

Human Resource Management Compensation Management

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Concept of Compensation

- Compensation refers to the extrinsic rewards that employees receive in exchange for their work. It is composed of the base wage or salary and incentives or bonus and any benefits. – *Bayers and Rue*
- From the above definition it can be concluded that the organization mainly consist of two types of compensation scheme:
 - Direct compensation
 - Indirect Compensation

Direct-Indirect Compensation

Direct Compensation

- Money is included under the direct compensation popularly known as wages/gross pay. There are direct financial payments in the form of the wages, salaries, incentives, commission and bonuses.

Indirect Compensation

- Benefits come under indirect compensation. It may consist of insurance (life and death insurance), the employer's contribution to retirement, pay for illness and vacation, and employer's required payments for employment welfare as a social security.

Purposes and Uses of Compensation

Total compensation is important because of the several purposes it can serve including.

- **To attract potential job applicants:** In relation with the organizational recruitment and selection efforts the compensation program can help assure that pay is sufficient to attract the right people at right time for the right jobs.
- **To retain good employee:** internally equitable and externally competitive compensation scheme help to retain the employee.
- **To motivate employee:** it acts as a tool of motivation to increase the productivity or potential of the employees.

Purpose and use of Compensation

- **To administer pay within legal requirements:** there are many organizations to monitor the compensation payment according to the law so to avoid the violation of the law the compensation should be provided to the employees.
- **To facilitate organizational strategic objectives:** the organizational may want to create a very rewarding and supportive climate. And to attract the potential candidate for the job the proper compensation scheme could be the effective tool to attain the strategic objectives like rapid growth, survival and innovation.

Structure and components of compensation

■ **Wages and salary:**

- wage is the remuneration paid periodically to an employee or worker (blue-collar workers).
- On the other hand salary refers to the weekly or the monthly rates paid to clerical, administrative and professional employee (white-collar employee)

■ **Incentives:**

- it refers to all the plans that provide extra pay for extra performance in addition to regular salary and wages. They acts as the extra financial motivation.

Structure and components of compensation

Benefits:

- They are usually known as fringe benefits because they are offered by employer to the employee as a fringe (free of cost). They are supplements to wages received by employee at a cost to employer.
 - Pay for time not worked (holidays, leaves, paid vacations)
 - Protection programs (insurance, pension, or gratuity)
 - Executive benefits (telephone, security guards, newspapers)

Structure and components of compensation

■ **Service perquisites**

- Org. also provide a number of services that employees find desirable. These service are usually provided by the organization at no cost to the employee at a significant reduction from what might have to be paid without the organization support.
 - Free or subsidized housing, flooding, work clothing, transportation etc.
 - Child care facilities (day care, nurseries)
 - Financial and legal services
 - Purchasing services
 - Educational, medicinal, outplacement services.

