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Compensation Management

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MBA - HRM

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UNIT- I

Unit Structure

Lesson 1.1 - Compensation

Learning Objectives

After reading this chapter you should be able to:

- Define Compensation
- Understand the Concept of Compensation
- List Components of Compensation
- Know the Process of determination of Compensation
- To identify the factors considered in deciding the compensation
- To evaluation the compensation

Introduction

Compensation of employees for their services is important responsibility of human resource management. Every organization must offer good wages and fringe benefits to attract and retain talented employees with the organization. If at any time, the wages offered by a firm are not competitive as compared to other firms, the efficient workers may leave the firm. Therefore, workers must be remunerated adequately for their services. Compensation to workers will vary depending upon the nature of job, skills required, risk involved, nature of working conditions, paying capacity of the employer, bargaining power of the trade union, wages and benefits offered by the other units in the region or industry etc., Considering that the current trend in many sectors (particularly the knowledge intensive sectors like IT and Services) is to treat the employees as "creators and drivers of value" rather than one more factor of production, companies around the world are paying close attention to how much they pay, the kind of components that this pay includes and whether they are offering competitive compensation to attract the best talent

Definition

Gary Dessler in his book Human Resource Management defines compensation in these words "Employee compensation refers to all forms of pay going to employees and arising from their employment." The phrase 'all forms of pay' in the definition does not include non-financial benefits, but all the direct and indirect financial compensations.

According to Thomas J. Bergmann(1988) compensation consists of four distinct components: Compensation = Wage or Salary + Employee benefits +Non-recurring financial rewards+ Non-pecuniary rewards.

The Concept of Compensation

Compensation refers to a wide range of financial and non financial rewards to employees for their services rendered to the organization. It is paid in the form of wages, salaries and employee benefits such as paid vacations, insurance maternity leave, free travel facility, retirement benefits etc., Monetary payments are a direct form of compensating the employees and have a great impact in motivating employees.

The system of compensation should be so designed that it achieves the following objectives.

- The capable employees are attracted towards the organization
- The employees are motivated for better performance
- The employees do not leave the employer frequently

Components of Compensation

Basic Wages/Salaries

Basic wages / salaries refer to the cash component of the wage structure based on which other elements of compensation may be structured. It is normally a fixed amount which is subject to changes based on annual increments or subject to periodical pay hikes.

Wages represent hourly rates of pay, and salary refers to the monthly rate of pay, irrespective of the number of hours put in by the employee. Wages and salaries are subject to the annual increments. They differ from employee to employee, and depend upon the nature of job, seniority, and merit.

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. The onslaught of price increase has a major bearing on the living conditions of the labour.

The increasing prices reduce the compensation to nothing and the money's worth is coming down based on the level of inflation. The payment of dearness allowance, which may be a fixed percentage on the basic wage, enables the employees to face the increasing prices.

Incentives

Incentives are paid in addition to wages and salaries and are also called 'payments by results'. Incentives depend upon productivity, sales, profit, or cost reduction efforts.

There are:

(a) Individual incentive schemes, and
(b) Group incentive programmes.

Individual incentives are applicable to specific employee performance. Where a given task demands group efforts for completion, incentives are paid to the group as a whole. The amount is later divided among group members on an equitable basis.

Bonus

The bonus can be paid in different ways. It can be fixed percentage on the basic wage paid annually or in proportion to the profitability. The Government also prescribes a minimum statutory bonus for all employees and workers. There is also a bonus plan which compensates the managers and employees based on the sales revenue or profit margin achieved. Bonus plans can also be based on piece wages but depends upon the productivity of labour.

Non-Monetary Benefits

These benefits give psychological satisfaction to employees even when financial benefit is not available. Such benefits are:

(a) Recognition of merit through certificate, etc.
(b) Offering challenging job responsibilities,
(c) Promoting growth prospects,
(d) Comfortable working conditions,
(e) Competent supervision, and
(f) Job sharing and flexi-time.

Commissions

Commission to managers and employees may be based on the sales revenue or profits of the company. It is always a fixed percentage on the target achieved. For taxation purposes, commission is again a taxable component of compensation.

The payment of commission as a component of commission is practiced heavily on target based sales. Depending upon the targets achieved, companies may pay a commission on a monthly or periodical basis.

Mixed Plans

Companies may also pay employees and others a combination of pay as well as commissions. This plan is called combination or mixed plan. Apart from the salaries paid, the employees may be eligible for a fixed percentage of commission upon achievement of fixed target of sales or profits or Performance objectives. Nowadays, most of the corporate sector is following this practice. This is also termed as variable component of compensation.

Piece Rate Wages

Piece rate wages are prevalent in the manufacturing wages. The laborers are paid wages for each of the Quantity produced by them. The gross earnings of the labour would be equivalent to number of goods produced by them. Piece rate wages improves productivity and is an absolute measurement of productivity to wage structure. The fairness of compensation is totally based on the productivity and not by other qualitative factors.

Fringe Benefits

Fringe benefits may be defined as wide range of benefits and services that employees receive as an integral part of their total compensation package. They are based on critical job factors and performance. Fringe benefits constitute indirect compensation as they are usually extended as a condition of employment and not directly related to performance of concerned employee. Fringe benefits are supplements to regular wages received by the workers at a cost of employers. They include benefits such as paid vacation, pension, health and insurance plans, etc. Such benefits are computable in terms of money and the amount of benefit is generally not predetermined. The purpose of fringe benefits is to retain efficient and capable people in the organization over a long period. They foster loyalty and acts as a security base for the employees.

Profit Sharing

Profit-sharing is regarded as a stepping stone to industrial democracy. Profit-sharing is an agreement by which employees receive a share, fixed in advance of the profits. Profit-sharing usually involves the determination of an organization's profit at the end of the fiscal year and the distribution of a percentage of the profits to the workers qualified to share in the earnings. The percentage to be shared by the workers is often predetermined at the beginning of the work period and is often communicated to the workers so that they have some knowledge of their potential gains. To enable the workers to participate in profit-sharing, they are required to work for certain number of years and develop some seniority. The theory behind profit-sharing is that management feels its workers will fulfill their responsibilities more diligently if they realize that their efforts may result in higher profits, which will be returned to the workers through profit-sharing.

Types of Compensation / Base and Supplementary Compensation

Total compensation returns are more transactional. They include pay received directly as cash (like base, merit, incentives, cost of living adjustments) and indirectly as benefits (like pensions, medical insurance, programs to help balance work and life demands, brightly coloured uniforms). Programme to pay to people can be designed in a wide variety of ways, and a single employer typically uses more than one.

Direct /Base Compensation

Direct compensation refers to monetary benefits offered and provided to employees in return of the services they provide to the organization. The monetary benefits include basic salary, house rent allowance, conveyance, leave travel allowance, medical reimbursements, special allowances, bonus, Pf/Gratuity, etc. They are given at a regular interval at a definite time.

Basic Salary

Salary is the amount received by the employee in lieu of the work done by him/her for a certain period say a day, a week, a month, etc. It is the money an employee receives from his/her employer by rendering his/her services

House Rent Allowance

Organizations either provide accommodations to its employees who are from different state or country or they provide house rent allowances to its employees. This is done to provide them social security and motivate them to work.

Conveyance

Organizations provide for cab facilities tto their employees. Few organizations also provide vehicles and petrol allowances to their employees to motivate them

Leave Travel Allowance

These allowances are provided to retain the best talent in the organization. The employees are given allowances to visit any place they wish with their families. The allowances are scaled as per the position of employee in the organization.

Medical Reimbursement

Organizations also look after the health conditions of their employees. The employees are provided with medi-claims for them and their family members. These medi-claims include health-insurances and treatment bills reimbursements.

Bonus

Bonus is paid to the employees during festive seasons to motivate them and provide them the social security. The bonus amount usually amounts to one month's salary of the employee.

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

Direct Compensation

Indirect /Supplementary Compensation

Indirect compensation refers to non-monetary benefits offered and provided to employees in lieu of the services provided by them to the organization. They include Leave Policy, Overtime Policy, Car policy, Hospitalization, Insurance, Leave travel Assistance Limits, Retirement Benefits, Holiday Homes.

Leave Policy

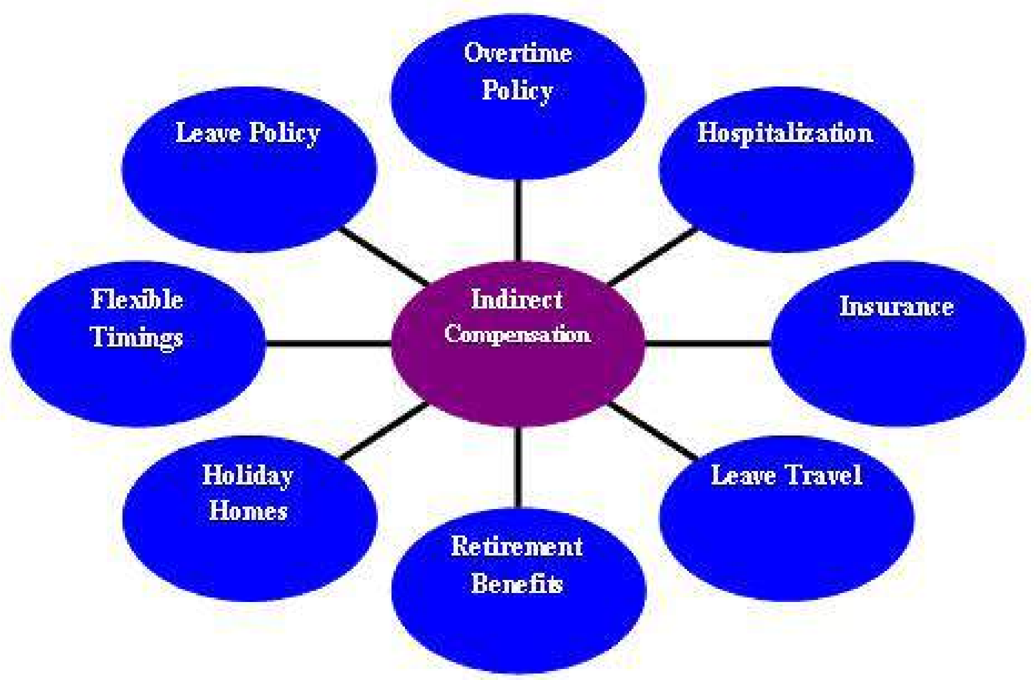
It is the right of employee to get adequate number of leave while working with the organization. The organizations provide for paid leaves such as, casual leaves, medical leaves (sick leave), and maternity leaves, statutory pay, etc.

Overtime Policy

Employees should be provided with the adequate allowances and facilities during their overtime, if they happened to do so, such as transport facilities, overtime pay, etc.

Hospitalization

The employees should be provided allowances to get their regular check-ups, say at an interval of one year. Even their dependents should be eligible for the medi-claims that provide them emotional and social security.



Indirect Compensation

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.

Leave Travel

The employees are provided with leaves and travel allowances to go for holiday with their families. Some organizations arrange for a tour for the employees of the organization. This is usually done to make the employees stress free.

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.

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. The organizations make sure that the employees do not face any kind of difficulties during their stay in the guest house.

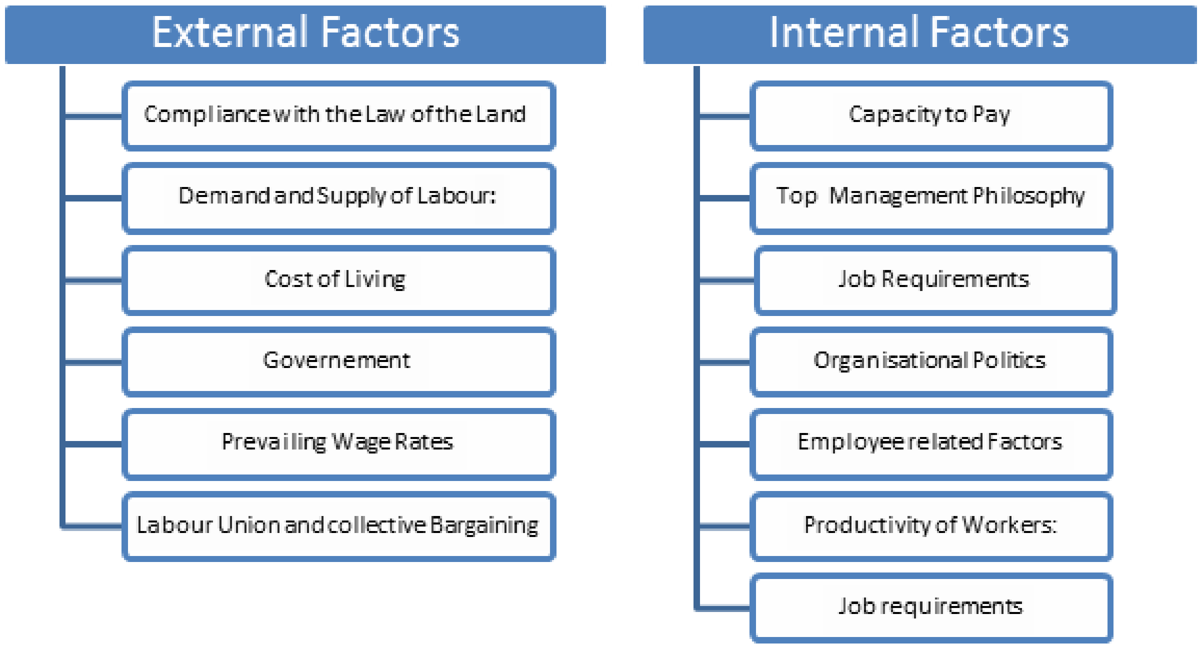
Flexible Timings

Organizations provide for flexible timings to the employees who cannot come to work during normal shifts due to their personal problems and valid reasons.

Factors Considered in Deciding the Compensation

Employers decide on what is the right compensation after taking into account the following points. The Job Description of the employee that specifies how much should be paid and the parts of the compensation package. The Job Description is further made up of responsibilities, functions, duties, location of the job and the other factors like environment etc. These elements of the job description are taken individually to arrive at the basic compensation along with the other components like benefits, variable pay and bonus. It needs to be remembered that the HRA or the House Rental Allowance is determined by a mix of factors that includes the location of the employee and governmental policies along with the grade of the employee. Hence, it is common to find a minimum level of HRA that is common to all the employees and which increases in proportion to the factors mentioned above.

The Job Evaluation that is a system for arriving at the net worth of employees based on comparison with appropriate compensation levels for comparable jobs across the industry as well as within the company. Factors like Experience, Qualifications, Expertise and Need of the company determine how much the employer is willing to pay for the employee. It is often the case that employers compare the jobs across the industry and arrive at a particular compensation after taking into account the specific needs of their firm and in this respect salary surveys and research results done by market research firms as to how much different companies in the same industry are paying for similar roles. The components of compensation that have been discussed above are the base requirements for any HR Manager who is in charge of fixing the compensation for potential employees. Hence, all HR professionals and managers must take this following aspect into account when they determine the compensation to be paid to employees



Factors Considered in Deciding the Compensation

External Factors

Demand and Supply of Labour

Wage is a price or compensation for the services rendered by a worker. The firm requires these services, and it must pay a price that will bring forth the supply which is controlled by the individual worker or by a group of workers acting together through their unions. The primary result of the operation of the law of supply and demand is the creation of the going wage rate. It is not practicable to draw demand and supply curves for each job in an organization even though, theoretically, a separate curve exists for each job.

Cost of Living

Another important factor affecting the wage is the cost of living adjustments of wages. This tends to vary money wage depending upon the variations in the cost of living index following rise or fall in the general price level and consumer price index. It is an essential ingredient of long-term labour contract unless provision is made to reopen the wage clause periodically.

Labour Union

Organized labor is able to ensure better wages than the unorganized one. Higher wages may have to be paid by the firm to its workers under the pressure or trade union.

If the trade union fails in their attempt to raise the wage and other allowances through collective bargaining, they resort to strike and other methods hereby the supply of labour is restricted. This exerts a kind of influence on the employer to concede at least partially the demands of the labour unions.

Government

To protect the working class from the exploitations of powerful employers, the government has enacted several laws. Laws on minimum wages, hours of work, equal pay for equal work, payment of dearness and other allowances, payment of bonus, etc., have been enacted and enforced to bring about a measure of fairness in compensating the working class. Thus, the laws enacted and the labour policies framed by the government have an important influence on wages and salaries paid by the employers. Wages and salaries can't be fixed below the level prescribed by the government.

Prevailing Wage Rates

Wages in a firm are influenced by the general wage level or the wages paid for similar occupations in the industry, region and the economy as a whole. External alignment of wages is essential because if wages paid by a firm are lower than those paid by other firms, the firm will not be able to attract and retain efficient employees. For instance, there is a wide difference between the pay packages offered by multinational and Indian companies. It is because of this difference that the multinational corporations are able to attract the most talented workforce.

Internal Factors

Ability to Pay

Employer's ability to pay is an important factor affecting wages not only for the individual firm, but also for the entire industry. This depends upon the financial position and profitability of the firm. However, the fundamental determinants of the wage rate for the individual firm emanate from supply and demand of labour. If the firm is marginal and cannot afford to pay competitive rates, its employees will generally leave it for better paying jobs in other organizations. But, this adjustment is neither immediate nor perfect because of problems of labour immobility and lack of perfect knowledge of alternatives. If the firm is highly successful, there is little need to pay more than the competitive rates to obtain personnel. Ability to pay is an important factor affecting wages, not only for the individual firm but also for the entire industry.

Top Management Philosophy

Wage rates to be paid to the employees are also affected by the top management's philosophy, values and attitudes. As wage and salary payments constitute a major portion of costs and /or apportionment of profits to the employees, top management may like to keep it to the minimum. On the other hand, top management may like to pay higher pay to attract top talent.

Productivity of Workers

To achieve the best results from the workers and to motivate him to increase his efficiency, wages have to be productivity based. There has been a trend towards gearing wage increase to productivity increases. Productivity is the key factor in the operation of a company. High wages and low costs are possible only when productivity increases appreciably.

Job Requirements

Job requirements indicating measures of job difficulty provide a basis for determining the relative value of one job against another in an enterprise. Explicitly, job may be graded in terms of a relative degree of skill, effort and responsibility needed and the adversity of working conditions. The occupational wage differentials in terms of

a) Hardship,
b) Difficulty of learning the job
c) Stability of employment
d) Responsibility of learning the job and
f) Change for success or failure in the work.

This reforms a basis for job evaluation plans and thus, determines wage levels in an industry.

Employees Related Factors

Several employees related factors interact to determine his remuneration. These include

i) **Performance:** productivity is always rewarded with a pay increase. Rewarding performance motivates the employees to do better in future.

ii) **Seniority:** Unions view seniority as the most objective criteria for pay increases whereas management prefer performance to effect pay increases.

iii) **Experience:** Makes an employee gain valuable insights and is generally rewarded

iv) **Potential:** organizations do pay some employees based on their potential. Young managers are paid more because of their potential to perform even if they are short of experience.

Organizational Politics

Compensation surveys, job analysis, job evaluation and employee performance are all involved in wage and salary decisions. Political considerations may enter into the equation in the following ways:

i) Determination of firms included in the compensation survey: managers could make their firm appear to be a wage leader by including in the survey those organizations that are pay followers.

ii) Choice of compensable factors for the job evaluation plan: Again, the job value determined by this process could be manipulated

iii) Emphasis placed on either internal or external equity and

iv) Results of employee performance appraisal may be intentionally disported by the supervisor

Thus, a sound and objective compensation system may be destroyed by organizational politics.

Evaluation of Compensation

Today's compensation systems have come from a long way. With the changing organizational structures workers' need and compensation systems have also been changing. From the bureaucratic organizations to the participative organizations, employees have started asking for their rights and appropriate compensations. The higher education standards and higher skills required for the jobs have made the organizations provide competitive compensations to their employees. Compensation strategy is derived from the business strategy. The business goals and objectives are aligned with the HR strategies. Then the compensation committee or the concerned authority formulates the compensation strategy. It depends on both internal and external factors as well as the life cycle of an organization

CASE STUDY

In 2007, the Indian subsidiary of a multinational refinery became a Government of India company. The government company had announced an ambitious expansion programme which meant doubling the work force in less than four years. In 2007 at the time of wage revision, the union and management agreed to a two-tier pay structure. Those already employed will be eligible for a higher grade and those who are (to be) recruited afresh will get a lower grade though jobs are similar in skill, responsibility and effort. Both the union and the management justified that this is an innovative practice widely followed in deregulated companies abroad, particularly the airlines in North America.

Questions

a) Is it fair agreement

b) Would it contravene with the concept of equal pay for equal work?.

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Lesson 1.2 - Compensation Responsibilities

Learning Objectives

After reading this chapter you should be able to:

- Define Compensation Responsibilities
- Understand the Compensation Objectives
- List different Significance of Compensation Management
- Know the Principles of Compensation Management

Introduction

A good compensation package is important to motivate the employees to increase the organizational productivity. Unless compensation is provided no one will come and work for the organization. Thus, compensation helps in running an organization effectively and accomplishing its goals. Salary is just a part of the compensation system, the employees have other psychological and self-actualization needs to fulfill. Thus, compensation serves the purpose.

The most competitive compensation will help the organization to attract and sustain the best talent. The compensation package should be as per industry standards. Human Resource Management (HRM) has never been as significant as it is today. Companies want to attract, retain and motivate brains to meet objectives. Today humans are regarded as one of every company's assets, so they need to be efficiently and effectively managed. One of the tools companies use to attract, retain and motivate its people is Compensation Management.

Objectives of Compensation Management

To Establish a Fair and Equitable Remuneration

Effective compensation management objectives are to maintain internal and external equity in remuneration paid to employees. Internal equity means similar pay for similar work. In other words, compensation differentials between jobs should be in proportion of differences in the worth of jobs. External equity implies pay for a job should be equal to pay for a similar job in other organizations. Payments based on jobs requirements, employee performance and industry levels minimize favoritism and inequities in pay.

To Attract Competent Personnel

A sound wage and salary administration helps to attract qualified and hard-working people by ensuring an adequate payment for all jobs. For example IT companies are competing each other and try their level best to attract best talents by offering better compensation packages.

To Retain the Present Employees

By paying competitive levels, the company can retain its personnel. It can minimize the incidence of quitting and increase employee loyalty. For example employees attrition is high in knowledge sectors (Ad-agency, KPO, BPO etc.,) which force the companies to offer better pay to retain their employees.

To Improve Productivity

Sound wage and salary administration helps to improve the motivation and morale of employees which in turn lead to higher productivity. Especially private sectors companies' offer production linked compensation packages to their employees which leads to higher productivity.

To Control Cost

Through sound compensation management, administration and labour costs can be kept in line with the ability of the company to pay. If facilitates administration and control of pay roll. The companies can systematically plan and control labour costs.

To Improve Union Management Relations

Compensation management based on jobs and prevailing pay levels are more acceptable to trade unions. Therefore, sound wage and salary administration simplifies collective bargaining and negotiations over pay. It reduces grievances arising out of wage inequities.

To Improve Public Image of the Company

Wage and salary programme also seeks to project the image of the progressive employer and to company with legal requirements relating to wages and salaries.

To Improve Job Satisfaction

If employees would be happy with their jobs and would love to work for the company if they get fair rewards in exchange of their services.

To Motivate Employees: Employees

All have different kinds of needs. Some of them want money so they work for the company which gives them higher pay. Some of them value achievement more than money, they would associate themselves with firms which offer greater chances of promotion, learning and development. A compensation plan that hits workers' needs is more likely to motivate them to act in the desired way.

Peace of Mind

Offering of several types of insurances to workers relieves them from certain fears, as a result workers now work with relaxed mind.

Increases Self-Confidence

Every human being wants his/her efforts to get acknowledgment. Employees gain more and more confidence in them and in their abilities if they receive just rewards. As a result, their performance level shoots up.

Significance of Compensation Management

Compensation and Reward system plays vital role in a business organization. Since, among four Ms, i.e. Men, Material, Machine and Money, Men has been most important factor, it is impossible to imagine a business process without Men.

Every factor contributes to the process of production/business. It expects return from the business process such as rent is the return expected by the landlord, capitalist expects interest and organizer i.e. entrepreneur expects profits. Similarly the labour expects wages from the process.

Labour plays vital role in bringing about the process of production/business in motion. The other factors being human, has expectations, emotions, ambitions and egos. Labour therefore expects to have fair share in the business/production process. Therefore a fair compensation system is a must for every business organization. The fair compensation system will help in the following:

- An ideal compensation system will have positive impact on the efficiency and results produced by employees. It will encourage the employees to perform better and achieve the standards fixed.
- It will enhance the process of job evaluation. It will also help in setting up an ideal job evaluation and the set standards would be more realistic and achievable.
- Such a system should be well defined and uniform. It will be apply to all the levels of the organization as a general system.
- The system should be simple and flexible so that every employee would be able to compute his own compensation receivable.
- It should be easy to implement, should not result in exploitation of workers.
- It will raise the morale, efficiency and cooperation among the workers. It, being just and fair would provide satisfaction to the workers.
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- It should be easy to implement, should not result in exploitation of workers.
- It will raise the morale, efficiency and cooperation among the workers. It, being just and fair would provide satisfaction to the workers.
- Such system would help management in complying with the various labor acts.

- Such system should also solve disputes between the employee union and management.
- The system should follow the management principle of equal pay.
- It should motivate and encouragement those who perform better and should provide opportunities for those who wish to excel.
- Sound Compensation/Reward System brings peace in the relationship of employer and employees.
- It aims at creating a healthy competition among them and encourages employees to work hard and efficiently.
- The system provides growth and advancement opportunities to the deserving employees.
- The perfect compensation system provides platform for happy and satisfied workforce. This minimizes the labour turnover. The organization enjoys the stability.
- The organization is able to retain the best talent by providing them adequate compensation thereby stopping them from switching over to another job.
- The business organization can think of expansion and growth if it has the support of skillful, talented and happy workforce.
- The sound compensation system is hallmark of organization's success and prosperity. The success and stability of organization is measured with pay-package it provides to its employees.

Principles of Compensation Administration

- Compensation policy should be developed by taking into consideration of the views of employers, the employees, the consumers and the community.
- The compensation policy or wage policy should be clearly defined to ensure uniform and consistent application.
- The compensation plan should be matching with overall plans of the company. Compensation planning should be part and parcel of financial planning
- Management should inform the wage/salary related policies to their employees. Workers should be associated in formulation and implementation of wage policy

- All wage and salary related decisions should be checked against the standards set in advance in the wage/salary policy
- To manage compensation related matters adequate information/data should be developed and stored for future planning and execution.
- The compensation policy and programme should be reviewed and revised periodically in conformity with changing needs.

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Lesson 1.3 - Compensation System Design Issues

Learning Objectives

After reading this chapter you should be able to:

- Define Compensation Design
- Understand the Objectives of compensation Design
- List different steps in Compensation Design Programme
- Know the Components of Compensation Design
- Recognize the Issues in Compensation Design

Introduction

Compensation design determines the value of specific, properly executed accomplishments toward the achievement of desired outcomes. The value of the accomplishment, not the level of activity, is used to establish the nature and amount of compensation. Ultimately, compensation design should foster a productive and equitable, long-term relationship among members, and between each member and the organization. The process begins by identifying desired outcomes for the organization or operating unit. Importance and value are attached to the results people achieve with reference to the need of the organization. Compensation is based on the achievement of results that are critical to organizational success. Attracting, retaining and motivating employees in today's business environment requires utilizing a host of tools including base pay, incentives, equity, performance management, and benefits. Balancing these tools in an equitable, affordable and real manner can present difficulties for even the most dedicated employers. No universal, standard programme exists that can meet every organization's needs. In order for the total rewards programme to work, it must fit the organization's culture and strategic initiatives and compensation objectives.

These objectives are as follows

- External competitiveness to recruit and retail
- To reward performance through salary without grade promotions

- Rewards for skill acquisition
- Internal equity among employees
- Pay for the person rather than just the job
- Built-in controls and cost constraints
- An understandable and equitable system
- Parallel career paths for managers and technical employees
- Flexibility to adapt quickly to market changes and
- Management flexibility to assign a range of duties

Process of Compensation Design

1. Determine the critical goals for the organisation
2. Translate critical goal into realistic performance expectations
3. Establish specific performance responsibilities
4. Develop accurate performance measures and
5. Compensate employees for results and value received

Process of Compensation Design

Essentials of a Sound Compensation Design

Internal Equity

It implies a proper relationship between wages paid for different jobs within the company. For example salary of a Sr. Manager is lower than a manager; there is lack of internal equity. Pay differentials should be related directly to differential in job requirements. Fair pay differentials between jobs can be established with the help of job evaluation.

External Competitiveness

Wages and salaries in the organization should be in line with wages and salaries for comparable jobs in other organization. Otherwise the organization may not be able to attract and retain competent personnel. Data relating to pay levels in other organizations can be collected through wage and salary survey.

Built-in Incentive

Wage or salary plan should contain a built-in incentive so as to motivate employees to perform better. Such an incentive can be developed through performance based payment. A part of the total payment should be linked to individual or group performance. A sound performance appraisal system should be used to measure accurately and objectively the performance of individual employees.

Link with Productivity

Some part of the total pay should be linked to productivity. Such linkage is necessary because workers expect a share in productivity gains. This will help to control labour costs.

Maintain Real Wages

At least part of the increase in the cost of living should be neutralized so as to protect the real wages of labour. Dearness allowances are used in India for this purpose.

Increments

Compensation policy can be good motivator if pay increases are linked with merit. But annual increments should partly be linked to seniority or years of service. The logic for seniority based increments is that as a person accumulates experience his skill get sharpened and his efficiency tends to increase.

Challenges Faced by Compensation Design

Designing a truly effective compensation plan is like climbing a mountain. It is a complex, and often difficult, journey with numerous possibilities for pitfalls along the way, the most common of which are:

- Using compensation in lieu of sound management: this equates to trying to solve a problem by throwing money at it. No amount of compensation makes up for poor management.

- Confusing compensation and benefits with rewards and recognition: the fact is that employees rarely leave organization for relatively small increases in pay. More often, they leave for intrinsic reason such as feeling valued by an organization or seeing opportunity for growth. Compensation, no matter how much, does not fill intrinsic needs.

- Utilizing compensation strategies that are not linked to achieving an organization's goals and objectives: the only reason to hire or retail an employee is because he/she directly or indirectly adds value to the company. Therefore, how much an employee should be paid, depends solely on how much value he/she adds in reaching the company's goals and objectives.

- Designing compensation strategies that are not aligned with business philosophy: An effective compensation strategies cannot be designed without answering some key questions, such as:

  - Does the company want to hire younger, less experienced staff so that they can be paid less, knowing they will have to be replaced in two or three years? Or
  - Should an older, more experienced staff be hired and paid more to keep them
  - Does the company want to pay the going rate based on competition?
  - Does the company want to pay staff in accordance with their level of contribution to the company?

- Using compensation strategies that are designed to support change: The companies that stand the test on time are those who are willing and able to embrace change. An intensively competitive marketplace combined with constant innovations in technology makes change an ongoing process. As a result, the division that is the star performer today may be second best tomorrow, or even outdated the day after that. Conversely, today's one-person department may become tomorrow's powerhouse. Therefore, compensation strategies must be designed to (a) accommodate for increases and decreases in profit and (b) share wealth with those employees who are providing the most value at the time.

Factors Considered in Designing Compensation Package/ Compensation System Design Components

Determine the best total rewards philosophy for the organization. Reviewing the current compensation and benefits system to see how it compares to labour market competition and Formulating effective communication strategies focused on the value of the compensation, performance management and benefits programme.

Base Pay to determine the base pay the following is to be taken into consideration

- Conducting job analysis and documenting job content
- Developing systematic base pay structures
- Using market benchmarking or job evaluation methods
- Development of employer specific base pay strategic
- Analysis of employee base pay to new base pay structures and
- Job description development

Incentive Programme to develop the incentive programme the following is taken into consideration

- Developing motivating variable pay programmes for production, office, management and sales employees that tie organizational strategies and goals to individual or team performance and
- Creating pay-for-performance system including performance appraisal tools and merit increase guidelines

Benefits Programme to develop benefit programme the following is to be considered

- Assessing employees' satisfaction with your current benefit package through a Benefit Assessment Survey
- Analysis of current benefit offerings and recommendation of effective benefit changes

Guiding Principles of Compensation Design

1. Making salary decisions that are based upon appropriate equity and budget considerations

2. Encouraging and rewarding excellent performance with merit increases whenever possible
3. Providing salary increases within available funding and
4. Motivating employees by demonstrating the link between performance and pay

Compensation System Design Issues

Compensation must be viewed strategically as a lot of organizational funds are spent on compensation related activities. Organizations must make a number of important decisions about the nature of a compensation system. Especially the following things need to be questioned.

- What philosophy and approach will be taken?
- How will the firm react to market pay levels?
- Will the job be paid or the person's level of competence?
- Will pay be individual or team based?

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Lesson 1.4 - Compensation Philosophies

Learning Objectives

After reading this chapter you should be able to:

- Define Compensation Philosophy
- Understand the Factors influencing Compensation Philosophy
- Know the Development of Compensation Philosophy
- To identify the factors considered in deciding the compensation
- To know link between Compensation Philosophy and Compensation Policy

Introduction

A company's compensation philosophy refers to the set of guiding principles that drive decision making about compensation. In its compensation philosophy, the firm will spell out why it makes the choices it does about how to pay employees. This philosophy differs from business to business, but every company seeks to hire and retain the best talent, and it will express that sentiment in its compensation philosophy. All companies with employees must determine how and what to pay their workers and when to offer things like raises, bonuses and other incentives. Businesses of all types tend not to do this haphazardly. Rather, they evolve what is called a compensation philosophy. This is an actual plan for how employees are to be paid, when payments will rise, and when bonuses are appropriate. Such a plan is often made available to employees, so they have a sense of the organization's philosophy and can thus determine their treatment by the organization, as it relates to compensation, not just at present but also in the future.

Factors Influencing Compensation Philosophy

Some of the factors that influence compensation philosophy include present revenue of the company and expected profits in the future, market value of the jobs for which the company is hiring, and degree of competitiveness in the types of jobs a company offers. The way an organization views its employees and its responsibility to those employees' factors into the development of a compensation philosophy too. Essentially, many different elements may contribute to the way an employer determines rate of pay, raises and bonuses. It may be easy to create a compensation philosophy in some fields. For instance those that require rising levels of expertise and education usually have set rates, and they may have a salary range that matches market value prices and that gives employees something to aim for. Hospitals, for example, can hire employees of numerous types, and clearly compensation will be different for nurses than it is for doctors or janitors.

Factors Influencing Compensation Philosophy

Developing a Compensation Philosophy

A compensation philosophy lays out the guiding principles for a company compensation policy. It serves as a mission statement of the company policy. Some important questions to be raised before develop compensation Philosophy:

- How does current compensation strategy support the goals of the organization?
- Where does company sit regarding compensation in their industry and market?
- Does company demonstrate fair, equitable, and competitive pay practices?
- How do each employee's talents link to the organizations goals?

These questions should be answered in a way that considers every person in the organization, from the clerk or to the CEO. While employees' compensation packages may look completely different, the compensation philosophy makes sure that the compensation packages are derived from the same set of core values.

The following are tips for creating a lasting compensation philosophy:

- Be as concise as possible. Company philosophy should be about two paragraphs in length.
- Company to maintain an optimistic yet realistic tone.
- Company should keep in mind that the organization has and will go through changes. Policy can change, but remember, company compensation philosophy should weather these changes with few adjustments.
- Company should ensure that compensation philosophy reflects some of the values already listed in your company's mission statement.
- Company should see attractive, flexible, and market based pay, competitive in recruiting and retaining employees through high-quality compensation plans, or compensation program aligned with shareholder interest.

Types of Compensation Philosophy

Usually, there are two types of philosophies of compensation rates/wage rates including the productivity philosophy and purchasing power philosophy.

Productivity Philosophy: which is relates to high wages and low unit cost of production which assumes:

- That the employers should provide the best possible tools, machines, goods and buildings etc., while the management should apply the latest production technique.
- That the production should increase without the uses of commensurate physical efforts of employees while the unit cost of production should decrease leading to lower prices of goods.
- That the market for goods should expand leading to enhanced sales volume and
- That the part of resultant enhanced profits should be used to increase the wages of the employees and remaining can be ploughed back in the business

Purchasing Power Philosophy: makes the following propositions:

- That the workers should be paid high wages because they form a large proportion of the work force and are equipped with a higher propensity to consume. It results in expansion of the economy's purchasing power supply
- That effective demand for goods and services produced should enlarge in each establishment
- That productivity per worker should increase while the unit cost of output should decrease leading to enhanced profits and
- That increased wages should be paid from this enhanced income to average the cycle.

Compensation Philosophy to Develop a Compensation Policy

Once a company compensation philosophy is ready it will continue the process of developing a compensation policy. A solid compensation policy is the beginning of a well-constructed, defensible compensation program. The compensation policies are guidelines for action. They are decisions which are applied to recurring situations. Therefore, they are called standing decisions. Since they are applied again and again, they should be designed with great care so that they can remain applicable for fixed periods of time or until operating conditions demand their alteration.

The compensation policy provides a frame work company compensation program. Following are steps to make compensation policy more effective:

- Keep company compensation policy in the format in which other policies are written. This way it is consistent with other company policies.
- Include language reflecting the company's intent to create equitable and fair pay practices free from discrimination.
- Before a legal review, company may want to consider asking key stakeholders and the board to review policy's language.
- Request sign off on the policy by an executive such as the CEO or president.

Company compensation Policy Should Include

- Defining the market company will use for external market comparison or "competitive set."

- A definition of the process used to determine internal equity (job evaluation).
- The different types or elements of compensation.
- Clearly defined management responsibilities.
- A guide for the administration of the compensation program.
- Minimum wages and salaries
- Methods of wage/salary payment
- Profit sharing and incentive plans
- Non monetary rewards
- Procedure for getting pay
- Whether to pay prevailing or more than prevailing salary scale

Types of Compensation Policies

According to Dunn et al compensation policies should be established to cover at least the following compensation subjects:

1. The general compensation level
2. The wage and salary structure and
3. Formulas based on time or productivity governing disbursement of wage or salary funds to individuals

Each of these compensation policies should be related to specific compensation objectives to recruit, retain and motivate individuals and teams to work towards the achievement of organization goals.

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Lesson 1.5 - Compensation Approaches

Learning Objectives

After reading this chapter you should be able to:

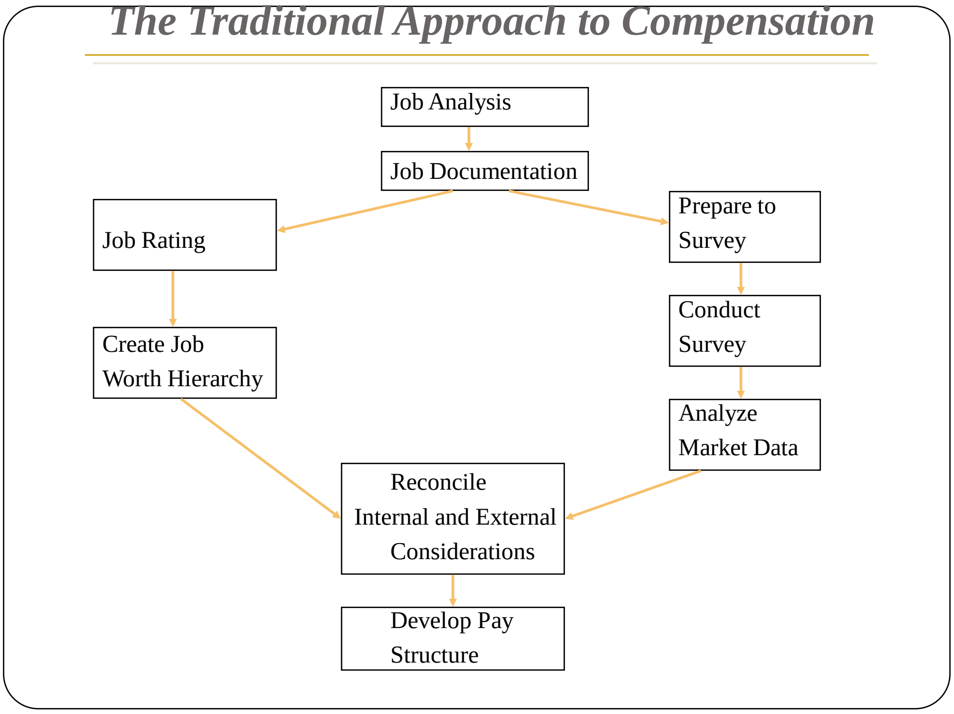
- Define Compensation Approach
- Understand the Traditional and Total Reward Approach of Compensation
- List 3 P's Approach to Compensation

Introduction

Compensation Management is an integral part of the management of the organization. Compensation is a systematic approach to providing monetary value to employees in exchange for work performed. It may achieve several purposes assisting in recruitment, job performance, and job satisfaction. It is the remuneration received by an employee in return for his/her contribution to the organization. It is an organized practice that involves balancing the work-employee relation by providing monetary and non-monetary benefits to employees. It is a tool used by management for a variety of purposes to further the existence and growth of the company. It may be attuned according to economic scenario, the business needs, goals, and available resources. Compensation Management contributes to the overall success of the organization in several ways. There are three different main goals of compensation management recruiting, motivating and retaining good people have not changed over the time, but they ways in which some companies approach them differ dramatically from previous approaches. Performance based pay, tailored to the strategic circumstances of each organization, may consist of base pay, an annual bonus, and a choice of various other benefits. This is known as "total rewards" package.

