

Lesson - 8

COMPENSATION FUNCTION WAGE AND SALARY COMPONENT'S

8.0 Objective:

On the completion of this lesson, you should be able to understand the:

- * meaning, nature, purpose and significance of compensation.
- * wage and salary determination process.
- * factors influencing wage and salary structure and administration.
- * national wage policy.

Structure:

- 8.1 Introduction**
- 8.2 Meaning, Nature and Significance of Compensation**
- 8.3 Wage and Salary Components**
- 8.4 The Wage Determination Process**
- 8.5 Factors influencing Wage and Salary**
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8.1 Introduction:

One of the most difficult functions of personnel management is that of determining rates of monetary compensation. Not only is it one of the most complex duties, but it is also one of the most significant to both the organisation and the employee. It is important to the organisation, because wages and salaries often constitute the greatest single cost of doing business; in 1929 employee compensation amounted to 58 percent of the nation's income, as compared with 75 percent in recent years. It is important to the employee because the paycheck often is the sole means of economic survival; it is also one of the most influential factors determining status in society.

As far as the organisation is concerned, employee compensation programmes are designed to do three things; (1) to attract capable employees to the organisation, (2) to motivate them towards superior performance, and (3) to retain their services over an extended period of time.

8.2 Meaning, Nature, Purpose and Significance of Compensation:

Compensation may be defined as money received in the performance of work, plus the many kinds of benefits and services that organisations provide their employees. 'Money' is included under direct compensation (popularly known as wages i.e. gross pay) while benefits come under indirect compensation, and may consist of life, accident and health, insurance, the employer's contribution to retirement, pay for vacation or illness, and employee's required payments, for employee welfare as social security.

Significant Factors Affecting Compensation Policy:

Though a considerable amount of guess work and negotiation are involved in salary determination, certain factors have been extracted as having an important bearing upon the final dollar decision. Among these factors are the following: (1) supply and demand for employee skills (2) labour organisation (3) the firm's ability to pay (4) productivity of the firm and the economy (5) cost of living, and (6) government. Each of these will be discussed briefly in order to demonstrate the exceedingly complex nature of compensation. Perhaps a realisation of these complexities will lead to a greater appreciation and acceptance of job evaluation despite its arbitrariness and scientific failings.

8.3 Wage and Salary Components:

A 'wage' (or pay) is the remuneration paid, for the service of labour in production, periodically to an employee/worker "wages" usually refer to the hourly rate paid to such groups as production and maintenance employees ("blue-collar worker's). On the other hand, 'Salary normally refer to the weekly or monthly rates paid to clerical, administrative and professional employee's. (white-collar workers). The 'wage' level represent the money an average worker makes in a geographic area or in his organisation. It is only an average; specific markets or firms and individual wages can vary widely from the average. The term, 'wage' 'structure' is used to describe wage/salary relationships within a particular grouping. The grouping can be according to occupation, or organisation, such as wage structure for craftsman (carpenters, mechanics, bricklayers, etc).

8.4 The Wage Determination Process:

Usually, as would be clear from the following table, the steps involved in determining wage rates are performing job analysis, wage surveys, analysis of relevant organisational problems forming wage structure, framing rules of wage administration, explaining these to employees, assigning grades and price to each job and paying the guaranteed wage.

8.5 Factors Influencing Wage and Salary Structure and Administration:

The wage policies of different organisations vary somewhat. Marginal units pay the minimum necessary to attract the required number and kind of labour. Often, these units pay only the minimum wage rates required by labour legislation, and recruit marginal labour. At the other extreme, some units pay well above the going rates in the labour market.

On the basis of above points, we may summarise the factors affecting wage and salary rates as under:

1. Demand and Supply of Labour:

Demand and supply conditions of labour have considerable influence on the determination of wage and salary rates. If there is a short supply of labour, the wages/salaries may be high whereas if there is no dearth of labour, the wages tend to be low.

2. Labour Unions:

If the labourers are well organised into strong trade unions, their bargaining power would be high and they can demand higher rates of wages. On the other hand, if the labourers are not organised, the management may fix low wages.

3. Cost of Living:

The cost of living of workers also has a strong influence on the rate of wages. If this factor is not considered, the labour may not be in a position to make both ends meet and this will affect their efficiency. Hence progressive employers consider this factor also.