Compensation of Total Compensation

Dr. Kama Subedi, 2016

**EXTERNAL ENVIRONMENT
INTERNAL ENVIRONMENT**

COMPENSATION

FINANCIAL

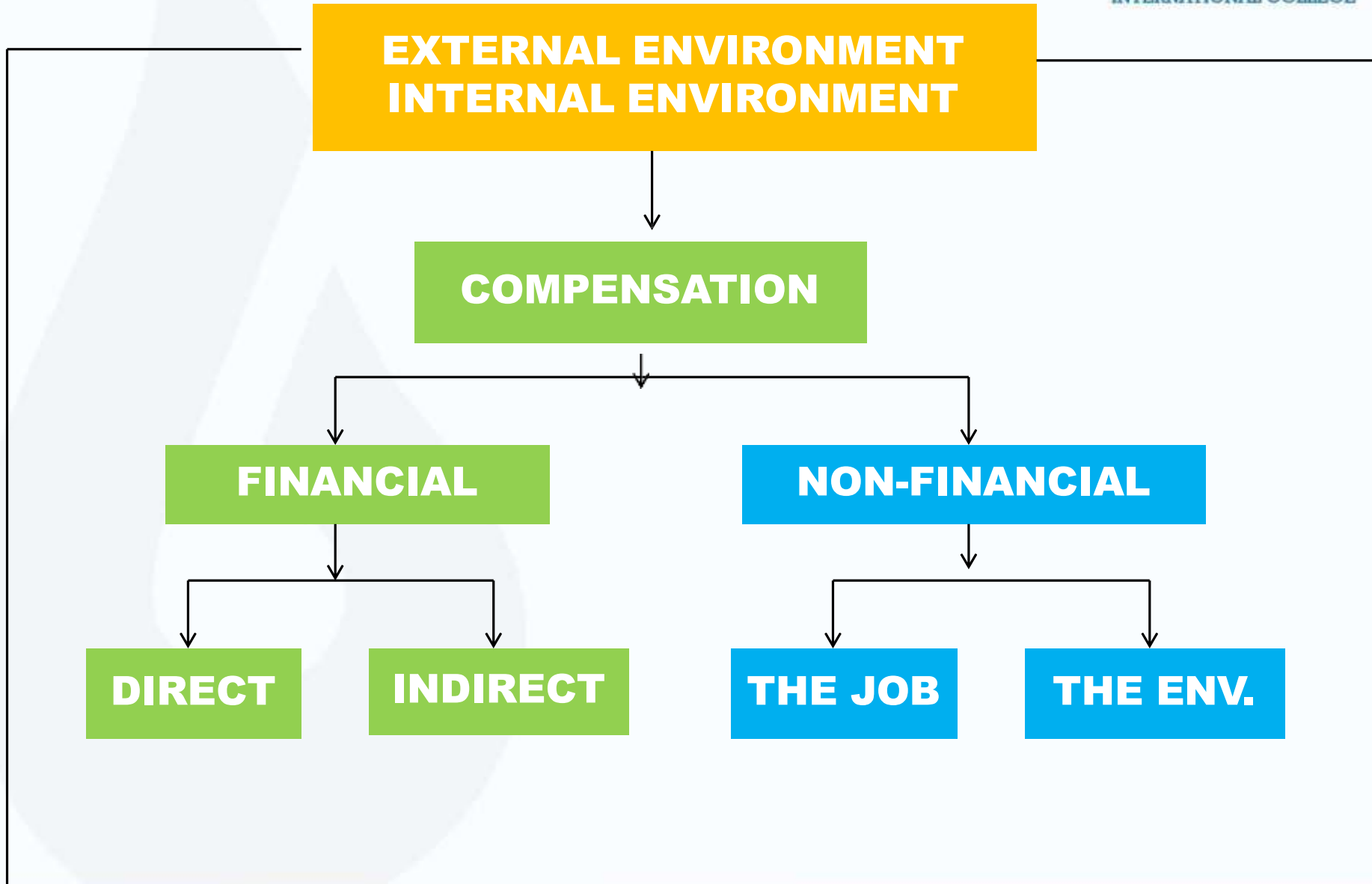
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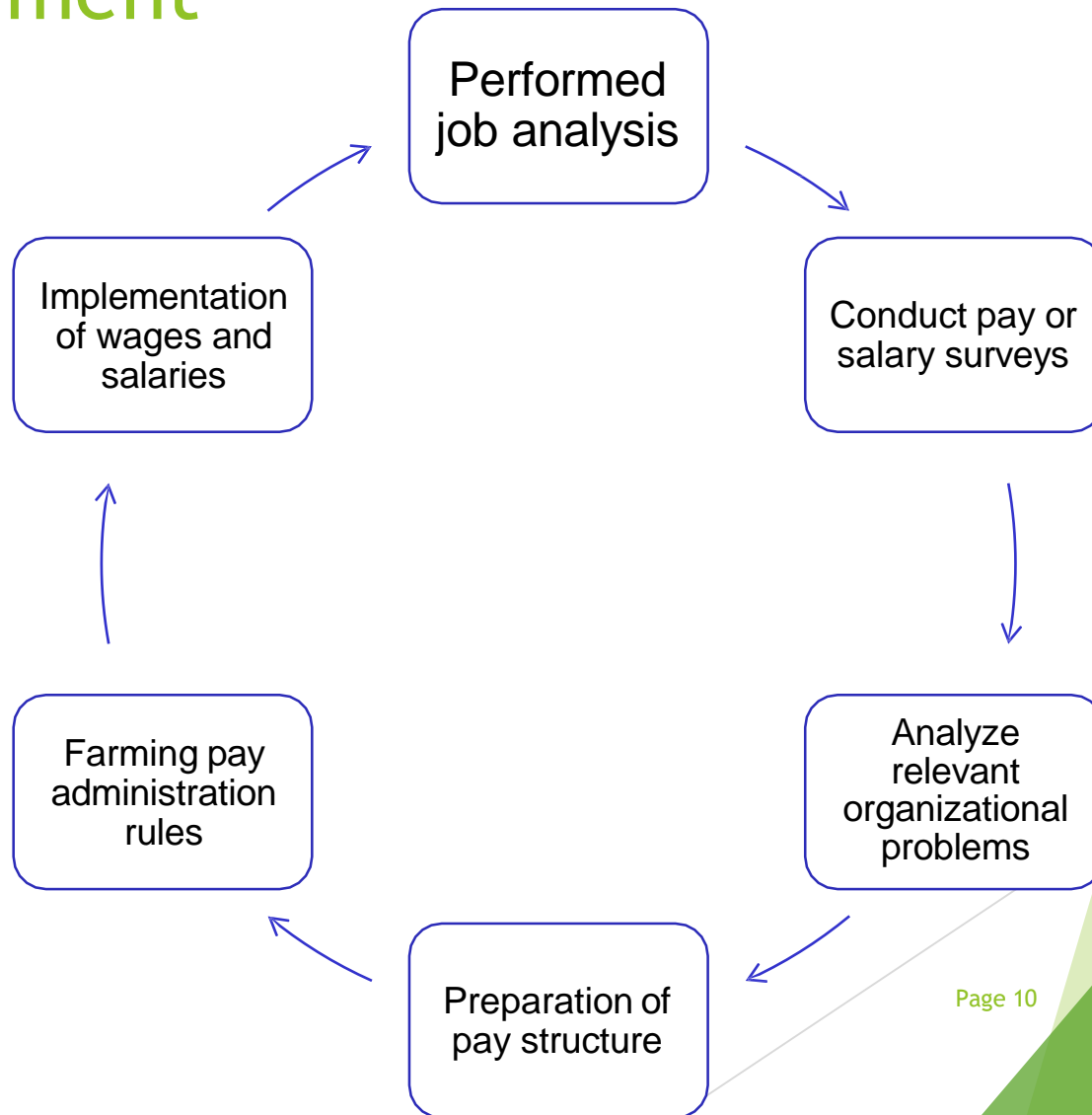
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Process of Compensation Management



