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# Performance Management and Compensation Management

**SEMESTER 2**

# POST GRADUATE DIPLOMA IN HUMAN RESOURCE MANAGEMENT

**BLOCK 2**

**KRISHNA KANTA HANDIQUI STATE OPEN UNIVERSITY**

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# PG DIPLOMA IN HUMAN RESOURCE MANAGEMENT

# Performance Management and Compensation Management

## Block 2

## DETAILED SYLLABUS


**UNIT 9: Incentive Schemes** **Pages: 135-151**

Pay for Performance or Wage Incentives, Types of Wage Incentive Schemes, Prerequisites of Effective Incentive System and Merits and Demerits of Incentives

**UNIT 10: Benefits and Services** **Pages: 152-167**

Concept and Nature of Benefits, Classification of Employee Benefits, Employee Benefit Programs, Long Term Incentive Plans, Strategic Perspective on Benefits, Factors Influencing Choice of Benefit Program, Administration of Benefits and Services and Designing a Benefit Program

**UNIT 11: Voluntary Retirement Scheme** **Pages: 168-181**

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**UNIT 12: Pay Structures** **Pages: 182-193**

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Performance Management System (PMS), Importance of a PMS, Performance Appraisal, Purpose of Performance Appraisal, Performance Appraisal Measurement System, Pay for Performance, Pay for Performance Plans and Internal and External Equity

**UNIT 14: Compensation Strategy:New Thinking for the New Millennium Pages: 213-228**

Pay the Person, Reward Excellence, Individualizing the Pay System, Organizational and External Factors Affecting Compensation Strategies, Compensation Strategies as an Integral Part of HRM and Compensation Policies

**UNIT 15: Rewards and Recognition Pages: 229-245**

Concept of Reward Management, Reward and Recognition Policies, Reward Strategy, Total Reward Approach, Reward Management in Service Sector,Total Reward Framework of Service Industries in India, Factors Affecting Reward Management Policies in Service Sector and Designing Reward Strategy

# BLOCK INTRODUCTION

This is the second block of the course 'Performance Management and Compensation Management'. The Block is divided into 7 units which are related to the differnt concepts of Performance Management and Compensation Management.

This block comprises of the following seven units:

The *ninth unit* introduces us to concepts of Pay for Performance or Wage Incentives, Types of Wage Incentive Schemes, Prerequisites of Effective Incentive System and Merits and Demerits of Incentives. The *tenth unit* gives us a broad idea on the concepts of Concept and nature of benefits, Classification of employee benefits, Employee benefit programs, Long term incentive plans, Strategic perspective on benefits, Factors influencing choice of benefit program, Administration of benefits and services and designing a Benefit program. The *eleventh unit* gives us an idea on the Concept of Voluntary Retirement Scheme(VRS), Procedure for a VRS Scheme, Challenges of VRS Implementation, Approaches to deal with workforce redundancy, Costs and benefits to the company and VRS for Central Public Sector. The *twelvlth unit* will help us in knowing concept of Pay based and Performance based structures, Designing pay structures, Comparison in evaluation of different types of pay structures, Designing pay ranges and bands, Significance of factors affecting pay levels, Confrontation Meetings, System 4 Management and Learning Organisations. The *thirteenth unit* gives us a broad idea on Performance management system (PMS), Importance of a PMS, Performance Appraisal, Purpose of Performance Appraisal, Performance Appraisal measurement system, Pay for performance, Pay for performance plans and Internal and external equity. The *forteenth unit* will help us in understanding the reward excellence, Individualizing the pay system, Organizational and external factors affecting compensation strategies, Compensation strategies as an integral part of HRM and Compensation Policies. The *fifteenth unit* gives us an idea on concept of reward management,Reward and recognition policies, Reward strategy, Total reward approach, Reward management in service sector,Total reward framework of service industries in India, Factors affecting reward management policies in service sector and Designing reward strategy.

The Block is devided into seven units:

UNIT 9: Incentive Schemes

UNIT 10: Benefits and Services

UNIT 11: Voluntary Retirement Scheme

UNIT 12: Pay Structures

UNIT 13: Performance Linked Compensation

UNIT 14: Compensation Strategy:New Thinking for the New Millennium

UNIT 15: Rewards and Recognition

Each unit of this blocks includes some along-side boxes to help you know some of the difficult, unseen terms. Some “EXERCISES” have been included to help you apply your own thoughts. You may find some boxes marked with “LET US KNOW”. These boxes will provide you with some additional interesting and relevant information. Again, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be helpful for you if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PROGRESS” given at the end of each unit. You in making your learning more active and efficient. And, at the end of each section, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your learning.

# UNIT 9: INCENTIVE SCHEMES

## UNIT STRUCTURE


9.1 Learning Objectives

9.2 Introduction

9.3 Pay for Performance or Wage Incentives

9.4 Types of Wage Incentive Schemes

9.5 Prerequisites of Effective Incentive System

9.6 Merits and Demerits of Incentives

9.7 Let us Sum Up

9.8 Further Reading

9.9 Answers to Check Your Progress

9.10 Model Questions


## 9.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the pay for performance or wage incentive plans
- describe the different types of wage incentive schemes
- explain the prerequisites of effective incentive system
- outline the merits and the demerits of the incentives.

## 9.2 INTRODUCTION

This unit is about the meaning and concept of pay for performance or wage incentives. The unit will help us know all the different types of incentive schemes that have been introduced. The unit outlines the essentials for laying down an effective incentive system. In this unit we are also going to discuss the merits and demerits associated with incentives.

## 9.3 PAY FOR PERFORMANCE OR WAGE INCENTIVES

Pay for performance or financial incentives or rewards all synonymously mean any form of monetary recognition that is given to the employee for his superior performance or productivity as is obvious from the performance

index of the organization he is working for. According to Burack and Smith "An incentive scheme is a plan or program to motivate individual or group performance. An incentive program is most frequently built on monetary rewards (incentive pay or monetary bonus), but may also include a variety of non-monetary rewards or prizes''. Financial incentives respond to monetary needs of employees to motivate them and non-financial incentives satisfy the higher order needs of employees to motivate them.

The objective of incentives is primarily to motivate employees to achieve organizational goals, such as increasing profits, improving product quality, enhancing labor efficiency, reducing costs, generating organizational effectiveness etc.

According to Hummel and Nickerson wage incentives "refers to all the plans that provide extra pay for extra performance in addition to regular wages for a job". Florence can be quoted as "It refers to increased willingness as distinguished from capacity. Incentives do not create but only aim to increase the national momentum towards productivity". Scott may be quoted as "it is any formal and announced program under which the income of an individual, a small group, a plant work force or all the employees of a firm are partially or wholly related to some measure of productivity output". According to National Commission on Labor "wage incentives are extra financial motivation. They are designed to stimulate human effort by rewarding the person, over and above the time rated remuneration, for improvements in the present or targeted results".