Traditional Compensation Approach

For some organizations, a traditional compensation approach makes sense and offers certain advantages in specific competitive situations. It may be more legally defensible, less complex, and viewed as more "fair" by average and below average employees. It reflects a logical, rational approach to compensating employees.



Traditional Compensation Approach

Total Rewards Approach

It tries to place a value on individual rather than just the jobs. Widespread use of various inventive plans, team bonuses, organizational gain sharing programmes, and other designs serves to link growth in compensation to results. However, management must address the following two main issues when using variable pay systems:

- Should performance be measured and rewarded based on individual, group or organizational performance?
- Should the length of time for measuring performance be short term (less than one year) or longer term (more than one year)

Differences between Traditional Compensation Approach and Total Rewards Approach

Traditional Compensation Approach	Total Rewards Approach
➢ Compensation is primarily base pay	➢ Variables pay is added to base pay
➢ Bonuses/perks are for executives only	➢ Annual/long-term incentives are provided to all
➢ Fixed benefits are tied to long tenure	➢ Flexible and portable benefits are offered

➢ Pay grade progression is based on organizational promotion	➢ Knowledge/ skill-based broad band's determine pay grade
➢ Organizational wide standard pay plan exists	➢ Multiple plans, consider job family, location and business units

3 P's Approach to Compensation Management

There are 3P approach of developing a compensation policy centered on the fundamentals of paying for Position, Person and Performance. Drawing from external market information and internal policies, this approaches helps to establish guidelines for an equitable grading structure, determine capability requirements and creation of short and long-term incentive plans. The 3P approach to compensation management supports a company's strategy, mission and objectives. It is highly proactive and fully integrated into a company's management practices and business strategy. The 3P system ensures that human resources management plays a central role in management decision making and the achievement of business goals.

- ➢ Paying for position
- ➢ Paying for person
- ➢ Paying for performance

Because it is so important to employees, the issue of pay deserves to be clearly addressed. In spite of their hesitance, managers are capable of dealing with this sometimes difficult issue in a professional and effective manner. By keeping the following basic points about pay in mind, they can address virtually any pay-related topic with the employees in a professional and productive manner.

Specificity is Key

Pay is a topic with many different shades and a variety of implications. Whenever approaching the subject, it is important to work out the details beforehand so that specifics can be clearly communicated. For the manager, this means that the increase amount is nailed down before discussing a promotion with an employee. No chance of misunderstanding or false expectations can be permitted. Far too often, managers are apt to discuss generalities. "It will mean a good increase." What exactly does that mean in terms of the employee's monthly budget? If care is not taken here, good news can become the source of conflict and resentment.

Pay is Relative

What one employee considers a fantastic increase maybe an insult to another? Each individual has a unique set of creativity and competencies. Pay should be based on the performance, position and the competencies/skills the person is having.

Pay is Not Created Equal

Various forms of pay have different purposes. The two most common forms of direct cash compensation in most companies are base pay and bonus. Base pay is the annual salary or hourly wage paid to an employee given the job he holds, While bonus is typically (or at least should be) rewarded based on the achievement of a goal of the organization. Discussions about bonus payments should be as specific as possible. This is the opportunity to point out particular accomplishments that contributed to overall team or company success. Even if the bonus is paid to all employees based on a simple overall company profit target, the manager should use the opportunity to point out specifically how individual employees helped achieve that target.

Pay Based on the Performance

Even when performance is a factor, the manager is faced with the difficult task of evaluating an entire year's worth of activity and then categorizing it according to the percentage increase options allowed by the budget. It becomes very difficult to pinpoint specific employee actions or accomplishments as the reason for the increase. For these reasons, it's appropriate for the discussion about base pay increases to be more general and balanced. Both strengths and weaknesses of the employee should be addressed. The actual increase is then based on an overall assessment, as opposed to a link with one or two specific outcomes. Any other factors that impact the increase percent, such as budget or pay range should be openly discussed as well.

Self Assessment Questions

1. Discuss the concepts of compensation and compensation management
2. Explain base compensation and supplementary compensation. What is the difference between the two?
3. Discuss the concept of compensation. What are the factors affect compensation of employees in industrial organization
4. Explain various forms of compensation used in industry

5. Explain the principles which are to be followed for effective compensation management
6. Briefly discuss types of supplementary compensation used in industry to motivate the employees
7. Describe the essentials of wage and salary administration
8. Discuss the compensation responsibilities
9. Critically examine the objectives of compensation management
10. "Compensation as effective tool to motivate employees in an organization" – Discuss
11. Bring out the significance of compensation management
12. Enumerate the principles of compensation management
13. How compensation be used as employees retaining strategies
14. What is compensation design?
15. What is the process of compensation design?
16. What are the challenges faced in designing a compensation programme?
17. What are the goals of compensation design?
18. Discuss various issues involving determination of individual pay and its increases.
19. Define compensation philosophy.
20. How compensation philosophy helps to frame compensation policy?
21. What are the factors taken into consideration in determining compensation philosophies?
22. Define compensation policy. What are the factors to be taken into consideration in framing compensation policy?
23. Critically examine different types of compensation philosophies
24. Discuss productivity and purchasing power compensation philosophies
25. Discuss various issues relating to compensation system design
26. Differentiate traditional compensation approach from total rewards approach
27. Explain external equity. What are the major decisions involved in establishing external equity?
28. Define traditional approach to compensation.
29. Differentiate traditional approach of compensation with total reward approach of compensation
30. Explain the 3 P's compensation approach with recent day's development.

CASE STUDY

An employer made alteration in the wages structure as a result of which certain allowances paid to an employee were stopped. His total wages however were not less than before.

(a) Does stopping of these allowances amount to deduction from the wages?

(b) Will an application under section 15 (2) of the payment of wages act 1936 lie for this? Comment.

Questions

(a) If you were the HR Manager what comments would you make?

(b) What follow up actions should the HR Manager take or recommend that Ramesh take?

(c) Do you assess the need for any training of the employees? If yes, what inputs should be embodied in the training programme?

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UNIT – II

Unit Structure

Lesson 2.1 - Fringe Benefits

Learning Objectives

After reading this chapter you should be able to:

- Define Fringe Benefits
- Understand the Objectives of Fringe Benefits
- List Features of Fringe Benefits
- Key Reason for offering fringe benefits
- Understand different types of fringe benefits
- Recognize the recent practices of fringe benefits
- Know the principles of fringe benefits

Introduction

Fringe benefits are indirect form of compensation given to employees in addition to the various forms of cash pay- base pay, dearness allowance and inventive pay. They provide a quantifiable value for individual employees. They are the indirect form of compensation as they are not related to the performance but are granted to the employees for just being a member of the organization. They are called benefits as the employees stand benefited on account of such provisions. They are not in the form of wages, salaries and time related payments. For example key executives in large companies might also enjoy fringe benefits like use of time-share condominiums, paid continuing education, use of a company jet, use of a company credit card, discounted or free health club memberships, and a significant amount of paid vacation.

According to the International Encyclopedia of social sciences “A fringe benefits has to meet two tests, it must provide a specific benefit to an employee and it must represent a cost to the employer”

Objectives of Fringe Benefits

The employer’s views are that fringe benefits form an important part of employee incentives to obtain their loyalty and retaining them.

The important objectives of fringe benefits are:

- To create and improve sound industrial relations
- To boost up employee morale.
- To motivate the employees by identifying and satisfying their unsatisfied needs.
- To provide qualitative work environment and work life.
- To provide security to the employees against social risks like old age benefits and maternity benefits.
- To protect the health of the employees and to provide safety to the employees against accidents.
- To promote employee’s welfare by providing welfare measures like recreation facilities.
- To create a sense of belongingness among employees and to retain them. Hence, fringe benefits are called golden hand-cuffs.
- To meet requirements of various legislations relating to fringe benefits.

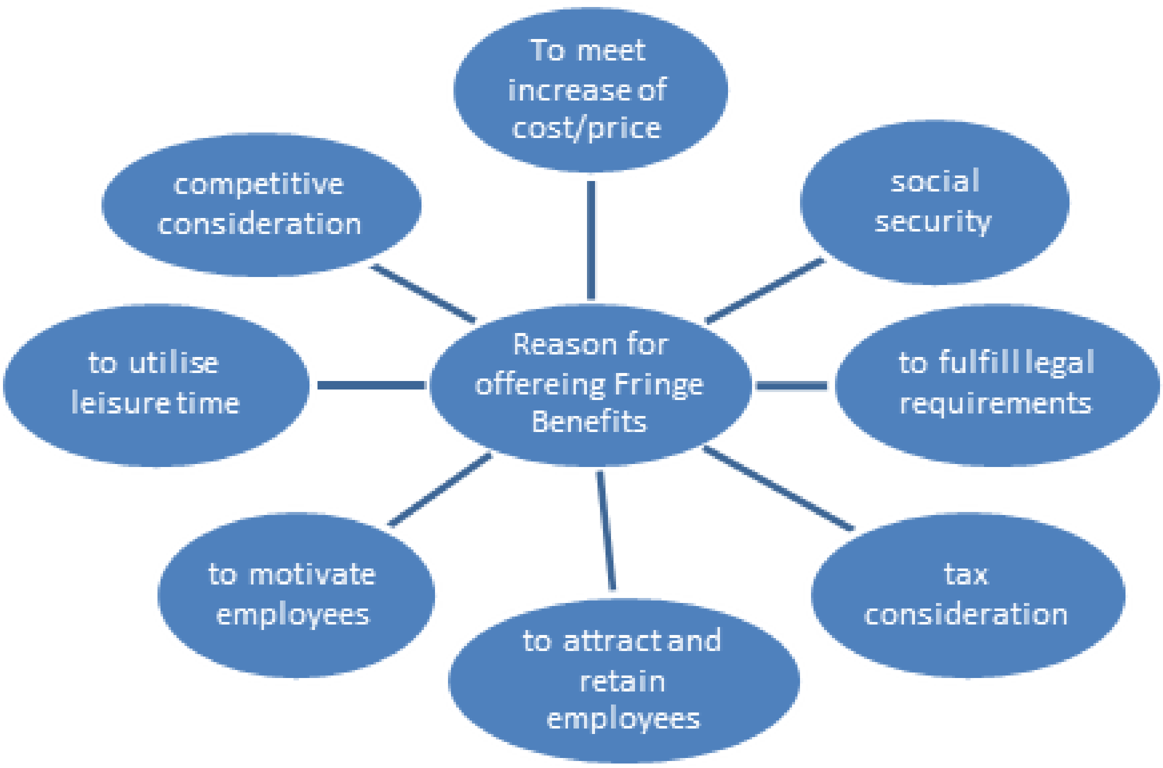
Features of Fringe Benefits

- They are the payments and benefits to an employee by his employer in addition to his normal earnings
- Fringe benefits are not linked to performance or efficiency of any employee
- Fringe benefits may be statutory or voluntary in nature

- Difference in fringe benefits may exist due to classification of employees based on organizational status
- Fringe benefits are paid to all the employees based on their membership in the organization
- Fringe benefits are indirect compensation because these are usually extended as a condition of employment and are not directly related to performance.
- Fringe benefits involve labour cost for the employer and are not meant directly to improve efficiency
- Fringe benefits may be statutory or voluntary. Provident fund is a statutory benefit whereas housing is a voluntary benefit
- Fringe benefits raise the standard of living of the employees

Factors Determining /Reasons for Offering Fringe Benefits

When a company wants to hire or keep an employee, they look at all the standard and non-standard compensation they can offer. The set of perks the business comes up with is known as a fringe benefits package. Creating one of these packages is challenging because even though the company wants to look like a good, competitive employment choice, they cannot make offers that put financial strain on the business.



Reasons for Offering Fringe Benefits

They must find a balance between meeting or exceeding market expectations and maintaining the company budget. Companies also know that employees will want benefits to increase over time, so they need to create a package that has room to grow. The following are the main reason company offers fringe benefits:

Social Security

The employers must pay in whole or in part for certain legally mandated benefits and insurance coverage also known as social security. According to ILO, social security refers to the protection which society provides for its members through a series of public measures against the economic and social distress that otherwise would be caused by the stoppage or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment invalidity, old age and health.

Paternalistic or Humanistic Consideration

Historically, fringe benefits were introduced with humanistic considerations to support wage compensation with certain infrastructure or facilities to provide for health, education and housing as also social, cultural, religious and recreational activities.

Tax Considerations

There are individual and organizations to develop ingenious methods of avoiding the obligations through restructuring the pay packet. The various fringe benefits like house rent, education expenses, travel charges and many more are shown as re-imbursement of expenditures. However, in recent years the tax authorities are taking exception to such camouflaging and disallowing non-wage benefits beyond certain limits.

Utilization of Leisure Time

There is awareness about the effects of off-duty life style on working life and vice-versa. The importance of leave and holidays for rest and recuperation is increasingly being understood. Keeping these in mind, organizations are providing various facilities for leave travel including expenses of travel maintenance of guest houses etc.

Competitive considerations

A variety of incentives and benefits are being offered like company housing liberal loan facilities, construction of schools or re-imbursement of education expenditure, membership in clubs/professional associations, sponsorship for training and conference abroad etc to attract and retain people based on the competitors companies in the field.

To Meet Price Rises

Rising prices and cost of living has brought about incessant demand for provision of extra benefit to the employees. Employers too have found that fringe benefits present attractive areas of negotiation when large wage and salary increases are not feasible.

To Attract and Retain Best Talents

As organizations have developed more elaborate fringe benefits programs for their employees, greater pressure has been placed upon competing organizations to match these benefits in order to attract and keep employees. Recognition that fringe benefits are non-taxable rewards has been major stimulus to their expansion.

To Protect Employees from Adverse Impact

Rapid industrialization, increasingly heavy urbanization and the growth of a capitalistic economy have made it difficult for most employees to protect themselves against the adverse impact of these developments. Since it was workers who are responsible for production, it was held that employers should accept responsibility for meeting some of the needs of their employees. As a result, some benefits-and-services programs were adopted by employers.

Due to Government Legislation

The growing volume of labor legislation, particularly social security legislation, made it imperative for employers to share equally with their employees the cost of old age, survivor and disability benefits.

Collective Bargain by Trade Unions

The growth and strength of trade unions has substantially influenced the growth of company benefits and services.

Labour Scarcity and Competition

Labor scarcity and competition for qualified personnel has led to the initiation, evolution and implementation of a number of compensation plans.

Types of Fringe Benefits/ Bases Classification of Fringe Benefits

There is wide range of benefits available and they are categorized in many ways:

Mandated (Statutory) and Optional (Voluntary) Benefits

Mandated benefits include social security and employee welfare, optional benefits include health insurance, life insurance, retirement plan, leave, welfare and recreational plans.

Accounting Purpose Classification

- Payment for the time on the job. It includes overtime payment and cost of living increases
- Payment for time not on the job. It involves paid holidays, vacations, sick leave, unemployment insurance, vacations and holiday's sick leave, paternity leave, maternity leave, severance pay, supplemental unemployment benefits.
- Payment for varied benefits (a) pay for time not worked (b) insurance benefits (c) Retirement benefits (d) Employee services

Classification Based on its Objectives

Those providing for employees security such as retirement programme, unemployment compensation, workmen's compensation, insurance and allied provisions.

Those purporting to increase employees' job satisfaction causing reduction in labour turnover and improvement in productivity. It includes vacations, holidays, sick leave, discounts on company goods and services and allied intangible and tangible benefits.

Deferred Benefits and Immediate Benefits

Pension scheme, insurance cover, sick pay are some of the deferred benefits, whereas providing company car to an employee constitute immediate benefits.

Types of Fringe Benefits

The following are the general types of fringe benefits offered to the employees

For 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.

For Health Protection

Benefits under this head include accident insurance, disability insurance, health insurance, hospitalization, life insurance, medical care, sick benefits, sick leave, etc.

For Old Age and Retirement

Benefits under this category include: deferred income plans, pension, gratuity, provident fund, old age assistance, old age counseling, medical benefits for retired employees, traveling concession to retired employees, jobs to sons/daughters of the deceased employee and the like.

For Personnel Identification, Participation and Stimulation

This category covers the following benefits: anniversary awards, attendance bonus, canteen, cooperative credit societies, educational facilities, beauty parlor services, housing, income tax aid, counseling, quality bonus, recreational programs, stress counseling, safety measures etc.

Employee Security

Physical and job security to the employee should also be provided with a view to promoting security to the employee and his family members. The benefit of confirmation of the employee on the job creates a sense of job security. Further a minimum and continuous wage or salary gives a sense of security to the life.

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.

Lay-off Compensation

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.

Health Facility

Employee's health should be taken care of in order to protect the employee against accidents, unhealthy working conditions and to protect worker's capacity. In India, the Factories Act, 1948, stipulated certain requirements regarding working conditions with a view to provide safe working environment.

These provisions relate to cleanliness, disposal of waste and effluents, ventilation and temperature, dust and fume, artificial humidification, over-crowding, lighting, drinking water, latrine urinals, and spittoons.

Safety Facility

Provisions relating to safety measures include fencing of machinery, work on or near machinery in motion, employment of young person's on dangerous machines, striking gear and devices for cutting off power, self-acting machines, easing of new machinery, probation of employment of women and children near cotton openers, hoists and lifts, lifting machines, chains ropes and lifting tackles, revolving machinery, pressure plant, floors, excessive weights, protection of eyes, precautions against dangerous fumes, explosive or inflammable dust, gas etc. Precautions in case of fire, power to require specifications of defective parts of test of stability, safety of buildings and machinery etc.

Accident or Health Plans

The value of accident or health plan coverage provided by the employer is usually not included in the income. However, benefits may be taxable to employee. If employer does not pay the entire cost of your health insurance, employee may be able to enter into a "salary reduction agreement" with employer. Under these agreements, employer reduces salary or wages by the amount of cost of the health insurance and pays the full amount.

Adoption Assistance

Employee may be able to exclude from your income amounts paid or expenses incurred by your employer for qualified adoption expenses if employee attempt to adopt an eligible child.

DeMinimis Benefits

These are benefits having a minimal value. If the cost is so small it would be unreasonable for the employer to account for it, the value is not included in employee income. Examples would include use of the copy machine, coffee, discounts at company cafeterias, and the cost of company picnics.

Holiday Gifts

If employer gives employee a ham, turkey, or other item of nominal value at Christmas or other holidays, it is not included in employee income. However, cash, gift cards, or similar items are included in the income regardless of the amount.

Qualified Employee Discounts

These are not taxable if the discount for services does not exceed 20%. Discounts for merchandise are limited to the employer's gross profit percentage. No discounts are allowed for real estate, stock, or other investment property. This is available to employees, spouses, dependents and retirees.

Working Condition Benefits

These include items such as professional dues paid by the employer or subscriptions to professional publications and are not included in income.

Qualified Transportation Fringe Benefits

Employer may provide to the employee transit passes and tokens for parking. These amounts are excluded from employee income. Also, transportation in a commuter highway vehicle, provided by employer, between employee home and place of work is not taxable income.

Recreation and Athletic Facilities

The use of employer-owned athletic or recreation facilities is not taxable income. This benefit is available for employees, spouses, dependents and retirees.

Educational Assistance

Employer provides educational assistance to employee to go for higher studies, training, children's education etc.,

Employer-Provided Vehicles

Employer provides a vehicle employees personal use is a taxable non cash fringe benefit. Employer must determine the actual value of the benefit and include that amount on employees account.

Retirement Planning Services

Employer has a qualified retirement plan, qualified retirement planning services provided by the employer to employee and his spouse are not included in employee income. This does not include the value of tax preparation, accounting, legal, or brokerage services provided by employer. These items are taxable income to employee.

Retirement Plan Contributions

Employer's contributions qualified retirement plans for the employee are not included in his income. Generally speaking, contributions into a non-qualified plan are taxable income.

Stock Options

These are classified as non-statutory or statutory options. If it is a non-statutory option employee will have income when he receive the option, when he use the option, or when he sell or otherwise dispose of the option.

With a statutory option, employee does not recognize any income until you sell or exchange your stock from the option. Employer can tell you which type of options employees have.

Meals and Lodging

Meals provided by an employer may be excluded from an employee's income if the meals are furnished on the employer's premises and are for the convenience of the employer. Lodging provided by an employer may be excluded from an employee's income if it is furnished on the employer's premises, is for the convenience of the employer, and is required that the employee accept the lodging as a condition of employment.

Dependent Care Benefits

These benefits are employee-financed programs that provide care for an employee's children or other dependents. The care must be care that would qualify for the dependent care credit if the employee had paid the amounts.

Employee Death Benefits

These are payments made to the family or friends of a relative who dies. They may or may not be taxable, depending on the facts and circumstances. If the payments were for past services such as bonuses, accrued wages, or unused vacation pay they are taxable income to the family. The important issue here is if the employee would have received these payments had he lived.

Different forms of Non-monetary Rewards

Treats	Knick-Knacks	Awards	Environment	Social acknowledgement	Tokens	On-the-Job Rewards
Free lunches	Decorative	Trophies	Renovation	Information recognition	Movie tickets	More responsibility
Festival bashes	Company Watches	Plaques	Music	Recognition at office get-together	Vacation trips	Job rotation
Coffee breaks	Brooches	Certificates	Flexible Hours	Friendly greetings	Coupons redeemable at stores	Special arrangement
Picnics	Diaries	Scrolls	E-Mail	Solicitation of advice, suggestions	Early time offs	Training
Dinner with Boss	Calendars	Letters of Appreciation		Membership of clubs	Anniversary/ birth day presents	Representing the company at public fora

Birthday treats	Wallets					
	T-Shirts					

Current Fringe Benefit Practices

Currently three main approaches are in vogue in the area of fringe benefits:

- Innovation: organizations are offering many new types of fringe benefits to their employees
- Flexibility in fringe benefits: employees are allowed to choose from an array of benefits within certain cost limits and
- Harmonization is tried to be attempted to give a feeling of equity and fair play to employees

Principles of Fringe Benefits

The following principles must govern the administration of fringe benefits

- Benefits and services must be provided to the employees on the basis of a genuine interest in the protection and promotion of their well-being. The management should not feel that the fringes are thrust upon them. Nor should the management feel that they are providing the benefits as a matter of charity.
- The benefits must satisfy a real need. Employees resist or are indifferent to any benefit which is not like by them
- The benefits must be cost-effective
- The benefits should be as broad based as possible
- Administration of the benefits should be preceded by sound planning
- The wishes of employees expressed by their union representatives and the bargaining power of the union must be considered
- Employees should be educated to make use of the benefits.

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Lesson 2.2 - Strategic Compensation Planning

Learning Objectives

After reading this chapter you should be able to:

- Define Strategic Compensation Planning
- Understand the Process of Compensation Planning
- List different Methods of Compensation Planning
- Know Traditional Compensation Planning
- Understand Modern Compensation Planning

Introduction

Once employees have done their jobs and been appraised, they expect to be paid. Each employee's pay should make sense in terms of the company's overall pay plan. Developing a pay plan is as important in a small firm as a large one.

Paying wages rate that are too high may be unnecessarily expensive, and paying less may guarantee interior help and high turnover. Furthermore, internally inequitable wage rates will reduce morale and cause endless badgering by employees demanding rises.

The strategic compensation planning otherwise called the process of looking ahead at what an organization needs to do about its reward policies and practices in the future.

The strategic compensation management deals with both ends and means. As an end, it describes a vision of what reward policies will look like in a few years time. As a means, it shows how the vision will be realized.

Therefore, strategic compensation management is also called visionary management. But it is also called empirical management which decides how, in practice, it is going to get there.

Process of Determination of Compensation

Today the compensation systems are designed aligned to the business goals and strategies. The employees are expected to work and take their own decisions. Authority is being delegated. Employees feel secured and valued in the organization. Organizations offer monetary and non-monetary benefits to attract and retain the best talents in the competitive environment. Some of the benefits are special allowances like mobile, company's vehicle; House rent allowances; statutory leaves, etc. The wage determination process consists of the following steps:

Evolution of Strategic Compensation

Traditional Compensation Systems

In the traditional organizational structures, employees were expected to work hard and obey the bosses' orders. In return they were provided with job security, salary increments and promotions annually. The salary was determined on the basis of the job work and the years of experience the employee is holding. Some of the organizations provided for retirement benefits such as, pension plans, for the employees. It was assumed that humans work for money, there was no space for other psychological and social needs of workers

Change in Compensation Systems

With the behavioral science theories and evolution of labour and trade unions, employees started asking for their rights. Maslow brought in the need hierarchy for the rights of the employees. He stated that employees do not work only for money but there are other needs too which they want to satisfy from there job, i.e. social needs, psychological needs, safety needs, self-actualization, etc.

Now the employees were being treated as human resource. Their performance was being measured and appraised based on the organizational and individual performance. Competition among employees existed. Employees were expected to work hard to have the job security. The compensation system was designed on the basis of job work and related proficiency of the employee.

Steps in Determination of Compensation

Modern Compensation Systems

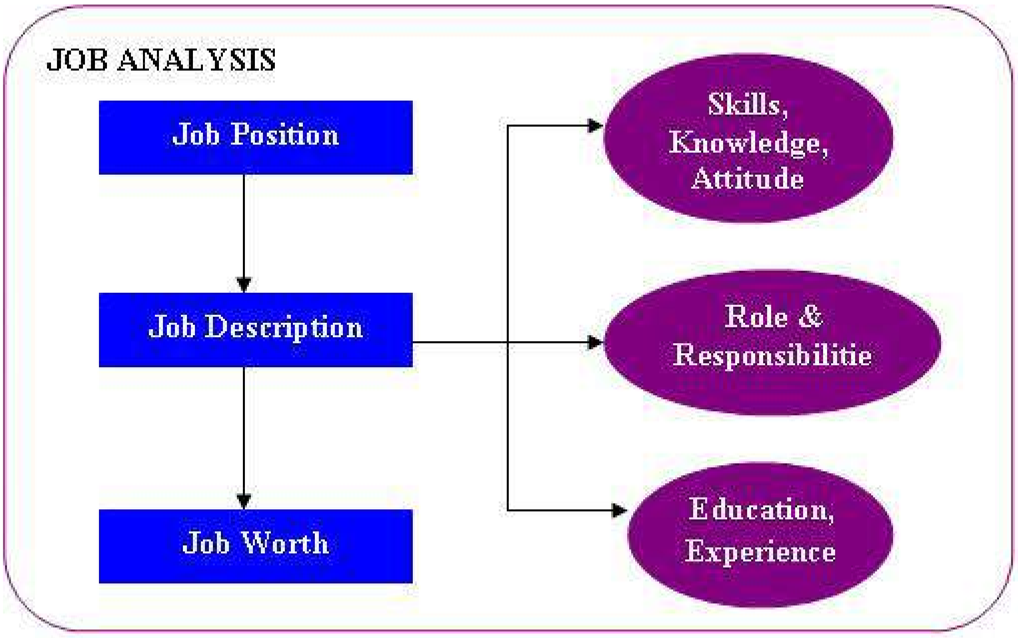
1. The Salary/Wage Survey

It is difficult to set pay rates if one don't know what others paying, so salary survey of what others are paying will play a big role in pricing jobs. Virtually every employer conducts at least an informal telephone, newspaper, or internet salary survey.

2. Job Analysis

Job analysis is a systematic approach to defining the job role, description, requirements, responsibilities, evaluation, etc. It helps in finding out required level of education, skills, knowledge, training, etc for the job position. It also depicts the job worth i.e. measurable effectiveness of the job and contribution of job to the organization.

Thus, it effectively contributes to setting up the compensation package for the job position.



Job Analysis

Job Description

Job description refers the requirements an organization looks for a particular job position. It states the key skill requirements, the level of experience needed, level of education required, etc. It also describes the roles and responsibilities attached with the job position. The roles and responsibilities are key determinant factor in estimating the level of experience, education, skill, etc required for the job. It also helps in benchmarking the performance standards.

Job Position

Job position refers to the designation of the job and employee in the organization. Job position forms an important part of the compensation strategy as it determines the level of the job in the organization. For example management level employees receive greater pay scale than non-managerial employees. The non-monetary benefits offered to two different levels in the organization also vary

Job Worth

Job Worth refers to estimating the job worthiness i.e. how much the job contributes to the organization. It is also known as job evaluation. Job description is used to analyze the job worthiness. It is also known as job evaluation. Roles and responsibilities helps in determining the outcome from the job profile. Once it is determined that how much the job is worth, it becomes easy to define the compensation strategy for the position

Job Evaluation

The relative value of every job is determined through job evaluation. The relative job value is then converted into money value so s to fix. Wage Survey: Wage or salary surveys are conducted to find out wage or salary levels prevailing in the region or industry for similar jobs. Other organizational problems such as recruitment policy, fringe benefits, etc., are also considered.

3. Groups Similar Jobs Into Pay Grades

Once the committee has used job evaluation to determine the relative worth of each job, it can turn to the task of assigning pay rates to each job; however, it will usually want to first group jobs into pay grades. It could, of course, just assign pay rates to each individual job. But for a larger employer, such a plan would be difficult to administer, since there might be different pay rates for hundreds or even thousands of jobs. And even in smaller orgnisation, there's a tendency to try to simplify wage and salary structures as much as possible. Therefore, the committee will probably group similar jobs into grades of pay purposes.

4. Developing Wage Structure

On the basis of foregoing steps an equitable wage structure is prepared. While determining such a structure several points need to be considered;

a) Legislation elating to wages
b) Payments equal to, more or less than prevailing wage rates
c) Number and width of pay grades
d) Jobs to be placed in each pay grade
e) Provision for merit increases
f) Differentials between pay and plans and
g) Dealing with wages or salaries that are not line with the structure

5. Wage Administration Rules

Rules are required to determine the degree to which advance will be based on length of service rather than merit, the frequency with which pay based on length of service rather than merit, the frequency with which pay increments will be awarded, the rules that will govern promotions from one pay grade to another, and the way control over wage/salary costs can be maintained. Once the rules are framed these should be communicated to the employees.

6. Employee Appraisal

In order to reward merit and performance, it is necessary to evaluate the performance of individual employees. Some differentials in pay are maintained on the basis of employee's performance. This is necessary to provide incentive for hard work and superior performance is evaluated against predetermined standards of performance.

Therefore, job analysis forms an integral part in the formulation of compensation strategy of an organization. Organizations should conduct the job analysis in a systematic at regular intervals. Job analysis can be used for setting up the compensation packages, for reviewing employees' performance with the standard level of performance, determining the training needs for employees who are lacking certain skills.

CASE STUDY

The case discusses the compensation management practices at Tata Consultancy Services Ltd. (TCS), one of the leading Indian IT companies. TCS' compensation management system was based on the EVA model. With the implementation of Economic Value Added (EVA)-based compensation, the salary of employees comprised of two parts – fixed and variable. The variable part of the salary was arrived after considering business unit EVA, corporate EVA, and also individual performance EVA. During the fourth quarter of the financial year (FY) 2007-2008, TCS announced its plans to slash 1.5 percent of the variable component of employee salaries since its EVA targets for the third quarter of FY 2007-2008 were not met The announcement came as s jolt not only to TCS employees but also to the entire Indian IT industry. The company came in for severe criticism and it was accused of not being transparent with respect to EVA calculation. However, some analysts felt that the pay cuts were a result of the macroeconomic challenges that the Indian IT companies were facing — rapid appreciation of the rupee against the US dollar and the recession in the US economy (USA was the largest market for the Indian IT companies)

Questions

1. Analyze TCS' HR practices with respect to its policy related to compensation of its employees.

2. Discuss various concepts related to compensation management.
3. Discuss the importance of variable compensation in light of its ability to motivate employees and enhance organizational productivity.
4. Discuss the pros and cons of the EVA-based compensation management system and also analyze EVA as a performance measurement tool.
5. Understand the rationale behind the cut in the compensation of the employees at TCS.
6. Understand how macroeconomic variables could affect a company's HR policies.
7. Appreciate the importance of HR goals and strategies in the success of an organization

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Lesson 2.3 - Development of Base Pay System

Learning Objectives

After reading this chapter you should be able to:

- Define Base Pay System
- Understand the types of Base Pay System
- Know the process of selecting and installing pay system
- Know the Process of determination of Compensation
- To Maintain, Monitor and Evaluate Pay System

Introduction

Pay is a key factor affecting relationships at work. The level and distribution of pay and benefits can have a considerable effect on the efficiency of any organization, and on the morale and productivity of the workforce. It is therefore vital that organizations develop pay systems that are appropriate for them, that provide value for money, and that reward workers fairly for the work they perform. Pay systems are methods of rewarding people for their contribution to the organization. Ideally, systems should be clear and simple to follow so that workers can easily know how they are affected. In considering rewards it should be borne in mind that pay and financial benefits are not the only motivator for worker performance. Other important motivators for individuals may include job security, the intrinsic satisfaction in the job itself, recognition that they are doing their job well, and suitable training to enable them to develop potential.

Defining Pay System

Pay systems provide the foundation for financial reward systems There are basic rate systems, where the worker receives a fixed rate per hour/week/month with no additional payment There are systems related in whole or part to individual or group performance or profit There are systems based in part on the worker gaining and using additional skills or competencies Pay systems provide the bases on which an organization rewards workers for their individual contribution, skill and performance. Pay structures are different - they are used to determine specific pay rates for particular jobs, usually based on the nature of the job, its content and requirements. A pay structure provides the framework within which the organization places the pay rates for its various jobs or groups of jobs. Pay systems fall into two main categories:

- Those where pay does not vary in relation to achievements or performance, (basic rate systems), and
- Those where pay, or part pay, does vary in relation to results/profits/performance (including the acquisition of skills).

There are also systems where pay, and any enhancement, is related to the gaining of extra skills or competencies. These systems can provide opportunities for greater job satisfaction - allowing workers to carry out a wider range of work, or work at a higher level. Basic rate systems are the easiest to operate, and apply to many workers in the India. The worker receives a fixed rate per hour, week or month. Substantial numbers of workers however, have part (though generally not all) of their pay based on incentive, or variable, systems. Their earnings can therefore vary according to their own performance, that of their team or group, or perhaps that of the enterprise as a whole. Relativities and pay differentials between individuals or groups of workers are, of course, also of fundamental importance. These are generally determined by the wage or salary structure of the organization, rather than by the pay system, but they may be affected by changes in the pay system. The selection of an organization's pay system is often determined by negotiations between management and worker representatives. In theory these negotiations can be kept quite separate from negotiations over payment structures and levels or amounts of pay; but in practice negotiations often embrace all pay-related issues.

Reason to have Different Types of Pay Systems

- Basic rate schemes, while clear, may not offer incentives for increased or improved performance or quality, nor for recruitment and retention of workers
- Incentive schemes may be individual or group based, short or long term
- Productivity or efficiency gains may be required if a scheme is to be 'self-financing'
- Organizations may use a combination of systems to meet their particular requirements

Basic Rate Schemes

Basic rate schemes tend to be job-based (ie the rate for the job). A grading structure may be developed through a job evaluation scheme which is used to put jobs into an appropriate grade or band in the organization. Pay increases may then depend on moving up a scale, skill development, promotion to another grade, or a general updating of pay levels.

Incentive Schemes

Incentive schemes may be short- or long-term. Schemes based on individual performance, such as weekly or monthly production bonuses or commission on sales, generally offer a short-term incentive. Longer-term schemes such as profit sharing and share option schemes may not provide as much incentive to individual workers as schemes based on personal performance. They can, however, help to generate in workers a long-term interest in the success of the organization. Pay is not the only factor that might produces enhanced performance. As well as the job-related factors mentioned earlier, additional payments, non-contributory pension schemes, and non-cash benefits such as cars, life insurance, and assistance towards child care (eg workplace nurseries/crèches) may all play a part. Nevertheless, the prospect of higher pay for increased output/quality often provides an incentive and many schemes are introduced in the clear expectation that performance will thereby be improved. Increases in pay are often linked to productivity or 'self-financing' pay schemes, especially where organizations have no 'new' money to put into the pay rates. In such systems the results of increases in productivity and efficiency can be shared between the employer and workers to their mutual benefit. There is an increasing trend for organizations to build a quality factor into incentive scheme calculations, offering additional payments for reductions in waste, more good quality goods or services and increased customer satisfaction. Productivity and efficiency schemes can be based on individual, group or organization performance dependent upon the needs of the organization and the availability of suitable performance measures. Organizations often use a combination of systems to provide greater flexibility in the pay package to address particular needs. For instance they may have a basic rate for the job, with a top-up increase that is self-financing, and an element for individual performance. This has been particularly common in the public sector and the privatized ex-public sector/agencies.

Selecting and Installing a Pay System

Accept the Cost

Any consideration given to changes in the pay system mean costs will be incurred - management and staff time, expert help if necessary, as well as the actual pay costs that are likely to result.

Be Systematic

A systematic approach to considering and introducing a new pay system is likely to be more successful than trying to deal with problems only as they arise. Careful planning, and above all the involvement of workers, can avoid many potential difficulties.

Involve the Workforce

Involving the workforce is important for several reasons:

- Workers and their representatives may be able to contribute valuable information, which management could be unaware of, about the operation of the existing system and the likely effect of a new one.
- Time, trouble and expense can be saved, especially by reducing any risk of disagreement at a later stage, particularly if existing differentials are likely to be affected
- Workers will have more opportunity to understand the new system and the reasons for the change and are therefore more likely to accept it, especially if their representatives are fully involved in its design.

In organizations where an independent trade union is recognized, the employer is required to disclose to that union any information necessary for collective bargaining(1), and this is likely to include information about pay systems. Selecting or changing a pay system may have repercussions on pay differentials and relativities as well as on individual rewards and should be done in agreement with trade union and worker representatives. Consultation between management and workers and their representatives should identify any potential problems in this area before the system is installed.

Take Stock of the Existing System

Re-examine the reasons for considering change and take advice both inside and outside the organization, perhaps including expert opinion. Discussions and consultations between worker representatives and management can offer the organization the opportunity to review the existing system. For example: it may be found that faults are more apparent than real and less extensive adjustments may produce a better working system for the organization. The current system may have merits which the parties want to incorporate into any new system - taking stock allows these to be identified and their place considered in any revised pay system. Thus any new system builds on the strengths of the old.

Identify the Objectives

The objectives of the pay system needs to be identified and related to the organization's overall objectives. For example are they to:

- Increase productivity?
- Control unit labour costs?
- Recruit, retain and motivate suitably qualified workers?
- Improve quality?
- Move towards, or encourage, teamwork?
- Change organizational culture and attitudes?
- Simplify the existing system?
- Reduce conflict arising from the existing system?
- Comply with the law on equal pay?

Select a new scheme

In selecting the most appropriate and acceptable type of system, consider whether:

- One type of system suits the work-process more than any other
- Volume of output, or predictability of output, have higher priority
- The system needs to cover additional factors such as new technology, reduction of waste, staffing levels
- As changes may be made to pay rates, some jobs may require 'red-circling' of current pay levels to avoid detriment to individuals - the ideal system may be too expensive
- All staff, production and non-production, are to be covered in the new system
- The new scheme complies with the law on equal pay

Shape to Local Needs

In shaping the system to meet local requirements, consider:

- What measures will be used in assessing performance - for instance individual, team, group, enterprise based
- How standards will be set - perhaps by work measurement or reference to past performance

- Whether the measures and standards are free from any elements of bias or discrimination and comply with relevant legislation such as the law on equal pay, the prevention of discrimination in employment and the national minimum wage
- How the organization will deal with relativities and differentials
- How management and worker representatives will jointly review the system and address changing standards.

These considerations hold true whatever the type of industry or service - they are as important in a 'high-technology' environment as in a service industry or a manufacturing organization.

Keep it Simple

The overall aim must be to keep the system as simple and straightforward as possible. People need to be able to calculate their earnings, or at least understand how they have been calculated. They may otherwise become de-motivated and dissatisfied. Any changes to pay can make people anxious. The best schemes:

- Are clear and easy to understand
- Take account of the needs of the organization and the workforce
- Allow for flexibility to be built in to meet changing environments
- Are straightforward and cost effective to administer
- Are developed with the participation of worker representatives
- Have the commitment of management and the workforce.

Changes to pay systems should always be agreed with workers and their representatives. Proper consultation and thorough preparation will help to make sure that pay is fair and acceptable to workers, and complies with relevant legislation, such as the law on equal pay, discrimination and minimum wage. Changing pay systems without the agreement of workers may be in breach of contract and may result in complaints to employment tribunals or other legal action.

Prepare the Way

Give thought to the mechanics of the introduction of the system. Any new pay system is likely to focus attention on problems that might be outside the scope of the system. Wherever possible these should be eradicated before the new system is introduced. For instance, if internal pay relativities are an issue, it may be appropriate to apply job evaluation before commencing the new system(2). For example, women have the right to equal pay with men if they are doing 'like' work or work that is of 'equal value'. As pay arrangements are often very complicated it is, therefore, good practice to evaluate the existing pay system in order to help avoid any sex discrimination.

Install the System

Preparations should include:

- Briefing the workforce about the new system and how it is intended to work
- Training supervisors, managers, and worker representatives so that they understand the nature of the system and can answer many of the potential queries - agree a communications policy with any working group/employee representatives to avoid misunderstandings
- If the new system is expected to improve productivity, making sure that all departments will be able to respond
- Proper documentation of the system so that room for misunderstanding is minimized.

If possible run the new system for a trial period, with a review at the end to allow for adjustments to be made in the light of experience. In the early stages it is essential to recognize and deal with any anomalies or problems fairly and quickly.