Process of Compensation Management

- **Performing job Analysis:** job analysis has two major outcomes, job description and job specification. After which the rating of the job occurs. A job evaluation is the process of determining the value of the job related to other job. And it is also concerned with converting the work value to monetary value.
- **Conducting pay surveys:** in the another step the actual amount to be paid is determined with the wage and salary surveys. The information is collected with.
 - Benchmarking
 - Packaging surveys
 - Own surveys

Process of Compensation Management

- **Analysis of organizational problems:** determination of pay requires more than wage and salary surveys. Dozens of variables can affect wage structure. HR manager may be interested in following queries.
 - What should be the relationship between the pay structure and fringe benefit?
 - Would the firm recruit new employee after revised pay structure?
 - Are the prevailing rates in industry consistent with the result of the job evaluation?

Process of Compensation Management

- **Preparation of Pay Structure:** it is the joint outcome of above three steps. For the purpose of determining pay structure a lot of decisions need to be taken. For example.
 - Whether to pay amounts equal, above or below industry level?
 - The number of width of pay grades and the extent of overlap.
- **Farming pay administration rules:** as the rates ranges have been determined, the development of rules/policies of pay system has to be fixed. A lot of the policies and rules required to answer:
 - A trade of between seniority and merit basis
 - The frequency of pay increases
 - How to control salary and wage costs

Process of Compensation Management

- **Implementation of wages and salaries:** finally, it should be implemented and controlled by authorized executives. Due to the seniority of pay system, it is usually assigned to a committee composed of high-ranking officers. This committee may require frequent advise and help from technical HR staff.

Methods of Employee Compensation

There are various method of compensation available in HRM. A single organization can use single or two or more methods at a time.

- Base plus cost of living allowance (BCOLA)
- Scale plus cost of living allowance (SCOLA)
- Cash incentives
- Bonus or variable pay
- Broad banding method
- Job or skill based pay method
- Merit pay method
- Other forms of compensations.

Base plus cost of living allowance (BCOLA)

- This method is based on two factors viz, base and allowance. Every organization has their base salary for all the types of jobs. On and above that employees are provided with cost of living allowance. COLA Is an adjustment to the base salary by a percentage that is assumed to match increases in cost for good and services on a national regional or local level or account for change in the market.