According to Mamoria and Gankar "wage incentive is a system of payment under which the amount payable to a person is linked with his output. Such a payment may also be called payment by results".



**CHECK YOUR PROGRESS**

**Q.1:** Incentives are ….....

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**Q.2:** Objective of incentive is …….....……

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## 9.4 TYPES OF WAGE INCENTIVE SCHEMES

Wage incentive plans may be categorized as:

1) Plans for blue collar workers
2) Plans for white collar workers
3) Plans for managerial personnel

This categorization is essential as all these groups of employees have definite needs and different incentive plans adapted to their needs will prove effective.

**1) Incentive Plans for Blue Collar Workers: For individuals**

**A) Short term plans:**

**i) Halsey Premium Plan:** A worker's day wage is guaranteed irrespective of the bonus earning. A standard output and standard time is fixed. The bonus is based on the time saved by the worker. Bonus is generally $33^1/_3$% of the time saved. For e.g., If 8 hours is standard time for doing a job, Rs. 0.50 is guaranteed wage per hour and the worker takes 8 Hours to do the task he receives Rs. 4/-. If he does the task in less than 8 hrs (standard time) he gets a bonus on the time saved.

Bonus (formula) = ½ of time saved/time taken x daily wage

As per bonus formula, If the worker performs the task in 4 hours then his bonus is Rs. 2/- and total wages is Rs. 6/-.

This plan is very easy to understand for workers and to calculate for management. Moreover daily wages are guaranteed is a relief to workers. However there is no scope to review and establish newer standards.

**ii) Halsey-Weir Premium plan:** This method is similar to Halsey plan except that 50% of the time saved is given as bonus to worker. Bonus (formula) = ½ × time saved × hourly rate

**iii) Rowan premium plan:** It is the same again as the Halsey plan except for bonus calculation which is more complex than the Halsey plan.

Bonus (formula) = time saved/time allowed × time taken × hourly rate

E.g., If 8 hours is the standard time for a given job, Rs. 4/- per day wage, and the job is completed in 3 hours then the bonus and total wages will be as per Bonus formula, bonus Rs. 3/- and total wages Rs. 7/-.

All the three schemes are based upon the principle that a worker is entitled to financial increments if his output is greater than the standard rate.

iv) **100 percent premium plan:** Work standards are pre-determined and wage rates are expressed through time rates. A fixed time rate is guaranteed for each work hour and the bonus is full value (time rate) on the time saved. For e.g., if a worker completes the task of 10 hours in 8 hours and if the hourly rate is Rs. 0.50, his total earnings will be–
Rs. 8 × 0.50 + (10–8) × 0.50 = Rs. 4.00 + Rs 1.00 = Rs. 5.00

v) **Bedeaux Point plan:** Here the standard time for doing a job is divided into minutes, each minute labeled as 'B'.Every job to be incentivized is expressed in Bs meaning every job is to be completed in specified minutes and the rate per hour is fixed. The most favorable advantage of Bedeau × Point plan is that it is applicable to all jobs which require different time standards.

For e.g., 1) if the worker completes the job in more than standard time, then his wages are as per the **time-rate.**

Suppose, Standard Time is 8 hrs, Rate per Hour is Re 1, Actual Time = 10 hrs, Then workers earning is 10 × 1 = Rs. 10/-

2) In case, the worker completes the job in less than the standard time; then the worker qualifies for a bonus in addition to the hourly rate. 75% of the wages of the time saved is paid to the worker as bonus.

Suppose Actual Time is 6 hrs then his simple wages are:
6 × 1 = Rs. 6 and Bonus is calculated as–

Standard Bs = 60(minutes) × 8(standard hour) = 480

Actual Bs = 60 (minutes) × 6 (actual hour) = 360

Saved Bs = 120(480–360) or 2 hours

Bonus = 75% of 2 hours wages(wages of the time saved)

= 75/100 × 2 × 1 = 1.50

**Thus, total earnings = Rs. 6 + 1.50 = 7.50**

vi) **Taylor's differential piece rate :** It is a very scientific method of wage incentive determination as the work units and the time standards set are solely based on a time and motion study. Those who reach the standard output are entitled to a higher rate and those who are below the standard are given a lower rate. The advantage of this system is that the efficient worker is recognized with higher piece rate of and the inefficient worker is penalized by a lower piece rate.

Therefore, Taylor advocated the system of two piece rates, so that if a worker performs the work within or less than the standard time, he is paid a higher piece rate, and if he is unable to complete the work within the standard time, he is given a lower piece rate.

For instance, if the standard has been fixed at 8 units per day of 8 working hours (taking normal piece rate as Re 1), the higher piece rate for 8 units or beyond may be Rs. 1.20 per unit and the lower rate for an output of less than 8 units per day, may be 80 p. per unit.

vii) **Merrie's Multiple Piece rate system:** This is an extension of Taylor's system. The objective of this plan is similar to that of Taylor's highlighting low piece rate for slow worker and higher piece rate for fast worker. The only difference it has with that of Taylor's plan is that it offers three piece rates for a job instead of two as in the earlier case.

The worker is paid the **normal rate up to 83%** of the standard output, **10% above the normal rate** for producing between **83% – 100%** of the standard output and **20% above the normal rate** for producing **more than 100%** of the

standard output. Here also, the minimum wages of the worker are not guaranteed**.**

For e.g., Standard Output is 200 units Piece-rate is 10 paise **Suppose a worker produces** 160 units, Efficiency = 160/200 × 100 = 80%. Since efficiency is less than 83%, so he is paid only the basic rate, i.e., 10 paise. His, **earnings will be Rs. 8 (80 × 0.1).**

**Suppose a worker produces** 180 units, Efficiency = 180/200 × 100 = 90%.Since efficiency is between 83% and 100 percent, so he is paid 10% above the normal rate.Thus,

**Earnings = 90 × 110/100 × 0.1 = Rs. 9.9**

Suppose a worker produces 220 units, Efficiency = 220/200 × 100 = 110%.Since efficiency exceeds 100% i.e., is 110%, so he is paid 20% above the normal rate. Thus,

**Earnings = 110 × 120/100 × 0.1 = Rs. 13.30**

viii) **Gnatt task and bonus plan:** Here, though fixed time rates are guaranteed, standard output and standard time are predetermined for each job.

