. These are:

**i. Time span of Discretion method****ii Decision Band Method****iii Direct Consensus method****iv Guide Chart Profile method****v Urwick Orr Profile method****20.11.1 .Conventional:****20.11.1(i) .Ranking Method**

In this method simple & easy job-descriptions are made and sorted in the sequential order of their worth as whole. The jobs common in various organisations are checked and job sare ranked/rated by interpolation. All the jobs in an organisation are ranked in the order of complexity, responsibility and demands they make on the respective employees. Ranking of all the jobs is made easier by first identifying those that come at two extreme ends of the scale and locating the rest in the middle-region. A committee carries out this ranking more than once and the results of repeated ranking are pooled to arrive at the final ranking.

**Advantages**

1. It is simplest of all procedures
2. It is less time consuming

3. It leaves more room for unions to bargain Disadvantages
4. Sometimes equal differentials are assessed to adjacent ranks
5. None of the committee member is likely to be familiar with all jobs

#### **20.11.1(ii) Classification Method**

This method is sometimes called as predetermined grading method. A limited number of job grades are established on the basis of a knowledge about the existing jobs in the organisation. Each of these grades is defined in terms of general functions and qualifications required. This is followed by development of job descriptions which briefly state the nature of duties of each job. These global job descriptions are matched with the grades, and jobs are classified into one or the other grades.

##### **Advantages**

1. It is comparatively easier method
2. It is less time consuming
3. Disadvantages
4. It is irrational in absence of logic, and nearby jobs are sometimes put in different classes
5. It is very hard to determine the pre-requisites of classes.

#### **20.11.1(iii) Point Rating Method**

In this method the whole job is analysed through 5-8 factors and over 20-50 sub-factors based on requirements. These factors/sub-factors are given points which totals out as the overall position of the jobs. Though it is not scientific it is systematic method. It is the most popular method in use today in judging the relative of worth of job factor.

##### **Advantages**

1. It is the most sophisticated system.
2. All the outcome is in hard fact numbers
3. Disadvantages
4. It is time consuming
5. Satisfying Benchmark jobs for the degrees are required to be put forth for rating effectively.

#### **20.11.1(iv) Factor Comparison Method**

The factors usually considered in this system are five in number. Mental requirement, skill, physical requirements, Responsibility and working conditions. The system involves detailed job analysis, ranking jobs in respect of pre-determined factors, apportioning the total money paid to the different factors of the job, fitting key jobs into the system, and locating all other jobs in relation, to the key jobs. The main features of the system consist of evaluating important elements of the job in terms of money value and establishing the relative positions of jobs in terms of specific factors.

##### **Advantages:**

1. Internal comparison & External comparison of job within and out of the industry are considered.
2. Monetary units are used for comparison

**Disadvantages:**

1. Conflict may arise on the valuation of each factor
2. It is difficult of apportion the total wage in various factors

**20.11.2 Innovative/Non-Conventional:****20.11.2(i) Time Span of Discretion Methods**

This system uses the concept that all make decisions in their work and the effect of such a decision on the work/organisation is felt after a certain period for taking up a follow-up action. Here "the longest possible time for which discretion (decision' to . fructify) could be exercised without direct managerial review" is considered, as the key factor in determining the levels. For e.g. A decision taken by a board member may get reflected after a few years, as against a supervisors in a week and a worker in a few hours similarly.

1. Unskilled worker - few hours
2. Marketing Manager- 2-3 years
3. Board of direction- 10 years

**20.11.2(ii) Decision Band Method**

Here, type of decision to be made by the job is considered and placed in the applicable band. The Bands are:

- Band E-Policy Making decisions i.e. Top Management
- Band D-Programming decisions i.e. by Senior Managers
- Band C-Interpretive decisions i.e. by middle managers
- Band B-Routine decisions i.e. by skilled operators on line
- Band A-Automatic decisions regarding when, how & where i.e. by semi-Skilled operators
- Band O-Defined decisions by unskilled workmen.

**20.11.2(iii) Direct Consensus Method**

Here the workman & evaluator reach to the value by mutual consensus.

**20.11.2(iv) Guide Chart Profile method**

This method is also called Hay MSL method. Its operational distinction is that it attempts to combine job evaluation with external comparison of market rates as a unified package. Its concern only managerial jobs.