Scale plus cost of living allowance (SCOLA)

- This is the second method of compensation used by many organizations. It also has two components viz. scale level for a particular level of job plus the COLA given. Many companies set a range of pay rates from minimum to maximum, designed for specific pay grades.
- On and above that a cost of living adjustment/allowance is given to the employees as discussed in first method.

- **Cash incentives:** this is the third method in compensation. This method takes one of the two methods explained above. Again the employee is given, additional compensation to motivate and reward him/her for exceeding performance goals in the form of cash incentives.
- **Bonus or Variable Pay:** it is another method that is used by many organizations to compensate their employee according to their contributions. Bonus or variable pay plan method is an incentive pay plan which awards employee compensation in addition to their basic salary. It is given for achieving, individual or group performance and productivity goals.

- **Broad Banding method:** Broad banding means collapsing salary grades and ranges into just a few wide levels each of which contains a wide range of jobs and salary levels. It creates vertical pay rates ranges.
- **Job or Skill based pay method:** it is another type of compensation method which is becoming very popular in recent years. It may be due to high demand for skills experience, and education trend in the market. In a real sense it is salary differentiation system that bases compensation on an individual education experience, knowledge, skills or specialized training.

- **Merit pay method:** it is also a very popular method of compensation used by majority of organizations in recent days. Merit pay is a compensation system where by base pay increase are determined by individual performance.
- **Other forms of compensation:** these techniques are only supplementary in nature than an established method. Some examples are: award programs, sabbaticals team based pay and so on.

Compensation and incentive for management employees

- **Concept and needs:** the executives of the company plays an important role for looking the economic health of the company. As they are important for the success, growth and profitability of an organization they have to be compensated properly. To make the executive happy as far as possible, companies have been giving in recent years bigger and more frequent rise in salaries.
 - The executive compensation cost a sizeable cost and rising cost.
 - The payment can be in form of, medical care, professional services in legal and financial matters, facilitates for entertaining customers and for dining, customer recreational services.

Why organization needs separate plan for managers?

Components of executives compensations and incentives

- The executives total compensation package consists of four package for short term and long term incentive perquisites.
 - **Basic Salaries:** fixed element of pay and it does not normally vary in relation to company performance.
 - **Short term incentives:** they are awarded annually. Award incentives reflect hierarchical position relationship in most cases with higher opportunities relative to higher position and vice versa.
 - **Long term incentives;** the payments is based on the performance for the period beyond one year
 - **Benefits/perquisites:** it is not based on the quantity benefits, this consists of company cars, club membership, housing etc.