Maintain, Monitor and Evaluate

Maintenance, monitoring and evaluation of the system are on-going processes. While these are clearly management's responsibility, worker representatives may well have a valuable contribution to make to the evaluation process. They are likely to quickly hear of any problems, particularly if the scheme has involved new job roles, changes in relativities, or new skills requirements. The introduction of new machinery and technology may also have an impact on the pay system by altering standards and work measures. It is essential that any pay system should not discriminate between men and women. Both may claim equal pay where they are employed on like work, or work rated as equivalent, or work of equal value(3). It is the employer's responsibility to demonstrate that evaluation methods do not discriminate. Monitoring of the pay scheme should be designed to identify differences related to gender, race, disability or age in the way pay is allocated. The Equal Opportunities

Commission has produced an Equal Pay Tool Kit which sets out a five-step process for undertaking an equal pay audit. The five steps are:

1. Deciding the scope of the review and identifying the data required
2. Identifying where men and women are doing equal work
3. Collecting and comparing pay data to identify any significant equal pay gaps
4. Establishing the causes of any significant pay gaps and deciding whether these are free from discrimination
5. Developing an Equal Pay Action Plan if there are gaps between men and women's pay or, if not, reviewing and monitoring

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Lesson 2.4 - Compensation as a Retention Strategy

Learning Objectives

After reading this chapter you should be able to:

- Define Retention
- Understand the Components of Retention Strategy
- List different reasons for Employees Turnover
- Key to use Compensation as Retention Strategy
- Recognize the Effective steps to Retain Employees

Introduction

In today's globalized economy, the importance of opportunities for growth, advancement, and work-life balance in the office vary from employee to employee. If one or all of those needs are not met, employees may seek employment elsewhere. The role of Human resources professionals in hiring and retaining the right employees is becoming more and more important to an organization's overall strategy.

Compensation can have a direct impact on employee retention. While employers may use employee incentives and monetary rewards to retain employees, there are ways to complement compensation that have a much greater impact. Based on the type of compensation, along with the terms and conditions of an employee compensation package, an employer can boost employee retention.

Employee retention refers to the number or percentage of employees your organization retains. The term retention is often used in discussions about employee turnover. The differences between retention and turnover are subtly related; however, retention is more about improving satisfaction of current employees by providing challenges, development opportunities and incentives such as retention bonuses and compensation that encourages your most talented employees to stay with the company. Turnover, on the other hand, is inevitable within any organization. Turnover occurs both involuntarily and voluntarily for a number of reasons. Attempts to reverse turnover using retention strategy that includes compensation is ill-advised, not to mention counterproductive.

Components of Overall Retention Strategy

An effective retention strategy has several components that must be addressed in order to retain top employees. “Strategies for Staff Retention” outlines eleven key learning’s, which are summarized below and help define compensation’s role in the overall retention strategy.

Summary of Key Learning’s from “Strategies for Staff Retention”

1. **A retention strategy is pragmatic.** An effective strategy leads to fewer turnovers which results in fewer costs due to turnover and increased productivity.
2. **The culture and values of an organization are expressed primarily by its actions, and through the actions of management and employees.** When hiring new employees, cultural values should be in the forefront to ensure employees “fit” the organization’s needs.
3. **Leadership and management’s responsibilities include motivating employees and encouraging commitment.** Their job is not just ensuring tasks are done, but also that employees are engaged.
4. **Communication should reflect the culture and value of the organization.** Effective communication can inspire while poor communication can create an atmosphere of cynicism and distrust.
5. **A performance management system that compensates employees fairly leads to trust and commitment by employees.** In addition to above-market pay, employees seek flexible work schedules, opportunities for advancement, and a share in profits and operations of the organization.
6. **Managing poor performance is just as important as recognizing good performance.** Non-performers can be a factor that demotivates good employees.
7. **Terms and conditions are not key to a retention strategy as long as they are perceived as competitive with the market and equitable among employees.** The organization should regularly benchmark its salaries and benefits against others in the market and communicate to employees that their salary and benefits are distributed in a fair and equitable manner.
8. **Effective resourcing strategies and policies provide a competitive advantage.** Hiring and promoting the right people ensures companies have the right people in place to succeed in achieving the organization’s business strategy.

9. **Promotions provide employees with a motivating factor to remain at an organization and to be productive.** A clear and well-communicated promotion policy provides guidelines and prevents resentment in the future.

10. **Career development motivates employees and also allows them to build skills for promotion.** Opportunities for personal and professional growth occur through training and education, challenging assignments and career movement.

11. **Talent management provides a channel to monitor and maintain morale and motivation.** When the learning curve begins to plateau, talented individuals are at risk of getting bored and underperforming or looking for opportunities outside the organization.

Function

Companies concerned with employee retention will make concessions to ensure employees are satisfied and that morale is high. Pay increases and bonuses are examples of ways a company can compensate employees to encourage continued employment.

Strategies

Some companies may offer employees attractive benefits such as flexible work schedules, vacation time and attractive health insurance packages in lieu of higher wages. Some employees may find flexibility in the workplace a greater benefit than money, which may influence the employee to stay with a company when times get tough.

Reason for Employees Switch Over

Employees looking voluntarily to make a change want to continue their career with a company that offers promotion and development opportunities, a collegial work environment and a leadership team that's openly appreciative of its human capital. Compensation and benefits may be important factors in the decision to look for employment elsewhere; however, many reports indicate compensation is low on the list of priorities in looking for another position. Employees have an intrinsic need for respect, motivation and challenging work, which are compelling reasons for seeking employment elsewhere. Employers who consider compensation as part of the strategy for employee retention are headed in the right direction, but are looking at just one half of the equation. Compensation coupled with better opportunities to develop employee skills is a more complete way of formulating an effective retention strategy.

Potential Reasons for Leaving the Organization

Factor	Description
1. Salary	Not being paid at or above market and not having internal and external equity.
2. Lack of challenge and opportunity	The position not offering adequate challenges and the opportunity to learn new tasks and responsibilities
3. Lack of career advancement opportunities	Not being able to advance in one's career within a reasonable time and with higher levels of performance.
4.Lack of recognition	Not being rewarded fairly for work performed. Rewards may be financial or non-financial.
5. Ineffective leadership	The inability of leaders to develop and communicate the Company's vision and effectively developing employees to maximize their potential.
6. Inadequate emphasis on teamwork	The lack of effort exerted by employees and leaders to foster a teamwork type environment.
7. Not having the opportunity for a flexible work schedule.	The inability to work a flexible work schedule including reduced hours, telecommuting, four ten-hour days per week and job-sharing
8.Too long of a commute	The distance an employee has to commute to and from work.
9. Lack of trust in senior management	Lack of confidence in the Senior Management to do what is right for the employees.
10. Inadequate opportunities for training & development	The unavailability and inadequate opportunity to take classes at local colleges and universities and participating in the in-house training program.
11. Low overall job satisfaction	Not feeling a sense of satisfaction from performing one's job.

Tying Compensation to Retention

One of the most effective ways compensation can have a positive impact on employee retention is to construct an employee development plan that promises employees career track opportunities with the company. Being on an upward career track should come with corresponding salary and merit increases. In addition, performance-based bonuses motivate employees in terms of aligning their individual goals with company goals. Implementing incentives such as stock options, profit sharing and spot rewards are other ways compensation affects retention. These forms of compensation demonstrate how critical employee performance is to the organization's overall profitability. Spot rewards are usually not as lucrative; however, they provide immediate recognition, reward and compensation when company leadership observes an employee performing superior work. Appreciation is key to employee retention, and if compensation is a part of recognition, then compensation is likely to increase employee retention.

Successful Human Resource Retention Strategies

Employee retention is a critical goal for any organization. The successful retention of employees is always a business priority, even during tough economic times when there are more employees available for open positions. Strategies to improve retention include understanding what motivates employees, providing open channels of communication, maintaining competitive pay and benefits packages and providing employees opportunities for making decisions that impact them. Employee rewards represent an important factor in keeping employees engaged, loyal and productive. Each employee is different and will have different motivations. Fortunately, managers can choose from a number of incentives — monetary and non-monetary — to impact retention, including pay, benefits, recognition, involvement and flexibility. Even small organizations can compete against larger companies by focusing on those rewards that are most valued by their employees.

Understanding What Motivates Employees

Employees are not all alike in terms of their beliefs, attitudes and preferences. This has an impact on HR's ability to develop strategies to successfully motivate and retain an increasingly diverse employee audience. Understanding what motivates employees is the first step toward developing pay, benefits and policies that increase motivation and, ultimately, retention. This can be done formally through quantitative surveys that provide an indication of overall workforce preferences and relative weights. It can also be done through ongoing communication between supervisors/managers and employees and through a culture of open communication where employees feel free to share their thoughts and concerns.

Providing Open Channels of Communication

Providing open channels of communication is an important means of ensuring that the organization is getting input on issues that matter to employees on an ongoing basis.

Open channels of communication start at the employee/supervisor level, but that should not be the only opportunity employees have to give or receive feedback. Other communication channels include a company intranet, a suggestion program, online forums and social media channels, company meetings and any number of other opportunities for employees to interact with each other, with their managers and supervisors and with the organization's leaders.

Maintaining Competitive Pay and Benefits Packages

Organizations operate within an increasingly competitive environment, even when economic times are tough. Organizations are always concerned about attracting and retaining the most qualified and effective employees. Ensuring that pay and benefits packages are competitive is a key part of this process. HR professionals should be constantly monitoring the external pay and benefits environment, paying particular attention to the organizations that they compete directly with for employees, generally those within the same geographical area or industry where staff members are being recruited.

Clear Direction and Open Feedback

Employees need to know what is expected of them and how their work contributes to the overall successful performance of their work team, department, division and the organization at large. Goals should be clear and measurable, with opportunity for employees to influence the establishment and monitoring of these goals. Feedback should be open, immediate and specific so that employees have a clear understanding of how they might change their actions and behaviors or increase their skills and knowledge in specific areas to improve their performance.

Understanding the Competitive Landscape

No business operates in a vacuum. Employers need to have a solid understanding of their competition relative to employee recruitment and retention, including an understanding of the pay and benefit packages offered by other organizations. Competition may be local, regional or even national depending on the position and the availability of candidates. Importantly, pay alone is often not the most important factor in retaining employees. For instance, today's employees who often find themselves juggling the demands of both children and parents often appreciate flexibility in the workplace, which can be accommodated through flexible schedules, the ability to work remotely and an understanding of work/life balance needs.

Understanding Employee Motivators

To be effective in administering reward packages that positively impact retention, employers must understand the motivators that drive their employees to high levels of performance. While there is much literature on the subject, organizations will vary depending on their industry, geography and the unique make-up of their employee population.

One way of understanding employee motivators is to literally ask employees what motivates them to perform at high levels — this can be done one-on-one or through quantitative surveys or employee assessments.

Recognizing the Impact of Non-Monetary Incentives

Employees are motivated by more than money. Non-monetary incentives can have a major impact on employee satisfaction, engagement and retention. Non-monetary incentives include such things as recognition, the opportunity to be involved in decisions that impact their daily work, opportunities for learning and development, and work/life balance and flexibility. Since no two employees will be impacted in the same way, companies that have a variety of ways to reward employees allow their managers and supervisors to be flexible in their implementation of these rewards.

Ongoing Assessment and Modifications

The effectiveness of reward packages is impacted by internal and external factors and it is important for employers to continually monitor, evaluate and adjust their rewards and benefits packages to ensure that they continue to meet employees' needs. Changes in the competitive landscape, in the economy, in employee needs and in demographics can all impact how effectively existing packages meet employee needs. Ongoing assessment of both internal drivers and external environmental impacts can help ensure that companies' reward packages serve to drive retention in a positive way.

How do you make them feel?

Small things add up. Many decisions are made, at least partly, based on how an individual feels. Being proactive about giving compliments to employees and pointing out what they are doing right can help increase positive vibes at your workplace. Looking for win-win solutions in conflict situations also helps promote positive feelings. Take the time to form meaningful relationships and connect with others.

Encourage Work-Life Balance

Offer flexible working arrangements, such as telecommuting. Even allowing telecommuting one day a week goes a long way in promoting positive retention rates. However, make sure that whatever options for flexibility you provide are distributed fairly among employees.

Offer horizontal mobility and training

People specialize in a wide variety of skills. Offer some form of continued training that increases an employee's ability to achieve greater horizontal and vertical mobility. If someone is getting bored with his job, finding a way that he can contribute in a different department, while still using the skills in his current department, helps retention.

Benefits

Offer competitive benefits packages which best fit the needs of the employee. Think about a specific type of pension plan that is competitive with what other similar companies are offering. Also consider health and life insurance premiums that are reasonable.

Perks

Bring in bagels or donuts once a week. Find ways to include environmental stewardship such as incentives for carpooling or riding a bicycle. Some businesses offer reduced gym membership fees or have a gym on site where employees can work out while on the clock.

Effective Steps to Retain the Employees

Retaining your workforce requires consistent effort. Once you attract and bring that great new employee on board, the last thing you want to do is lose him to a competitor. For optimal success, write a retention plan that addresses events throughout the employee life-cycle. Influencing whether your employees to stay or leave begins with initial recruiting.

1. Recruit with integrity. The key to recruiting an employee who stays is selling them an accurate picture of your business. Resist promising what is not real. A new employee who feels lied to is more likely to leave.
2. Develop a hiring process that explains your company value proposition. Make sure employees who manage the hiring process can communicate reasons to join and

stay. Keep the hiring process high-touch (lots of contact), and treat your candidate with respect.

3. Implement an orientation process for employees with the end goal of retention. To combat early attrition, space orientation activities over the first month and require frequent manager and employee one-on-one meetings. Effective employee orientation promotes retention.

4. Create training programs that place the new employee in key meetings, in interactions with key players, and that provides her with the tools necessary to do the job. To reduce attrition, provide early opportunities for trial and error in a supportive environment.

5. Provide mentorship for your new employee. Train mentors to demonstrate passion for their work. Strong mentors are key to effective employee-retention plans.

6. Engage in fair evaluation processes. If the new employee's first evaluation experience is poor, she will begin to question her value to the business. Key to an effective evaluation process is delivery of feedback that is not just manager to employee but is also employee to manager.

7. Manage the employee departure process well. Even if you do everything right, some employees will need to leave. Exit interview processes need to encourage honesty. Share exit data in aggregate form to the whole organization, and openly work to combat problem areas. If an employee feels respect on his way out, he will certainly share that feeling with people still employed by you.

Self Assessment Questions

1. Explain the meaning of fringe benefits. Enlist their features
2. Discuss the factors that determine the benefits practices followed by organizations
3. How are benefits classified? Discuss
4. Discuss some of the current practices in the field of fringe benefits management, in brief
5. Describe the innovation taking place in the field of fringe benefits
6. Define Compensation Planning
7. What is compensation planning? What are the steps involved in compensation planning?
8. Differentiate traditional compensation planning with modern compensation planning

9. What are the different methods of compensation planning available?
10. Bring out the steps involved in compensation planning
11. Prepare the compensation planning statement for the IT firm.
12. Bringout the significance of compensation planning and point out the problems encountered during the compensation planning process.
13. Define base pay system
14. Bring out the different types of pay system
15. Why companies of different pay system. What are the advantages of it?
16. Bring out the different steps involved in development of base pay system
17. Differentiate basic rate system of pay and incentive schemes of pay.
18. Enumerate the different steps involved in installing pay system
19. What the pay objectives related points to be considered in pay system evolution
20. Bring out the steps involved in base pay development
21. Develop a base pay system for an automobile company and evaluate its strength and weakness.
22. Define employees retention
23. Describe the different reasons for employees switch over
24. Enumerate the different components of overall retention strategy of a company
25. What are the steps company take to retain the employees
26. Bring out the strategic steps adopt by the companies in retaining the best talent.
27. Explain the potential reason for employees' turnover and bring out the different reasons for employees turnover.
28. Bring out the successful retention strategies adopts by companies in these days to retain the employees
29. What are the motivational tips manager can adopt to retain the employees.
30. How can you link compensation as best tool to retain the employees
31. Can compensation be used as strategy to retain the employees? - Explain

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UNIT - III

Unit Structure

Lesson 3.1 - Wage Theories

Learning Objectives

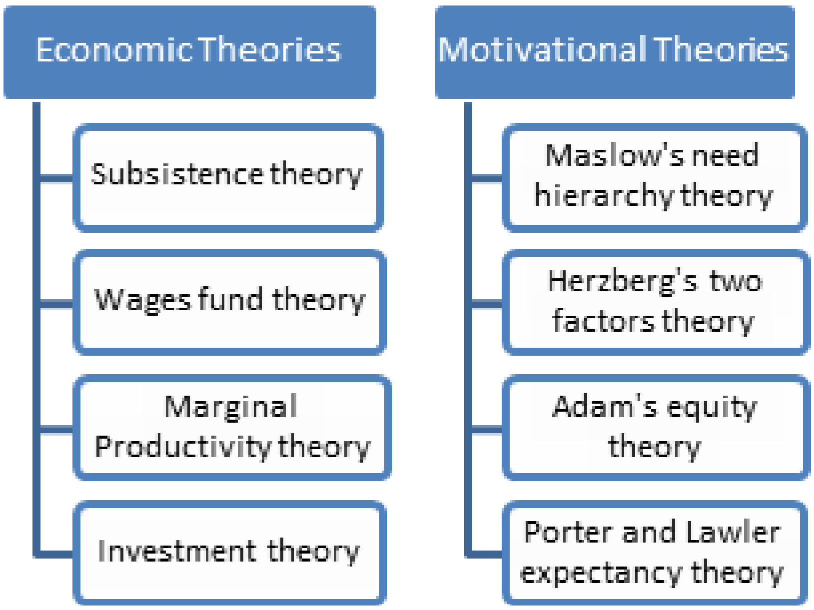
After reading this chapter you should be able to:

- Know Wage Theories
- Understand Different types of Wage Theories
- Find out the Advantages of different types of Wage Theories
- Find out the Disadvantages of different types of Wage Theories
- Examine Criticism made against of Wage Theories

Introduction

Labour is an important factor and also a peculiar factor of production. Among all factors labour alone perishable and inseparable from the labourer. At any time, the landlord may withhold the supply of land or the capitalist may withhold supply of capital but the labourer is forced to sell labour at whatever price is available in the market. Because of this peculiarity, there is always a danger that the labour shall get less than what is actually due to him. It is on account of this important aspect of wage determination that from the very early times economists have formulated theories explaining the determination of wages. There are many theories of wages, but most of them are either wrong, or insufficient to explain the rate of wages. A consideration of the earlier theories in spite of their defects and shortcomings will help us in properly comprehending easily the explanation of wages by modern economists. A theory is a generalization that expresses relationship between facts. Compensation theories attempt to explain the magnitude and composition of the reward packages and its impact upon the behavior of the employees. To be meaningful and practically useful, a theory must address specific and important questions. Two distinct branches of compensation theories are

i) Economic wage theories and
ii) Motivation theories.



Wage Theories

Economic Theories

The Central Questions of a Wage Theory

There are three types of questions which a wage theory attempts to answer. These are discussed below:

➢ ***Wage Level Related Questions?***

What determines the general wage level or causes it to be what it is? General wage level is defined as an average, or some measure of central tendency, of wage rates for some given universe. The wage level in question may be for a job, an occupation, an establishment, a plant, a firm, an industrial grouping, or an entire country.

- ***Wage Structure Questions?***

The theory attempts to generalize what determines the wage structure? A wage structure has been defined as a hierarchy of jobs, for some defined universe, to which wage rates have been attached.

- ***Variations in Wage Rates and Structures:?***

Why do wage rates and structures vary widely between nations, firms industries and geographic regions?

The Subsistence Theory of Wages

This theory was formulated by the French economists Physicorates later elaborated by David Ricardo Lassale called this theory as iron law of wages. This theory is based on two assumptions namely

i) The law of diminishing return applies to industry
ii) There is a rapid increase in population

Analysis of the Theory

The theory stated that the wages of labour always remained at the subsistence level. Just the normal value of a commodity under free competition is determined by its cost of production, so value of commodity 'labour' is determined by its cost of production. This theory meant that the minimum subsistence are required for the support of the labourer and that of his family in order to expense a continuous supply of labour.

According to the theory, the labourer should be paid just enough to live and perpetuate his clan. The theory quotes if wages exceeded the minimum subsistence level, population would increase and with it supply of labour, until wages were again at bare subsistence level. If on the other hand, wages fell below the level there would be a reduction in population and therefore in the supply of labour, until wages were raised to the subsistence level. Thus the theory is closely associated with the doctrine of Malthusian over population.

Criticism Against the Theory

- There is no reason why a labourer should increase the number of children in his family if he gets a higher wages. It would be more natural for the labourer to think of improving his standard of living instead of increasing the number. The standard of living when once improved will powerfully influence the rate of wages in future.
- If the subsistence theory was accepted, the wages of all labourers, assuming the each has an equally big family to support, would be more or less equal. But in practice we find it is not so. More efficient labourers get higher than less efficient. The theory is too pessimistic and does not contemplate about the role of efficiency in determining wages.
- It is absurd to imagine that the labour population would increase if the wage rate were increased above subsistence. The former is a long-term phenomenon, while the change in wage rate is a short-term phenomenon.
- The theory considered only the supply side of labour, but not the demand side. Even taking the analogy of general theory of value, the positive role is played by demand and the supply gets adjusted. The former is a long phenomenon, while the change rate is a short-term phenomenon.
- Any way the theory contains an element of truth as it indicates that wages cannot fall below a certain minimum level.

Wage Fund Theory

Introduced by John Stuart Mill (1891), this theory assumes that there is a fixed wages fund (Lump Sum) which is distributed equally among all the labourers. In other words:

$$\text{Wage level per worker} = \frac{\text{Wage Fund (a fixed sum in the short-run)}}{\text{No. of Labourers}}$$

Thus, if the fund is large, wages would be high, if it is small wages would be reduced to the subsistence level. The demand for labour and the wages that could be paid are determined by the size of the fund.

J.S. Mill said that wages mainly depend upon the demand and supply of labour or the proportion between population and capital available. The amount of Wages Fund is fixed.

Wages cannot be increased without decreasing the number of workers and vice versa. It is the wages fund which determines the demand for labour. However, the supply of labour cannot be changed at a given time. But if the supply of labour increases along with increase in population, the average wages will go down. Therefore, in order to increase the average wages, firstly, the wages fund should be enlarged, secondly, the number of workers asking for employment should be reduced.

Analysis of the Theory

- It puts more emphasis on demand of labour (wages fund) compared to the supply of labour
- It attempts to study wage level in the short-term. It tried to take into account long-run too by suggesting wage fund might grow or shrink in the long run but that was not the focal point of the theory.
- The theory generalizes about the general level of wages for an entire economic system, however it can be applied to an employer.
- Just like subsistence theory, this theory also attempts to answer the question of wage level and not of wage structure and differentials. The reasons may be that they were developed during the time when economies, even of America and Europe were agrarian.
- In the short run, many organizations, particularly those in the public sector, do allocate a fixed run for payment of wages. However, critics argue that the assumption of a fixed sun itself is wrong as the sum can be increased. Even J.S.Mill also accepted this criticism.

Criticism Against the Theory

- The wage fund theory is criticized on the following grounds:
- It is not clear from where the wages fund will come
- No emphasis has been given to the efficiency of workers and productive capacity of firms
- This theory is unscientific as wages fund is created first and wages are determined later on. But, in practice, the reverse is true.
- This theory does not explain differences in wages at different levels and in different regions

- This theory is more applicable to pure agrarian society where the gap between two crops is too big. Now as labour has moved to manufacturing and there is a move to pay for performance, it is possible to pay workers out of the surplus of current operations also.

Marginal Productivity Theory of Wages

The general theory of distribution has been extended to wages and this has come to be known a marginal productivity theory of wages. The theory as has been studied assumes certain conditions to enumerate the concept of marginal productivity. This theory was developed by Phillips Henry Wicksteed (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 workers. In other words, it assumes that wages depend upon the demand and supply of labour.

Consequently, workers are paid what they are economically worth. The result is that the employer has a larger share in profit as he has not to pay o the non-marginal workers. As long as each additional worker contributes more to the total value than the cost or wages, it pays the employer to continue hiring. Where this becomes uneconomic, the employer may resort to superior technology. It is said to be the most highly perfected and logically contributed theory of wages. As it is based on economics, this remains the best theory to explain the long-run wage levels of an economic system as well as understanding of short-run wage determination within the firm.

It is based on the assumptions of a perfect economy which are as under.

- Homogeneous factors of production
- Multiplicity of buyers and sellers- so many that no one can control supply and demand
- Certain fixed factors of production
- Perfect knowledge
- Full employment of all the resources
- Perfect knowledge
- Full employment of all the resources
- Perfect mobility f the factors of production
- Profit maximization as the guiding force
- Law of diminishing returns

Analysis of the Theory

- It is totally emphasized demand for labour and supply of labour has not received its due importance
- It was developed making assumptions about a firm operating in short-run. However, it has been refined and has greater usefulness when applied to long run problems.
- The theory can be used for the study of both for the micro as well as macro level. When factors of production are presumed to be constant, it is applicable at micro level; when all the factors can be increased or decreased, it becomes operational at macro level.
- Just like subsistence theory and wages fund theory, this theory also attempts to answer the question of "wages level" only.
- This theory focuses on productivity and productivity is undoubtedly a crucially important concept to practitioners.

Criticism Against the Theory

- In practice, the employers offer wages less than the marginal productivity of labour. In many cases, the labour unions are able to bargain for wages higher than the marginal productivity of labour.
- This theory is based on perfect competition in the market which is seldom found in practice
- It is wrong to assume that more labour could be used without increasing the supply of production facilities.

Investment Theory of Wages

This theory has developed by Gilelman for the replacement of marginal productivity theory. Whereas marginal productivity theory focuses on the output of labour, investment theory concentrates on labour inputs, another side of the same coin. The theory proposes that the productivity of an individual employee is a function of his personal attributes with which his labour is combined. Workers attributes include values, personality, and physical abilities.

In a sense, however, these attributes are reflected in education, training, and experience. Highly motivated, emotionally mature and energetic individuals are essentially investments in productivity. The larger the investments possessed by workers, the wider the geographic scope of the labour market in which he has a potential to participate. So he is highly mobile. Wages are related to mobility potential.

Analysis of the Theory

- It focuses both on the supply of and the demand for labour. It emphasizes worker's investment in productivity
- Its emphasis is on short-run
- It emphasizes the micro aspect
- It tries to answer wage structure as well as the wage level
- If wages are assumed to be a return on investment, logically one would assume that the larger the investment, the higher the wage. However, in practice, this will not be true always s employees seek a number of other satisfaction from job, income being only one of them.

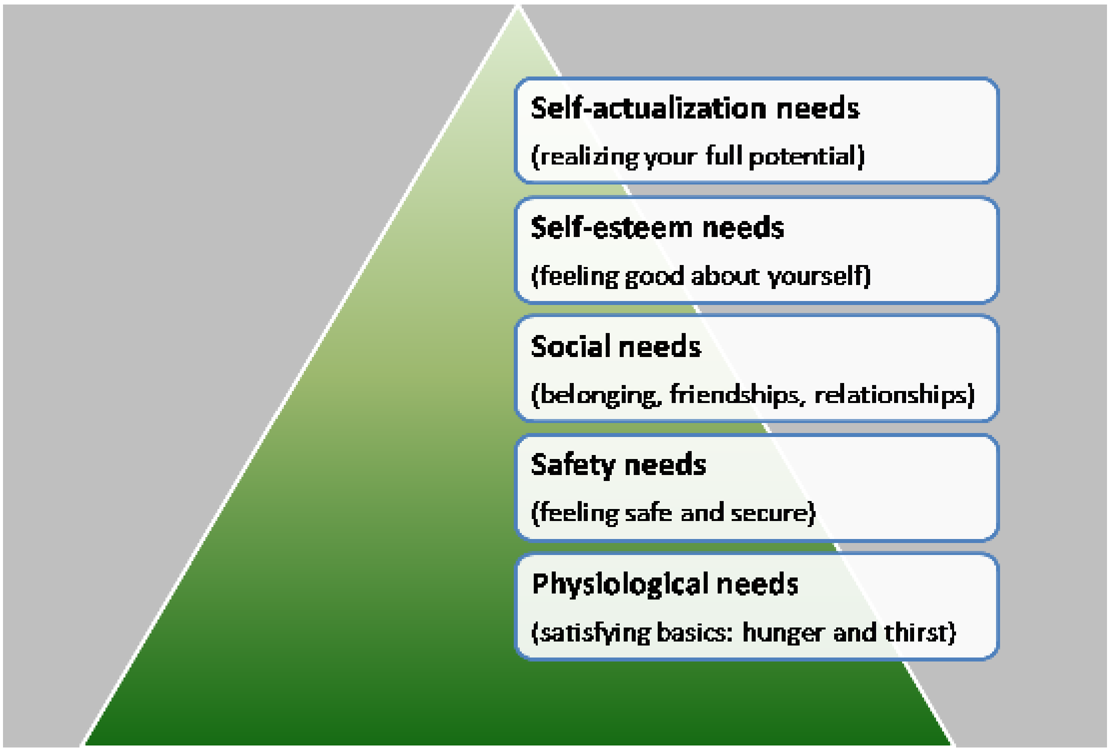
Further, the wage decisions are influenced by the organization's policy in regard to job design, employment and lay-off as these factors affect profitability of the organization and its ability to pay. Generally stated, employment (demand for labour) is a function primarily of the demand for output and only several times removed it is a function of wages as wages affect costs, costs –prices – demand- employment. Despite its limitations, the theory can be tested empirically and has great value for the practitioners.

Motivational Theories

1.Maslow's Motivational Theory

Abraham Maslow is considered to be the father of Humanistic Psychology, also known as the "Third Force". Humanistic Psychology incorporates aspects of both Behavioral Psychology and Psychoanalytic Psychology. Behaviorists believe that human behavior is controlled by external environmental factors. Psychoanalytic Psychology is based on the idea that human behavior is controlled by internal unconscious forces. Though he studied both Behavioral and Psychoanalytic Psychologies, Maslow rejected the idea that human behavior is controlled by only internal or external forces. Instead, Maslow's motivation theory states that man's behavior is controlled by both internal and external factors. In addition he emphasizes that humans have the unique ability to make choices and exercise free-will.

Maslow showed little interest in animal or laboratory studies of human behavior. He chose instead to collect data for his theories by studying outstanding individuals. His studies led him to believe that people have certain needs which are unchanging and genetic in origin. These needs are the same in all cultures and are both physiological and psychological. Maslow described these needs as being hierarchal in nature, meaning that some needs are more basic or more powerful than others and as these needs are satisfied, other higher needs emerge.



Maslow's Motivational Theory

Maslow Motivation Theory: the Hierarchy of Needs

The Maslow motivation theory is typically represented by 5 steps:

- **Physiological needs** - such as hunger, thirst and sleep
- **Safety needs** - such as security, protection from danger and freedom from pain.
- **Social needs** - sometimes also referred to as love needs such as friendship, giving and receiving love, engaging in social activities and group membership.
- **Esteem needs** - these include both self-respect and the esteem of others. For example, the desire for self-confidence and achievement, and recognition and appreciation.

- **Self-actualization** - This is about the desire to develop and realize your full potential. To become everything you can be.

Maslow's Hierarchy of Needs

Maslow believed that human beings have a strong desire to reach their full potential. In his own words:

"A man's desire for self-fulfillment, namely the tendency for him to become actually in what he is potentially: to become everything that one is capable of being…."

Understanding Maslow's Needs Hierarchy

To understand Maslow's thinking it's worth noting some of his main assertions:

- Broadly, as one set of needs is met, the next level of needs become more of a motivator to an individual.
- A satisfied need is not a motivator.
- Only unsatisfied needs motivate an individual. We have an innate desire to work our way up the hierarchy, pursuing satisfaction in higher order needs.
- Self-actualization stimulates a desire for more due to what Maslow explained as "peak experiences".

2. Herzberg›s Motivation-Hygiene Theory (Two Factor Theory)

To better understand employee attitudes and motivation, Frederick Herzberg performed studies to determine which factors in an employee's work environment caused satisfaction or dissatisfaction. He published his findings in the 1959 book The Motivation to Work. The studies included interviews in which employees where asked what pleased and displeased them about their work.

Herzberg found that the factors causing job satisfaction (and presumably motivation) were different from those causing job dissatisfaction. He developed the motivation-hygiene theory to explain these results. He called the satisfiers motivators and the dissatisfies hygiene factors, using the term "hygiene" in the sense that they are considered maintenance factors that are necessary to avoid dissatisfaction but that by themselves do not provide satisfaction. The following table presents the top six factors causing dissatisfaction and the top six factors causing satisfaction, listed in the order of higher to lower importance.

Factors Affecting Job Attitudes

Leading to Dissatisfaction	Leading to Satisfaction
➢ Company policy	➢ Achievement
➢ Supervision	➢ Recognition
➢ Relationship w/Boss	➢ Work itself
➢ Work conditions	➢ Responsibility
➢ Salary	➢ Advancement
➢ Relationship w/Peers	➢ rowth

Herzberg reasoned that because the factors causing satisfaction are different from those causing dissatisfaction, the two feelings cannot simply be treated as opposites of one another. The opposite of satisfaction is not dissatisfaction, but rather, no satisfaction. Similarly, the opposite of dissatisfaction is no dissatisfaction. While at first glance this distinction between the two opposites may sound like a play on words, Herzberg argued that there are two distinct human needs portrayed. First, there are physiological needs that can be fulfilled by money, for example, to purchase food and shelter. Second, there is the psychological need to achieve and grow, and this need is fulfilled by activities that cause one to grow. From the above table of results, one observes that the factors that determine whether there is dissatisfaction or no dissatisfaction are not part of the work itself, but rather, are external factors. Herzberg often referred to these hygiene factors as "KITA" factors, where KITA is an acronym for Kick In The A..., the process of providing incentives or a threat of punishment to cause someone to do something. Herzberg argues that these provide only short-run success because the motivator factors that determine whether there is satisfaction or no satisfaction are intrinsic to the job itself, and do not result from carrot and stick incentives.

Implications for Management

If the motivation-hygiene theory holds, management not only must provide hygiene factors to avoid employee dissatisfaction, but also must provide factors intrinsic to the work itself in order for employees to be satisfied with their jobs. Herzberg argued that job enrichment is required for intrinsic motivation, and that it is a continuous management process. According to Herzberg:

- The job should have sufficient challenge to utilize the full ability of the employee.
- Employees who demonstrate increasing levels of ability should be given increasing levels of responsibility.

- If a job cannot be designed to use an employee's full abilities, then the firm should consider automating the task or replacing the employee with one who has a lower level of skill. If a person cannot be fully utilized, then there will be a motivation problem.

Critics of Herzberg's theory argue that the two-factor result is observed because it is natural for people to take credit for satisfaction and to blame dissatisfaction on external factors.

Furthermore, job satisfaction does not necessarily imply a high level of motivation or productivity. Herzberg's theory has been broadly read and despite its weaknesses its enduring value is that it recognizes that true motivation comes from within a person and not from KITA factors.

3. Adams' Equity Theory

John Stacey Adams, a workplace and behavioral psychologist, put forward his Equity Theory on job motivation in 1963. There are similarities with Charles Handy's extension and interpretation of previous simpler theories of Maslow, Herzberg and other pioneers of workplace psychology, in that the theory acknowledges that subtle and variable factors affect each individual's assessment and perception of their relationship with their work, and thereby their employer.

However, awareness and cognizance of the wider situation - and crucially comparison - feature more strongly in Equity Theory than in many other earlier motivational models.

The Adams' Equity Theory model therefore extends beyond the individual self, and incorporates influence and comparison of other people's situations - for example colleagues and friends - in forming a comparative view and awareness of Equity, which commonly manifests as a sense of what is fair.

When people feel fairly or advantageously treated they are more likely to be motivated; when they feel unfairly treated they are highly prone to feelings of disaffection and de-motivation. The way that people measure this sense of fairness is at the heart of Equity Theory.

Equity, and thereby the motivational situation we might seek to assess using the model, is not dependent on the extent to which a person believes reward exceeds effort, nor even necessarily on the belief that reward exceeds effort at all. Rather, Equity, and the sense of fairness which commonly underpins motivation, is dependent on the comparison a person makes between his or her reward/investment ratio with the ratio enjoyed (or suffered) by others considered to be in a similar situation.

Adams called personal efforts and rewards and other similar 'give and take' issues at work respectively 'inputs' and 'outputs'.

- Inputs are logically what we give or put into our work. Outputs are everything we take out in return.
- These terms help emphasize that what people put into their work includes many factors besides working hours, and that what people receive from their work includes many things aside from money.
- Adams used the term 'referent' others to describe the reference points or people with whom we compare our own situation, which is the pivotal part of the theory.
- Adams Equity Theory goes beyond - and is quite different from merely assessing effort and reward. Equity Theory adds a crucial additional perspective of comparison with 'referent' others (people we consider in a similar situation).

Equity theory thus helps explain why pay and conditions alone do not determine motivation.

In terms of how the theory applies to work and management, we each seek a fair balance between what we put into our job and what we get out of it. But how do we decide what is a fair balance?

The answer lies in Equity Theory. Importantly we arrive at our measure of fairness - Equity - by comparing our balance of effort and reward, and other factors of give and take - the ratio of input and output - with the balance or ratio enjoyed by other people, whom we deem to be relevant reference points or examples ('referent' others).

Crucially this means that Equity does not depend on our input-to-output ratio alone - it depends on our comparison between our ratio and the ratio of others.

We form perceptions of what constitutes a fair ratio (a balance or trade) of inputs and outputs by comparing our own situation with other 'referents' (reference points or examples) in the market place as we see it.

In practice this helps to explain why people are so strongly affected by the situations (and views and gossip) of colleagues, friends, partners etc., in establishing their own personal sense of fairness or equity in their work situations.

Adams' Equity Theory is therefore a far more complex and sophisticated motivational model than merely assessing effort (inputs) and reward (outputs).

The actual sense of equity or fairness (or inequity or unfairness) within Equity Theory is arrived at only after incorporating a comparison between our own input and output ratio with the input and output ratios that we see or believe to be experienced or enjoyed by others in similar situations.

This comparative aspect of Equity Theory provides a far more fluid and dynamic appreciation of motivation than typically arises in motivational theories and models based on individual circumstance alone.

For example, Equity Theory explains why people can be happy and motivated by their situation one day, and yet with no change to their terms and working conditions can be made very unhappy and de-motivated, if they learn for example that a colleague (or worse an entire group) is enjoying a better reward-to-effort ratio.

It also explains why giving one person a promotion or pay-rise can have a de-motivating effect on others.

Note also, importantly, that what matters is the ratio, not the amount of effort or reward per se.

This explains for example why and how full-time employees will compare their situations and input-to-output ratios with part-time colleagues, who very probably earn less, however it is the ratio of input-to-output - reward-to-effort - which counts, and if the part-timer is perceived to enjoy a more advantageous ratio, then so this will have a negative effect on the full-timer's sense of Equity, and with it, their personal motivation.

Remember also that words like efforts and rewards, or work and pay, are an over-simplification - hence Adams' use of the terms inputs and outputs, which more aptly cover all aspects of what a person gives, sacrifices, tolerates, invests, etc., into their work situation, and all aspects of what a person receives and benefits from in their work and wider career, as they see it.

Inputs	Equity dependent on comparing own ratio of input/output with ratios of 'referent' others	Outputs
Inputs are typically: effort, loyalty, hard work, commitment, skill, ability, adaptability, flexibility, tolerance, determination, heart and soul, enthusiasm, trust in our boss and superiors, support of colleagues and subordinates, personal sacrifice, etc.	People need to feel that there is a fair balance between inputs and outputs. Crucially fairness is measured by comparing one's own balance or ratio between inputs and outputs, with the ratio enjoyed or endured by relevant ('referent') others.	Outputs are typically all financial rewards - pay, salary, expenses, perks, benefits, pension arrangements, bonus and commission - plus intangibles - recognition, reputation, praise and thanks, interest, responsibility, stimulus, travel, training, development, sense of achievement and advancement, promotion, etc.

If we feel are that inputs are fairly rewarded by outputs (the fairness benchmark being subjectively perceived from market norms and other comparable references) then generally we are happier in our work and more motivated to continue inputting at the same level.