This involves three stages of payment. (a) Below the standard output (efficiency less than 100), minimum guaranteed wage is paid for the time taken by him (b) at the level of standard output (efficiency is 100%), standard wage and 20% of wages earned is paid (c) above the standard output (efficiency more than 100) standard wage plus a bonus of 20% of the wages for the standard time. This plan is effective for efficient workers because the wage increase proportionately as under piece wage rate system and bonus is effective on the increased wage. It is simple and do not penalize but guarantees time wages to the below average workers.

ix) **Emerson Efficiency Plan:** Like the previous ones, standard time and standard output is fixed. The daily wage is guaranteed. But in this plan there is no sudden rise in wages on achieving the standard output. The efficiency bonus rises only gradually.

x) **Co-partnership system:** Here, the workers are given share in profits of the concern and can also take part in its control, thereby making them enthusiastic partners in the business.

B) **Long term wage incentive plans:** These are group incentive schemes and are significant when worker's efforts are reflected as group efforts. This sets in the spirit of team work gearing up everyone in the team to work so that all can share the gains of the group incentive scheme. Also group incentives have less variance than individual incentives and group production has more stability. The disadvantages are: The group rewards cannot proportionate individual efforts in the group. The efficiency level of individual workers will vary in more or less amounts though the rewards of the efforts will be the same.

The incentives generally take three forms:

1) a) Rewards are linked with attainment of standard output.
   b) Rewards are paid in proportion to which, the actual output per man-hour exceeds the standard output per man-hour.
2) Rewards whose money value is a percentage of the cost reduction in cases where actual cost of production is less than standard cost of production due to the joint efforts of the workers.
3) Rewards can also be based on increased sales value.

**Group incentive plans are:**

1) Profit sharing plan
2) Scanlon plan

**1) Profit sharing plan:** According to Mamoria and Gankar "Profit sharing involves the determination of organization's profit at the end of the fiscal year and a distribution of a percentage of the profits to workers qualified to share the earnings. The percentage to be shared by the workers is determined before the work period and is communicated to the workers.'' The ideology behind profit sharing is that "management feels its workers will fulfill their responsibilities better when they realize their efforts will fetch higher profits,

which will be returned of the workers through profit sharing". There are three types of profit sharing plans:

a) In current profit sharing employee is payed in cash his share of the profit.

b) In deferred profit sharing employees share of profit is either credited to his PF Account or Pension account or is payed in the form of bonus shares.

c) A third type of profit sharing is combination method where a part of profit is payed in cash and a part is deferred and placed in employee accounts.

2) **Scanlon plan:** The plan is a brain child of Joseph Scanlon (1937) aimed to involve workers in taking their suggestions for cost cutting measures along with work improvement initiates and thereby sharing the gains of productivity through financial incentives. It is a comprehensive system where all workers in the plant participate in giving suggestion that is evaluated by several committees. If the suggestion is implemented and is successful, all workers share 75% of the successful saving and the rest 20% is set aside for the months when labor costs exceed the standard. But for the plan to be successful, number of workers has to be less than 1000 with stable product line and more so since it is a participative program good labor relation is a precondition.



**CHECK YOUR PROGRESS**

**Q.3:** Explain any one of short term and of long term incentive plans for blue collar workers?

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2) **Incentive Plans for White Collar Workers/Salesman:** The incentives for salesman are in the form of sales commission. There are originally 3 types of such incentive plans and others are slight variations of these original plans.

   a) **Straight salary method:** Here, the salesman is paid on weekly, monthly, or yearly basis and the pay is not related to results. This method is applicable when the nature of job is more service oriented like surveying and finding prospective clients over an area or location, or conducting door to door feedback survey of consumers or organizing product training programs for distributor's sales force etc. The positive side of method is that the salesman knows beforehand what his financial return will be and the employer is also aware of his fixed expense through salary method. In commission method the salesman is more inclined to making the sale than creating a strong customer base. But through salary method a long association with customers can be the focus of salesman as their salary is predetermined and certain. The negative side of salary method is that there is no focus on results but mostly seniority.

   b) **Straight commission basis:** Here, the salesmen are paid only on basis of results shown by him (i.e., his sales). It is rewarding for high performance salesman. But the run after money concept makes the salesman less focused on creating long term customer base, selling hard-to-sell items and being less oriented towards the company. Also as their income fluctuates highly based on their sales generating inequity among the salesforce.

   c) **Combination method of salary and commission basis:** Here, salesman gets a fixed salary plus a commission based on their sales. Because of the fixed salary component they have a financial guarantee. They also can establish some association with the company by knowing what services they are being paid for by the salary component while the incentive component takes care of performance. Such plans are complicated to generate and as

the salary part is not related to performance this might not trigger any efforts in the underperformers.



**CHECK YOUR PROGRESS**

**Q.4:** Explain any one Incentive plans for white collar workers?

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3) **Incentives for Management Employees:** It comes in the form of bonus. Bonus plan is of two types– One is determined by some fixed criteria like greater sales and the other is determined by some discretion criteria. The bonus plans are periodically reviewed.

## 9.5 PRE-REQUISITES OF EFFECTIVE INCENTIVE SYSTEM

The following are some of the fundamentals that are considered for effective incentive system:

1) **Establishing the incentive scheme** in a way that is going to achieve the desired business objectives is not only an incentive prerequisite but more essentially a business requisite. Aligning behavior/output for the incentives with behavior/output for attainment of organizational goals will motivate workers to work toward both in the same capacity.
2) **The co-operation of workers is an essential ingredient** in an incentive scheme. The worker's co-operation is sought in the following areas– the methods adopted to analyse the output on the basis of which payment is done, the methods used in setting wage rates for different work categories and the pre-required safeguards relating to job security, earnings and dispute settlement regarding work standards.
3) **Objective to incentivize is to attain some organizational goal**, so communicating to employees the organization goals, and the

rewards in the way to achieve them and the timely progresses keeps the workers focused and gives them a feeling of belongingness to the organization.

**4)** The incentive scheme must be based on **scientific work and motion study measurement** and not any rule of the thumb. The standards of work set to attain the incentives must be realistic and attainable. Workers must be provided with necessary tools, equipment and materials so as to enable them reach their standards. Attainable standards and adequate aids to attain the standards will inspire the workers to work towards their goals.

**5)** The incentive scheme must be all **inclusive comprising of indirect workers and direct workers.** It must not be fragmented in its approach to group workers for incentives. Indirect workers like supervisors, foremen, attendants, crane operators, canteen staff, store keepers, and clerical staff must also be part of the incentive scheme.

**6)** In executing the incentive scheme, workers will look upto senior management support, so **management must be committed** to the cost and time factor for calculating the incentives just as they have been assessed before launching the incentive programme. They must not display a lack luster attitude mid way between the scheme.