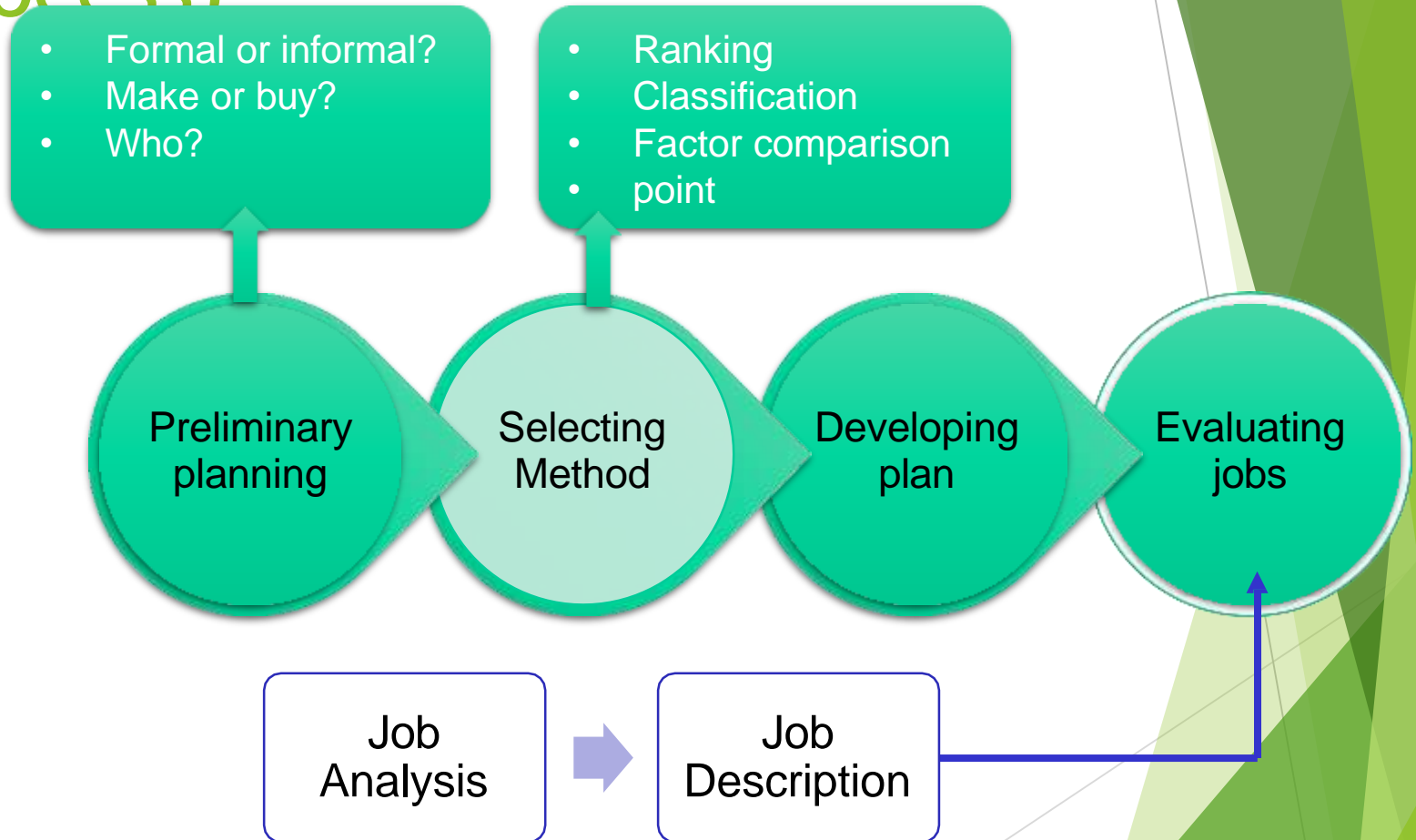
Issues in management compensation

- Executives compensation has assumed importance in recent years. They are increasing ever years and has become public comment. The issue covers three major aspects.
 - What and how much are the executives paid?
 - Why are they paid heavy remuneration?
 - What issues are involved in payment of higher remuneration?
- The reasons are:
 - First, the management compensation differs country to country and they are kept confidential.
 - Second, they are paid for the talents, and to satisfy their GREED honest business practices must be adopted.
 - Third, higher salaries and benefit do not guarantee motivation

Job Evaluation System (Process)

- Job evaluation is the process of determining the relative worth of various jobs within the organization, so that different wages may be paid to jobs of different worth.
- It is the quantitative measurement of relative job worth
- Its purpose is to establish consistent wage rate differentials by objective means.
- It measures the differences between job requirements.
- It does not set the price of the job; it merely fixes its relative worth.
- It rates the job, not the qualities of the individual employees on the job.
- Job evaluation process ignores individual abilities or the performance of the jobholder.

Job Evaluation System (Process)



Job Evaluation System (Process)

- **Preliminary planning:** it is the first issues whether to conduct job evaluation formally or informally. The formal evaluation is relatively systematic application of standards and decision rules to rank or rate jobs. It is longer and costly process.
- **Selecting the job evaluation plan:** four common job evaluation methods are available viz., marketing, classification, factor comparison, and point. The point method is basically the most widely used method.
- **Developing the plan:** in this third step, a job hierarchy is developed by comparing the content of various jobs against the specified standards using predetermined procedures.

Job Evaluation System (Process)

- **Evaluating jobs:** job cannot be adequately evaluated without accurate up-to-date information about job duties and responsibilities. Very often members of the job evaluation committee also observe the job and interview.
 - Job holders and supervisors to obtain additional information for the evaluation.
 - It is preferable for evaluations to be done independently by two or more evaluators.
 - where disagreements exists, the reason should be explored and more information about jobs should be gathered if necessary.
 - Differences should be resolved through discussion.
 - The above process helps in validating the job hierarchy.

Job Evaluation Methods

- There are two basic types and four methods of job evaluation.
 - Non-analytical methods
 - Ranking method
 - Job classification or grading method
 - Analytical Method
 - Point (rating) method
 - Factor comparison method

Reference:



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Non Analytical Methods

- **Ranking Methods:** The ranking method is the simplest form of job evaluation. In this method, each job as a whole is compared with other and this comparison of jobs goes on until all the jobs have been evaluated and ranked. All jobs are ranked in the order of their importance from the simplest to the hardest or from the highest to the lowest.
- The importance of order of job is judged in terms of duties, responsibilities and demands on the job holder. The jobs are ranked according to “the whole job” rather than a number of compensable factors.