**20.11.2(v) Urwick-Orr Profile Method**

Here the point & ranking methods are applied with an addition of consensus method. It is not a new method but an advancement in evaluation with the addition of employees! union to a very high degree.

**20.12 Employee Satisfaction****Meaning**

Employee satisfaction or job satisfaction is, quite simply, how content or satisfied employees are with their jobs. Employee satisfaction is typically measured using an

employee satisfaction survey. Factors that influence employee satisfaction addressed in these surveys might include compensation, workload, perceptions of management, flexibility, teamwork, resources, etc.

#### **Define**

Dawes (2004) describes "Job satisfaction basically as a psychological contract that has two components: an affective component (feelings along with cognition) and a cognitive competent (needs are being fulfilled according to one's perception)".

### **20.13 Factor Affecting Employee Satisfaction**

#### **20.13(i) .Personal Factor**

The personal determinants also help a lot in maintaining the motivation and personal factors of the employees to work effectively and efficiently. Employee satisfaction can be related to determining the numbers of personal variables and psychological factors an of the employees

##### **a. Emotion**

Mood and emotions form the affective element of job satisfaction. Moods tend to be longer lasting but often weaker states of uncertain origin, while emotions are often more intense, short-lived and have a clear object or cause

##### **b. Race**

Research evidence with regard to the relationship between race and job satisfaction have yielded inconsistent results Research conducted on various occupational classes consisting of blue collar and white collar employees, reflected that African employees experienced higher levels of job satisfaction than the other racial groups

##### **c. Genetics**

It has been well documented that genetics influence a variety of individual differences. The genetics also play a role in the intrinsic, direct experiences of job satisfaction like challenge or achievement was suggested by some research (as opposed to extrinsic, environmental factors like working conditions).

##### **d. Personality**

Some research suggests an association between personality and job satisfaction. The research describes the role of negative affectivity and positive affectivity. Negative affectivity is related strongly to the personality trait of neuroticism. Individuals high in negative affectivity were experience less job satisfaction. Positive affectivity is related strongly to the personality trait of extraversion. Those high in positive affectivity were satisfied with most of the dimensions of their life and including their job.

##### **e. Age:**

Age is one of the important determinants of employee satisfaction. The younger age employees having higher energy levels, so they were highly satisfied then the older age employees.

**f. Education:**

Education plays a significant determinant of employee satisfaction as it provides an opportunity for developing one's personality. Education develops and creates individual understanding and evaluation process. The highly educated employees can better understand the situation and evaluate it positively as they possess persistence, rationality and thinking power.

**g. Gender Differences**

The gender of the employees plays an important role in determining of employee satisfaction. Women, the fairer gender are more likely to be satisfied than their counterpart even if they are employed in same job.

**h. Tenure**

Tenure refers to the number of years an employee has spent working in organization

**i. Marital Status**

The effect of marital status of employee on job satisfaction has produced inconclusive effects.

The study carried out by Kuo and Chen (2004) found that marital status of employee is highly correlated to general, intrinsic and overall satisfaction and it indicated that married employees experienced higher levels of job satisfaction in comparison of unmarried employees

**20.13(ii) .Organizational Factors**

The organizational determinants play an important role in employee satisfaction. The employees spend lots of time in organization so there are number of organizational factors that affect satisfaction of the employees.

**a. Working Environment**

Work environment plays an important role in influencing job satisfaction, as a comfortable physical work environment that will ultimately render a more positive level of job satisfaction in employees. Lack of favourable working conditions, amongst other things, can affect badly on the employees' mental and physical health.

**b. Workload and Stress Level**

Dealing with a workload that was too heavy and deadlines that were impossible to touch it can cause job dissatisfaction in the most dedicated employee. Falling short of deadlines can cause conflict between employees and supervisors and it could raise the stress level in the workplace.

**c. Respect from Co-Workers**

Employees seek to be treated with respect by those they work with. A hostile work environment with rude or unpleasant co-workers is one that usually has lower job satisfaction.

**d. Organization Development**

Organizational development is a continuous and organized process to implement effective change in an organization. Its objective is to enable the organization in adopting better to the fast-changing external environment of new markets, regulations, and technologies. It starts with a careful organization-wide analysis of the current situation and of the future requirements.