**7)** Before scheme implementation time must be set aside for planning as planning is one of the prerequisites**.** Many incentive schemes, started hurriedly have midway proved to be slipshod rather than effective.

**8)** The other safeguards are:

i) The incentive scheme should be appropriate to the nature of work carried out and the workers employed in the organization.

ii) The reward should align with the efforts of the individual or group.

iii) Individuals or groups should be able to calculate the reward they get.

iv) The scheme should be properly instituted and maintained, and controlled. It has to be periodically reviewed along with the organization objectives and maybe at time with circumstances rates have to be amended.

v) The plan must be simple to understand and to operate. The workers should themselves be able to calculate their wages than be suspicious of the scheme.

vi) Incentive should be large enough, so that workers are tempted to *earn* it.

vii) The scheme should avoid any attempt to overstrain workers by requiring them to work for long hours or at much faster speed that it affects their health.

viii) In some cases the employee will need to receive the reward as close in time to the result or behavior displayed. It there is no proximity between the reward or behavior the reward will be weakened in the mind of the employee. There are many non-monetary rewards that can be given immediately. In other cases (monetary) the delivery of the incentives has to be timely.

ix) Employee incentive programs fail if the reward is not valuable to the employee. It is not possible to design a myriad of incentives keeping in mind everyone's requisite but establishing schemes that caters to a majority is effective.



**CHECK YOUR PROGRESS**

**Q.5:** List 5 prerequisites for effective incentive schemes?

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## 9.6 MERITS AND DEMERITS OF INCENTIVES

**Merits:** The following are the Merits of Incentives:

1) Astonishing increase in output as the workers increases their efficiency to prove to be more productive to get more wages.

2) Cost of production per unit of output declines due to decrease in labor cost and overheads per unit. Reduction of cost of production per unit is passed on to the consumers by reducing the selling price.
3) Workers are motivated to be regular at work and to stay longer on with the organization to receive the incentives and employers have to invest less in new recruitment and training.
4) It creates lesser chances of disputes between employers and workers if the incentive scheme is institutionalized after consulting all the parties.
5) Supervision is reduced to the status of check measure on materials and machines rather than on man.
6) Since the reward schemes are in alignment with organizational goals the workers knowingly or unknowingly are wayward towards organizational goals while trying for the rewards.

**Demerits:** The following are the Merits of Incentives:

1) Fixation of standard time and standard quality based on time and motion study is not easy.
2) As the workers work faster to get more wages, more supervision is necessary to check drop in quality and avoid wastage of raw materials.
3) Unions may oppose the incentive plan because it weakens them and creates jealousies and greed among workers leading to strikes and lock-outs.
4) Product quality might come down due to mindless output rate increase and production might also come down due to breakdown of machinery and equipment due to excessive and incessant use of them by an over enthusiastic workforce.
5) It is difficult to measure the exact proportion of the extra work done.
6) Quality of work life reduces as workers become more and more work centric.
7) The scheme infuses inequality in the income of workers as some workers are able to prove more efficient than others. This inequity brings in jealousy and hatred.

8) Workers might labor too hard for the reward and over strain their health and undermine safety measures.
9) Employees tend to be insensitive to incentives when these incentives become regular part of their pay.



**CHECK YOUR PROGRESS**

**Q.6:** List 2 each of merits and demerits of incentives.

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## 9.7 LET US SUM UP

- Incentives are financial rewards given to an employee in recognition of his superior performance.
- The objective of incentives is to motivate employees to achieve organizational goals whatever the goals may be.
- Wage incentive plans may be categorized as–
  1) Plans for blue collar workers
  2) Plans for white collar workers
  3) Plans for managerial personnel
- Incentive plans for blue collar workers: (for individuals) Short term plans:
  a) Halsey Premium Plan
  b) Halsey-Weir Premium plan
  c) Rowan premium plan
  d) 100 percent premium plan
  e) Bedeaux point plan
  f) Taylor's differential piece rate
  g) Merrie's Multiple Piece rate system
  h) Gnatt task and bonus plan
  i) Emerson efficiency plan
  j) Co-partnership system

- Long term wage incentive plans:
  a) profit sharing plan
  b) Scanlon plan
- Incentive plans for white collar workers (salesman):
  a) Straight salary method
  b) Straight commission method
  c) Combination of straight salary and Straight commission method
- Incentives for management employees: Bonus (criteria based and discretion based).
- Launching an incentive system may not always be effective. It is always necessary to qualify through the pre-requisites for establishing an effective incentive system.
- An incentive system has both merits and demerits.



## 9.8 FURTHER READING

1) Bhattacharyya, Dipak Kumar. (2014*). Compensation Management*. (2nd Edition). Oxford.
2) Bhattacharya, Mousumi S. and Sengupta, Nilanjan. (2008). *Compensation Management*. Excel Books.
3) Deb, Tapamoy. (2008). *Compensation Management: Text and Cases*. Excel Books.
4) Goel, D. (2012). *Performance Appraisal and Compensation Management: A Modern Approach*. Prentice Hall India Learning Private Limited.
5) Singh, B. D. (2017), *Compensation and Reward Management*. Excel Books.



## 9.9 ANSWERS TO CHECK YOUR PROGRESS

**Ans. to Q. No. 1:** Incentives are employee rewards for superior performance.

**Ans. to Q. No. 2:** Objective of incentive is to motivate employees to perform to attain organizational objectives.

**Ans. to Q. No. 3:** Gnatt task and bonus plan:Here fixed time wages are guaranteed, and standard output and standard time are determined for each job. This involves three stages of payment. (a) Below the standard output, minimum guaranteed wage is paid (b) at the level of standard output, standard wage and 20% of wages earned is paid (c) above the standard output standard wage plus a bonus of 20% of the wages for the standard time is paid. This plan is effective for efficient workers because the wage increase proportionately as under piece wage rate system and bonus is effective on the increased wage.

Scanlon plan– The plan takes into consideration workers' suggestions on cost cutting and work improvement to make them share the gains of productivity through financial incentives. The suggestions are evaluated by several committees. If the suggestion is implemented and is successful, all workers share 75% of the successful saving.

**Ans. to Q. No. 4:** Straight commission basis: Here the salesmen are paid on results shown by them (i.e., sales). It is rewarding for high performance salesman. As income fluctuates highly between those of performing and non-performing employee it generates inequity among the salesforce.

**Ans. to Q. No. 5:** The co-operation of workers is essential for an incentive scheme else they will lose trust in the scheme, undermine it and try to evade the scheme. Communication with employees about the organization goals, and the rewards on achieving them keeps the workers focused on the goal. Work and time standards for the incentive scheme must be based on scientific work and motion study measurement and not any rule of the thumb to make the standards attainable. The incentive scheme must include indirect workers and direct workers to avoid groupism. The scheme should not overstrain workers affecting their health and life.