4. Ability to Pay:

The wage level, to a large extent, is determined by the ability of the enterprise to pay its workers. The ability to pay in turn is determined by the profit-earning capacity of the enterprise.

5. Prevailing wage rates:

Prevailing wages in a particular industry are also taken into account by the employers while deciding wage levels for their employees. By considering the prevailing wage level, employers will come reasonably close to the wage level of competitors, and this will enable them to retain and attract qualified workers to the organisation.

6. Increment System:

In some organisations wages/salaries automatically increase annually at a prescribed rate without any relation to worker's performance. In some other organisations annual increase is based on merit. Thus, the prevailing system of granting increments also affects wages.

7. State Regulation:

State regulation is another important factor influencing wages rates. As the state assumes responsibility for safe guarding the interest of citizens, it has to step into regulate the wage rates of labourers through legislative measures.

8. Job Requirements:

Job requirements are also an important factor affecting wages. Jobs requiring specialised knowledge or involving much mental or manual effort are priced higher than those which are light or which do not need any specialised knowledge.

8.6 Principles of Wage & Salary Administration:

The generally accepted principles governing the fixation of wages and salary are:

1. There should be a definite plan to ensure that differences in pay for jobs are based upon variations in job requirements, such as skill, effort, responsibility or job or working conditions, and mental and physical requirements.
2. The labour market criterion is most commonly used.
3. The plan should carefully distinguish between jobs and employees.
4. Equal pay for equal work.
5. An equitable practice should be adopted for the recognition of individual differences in ability and contribution.
6. There should be a clearly established procedure for hearing and adjusting wage complaints.
7. The trade unions play a vital role to maintain wage structure in uniform method in an organisation.
8. The wage should be sufficient to ensure for the worker and his family reasonable standard of living.
9. The wage and salary structure should be flexible so that changing conditions can be easily met.
10. Prompt and correct payments of the dues of the employees must be ensured and arrears of payment should not accumulate.
11. For revision of wages, a wage committee should always be preferred to the individual judgement, however unbiased, or a manager. Lastly.,
12. The wage and salary payments must fulfil a wide variety of human needs, including the need for self-actualisation.

8.7 Wages in India

Major Components of Indian Wage Packet:

The monthly wage packet of an industrial worker in India consists of 4 paramount elements, viz.,

- Basic wage
- Dearness allowance
- Annual statutory bonus and
- Incentive bonus.

There are a number of other components also but because they have no direct link with the work or output of a worker they are generally referred to as perquisites or fringe benefits.

We describe below the four principal elements of Indian Wage Packet. Fringe benefits have been described in the chapter on labour welfare and social security.

1. Basic Wage:

The basic wage is the remuneration by way of basic salary and allowances, which is paid or payable to an employee in terms of his contract of employment for the work done by him.

2. Dearness Allowance:

The second important component of the wage packet in India is Dearness Allowance which is paid to offset the rise in prices. Under changes in consumer price index method, first of all, a point in the consumer price index when even changed the D.A. percentage has been increased.

3. Bonus:

The third important component of wage packet is bonus. It means, "an allowance in addition to what is usual, current or stipulated; a sum given or paid beyond what is legally required to be paid to the recipient; something given in addition to what is ordinarily received by or strictly due to the recipient.

4. Incentive Bonus:

The last major component of Indian wage packet is the production linked incentive bonus. It refers to all the plans that provide extra pay for extra performance in addition to regular wages for a job.

8.8 Elements or Ingredients of a Good Wage Plan:

Under a good wage plan, it would be fruitful to know the ingredient of a good wage plan. These are:

- i) It should be easily understandable:** All the employers should easily understand what they are to get for their work. They should be instructed in how the wage plan works.
- ii) It should be capable of easy computation:** It should be sufficiently simple to permit quick calculation. Mathematical tables may be supplied, by reference to which calculations can be quickly made.
- iii) It should be capable of effectively motivating the employees:** It should provide an incentive for work. If both the quality and quantity of work are to be stressed at the same time a plan should be selected that will not unduly influence the worker to work too fast or to become careless of quality.
- iv) It should provide for remuneration to employees:** As soon as possible after the effort has been made. Daily or weekly payment of wages would be preferable to induce employees to work.
- v) It should be relatively stable:** Rather than frequently varying so that employees are assured of a stable amount of money.