**e. Policies of Compensation and Benefit**

Pay is one of the fundamental components of job satisfaction since it has a powerful effect in determining job satisfaction. Employees should be satisfied with competitive salary packages and they should be satisfied with it when comparing their pay packets with those of the outsiders who are working in the same industry.

**f. Promotion and Career Development**

Promotion can be reciprocated as a significant achievement in the life. It promises and delivers more pay, responsibility, authority, independence and status. So, the opportunity for promotion determines the degree of satisfaction to the employee.

**g. Job Security**

Job security is an employee's assurance or confidence that they will keep their current job. Employees with a high level of job security have a low probability of losing their job in the near future

**h. Relationship with Supervisor**

Research demonstrates that a positive relationship exists between job satisfaction and supervision. According to Ramsey (1997), supervisors contribute to high or low morale in the workplace. The supervisor's attitude and behaviour toward employees may also be a contributing factor to job-related complaints (Sherman & Bohlander, 1992).

**i. Leadership Styles**

The satisfaction of employees was also affected by the leadership style. Employee satisfaction is high with democratic style of leadership. It is because democratic leaders encourage friendship, respect and warmth relationship among the employees.

**20.14 Importance of Employee satisfaction****i. Life Satisfaction**

Job satisfaction is correlated to life satisfaction which means that people who satisfied with life will tend to be satisfied with the job and people who satisfied with job will tend to be satisfied with their life

**ii. Productivity**

The satisfied workers will be more productive and stay with the organization longer, while dissatisfied workers will be less productive and will have more tendency to quit the work

**iii. Organizational Commitment**



The researchers showed relationship between organizational commitment and job satisfaction. Both the organizational commitment and the job satisfaction are interrelated, to attitudes.

#### **iv. Reduced Turnover**

Another benefit of job satisfaction is reduced turnover. The satisfied employees are more likely to stay in the organization than those who are dissatisfied.

### **20.15 Theories of Employee Satisfaction**

#### **20.15.(i.) Comparison Theory**

The most widely accepted view of job satisfaction assumes that the degree of affect experienced, results from the objective outcomes from the job received by the individual. Rather, the magnitude of satisfaction is a function of the size of the discrepancy between the individual's standard and what the individual believes he or she is receiving from job. The bigger the discrepancy the bigger the dissatisfaction (Porter, 1961). The standard is considered by some as the individual's need (Porter, 1962; Morse, 1953), and by others as his values (Locke, 1976). This theory referred as the aspiration-achievement or expectation-achievement discrepancy theory of job satisfaction. However, the situation is complicated by the fact that aspiration and achievement are not independent of each other. Aspiration or expectations can be set by the minimum needs of the individual and/or current level of achievement of needs.

#### **20.15.(ii). Instrumentality Theory**

A second view of job satisfaction is that individuals calculate the degree to which the extent to which the job is satisfying by considering the extent to which the job leads to valued outcomes. This theory postulates that individuals assess their satisfaction with jobs by considering the extent to which the jobs lead to valued outcomes. It is assumed here that each individual has a set of judgments' about how much he values certain outcomes such as pay, promotion, good working, condition etc. The person then estimates the extent to which holding the job leads to these valued outcomes. Job satisfaction then results from a summation of outcomes or instrumentalities obtained multiplied by the valences of these outcomes. Job satisfaction then results from a summation of outcomes or instrumentalities obtained multiplied by the valences of these outcomes.

#### **20.15.(iii). Social Influence Theory**

Salancik & Pfeffer (1997) questioned comparison theories of job satisfaction and suggested that perhaps people decide how satisfied they are with their job not by processing all kinds of information about it but by observing others on similar jobs and making inferences about others satisfaction. The basic assumption of the social influence theory of job satisfaction is that individuals may come into new job not knowing how satisfied they will be with these. They look around, see others like themselves who are satisfied or dissatisfied with these and are then influenced by these observations. Thus people decided how satisfied how satisfied they are with their jobs not by processing all types of information about themselves but by observing others on similar jobs and making inferences about their satisfaction. Thus satisfaction more a product of self- perception and social perceptions, rather than determined by intrinsic characteristic of job. An individual simply infers a level of his or her personal satisfaction by their perception of other's satisfactions.

**20.15.(iv). Equity Theory**

Adams (1965) argued that satisfaction is determined by a person's perceived equity, which is determined by his / her input / outcome balance compared to some other's perceived input / output balance.