**Ans. to Q. No. 6:** Merits of incentive are: Increased output, Motivated workforce, Demerit, Fall in product quality and Surfaces the problem of payment inequity.



## 9.10 MODEL QUESTIONS

**Q.1:** Taylor's differential piece rate system is an ideal incentive payment scheme. Justify?

**Q.2:** Explain Bedeaux Point plan with an example?

**Q.3:** For an industry that sells technical products, which incentive do you think is applicable for the sales force?

**Q.4:** Briefly explain management incentives?

*** ***** ***

# UNIT 10: BENEFITS AND SERVICES

## UNIT STRUCTURE


10.1 Learning Objectives

10.2 Introduction

10.3 Concept and nature of benefits

10.4 Classification of employee benefits

10.5 Employee benefit programs

10.6 Long Term Incentive Plans (LTIPS)

10.7 Strategic perspective on benefits

10.8 Factors influencing choice of benefit program

10.9 Administration of benefits and services

10.10 Designing a Benefit program

10.11 Let Us Sum Up

10.12 Further Reading

10.13 Answers to check your progress

10.14 Model Questions


## 10.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the benefit component in the compensation package
- categorize the different types of benefits made available for the employee
- illustrate the benefit programs placed under these categories
- elaborate the incentive plans which are focused on a longer term (LTIPs)
- highlight how an organization has to balance different objectives at the same time to adopt a strategic approach
- describe the factors that go into incorporate a benefit program
- explain how benefits can be administered smoothly
- outline the steps to design a benefit package.

## 10.2 INTRODUCTION

The tenth unit of the course on Compensation Management is about the benefits within a compensation package that is provided by the organization to the employees for their involvement in the organization.

The unit also shows broadly the groups into which the benefits can be categorized by their very nature. The unit will help us know further the benefit programs run under these specific heads and will also include the kind of benefit which is provided to the employee after he has been attached to the organization for a longer period of time knows as the Long Term Incentive Plan. In this unit we are going to discuss how an organization strategically places its objective related to employee benefit similarly as it does with other organizational objectives. The many factors affecting the choice of benefit– legislation, tradition, employee needs, budget, union demands are listed in this unit. The unit will consider the manifold difficulties in administering benefit program and how they can be minimized. Finally the unit ends by elaborating on the methodology to be followed to design a transparent benefit package.

## 10.3 CONCEPT AND NATURE OF BENEFITS

Every person working in any concern naturally expects that his labor and time is compensated adequately. Compensation, for that matter, is the concern's acknowledgement of the worker' s input in terms of labor(both physical and mental) and his time invested. This compensation consists of salary and non- salary components. In other words compensation consists of the following fractions of the total labor costs.

| COMPENSATION | |
|---|---|
| **Salary/Wage Component** | **Nonwage Component** |

Though wage component is in cash, non wage components are in indirect and non cash form. It is important to mention here that both the fractions of compensation are taxable (except a few). Since the wage component is in cash it is like normal salary and wage, whereas the non wage component being non cash and indirect is more in the nature of benefits. The non salary

compensation component is what we call the employee benefits. Benefits have a number of attached advantages:

1) The cost value of benefits is less than the cost value of cash rewards.
2) The employee takes pride in displaying the obvious benefits to co-workers and is committed to the organization for the honor and pride conferred on him.
3) The benefits have a flexible nature of being designed according to the organization mission and objectives and organization financial position. This is advantageous to the organization.
4) The benefits leave a long lasting impression in the minds of the employees as they take care of him and his family's needs and comfort (personal and social).



**CHECK YOUR PROGRESS**

**Q.1:** What are benefits?

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## 10.4 CLASSIFICATION OF EMPLOYEE BENEFITS

The employee benefits vary from organization to organization according to the organization's vision, mission, objective and culture and also the tradition followed in the area and industry and the benefit trend of the present time.

An attempt to list employee benefits would include the following three types– non-statutory, statutory, and deferred.

1) **Non-statutory benefits or voluntary benefits:** The business environment is constantly changing. With innovations and adaptations to meet the ever increasing and current trend demands of the modern population, establishments need the best talent to support their business. The way to attract and retain talent now has become one of the strategic approaches of all business establishments. Such strategies differ from organization to organization. Organizations tailor

make their employee attraction and retention strategy according to their budget and corporate objectives. One of the attraction and retention strategies is manifested through the benefits offered to the employees. The employees feel proud by the trophy value of these benefits. They take pride in showcasing these benefits to peers and colleagues and contemporaries.

2) **Statutory benefits:** In India there are various legal provisions which are protective of and beneficial to the employee. These mandates are meant for ensuring the safety and security of workers, whereby they cannot be reduced to commodity for labor at the whims and fancies of the employer. They are directed towards the essential benefits needed to safeguard the health, life, work and family of the workers.
3) **Deferred benefits:** Some benefits come under deferred schemes whereby an employee or employer defers a part of employee's current income till a specific future date eg life insurance. The deferred amount provides the payment of life insurance premiums. The cash value can be made available at retirement or if the insured dies before retirement, the insured's designated beneficiary would get the policy's death benefits.



**CHECK YOUR PROGRESS**

**Q.2:** List some mandated provisions for employee benefits in India?

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## 10.5 EMPLOYEE BENEFIT PROGRAMS

The general employee benefit programs under the above mentioned groups can be shown as:

1) **Non-statutory benefit programs**: Non-statutory benefit programs are– Housing, Group Insurance, Retirement benefits, Tuition fees

reimbursement, Children education, Social schemes, Club membership, Foreign tours, Leaves other than statutory leave (vacation leave, sabbatical leave), Employment security and Medical benefits.

The term perks is generally used in case of benefits conferred on senior level executives e.g., company cars, 5 star hotel stay, dining allowance etc.

Since the non statutory benefits are based on the employer's discretion there can be any number and form of benefit under this group. Some of them can be illustrated as:

a) *Retirement benefits:* These include Pension, Gratuity, PF, old age medical benefits (for retired employees), travelling concessions (for retired employees), jobs to dependants of deceased employees (these benefits also come under deferred income plans),

b) *Employment security:* This security is provided during and beyond employment ie leaves pay, overtime pay, holiday pay, pay for adjusting greater cost of living, unemployment allowances, lay off and retrenchment compensation and jobs to the children of employees etc.

c) *Medical benefits:* Sick benefits, hospitalization and medical care, life insurance, health insurance, accident insurance etc are in the nature of employee medical benefits.

d) *Social schemes:* Birthday and anniversary gifts, education facilities, spouse allowances, recreational programs, stress counseling, etc. come under social schemes.