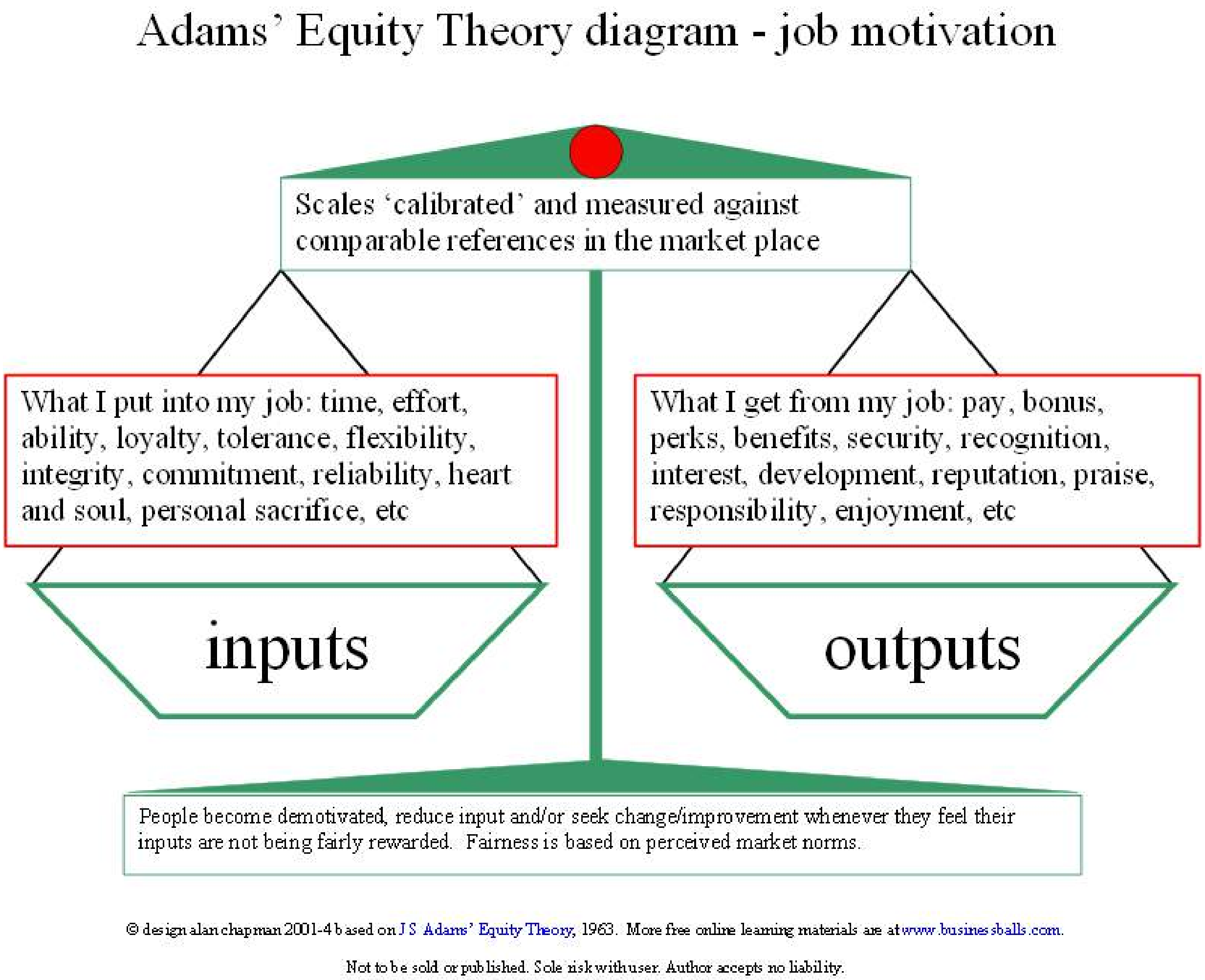
If we feel that our ratio of inputs to outputs is less beneficial than the ratio enjoyed by referent others, then we become de-motivated in relation to our job and employer.

People respond to a feeling of inequity in different ways. Generally the extent of de-motivation is proportional to the perceived disparity with other people or inequity, but for some people just the smallest indication of negative disparity between their situation and other people's is enough to cause massive disappointment and a feeling of considerable injustice, resulting in de-motivation, or worse, open hostility.

Some people reduce effort and application and become inwardly disgruntled, or outwardly difficult, recalcitrant or even disruptive. Other people seek to improve the outputs by making claims or demands for more reward, or seeking an alternative job.

Understanding Equity Theory - and especially its pivotal comparative aspect - helps managers and policy-makers to appreciate that while improving one person's terms and conditions can resolve that individual's demands (for a while), if the change is perceived by other people to upset the Equity of their own situations then the solution can easily generate far more problems than it attempted to fix.

Equity Theory reminds us that people see themselves and crucially the way they are treated in terms of their surrounding environment, team, system, etc - not in isolation - and so they must be managed and treated accordingly.



Adams' Equity Theory:

4. Expectancy Theory

Expectancy theory proposes that a person will decide to behave or act in a certain way because they are motivated to select a specific behavior over other behaviors due to what they expect the result of that selected behavior will be. In essence, the motivation of the behavior selection is determined by the desirability of the outcome. However, at the core of the theory is the cognitive process of how an individual processes the different motivational elements. This is done before making the ultimate choice. The outcome is not the sole determining factor in making the decision of how to behave. Expectancy theory is about the mental processes regarding choice, or choosing. It explains the processes that an individual undergoes to make choices. In the study of organizational behavior, expectancy theory is a motivation theory first proposed by Victor Vroom of theYale School of Management. This theory emphasizes the needs for organizations to relate rewards directly to performance and to ensure that the rewards provided are those rewards deserved and wanted by the recipients. Victor H. Vroom (1964) defines motivation as a process governing choices among alternative forms of voluntary activities, a process controlled by the individual. The individual makes choices based on estimates of how well the expected results of a given behavior are going to match up with or eventually lead to the desired results. Motivation is a product of the individual's expectancy that a certain effort will lead to the intended performance, the instrumentality of this performance to achieving a certain result, and the desirability of this result for the individual, known as valence.

Key Elements

The Expectancy Theory of Motivation explains the behavioral process of why individuals choose one behavioral option over another. It also explains how they make decisions to achieve the end they value. Vroom introduces three variables within the expectancy theory which are valence (V), expectancy (E) and instrumentality (I). The three elements are important behind choosing one element over another because they are clearly defined: effort-performance expectancy (E>P expectancy), performance-outcome expectancy (P>O expectancy).

Three components of Expectancy theory: Expectancy, Instrumentality, and Valence

1. Expectancy: Effort → Performance (E→P)
2. Instrumentality: Performance → Outcome (P→O)
3. Valence- V(R)

***Expectancy: Effort → Performance* (E→P)**

Expectancy is the belief that one's effort (E) will result in attainment of desired performance (P) goals. Usually based on an individual's past experience, self-confidence (self efficacy), and the perceived difficulty of the performance standard or goal. Factors associated with the individual's Expectancy perception are self efficacy, goal difficulty, and control. Self efficacy is the person's belief about their ability to successfully perform a particular behavior. Goal difficulty happens when goals are set too high or performance expectations that are made too difficult are most likely to lead to low expectancy perceptions. Control is one's perceived control over performance. In order for expectancy to be high, individuals must believe that they have some degree of control over the expected outcome.

***Instrumentality: Performance → Outcome* (P→O)**

Instrumentality is the belief that a person will receive a reward if the performance expectation is met. This reward may come in the form of a pay increase, promotion, recognition or sense of accomplishment. Instrumentality is low when the reward is the same for all performances given. Factors associated with the individual's instrumentality for outcomes are trust, control and policies. If individuals trust their superiors, they are more likely to believe their leaders promises. When there is a lack of trust in leadership, people often attempt to control the reward system.

When individuals believe they have some kind of control over how, when, and why rewards are distributed, Instrumentality tends to increase. Formalized written policies impact the individuals' instrumentality perceptions. Instrumentality is increased when formalized policies associates rewards to performance.

Valence*- *V(R)

Valence: the value the individual places on the rewards based on their needs, goals, values and Sources of Motivation. Factors associated with the individual's valence for outcomes are values, needs, goals, preferences and Sources of Motivation Strength of an individual's preference for a particular outcome.

The valence refers the value the individual personally places on the rewards. -1 →0→ +1

-1= avoiding the outcome 0= indifferent to the outcome +1=welcomes the outcome

In order for the valence to be positive, the person must prefer attaining the outcome to not attaining it.

Expectancy Theory of motivation can help managers understand how individuals make decisions regarding various behavioral alternatives. The model below shows the direction of motivation, when behavior is energized:

Motivational Force (MF) = Expectancy x Instrumentality x Valence

When deciding among behavioral options, individuals select the option with the greatest motivational force (MF). Expectancy and instrumentality are attitudes (cognitions) that represent an individual's perception of the likelihood that effort will lead to performance that will lead to the desired outcomes. These perceptions represent the individual's subjective reality, and may or may not bear close resemblance to actual probabilities. These perceptions are tempered by the individual's experiences (learning theory), observations of others (social learning theory), and self-perceptions. Valence is rooted in an individual's value system. One example of how this theory can be applied is related to evaluating an employee's job performance. One's performance is a function of the multiplicative relationship between one's motivation and ability [P=f (M*A)] Motivation can be expressed as [M=f (V*E)], or as a function of valence times expectancy. In layman's terms, this is how much someone is invested in something along with how probable or achievable the individual believes the goal is.

Victor Vroom's expectancy theory is one such management theory focused on motivation. According to Holdford and Lovelace-Elmore (2001, p. 8), Vroom asserts, "Intensity of work effort depends on the perception that an individual's effort will result in a desired outcome". Vroom suggests that "for a person to be motivated, effort, performance and motivation must be linked" (Droar, 2006, p. 2). Three factors direct the intensity of effort put forth by an individual, according to Vroom; expectancy, instrumentality, and preferences (Holdford and Lovelace-Elmore, 2001).

In order to enhance the performance-outcome tie, managers should use systems that tie rewards very closely to performance. Managers also need to ensure that the rewards provided are deserved and wanted by the recipients. In order to improve the effort-performance tie, managers should engage in training to improve their capabilities and improve their belief that added effort will in fact lead to better performance.

- Emphasizes self-interest in the alignment of rewards with employee's wants.
- Emphasizes the connections among expected behaviors, rewards and organizational goals

Expectancy Theory, though well known in work motivation literature, is not as familiar to scholars or practitioners outside that field.

Computer Users

Lori Baker-Eveleth and Robert Stone, University of Idaho, conducted an empirical study on 154 faculty members' behavioral intentions/responses to use of new software. The antecedents with previous computer experience ease of the system, and administrator support for they are linked to behavioral intentions to use the software through self-efficacy and outcome expectancy. Self-efficacy and outcome expectancy impacts a person's effect and behavior separately. Self-efficacy is the belief a person has that they possess the skills and abilities to successfully accomplish something.

Outcome expectancy is the belief a person has when they accomplish the task, a desired outcome is attained. Self-efficacy has a direct impact on outcome expectancy and has a larger effect than outcome expectancy. Employees will accept technology if they believe the technology is a benefit to them. If an employee is mandated to use the technology, the employees will use it but may feel it is not useful. On the other hand, when an employee is not mandated, the employee may be influenced by other factors that it should be used.

The self-efficacy theory can be applied to predicting and perceiving an employee's belief for computer use (Bandura, 1986; Bates & Khasawneh, 2007). This theory associates an individual's cognitive state affective behavioral outcomes (Staples, Hulland, & Higgins, 1998). Motivation, performance, and feelings of failure are examples of self-efficacy theory expectations. The following constructs of the self-efficacy theory that impact attitudes and intentions to perform: past experience or mastery with the task, vicarious experience performing the task, emotional or physiological arousal regarding the task, and social persuasion to perform the task.

Models of Teacher Expectancy Effects

Jere Brophy and Thomas Good (1970, 1974) provided a comprehensive model of how teacher expectations could influence children's achievement. Their model posits that teachers' expectations indirectly affect children's achievement: "teacher expectations could also affect student outcomes indirectly by leading to differential teacher treatment of students that would condition student attitudes, expectations, and behavior" (Brophy, 1983, p. 639). The model includes the following sequence. Teachers form differential expectations for students early in the school year. Based on these expectations, they behave differently toward different students, and as a result of these behaviors the students begin to understand what the teacher expects from them. If students accept the teachers' expectations and behavior toward them then they will be more likely to act in ways that confirm the teacher's initial expectations. This process will ultimately affect student achievement so that teachers' initial expectancies are confirmed.

In discussing work related to this model, Brophy (1983) made several important observations about teacher expectation effects. First and foremost, he argued that most of the beliefs teachers hold about student are accurate, and so their expectations usually reflect students' actual performance levels. As a result, Brophy contended that self-fulfilling prophecy effects have relatively weak effects on student achievement, changing achievement 5% to 10%, although he did note that such effects usually are negative expectation effects rather than positive effects. Second, he pointed out that various situational and individual difference factors influence the extent to which teacher expectations will act as self-fulfilling prophecies. For instance, Brophy stated that expectancy effects may be larger in the early elementary grades, because teachers have more one-on-one interactions with students then, as they attempt to socialize children into the student role. In the upper elementary grades more whole-class teaching methods are used, which may minimize expectation effects. Some evidence supports this claim; expectancy effects in Rosenthal and Jacobson's (1968) study were strongest during the earlier grades. Raudenbush's (1984) meta-analysis of findings from different teacher expectancy studies in which expectancies were induced by giving teachers artificial information about children's intelligence showed that expectancy effects were stronger in Grades 1 and 2 than in Grades 3 through Grade 6, especially when the information was given to teachers during the first few weeks of school. These findings are particularly relevant because they show a form of the expectancy theory and how teachers have certain expectations of students and how they treat the students differently because of those expectations.

Criticisms

- Some of the critics of the expectancy model were Graen (1969) Lawler (1971), Lawler and Porter (1967), and Porter and Lawler (1968). Their criticisms of the theory were based upon the expectancy model being too simplistic in nature; these critics started making adjustments to Vroom's model.

- Edward Lawler claims that the simplicity of expectancy theory is deceptive because it assumes that if an employer makes a reward, such as a financial bonus or promotion, enticing enough, employees will increase their productivity to obtain the reward. However, this only works if the employees believe the reward is beneficial to their immediate needs. For example, a $2 increase in salary may not be desirable to an employee if the increase pushes her into a tax bracket in which she believes her net pay is actually reduced, which is actually impossible in the United States with marginal tax brackets. Similarly, a promotion that provides higher status but requires longer hours may be a deterrent to an employee who values evening and weekend time with his children.

- Lawler's new proposal for expectancy theory is not against Vroom's theory. Lawler argues that since there have been a variety of developments of expectancy theory since its creation in 1964; the expectancy model needs to be updated. Lawler's new model is based on four claims. First, whenever there are a number of outcomes, individuals will usually have a preference among those outcomes. Two, there is a belief on the part of that individual that their action(s) will achieve the outcome they desire. Three, any desired outcome was generated by the individual's behavior. Finally, the actions generated by the individual were generated by the preferred outcome and expectation of the individual.

- Instead of just looking at expectancy and instrumentality, W.F. Maloney and J.M. McFillen found that expectancy theory could explain the motivation of those individuals who were employed by the construction industry. For instance, they used worker expectancy and worker instrumentality. Worker expectancy is when supervisors create an equal match between the worker and their job. Worker instrumentality is when an employee knows that any increase in their performance leads to achieving their goal.

- In a chapter entitled "On the Origins of Expectancy Theory" published in Great Minds in Management by Ken G. Smith and Michael A. Hitt, Vroom himself agreed with some of these criticisms and stated that he felt that the theory should be expanded to include research conducted since the original publication of his book.

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Lesson 3.2 - Executive Compensation

Learning Objectives

After reading this chapter you should be able to:

- Define Executive Compensation
- Understand Components of Executive Compensation
- List different Executive Benefits and Perquisites
- Understand Executive Compensation as Psychological Compensation
- Designing Effective Executive Compensation

Introduction

The financial payments and non monetary benefits provided to high level management in exchange for their work on behalf of an organization. The types of employees that are typically paid with executive compensation packages include corporate presidents, chief executive officers, chief financial officers, vice presidents, managing directors and other senior executives.

A well-designed executive compensation plan focuses on a number of important objectives. It attracts and retains the talent necessary to lead complex organizations to success. It aligns the interests of executives with those of shareholders. It focuses the efforts of executives on achieving the organization's business goals, both short- and long-term. Finally, it provides programs that are regarded as credible and responsible by investors and other stakeholders, and that meet legal and regulatory requirements. While these objectives have not changed, the manner in which companies are achieving these objectives is evolving rapidly. This is unfolding in a context of growing demands for transparency and accountability. An organization developing an executive compensation program will improve its chances of success by following five approaches:

- First, define the organization's short- and long-term strategies, objectives and key measurements.
- Second, vest responsibility for executive compensation in a compensation committee consisting of independent board members.

- Third, take a total rewards perspective by looking at each component of the compensation program as part of a portfolio of provisions rather than stand-alone items.
- Fourth, establish the executive compensation portfolio to provide an appropriate allocation of base and variable (at risk) compensation, short- and long-term programs and performance incentives versus retention and attraction incentives. The optimal mix will vary by company.
- Fifth, make the program as simple as possible.

Performance Objectives and Measurements

All executive compensation programs and decisions should derive from the performance objectives and measurements of the participating executives. Traditionally, executives' performance measurements have been focused on hard financial metrics such as earnings-per-share, total shareholder returns, revenue and profit before tax. In recent years, there has been an increasing concern that an excessive focus on financial results will actually cause a decline, over time, in financial performance. The argument is that financial results are the result of doing everything else well. Executives should also be measured on that. Executive performance has normally been measured against the organization's pre-established targets. An emerging practice is to measure company performance, and reward executives based on the organization's performance relative to that of a designated group of similar companies (usually in the same industry). Since publicly available performance data from other companies is almost all financial in nature, so are comparative performance metrics.

Executive Benefits and Perquisites

Company practices on benefits and perquisites differ widely. The general trend is towards a reduction in special provisions for executives. For benefits, the most common practice is for companies to provide the standard insurance programs to their executives. Where the amount of a benefit provision is contingent on income (life or disability coverage, for example), some companies will adjust the standard maximums for coverage to reflect the higher levels of income that will need to be replaced in the event of the death or disability of an executive. Similarly, for companies with defined benefit pension programs,. Applying the standard income tax maximums for registered pension plans will result in executives exceeding the maximum benefit levels. Some companies will bridge this gap through supplemental executive retirement plans. These plans cannot be financed from a pension fund. Payouts are treated as regular business expenses. A large portion of executive compensation is based on incentive wards rather than salary. As a result, companies have to decide whether income-contingent benefits such as pensions should be calculated on the executive's salary only, or on salary and bonuses. Perks should be congruent with the company's desired culture. A hierarchical organization will tend to have more. A flatter, more egalitarian organization, or one with an active board or shareholders, will tend to minimize perks. Justifiable perks are usually related to the nature of the demands of the executive's job. For example, memberships in golf clubs, social clubs or business associations are sometimes provided for the purpose of customer meetings and networking.

Psychological Compensation

While compensation discussions tend to focus on financial provisions, a total rewards approach also looks at non-financial or psychological compensation. This is directed at more intrinsic motivators. An executive's psychological compensation is most likely to come from the characteristics of his or her work environment or individual nature. Examples include congruence between work and values, degree of autonomy, relationships with peers and more senior executives or board members, relationships with the people they lead, the opportunity for visible achievement and public recognition, intellectual and professional challenge and the ability to have an impact outside the company by being involved in charitable, educational, public policy or other community endeavors. In summary, executive compensation has become a subject of considerable public scrutiny.

The result has been a marked improvement in transparency and accountability, compensation program design and governance. Boards and compensation consultants are becoming more creative in developing incentive programs tailored tore ward specific individual performance and behaviors. The prerequisite for an effective executive compensation program is a clear understanding and definition of the organization's business objectives, performance drivers and performance measurements. Once these have been established, the design of a total rewards package becomes an exercise in crafting an appropriate mix of the various executive compensation components to drive the behaviors required to achieve the organization's short- and long-term objectives.

Components of Executive Compensation

In crafting the executive compensation program, companies need to determine where they want to position their compensation relative to the market. Most want to be at the market median, while a substantial minority seeks to be above market. One major challenge in establishing market-competitive compensation provisions for executives is identifying an appropriate group for benchmarking. That benchmark can consist of direct competitors, companies with comparable revenue or employee populations, companies in the same region and companies that the organization would like to emulate. The executive compensation portfolio can be made up of six elements.

1. Base Pay

This comprises a decreasing portion of executives' total compensation. That is a natural corollary of the increasing importance of incentive-based rewards. In recent years, base pay annual increases for executives have averaged only a few tenths of a percentage point more than increases for the broader employee population.For chief executive officers (CEOs) of companies in the S&P/TSX Composite Index, base pay averaged about one-third of total compensation.

It averaged about one-fifth for the 60 largest companies on the index. The mechanics of executive base pay programs are much the same as for other employees. Executives earn increases based on individual performance, internal equity and competitive market rates for comparable positions. The percentage of total compensation made up by base pay is inversely proportional to the executive's ranking in the organization.

2. Non-Discretionary Cash Bonuses

These are a significant element of executive compensation. They are the largest incentive compensation component in organizations that are privately held, and where stock-based incentive programs are not applicable. Non-discretionary bonuses are tied to the achievement of measurable targets. There is usually a threshold level of performance required before any payout is made, a target level of performance at which the target payout is made and a higher level of performance at which the maximum allowable payout is made. These bonuses are usually based on performance within a fiscal year. The shorter time frame for measuring and rewarding performance is consistent with short-term (quarterly and annual) shareholder expectations.

3. Discretionary Cash Bonuses

These bonuses are not linked to specific performance measurements or targets. Discretionary bonuses may be appropriate where company performance is weak, thresholds for non-discretionary cash bonuses have not been met and where there is a need to provide additional compensation to key executives for retention purposes. In some cases they are used for valued achievements that are not rewarded through other components of the compensation package. Despite these opportunities, they are decreasing in use.

4. Stock Options

Stock options, or other share-based instruments, are intended to align the interests of executives with those of shareholders by encouraging executives to increase share prices. A stock option program provides an executive with the option to buy shares — typically at the Fair Market Value (FMV) of the stock as of the day the option grant is issued. Some companies have begun to price options above the FMV so that the options will not have any value unless the stock price attains a stipulated increase in value. The options usually vest over a period of three to five years. The option recipient usually has five to 10 years from the option grant date to exercise the options. One emerging trend has companies making the vesting of options dependent on the achievement of specified performance objectives, rather than simply on the passage of time. Stock options do not completely align the interests of executives and shareholders. Unlike direct share ownership, stock options do not entail the possibility of financial loss, and do not reflect returns to shareholders via dividends. Accordingly, an increasing number of companies are requiring executives and board members to have a defined amount of personal share holdings. One of the criticisms of stock options is that, in a bull market, even poorly managed companies experience an increase in share price. That rewards executives even when their organization's performance is below average. Companies can mitigate this risk by pricing options above the FMV as of the date of the grant, or by providing shorter time frames (perhaps five years rather than 10) for the exercise of options.

Conversely, well-run companies may experience a decrease in share price during a bear market. That can have a significantly negative impact on executive morale and retention. In such cases, some companies have chosen to revalue their options (reduce the price at which they can be converted into shares). This can be perceived as sheltering executives from the pain felt by shareowners, which violates the principle of aligning the interests of executives and shareholders. Option revaluation is becoming rare. A less controversial approach to this problem is to reduce the stock option component of the executive compensation package, and to increase the bonus component (especially non-discretionary bonuses based on the individual's performance rather than the share price).

5. Stock Appreciation Rights

These are like stock options, except that the recipient does not actually have to buy and then sell the shares vested. Stock appreciation rights involve notional stock. They have the advantage of providing cash compensation if the share price increases, but not diluting shareholder equity. They are often used by multinational corporations for executives in countries where stock option programs are not allowed by law.

6. Share Unit Plans

Under stock option and stock appreciation rights plans, executives are compensated only on the increase in the value of the shares over the option price. Under share unit plans, executives receive the full cash value of each share unit granted rather than just the appreciation of the share price. Depending on the plan, the share unit holder may receive cash or actual stock at the point of exercise. Share unit holders will also normally receive the same dividends as regular shareholders Because each share unit has more value than a stock option, fewer units need to be granted to provide the same compensation value to the executive. Share unit plans can be criticized for rewarding executives even though the stock price may have declined. Also, because of the smaller number of units typically granted, there is less upside (compared to stock options) for increases in share price. However, they encourage executives to protect or increase the existing value of shares, and to preserve or enhance dividend yields. Income gained under share unit plans is currently taxed, upon receipt, as ordinary income. There are three types of share unit plans:

Restricted Share Units

These units vest under a predetermined schedule, typically at the end of a specified period such as three years.

Performance Share Units

These are increasing rapidly in popularity as an alternative or complement to traditional stock options. Performance share units vest depending upon the achievement of certain predefined and time-bound performance objectives.

Deferred Share Units

With these units payment is deferred until the executive's employment with the company ends. They direct executives' attention to the long-term performance of the organization. An unintended consequence of deferred share units may be to encourage executives to leave if they anticipate a significant reduction in share price.

Steps in Designing an Effective Executive Compensation Program

1. Analyze Existing Benefit Plans and Executive Compensation Arrangements

One of the first things you will want to do is review the benefits provided under the standard package of employee benefit plans that will be offered to the key employee.

Analysis of the base retirement and tax-deferred savings plans is necessary in order to identify gaps in coverage and opportunities that maximize benefits provided under the available limits. In other words, do the math. Addressing what is needed or desired can only be accomplished after determining what is already being provided.

For existing executive compensation arrangements, you will want to determine if the programs still meet their primary objectives and remain in compliance with current regulatory and legislative requirements. You will also want to analyze the administrative requirements and costs of the benefit program to ensure that it remains affordable and efficient. Finally, as with any employee benefit plan, you will want to ensure that the executive compensation package that is being offered or considered is not only adequate, but also understood and appreciated by the key employee.

2. Establish Primary Plan Objectives for Executive Compensation Program

This step basically asks the question, why are we considering development of a supplemental executive compensation package?

- Is it simply to provide the key employee with additional retirement contributions above and beyond those provided by the standard employee benefit plans?
- Is it to restore benefits lost under these standard plans due to the IRS limits placed on compensation or nondiscrimination testing?

- Is it to provide the key employee with additional salary deferral opportunities?
- Is it to attract or retain the services of a key employee or to reward performance?

The answer to these questions will help identify the most appropriate executive compensation arrangement for the circumstance. "Yes" answers to the first three questions can, in many cases, be accomplished without complex plan designs and—depending on the amounts under consideration—within the established limits of eligible nonqualified deferred compensation plans. Plans with an objective of recruiting and retaining the services of key employees generally tend to be more complex in design and involve higher compensation limits.

3. Identify Optimal Plan Design Features

Once you have determined the plan's primary objective, you will want to gauge the relative importance of certain design features from an institutional perspective. A common consideration is the issue of public disclosure and/or Form 990 reporting. In the case of a highly recruited athletic coach, these issues generally tend to get played out in the local media and are difficult to manage. However, the type of plan selected will determine when or how the compensation is disclosed. (Note: all public institution information is subject to state open records laws, and independent institutions must disclose all compensation in the Form 990.)

Other considerations include determining the importance of protecting the benefit from the institutions' creditors, whether future service requirements are required, and when benefits are to be made available. (Some plans, such as 457(f) arrangements and 457(b) plans of tax-exempt organizations, must be "unfunded," whereby the assets remain the property of the institution and must be made available to creditors until they are distributed.) Design features such as rolling risks of forfeiture, the use of non-compete agreements, or requirements for performance of consulting services following separation from service are generally no longer available.

4. Determine Tax and Distribution Strategy

Of great importance to both the institution and the key employee is the tax liability and distribution strategy associated with the executive compensation plan selected. Although tax-exempt and governmental employers do not have the same tax incentives as for-profit organizations when establishing executive compensation arrangements, some plan designs have bookkeeping requirements that must be considered. The institution also must determine the importance of employer control of the assets and benefit distributions prior to and after vesting or before retirement. Of particular concern to the key employee are the individual tax consequences of the benefits during the accumulation phase, upon vesting, prior to distribution, and following separation from service. Rules vary by plan type and must be analyzed carefully.

5. Select Appropriate Financing Methodology

Depending on the type of executive compensation plan under consideration, an institution will need to base its financing strategy on projections of future assets, benefit liabilities, and cash flows. Simply put, how is the institution going to pay for or account for the benefits promised?

Common financing arrangements include:

- Cash/lump-sum settlement (pay as you go).
- Shadow account (defined interest and earnings assumptions).
- Institutionally owned annuity/mutual fund accounts.
- Institutionally owned life insurance policy.
- Use of Rabbi Trust, Employee Trust.

From the key employee's perspective, various funding arrangements tend to involve a trade-off between the level of security provided on the underlying benefits and the amount of tax deferral that can be achieved. Certain executive compensation arrangements have maximum contribution limits placed on them with the benefit of spreading out the tax liability over time upon distribution while others provide for unlimited contribution amounts but are heavily taxed upon vesting or distribution.

6. Establish Guidelines for Periodic Review and Evaluation

As previously mentioned, a successful executive compensation program begins and ends with good governance and compliance with all legislative and regulatory requirements. It is critical to review these arrangements on an annual basis to ensure they remain consistent with the institution's overall compensation philosophy, policies, and practices and are in compliance with applicable laws and regulations.

While the focus of this article centered on the types of executive compensation packages most commonly used in higher education, the annual review should take into consideration the total compensation package: base salary, benefits, short- and long-term incentive programs, and perquisites. It is also important to ensure that all executive compensation plans are well documented, including the decision-making process and procedures that went into their development. And finally, good governance requires involving all of the key stakeholders (human resources, finance/business office, and legal counsel) and clear communication between senior leadership and the institution's governing body.

CASE STUDY

Executive Compensation Strategy in Fortune Furnitech

Fortune Furnitech is a state-of-art modular furniture manufacturer, started with an initial ₹ 500 crores investment, by raising a term loan from different financial institution and about 65 percent contribution from the traditional family business. The group has a traditional family history of woodcraft manufacturing. Leveraging the family trend, the present owner Asim singh and his wife Ragini ventured into this business. Asim Singh has toured extensively all over the world with his father, right from his childhood. According to Mr.singh, India has top quality berg woods in its North-eastern states, which are imported by countries such as the USA. However, Indian use them as firewood, because of lack of awareness. The company launched an ambitious plan to manufacture and sell hardwood furniture worldwide, as their study indicated that the Indian market for furniture is still unorganized, and the affluent class used imported furniture made out of concentrated wood dust or waste products.

To achieve this goal, the company recruited the best designers, business heads, and production people worldwide. Many designers were either Italian-born or trained in Italy. The biggest challenge the company faced was in designing managerial compensation.

Management compensation received attention primarily because of its performance implication and strategic fit in Fortune Furnitech. The HR manager claimed that it had a positive effect on the company's financial performance and recommended the appropriateness of different compensation for specific strategic situations. However, he could not convince the top management of the need to formulate an executive compensation package accordingly.

Asim Singh only considered such alignment for executives on the board, arguing that their achievements was traceable. The HR manager argued that compensation cost in the company was the second largest expense category, the first being the cost of raw materials and other implements (excepting labour). Hence, it has to be managed strategically, aligning with the performance of the organization and its fit with overall organizational strategy. He supplied extensive literature to sell his argument. He complained that the organization did not have a well-documented compensation philosophy, despite this evidence. Some incentives were also counter productive. He argued that it is time to develop executive compensation, de-emphasizing the immediate financial gains and tagging it with long range strategy of the organization. After listening to the HR head's argument, the CEO directed him to develop a model that may work in the organization.

Question

1. Imagine you are the HR Manager. Design the appropriate pay model for executives of the organization.

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Lesson 3.3 - Incentives Plan

Learning Objectives

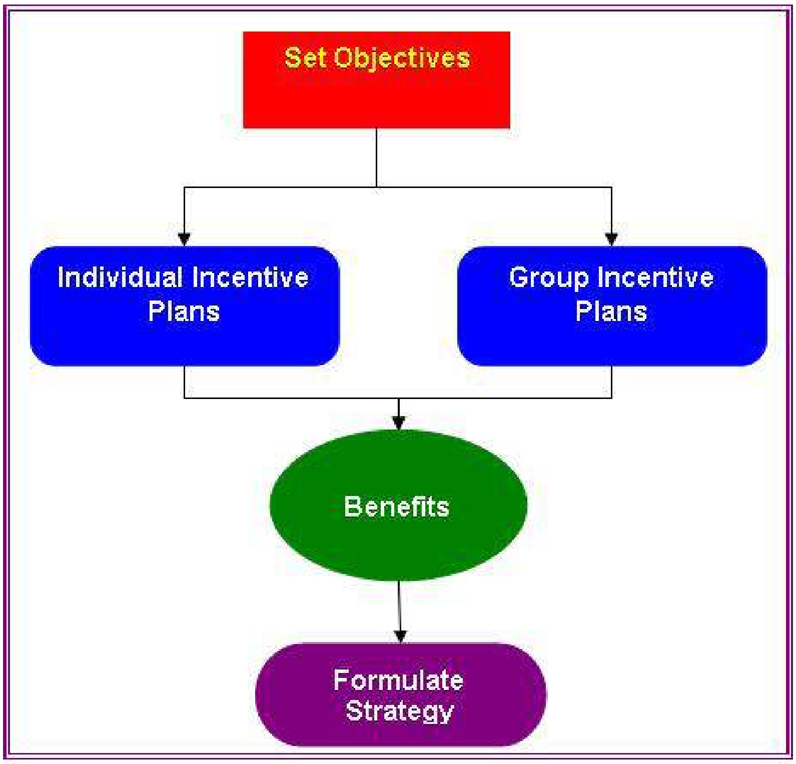
After reading this chapter you should be able to:

- Define Incentive Plan
- List different Types of Incentive Plans
- Understand different aspects of:
- Incentive Plan for Individuals
- Incentive Plan for Groups
- Gain Sharing Incentive Plans
- Other Schemes

Introduction

In today's competitive business world of globalization organizations should formulate compensation strategies keeping in mind their employees' interest. With more and more players entering the market and high attrition rate, it is a challenge for organizations to retain their talented human resource. The organizations should follow a systematic process to formulate the incentive plans. Incentive Strategy Formulation Process involves the following steps:

- Organizations should first understand the need of incentive plans.
- They should set clear objectives as of why incentive plans are formulated, what are the objectives.
- These objectives should be in alignment with organizational goals and objectives
- Various options for individual and group incentive plans should be explored.
- Benefits and disadvantages of each plan should be considered and from the various options available one incentive plan should be chosen.
- Using the best incentive plan, compensation strategy should be formulated



Incentive Strategy Formulation Process

Types of Incentive Plans

Organizations can opt for an effective incentive plans from the various alternatives available. The organizations usually opt for that incentive plans which suits its requirement the most. As incentives covers the financial matters, organizations need to be very focused in choosing the best alternative that is in alignment to the business goals and objectives. The various incentives plans available are:

Basic Rate System

Basic rate systems are straightforward but may not provide incentives to individual workers Under basic rate systems a worker is paid in relation to a given period of time - an hourly rate, weekly wage or annual salary. Generally this rate is the established rate for all workers in one category, but there are often incremental scales which allow for progression, perhaps as additional experience and skills are obtained.

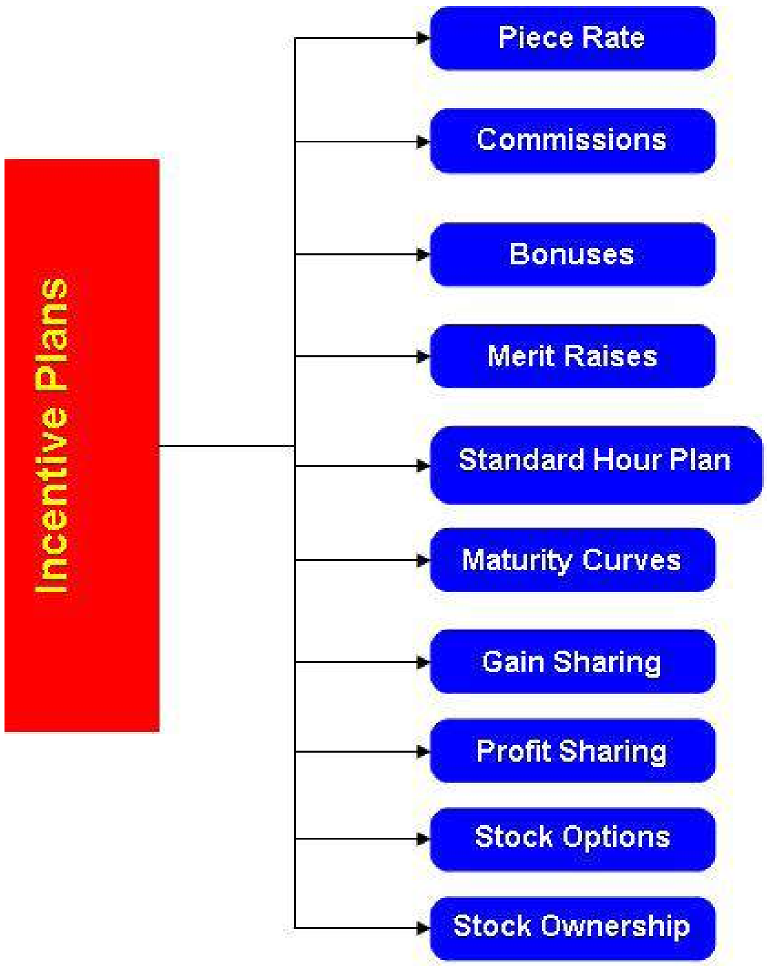
Advantages

- They are relatively simple and cheap to administer and allow labour costs to be forecast with accuracy

- They lead to stability in pay and are easily understood by the workforce, who will be able to more readily predict and check their pay
- There may be fewer disputes and individual grievances than under systems linking pay to performance or results.

Disadvantages

- Basic rate systems do not by definition provide direct incentives to improve productivity or performance. Nevertheless employers may prefer to operate simple basic rate systems and improve the design of jobs, so that the job provides the necessary interest, motivation and satisfaction
- Basic systems may be criticized by individual workers, who wish to see their own abilities specifically rewarded
- Basic rate systems can also lead to a rigid, hierarchical system of spot-rates or pay ranges.



Incentive Plans

Suitability of Basic Rate System

- All workers do identical or similar work
- The volume or quality of work is difficult to measure, or where the workflow is uneven
- Where the volume and/or pace of work is outside the workers' control
- Where high output is not as important as other considerations (eg quality, stable production levels).

Incentive Schemes for Individuals

Individual payment schemes include payment by results, piecework and bonuses, work measurement (including measured day work) and appraisal and performance related pay • Other individual types of scheme include market-based pay, which links pay to what is available outside the organization, and competency/skills based pay, which offers the opportunity for higher reward based on the acquisition and utilization of additional skills and competencies. Many sectors of employment use pay systems that contain direct links to individual performance and results. On an individual basis this may be via:

- Payment by results (PBR) for example bonus, piecework, commission
- Work-measured schemes and pre-determined motion time systems
- Measured day work (MDW)
- Appraisal/performance related pay
- Market-based pay
- Competency and skills based pay.

Individual Payment by Results (PBR)

The aim of any PBR scheme is to provide a direct link between pay and output: the more effectively the worker works, the higher their pay. This direct relationship means that incentives are stronger than in other schemes. However, traditional bonus, piecework and work-measured schemes have declined in recent years, as many employers have moved to all-round performance rather than simple results/output based pay. Many bonus schemes incorporate quality measurements or customer service indicators in the assessment to avoid the likelihood of workers cutting corners or compromising safe working methods in order to increase output. Earnings may fluctuate through no fault of the individual. Supervisors and managers may fail in their responsibilities towards workers by inconsiderate allocation of work or using the incentive scheme to control output. Targets may not be accurate enough resulting in the perception of easy or difficult jobs. Material shortages or delays can affect production. Individual skills are not rewarded and indeed the most skilled may be put onto more difficult and potentially less rewarding work. In instances where workers regulate their own output to satisfy their individual needs production can be affected and forward planning made more difficult.

Piecework, Bonus Schemes and Home Workers

Piecework is the simplest method of PBR – workers are paid at a specific rate for each 'piece' of output. This means the system is straightforward to operate and understand, although open to the disadvantages that quality and safety may be compromised to achieve a higher output. Pieceworkers must be paid at least the national minimum wage and there are special rules for working this out. Other individual PBR schemes include incentive bonus schemes where for instance an additional payment is paid when volume of output exceeds the established threshold, or where there is an increase in sales which exceeds given targets. Variable bonuses can also be paid in relation to performances achieved against pre-determined standards so that the higher the performance achieved, the greater the level of bonus generated. Home workers must also be paid at least the national minimum wage, with employers being able to demonstrate that they have worked out rates paid to home workers to ensure compliance.

Work Measured Schemes

Work measurement is often used to determine target performances and provides the basis for many PBR schemes for shop-floor workers. In these systems, a 'standard time' or 'standard output level' is set by rate-fixers, or by work study, for particular tasks. Work study calculates a basic time for a task by using laid down methods, observing workers performing the operation and taking into account their rate of working. Incentive payments are then linked to performance or to the output achieved relative to the standard, or to the time saved in performing the task. British Standard Institution (BSI) formulas are frequently used to calculate the incentive payment and examples of these are in the Appendix: Examples of some commonly used schemes. As the setting of standard times usually includes an assessment of how the individual being studied is performing, which can have a significant impact on bonus earnings, such judgments often result in disputes. Organizations using this system often train trade union representatives in the technique to promote understanding of the way judgments are made. An alternative is to use 'pre-determined motion time systems (PMTS)'. In these systems a synthetic time for a job is built up from a database of standard times for each basic physical movement. A common form of this system is Methods Time

Measurement (MTM). Allowances for relaxation and contingencies are then added to the basic time to form the standard time for the task. Such systems are arguably less open to dispute than work-measured schemes as long as the synthetic times upon which the standards are based are acceptable to the workers and their representatives. When the organization is considering the relationship of performance to reward there will generally be a starting point from which additional pay is attracted - performance at or below the starting point attracts no additional payment, but performance above the starting point attracts additional payment at a proportion of the basic wage or bonus calculator. Most schemes are 'straight proportional', which allow the reward to rise in direct proportion to the rise in performance. Examples of proportional incentive schemes are in the Appendix: Examples of some commonly used schemes. Schemes should include provisions covering the effects of downtime or other non-productive time on pay. Schemes should be controlled fairly and regularly reviewed to ensure there is no degeneration of work-measured standards. The operation of the scheme should be audited regularly. Arrangements need to be in place to accommodate changes in product, material, specifications and methods – re-measurement of the job may be necessary. Work-measured schemes may be appropriate in organizations that work on short-cycle repetitive work, where changes in methods are infrequent, where shop-floor hold ups or downtime are rare and where management should be capable of successfully managing the scheme to increase productivity. Procedures should be in place to deal with any grievances or issues that might arise. Even the simplest systems require a set of rules or guidelines to ensure fairness and equal earning opportunity for equal effort.