Ranking Method

- **The application of the Ranking Method involves the following procedure:**
 - Analyze and describe jobs, bringing out those aspects which are to be used for purpose of job comparison.
 - Identify bench-mark jobs (10 to 20 jobs, which include all major departments and functions).
 - Rank all jobs in the organization around the bench-mark jobs until all jobs are placed in their rank order of importance.
 - Finally, divide all the ranked jobs into appropriate groups or classifications by considering the common features of jobs such as similar duties, skills or training requirements. All the jobs within a particular group or classification receive the same wage or range of rates.

Ranking Methods

■ Merits:

Ranking method has the following merits:

1. It is the simplest method.
2. It is quite economical to put it into effect.
3. It is less time consuming and involves little paper work.

■ Demerits:

The method suffers from the following demerits:

1. The main demerit of the ranking method is that there are no definite standards of judgment and also there is no way of measuring the differences between jobs.
2. It suffers from its sheer unmanageability when there are a large number of jobs.

Job Classification or Grading Method

- Grading method is also known as 'classification method'. This method of job evaluation was made popular by the U.S. Civil Service Commission. Under this method, job grades or classes are established by an authorized body or committee appointed for this purpose.
- A job grade is defined as a group of different jobs of similar difficulty or requiring similar skills to perform them. Job grades are determined on the basis of information derived from job analysis.
- The grades or classes are created by identifying some common denominator such as skills, knowledge and responsibilities.
- Once the grades are established, each job is then placed into its appropriate grade or class depending on how well its characteristics fit in a grade. In this way, a series of job grades is created. Then, different wage/salary rate is fixed for each grade.

Job Classification or Grading Method

■ Merits:

The main merits of grading method of job evaluation are:

1. This method is easy to understand and simple to operate.
2. It is economical and, therefore, suitable for small organizations.
3. The grouping of jobs into classifications makes pay determination problems easy to administer.
4. This method is useful for Government jobs.

■ Demerits:

The demerits of this method include:

1. The method suffers from personal bias of the committee members.
2. It cannot deal with complex jobs which will not fit neatly into one grade.
3. This method is rarely used in an industry.

Analytical Methods

Points Rating:

- This is the most widely used method of job evaluation. Under this method, jobs are broke down based on various identifiable factors such as skill, effort, training, knowledge, hazards, responsibility, etc. Thereafter, points are allocated to each of these factors.
- Weights are given to factors depending on their importance to perform the job. Points so allocated to various factors of a job are then summed. Then, the jobs with similar total of points are placed in similar pay grades. The sum of points gives an index of the relative significance of the jobs that are rated.

Points Rating

■ Merits:

► The method has the following merits:

1. It is the most comprehensive and accurate method of job evaluation.
2. Prejudice and human judgment are minimized, i.e. the system cannot be easily manipulated.
3. Being the systematic method, workers of the organization favor this method.
4. The scales developed in this method can be used for long time.
5. Jobs can be easily placed in distinct categories.

Points Rating

■ Demerits:

► The drawbacks of the method are:

1. It is both time-consuming and expensive method.
2. It is difficult to understand for an average worker.
3. A lot of clerical work is involved in recording rating scales.
4. It is not suitable for managerial jobs wherein the work content is not measurable in quantitative terms

Factor Comparison Method

- This method is a combination of both ranking and point methods in the sense that it rates jobs by comparing them and makes analysis by breaking jobs into compensable factors. This system is usually used to evaluate white collar, professional and managerial positions.
- **The mechanism for evaluating jobs under this method involves the following steps:**
- First of all, the key or benchmark jobs are selected as standards. The key jobs selected should have standards contents, well accepted pay rates in the community, and should consist of a representative cross-section of all jobs that are being evaluated—from the lowest to the highest paid job, from the most important to the least important—and cover the full range of requirements of each factor, as agreed upon by a Committee representing workers and management.

Contd.