**2) Statutory benefit programs:** Statutory benefits mandated by Indian labor laws include the following:

a) *Bonus*: It is an extra payment over the normal wage payment. Bonus is what the worker gets from the organizational surplus and it is generally 8.33% of pay as minimum bonus.

b) *Employment security*: Security need is a predominant human need according to Maslow's hierarchical theory. Organization's can fulfill the job security need of employee by confirming them on the regular pay roll after completion of their probation. Regular

payment of wages along with timely disbursement of benefits also addresses the security need of employee.

c) *Retrenchment and lay off compensation*: Industrial Disputes Act 1947 makes provisions for compensation in case of lay off and retrenchment. For retrenchment compensation is paid at the rate of 15 days wages for every completed year of service, with a maximum of 45 days wages in a year. For lay off compensation is paid at the rate of 50% of the total of the basic wage and DA, for the period of their lay off except weekly holidays.

d) *Safety and health provision*: Ensuring work safety and health measures are essential benefit coverage to be provided by employers. The Factories Act 1948 lists all the requirements to ensure a safe working environment.



**CHECK YOUR PROGRESS**

**Q.3:** List the various old age benefits.

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## 10.6 LONG TERM INCENTIVE PLANS (LTIPS)

Every business, irrespective of its other strategic organization objectives, will always have cost cutting at the top of its business priorities. One way of cost cutting is reducing labor costs. Recruitment and training involves a bulk of the labor cost. So retaining good employees has always been a business priority. The question playing in the minds of every employer is on how to retain employees? Long term incentive plans (LTIPs) encourage employees to continue with the organization as LTIPs provide rewards only after a definite period (generally 2-5 years), thus motivating employees to stay with the organization for a longer tenure. Furthermore, if the LTIPs are tied with the achievement of organizational goals, it will promote desired behavior from employees to attain those goals. The organization must do the needful to communicate those goals tied with LTIPs to the employees.

In brief, LTIPs are long term rewards for those who create value or maximize shareholder's value by contributing to company's growth through the achievement of company's strategic objectives.

Now considering LTIPs from the point of cost cutting, it cannot be looked down as an additional expense. It is an investment that is paid out after additional value has been created. Employees are awarded company shares generally distributed in half shares meaning half are given immediately and the other half is deferred till a later date.

LTIPs also come in the form of stock based compensation, such as stock options, restricted stock, performance shares, cash, or stock settled performance unit. Generally LTIPs are a mix of equity types and may include a cash component as well. The eligibility criteria for such LTIPs are grounded on various performance parameters. To summarize, there are different types of LTIPs. Choosing an LTIP is an organization discretion depending on its alignment with the nature of specific and strategic organizational objectives it aims to achieve.

LTIPs differ from annual incentives. As the name suggests annual incentive come annually but LTIPs are rewarded after a longer tenure of the employees association with the organization. Moreover they are tied to a specific level of performance– total return to shareholders, operational measures as earning per share and return measures as return on assets. To sum up, LTIPs respect the interest of the shareholders, generates a sense of ownership among the best employees and promotes employee long term association.



**CHECK YOUR PROGRESS**

**Q.4:** What are LTIPs?

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## 10.7 STRATEGIC PERSPECTIVES OF BENEFITS

The term 'strategic perspectives' in whatever business context used, means the focused and quantified approach the company identifies to solve its problems or rather priority problems after analyzing the problem in the light of predetermined business objectives. Suppose the business objective is to retain talent when the arising problem is attrition in the industry. Strategic perspective will be, the approach company will adopt out of various alternatives to minimize the attrition. One such strategic perspective is attracting employees through benefits. This strategic approach could be made more appropriate if the company further explores how the benefits affect the company budget. The additional costs tied to benefits in the total compensation package, apart from wage and salary puts a tremendous strain on the company budget. A right approach as is the case here with benefits, will be the one that supports the organization cost factor, fulfills the employee needs and to keep them motivationally driven towards the organization achievement thus reducing attrition. Strategic perspective needs to juggle many different objectives at the same time be it benefits objective or any other organizational objective.

## 10.8 FACTORS INFLUENCING CHOICE OF BENEFIT PROGRAM

The business objectives are of paramount importance in deciding on the benefit program. Business objectives are bound to change with changes in the business environment and employee benefit package has to evolve according to the demands of the business objectives from time to time.

There are a number of factors influencing organization's choice of the benefit program for their employees. One is legislation ie what the organization has to compulsorily provide as per all the mandates made essential for the industry, other is discretion of the management based on traditions of the industry or area, employee needs, union demands or its financial position to run different kinds of benefits.

a) *Legislation:* Under this heading we have all those benefits for which the employer has to compulsorily make expenditure irrespective of any choice. So legislation is an intensifying factor that the employer cannot undermine as part of his benefit program. It includes expenditure for the health and safety of employees, and also different forms of insurance to cover any form of the employee's loss of income due to illness, injury, unemployment (layoff, retrenchment compensation) and old age (retirement) benefits. The Factories Act 1948 has various provisions to protect employees against workplace accidents and unhealthy working conditions. The Industrial Disputes Act 1947 enumerates the payment of compensation toward layoff and retrenchment. Such benefits made compulsory by law ensures that the labor force is protected from all the apparent risks during its employment tenure.

b) *Discretions:* Organizations tend to choose the benefit program prevalent in the industry and geographical area. Employees by nature will opt for the employer with the best compensation package. So understanding the prevalent benefits given by competitors through benefit surveys cannot be overlooked.

Another factor is the employee's acceptance of the benefit program. Analyzing employee needs and preferences for benefits program is more rewarding in terms of elongating their tenure in organization. But such analysis at times become a futile exercise because the variety in benefit choices increases with greater number of employees or greater employee group. Organizations differ in their demographic makeup (age, background, culture etc.), so the employee preferences for benefits will also differ. However organization will be focused on selecting benefits that will motivate the majority.

In giving out benefits, organization has to check a balance between direct wages and benefits. Increase in wages and changes in benefits will excessively increase labor costs.

Union pressures also affect the implementation of benefit program. As per general rule if the union enforces the employee preferences then the choice of benefit program is advantageous to all the parties' employer,

employee and union. But in case union's demands do not reflect genuine employee preferences but rather tries to put in place a benefit just to satisfy a large majority of union then the decision on the choice of benefit is a problem.