Measured Day Work (MDW)

Measured day work (MDW) is a hybrid between individual PBR and a basic wage rate scheme. Pay is fixed and does not fluctuate in the short term providing that the agreed level of performance is maintained. MDW systems require performance standards to be set through some form of work measurement and undergo revisions as necessary. Motivation comes from good supervision, goal setting and fair monitoring of the worker's performance. MDW is difficult and costly to set up and maintain. It requires total commitment of management, workers and trade unions. There must be effective work measurement and efficient planning, control and inventory control systems. The pay structure is often developed by job evaluation and with full worker consultation. A version of MDW is 'stepped' MDW. Under this scheme the worker agrees to maintain one of a series of performance levels and different levels of pay apply to each one. Movement between levels is possible, usually after a sustained change in performance.MDW is now relatively rare. It suits organizations where a high, steady, predictable level of performance is sought, rather than highest possible individual performance. MDW may be worth considering where stability of earnings is important, or where the manufacturing cycle is lengthy.

Appraisal/Performance Related Pay

Appraisal/performance related pay is generally used to link progression through a pay band to an assessment of an individual's work performance during a particular reference period, often a year. Alternatively, the reward may be an additional sum of money paid in the form of a bonus. Assessments usually relate to an individual's achievements against agreed objectives relating to output and quality of work but may also include an element of evaluation of personal characteristics, such as adaptability, initiative and so on.

Advantages of Appraisal-Related Pay

- It may provide a 'felt fair' system of rewarding people according to their contribution
- Higher performance within the organization may result
- It provides a tangible means of recognizing achievements
- People understand the performance imperatives of the organization
- The link between extra pay and extra performance is clear.

Disadvantages

- Appraisal-related pay can prove difficult because measurements of individual performance may be broad and lack objectivity and may be inconsistent
- As noted, such schemes also usually involve only an annual assessment and payout, which may weaken any incentive effect
- Many appraisal-related or performance pay schemes pay quite small sums in terms of performance pay progression or annual 'bonus'. While any such scheme may encourage workers to focus on organizational objectives, they are unlikely to provide a great deal of individual motivation and may even de-motivate.

Linking pay to appraisal can also have the disadvantage of turning the appraisal into a backward looking event where assessments are made and where workers may become defensive, as opposed to using the appraisal to look forward and agree new objectives, discuss development and any training needs. Where pay is at stake the individual may be less receptive to work counseling and may seek to negotiate softer objectives at the outset. If a worker rated 'less than satisfactory' receives no increase at all under an appraisal pay scheme their motivation and morale may be adversely affected. It is important therefore to focus appraisals on the assessment of performance, the identification of training needs and the setting of objectives, not on any dependent pay. Any organization that chooses appraisal related pay should have good industrial relations and good communications systems in place. It is also important that the finance necessary to operate the scheme is available. Appraisal related pay is most successfully introduced when it is linked to an existing appraisal scheme that is working well, rather than a simultaneous introduction of appraisal and appraisal-related pay. It is important to monitor the appraisals, to pick up any drift from the overall distribution of ratings and to check the fairness, equity and consistency of the ratings.

Market-Based Pay

Market-based pay links salary levels, and progression through the scales, to those available in the market. It is often used in conjunction with a performance pay matrix, which allows faster progression from the bottom of the scale to the market rate, which will be the mid-point. Progression then slows, regardless of the performance of the worker, as they are deemed to be earning above the market rate for their job. It is rarely used as a scheme in isolation, but may be part of a reward strategy incorporating several performance elements.

Competency and Skills-Based Pay

Competency and skills-based pay schemes have increased in popularity in recent years. A direct link is created between the acquisition, improvement and effective use of skills and competencies and the individual's pay. Competency and skills-based schemes measure inputs, ie what the individual is bringing to the job, unlike traditional performance based schemes which measure outputs. Competency may be generally defined as the ability of an individual to apply knowledge and skills and the behaviors necessary to perform the job well. Competency based systems have become more wide-spread because many organizations already use competencies in recruitment and in performance appraisal for non-pay purposes, such as development and training. It goes along with the increasing tendency for pay to be linked to the abilities of the individual rather than a single set rate for the job. Competency based pay is often used in conjunction with an existing individual performance related pay scheme and will reward on the basis of not only what the individual has done, but how they have achieved their targets. Examples of competencies may include leadership skill, or team-working ability. Competency-related pay fits well with an overall organizational philosophy of continuous improvement.

Difficulties may arise in defining the competencies valued by the organization. There are differences between behaviors that are in-built and those that can be developed. Problems may also arise because of the complex nature of what is being measured and the relevance of the results to the organization. Judgments about people's behavior may be less than objective. Competency assessment rests on several factors - identifying the correct competencies, choosing the right form of assessment and crucially, training the assessors to make accurate, objective judgments. Skills-based pay also rests on workers gaining new and improved skills - often in a manufacturing environment. Reward is given for skills that can be used in other jobs in the same job band, encouraging multi-skilling and increased flexibility. Workers may also be allowed to develop the skills of a higher job band. Skills may be based on National Vocational Qualifications or internal evaluation and accreditation. Both competency-based and skills-based pay have similar advantages and disadvantages:

Advantages

- Increased skill and flexibility in the workforce
- Reduction in traditional demarcations
- Increased efficiency
- Tangible benefits for workers in return for changes in working practice.

Disadvantages

- Payroll costs will increase as workers gain higher rewards for increased skills
- Increased training costs (time and expenses)
- Employers may be paying for skills/competencies rarely used
- Queuing for training - if people cannot be released, then there might be resentment and questions of fairness
- Can de-motivate once workers reach a ceiling of their training opportunities or there are no higher grade positions available when they have completed their training
- Highly trained workers will be more marketable and may be 'poached' or tempted to leave.

Incentive Schemes for Groups/ Team Compensation

Group pay schemes include those based on the performance of the team, plant or company. They also include 'gain sharing', which is a form of added-value scheme which links pay to the achievement of organizational goals. Share incentive plans involve the provision of shares to employees - either by giving them direct or allowing them to be bought - and can be related to performance. Some organizations utilize pay systems based on the performance of the team, or group. Sometimes it may be the performance of the whole plant or enterprise that is the trigger for the performance elements of pay.

Team-Based Pay

While team-based pay has been around for some time - in the shape of departmental or group bonus systems - it has taken on more importance with the increased interest in team working. In team-based pay systems the payments reflect the measurable goals of the team. Team working may be most effective in situations involving high task interdependence and creativity, although it can be difficult to define the team, the goals, and the appropriate reward. Schemes can be divisive if they are not open and transparent. Goals should not be shifted once agreed - they need to be achievable.

The aim of team-based pay is to strengthen the team through incentives - building a coherent, mutually supportive group of people with a high level of involvement. The team achievements are recognized and rewarded. Peer group pressure can also be helpful in raising the performance of the whole team. As with any other pay system, involvement of the workers who will be affected is crucial in the design of the scheme. They must be involved particularly in the way objectives are set, how performance is measured, and the basis on which team rewards are distributed. Team-based pay has both advantages and disadvantages:

Advantages

- It can encourage team working and co-operation between workers
- Team goals can clearly be integrated with organizational objectives
- It encourages less effective performers and acts as an incentive for the whole team to improve
- It may help in developing self-management within the team
- It enhances flexibility of working and encourages multi-skilling.

Disadvantages

- Difficulty in defining the team
- It can take time for teams to become well-defined and work together effectively
- Individuals may feel their personal self-worth is diminished
- Peer pressure could be oppressive and lead to conformity rather than creativity. Pressure on individuals perceived to be under-contributing or not ‘fitting in’ can degenerate into bullying and/or harassment

- Inter-team competition may become dysfunctional for the organization as a whole
- Once effective the team could prove difficult to change or break-up in response to changing processes, markets or competitive pressures
- Each team should have equality of earnings opportunity or inter-team movement will be restricted
- Introducing a new member to a team may be problematic, if the team perceive that their earnings could be affected by a less skilled operator
- Reduced flexibility because individuals in high performing teams are often reluctant to move to other teams

Plant or Company Based Pay / Enterprise Incentive Plan

Plant or company based performance pay schemes are based on larger groups than teams, for instance, divisional, plant or the whole organization. They may well use the same factors as team-based or individual performance schemes, or perhaps total sales within a set period, or comparative reductions in labour costs. The most common forms of plant or company based payment systems tend to be based on overall profits (profit sharing), or alternatively on schemes that owe more to the improvements within the direct control of the workforce, such as added value or similar types of gain sharing systems. Overall profitability in an organization is subject to factors outside the workforce's control, such as depreciation, economic changes, taxation, as well as the productivity improvements of individuals and therefore may not reflect real efficiency gains by the workforce. Plant/company based pay schemes are generally most effective in organizations where the workforce can clearly see the results of their efforts. They are successful where communications and employment relations are good and where the performance measurement is not subject to major changes arising from external causes. There are advantages and disadvantages to plant and company based pay schemes:

Advantages

- They can encourage wider co-operation within the plant, with workers being more aware of their contribution to the total effort of the organization
- They provide a more obvious and direct link with the organization and its ability to pay
- They may encourage greater flexibility in ways of working to increase efficiency and productivity.

Disadvantages

- The direct incentive value of such schemes tends to be relatively weak, as the link between daily work and bonus may seem quite remote, especially if the payments are quarterly or annually
- Bonus payments may come to be seen as part of normal pay
- Added-value schemes may involve complex financial information and may be difficult to understand.

Gain Sharing Incentive Plan

Gain sharing is a form of added-value pay scheme linking workers' pay to the achievement of organizational goals by rewarding performance above a pre-determined target. This may be in the form of a share in the profits generated by sales, or on measures of customer satisfaction, but is almost always led by measures of productivity, performance and quality. Gain sharing schemes have to be based on factors that are in the workers' control. Gain sharing should be part of a long-term strategy to improve communications, staff involvement and teamwork.

The goal is not to work harder, but more effectively. It may be used as a replacement for bonus/piecework schemes, where quality is sometimes lost to quantity. All workers and management who have any involvement in the product of the organization should be included in any gain share plan. In this way their support is encouraged so that they can feel a direct responsibility for the plan's success. Performance measures and results should be made available and everyone encouraged to offer suggestions for improvements. Open communications and exchange of information are crucial. Common types of gain sharing schemes include:

Scanlon Plan

- This formula measures labour costs as a proportion of total sales and sets a standard ratio which will trigger some distribution of savings to a pre-established formula.
- Rucker plan
- This is a refinement of the Scanlon plan which measures labour costs against sales less the cost of materials and supplies and provides a simple added-value calculation.
- Other gain sharing / value-added schemes

- There are several forms which further refine the calculations and link bonus payments to the increase in added value, above a given norm. Value-added deducts wages and salaries, administration expenses, services and materials from income derived, and thus represents the value added by the production or other process within the organization. The level of added value of an enterprise is an indicator of its efficiency. Some examples of the above gain sharing schemes are included in the Appendix: Examples of some commonly used schemes.

Share Incentive Schemes

Share incentive schemes involve the provision of shares to employees - either by giving them direct or allowing them to be bought. The aim is to encourage staff involvement in the company's performance and therefore improve motivation and commitment. The Share Incentive Plan (previously the All-employee share ownership plan (AESOP)). The share incentive plan ("SIP") was introduced by the government as part of the 2000 Finance Act. SIPs can include four types of shares:

- Free shares
- Partnership shares
- Matching shares - companies can reward this commitment by giving up to 2 matching shares for each partnership share an employee buys
- Dividend shares - companies can provide for dividends paid on free shares, partnership shares and matching shares to be reinvested in further shares

Other Schemes

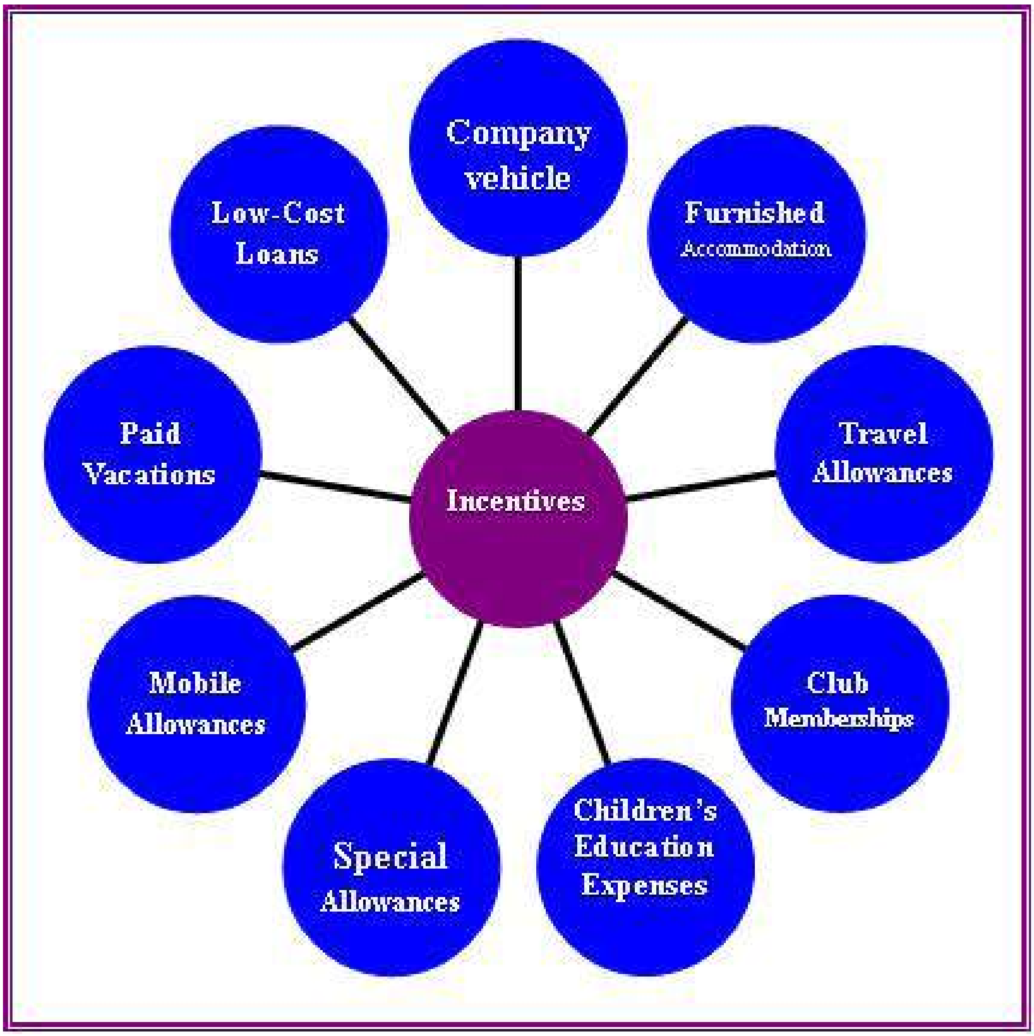
Examples of other share incentive schemes include:

- Savings Related Share Option Schemes (SAYE)
- Enterprise Management Incentives (EMI
- Company Share Option Plans (CSOP)

Although share-owning schemes can appear attractive to employers it is not always helpful to a company's finances to have a constant turnover of shareholders. Companies therefore need to be clear about how much of the equity can be held in this way and how to create ways to get workers to keep their shares long-term.

Executive Incentives

Ex Organizations offer heavy incentives to executives to retain the talented workforce. The immense competition in the market has forced the organizations to offer lucrative compensation packages. Performance based incentives comes out to be the only solution for the demand-supply disparity. Who works- receives the appreciation and who does not works- lacks behind. executive Incentives are more effective in the marketing segment as it results in more and more sales. The business development executives strive for more incentives and in the effort produce more business and receive heavy perks



Executive Incentives

The issues that have come up related to executive incentives are:

- People believe that the incentives offered to the executives are much more than what the stockholders receive.

- Some people also criticize the appraisals blaming the time duration given in achieving the set performance standards.
- Some people also complaint of the un-fair distributions of incentives. They believe that team members actually work and more appreciation is given to the team leader.
- Some people also complain that more incentives are given to place the organizations on top of the salary surveys conducted by the respected research organizations

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Lesson 3.4 - Profit Sharing and Co-Partnership

Learning Objectives

After reading this chapter you should be able to:

- Define Profit sharing
- Understand the Objectives of Profit sharing
- Know the Features of Profit sharing
- Identify Profit Sharing Methodologies of companies
- Know the Types of Profit Sharing
- Evaluate the Advantages and Disadvantages of Profit Sharing
- Find out Profit Sharing in India and Issues
- Understand Co-Partnership and its advantages and disadvantages

Introduction

The workers are regarded as partners of the industry and therefore, profits of the enterprise must be shared with the labour because profits have been earned by the enterprise with their active cooperation and therefore a rightful due must be given to them. Under the scheme of profit sharing the profits of the concern are paid to the workers annually as agreed upon, over and above the wages. Meaning-:profit sharing is meant to provide organization wide incentive based on the profit earned by the organization.

The concept of profit-sharing started around 1880s and international cooperative congress held in perish in 1889 considered the issue of profit sharing and defined it as “an arrangement by which employee receive a share, fixed in advance, of profit, thus profit sharing, as its name suggest, is the distribution of a portion of an organization profit among employee at the end of financial year. The basic idea behind profit sharing is that the organization profit is earned through the cooperative approach of all organization members and, therefore should share that just like shareholders get dividend for the investment in their capital.

Profit sharing refers to monetary benefits offer to the employees by the employer apart from salary and bonuses. They are a form of incentives given to employees either directly or perhaps indirectly, depending upon the profits made by the respective company.

The profit can be shared in the form of bonds, stocks or cash, which can be given at the time of retirement. A company will share its pre-taxed profits with employees who are eligible for it. The base salary of the employee will be taken into consideration and depending upon the amount the profit will be shared.

Those employees having higher base salaries will get a higher share of the profits to be shared. Profit sharing is a gesture extended by the company to make the employee feel that he or she is also part of the company. Any employee who is well taken care of will perform better. His or her motivation to work will be higher.

Definition of Profit-Sharing

A plan that gives employees a share in the profits of the company. Each employee receives a percentage of those profits based on the company's earnings. Also known as "deferred profit-sharing plan" or "DPSP."

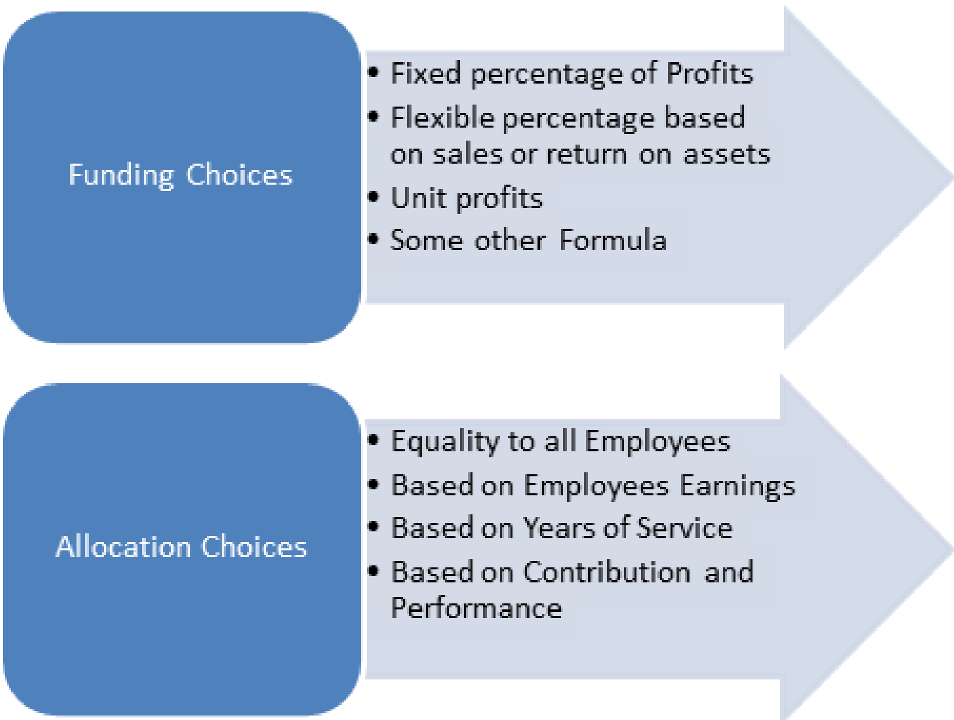
Features of Profit-Sharing

- Profit sharing denotes the extra payment given to workers in addition to usual wages/ salaries and allowances
- It is paid out of the net profits and as per the agreement between the two parties i.e. employers and employees
- The sharing of profits in a particular proportion is decided by an agreement between the employers and the employees
- The profit-sharing agreement is possible at the unit level or even at the industry level. It is also possible to have such agreement on regional basis or industry-cum-region basis.
- The payment to workers under profit-sharing is generally made on cash basis, but it is also possible to make such payment in shares or transfer of money to provident fund account of the employees
- Workers share the profit only. They do not share the losses incurred by the firm.

Objectives of Profit –sharing

Profit-Sharing Methodologies of Companies

Typically, the percentage of the profits distributed to employees is agreed on by the end of the year before distribution. In some profit-sharing plans, employees receive portion of the profits at the end of the year; in other, the profits are deferred, placed in a fund and made available to employees on retirement or on their leaving the organization. The following are the show the companies in these days set the profit –sharing plan:



Profit-Sharing Plan Frame Work- Choices

Basis of Profit Sharing

1. **Individual Basis.** Each worker may be paid that share of the profit which the concern has earned due t his efforts. In this way, a direct relationship between his effort and reward will be established. But it is very difficult to find out individual's contribution to the profit.
2. **Departmental Basis.** The profit earned by the particular department are shred by the employees of the department. For this purpose, each department may have its own arrangement.
3. **Unit Basis.** The profit earned by the unit is distributed among the employees and the employer of the unit. Thus efforts of the workers are duly rewarded.
4. **Locality Basis.** The profits of all the industrial units in a particular locality are pooled and divided among the workers and employers of the locality in a predetermined ratio.
5. **Industry Basis.** The profits of all units belonging to a particular industry are added together and divided between the employers and the employee in the given ratio. In this way, the workers of the unit having losses, may also get the shares in the profits of the industry.

Types of Profit Sharing Plans

Cash Plan

Cash payment profit-sharing plans pay out a percentage of profits to employees annually or quarterly in the form of cash, check or stocks. The amount is taxed as ordinary income when distributed.

Deferred Plan

Employers with deferred profit-sharing plans place a percentage of company profits into a trust which the employee can access upon retirement. These plans are ideal for companies with an older workforce that plans to stay with the company until retirement. One advantage of deferred plans is that employers can write them off as a business expense for tax purposes, and the taxes to the employees are deferred until the money is disbursed. Profit-sharing contributions are not paid out currently but rather are deferred to individual accounts set up for each employee. Benefits—and any investment earnings accrued—are distributed at retirement, death, disability, and sometimes at separation from service and other events.

Combination Plan

Cash and deferred plans can be mixed and matched in a variety of ways to give both employers and employees the best of both worlds. In this type of plan, the participant has the option of deferring all or part of the profits t-sharing allocation. The portion taken as a deferral is placed into the participant's account, where it and investment earnings accrue tax-free until withdrawal. Any amount taken in cash is taxed at current rates. For tax purposes, Internal Revenue Service (IRS) qualification of profit-sharing plans is restricted to deferred or combination plans.

Advantages of the Profit-Sharing Scheme

(i) **Increased Productivity.** The scheme creates an interest and a desire among the workers to work whole heartedly for the concern, because they realize that increase in output or a reduction in cost will benefit not only the employer but also to their personal advantage.

(ii) **Improved Industrial Relations.** Industrial unrest and strike come to an end and are replaced by the community of interests. The management and workers cooperate to maximize the profits of the concern and thus ensure industrial peace and better industrial relations.

(iii) **Increased Earning for Workers.** It is an additional earning thus contributes materially to the welfare of the workers. The lump sum paid to them can be sued for some constructive purpose. It also ensures greater economic security.

(iv) **Stabilization of Labour Force.** The workers who leave the concern during the course of year, lose their share of profit hence the scheme is a positive incentive to the workers to stick on their jobs. Thus, it ensures stabilization of labour.

(v) **Improvement in supervision and Administration.** As the workers are directly linked with the share of profit and then their morale is keep thigh. They do not need strict supervision. Disciplined workers only can keep the standard of administration high.

(vi) **Realization of Social Justice.** It achieve some measure of social justice by relating earning of the workers to the company's financial position and by affording them the place of equal partners in an industrial enterprise.

(vii) **Sense of Responsibility.** The worker is self-motivated and feels a sense of responsibility as he is interested in the prosperity of the concern.

(viii) **Advantage the society.** Society is benefited to a great extent by the reduction in industrial disputes, reduction in the cost of production, improvement in the quality of the goods and low price of the commodity. Wastage of man, material and machines are avoided or minimized.

(ix) **Increased National Income.** Lesser industrial disputes, more production, better quality, increased income of workers and employers are some of the contributor factors for the increased national production and national income.

Disadvantages of Profit Sharing Scheme

(i) **Not well founded.** The profit result not merely from the availability of capital or efforts of labour. It depends of several other factors such as efficiency of management, market conditions, on several other factors beyond the control of the workers. Thus profit sharing maintains n relationship between effort and reward.

(ii) **Equal share.** Profit sharing does not distinguish between efficient and in-efficient workers. All workers share equally irrespective of individuals efficiency. This lowers the morale of an efficient workers and their productivity comes down.

(iii) **Delay in remuneration.** A share of profit is paid to the worker only at the end of a specified period. In other words, reward comes long after the exertion has been made. It reduces the eagerness to get something for the efforts.

(iv) **Industrial Unrest.** During the lean years of depression, the profits of the concern are either very low or are turned into losses, the workers morale will be at its lowest. Instead of eliminating industrial disputes, it may well be a cause of industrial unrest.

(v) **Determination of Profit.** The determination of the exact amount of profit and the workers' share thereof may pose a number of complex problems, because management tempers account. Even if the management is honest, trade unions may still have their own doubts about the correctness of accounts.

(vi) **Opposition by Trade Unions.** Trade unions generally put up stiff opposition to the scheme on the plea that it is a mischievous move on the part of the management to tempers account. Even if the management is honest, trade unions may still have own doubts about the correctness of accounts.

(vii) **Opposition by Employers.** Employers even object to the profit sharing scheme. They argue that profit is partly the reward of the risk which the employer runs. Further if there is a loss why should the workers not bear the share of it?

(viii) **Reduced Mobility of Labour.** Profit sharing ensures the stability of workers. It means it reduces the mobility of workers which is always not int the interest of the worker and the organization.

Profit Sharing in India

The Employees' Provident Fund Organization (EPFO) is a statutory body of the Government of India under Ministry of Labour and Employment. It administers a compulsory contributory Provident fund, pension and a insurance scheme for Indian Work force. It is one of the largest social security organizations in the world in terms of members and volume of financial transactions undertaken

The Employee's Deposit Linked Insurance Scheme, 1976

Short title, commencement and application:

1. The Scheme may be called the Employees' Deposit-Linked Insurance Scheme, 1976.
2. The provisions of this Scheme shall come into force on the 1st day of August, 1976.
3. Subject to the provisions of sub-section (2) of section 16 and section 17(2A) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, this Scheme shall apply to the employees of all factories and other establishments to which the said Act applies:

Provided that the provisions of this Scheme shall not apply to tea factories in the State of Assam

Special provisions relating to establishments in respect of which applications are received for exemption from the provisions of this Scheme. – (1) (i) A Commissioner may be order and subject to such conditions as may be specified in this order exempt from the operation of all or any of the provisions of this Scheme an employee to whom this Scheme applies on receipt of application from such an employee:

Provided that such an employee is without making any separate contribution or payment of premium, in enjoyment of benefits in the nature of life assurance, whether linked to their deposits in provident funds or not, according to the rules of the factory or other establishment and such benefits are more favourable than the benefits provided under this Scheme.

(i) Where an employee is exempted, as aforesaid, the employer shall in respect of such employee maintain such accounts, submit such returns, provide such facilities for inspection as the Commissioner may direct and pay such inspection charges and make such investments as the Central Government may direct.

1. An employee exempted under sub-paragraph 1 may, by an application to the Commissioner, make a request that the benefits of this Scheme be extended to him.

2. No employee shall be granted exemption or permitted to apply out of exemption more than once on each account.

3. (i) The Central Provident Fund Commissioner may by order and subject to such conditions as may be specified in the order exempt from the operation of all or any of the provisions of this Scheme any class of employees to whom this Scheme applies, on receipt of an application therefore, in such form as the Commissioner may specify:

Provided that such class of employees is, without making any separate contribution on payment of premium, in enjoyment of benefits in the nature of life assurance, whether linked to their deposits in provident fund or not, according to the rules of the factory or other establishment and such benefits are more favorable than the benefits provided under this Scheme.

(ii) Where any class of employees is exempted as aforesaid, the employer shall in respect of such class of employees maintain such accounts, submit such returns, provide such facilities for inspection, pay such inspection charges and make investments in such manner as the Central Government may direct.

4. A class of employees exempted under sub-paragraph 4 or the majority of employees constituting such class may, by an application to the Commissioner, make a request that the benefits of this Scheme be extended to them.

5. No class of employees or the majority of employees constituting such class shall be granted exemption or permitted to apply out of exemption more than once on each account.

6. Notwithstanding anything contained in this Scheme the Commissioner may in relation to a factory or other establishment in respect of which an application for

exemption under section 17 (2A) of the Act has been received, relax pending the disposal of the application, the provisions of this Scheme in such manner as he may direct.

Contribution

1. The contribution payable by the employer and the Central Government under sub-section
2. Sub-section of section 6C of the Act, shall be calculated on the basis of the basic wages, dearness allowance (including the cash value of any food concession) and retaining allowance, if any, actually drawn during the whole month whether paid on daily, weekly, fortnightly or monthly basis:

Provided that where the monthly pay of an employee exceeds five thousand rupees, the contribution payable in respect of him by the employer and the Central Government shall be limited to the amounts payable on a monthly pay of five thousand rupees including dearness allowance, retaining allowance if any and cash value of food concession.

(1) Each contribution shall be calculated to the 3 nearest rupee, 50 paise or more to be counted as the next higher rupee and fraction of a rupee less than 50 paise to be ignored.

Mode of Payment of Contribution

1. The contribution by the employer shall be remitted by him together with administrative charges at such rate as the Central Government may fix from time to time under sub-section 4 of Section 6C of the Act, to the Insurance Fund within fifteen days of the close of every month by a separate bank draft or cheque or by remittance in cash in such manner as may be specified in this behalf by the Commissioner. The cost of remittance if any, shall be borne by the employer.
2. It shall be the responsibility of the employer to pay the contribution payable by himself in respect of the employees directly employed by him and also in respect of the employees employed by or through a contractor.
3. The Central Government shall credit its contribution to the Insurance Fund as soon as possible after the close of every financial year.
4. The Commissioner shall deposit the bank draft or cheque received from the employers in the State Bank of India or any Bank specified in the First Schedule to the Banking

Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970).

8-A. Recovery of damages for default in payment of any contribution: - (1) Where an employer makes default in the payment of any contribution to the Insurance Fund, or in the payment of any charges payable under any other provision of the Act or of the Scheme, the Central Provident Fund Commissioner or such officer as may be authorized by the Central Government, by notification in the Official Gazette, in this behalf, may recover from the employer by way of penalty, damages at the rates given below: -

Period of default	Rate of damages (Percentage of arrears per annum).
(a) Less than two months.	Seventeen.
(b) Two months and above but less than four months.	Twenty-two.
(c) Four months and above but less than six months.	Twenty-seven.
(d) Six months and above.	Thirty-seven.

(2) The damages shall be calculated to the nearest rupee, 50 paise or more to be counted as the nearest higher rupee and fraction of a rupee less than 50 paise to be ignored. Employer's contribution not to be deducted from the wages of the employees. –

Notwithstanding any contract to the contrary, the employer shall not be entitled to deduct the employer's contribution payable by him under this Scheme from the wages of the employees or to recover it from them in any other manner.

Bonus is a Main or a Medium of Profit Sharing in India

Profit sharing commence in India from 1948& time to time it recommended (in 1961, 1965,1972, 1977 and lastly in 1980) In 1980, if worker is less than 15 years he will get 60 ₹ Minimum bonus For bonus workers should work minimum 30 days.

Problems in Profit Sharing Scheme in India

Profit sharing is a good long-term incentive scheme which recognize the role of employee in the organizational effectiveness. If the scheme is properly followed, it helps in building supportive organizational climate. however, profit sharing being good in principle, it has many weakness and problems emerging in its operation and its strength as an incentive. Some of the problems of profit sharing scheme are as follows.

(1) Profit sharing is a long term scheme which links efforts and reward after a long time. Incentive system works well in which there is immediate feed back about the efforts and there rewards.

(2) The most critical problems emerges in determining the quantum of profit of the organization. the calculation of profit depends on the accounting methods followed. in India, a company profit is calculated differently under the company act as compared to Income tax act. When the question of linking bonus to organization, profit arose, the employer is asserted that what was presented in annual profit and loss account of a company should be acceptable to employees. the trade union asserted that they should has freedom to scrutinize the accounts and the property of the items of expenditure charged to profit and loss accounts. In such a situation, profit sharing scheme is unlikely to work.

Introduction Co-Partnership

The concept of co-partnership was applied in industries to overcome some of the problems of profit-sharing scheme. In co-partnership, employees participate in the equity capital of the company. The shares may be allotted to them either on cash payment basis or in lieu of various incentives payable in cash. Under co-partnership, employees become shareholders of a company and may exercise control over it as other shareholders do. Thus, employees are able to participate in both, sharing of the profit and participation management through their representatives.

Co-partnership is an extension of profit sharing. It is a system wherein employees are made partners of the enterprise and are allowed to participate in the management and control of the undertaking. Workers' share in the company's profits is paid in the form of shares by which they can entitled to participate in the decision-making process. In this way, co partnership involved both profit sharing and control sharing.

Advantages of Co Partnership

- Co-partnership helps to improve the status of employees.
- They become partners or shareholders of the company.
- Employees get an opportunity to participate in the management of the enterprise.
- There is improvement in labour management relations because their interests are interlinked.
- The employees become more loyal and commitment to the enterprise because their future is linked with the company's future.

However, the idea of co-partnership has been subscribed to a very limited extent throughout the free-economy world both by the employees as well as by employers.

Limitations of Co-Partnership

Co-partnership has not been successful due to the certain weaknesses of the scheme. Some of the weaknesses are as follows:

1. Employees in general do not like the idea of co-partnership. They prefer to be wage earners rather than become co-owners.
2. Trade unions oppose the attempt to make employees as shareholders.
3. Workers prefer bonus in cash rather than in the form of shares.
4. It is very risky for a worker to invest his savings in one company.
5. The share of workers in the capital is too small and therefore, workers get very limited voting power.
6. On becoming shareholders of a company, the employees take same risk as other shareholders do. Other shareholders are mentally prepared for assuming such a risk. The question is: are employees also prepared to take such a risk?

In India, the concept of co-partnership has been adopted in a different manner in which employees of a company are allotted shares on preferential basis out of the shares issued to different classes of investors. However, this scheme has been used by the employees to have capital gain by selling the shares at higher prices in the stock market rather than using these shares to become co-partner.

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Lesson 3.5 - Employee Stock Ownership Plans (ESOP)

Learning Objectives

After reading this chapter you should be able to:

- Define 'Logistics' and Associated terms
- Understand the Concept of logistics
- List different activities of logistics and understand the relationship between them
- Key logistics objectives
- System elements of logistics
- Recognize the Significance of logistics

Introduction

Attracting and retaining competent professionals is an uphill task Employee Stock Ownership Plan (ESOP) is an employee benefit plan. The scheme provides employees the ownership of stocks in the company. It is one of the profit sharing plans. Employers have the benefit to use the ESOPs as a tool to fetch loans from a financial institute. It also provides for tax benefits to the employers. Organizations strategically plan the ESOPs and make arrangements for the purpose. They make annual contributions in a special trust set up for ESOPs. An employee is eligible for the ESOPs only after he/she has completed 1000 hours within a year of service. After completing 10 years of service in an organization or reaching the age of 55, an employee should be given the opportunity to diversify his/her share up to 25% of the total value of ESOPs. Law has also provided an amendment for the employees who have attained the age of 60 and their ESOP shares are allotted after December 31, 1986. The amendment provides those employees with an option to diversify their shares up to 50%.

How an Employee Stock Ownership Plan (ESOP) Works?

Employee ownership can be accomplished in a variety of ways. Employees can buy stock directly, be given it as a bonus, can receive stock options, or obtain stock through a profit sharing plan. Some employees become owners through worker cooperatives where everyone has an equal vote. But by far the most common form of employee ownership in the U.S. is the ESOP, or employee stock ownership plan. Almost unknown until 1974, about 11,000 companies now have these plans, covering over 13 million employees. Companies can use ESOPs for a variety of purposes. Contrary to the impression one can get from media accounts, ESOPs are almost never used to save troubled companies—only at most a handful of such plans are set up each year.

Instead, ESOPs are most commonly used to provide a market for the shares of departing owners of successful closely held companies, to motivate and reward employees, or to take advantage of incentives to borrow money for acquiring new assets in pretax dollars. In almost every case, ESOPs are a contribution to the employee, not an employee purchase.

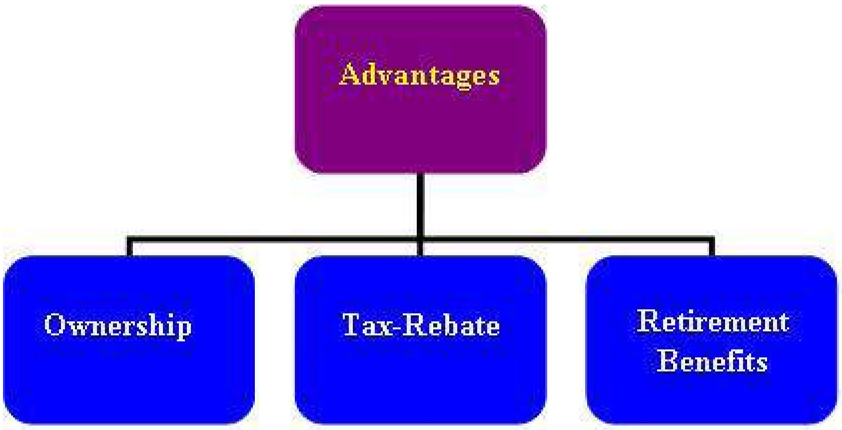
ESOP Rules

An ESOP is a kind of employee benefit plan, similar in some ways to a profit-sharing plan. In an ESOP, a company sets up a trust fund, into which it contributes new shares of its own stock or cash to buy existing shares. Alternatively, the ESOP can borrow money to buy new or existing shares, with the company making cash contributions to the plan to enable it to repay the loan. Regardless of how the plan acquires stock, company contributions to the trust are tax-deductible, within certain limits.

Shares in the trust are allocated to individual employee accounts. Although there are some exceptions, generally all full-time employees over 21 participate in the plan. Allocations are made either on the basis of relative pay or some more equal formula. As employees accumulate seniority with the company, they acquire an increasing right to the shares in their account, a process known as vesting. Employees must be 100% vested within three to six years, depending on whether vesting is all at once (cliff vesting) or gradual.

When employees leave the company, they receive their stock, which the company must buy back from them at its fair market value (unless there is a public market for the shares). Private companies must have an annual outside valuation to determine the price of their shares.

In private companies, employees must be able to vote their allocated shares on major issues, such as closing or relocating, but the company can choose whether to pass through voting rights (such as for the board of directors) on other issues. In public companies, employees must be able to vote all issues.



Advantages of ESOP

Merits of Employee Stock Option

To Understand the Company as Shareholder

It promotes mutually of interest between the employees and the employer. The employee is encouraged to consider the view-point of a shareholder. He is also led to read company literature such as operating results, balance sheet and annual report sent to him as a shareholder which he/she would have probably ignored as an employee.

To Know About the Future Progress of the Company

The employees get an opportunity to attend the meetings of the shareholders and have detailed information about the progress and future plans of the company.

To Motivate the Employee and Create Saving Habits

It promotes thrift, efficiency and security on the part of the employees. The employees feel that they are not merely servants but masters also. The stake in company profit and loss is a great motivating force towards increased efficiency.

Developing Interest in Investing in Company

Worker's income is supplemented by dividends. In the beginning, it may not be very alluring but when some more shares are acquired by a worker out of the dividends received, his interest goes on increasing.

To Maintain Relationship Between Company and Employee

The management also gains because of better cooperation, lesser supervision, reduced labour turnover. Improved industrial relations, better understanding on the part of workers, and elimination of waste and enhancement of efficiency.