- The factors common to all jobs are identified, selected and defined precisely. The common factors to all jobs are usually five, viz., mental requirements, physical requirements, skill requirements, working conditions and responsibility.
- Once the key jobs are identified and also the common factors are chosen, the key jobs are, then, ranked in terms of the selected common factors.
- The next step is to determine a fair and equitable base rate (usually expressed on an hourly basis) and, then, allocate this base rate among the five common factors as mentioned earlier. Following is a specimen of base rate and its allocation scheme:

Factor Comparison Method

■ Merits:

This method enjoys the following merits:

- It is more objective method of job evaluation.
- The method is flexible as there is no upper limit on the rating of a factor.
- It is fairly easy method to explain to employees.
- The use of limited number of factors (usually five) ensures less chances of overlapping and over-weighting of factors.
- It facilitates determining the relative worth of different jobs.

Factor Comparison Method

- **Demerits:**

The method, however, suffers from the following drawbacks:

- It is expensive and time-consuming method.
- Using the same five factors for evaluating jobs may not always be appropriate because jobs differ across and within organizations.
- It is difficult to understand and operate.

Pay for Performance/Incentive Pay

- 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.
- The components of the pay based system are:
 - **Merit pay systems:** they affect a relatively small percentage of an individual's total salary. Because it is generally used only to move an individual's compensation within rate range.
 - **Incentive systems:** in it performance is often measured by standards of productivity and direct indexes of individual, group or organizations.

Challenge of PBP

- The challenges associated with the performance based pay are as follows:
 - What are the obstacles to the design of effective performance based pay system? How can they be removed?
 - What are the limits on an organization's decision to use a performance based pay plan. Which plan is the best?
 - Can companies really afford to reward people for good performance?
 - Should companies use performance based pay, especially incentive pay?

Incentive systems (A tool of PBP)

- *Incentive pay is any formal and announced program under which the income of an individual, a small group, a plant work force or all the employees if a firm are partially or wholly related to some measures of productivity output.*
- **Developing incentives plan (system)**
 - Establishing the minimum job rates
 - Establish performance standards
 - Determine incentive rates
 - Establish process for changing standards
 - Try out the incentive plan on an experiment basis

Types of incentives pay plans

- Individual incentive pay plans
 - The piecework plan
 - The standard hour work plan
 - Sales incentives plan
 - Managerial incentive plans
 - Other types of plans
- Group level incentive pay plans
 - Production incentive program
 - Department head incentive program
 - Professional incentive program

Types of incentives pay plans

- Organizational level incentive plans
 - Profit sharing plans
 - The Scanlon plan
 - Gain sharing plans
 - Employee stock ownership plan

Employee benefits and services

- Indirect non cash compensation paid to an employee by the employing organization is called benefits. Some benefits are mandatory by law such as social, security etc.
- The different types of benefits/services
 - Economical financial benefits
 - Recreational social services
 - Professional services
 - Family welfare services

Issues of Compensation in Nepal

- The different issues of the compensation pay plan in Nepal are listed below:
 - The issue of the minimum wages
 - The issue of comparable worth
 - The issue of pay secrecy
 - The issue of inflation and salary compression
 - The issue of cost of living differentials
 - The issue of pay reviews
 - The issue of employee participation

Government regulations of compensation in Nepal

- **The legal environment and pay system is not satisfactory in the context of Nepal.**
 - Government legislation
 - Different acts
 - Labor act 2048 and labor regulation
 - Bonus act
 - Public service regulation
 - Company act 1996
 - Interim constitution of Nepal, 2063
 - Constitution of Nepal 2072

Contd.

- Labor laws
- Equal pay/no discrimination
- Minimum wages
- Provident fund
- Overtime payment
- Other provisions
- Bonus Act

Contd.

- Pay system governance (institutional framework)
 - Department of labor (DOL)
 - Wage boards
 - Pay commission committee
 - Tribunals
 - Labor court

Contd..

- Pay practices in Nepal
 - Governmental organizations
 - Private sector organizations
 - Private banks and financial institutions
 - Non governmental organizations

- Provision relating to minimum wages
- Social welfare incentive provisions and retirement benefits in Nepalese acts
 - Civil service acts 2049
 - Employee provident fund
 - Festival expenses and other facilities
 - Pension
 - Special economic facility
 - leaves

- Labor act 1992
 - Provision relating to health and safety
 - Welfare provisions
 - Compensations
 - Welfare funds
 - Leaves
 - Provident fund and medical expenses

- Social security
 - Purpose
 - Coverage
 - Insurance and contributions

Thank You 😊