**CHECK YOUR PROGRESS**

**Q.5:** List the different sub factors that influence employer's decision on the benefit package?

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## 10.9 ADMINISTRATION OF BENEFITS AND SERVICES

Administration of benefits and services means establishing, maintaining and disbursement of employee benefits throughout the organization ie managing all benefits like medical insurance, pension plans, retirement benefits, vacation leave, sick leave and maternity leave etc. But there are many factors that come in the way of smooth administration of benefits and services. Generally employees lack awareness about such programs. They are more focused on direct remuneration and managers also take little interest to communicate them that benefits are in addition to direct remuneration and come in an abundance of services which they receive as part of their total compensation package. Management also has to communicate that it is not related to performance but comes by way of employment and looks into their security, safety, health, medical, welfare and recreation. If these programs are well managed and well communicated then employees will be motivated and will look up to their organization as their guardian for well being. Employees can also be asked to participate in designing such programs. Trade union must take stand to bargain for statutory benefits and other benefits as per the industry norm and tradition and competition in the area and employee needs. The benefit program after considering all these factors has to be designed according to the capacity of the organization to pay.

These problems of employee ignorance, management's non-communication, trade union's improper bargaining can be avoided by establishing well defined benefit objectives, communicating benefit information through length and breadth of organization, standing for employee priorities (by the union) and at the same time controlling benefit cost.

Just as organizations chalk out long term objectives, similarly the organization can also establish benefit objectives ie what the benefits are intended to achieve for the employees. While administering the benefits organization has to assess environmental factors including the prevailing market competition to have a winning edge over other competitors. Communicating these to employees is an essential part of administering. Employees must know their total package inclusive of all these indirect benefits and not alone the direct benefits. Trade unions must voice for the employees legal rights and genuine needs. Finally pay capacity of the organization is the ultimate decisive factor in the administration of benefits.



**CHECK YOUR PROGRESS**

**Q.6:** What kind of problems come in the way of benefit administration?

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## 10.10 DESIGNING BENEFIT PACKAGE

It is obvious that benefit cost puts a heavy burden on the company funds, sometimes accounting to 40% or more of the total compensation costs. So the benefit component or indirect compensation becomes a costly endeavor for employers. Some benefits as discussed earlier are mandatory for the employer to provide, e.g., medical, health, safety, security, pension, gratuity etc. though some by nature are voluntary and come through employer's discretion. Designing a benefit package inclusive of both

mandatory and voluntary benefits is a huge investment. So employers must ensure that the voluntary part of the benefit package meets their objective of attracting, retaining and motivating the workforce. This can be done by the following procedure:

a) Identify organization benefit budget and benefit objective: The benefit objectives should be employee (need and priority) focused and at the same time in alignment with the organization strategic objectives. The benefit package should not undermine the employee needs and at the same time should not be in conflict with the organizational strategies. Since the employee needs and organization's strategies keep evolving with time the benefit objective should be evaluated from time to time and necessary changes should be incorporated. Besides these the other factors that contribute toward benefit objectives are the clauses mentioned in the collective bargaining agreement and the prevalent norms in the industry and area. Estimating current benefit costs is equally important as estimating the projected costs to prepare a spreadsheet on the annual benefit cost because the cost of certain items on the benefits itenary are bound to increase with time for, e.g., health insurance and medical benefits for employees and their dependents, education privileges etc.

b) Conduct needs assessment: As the employee needs are pivotal in designing benefit package an exercise in needs assessment cannot be ruled out as there is great variety in employee demography, so there is bound to be great variety in their needs and wants. Older employees will value medical and health benefits and retirement and pension benefits while the younger workforce will value vacation leave and education schemes for career enhancement etc. So for the employer understanding the demographics and a proper blending of the variety is important in designing benefit package along with the state and legal requirements. This can be in the form of personnel interview, questionnaire methodology. But this is effective only if the employee feedback is incorporated by the employer in designing the package. Other indirect forms of employee needs assessment may

be the employer perception of workforce needs, industry practices and tax laws and regulations.

c) Formulate a benefits plan program: Once the needs assessment is over a gap analysis between the need based benefits and existing benefits (in case there is already in existence a prior benefit program) has to be done. Now whether it is a new benefit design or an alternation to the existing benefit design the employer is in a position now to design the benefit program in order of priority as revealed from employee feedback. Next the employer will estimate the associated costs of all the prioritized benefits and check it against the benefits budget of the organization. Another question here arises for the employer is that whether the employee will have to contribute, if yes, under which heads and how much?

d) Communicate the benefits plan to employees: Communicating to employees the benefit plan based on their feedback boosts their morale. They feel valued in the organization that their feedback is being considered. Further an employee who has good knowledge of the benefit plan has less chances of leaving the organization. They will try to stay on with the organization for long term benefits. Even if the employee feedback is not totally implemented the causes for this should be made known and in future how plans can be made to accommodate them. However, a benefits program should go through a transparent communication system.

e) Develop a periodic evaluation process to determine effectiveness of the benefits: Like all the HR processes, evaluation and check measure of the effectiveness of benefit plan is also a significant step of benefit management. Initially the benefit was designed based on employee needs and organizations long term strategy. So it is necessary to assess whether the benefit plan after execution is taking care of these two vital factors. Also as the business environment, employee needs, the country's economy, workforce demography, regulatory provisions are constantly changing, flexibility of the benefit program from time to time to make adjustments for these changes is an absolute necessary.



**CHECK YOUR PROGRESS**

**Q.7:** Explain the importance of communication in designing a benefit package?

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## 10.11 LET US SUM UP

- Compensation consists of salary and non-salary components. The non salary component which is non cash and indirect is what we call employee benefit.
- Advantages of benefits are:
  a) The cost value of benefits is less than cost value of cash rewards.
  b) Benefits boost employee morale
  c) Benefits are flexible
  d) Benefits take care of employee and his family
  e) Benefits include the following three types– non-statutory, statutory, and deferred.
- Statutory benefits are compulsory.
- Non-statutory benefits are flexible according to employer's discretion.
- Deferred benefits are provided after a longer period.
- Some Non-statutory benefit programs: Housing, Group Insurance, Retirement benefits, Tuition fees reimbursement, Children education, Social schemes, Club membership, Foreign tours, Leaves other than statutory leave (vacation leave, sabbatical leave), Employment security and Medical benefits.
- Some statutory benefit programs: Bonus, Employment security, Retrenchment and lay off compensation and Safety and health provision
- LTIPs are provided only after a definite period in the form of stock based compensation, such as stock options, restricted stock, performance shares, cash, or stock settled performance unit.