8.9 National Wage Policy:

At present no national wage policy exists in India. However, the efforts made in this direction are worth consideration:

1. National Commission on Labour, 1969:

The Commission did not go beyond recognizing the need for a national wage policy in these words, "The wage policy has to be framed taking into account such factors as the price level which can be sustained, the employment level to be aimed at, requirement of social justice, and capital formation need for growth".

2. Chakraborty Committee - 1974:

Recognising the need for uniformity in wage payments across regions, industries, and occupations the committee suggested that a National Wage Commission and a National Wage Board be set up to evaluate all jobs, work out a grade structure based on skill differentials and fix wages for each grade.

3. Bhoothalingam Study Group 1978:

This group opined that the determination of a homogeneous national wage structure is very difficult. 'We are not beginning with a clean slate and the burden of history is with us. Disparities, anomalies and irrationalities exist and have come to be regarded as rights. Further, there is no reasonable method of determining what should be the absolute level of wage for each category of workers and what is a right differential between one category of workers and another. Even if a national wage structure is determined, which is doubtful, or the historically determined structure accepted, which is improbable, several adjustments in wages or earnings are required from time to time.

8.10 Executive Compensation:

Following factors seem to govern the compensation paid to an executive in an organisation:

1. Job Complexity:

The complexity of an executive's job depends upon (a) the size of his company as measured by its sales volume (b) the company's rate of growth as reflected in the percentage increase in company's fixed assets, and (c) Geographical diversity, i.e, the number of states in which the company carries in its business operations. On these variables will generally depend the number of levels of management, span of control and the magnitude of responsibility vested in the job. The greater the complexity, the higher is the compensation paid to an executive.

2. Employer's ability to pay:

This is a major determinant of executive compensation. Companies with greater ability to pay can offer higher remuneration, in order to complete for the scarce executive talent.

3. Employee's education and experience:

This factor through critical in determining entry into the management cadre of a company becomes less important for purposes of salary determination of executives who reach top management position. At this point the job and the person become inseparable from each other so that the determination of an executives salary becomes highly subjective in nature.

In India the Companies Act puts statutory limits on the amount of remuneration payable to different categories of managerial personnel of a public company or a private company which is subsidiary of a public company.

8.11 Summary:

The first and most difficult problem in wage and salary administration is the establishment of base compensation for the job. This problem is enormously complicated by such factors as supply and demand, labour organisation, the firm's ability to pay, variations in productivity and cost of living, and governmental legislation, including the Civil Rights Act.

Some important factors are influencing the wage and salary structure. Those are

1. Demand supply of labour,
2. Labour unions cost of living, ability to pay, prevailing wage rates, state regulations and job requirements.

In the Indian wage/salary components there have been four important elements viz. basic wage, dearness allowance, statutory bonus and incentive bonus.

At present no national wage policy exists in India. However, some commissions were represented and recommended wages to employees those who are working in an organisation. Some of the commissions were

1. National Commission on labour - 1969
2. Chakraborty Committee - 1974
3. Bhoothalingam Study Group - 1978.

8.12 Technical Terms:

- Compensation - Makeup for, counter balance
- Wage - Payment for work done
- Salary - Fixed payment of persons employed in non-manual or non mechanical work.
- Bonus - Extra payment, some thing good.
- Allowance - Grant, with additional payment for other dependent relatives.

8.13 Self - Assessment Questions:

1. Define the term compensation? Explain the meaning, nature and significance of compensation.
2. What are the factors affecting the compensation policy.
3. Define wage and salary? What are the steps involved in determination of wage rate.
4. What factors are influencing the wage and salary structure and administration.
5. Write an essay on "Indian Wage Policy".

8.14 Reference Books:

1. Edwin B. Flippo, *Personnel Management*, Mc Graw-Hill Book Company; New Delhi, 1984.
2. Mamoria C.B., *Personnel Management*, Himalaya Publishing House, New Delhi, 1999.
3. Tripathi, *Personnel Management, & Industrial Relations*, Sultan Chand & Sons, New Delhi, 1996

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