Uses for ESOPs

1. **To buy the shares of a departing owner**: Owners of privately held companies can use an ESOP to create a ready market for their shares. Under this approach, the company can make tax-deductible cash contributions to the ESOP to buy out an owner's shares, or it can have the ESOP borrow money to buy the shares (see below).
2. **To borrow money at a lower after-tax cost:** ESOPs are unique among benefit plans in their ability to borrow money. The ESOP borrows cash, which it uses to buy company shares or shares of existing owners. The company then makes tax-deductible contributions to the ESOP to repay the loan, meaning both principal and interest are deductible.
3. **To create an additional employee benefit:** A company can simply issue new or treasury shares to an ESOP, deducting their value (for up to 25% of covered pay) from taxable income. Or a company can contribute cash, buying shares from existing public or private owners. In public companies, which account for about 5% of the plans and about 40% of the plan participants, ESOPs are often used in conjunction with employee savings plans. Rather than matching employee savings with cash, the company will match them with stock from an ESOP, often at a higher matching level.

Major Tax Benefits

ESOPs have a number of significant tax benefits, the most important of which are:

1. **Contributions of stock are tax-deductible:** That means companies can get a current cash flow advantage by issuing new shares or treasury shares to the ESOP, albeit this means existing owners will be diluted.
2. **Cash contributions are deductible:** A company can contribute cash on a discretionary basis year-to-year and take a tax deduction for it, whether the contribution is used to buy shares from current owners or to build up a cash reserve in the ESOP for future use.

3. **Contributions used to repay a loan the ESOP takes out to buy company shares are tax-deductible:** The ESOP can borrow money to buy existing shares, new shares, or treasury shares. Regardless of the use, the contributions are deductible, meaning ESOP financing is done in pretax dollars.

4. **Sellers in a corporation can get a tax deferral:** In C corporations, once the ESOP owns 30% of all the shares in the company, the seller can reinvest the proceeds of the sale in other securities and defer any tax on the gain.

5. **In S corporations, the percentage of ownership held by the ESOP is not subject to income tax at the federal level (and usually the state level as well):** That means, for instance, that there is no income tax on 30% of the profits of an S corporation with an ESOP holding 30% of the stock, and no income tax at all on the profits of an S corporation wholly owned by its ESOP. Note, however, that the ESOP still must get a pro-rata share of any distributions the company makes to owners.

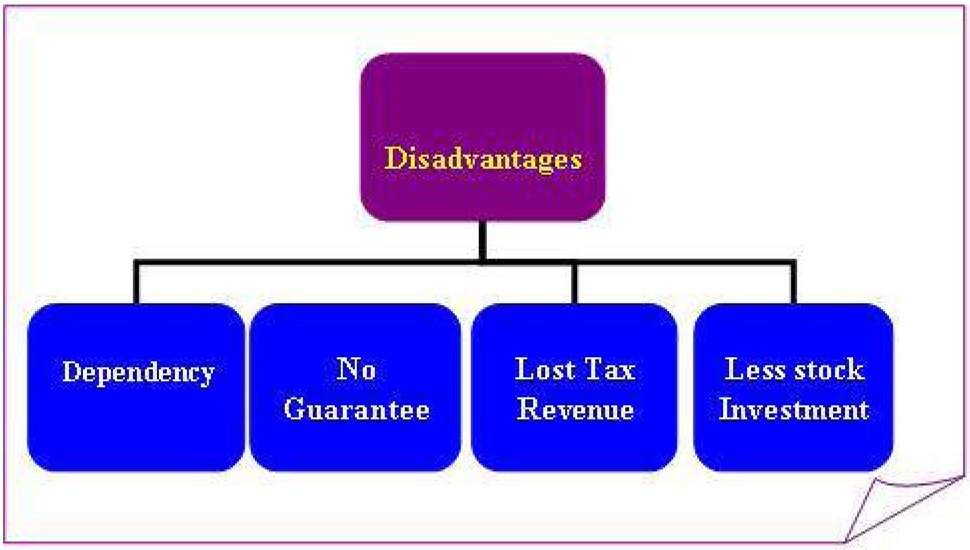
6. **Dividends are tax-deductible:** Reasonable dividends used to repay an ESOP loan, passed through to employees, or reinvested by employees in company stock are tax-deductible.

7. **Employees pay no tax on the contributions to the ESOP, only the distribution of their accounts, and then at potentially favorable rates:** The employees can roll over their distributions in an IRA or other retirement plan or pay current tax on the distribution, with any gains accumulated over time taxed as capital gains. The income tax portion of the distributions, however, is subject to a 10% penalty if made before normal retirement age.

Demerits of ESOP

1. Though voluntary in nature, some employees may feel they are being forced to join.
2. Employees earnings at present and in future become subject to a greater risk (that of performance of their employer)
3. It is being used as a management tool to fend off takeover attempts. Holders of employees owned stock often align with management to turn down bids that would not only benefit outside stock holders but would also replace existing inefficient management and restructure operations.
4. There is no direct relationship between the effort and reward

Therefore, ESOPs suffers from many disadvantages and are effective only during periods of prosperity. Still, they are continuously growing in popularity. A more extensive approach of employees stock option plan result in employees actually owning all or significant parts of their employers business. That is also known as Employee Stock Ownership Plan (ESOPs).



Disadvantages of ESOP

Appraisal of Employees Stock Option Plan

The main objectives of this scheme are to have good understanding between the employer and the employee. In addition to that to act as shareholder of the company the employee may know his role as shareholder. It may leads to the above advantages still many employees feel stock option plan not the preferred method of investment due to the following reasons:

- The employee is asked to invest savings as well as earnings in the company. Most of the workers have hardly any surplus to invest in shares.
- There is no guarantee about increase in the market value of shares in future
- As long as the share price go up. The morale of the employee is high. When share prices go down, the employees are like to blame the company.
- Employees participation in company meetings, management and control, sometimes, may prove to be more of an interference rather than an aid to cooperation.
- It is a very poor incentive because of indirect relationship between effort and reward of employees and remoteness and uncertainty of reward.

Employees Stock Ownership Plan (ESOP) Vs. Employees Stock Option Scheme (ESOS)

In contrast to the ESOP, the ESOS is simply a scheme through which participation of employees in the shareholding of the company is encouraged. The employees can be allotted shares through the preferential allotment route every financial year or they may be given shares by way of reservation in a if fresh issue. Shares are issued under ESOS directly to the employees. However, in an ESOP, shares are issued to a trust which held the shares for the benefit of a group of employees. The companies get tax benefits for making contribution to the ESOP in USA. However, in India, such provisions are yet to be incorporated in the Income Tax Act 1961.

Employees Stock Option Scheme in India

The Securities and Exchange Board of India (SEBI) guidelines for disclosure and Investor Protection explain that ESOS is a voluntary scheme on the part of the company to encourage employee's participation in the company. A suitable percentage of reservation can be made the issue for the employees of his company. However, under the existing guidelines, 5% of the new issue may be reserved for the ESOS subject in a maximum of 200 shares per employee who agree to participate to the ESOS. Further, the membership of the ESOS should be restricted only to the permanent employees of the company.

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Lesson 3.6 - Compensation Management in Multi-National Companies (MNCS)

Learning Objectives

After reading this chapter you should be able to:

- Define International Compensation
- Know the Objectives of International Compensation
- Understand the Components of International compensation
- Analyze Approaches to International Compensation

Introduction

Global compensation managers two important compensation related area in which focuses. They must manage highly complex and turbulent local detail while concurrently building and maintaining a unified, strategic pattern of compensation policies, practices and values. For multinationals successfully mange compensation and benefits requires knowledge of employment and taxation, 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.

The level of local knowledge needed in many of these areas requires specialist advice and many multinational retain the services of consulting firms which may offer a broad range of services or provide highly specialized services relevant to Human Resource Management in a multinational context.

International compensation management is difficult issue due to two reasons. First payment of the same pay scale for all the employees of a particular rank meets the norm of equity and simplifies the task of keeping track of disparate country by country compensation rates. But, it may create more problems than it solves. The cost of living may vary significantly from one country to another. For example, it is enormously more expensive to live in London than in New Delhi. Unless the cost of living differences are duly incorporated in compensation levels, it may be highly difficult to make executives take up the high cost overseas assignments. Thus, one of the most difficult problems in managing compensation in multinationals is establishing a consistent compensation measures between countries that builds credibility and is fair and equitable.

Objectives of International Compensation Management

During course of compensation policies development the firm should seek to satisfy the following objectives:

1. The compensation policy should be consistent with the overall strategy, structure and business needs of the multi-national companies.
2. The compensation policy must work to attract and retain staff in the areas where the multinational has the greatest needs and opportunities.
3. The compensation policy must be competitive and recognize factors such as incentive for Foreign Service, tax equalization and reimbursement for reasonable costs.
4. The compensation policy should facilitate the transfer of international employees in the most cost-effective manner for the firm
5. The compensation policy should must give due consideration to equity and ease of administration
6. The compensation policy should give financial protection in terms of benefits, social security and living costs in the foreign location.
7. Compensation should give to the expatriate some opportunities in terms of financial advancement through income and or/ savings.
8. The compensation should meet the issues such as employees housing, education of children and recreation needs.

Key Components of an International Compensation

The international compensation is complex primarily because multi-nationals must cater to three categories of employees: Parent Country Nationals (PCN), Third Country Nationals (TCN), and Host Country Nationals (HCN).

Base Salary

The term base salary acquires a somewhat different meaning when employees go abroad. 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 primary component of a package of allowances, many of which are directly related to base pay. For example 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 difference 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 or 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. Under such circumstances, the definition of hardship, eligibility for the premium and amount and timing of payment must be addressed. In cases in which hardship are determined.

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.

- **Cost of living allowance:** which is typically receives the most attention, involves a payment to compensate for difference in expenditures between the home country and the foreign country. Often this allowance is difficult to determine, so companies may use the services of organization who are expert in calculating above.

- **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. Such allowances are often paid on either an assessed or an actual basis. Other alternative include company provide housing, either mandatory or optional, a fixed housing allowance or assessment of a portion of income, out of which actual housing costs are paid.

- **Home leave allowance:** Many employees cover the expense of one or more trips back to the home each year. The purpose of paying for such trips is to give expatriates the opportunity to renew family and business ties, thereby helping them to avoid adjustment problems when they are repatriated. Although firms traditionally have restricted the use of leave allowances to travel home, some firms give expatriates the option of applying the allowances to foreign travel rather than returning home.

- **Education allowances:** for expatriates the 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.

- **Relocation allowances:** usually cover moving, shipping and storage charges, temporary living expenses, subsidies regarding appliance or car purchases and down payments or lease related charges. Allowances regarding perquisites (cars, club memberships, servants) may also need to be considered.

- **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.

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. Therefore, 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 benefits programs and or making up any difference in coverage.
- Whether expatriates should receive home-country or host-country social security benefits.

Approaches to International Compensation

Two main approaches adopts by the MNCs in fixing compensation for their employees are:

1. Going Rate Approach
2. Balance sheet Approach

Going Rate Approach

In this approach salary has been fixed based on the local market rates. The local market rates are decided based on survey conducted in comparing compensation of local nationals (Host country Nationals (HCNs), expatriates of the same nationality and expatriates of all nationalities. The selected survey comparison the base pay and benefits offered.

Advantages

- Compensation paid with equality with local nationals
- This method of compensation is easy to calculate
- Compensation decided in identification with host country
- Equity is maintained amongst different country nationals

Disadvantages

- Variation in compensation is exist between assignments for the same employee
- Variations between expatriates of the same nationality in different countries
- Due to this method of compensation re-entry problems will come in future.

Balance sheet Approach

The balance sheet approach aims to develop a salary structure that equalizes purchasing power across countries so expatriates have the same standard of living in their foreign assignment as they had at home. There are three common methods implementing the balance sheet compensation plan.

Home based Method- sets compensation based on the salary of a comparable job in his or her home city.

Headquarters based Method set salary in terms of the salary of a comparable job in the city where the MNCs has its headquarters and

Host Based Method- bases compensation on the prevailing pay scales in the locale of the foreign assignment, plus foreign-service premiums, extraordinary allowances, home-country benefits, and taxation compensation.

Advantages

- This method gives advantage in terms of equity between assignments and between expatriates of the same nationality
- This approach facilitates expatriate re-entry
- In this approach it is easy to communicate to employees

Disadvantages

- This approach of compensation can result in great disparities between the expatriates of different nationalities and between expatriates and local nationals
- This approach of compensation can be complex to administer

Self Assessment Questions

1. Define wages. Explain the characteristics of wages
2. Explain the various theories of wages
3. What is meant by nominal wages? Differentiate it from real wages?
4. Give an account of economics of wages
5. How will you develop rational wage system?
6. Distinguish between wage and salary
7. Discuss the Maslow theory and examine its merits demerits
8. How Maslow theory of hierarchy helps in deciding wage for an employee?
9. Define Executives
10. Comment on "Executive high pay" – Debate its reasonableness
11. Discuss the components of executive compensation
12. Explain annual incentive plans given to the executives
13. Discuss the various aspects of executive incentives and bonus schemes
14. Discuss the methods of job evaluation for managerial job
15. Discuss the issue of total compensation design for executives
16. Define Incentive Plan
17. Discuss different types of Incentive Plan
18. Enumerate Incentive plan for groups

19. What is incentive plan? What are the different types of incentive plans?
20. Define gain sharing. What are the advantages and disadvantages of gain sharing?
21. Define executive incentives and discuss different types of incentives offered to executives.
22. What are the steps involved in incentive strategy formulation process?
23. Define Team compensation and explain its advantages and disadvantages.
24. Explain competency based pay? What are its objectives, advantages and disadvantages?
25. Define profit-sharing
26. What is profit sharing plan? What are its objectives?
27. Discuss profit sharing plan of a company
28. Define profit sharing? What are the different types of profit-sharing plan
29. Discuss the advantages and disadvantages of profit sharing plan
30. Explain the profit sharing plan in India and its advantages and disadvantages
31. Define co-partnership. What are its advantages and disadvantages?
32. What are the steps involved in profit sharing?
33. On what basis profit sharing take place in companies?
34. Discuss the meaning and features of profit-sharing. Write a note on profit-sharing in India
35. Explain the concept of profit-sharing. What are its features? Is there any difference between profit-sharing? Discuss its merits and limitations
36. What is profit sharing? Discuss its merits and limitations
37. Write an explanatory note on Employees Stock Option Plan (ESOP)
38. What is meant by Employees Stock Option Plan? What are its features
39. What should be the main objectives for a multinational firm with regard to its compensation policies?
40. Describe the main differences in the Going Rate and Balance Sheet Approaches to international compensation.
41. What are the key differences in salary compensation for PCNs and TCNs? Do these differences matter?
42. What are the main points that MNEs must consider when deciding how to provide benefits?

43. Why is it important for MNEs to understand the compensation practices of other countries?
44. Explain how balancing the interests of global and local, occupational and functional perspectives might play out in a compensation decision scenario.
45. Write a note introducing the concept of international compensation
46. Write a detailed note on various types of overseas employment
47. Why it is important to determine base rate of pay for overseas jobs? How is such wage determined usually? What are the advantages of determining base pay in such usual way?
48. Describe in detail, the benefits associated with international programmes
49. Discuss the issue of compensating third country nationals
50. What is balance sheet approach? What are its objectives? What method of payment can be adopted to pay the amount of compensation determined according to this approach?

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UNIT - IV

Unit Structure

Lesson 4.1 - Sales Force Compensation

Lesson 4.2 - Sales Incentive

Lesson 4.1 - Sales Force Compensation

Learning Objectives

After reading this chapter you should be able to:

- Understand the Sales force Compensation
- List different Need for Salesmen Compensation Plan
- Know the Methods of Rewarding Sales Personnel
- To evaluation the steps in Devising Salesmen Compensation Plan

Introduction

Compensation is essential for the purpose of retaining and motivating the sales force. Since monetary rewards are important factors in the motivation of salesman, they are considered the methods of compensating them. Monetary incentives may be in the form of salary, commission, bonus, etc., the commission is considered to be a useful method of compensating because it provides a direct link between sales performance and compensation. A minimum amount of salary is guaranteed to salesmen to ensure the safety of, and satisfaction with the job. Commission and salary are combined to compensate salesmen and stimulate them to achieve the targets. The salaries are commensurate with the responsibility and nature of job. Travel and out-station allowance should be adjusted properly to motivate them. Compensation may be in the form of a straight salary plan, a straight commission plan, a salary-plus-commission plan, and salary –plus bonus plan, and a salary-plus-bonus-plus commission plan.

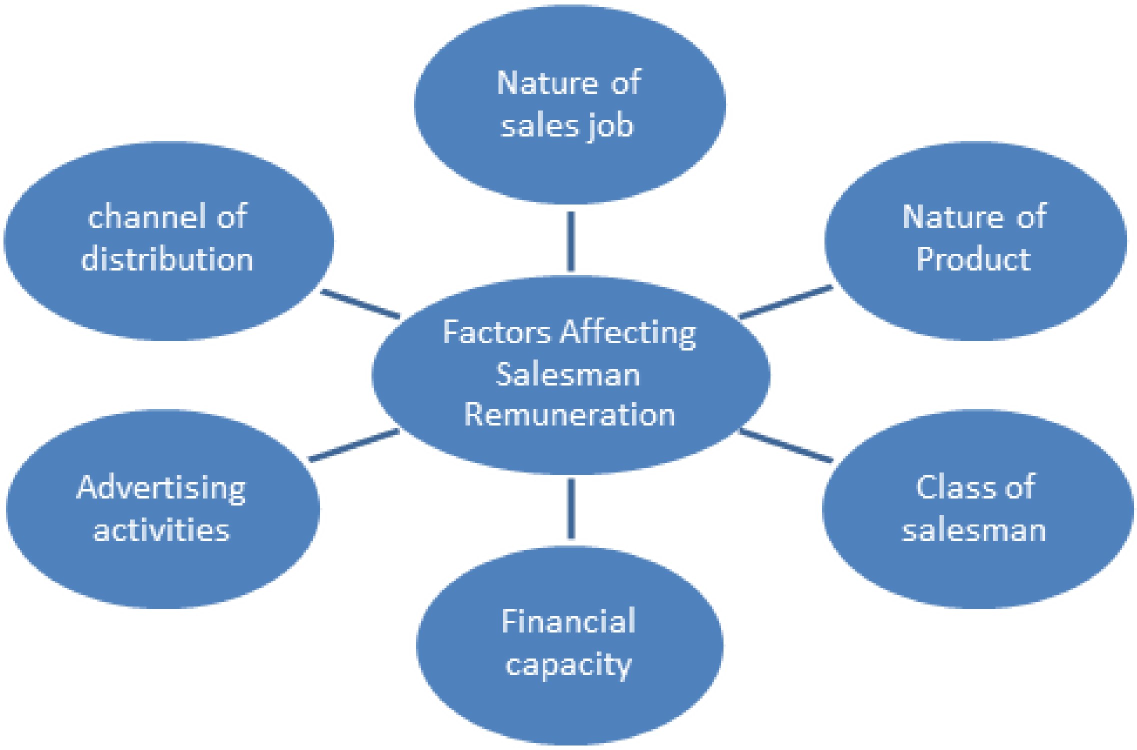
Need for Salesmen Compensation

- First it provides a living wages, preferably in the form of secure income. Individuals worried about money matters do not concentrate on doing their jobs well.
- Secondly, the plan fits with the rest of the motivational program. It does not conflict with other motivational factors, such as the intangible feeling of belonging to the sales team.
- Thirdly, the plan is fair. It does not penalize sales personnel because of factors beyond their control within the limits of seniority and other special circumstances, sales personnel receive equal pay for equal performance.
- Fourth, it is easy for sales personnel to understand they are able to calculate their own earnings.
- Fifth, the plan adjusts pay to changes in performance
- Sixth, the plan is economical to administer
- Seventh, the plan helps in attaining the objectives of the sales organization.

Good Sales Compensation Plan

Factors Affecting Salesman Remuneration

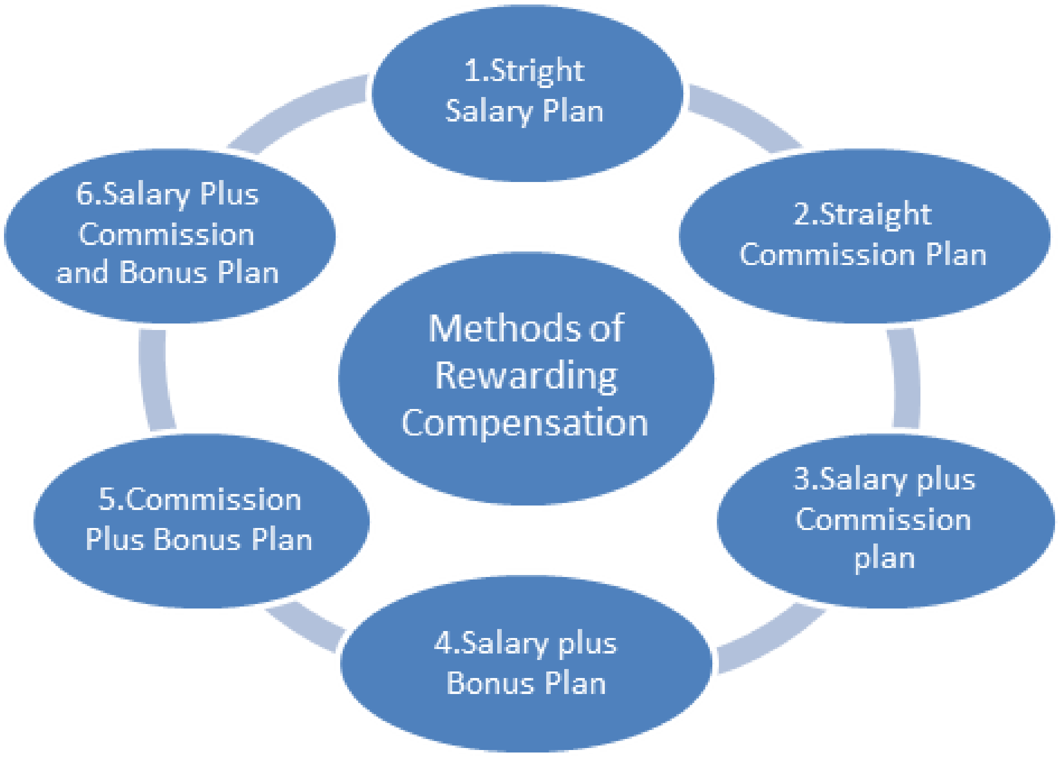
An ideal compensation scheme necessarily maximizes the goals of the firm as well as of the sales force. No doubt, the method of remuneration differs from firm to firm but there are several factors which influence the remuneration plan of any organization directly. These factors determine the nature and amount of remuneration of the sales force.



Factors Affecting Salesman Remuneration

Methods of Rewarding of Sales Personnel

Not all employees are the same, nor are the jobs they hold. Some groups within an organization need special compensation systems in order to take advantage of the type of person that is attracted to that type of job and the special characteristics of the job. In most organizations the compensation program for sales personnel is different and separate from that of other employees. This different treatment has to do with the nature of the job, the importance of the job, and the nature of sales personnel. The dominant feature of sales compensation is the use of variable pay. Whereas variable pay plans are becoming more popular for a wide range of employee groups, the sales group has always been paid on a variable pay system due to the nature of the job. To attract, retain and motivate the best salespeople one should pay them more than they are worth. The following figure shows that the different compensation rewarding methods followed by the companies to their sales personnel.



Methods of Rewarding of Sales Personnel

1. Straight Salary Plan

The straight salary plan normally offers the maximum security to salesmen. The management guarantees payment of at least a minimum salary to salesman and expects from the a minimum productivity. This method is based on the time-wage system. The salary is fixed whether work is more or less. However, salesmen are paid travelling expenses and other expenses incurred by them in the discharge of their duties.

Advantages of this method

- Salesman are benefited by this because they are assured of a minimum amount every month.
- It gives them a sense of security and promotes their loyalty to the organization.
- Salesmen are motivated to explore new areas of sales because they work seriously to develop an untapped are into a full-fledged market.
- Salesmen are not required to adopt aggressive salesmanship procedures. They may devote more time to satisfy customers and understand their requirements.
- Supervision and other managerial jobs can be assigned to them whenever necessity arise

Disadvantages

- It does not offer any inventive to salesmen.
- All the salesmen are given almost the same salary, none strives to prove himself to be more efficient than others.
- There is no direct relationship between the volume of sales and the cost of sales.
- Salesmen do not take up any difficult task because that does not yield any extra remuneration to them
- Straight salary method is suitable when salesmen are newly recruited, and management desires to enter untapped territories to sell new products in the market

2. Straight Commission Plan

The straight commission plan incorporates payment of compensation on the basis of the sales made by each salesman. The payment is made on the basis of sales performance. The commission may be paid on the net sales or on the total number of units sold. The compensation based on commission is not fixed. It varies from salesman to salesman, depending upon their sales performance. It provides direct financial incentive. Since the sales result is the basis of compensation, the total sales performance is maximized.

Advantages

- It is most suitable method of expending sales
- It attract those people who are energetic, industrious and enthusiastic.
- There is no dissatisfaction because of either over-payment or less payment
- The selling cost is controlled in relation to the sales volume
- This plan has been useful in motivating the sales force.

Disadvantages

- The salesman are careless in many cases because there is no supervision
- The aggressive selling method is used without caring for the reputation of the company
- Salesmen may concentrate on easy sales, and may not devote time to the exploration of new markets.
- They may lack creative salesmanship.

3. Salary Plus Commission Plan

The salary plus commission plan combines two methods. A fixed salary is paid to all salesmen. If they sell more than the minimum requirement, they are given commission at a fixed rate on the total sales effected by them. Salesmen are satisfied with the fixed regular salary because it assures safety and security. On the other hand, industrious, energetic, efficient and enterprising salesmen earn a larger amount on the basis of their sales performance. Incentives and safety are combined.

Advantages

- Advantages of both salary and commission plan is available under this method
- The management and salesmen decide the minimum level of sales for the salary paid and the rate of commission to be given for a sales performance higher than the minimum laid down.
- Mutual agreement guides future activities

4.Salary Plus Bonus Plan

Bonus is paid when a particular sales quota is achieved, or when promotion activities are undertaken, or when the objectives are attained and all the assigned jobs have been performed. The salary plan offers satfety and satisfaction, while bonus is an additional incentive for the attainment of targets. Bonus is given only for performance above the standard level, while commission is paid on every sale made by the salesman. Bonus is infrequently, but commission is frequent.

Therefore, bonus is a satisfactory incentive. The bonus plan may create some confusion and problems if not designed properly. The procedure for bonus payment should be determined clearly and fairly. Salesmen are informed from time to time about their performance and rewards in the forms of bonus to avoid any conflict and motivate them towards higher achievement.

5.Commission Plus Bonus Plan

Salesmen may be motivated by the offer of commission and bonus if their performance is better than the average laid down. Bonus is paid when the sales are higher than the targeted level. In some cases, bonus is paid if the commission exceeds a fixed amount. Salesmen are motivated to earn a higher amount by way of bonus on higher sales.

6.Salary Plus Commission and Bonus Plan

Salesmen may be given salary as well as commission on their regular sales. If their performance exceeds the prescribed level, they are rewarded with a bonus. The bonus stimulates, the commission gives incentives, and the salary ensures security. Thus, the three elements are combined to ensure the highest performance.

Steps in Devising Salesmen Compensation Plan

Whether contemplating major or minor changes or drafting a completely new sales compensation plan, the sales executives approaches the project systematically. Good compensation plans are build on solid foundations. A systematic approach assures that no essential step is overlooked. The following are the steps followed while framing compensation plan for the sales personnel.

Steps in Devising Salesmen Compensation Plan

1. Customer to whom the Salesperson going to deal

The nature of the sales job varies not only with where in the process the sales person operates, but also with the customers that they deal with. New vs. existing accounts is one distinction. Generally, developing new customers is a more difficult process than dealing with a group of customers with which the sales person is already familiar. If the customers are end users there is a higher probability of constantly having to be involved with developing new accounts. Selling to non-end users, such as distributors, requires less of a need to develop new accounts, but the sales person needs to support the intermediary in selling to the end user by doing training and promotional work. Grouping customers by size is often done as there are clear differences in the needs of large and small customers. Frequently small customers get neglected when sales to large customers make the sales person more money. A company with many divisions and multiple products will tend to organize sales around product lines that often have very different characteristics from each other. Lastly, sales are often organized around either industries or geographical area, thus taking advantage of the knowledge the sales person can obtain in these specialized segments.

2. Analyze the Nature of Sales Job

Sales work involves working with customers to convince them to order the products or services of the organization. The importance of this activity is obvious. Except in the odd circumstance where the organization's product sells itself, this activity is vital to the continuing operation of the organization. Furthermore, this importance of the job is highly visible in the organization, making the impact of the job even clearer. But an in-depth analysis shows two things about sales work that should be kept in mind: not all of the salesperson's activities are sales work, and not all sales activity is carried out by staff labeled as sales personnel.

3. Evaluate the Types of Sales Activity Salesperson going to carry out

Most sales jobs include activities such as soliciting orders, servicing customers, seeking out buyers, obtaining information, and performing cold calls and product promotion. Some sales personnel also engage in credit-information collection and analysis, product modification, customer-personnel training, and technical advice and assistance. All sales jobs require that the salesperson perform some administrative work, such as making reports and keeping records. Depending upon the market, the products, and the organization, various aspects of these activities are more or less important in particular sales jobs. Further, although some of these activities are important and necessary, they may not really be sales work, indicating that sales personnel do more than just sell.

This variety of sales activities suggests that it is necessary to develop job descriptions for sales jobs that clearly describe the contributions required of the employee. When the salesperson is paid on an incentive basis the non-selling activities can often be neglected unless they are clearly spelled out as a part of the job. These descriptions are most useful where there are a number of different types of sales positions in the organization. Sales job descriptions typically include not only information about activities, but also information about the number of customers, volume of sales, diversity of products sold, and geographical area covered.

4. To find out Salesperson support to the Organization Sales

The typical mental picture of a salesperson is someone operating alone with the customer. For some positions this is an inaccurate depiction. Sales work requires the support of others in the organization. At one level there is administrative support enabling the salesperson to operate in the field. Some of this support is clerical. Another level in today's complex economic environment is support of the field sales effort by inside sales personnel. Many sales situations also require help in the form of technical expertise that is available from others in the organization. All of this support changes the picture of a salesperson. They are no longer seen as an independent operator and this has a considerable impact on developing incentive programs, which assume that it is the activity of the salesperson that brings in the sales orders.

5. Consider Compensation Patterns in Community and Industry

Compensation levels for sales personnel are related to external supply and demand factors, it is important to consider prevailing compensation patterns in the community and industry. Management needs answers to four questions: What compensation system are being used? What is the average compensation for similar positions? How are other companies doing with their plans? And what are the pros and cons of departing from industry or community patterns? If there is a companywide formal job evaluation program., it should take into account the current rates for sales positions in the community and industry.

6. Consult the Present Sales Force

Management should consult the present sales personnel in as much as many grievances have roots in the compensation plan. Management should encourage sales personnel to articulate their likes and dislikes about the current plan and to suggest changes in it. Criticisms and suggestion are appraised relative to the plan or plans under consideration. But at this point, management compares the caliber of the present sales force with that of the people whom it would like to have.

7. Determine the Compensation Level

Management must determine the amount of compensation a salesperson should receive on the average. Although the compensation level might be set through individual bargaining, or on an arbitrary judgment basis, neither expedient is recommended. Management should ascertain whether the caliber of the present sales force measures up to what the company would like to have.

If it is too low, or if the company should have lower-grade people than those currently employed, management should determine the market value of sales personnel of the desired grade. Management weighs the worth of individual person through estimating the sales and profit that would be lost if particular salespeople resigned. Another consideration is the compensation amount the company can afford to pay.

8. Provide for the various Compensation Elements

A sales compensation plan has as many as four basic elements: 1) a fixed element, either a salary or a drawing account, to provide some stability of income 2) a variable element for example a commission, bonus, or profit sharing to serve as an incentive, 3) an element covering the fringe or plus factor such as paid vacations sickness and accident benefits, life insurance, pension and the like and 4) an element providing for reimbursement of expenses or payment of expenses allowances. Not every company includes all four elements. Management selects the combination of elements that best fits the selling situations.

9. Implement the Plan and Provide for Follow-up

At the time the new plan is implemented, it is explained to sales personnel. Management should convince them of its basic fairness and logic. The sales personnel are made to understand what management hopes to accomplish through the new plan and how this is to be done. Details of changes from the old plan, and their significance require explanation.

All sales personnel should receive copies of the new plan, together with written examples of the method used for calculating earnings. Provisions for evaluation of compensation plant are made. Periodic checkups, need for further adjustments is detected. Period evaluation provides evidence of plans' accomplishments, and they uncover weaknesses needing correction.

CASE STUDY

Ian Renton is the newly appointed sales manager at Denham Pharmaceuticals, a medium sized company (small by comparison to competitor) in the are of over-the counter drugs and proprietary medicines prescription. In its early years, the company grew rapidly, marketing several related drugs developed by the founders of the business and a highly motivated and innovative research team. Selling by five or six representatives concentrated on wholesalers and larger chemist outlets. The importance of specifies, namely, general practitioners and hospitals, had always been recognized but the company did not have the resources to call personally on all UK doctors and pharmacists. The current sales force is 18 in number, some of whom have been seeking out specifies in response to leads and inquiries. These calls have been proving very effective in sales terms, although the link between specifying, stocking and end users has been hard to identify. Ian wants to encourage more detail calling as well as improving sales effort on existing accounts. A new remuneration package seems to be required to achieve these objectives.

Questions

1. Design a suitable remuneration package
2. Point out the possible advantages and disadvantages in your own plan.

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Lesson 4.2 - Sales Incentive

Learning Objectives

After reading this chapter you should be able to:

- Know Introduction to Incentives
- Understand Different types of Incentives
- Find out the steps in Developing Incentive Structure
- Know Fringe Benefits offered to Sales personnel

Introduction

Sales force incentives are a vital part of business and one of the best reasons is that they work. This is one of the few motivators that can rev up a sales force for pennies on the dollar. However it has to be well designed and executed to reap the full benefits and get the most out of sales force. The reasons sales force incentives are so effective, is that they appeal to the basic instinct of a true sales person. The need to compete, to be recognized for doing well and essentially having their ego stroked and last but not least the ability to acquire more stuff for doing what they love to do. A good sales force incentive program can almost always assure a business owner that they will get results, but there are several rules of engagement that they have to keep in mind. The sales force incentive requires a concise goal. This may be as basic as increasing sales, but there are other objectives that can be added to a sales force incentive. These range from generating new accounts to launching new products or even expanding sales territory. The sales force incentives goals will greatly depend on where that particular business sees they are lagging behind the competition, or that there is an untapped market they need to explore.

Defining Incentives

Incentive pay, also known as "pay for performance" is generally given for specific performance results rather than simply for time worked. While incentives are *not* the answer to all personnel challenges, they can do much to increase worker performance. Although each rewards specific employee behaviors, they differ substantially. In structured incentives, workers understand ahead of time the precise relationship between performance and the incentive reward. In a casual approach, workers never know when a reward will be given.

Great reasons to launch a Sales Force Incentive Program

Incentive Plan Design Process

In determining the appropriate sales incentive measures, it is critical to first understand the entire process

Step 1. Evaluate Business Economic Value Drivers

Every sales force is impacted by the marketing strategy and how senior management communicates it. The sales force is also directly impacted by how the business is organized, how it is managed and by its unique value drivers. Relative to value drivers, does the company have the best product, best price, best delivery, and best market coverage or does it rely heavily on the business relationships maintained by the sales force? Relative to business operations and culture, how realistic are management's sales goals and marketing strategy? Is there enough inside sales support and investment in promotion and marketing? Do sales people feel they have the freedom to adjust their approach to various situations, or are they required to use the same strategy for every customer?

Step 2. Analyze Current Plan Effectiveness

Is the current incentive plan working as well as management would like? It could be that there is significant turnover in the sales force. Perhaps the commission or salary structure is creating problems. This check list can also help identify issues and problems with the existing sales compensation plan. Keep the following issues in mind:

- The sales incentive plan must support the marketing strategy and the long-term continuity of the sales force.
- If the Return on Investment is negative or marginal the program should be reevaluated.
- Tactical issues revolve around avoiding the following: Over or underpaying the sales force Ignoring new business development, Resisting management and "doing my own thing", Gaming the goal-setting process. These issues indicate problems with the incentive plan that need further analysis before a new plan can be effectively implemented.

Step 3. Part A. Determine Pay Strategy

What is the current pay strategy? What level of pay and performance is required to reach the 50th or 75 th percentile of the market? Are there unique industry characteristics that require sales people with special scientific or technical skills? Sales compensation should be designed so that it is planned and predictable. It is a variable cost that fluctuates as sales change. A sales incentive program should never be designed to cause a lower or higher expense than planned. The pay strategy should be supported by outside market data and be internally equitable, i.e., all sales people with the same responsibilities should have the same total compensation opportunity. External industry competitiveness is an extremely important consideration in plan design. For example, sales representatives in medical specialty products like hip replacements or cardiac stents are in a very unique and well-compensated industry. Pay practices also reflect the importance of the sales person. In a commodity business, where there is little product differentiation, a salesperson's personality may be the only reason for the customer to buy. In industries such as consumer packaged goods where companies have large advertising and promotion budgets, individual salespeople may not have as much impact. The pay strategy and incentive plan should reflect the individual's impact on the completion of the sale. The compensation program should reward strong performers, identify poor performers who require improvement and help recruit top talent from other organizations. One of the key factors to analyze is the mix between salary and incentives and the relationship between performance and pay. Pay modeling must be done to make sure the plan works under a variety of economic scenarios.

Step 4. Analyze Companies that are in different stages of maturity typically have different products and unique strengths and weaknesses

Plan design will follow those characteristics. For example, in certain instances a pay system may be dominated by a commission schedule. In others it may be a traditional salary plus incentive structure, and yet in others it may follow a hybrid of the two, where the base salary level and cost is built into the sales expectation. This latter approach is interesting because it communicates that base salary levels have sales expectations built into them and incremental compensation is only achieved by exceeding those expectations. Most important, however, is the goal setting process. Goals must support the organization's strategy and be understood and agreed to by top management and both sales and marketing management. In the past, sales incentives were often based exclusively on giving sales people a percentage of their sales, but it is critical to tailor specific performance measures to the overall company's strategy and financial goals in order to maximize plan effectiveness. The most common goals used are sales revenue, gross profit and number of units sold. A number of organizations use gross profit or net profit as the sales incentive performance measure. This encourages not just sales, but profitable sales. It takes pricing into account and discourages low margin sales. Some companies try to focus the sales force on new customer development rather than just maintaining existing customer relationships. Here are some other goals to consider:

- Product mix (selling a certain amount of specific products in a given territory).
- Cross-selling different products to existing customers
- Territory market share

Types of Incentives

Casual Incentives

A bonus given routinely soon becomes part of the expected compensation package. Casual incentives communicate to employees that you have noticed their efforts. People thrive on positive feedback. Drawbacks. Three possible drawbacks to the casual incentive approach may include

(1) Envy among employees,

(2) Feelings among workers that the supervisor may be acting out of favoritism, and

(3) The use of rewards to maintain social distance.

While there are times when praising workers in public is appropriate, at other times it may do more harm than good. An example of the latter is when coworkers hear a direct or implied comparison between the rewarded employee and themselves. Even though workers are likely to tell others about their rewards anyway, the force of the comparison is reduced when you give casual incentives privately. Perceptions among workers that rewards are given in a capricious or arbitrary manner, however, may still remain. One way of overcoming both envy and favoritism challenges may be by having workers nominate others for these casual awards. The nominating procedure should be kept simple. Recognition coming from fellow employees is unlikely to cause resentment and is one of the most sincere forms of praise. This type of recognition could even be given in public. Unfortunately, chances are that workers will be rewarded for their popularity.

Structured Incentives

Structured incentives can help direct employee efforts. Other benefits include cost certainty and cost reductions.. Benefits to employees include higher pay and satisfaction. Examples of structured incentives.

(1) Must be capable of fluctuating (variable pay) as performance changes, and

(2) Is based on a specific accomplishment-reward connection understood by both management and workers.

Examples of Typical Incentives

- Piece-rate pay for pruning or picking
- Allowing workers to go home early, with full pay, when they finish a job
- End-of-season bonus for employees who stay to the end
- Quality or production incentive
- Bonus for reducing production costs
- Profit sharing.

Examples of Payments or Benefits which are not Incentives

Most mandated benefits such as unemployment insurance, workers' compensation, non mandated benefits that do not fluctuate, such as housing, wage increases, vacation, or rewards that, once earned, are seldom lost · pay tied to time worked (except for bonuses for attendance, difficult shifts, and the like).

Steps in Establishing Structured Incentives

This section provides seven guidelines helpful in deciding whether to establish, and how to design and troubleshoot, structured incentive programs.