The Equity theory of motivation suggests that individuals have a strong want to maintain a balance between what they perceive their inputs or contributions to be in relation to expected rewards (Dessler, 1988). In terms of the Equity theory, Robbins (1993) states that satisfaction is determined by an individual's input-outcome balance (Koneru & Chunduri, 2013).

**20.15.(v). Fulfilment Theory**

This theory proposes that employees will be satisfied in a direct proportion to the extent to which their needs are satisfied (Schafer, 1953). That people's satisfaction is a function of how much they receive and of how much they feel they should and / or want to receive (Locke, 1969).

**20.15.(vi). Dispositional Theory**

Crow and Hartmann (1995) offered that job satisfaction "is a result of a multiplicity of factors, most of which cannot be influenced by the employer". They further explained that "enhancing job satisfaction for chronically dissatisfied employees may be impossible", suggesting that some employees will be dissatisfied wherever they will find themselves given their inborn disposition towards life and work, by extension. Staw and Ross (1985) suggested that job satisfaction is influenced by an employee's genetics, which might be a determinant of personality. (Kumari, 2013).

**20.16 Summary**

A compensation plan is not rigid and fixed one but is dynamic since it is affected by a variety of factors which are dynamic. Therefore, compensation management should have a provision for evaluating and reviewing the compensation plan. After implementation of the plan, it will generate results either in terms of intervening variables like employee satisfaction and morale or in terms of end-result variable like increase of productivity. However, this latter variable is more important. The evaluation of compensation plan must be done in this light. If it does not work as intended, there should be review of the plan necessitating a fresh look.

**20.17 Key words**

**Cafeteria approach**-In Cafeteria benefit plan the employees could spend their benefits, allowances on a choice of benefits options

**Job security**- Job security is an employee's assurance or confidence that they will keep their current job.

**Job analysis**- It is the process of examining the content of a job, breaking it down into its task, functions, processes, operation & elements.

**Job Description**-It is the process of description of a job based on job analysis.

**Job Specification**-The statement of the content of job based on job description and job grading.

**Job Grading-** It is the process of ranking of job as a result of job analysis

**Job Classification-** It is the grouping jobs according to their worth

**Job Assessment-** It prescribes the ascription of a monetary value on the basis of job.

#### **20.18 Self Assessment Questions**

1. Briefly discuss the Job Evaluation and Wage and Salary survey system
2. Discuss the components of Pay structure in India
3. Examine the Comparison of Employee pay to local labor market
4. Elucidate the Procedure of job Evaluation procedure?

#### **20.19 Suggested Readings**

1. Strategic compensation HRM Approach, Joseph Martocchio, Pearson Publication, 2010
2. Compensation Management Mosumi Bhattacharya Nilanjan Sengupta, Excel Books , 2010
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7. Compensation Management R.C. Sharma, Sulabh Sharma Sage Publications, 2019.

**Dr. V.NAGA NIRMALA**

**MHRM DEGREE EXAMINATION, 2022**  
**First Year, Semester-II**  
Paper-I  
**EMPLOYEE COMPENSATION AND MANAGEMENT**

**Time: Three hours**

**Maximum : 70 marks**

**SECTION A — (5 x 4 = 20 marks)**  
**Answer any FIVE of the following**

- 1 (a). Employee compensation  
(b). Wages  
(c). Fringe Benefits  
(d). Downsizing  
(e). Wage Determination  
(f). Adjudication  
(g). Wage Boards  
(h). Time and Piece rate  
(i). Wage Incentives  
(j). Dearness Allowance

**SECTION B — (2 x 10 = 20 marks)**  
**Answer any TWO of the following**

- 2). Discuss the Concept, Principles of Wage and Salary ?  
3). Explain the Wage Fixation in Public Sector Undertakings  
4). Explain the Strategic Compensation Planning in wage Administration ?  
5). Examine the Wage Incentive Schemes in India?

**SECTION C — (2 x 15 = 30 marks)**  
**Answer any TWO of the following**

- 6). Explain the Wage Theories and compensation policy  
7). Discuss the Wage Determination and Development as a Base plan?  
8). Briefly Explain the Wage Payments Methods ?  
9). Describe the Role of HR Department in Compensation Management?

# 201 MA HRM

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