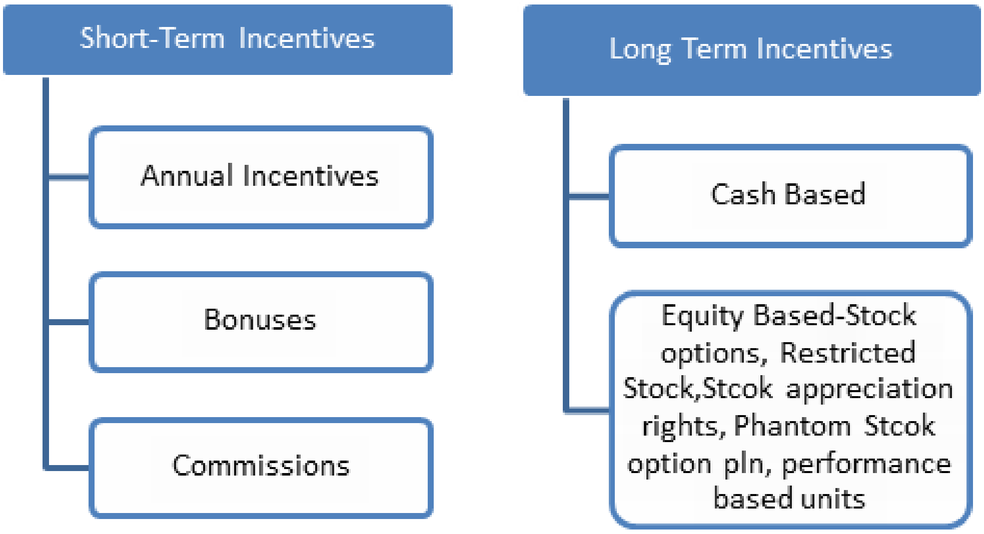
Steps in Establishing Structured Incentives

Types of Salesmen Incentives

Choosing the right sales incentives to motivate a team can be challenging. On the one hand, they need to be exciting enough to motivate a sales force to change their behavior, or at least point it in a certain direction. On the other hand, they also need to fit within an organization's budget and not cost so much that they cancel out the benefit of holding a sales contest in the first place. Incentives' can come in a number of different flavors, all f which can be effective.

Job-Related Incentives

This should be the least expensive form of incentive, since it can consist of items like additional vacation time which have no out-of-pocket cost. Non-tangible benefits like vacation time are only appropriate in a company culture which would allow employees to take advantage of them. There is still a "cost" to having people out of the office, but this type of reward can go a long way in terms of employee satisfaction. Other choices in this category include tangible sales incentives like a new cell phone, iPad or upgraded laptop. The item should be something “sexy” enough to get a salesperson excited but at the same time also have the potential to positively impact the salesperson’s productivity. This type of incentive can be a double-win. The salesperson wins by getting a neat toy that helps them to work more productively to drive more results. The company wins because the prize not only motivates the salesperson to work harder to earn it but also because it will ultimately make them more effective, generating increased sales. Plus, the salesperson could be piloting a new sales tool, and if it proves highly effective could be rolled out to others.



Types of Salesmen Incentives

Tangible Incentives

To understand what prize salespeople may desire, the sales manager should know the profiles of the members of their sales forces. On the other hand, for a sales team which maintains a business-formal dress code, a couple of custom-tailored suits could be very exciting. If the sales team likely could not afford to buy themselves a custom suit, it would be an even better gift. Finding a sales incentive that the members of the team generally do not have is also important. For example, giving away a 42 inch flat screen television today is likely to excite people, since they probably already have one. Spending the same money on a high-end watch or other apparitional item could very well be the ticket.

Experience Incentives

Surveys have shown that experiences impact happiness more than purchases. There is a way to squeeze more performance out of an experience incentive. Instead of sending one salesperson to Hawaii for a week, creating a team-based contest with a team experience as a prize can add an additional level of effectiveness, e.g., a nice team dinner or a team outing. Not only do these types of sales incentives reward high performers, but they also help them to bond to each other, increasing the likelihood that they will stick with you for the long run.

Every sales manager has stories about sales incentives that have failed to motivate their teams. By having a clear understanding of a team, their desires, and needs both inside and outside of work, sales managers can choose the right incentives to motivate sales performance.

Fringe Benefits to Sales Personnel

Fringe benefits, which do not bear direct relationship to job performance, ranges from 30 to 40 percent of the total sales compensation packages. The sales job requires sales manager to address different levels of human needs. Sales manager agree that salary is an important incentive; however, the fringe benefits (non financial compensation) contributes success of the sales person discussed as follows:

Based on Time

- Holidays, Vacations, Sick leave, Personal leave, Sabbaticals, and Pregnancy leave

Based on Organization Dues

- Trade association, Civic clubs, Country clubs, and Professional association

Based on Retirement Programme

- Social security, Pension, Profit Sharing, and Salary reduction plans

Insurance and Medicals

- Physical examination, Medical payments and reimbursements, Hospitalization insurance, Dental insurance, Disability insurance, Life insurance, Travel insurance, Accidents insurance, Worker's compensation, Unemployment insurance, and Cancer insurance

Miscellaneous

- Automobile, Use of vacation spot, Parking, Dry cleaning and laundry, Secretarial services. Employee stock purchase plan, Company-provided housing, Legal services, Financial counseling, Tuition for continuing education programmes, Financial support for dependent's education, Credit union, Discounts for purchase of company products, Child care payments, Matching funds to charities and schools, Career counseling, and Payment for moving expenses

Self Assessment Questions

1. What do mean by the term sales force compensation?
2. How do you determine the right type of compensation for your sales force?
3. What are fringe benefits? Why sales force need to have fringe benefits?
4. Why sales force is provided with salary and commission?
5. Define Incentives
6. What are the different types of inventive offered to sales personnel?
7. Discuss the different types of fringe benefits offered by companies to sales personnel.
8. What are the objectives behind in offering incentives to sales personnel?
9. Critically examine the different stages involved in developing incentive structure.

CASE STUDY

Mr.Immanuel has worked as a salesperson for an Indian Computer manufacturer for the past ten years. A global firm recently offered him a position as sales manager for ten countries in Southeast Asia. Given this new responsibility, he must move to the regional sales office in Singapore with his wife and three children. Immanuel is unsure about the compensation plan he has been offered. Does the plan pay him enough money to live on an equal level in Singapore as he can live in New Delhi? He also wonders about the cost of rental housing and international schooling for his children in Singapore. Immanual is very close to his family and wants to travel back to India regularly to check on their health and welfare. He would like to know where an individual can gain access to important compensation information.

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UNIT – V

Unit Structure

Lesson 5.1 - Wage Boards

Learning Objectives

After reading this chapter you should be able to:

- Understand the Wage Board
- List different Pay Commission and its Impact
- Know the Six Pay Commission and the Controversy

Introduction

In the 1950s and 60s, when the organized labour sector was at a nascent stage of its development without adequate unionization or with trade unions without adequate bargaining power, Government in appreciation of the problems which arise in the arena of wage fixation, constituted various Wage Boards. The Wage Boards are tripartite in character in which representatives of workers, employers and independent members participate and finalize the recommendations. With the passage of time, it was felt that Government need not set the wage rates in respect of employees in different sectors and can be left to the industry itself. However wages are still decided by the Wage Boards for journalists and non-journalists newspaper and news-agency employees, since the award given by the Wage Boards are non-statutory in nature, recommendations made by these Wage Boards are not enforceable under the law.

The importance of the non-statutory Wage Boards has consequently declined over a period of time and no non-statutory Wage Board has been set up after 1966, except for sugar industry, where last such Wage Board was constituted in 1985. The trade unions, having grown in strength in these industries, are themselves able to negotiate their wages with the management. This trend is likely to continue in future.

The Working Journalists and other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955 (45 of 1955) (in short, the Act) provides for regulation of conditions of service of working journalists and non-journalist newspaper employees. The Section 9 and 13 C of the Act, inter-alia, provide for constitution of two Wage Boards for fixing or revising the rates of wages in respect of working journalists and non-journalist newspaper employees, respectively. The Central Government shall, as and when necessary, constitute Wage Boards, which shall consist of

- Three persons representing employers in relation to Newspaper Establishments;
- Three persons representing working journalists for Wage Board under Section 9 and three persons representing non-Journalist newspaper employees for Wage Board under Section 13 C of the Act.
- Four independent persons, one of whom shall be a person who is, or has been a judge of High Court or the Supreme Court, and who shall be appointed by the Government as the Chairman thereof.

Since 1955, the government has constituted 6 wage boards for the working journalists and non-journalist newspaper employees. The following table gives the details of the constitution of wage boards and other relevant details:

S. No.	**Name of the Industry**	**Date of appointment of Wage Boards**	**Date on which final report was submitted to Govt.**	**Date of acceptance of recommendation by Govt.**	**Remarks**
1.	2.	3.	4.	5.	**6**
(I)	Wage Board for Working Journalists	02-05-1956	NA	11-05-1957	
(II)	(a) Wage Board for Working Journalists	12-11-1963	17-07-1967	27-10-1967	
	(b) Wage Board for Non-Journalists Newspaper Employees	25-02-1964	17-07-1967	18-11-1967	

(III)	(a) Wage Board for Working Journalists	11-06-1975	13-08-1980	26-12-1980 & 20-07-1981	Converted into one man Tribunal on 9th Feb,1979 (Palekar Wage Boards)
	(b) Wage Board for Non-Journalists Newspaper Employees	06-02-1976			
(IV)	Wage Boards for Working Journalists and Non-Journalists Newspaper Employees	17-07-1985	30-05-1989	31-08-1989	
(V)	Wage Boards for Working Journalists and Non-Journalists Newspaper Employees	02-09-1994	25-07-2000	05-12-2000 and 15-12-2000	
(VI)	Wage Board for Working Journalists & Non-Journalists Newspaper Employees	24-05-2007	31-12-2010	11-11-2011	

Source: Ministry of Labour Welfare

The Government of India constituted two wage boards (Majithia Wage Boards), one for working journalists and other for non-journalist newspaper employees in 2007 as sixth Wage Board under the Chairmanship of Justice Kurup as per the provisions of The Working Journalists and Other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955. Chairman, Justice K. Narayana Kurup resigned with effect from 31st July, 2008. Subsequently Justice G.R. Majithia took over charge as Chairman on 4th March, 2009. The Majithia Wage Boards submitted their final report to the Government of India on 31st Dec., 2010.

The Government accepted the recommendations of the Majithia Wage Boards and accordingly notified it vide S.O. No. 2532(E) dated 11/11/2011. The recommendations have been uploaded in the Ministry's web-site and in public domain. The notification is subject to the outcome of the Writ Petition (Civil) No. 246, of 2011 in the matter of ABP Pvt. Ltd. & ANR Vs. Union of India & others. In addition, 9 other Writ Petitions have also been filed upto April, 2012 before the Hon'ble Supreme Court by the different employers of newspaper industry regarding constitutional validity of the Wage Boards and not to implement the recommendations of the Majithia Wage Boards. There is no stay order by the Hon'ble Supreme Court on the implementation of the recommendations of the Majithia Wage Boards.

The primary responsibility for implementation of the recommendations lies with the State Governments/UTs. Accordingly, a copy of the notification (both Hindi & English) was forwarded to all the State Governments /UTs vide this Ministry's letter dated 24/11/2011. In order to monitor the implementation of the notification, a Central Level Monitoring Committee has been set up under the Chairmanship of Principal Labour and Employment Adviser with Joint Secretary, Ministry of Information and Broadcasting & Chief Labour Commissioner (Central) as Members and Dy. Director General as Member Secretary.

Pay Commission

A Pay Commission is a panel of members of the Union Cabinet of India for review and revision of the salaries of government employees. It was set up by the Central Government in the year 1965 and as an administrative committee to determine the salaries of central government employees. Six pay commissions have been set up till date.

History

Since India's Independence, six 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.

First Pay Commission

The first pay commission was constituted in May 1946, and had submitted its report in a year. and the importance is on the report. chairman was Srinivasa Varadachariar wef The first pay commission was based upon the idea of "living wages" to the employees, this idea was taken from the Islington Commission and the commission observed that "the test formulated by the Islington Commission is only to be liberally interpreted to suit the conditions of the present day and to be qualified by the condition that in no case should be a man's pay be less than a living wage." The commission emphasized on the idea of the living wages and stated that the government which is going to introduce the minimum wages legislation for the workers of the private industry should also follow the same principle for its own employees. The commission basically recommended that the lowest rung employee should at least get minimum wages.

Second Pay Commission

The second pay commission was set up in August 1957, 10 years after independence and it gave its report after two years. The recommendations of the second pay commission had a financial impact of ₹ 396 million. The chairman of the second pay commission was Jaganath Das.The second pay commission reiterated the principle on which the salaries have to be determined. It stated that the pay structure and the working conditions of the government employee should be crafted in a way so as to ensure efficient functioning of the system by recruiting persons with a minimum qualification.

Third Pay Commission

The third pay commission set up in April 1970 gave its report in March 1973 i.e. it took almost 3 years to submit the report, and created proposals that cost the government ₹ 1.44 billion. The chairman was Raghubir Dayal. The third pay commission added three very important concepts of inclusiveness, comprehensibility, and adequacy for pay structure to be sound in nature. The third pay commission went beyond the idea of minimum subsistence that was adopted by the first pay commission, the commission report say that the true test which the government should adopt is to know weather the services are attractive and it retains the people it needs and if these persons are satisfied by that they are getting paid.

Fourth Pay Commission

Constituted in June 1983, its report was given in three phases within four years and the financial burden to the government was ₹ 12.82 billion. This commission has been set up on dated 18.3.1987, Gazette of India (Extra ordinary) Notification No 91 dated 18.3.1987, The chairman of fourth pay commission was P N Singhal.

Fifth Pay Commission

The Fifth Pay Commission was set up in 1994 at a cost of ₹ 17,000 crore. The chairman of fifth pay commission was Justice S. Ratnavel Pandian.

Financial Impact of Fifth Pays Commission

With the implementation of the Fifth Pay commission a huge burden was taken up by the central government. It declared hike in salary of about 3.3 million central government employees. Further, it also insisted on pay revision at the state government level. The Fifth pay commission disturbed the financial situation of both the Central and the State Governments and led to a hue and cry after its implementation. The Central government's wage bill before the implementation of the commission's recommendations was 218.85 billion in 1996-1997 which also included pension dues and by 1999 it shoot up by about 99% and the burden on the exchequer was about to ₹ 435.68 billion in 1999-2000.With regard's to the state government the bill went up by 74%. The state governments which paid about ₹ 515.48 billion in 1997 as salaries, had to pay ₹ 898.13 billion in 1999 as salaries. This clearly indicates the burden on the state and the central government. Many economists[say that about 90% of the revenue of the state went in as salaries[*verification needed*]. 13 states of India were not in a position to pay salaries to its employees due to the hike and hence the central government's help was sought·

Other Recommendations of the Fifth Pay Commission

One of its recommendations was to slash government work force by about 30%. It also recommended to reduce the number of pay scale from 51 to 34 and to not recruit to about 3,50,000 vacant position in the government. None of these recommendations were implemented.

Criticisms of World Bank on Fifth Pay Commission

The World Bank criticized the Fifth Pay commission, stating that the Fifth Pay Commission as the 'single largest adverse shock' to the public finance of the nation. It also said that the number of employees of the government was 'not unduly' large, but there was a 'pronounced imbalance' in the skills. It noted that about 93% of the employees were of 3rd or 4th grade.

Sixth 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 ₹ 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 1 officers in India are grossly underpaid with an IAS officer with 25 years of work experience earning just ₹ 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 the year 2008 and balance 60% arrears (as promised by Government) has also been credited in Government employees account in the year 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.

Controversy

Several government services, most notably the armed forces have complained bitterly of down gradation due to pay commissions exceeding their brief, and introducing anomalies in the relative scales of pay of government services. At present, the armed forces have represented to the government for the removal of anomalies which it is felt that the civil servants on the commission have deliberately introduced to upgrade themselves vis-a-vis service officers in the defense forces.

SC Constitute a New Pay Commission for Trial Court Judges

The chief justice and other supreme court and high court judges got a threefold salary hike in the sixth pay commission however the trial court judges were paid low and a bench comprising Chief Justice K G Balakrishnan and Justices P Sathasivam and J M Panchal constituted a new pay commission for the trial court judges headed by retired Madras High Court judge, Justice E Padmanabhan for recommendation of revision of about 14000 trial court judges. This order from the SC came because of a petition filed by All India Judges Association, which stated that the first judicial commission which was headed by Justice Jagannatha Shetty had said that there should be an upward revision of salaries of lower court judges in proportion to the hike to the judges of high court and Supreme Court. It also sought direction from the court to the centre for setting up a committee "forthwith appoint a committee of one or more persons to look into the matter" relating the salary of officers in the lower judiciary.

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Lesson 5.2 - Employee Benefit Programs

Learning Objectives

After reading this chapter you should be able to:

- Understand the Employees Benefit Programme
- List different Reasons for Offering Employees Benefit Programme
- Know the Components of Employees Benefit Programme
- Identify the Reason for growth of Employees Benefits
- Know the steps in Planning and designing Employees Benefit Programmes
- Find out the issues faced by Employees Benefit Programme

Introduction

The total wage cost of an employee to the organization is far more than the pay rate of that employee. Likewise, the total compensation reward of the employee exceeds his or her take-home pay. Total compensation consists partly of the pay of the employee and partly of a set of other rewards that are loosely called benefits.

The addition of these items to the compensation package considerably complicates all aspects of the administration of compensation — from the compensation strategy to the implementation of the plan. Benefits are unlike base pay in that they are awarded for different objectives, they are not periodically given, they are oftentimes deferred rather than current, and they require different types of administration.

Since pay and benefits together make up the wage costs of the organization, there is a trade-off between direct pay and benefits. Benefits, until recently, were called fringe benefits. This was because they were considered a minor part of the compensation package. This is no longer true, and benefits are becoming more important in compensation administration as they become a larger proportion of total compensation, representing close to 40% of the total cost of compensation. Clearly then, it is especially important to properly manage them.

Reason for Offering Benefits to Employees

Companies provide their employees and workers with a variety of benefits. These benefits are basically forms of value or services that are provided by an employer to his employees for their contribution in the performance of the organization. Such benefits are an important component of a company's remuneration package for attracting and retaining its employees.

The benefits serve as incentives to the employees and encourage them to work harder for the organization. These also help in building up employee job satisfaction. These benefits may be financial or non-financial, long term or short term, free or at concessional rates. They may include educational, residential, medical, or recreational facilities. Such facilities may be provided individually or collectively and inside or outside the organization.

Thus the employee benefits are the comforts and the facilities given to employees to enable them to work in a healthy and peaceful atmosphere.

The employee benefits of a company generally includes:-

(i) A remunerative wage structure which motivates the employees to contribute their maximum worth to the enterprise

(ii) Bonus to the employees either on festive occasions or as a reward for their contribution in the high performance of the firm

(iii) Social security benefits for employee welfare in the form of provident fund, gratuity, medical facilities, compensation and insurance policies

(iv) Different types and number of leaves so that the employees may revitalize themselves and contribute their best effort to the organization

(v) Employees who wish to voluntarily retire from an organization are provided with several benefits under the voluntary retirement scheme.

Given the various types of employee benefits, a firm may design, administer and manage a comprehensive benefit package for its employees depending on its work culture and organizational set up. The employee benefits package may include the following:-

Examples of Benefits

1. Extra payments for time worked:	Paid lunch periods

1. Extra payments for time worked:

Weekend premiums

Holiday premiums

Overtime premiums

Shift premiums

2. Non-production awards and bonuses:

Anniversary awards

Attendance bonus

Christmas bonus

Quality bonus

Safety awards

Shift premiums

Weekend premiums

Service bonus

Suggestion awards

Waste-elimination bonus

Year-end bonus

3. Payments for time not worked:

Call-back pay

Call-in pay

Clean-up time

Clothes-changing time

Dental-care time

Down time

Family allowances

Holidays paid for but not worked

Jury duty time

Lay-off pay

Medical time

Military induction bonus

Military service allowance

National Guard duty

Paid death-in-family leave

Paid lunch periods

Paid sick leave

Portal-to-portal pay

Religious holidays

Reporting pay

Reserve military duty

Rest periods

Room and board allowances

Severance pay

Supper money

Time spent on contract negotiation

Time spent on grievances

Vacation pay

Voting time

Witness time

4. Payments for employee security, Contributions toward:

accident insurance

disability insurance

hospitalization insurance

life insurance

medical insurance

surgical insurance

Contributions to state disability insurance

OASI contributions

Contributions to unemployment compensation

Supplements to unemployment compensation

Free meals

Functions for retired employees

Health education

Hospital Facilities

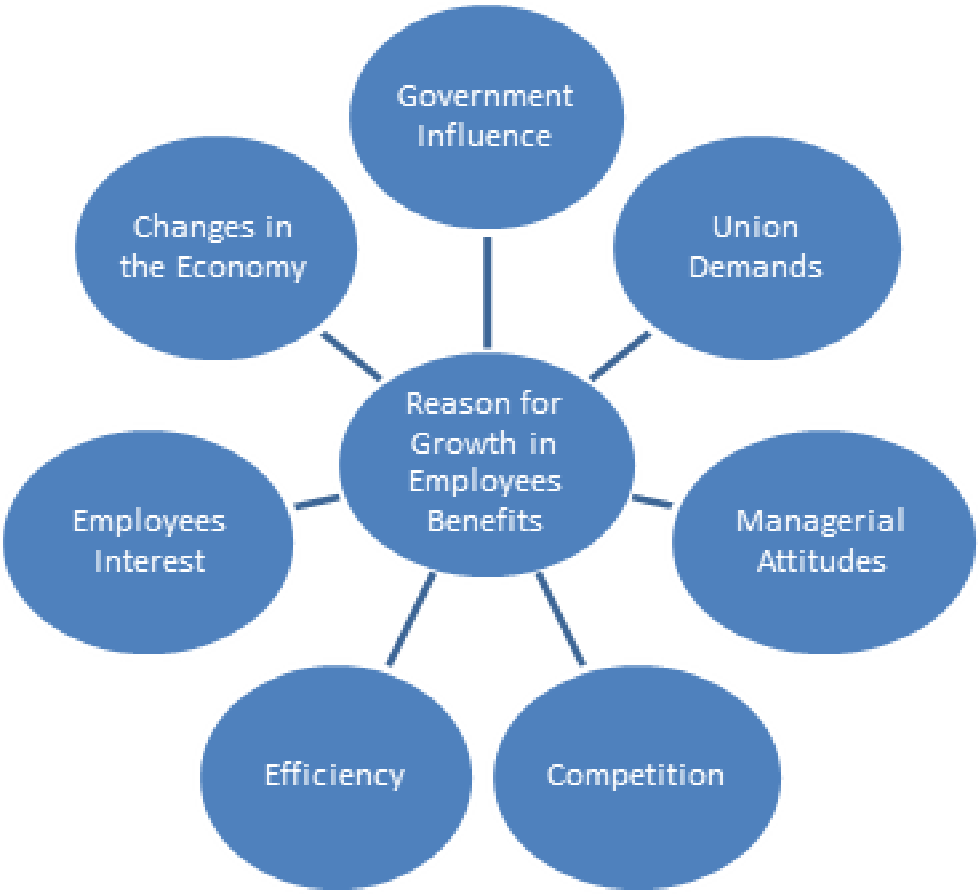
Legal aid

Lunch period entertainment

Medical examinations (voluntary)

Music at work Paid club memberships Paid subscriptions to magazines Parking space operation Purchasing service Reading room facilities Recreational facilities Rest room facilities Safety clothes at company expense Safety programs Scholarships Shower and locker rooms Transportation Vacation facilities Visiting nurse Wedding gifts Work clothes at company expense Contributions to Workers' Compensation Supplements to Workers' Compensation Contributions to employee thrift plan Contributions to employee stock purchase plans Credit union Employee loan association Health and welfare funds Home financing	Mutual benefit association Payment of optical expenses Pensions Savings Bond administration **5. Payments for employee services:** Annual reports to employees Beauty parlors Cafeteria Canteen service Company athletic teams Company housing Company stores Day Care Income tax service Information racks Dietetic advice Educational assistance Employee counseling Employee discounts on purchases Employee parties Employee pleasure trips Employee publications Financial advice Flowers for ill and deceased employees and families Free laundry

Reason for Growth in Employee Benefits



Reason for Growth in Employee Benefits

Government Influence

As indicated above, the government took a lead role in expanding this influence of government on benefits has come in four ways:

- **Directly through legislation:** Legislation that produced organizational requirements in the areas of Workers' Compensation, unemployment compensation, Social Security, Old Age and Survivors' Benefits, and disability insurance. More recently, some state legislation has provided for employer and employee contributions toward non-work accidents and illnesses.
- **Through attempts to Control the Economy:** At times, usually wartime, the government has imposed wage and price controls. These controls have given a strong impetus to the growth of benefits by permitting improvements in benefits while discouraging wage and salary increases on the grounds that the latter would contribute to inflationary pressures.

- **Control of Benefit Programs:** Flurry of legislation, designed not to create new benefits but to control programs currently offered by organizations. The most critical of these acts are the Employee Retirement, Job Security Act), dealing with retirement plans; the Civil Rights Act, which affects all areas of benefits; the Safety and Health Act, which deals with safety standards on the job; and the Health Insurance, which deal with health insurance.

- **Indirect Effects of Government:** Indirect, influence of the government on benefits has been income-tax legislation. High corporate income-tax rates make it advantageous for employers to include as business expenses a wide range of benefits, particularly those to executives. Since most of these benefits are not taxed as income, provision of these benefits results in huge savings for the employee, also.

Union Demands

Union demands have served to increase benefits as a proportion of total pay. Sometimes a benefit has been demanded to establish a principle of employer responsibility for risks facing workers. The union felt that a large portion of the down time in model changeovers could be reduced by management. At other times, benefits have been sought when pay increases appeared infeasible. Unions have sought to expand benefits for a number of reasons, including their desire for

- Increased status,
- Security,
- A shorter work week,
- More strength in the eyes of its members, and
- The development of the plant as a community.

Managerial Attitudes

Social responsibility may not be the best name for the response by employers to the needs of their employees, but it does get the point across. More recently, the trend has been to consider the employee a partner in the development and operation of benefit programs. The employee is making decisions about his/her own life and needs, and the organization provides the programs to accomplish this. For instance, there is a trend in providing employee services. Today it is seen that an employee who is healthy, both physically and mentally, is a more productive person. This has led to a series of employee services, such as athletic facilities and counseling in areas such as smoking and drug abuse, intended to create and maintain a healthy workforce. A current issue in this area is whether employers have a responsibility to provide care for children of employees.

Competition

All organizations are subject to a competitive labor market. Hiring and retaining employees requires that the organization be competitive, at least to some degree, in the labor market. When other organizations offer benefits, so must your organization. But this is not simple. Paying competitive wages is a single figure. Offering competitive benefits involves decisions about the type of benefits to offer as well as the cost of those benefits. The type and level of benefits offered makes the organization attractive or unattractive to different potential employees. There is also a trade-off between wages and benefits. Some individuals prefer high wages and care little about benefits while others need or desire certain types of benefits.

Efficiency

Most benefits are in the form of insurance. These benefits can be obtained at a lower cost by having savings in underwriting and administration through group contracts rather than by having each employee contract individually.

Employee Interest

To the employee, the advantages of benefits can be many. Certainly the two most prevalent are the tax advantages mentioned and the lower cost of receiving the benefit by belonging to a group. The fact that over half of all benefits are intended to reduce economic insecurity suggests that both employers and employees are aware that life in an industrial society requires these protections. At best, however, employee attitudes toward benefits are ambivalent. On one hand, people seem very interested in benefits, since this is a major item of consideration in the recruiting process. On the other hand, most employees do not know what benefits the organization is providing them and particularly the cost to the organization of those benefits. Employees differ considerably in their demand for benefits and even more clearly in the types of benefits they demand. The demographics of an organization's employees offer a hint as to the needs and preferences of its members, but they are not an infallible guide. Employee-preference studies have found that some demographic characteristics (particularly age and marital status) were good predictors of benefit preference, but that others (such as sex, age, and occupation) were not. Clearly there is a ranking of desirability of benefits by individuals, but it is not wholly predictable by employee characteristics.

Changes in the Economy

The continuing industrialization in modern times, or more accurately the move toward a postindustrial society, has created changes that encourage organizations to provide more benefits to employees. One of the effects of an increasing standard of living is that people's desire for leisure increases in proportion to their desire for more wages. In economic terms, the elasticity of the supply of labor is such that as wages rise, there is a point at which leisure becomes more appealing than more work, even work at a higher wage. In the India today there are two contrary trends. On one hand, the number of hours worked has risen, and on the other, a demand for more time and programs for family life has become increasingly important.

Continuing industrialization and consequent changes in modes of living have brought new risks to the employee and increased old ones. At the same time, increased productivity has afforded programs that provide security against these risks. Economic security in a society in which most individuals are employees depends on finding and keeping a job. Any threat to continuing employment becomes a risk to the employee and the family, and creates a demand for insurance against such risk. The result is that at least a portion of individual compensation represents protection against insecurity. In this way benefits provide more stability in the economy. The more that benefits are oriented toward reduction of insecurity among employees, the more stable is the economic environment.

Planning and Designing of Benefit Programmes

Decisions with respect to benefits are made more complex because of confusion of purpose, lack of agreement on which benefits do and do not constitute compensation, and the rapid growth of benefits and their costs. Perhaps the only point of agreement is that benefit administration is changing. To the employer, decisions on benefits represent a large and growing proportion of compensation expenditures and thus a large part of the organization's contribution to the employment exchange. To the union, benefits are often perceived as a social obligation of the employer and a right of the employee. To the employee, they represent protection from insecurity and a reward for continuing their employment with the organization.

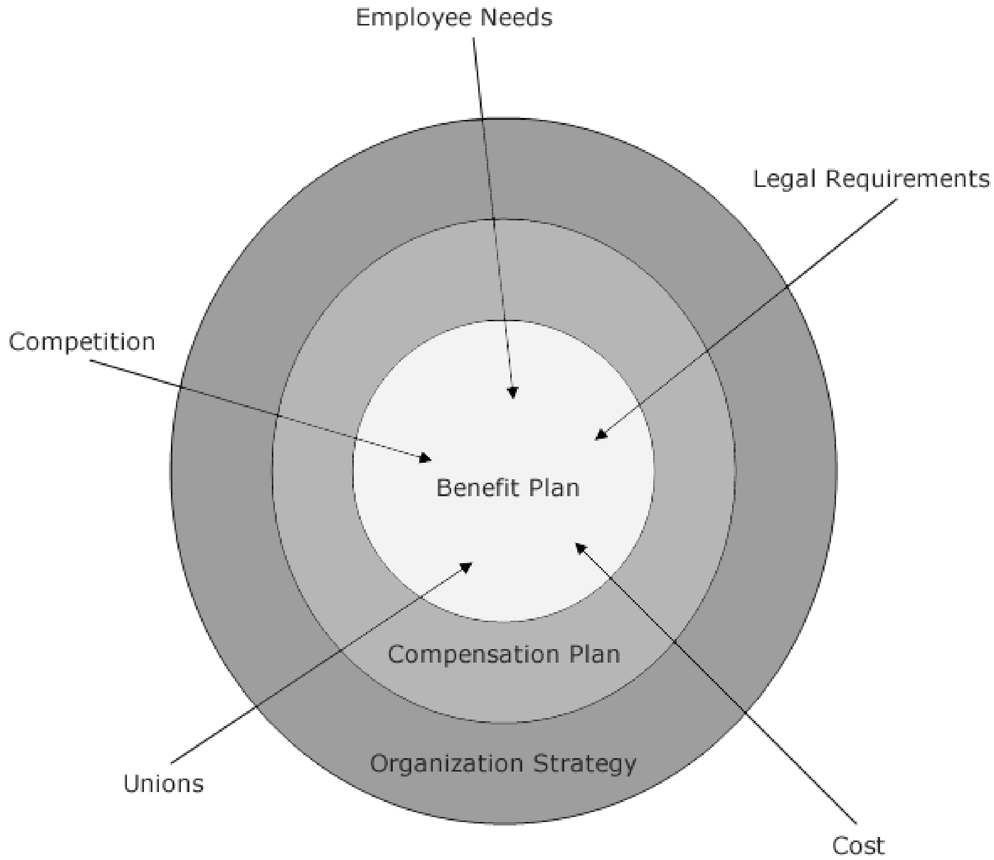
The process of benefit planning, then, has the following steps:

- Determining the goals and objectives
- Assessing and/or selecting benefits

➢ Designing the benefits Package
➢ Monitoring the plan

(1) Determining the Goals and Objectives

There are so many reasons why benefits have become a major part of any compensation plan. These reasons will influence the determination of the goals and objectives of a benefits plan. In addition, the benefits plan is a part of the organization's compensation plan that is in turn part of the organizational strategy. These relationships are illustrated in the following figure:.



Benefits as Part of Compensation and Organization Strategy

The benefits plan should not be just a collection of individual benefits, but rather an integrated set of benefits that supports the organization's strategies through the management of its human capital. To maximize this, employer need to ask what employee wants the benefits program to do for them. Not all organizations are going to answer this in the same way. Superficially, benefit decisions are similar to wage level decisions. In both instances, the basic issue to the employer is that of labor cost. The employer decision involves expenditures resulting from the employment exchange, and from a cost standpoint the organization is indifferent as to whether these costs are in the form of wages or benefits. The tendency to talk about wages and benefits as a package reinforces this view. Actually, however, decisions on benefits involve a number of choices different from other wage decisions. Benefits are not unitary, as are wages. There are many choices to make as to which ones to offer, and there are a number of influences on these decisions. Unions sometimes do and sometimes do not consider benefits to be pay equivalents. As indicated, employees value benefits differently. They do this not only on the basis of their own needs, but also upon being convinced of their importance by the union and management.

(2) Assessing and/or Selecting Benefits

Note that goals and objectives tell employer where he would like to be, not where he are. So if there are currently benefits, the second step is to assess these benefits to see where improvements are needed or new ones need to be added. Selecting and evaluating benefits is the first step in translating the goals and objectives into a benefits program. There are a number of forces on the organization that influence this decision process. Organizations have some choice in the benefits they offer but not complete choice. There are required benefits, as employer shall see, from legislation; second, there are customary benefits that are common to almost all organization. Finally, there are many possible benefits that can make benefits package unique.

- **Legislation**. Social legislation requires that the employer make expenditures for the health and safety of employees and for various forms of insurance to indemnify employee loss of income from illness and injury, unemployment, and old age. At another level, law also determines how the organization will develop and operate specific benefits, particularly retirement plans. These expenditures are required whether or not the employer wants to make them and whether or not the employee desires the resultant benefit.

- **Assessing the Competition**. Another consideration in benefit planning is industry and area practice regarding benefits. This helps to determine what customary benefits are. In order to keep employees, the organization must remain competitive for labor services, and knowing what benefits other employers are offering is necessary for decisions about what benefits to offer. Surveys of benefits, then, are conducted for the same reason as wage and salary surveys — to obtain information on the conditions prevailing in the labor market. Community wage surveys include a number of benefits practices. Employer-association wage and salary surveys customarily include benefit-program information. Without this information the wage rate information received in surveys may be misleading. The usual benefits survey seeks prevailing practice in the form of enumeration of the programs offered and descriptions of those programs and their coverage. Ideally, an organization would know both the benefits offered by competitors and the competitors' costs for those benefits. But the cost figures are hard to get. It is difficult to cost out individual benefits, and accounting practices vary considerably. As indicated, some organizations see an item as a benefit and others do not. Cost information on individual benefits may not be useful, since the composition of the work force in each organization differs. What is probably more important is to know the total benefit costs of organization and their competitors.

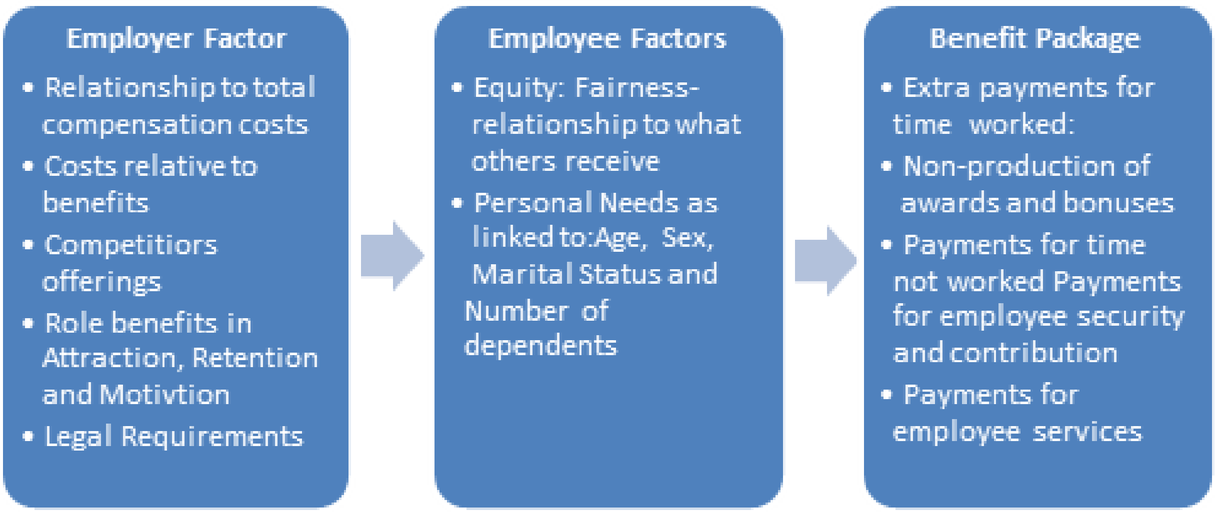
- **Organizational Benefit Plan Analysis**: Surveys of prevailing benefits may have the dysfunctional consequence of encouraging particular benefit programs simply because they exist in other organizations and not because they are wanted or needed by the organization's employees. Internal organizational analysis of benefit practices would seem to require a comparison of current benefit offerings with the needs and preferences of employees. Our designation of benefits as membership rewards is an aid in this analysis, for it specifies the organization's purpose in offering benefits is to obtain and retain employees. But the analysis gets complex because individual employees and groups have different needs and preferences. So the internal organizational analysis of benefits focuses on the needs and preferences of employees. Organizations differ in the demographic makeup of their work force, and this should, in turn, create differences in the types and levels of benefits that organizations offer.

- **Organizational Financial Analysis**: A further part of the organization analysis is a comparison between direct wages and benefits, in terms of both cost and employee need. This comparison is needed for a couple of reasons. The first is to maintain a balance between direct wages and benefits. Granting wage increases and benefit changes independently can lead to excessive increases in payroll costs where the organization loses control of the situation. When benefits or one benefit's costs are rising at a rapid rate, it negatively impacts the organization's ability to raise other parts of the compensation package. A further part of the organization's financial analysis is the employer's ability to pay.

- **Collective Bargaining and Benefits**: If it is assumed that union demands reflect employee preferences and that organizations have analyzed their own position, the results of collective bargaining can be advantageous to all parties. The employees should be receiving the benefits they want, and unions are motivated to convince employees of the value of the benefits bargained for. Unfortunately, unions often have goals that do not reflect employee preferences in particular organizations. The union may be striving to institute a benefit in the whole industry or to satisfy a majority of the total union. Because of the political nature of unionism, there is always pressure to achieve gains for the members, and benefits can often appear to be a big gain when pay increases are hard to bargain for. Further, union leaders often are caught in the same problem as the management of an organization with a diverse work force: there is no consensus on what the real needs and preferences of employees are.

(3) Designing the Benefit Packages

In continuation to the above analysis the following should question to be raised who should receive benefits. If benefits are truly membership rewards and not job- or performance-related, then they should be equally available to all employees. However, if an organization needs continuity of employment from only some groups and doesn't care about turnover in other groups, a case can be made for having different packages of benefits for different employee groups. This is an extension of the cost/benefit argument, that these expenditures, like all others, should clearly bring something of value to the organization. While designing the benefit packages the following questions to be raised and answered:



Factors Influencing Choice of Benefit Package

Questions on Who Should Receive Benefits

1. Should part time employees be covered? If so, for what?
2. Should dependents of covered employees be covered? If so for what? Should any cost sharing be different for dependents?

3. Should domestic partners be included as a spouse?
4. Should retired employees be covered? If so for what? Should their dependents be covered? What kind of cost sharing should these groups have?
5. Should survivors of deceased employees be covered? If so for what?
6. What coverage should be extended to employees with disabilities?
7. What coverage should employees who are temporarily separated have? [such as on family leave]

(4) Monitoring the Benefits Programmes

The field of benefits is changing rapidly. It is necessary for the organization to keep careful track of what is happening both externally and internally. The needs and preferences of employees are likely to change because the organization's work force is constantly changing. Surveying employee needs and preferences should be a continuing exercise and not a one-time project. The practices of competition in the labor market need to be monitored on the same basis as they do for wage information. But what become most complex for the organization to monitor are the changing costs of those benefits provided by outside organizations such as insurance companies.

Organizations that have been monitoring what has happened in this area have begun to develop alternative ways of providing these benefits to employees at a lower or stable cost. Last, legislation in this field is changing every day, and administrators need to examine these acts to see if the organization is meeting legal requirements and taking proper advantage of changes in the law.

Issues Faced by Benefit Programme

All businesses contend with issues common to provision of employee benefits. Small businesses meet the challenges with fewer resources than large companies. Employers offer most benefits voluntarily, with an eye to recruitment and retention of employees. Companies can choose from an increasingly long list of employee benefits, such as medical insurance, life insurance and retirement plans, in addition to financial benefits such as bonuses, stock options and profit sharing. However, small businesses often are challenged to provide employees with benefit packages like those offered by larger companies. All businesses, regardless of size and resources, are charged with managing employee benefit programs responsibly and legally.

Company Cost

Employee benefits are a normal part of doing business, but for a small business the cost can have a greater impact on profit, cash flow and decisions about investment, expansion and hiring. A small business's expenses could include hiring staff to manage its benefits program or paying outside benefit plan managers. Managing the benefit plan adds to legal and financial accounting services. Providing leave benefits can adversely affect a small business, requiring the company to hire temporary employee and pay the salary of an employee who is on vacation or maternity leave. Businesses can lower employee benefits costs by offering fewer benefits and passing along more of the cost to employees. Cost-saving measures typically include excluding working spouses and hourly workers from insurance coverage or requiring employees to be on the job for at least three months before they are eligible for benefits. Small businesses can often save on the cost of employee benefits by joining to form a larger purchaser of benefits.

Employee Cost

Small-business employees often pay higher portions of the cost of employee benefits plans that offer fewer choices, less flexibility and frequent changes in providers and policies that occur when small businesses shop and negotiate for lower prices. Delayed eligibility means newer employees may not have basic health care benefits. The impact on employee income, reflected in high payroll deductions, can influence decisions to remain with the employer. The added expense of employee benefits makes voluntary participation in employee benefit programs difficult. Workers who cannot afford the cost may choose plans that do not meet their needs or opt out of the benefit plans.

Government Regulations

Businesses must comply with the Employee Retirement Income Security Act of 1974, which establishes standards for the management of certain voluntary health, pension and severance plans. The act includes provisions for the control of plan assets and for the creation of formal grievance and appeal procedures. Businesses are subject to assessment of penalties for failure to file required reports with the Internal Revenue Service and for failure to provide employees with correct summary plan descriptions.

Difficult-to-Understand Benefits Summaries

Employees receive a summary of the benefits provided by employees at the start of their work and an updated summary every few years while they work. The law requires a summary so that employees know the benefits they receive. The problem lies in the difficulty understanding the summary. Companies sometimes use technical terminology that makes it difficult to determine the exact benefits so the employees do not take advantage of the benefits.

Company Buy Out

When a company with great benefits is purchased by another company, several problems occur. Not only is there a risk of losing a job, but the benefits can be lost as well. The company that purchases the other company might not provide the same benefits of the former company and while it might provide the same types of benefits, it might not provide the same services. Health insurance plans might rise or other problems occur relating to benefits.

Tax related Issues

Benefits are filed in an annual report. When they are not filed, the company or employees can face problems regarding taxes. While benefits are usually considered tax free, some benefits have taxes applied to them, such as some health insurance plans or retirement funds. The filed reports avoid tax problems while reports that are not filed create problems for taxes.

Legal Issues

Too often, human resources personnel (or others charged with responsibility for a company's employee benefit plans) pay insufficient attention to their plans' legal compliance until problems arise. A proactive approach utilizing the services of legal counsel (*e.g.,* a self-audit) is the best method for ensuring ongoing legal compliance and protecting the plan sponsor from penalties and other associated liabilities.

Employees Benefit Programmes in India

A. Statutory Employee Benefits

India does not have a Social Security system. However, there are statutory employee benefits controlled by legislature. Under the Employees' Provident Fund and Miscellaneous Provisions Act (EPFMP), employers are obligated to provide provident fund benefits. The Employees' Provident Fund and Miscellaneous Provisions Act (EPFMP) established the Employees' Pension Scheme (EPS) in 1995. The Employees' Pension Scheme replaced the Employees' Family Pension Scheme (1971) and is applicable to every employee who is a member of the Employees' Provident Fund. It is mandatory for the employer and employee to each contribute 12% of gross salary to the central Employees' Provident Fund Scheme (EPFS) on which interest is credited (at present 8.5%). Of these contributions, 8.33% is diverted to the Employees' Pension Scheme (EPS); i.e.; provided the company has more than 20 employees.

General statutory benefits in India include the following:

- Provident Fund
- Gratuity
- Medical Coverage
- Bonus
- Leave and Holidays
- Working Hours & Overtime

B. Private Employee Benefits Practice

As part of private benefits practice in India, most employers offer Employee Provident Fund Scheme (EPFS) participation to all employees, and they may take advantage of the stipulation that allows them to establish a private provident fund outside the EPFS. Some employers also offer an improved gratuity system, which allows for amounts that are higher than the prescribed statutory minimum. Additionally, larger companies provide pension schemes for their management personnel. These are largely on a defined contribution basis (10% - 15%). Normal retirement age is 58 or 60 or 64 (age 55 occasionally). However, retirement is allowed up to 10 years early (on a reduced pension or with the benefits deferred until normal retirement age). In summary, the following private employee benefits practices in India are common:

- Provident Fund
- Leave and Holidays
- Working Hours
- Long Service Award
- Medical Coverage
- Group Personal Accident
- Group Superannuation
- Group Life Insurance
- Group Credit Shield

CASE STUDY

Voluntary Benefits Supplement

Computer giant IBM UK is making full use of state-of-the-art technology to maximize staff take-up of voluntary benefits, says [Employee Benefits Magazine reporter] Nicola Sullivan.

Achieving higher-than-average employee take-up levels for a voluntary benefits scheme is no mean feat. But by using the latest technology, a robust communications strategy and offering an extensive range of perks, IBM UK has enticed 73% of its 20,000-strong workforce to take part in its voluntary benefits scheme. This is pretty impressive considering the average take-up for a blue-chip company is around the 50% mark. Voluntary benefits and retail discounts are not new to the information technology giant, which launched its first scheme, offering holiday trading and online discounts from 90 retailers, in 2004. But the firm's provision has changed beyond recognition since then. The company launched its current voluntary benefits scheme, IBM Rewards (provided by Asperity Employee Benefits, which took over from IBM's previous provider, BringMe) at the beginning of 2008. The scheme gives staff access to thousands of discount offers.

Employee Discounts

Through the scheme, employees can choose to shop online and take up in-store cards that they can load with various amounts to spend at specific retailers. They are then entitled to a discount, ranging from 5% to 10%, on the amount spent. Discounted retail vouchers can also be purchased through the scheme, enabling staff to make a direct saving on goods from participating retailers. Staff who shop online are also entitled to cash back on some of the things they buy. Instead of obtaining a straight discount on a purchase, cash back is paid into an online account, from where it can be withdrawn as a cheque or bank transfer. Louise Phillips, IBM UK's European HR benefits leader, says: "It is about using IBM's place in the marketplace. We have a large number of employees [so] how can we give benefit to them? I guess, ultimately, by giving them a scheme that enables them to make savings throughout the year."

Range of Core Benefits

IBM's voluntary benefits scheme sits alongside a range of core benefits and perks offered through its flexible benefits plan You, which is provided by Mercer. Employees can enrol annually into the flex plan, which also includes salary sacrifice arrangements around some employee-funded benefits, such as childcare vouchers and bikes-for-work. Meanwhile, the trust-based defined contribution (DC) pension scheme (which has been awarded a NAPF Pension Quality Mark), with employee and employer contributions, and private medical insurance (PMI) are offered to all IBM staff as employer-funded core benefits. "It is about making sure we have a full [benefits] portfolio for employees," says Phillips. "It is about choice and flexibility. One of our key drivers is around employee engagement and satisfaction. How can we best achieve these with only an annual-enrolment [flex] scheme? "By enhancing our discount scheme and utilizing innovative technology, we can provide an offering that drives satisfaction and engagement, but also fits in with employees' purchasing decisions as it is available all year around."

Tailored to Lifestyles

As well as complementing the firm's flex scheme, IBM Rewards is increasingly being tailored to suit employees' lifestyles and affinity with online media. For example, IBM has set up a Twitter page to update staff on the scheme. It also uses daily news alerts to tell employees when new providers have been added to the plan."This really drives employees to get better information," says Phillips. "It is obviously a media medium they want to get involved in because they signed up for it. It also allows us to target different types of employee. The number of staff following Twitter on a weekly and daily basis is increasing." An IBM community page on the scheme's website has been endorsed by company HR director Jonathan Ferrar. He appears on video, explaining the advantages of the voluntary benefits plan and how it works. Interviews have also been recorded with employees who use the site, and anyone who posts a review advising others on how to shop online is rewarded with £50 cash back to spend within the scheme.IBM is now planning to go one step further and introduce a personalized home page for users of the scheme this month. "If you are a user, you will go into the site and select the key areas you are looking at," says Phillips. "If an employee has a child, they can select all the items relating to that." Google maps technology has been added to the website so employees can easily find the location of their nearest provider or retailer. "We are trying to use all the technology available to us to bring the site alive and have much greater usability for the employee," says Phillips. "We recognize that our staff are very busy and want to make the best use of their time."

Management Information

Management information fed back from Asperity on how employees are using the scheme is very important to IBM, and Phillips says this is one of the main reasons for the scheme's success."Management information is absolutely essential in understanding where our employees use the scheme and where they do not," she explains. "It helps us decide

where to remove and add offers in a way that is attractive to staff and also fits in with our overall strategy. The perks that we offer through the scheme match the IBM strategy and image."Employees' response to benefits has always been important to IBM UK and it has consistently asked for such feedback. In 2007, for example, the company actively sought employees' views to boost understanding of their benefits packages and drive take-up. It invited all employees to attend focus groups, which were held at six of the firm's major sites in the UK. The organization was particularly interested in hearing the views of staff who had previously complained about, or praised, the benefits on offer. It also provided employees with information on the benefits it was offering at the time. Certainly, IBM UK wants to have all relevant data at its disposal when deciding how to adapt its benefits package to suit its employees' needs and their preferred methods of receiving information.
Apply SWOT analysis to the above IBM case

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Lesson 5.3 - Security Benefits to Employees

Learning Objectives

After reading this chapter you should be able to:

- Define Social Security Benefits to Employees
- Understand History of Social Security Benefits in India
- Know Social Security Laws in India
- Analyze Government of India Initiatives of Social Security Benefits
- Understand Social security Coverage in India

Introduction

Social Security protects not just the subscriber but also his/her entire family by giving benefit packages in financial security and health care. Social Security schemes are designed to guarantee at least long-term sustenance to families when the earning member retires, dies or suffers a disability. Thus the main strength of the Social Security system is that it acts as a facilitator - it helps people to plan their own future through insurance and assistance. The success of Social Security schemes however requires the active support and involvement of employees and employers. As a worker/employee, you are a source of Social Security protection for yourself and your family. As an employer you are responsible for providing adequate social security coverage to all your workers. According to Article 41 of the Indian Constitution says that **" The state shall, within the limits of its economic capacity and development, make effective provision for securing the right to work, to education and public assistance in cases of unemployment, old age, sickness and disablement and in other cases of undeserved want"**. Thus, social security measures seek to relieve individuals of anxiety as to what they would do in the cases of loss or stoppage of income. The feeling of confidence so gained will enable them to apply themselves to work wholeheartedly.

Background Information on Social Security in India

India has always had a Joint Family system that took care of the social security needs of all the members provided it had access/ownership of material assets like land. In keeping with its cultural traditions, family members and relatives have always discharged a sense of shared responsibility towards one another. To the extent that the family has resources to draw upon, this is often the best relief for the special needs and care required by the aged and those in poor health. However with increasing migration, urbanization and demographic changes there has been a decrease in large family units. This is where the formal system of social security gains importance. However, information and awareness are the vital factors in widening the coverage of Social Security schemes. Social Security Benefits in India are Need-based i.e. the component of social assistance is more important in the publicly-managed schemes- In the Indian context, Social Security is a comprehensive approach designed to prevent deprivation, assure the individual of a basic minimum income for himself and his dependents and to protect the individual from any uncertainties. The State bears the primary responsibility for developing appropriate system for providing protection and assistance to its workforce. Social Security is increasingly viewed as an integral part of the development process. It helps to create a more positive attitude to the challenge of globalization and the consequent structural and technological changes.

Workforce in India

The dimensions and complexities of the problem in India can be better appreciated by taking into consideration the extent of the labour force in the organized and unorganized sectors. The latest NSSO survey of 1999-2000 has brought out the vast dichotomy between these two sectors into sharp focus. While as per the 1991 census, the total workforce was about 314 million and the organized sector accounted for only 27 million out of this workforce, the NSSO's survey of 1999-2000 has estimated that the workforce may have increased to about 397 million out of which only 28 million were in the organized sector. Thus, it can be concluded from these findings that there has been a growth of only about one million in the organized sector in comparison the growth of about 55 million in the unorganized sector.

Organized and Unorganized Sectors

The organized sector includes primarily those establishments which are covered by the Factories Act, 1948, the Shops and Commercial Establishments Acts of State Governments, the Industrial Employment Standing Orders Act, 1946 etc. This sector already has a structure through which social security benefits are extended to workers covered under these legislations.

The unorganized sector on the other hand, is characterized by the lack of labour law coverage, seasonal and temporary nature of occupations, high labour mobility, dispersed functioning of operations, casualization of labour, lack of organizational support, low bargaining power, etc. all of which make it vulnerable to socio-economic hardships. The nature of work in the unorganized sector varies between regions and also between the rural areas and the urban areas, which may include the remote rural areas as well as sometimes the most inhospitable urban concentrations. In the rural areas it comprises of landless agricultural labourers, small and marginal farmers, share croppers, persons engaged in animal husbandry, fishing, horticulture, bee-keeping, toddy tapping, forest workers, rural artisans, etc. where as in the urban areas, it comprises mainly of manual labourers in construction, carpentry, trade, transport, communication etc. and also includes street vendors, hawkers, head load workers, cobblers, tin smiths, garment makers, etc.

Objectives of Social Security

The main objectives of social security measures are as follows:

1. To increase the productivity of industrial workers
2. To improve health and control sickness of industrial workers
3. To prevent occupational diseases and take remedial measures
4. To improve mental and physical hazards to prevent industrial accidents
5. To take care of old age and other consequences resulting therefrom
6. To ensure that various legislations are implemented properly to achieve the above objectives

Objectives of Social Security

Social Security Laws in India

The principal social security laws enacted in India are the following:

- The Employees' State Insurance Act, 1948 (ESI Act) which covers factories and establishments with 10 or more employees and provides for comprehensive medical care to the employees and their families as well as cash benefits during sickness and maternity, and monthly payments in case of death or disablement.

- The Employees' Provident Funds & Miscellaneous Provisions Act, 1952 (EPF & MP Act) which applies to specific scheduled factories and establishments employing 20 or more employees and ensures terminal benefits to provident fund, superannuation pension, and family pension in case of death during service. Separate laws exist for similar benefits for the workers in the coal mines and tea plantations.
- The Employees' Compensation Act, 1923 (WC Act), which requires payment of compensation to the workman or his family in cases of employment related injuries resulting in death or disability.
- The Maternity Benefit Act, 1961 (M.B. Act), which provides for 12 weeks wages during maternity as well as paid leave in certain other related contingencies.
- The Payment of Gratuity Act, 1972 (P.G. Act), which provides 15 days wages for each year of service to employees who have worked for five years or more in establishments having a minimum of 10 workers.
- Separate Provident fund legislation exists for workers employed in Coal Mines and Tea Plantations in the State of Assam and for seamen.

Government New Initiatives on Social Security Benefits

- The various Central Acts on Social Security are being examined in the light of the recommendations of the 2nd National Commission on Labour. Relevant amendments are proposed in the EPF and MP Act as also the ESI Act. The consultation process is on with reference to the amendment suggestions received in case of the Maternity Benefit Act and the Workmen's Compensation Act.
- Innovative measures are proposed in the running of the Social Security Schemes of EPFO and ESIC. This includes flexible benefit schemes tailored to the specific requirements of different segments of the population.

Present Initiatives in Working of EPFO and ESIC

The profiles of the Employees' Provident Fund Organization and the Employees' State Insurance Corporation are being changed towards greater accessibility and client satisfaction. The EPFO extends to the entire country covering over 393824 establishments. At present, over 3.9 crore EPF Members and their families get benefits under the social security schemes administered by the EPFO. The total corpus of the EPF Scheme 1952, EDLI Scheme, 1976 and Employees Pension Scheme 1995 together amounts to about ₹ 1,39,000 crores. Over the years, the volume of service rendered to subscribers as well as investments made, etc. by EPFO have grown manifold. With a view to provide better services to subscribers and employers, the organization has launched the Project RE-INVENTING EPF, INDIA since June, 2001. The prime objectives of this Project are to provide the subscribers better and efficient services, to help the employers by reducing the cost of compliance and to benefit the organization to register geometric growth in all fields. An important part of this Project is the allotment of the UNIQUE IDENTIFICATION NUMBER-the SOCIAL SECURITY NUMBER to the EPF subscribers, issuing of BUSINESS NUMBERS to the employers and Business Process Re-engineering.

The strategy for implementation has been evolved and the allotment of the Social Security Number has begun with the entire activity being carried out in smaller phases for effective data collection. The criteria considered for the allotment of SSN include the centralized control of Uniqueness, ensuring the least manual intervention during allotment and near 100% Uniqueness accuracy levels. The Social Security Number in a nutshell is a big effort towards solving the problem of providing social protection to migrant labour and to make the data base of EPFO adaptable to the present trend of high job mobility among workers.

Social security is essential for the well being of people and society. It is the basic human right and its fulfillment will contribute to achieving various developmental goals of nation. Social Security measures have far reaching benefits in the form of improving and bringing sense of pride and self respect amongst the citizens. Such measures also help in providing the minimal level of providing protection against health and life hazards in work situations. It can progressively pay standard to social security welfare measures involving provisions of better Health Care, Maternity Care, and Old Age Pension etc.

Social Security to the workers in the organized sector is provided through five Central Acts namely

1. Employees' Provident Fund and Miscellaneous Provisions Act, 1952.
2. Employees' State Insurance Act, 1948.
3. Payment of Gratuity Act, 1972.
4. Maternity Benefit Act, 1961.
5. Employee's Compensation Act, 1923.

Social Security of the formal sector workers is provided through the instrumentality of Employees' Provident Fund Organisation and Employees' State Insurance Corporation.

Employees' Provident Fund Organization (EPFO)

The EPFO expends to the entire country covering over 7 lacs establishments. At present, over 6.16 crores EPF members and their families get benefits under Social Security Schemes administered by EPFO. The total investment corpus as on 31st March, 2011 amounts to ₹ 466370 crores. Over the years, the volume of service rendered to subscribers as well as investments made etc. by EPFO have grown many folds. EPFO has focused its effort on automation of the work processes to achieve better efficiency and improved service delivery to its members. The work done in this direction by EPFO is given below:-

- All offices of EPFO barring one at Keonjhar in Odisha have been computerized.
- With effect from the financial Year 2012-2013 a facility for electronic submission of statutory EPF returns has been introduced.
- Employers can also remit their EPF dues electronically if they have a corporate internet bank account with the State Bank of India.
- Employers not having a corporate internet bank account with SBI shall have to pay EPF dues through cheque/DD
- Once the above returns are received electronically and payment is confirmed member accounts are being updated on monthly basis.
- Establishments can also view and print the annual PF account slips of its employees.
- Provisions are underway to enable the individual employees to register and view his/her EPF account online.
- For facilitating the employers to comply with statutory provisions of EPF and file necessary returns, an E-Return Tool has been made available.
- The members can now get their PF balances on their mobile phones after registering on www.epfindia.gov.in
- Members can also track their claims and payment status online as well as receive sms s for same.
- EPF amounts are being remitted electronically through NEFT to beneficiaries bank accounts.

A proposal for comprehensive amendment of EPF & MP Act, 1952 is under examination in Ministry of Labour and Employment under consultation with EPFO for improving scale of benefits to the beneficiaries.During 2011-12, special emphasis was laid on issue of Annual Accounts Slips. 16.62 crores Annual Accounts was updated during the year against the corresponding figure of 6.06 crores during 2010-11. 96 per cent of the Annual Accounts slips upto five years from 2011-2012, have been issued. The Annual Accounts for the year 2011-2012 are likely to be liquidated by 30th September, 2012. During 2011-12, 90.5 lacs EPF claims were settled, this been 24.84 per cent more than the corresponding figure last year. During 2011-12 ₹ 60648 crores were received as contribution, Whereas ₹ 28271 crores were paid out as benefits to members. More than 36 lacs pensioners are being paid monthly pensions by EPFO.

Employees' State Insurance Corporation (ESIC)

The Employees' State Insurance Scheme provides need based social security benefits to insured workers in the organized sector. As in the case of the EPFO, the ESIC has also taken up the daunting task of tailoring different benefit schemes for the needs of different groups. The scheme, which was first introduced at two centers in 1952 with an initial coverage of 1.20 lakh workers, today covers 1.55 crore workers in about 790 centers in the country. It benefits about 6.02 crore beneficiaries including the family workers of the insured persons, across the country. The scheme is being gradually to cover new centers and steps are being taken for creation of requisite infrastructure for providing medical care to a larger number of insured persons and their families. While the cash benefits under the scheme are administered through a network of about 799 Branch offices and pay offices, medical care is provided through 150 ESI Hospitals, 42 ESI Annexes, 1403/93 ESI Dispensaries / ISM Units and 1447 Clinics of Insurance Medical Practitioners. The total number of medical officers under the Scheme is about 6536.

There have been a number of developments in the ESIS during the past three years. Each year, it is extended to new areas to cover additional employees. The new employees covered in 2009-10, 2010-11 and 2011-12 are 1.23 lakh, 1.14 lakhs and 1.58 lakh respectively. Low paid workers in receipt of daily wages up to ₹ 100/- have been exempted from payment of their share of contribution. Earlier this limit was ₹ 70/-. This measure has benefited about eight lakh insured workers across the country. In order to provide relief to insured persons suffering from chronic and long term diseases, the list of diseases for which Sickness Benefit is available for an extended period up to two years at an enhanced rate of 70% of daily wages, was enlarged by adding four new diseases, keeping in view the international classification of disease profiles and the quantum of malignancies of some diseases which had come to light over the last few years.

In order to improve the standard of medical care in the States, the amount reimbursable to the State Governments for running the medical care scheme has been increased from ₹ 1200/- to ₹ 1500/- Per IP family unit per annum w.e.f. 01.04.2012. The ESIC has formulated action plans for improving medical services under the ESI Scheme with focus on modernization of hospitals by upgrading their emergency and diagnostic facilities, development of departments as per disease profiles, waste management, provision of intensive care services, revamping of grievance handling services, continuing education programme, computerization and up-gradation of laboratories etc. The ESIC has also taken new initiatives to promote and popularize AYUSH systems of treatment in ESIC Hospitals and Dispensaries in a phased manner.

ESIC IT Project Panchdeep, one of the largest e-governance projects is under implementation at present. All ESI Institutions are being networked under this project for enabling IPs and their family members to avail ESI benefits anywhere anytime.Two smart cards christened as "Pehchan Cards", one for insured person and other for the family are being issued. Also, the ESI Act, 1948 has been amended w.e.f. 01.06.2010 for enhancing the Social Security coverage, streamlining the procedure for assessment of dues and for better services to the beneficiaries.

Social Security to Workers in the Organized Sector

Social Security to the workers in the Organized Sector is provided through five Central Acts, namely, the ESI Act, the EPF & MP Act, the Workmens' Compensation Act, the Maternity Benefit Act, and the Payment of Gratuity Act. In addition, there are a large number of welfare funds for certain specified segments of workers such as beedi workers, cine workers, construction workers etc.

Social Security Coverage in India

Most social security systems in developed countries are linked to wage employment. In India our situation is entirely different from that obtaining in developed countries. The key differences are:

- India do not have an existing universal social security system
- India do not face the problem of exit rate from the workplace being higher than the replacement rate. Rather on the contrary lack of employment opportunities is the key concern,
- 92% of the workforce is in the informal sector which is largely unrecorded and the system of pay roll deduction is difficult to apply.

Even today 1/8th of the world's older people live in India. The overwhelming majority of these depend on transfers from their children. Addressing social security concerns with particular reference to retirement income for workers within the coverage gap has been exercising policy makers across the world. In India the coverage gap i.e. workers who do not have access to any formal scheme for old-age income provisioning constitute about 92% of the estimated workforce of 400 million people.

Hence the global debate and evaluation of options for closing the coverage gap is of special significance to India. The gradual breakdown of the family system has only underscored the urgency to evolve an appropriate policy that would help current participants in the labour force to build up a minimum retirement income for themselves.

a) Agricultural sector	= 180 million.
b) Contract, services, construction	= 60 million.
c) Trade, Commerce, transport, storage & Communications	= 100 million.
d) Others = 30 million.	
	Total = 370 million

However one important factor to be kept in mind on the coverage issue is that this classification does not include the various social security schemes run by other ministries for different target groups. We have also not included indirect funding through subsidies, pds, social assistance programmes, food-for-work programmes, tax concessions etc.

Extension of Social Security Coverage in India

Currently, social security policy makers and administrators are engaged in a wide-ranging debate to redress the problems in providing social security in the country. This debate has thrown up various arguments on the efficacy of publicly managed social security schemes as opposed to privately managed schemes. There is no standard model that can be adopted on this issue. In the Indian context the privately managed schemes can at best be considered as supplementary schemes after the mandatory schemes managed publicly. It is only the publicly managed scheme, which will extend to all the sectors of the workforce. The challenge of closing the coverage gap in social security provisions has to be developed at two levels. The first level involves the re-engineering of the institutional arrangements to increase efficiency. The second level is to create an appropriate legislative and administrative framework for significant increase in the social security coverage especially in the unorganized sector.

In India currently only about 35 million out of a workforce of 400 million have access to formal social security in the form of old-age income protection. This includes private sector workers, civil servants, military personnel and employees of State Public Sector Undertakings. Out of these 35 million, 26 million workers are members of the Employees' Provident Fund Organization. As such the current publicly managed system in India is more or less entirely anchored by the Employees' Provident Fund Organisation. It may be noted that in the last 50 years, the Employees' Provident Fund Organisation has been in existence, there has been no instance of any scam or a situation where the Fund has been exposed to speculation and risk.

Another important contribution of EPF is now proposed to extend to the critical life benefit of providing shelter. The Shramik Awas Yojana aims at providing a cost effective Housing Scheme specific for EPF numbers. This involves cooperation between organizations such as HUDCO, Housing Agencies, State Governments, Employers and EPF Members with the EPFO playing the role of facilitator. The investments are directed into the prescribed securities and portfolios as per the pattern laid down by the Finance Ministry.

EPFO Programs at a Glance

Program name	Program Type	Financing	Coverage
Employees Provident Fund (EPF)	➢ Mandatory	➢ Employer: 1.67-3.67% ➢ Employee:10-12% ➢ Government: None	➢ Firms with + 20 employees
Employees Pension Scheme (EPS)	➢ Mandatory	➢ Employer: 8.33% ➢ Employee: None ➢ Government: 1.16%	➢ Firms with + 20 employees
Employees Deposit Linked Insurance Scheme (EDLI)	➢ Mandatory	➢ Employer: 0.5% ➢ Employees: None ➢ Government: None	➢ Firms with + 20 employees

ESI Contribution Rates

- Employees- 1.75% of wages
- Employers- 4.75% of wages
- State Govts.-1/8th share of expenditure [expenditure on medical care]

A few examples of other retirement programs giving social security (Information on extent of coverage of the labour force under these programs is not available)

Program name	Program Type	Financing	Coverage
Civil Service Pension Scheme Government Provident Fund	Mandatory Mandatory	State or Central Government Employee contributions	Civil servants at state and central government level Civil servants at state and central government level
Special Provident Funds	Mandatory	Employer and employee contributions	Applies to Workers in particular sectors: Coal, Mines, Tea Plantation, Jammu and Kashmir Seamen, etc.
Public Provident Fund	Voluntary	Contributions	All individuals are eligible to apply
VRS plans	Voluntary	Contributions	Employees as decided by respective establishments
Personal Pension	Voluntary	Purchase of annuity type products	All individuals
State level social assistance	Government sponsored social assistance	State Government	Varies by State and type of Scheme
National Old Age Pension Scheme	Government sponsored social assistance	Central Government	Poor persons above age 65

Government New Initiative in Social Security

Varishtha Pension Bima Yojana (VPBY): This scheme proposed in the 2003-04 budget by the Ministry of Finance is to be administered by the Life Insurance Corporation of India (LIC). Its main features are summarized below:

- Under VPBY, any citizen above 55 years of age, could pay a lump-sum, and get a monthly pensions are pegged at ₹ 250 and ₹ 2000 per month respectively.
- These amounts are not indexed to inflation.
- There is a guaranteed return of 9 percent per annum for this scheme.
- The difference between the actual yield earned by the LIC under this scheme and the 9 percent will be made up by the Central Government.
- The EPF & Mp Act Is Proposed To Be Amended Suitably To Allow EPF Subscribers To Invest In The VBPY.

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Lesson 5.4 - Creating Work Life Setting

Learning Objectives

After reading this chapter you should be able to:

- Know Work-life balance
- Understand Misperception associated with work-life balance
- Analyses Impact of mismatching of work-life balance
- Find out Process of Determination work-life programmes
- Know the Steps involved in framing work-life balance programmes

Introduction

Work like balance is managing competing roles and responsibilities at work, at home and in the community. It is a moving target many Indians are having hard time hitting. Driven by complex changes in work and society, a growing number of workers are reporting the "struggle's and juggle". Whether the challenges are on the life side of the equation, on the work side, or on the sum total of "way too much to do and not enough time to do it", finding ways to manage work-life conflict is important. Creating a work-life balance is easier said than done. But creating one, nonetheless, is important to both the worker and the organization. The employee gets more control of their life and feels enjoyment both personally and professionally. The organization gets accountability, enhanced productivity, improved morale, and less organizational stress. It's a win-win for everyone.

Misperception towards Work Life Balance

A serious discussion of work-life balance can be sidelined by one of several false interpretations of the problem. The following information will help employer and the employee to understand the fact and fiction about the work-life balance.

It is a Private Issues

The personal impact is undeniable; research links work-life conflict to increased depression, marital problems, fatigue and stress-related illnesses. But it doesn't stop there.

These results translate into real problems for employers, such as increased absenteeism and reduced productivity.

It's a Parenting Issue

Work life conflict is a growing concern all the Indians, not just those with children at home. An increasing number of non-parents report difficulty fitting in volunteer commitments, or educational, leisure or health pursuits.

It's a Women Employee Issue

Women are twice as likely as men to report work-life imbalance, and with good reason; despite a massive influx into the workforce, women retain the greater share of responsibility for child care, elder care and domestic chores. However, a recent trend has been levels of work-life conflict rise among men. In fact, men are more likely than women to point to work pressures as the cause of the imbalance.

It is a Stage in Life

The call for more work life balance comes from all sections of the population; the university student with part-time job, the female executive with small children and the seasoned employee easing into retirement. Work-life balance is increasingly important to young people entering the labour market as well.

Work life should be Fifty and Fifty

Work life balance is rarely a partnership of equals. More often, it is a changing relationship- one part may dominate for a period of time, only to see the other part attracting more attention. Balance is also personally defined: what is balance to one person may be imbalance to another.

Work and Life are Separate Domains

Work and life issues are closely linked and changes in one almost always affect the other.3

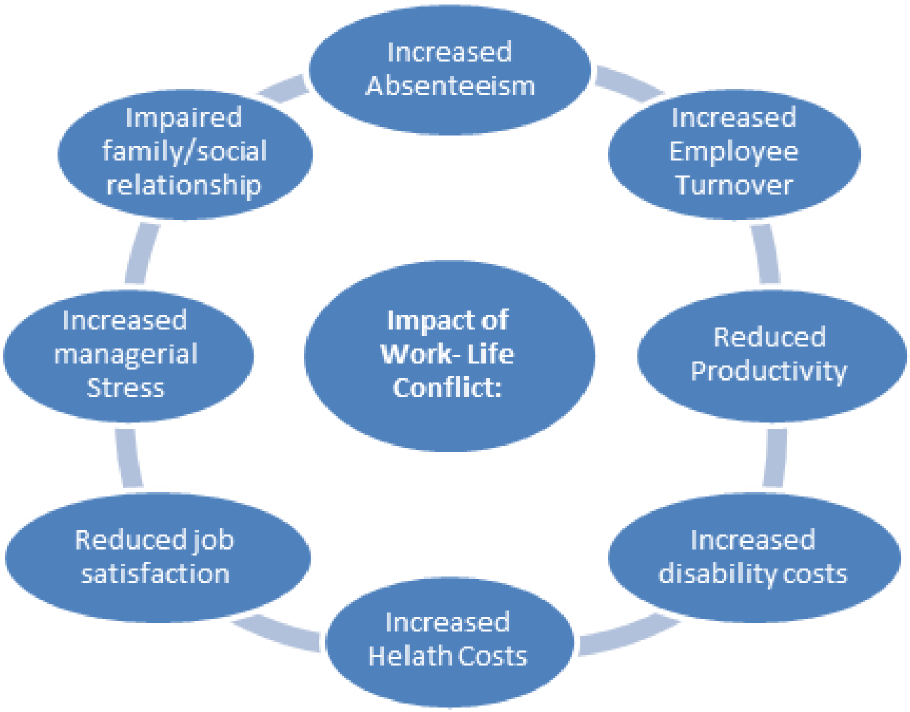
Technology will Help

Technology is a double-edged sword. While innovations such as cell phones, laptops, personal digital assistants and wireless networks allow us to work anywhere, they also allow work to follow us anywhere.

Little can be done

Companies have been able to show clear and measurable improvements in work-life balance by even the smallest of changes. Of course, there is a "magic bullet", but a willing manager or owner has plenty of tool and resources to achieve better balance and, through it, better business.

Impact of Work- Life Conflict



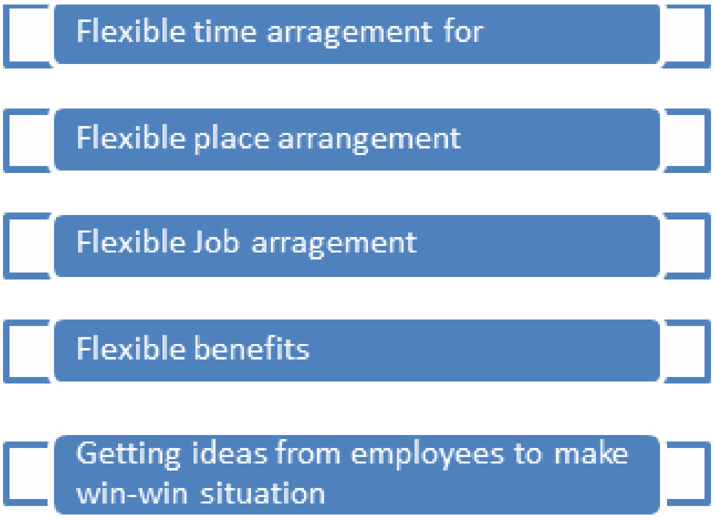
Impact of Work- Life Conflict

Workable Option to be Considered in Designing Work Life Balance Programme

Formal work-life balance programs may not be necessary in any organization if the organization know the workers, listen to their needs and try to be responsive and flexible. This is especially true for small businesses. Otherwise the following will help in developing workable options with regard to work-life balance related programmes:

Flex the Time

Flex-time arrangements are a broad category of work-life balance options that focus on the element of time; the days, hours, start time and end time of work. Included within this category are alternative work schedules, compressed workweeks and voluntary part-time or reduced hours.



Workable Option to Design Work-Life Balance

Flex the Place

Technological innovation have resulted in a wide range of options for working from home, from satellite offices or from remote locations, all collectively known as tele- work.

Flex the Job

May be the job itself needs to change, not just the time allocation. Flexing the job involves a basic consideration of how you define what a job is and how you divide these tasks into different job categories. Is there another way employer could divide up the work tasks? Can the employer re-cluster the repackage responsibilities to create more balanced work assignments? Job redesign or job sharing are two options to consider. For example • Flexible work arrangements (e.g., telecommuting, compressed workweek, part-time employment, job sharing)

Flex the Benefits

One-size-fits all benefit packages are not well suited to a diverse workforce. Offering a range of benefits option and flexibility in selecting the employee's preferred choices or the amount of coverage allows employees to create a personalized package tailored to meet individual needs and wants. For example • Child-care benefits (e.g., on- or off-site day care, vouchers, subsidies, resource and referral services, backup/sick-child care)• Elder-care benefits (e.g., on- or off-site daycare, vouchers, subsidies, resource and referral services, backup care, time off)• Adoption benefits (e.g., paid or unpaid leave, subsidies)• Assistance for employees' children with special needs

Winning Ideas

The ideas range from simple to complex, routine to wonderfully creative which comes from the employer and employees to be taken into consideration while framing work-life related programmes.To create a win-win situation get the input from the employees and your own:

Three Steps From Employee

- ***Figure out What Matters to you in Your Life***

Setting your life priorities is the first step in figuring out how to achieve that work-life balance you've dreamed of. Is it vacation/travel, family time, working out, time with your kids, a hobby, your health, etc.? Once you can prioritize your list, you are on your way!

- ***Ask and Accept help***

It's important and okay to allow yourself to rely on friends, family, or a partner for help when you need to focus on another priority. If you're too proud to ask for help, you are going to crash and burn. No one can do it all themselves without gold bangle bracelets and a truth lasso.

- ***Set Boundaries***

Only you can set your boundaries for your time. If you don't set them, someone else will and then you've lost control. Work isn't going to be there for you when you need a hug, a babysitter, a good cry. Work isn't going to love you back like you family, partner, or friends. You know that old saying: to be loved you have to love yourself first. Well, same holds true here. If you want people to respect your boundaries, you need to set and respect them first.

Three Steps for the Employer

- ***Build Rapport and Gain Respect***

Building rapport with your employees is important because it makes them feel like you listen and that they are being heard. This earns you respect. When an employee respects their boss, they are more productive.

- ***Don't Demand Excellence***

People don't usually respond well to demands unless they see a benefit at the end of the tunnel for them. Be sure to state your demands in the form of your expectations and be sure to be clear and realistic. If you know that Sally has to drop her kid off at day care in the morning, then don't schedule an 8:00a.m. meeting and expect her to be on time. That's unrealistic.

- ***Encourage them to have a Life***

The best way to get employees to be productive is to encourage them to have a life and make it sounds sincere that you care that they do.

Steps in Creating a Work-Life Balance

Defining Work-Life Balance

The definition of work-life balance differs with the age of the worker. For senior workers or owners nearing retirement, the balance often includes regular vacation time and weekends away from the job. While younger staff members enjoy vacation time, the group also defines the work-life balance as the ability to establish individualized work hours, including evening hours and work-from-home options, and personalized work conditions, featuring personal desk and office area decorations.

Creating Boundaries

Small business owners have the ability to establish boundaries for themselves and for staff members. This encourages employees to develop a balance between work hours and personal life. Setting down company rules incorporating regulations restricting the number of hours spent at work each week help employees create these boundaries and keep them. As the leader of the company, you need to model the sound work-life balance you encourage your staff to define.

Balanced Work Environment

Creating an environment at your small business to encourage you and your staff to develop the appropriate work-life balance means allowing your employees to participate in some family activities and meet personal responsibilities that take time away from work. This flexibility includes time off to see children in school plays, visit classes during parent days and accompany aging family members on medical appointments. Establishing firm work policies for this life balance also requires rules to prevent your staff from taking advantage of the policies to avoid job duties.

Scheduling and Planning

Creating a work-life balance involves scheduling times for relaxation. Effective scheduling ensures that you and your staff take the relaxation breaks by using a formal planning system for time away from work. Listing earned relaxation time on paychecks keeps formal records and encourages use of the time. If you don't provide paid release time or vacations, consider adding this option to reward employees meeting corporate standards or producing high-quality work over a set period of time. Encouraging your staff to plan periodic events also sets aside time for short periods of relaxation during the workday, even if it's only time to sit in lawn chairs and appreciate the outdoors or an extra 15 minutes added to a lunch break.

Self Assessment Questions

1. Define Wage Board
2. Define Wage board and critically examine the role of wage board
3. Critically examine the pay commission role in fixation of employees compensation over the period
4. Enumerate the special features of six pay commission
5. Six Pay Commission – Discuss the anomalies
6. Why World Bank criticized the 6^{th} pay commission of India
7. Define Employees Benefit Programme
8. What are the reasons behind in offering Employees Benefit Programme?
9. Discuss the different components of Employee Benefit Programmes
10. Critically examine the reason for Growth of Employees Benefits
11. Enumerate the steps in Planning and Designing of Employees Benefit Programmes
12. Define employees benefit programme and discuss the issues faced by Employees Benefit Programme
13. Define social security benefits to employees
14. Bring out the historical background of social security laws of India

15. How the act of social security laws of India works both in organized sectors and unorganized sectors of industry in India?
16. Explain the different types of Social Security available in India.
17. Enumerate the Government of India Initiatives on Social Security Benefits.
18. Discuss the social security coverage in India and explain its advantages and disadvantages of this scheme.
19. What are social security measures have been initiated by the Government of India?
20. What do you mean by social security? Discuss its importance and scope in the modern industry?
21. Explain the concept of social security and discuss its dynamic nature.
22. Write note on the following:
    a) Objectives of Social security
    b) Social assistance
    c) Group Life Insurance
    d) Retirement Benefits
23. Define work life balance
24. What are the factors taken into consideration while designing work-life balance?
25. Define work life balance. What will be the impact if there is no work-life balance in the organization?
26. Critically examine the options available to the organization to make effective work life balance
27. Discuss the steps in designing work life balance
28. What are the different misperceptions made in these days by the employer about work-life balance?

CASE STUDY

A world leader in building materials takes the next step in Work and Life Training

Lafarge's operations have the urgent demands and stresses of the deadline driven construction business. When Pete Turco took over as head of HR in the Midwest he became aware of the work-life balance concerns of its managers and employees. There were two key needs. One was to address the constant demand on every individual to do more with less on the job. The second, the desire of Lafarge to grow as an employer of choice everywhere it operates, required more recognition of people's family and personal lives. After Pete made the rest of the executive team aware of the bottom line value of better managing these challenges, the Business Unit (BU) president came to Pete, and said, "We've recognized the importance. Now give us some tools to do something about it."

Apply the work life balance strategy and provide them necessary tools to deal with problems

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