- The strategic approach to benefit management is one that will support the organization cost management and organization goal achievement.
- Factors influencing choice of benefit program are: Compulsory legislation and employer's voluntary discretion
- Administration of benefits and services means a proper establishment, maintenance and management of employee benefits.
- Designing a benefit package will involve the following steps:
  a) Identify organization benefit budget and benefit objective
  b) Conduct needs assessment
  c) Formulate a benefits plan program
  d) Communicate the benefits plan to employees:
  e) Develop a periodic evaluation process to determine effectiveness of the benefits.



## 10.12 FURTHER READING


1) Bhattacharyya, Dipak Kumar. (2014*). Compensation Management*. (2nd Edition). Oxford.
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3) Deb, Tapamoy. (2008). *Compensation Management: Text and Cases*. Excel Books.
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## 10.13 ANSWERS TO CHECK YOUR PROGRESS

**Ans. to Q. No. 1:** Benefits are indirect non cash payment component within the compensation package apart from the actual wage and salary.

**Ans. to Q. No. 2:** Employee's Provident Fund Act (1952), The Factories Act (1948), Industrial Disputes Act (1947), Maternity Benefit Act (1961), Payment of Bonus Act (1965), Payment of Gratuity Act (1972) etc.

**Ans. to Q. No. 3:** Pension, Gratuity, PF, old age medical benefits, travelling concessions, jobs to dependants of deceased employees (these benefits also come under deferred income plans).

**Ans. to Q. No. 4:** LTIPs are means to reward employees who accomplish desired conditions thereby leading to the organization's growth. Henceforth the organization rewards them on their long term performance out of the additional value they have created.

**Ans. to Q. No. 5:** Survey of competitor's trends, Analysis of employee needs and priorities, Understanding employee demographics, Pay capacity, Union pressures.

**Ans. to Q. No. 6:** The problems of employee ignorance on the benefit programs, management's non-communication of these programs, trade union's improper bargaining and inability to understand the employees needs and priorities come in the way of benefit administration.

**Ans. to Q. No. 7:** Communicating to employees the benefit plan which is based on their feedback makes them feel valued in the organization. Even if the employee feedback cannot totally implement the causes for this should be made known elaborating on the fact that in future plans could be made to accommodate them. Further an employee who has good knowledge of the benefit plan has less chances of leaving the organization.



## 10.14 MODEL QUESTIONS

**Q.1:** Explain how benefits motivate employees?

**Q.2:** List the benefit provisions under The Factories Act (1948)?

**Q.3:** List the different voluntary benefit programs?

**Q.4:** Do LTIPs help in retaining employees?

**Q.5:** Explain the factors influencing choice of benefit program?

**Q.6:** Elaborate how benefits can be well administered?

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# UNIT 11: VOLUNTARY RETIREMENT SCHEME

## UNIT STRUCTURE


11.1 Learning Objectives

11.2 Introduction

11.3 Concept of Voluntary Retirement Scheme (VRS)

11.4 Procedure of a VRS Scheme

11.5 Challenges of VRS Implementation

11.6 Approaches to Deal with Workforce Redundancy

11.7 Costs and Benefits to the Company

11.8 VRS for Central Public Sector

11.9 Let Us Sum Up

11.10 Further Reading

11.11 Answers to Check Your Progress

11.12 Model Questions


## 11.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the concept of VRS
- outline the necessity for a VRS
- relate why manpower redundancies arise in organizations
- explain the procedure, steps and challenges for a VRS
- describe the options other than VRS
- describe the ways to deal with employees taking VRS
- analyse the cost and benefit curve of an organisation after VRS
- outline VRS for public sector employees.

## 11.2 INTRODUCTION

This unit is about the meaning of a VRS scheme and why the necessity to promote such a scheme came into being. The reason is no doubt manpower redundancy but the causes of redundancy are manyfold which is elaborated this unit. The unit also says that a VRS cannot surge suddenly. It has to go

through a preliminary program which is then followed by the implementation procedure. The procedural problems are also dealt with in this unit.

The unit will help us know the humane way to handle the sentiments of the employees leaving the organization when VRS has been finally initiated after all other options seem futile.In this unit we are going to discuss the costs and benefits that surround an organisation after VRS has been executed and how sometimes cost factor may surpass the benefits. Finally the unit ends with a note on the VRS scenario in public sector enterprises.

## 11.3 CONCEPT OF VOLUNTARY RETIREMENT SCHEME (VRS)

The Government of India, with liberalization adopted a new economic policy. This new policy significantly changed the industrial and business scenario. One of the new concepts brought to the fore was the Voluntary Retirement Scheme (VRS). VRS is a method allowed by the Government to the business and industrial establishments to reduce the surplus workforce employed by them. The downsizing of manpower employed in an organization became an important management strategy to meet increasing competition in a liberalized economy.

It is apparent that strong labor laws in India, along with strong opposition by the trade unions do not permit the business establishments for retrenchment of unionized employees, giving rise to industrial relation problems. Further the retrenchment process is more complicated by the procedure under Industrial Disputes Act 1947. The Industrial Disputes Act put restrictions on the employer for reducing excess staff by retrenchment, by closure of establishments and the retrenchment process also involved legalities and complex procedures. VRS came as a ready answer to this as the scheme is voluntary and no pressure is put on any employee to exit. VRS is also known as 'Golden Handshake' as it is the most humane and dignified way of showing the retrenchment. So the Government adopted this option to take care of employee redundancy by offering them suitable voluntary retirement benefits and giving some tax relief on such payments to employees who are eligible to retire voluntarily under the guidelines issued

by Government and Income Tax authorities. According to Income Tax guidelines the amount receivable on account of voluntary retirement of the employees, does not exceed the amount equivalent to one and one-half months salary for each completed year of service or monthly emoluments at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation. In any case, the amount should not exceed rupees five lakhs in case of each employee.

Employee redundancy arises due to many factors. First, when businesses apply new technology and modes of operation, systems become more technical than manual. Second, investments in such technology may force the business to hold back its manpower cost. Third, Business is forced to compete with other concerns which might have gone ahead the latest technology. In such cases when the existing manpower cannot meet the demands of the new business model they become redundant. Fourth, Joint ventures and foreign collaborations, mergers and takeovers etc. lead to a reshuffling of manpower. Owing to which a certain department or category of employee may seem to be of no significance in the new set up. Fifth, in the present economic circumstance it is seen that businesses need to improve their efficiency. Here reduction of employees and wage bill becomes a necessary. Sixth, if a business has declining sales and increasing costs VRS is the tool used to cut manpower costs. Seventh, in a slow economy with little or no growth reduction in manpower becomes imperative.

Because of the above reasons of redundancy of manpower, most large public and private sector companies have implemented VRS in recent years. The vacancy caused by VRS is not to be filled up and the retiring employee shall not be employed in any other company or concern belonging to the same management.

## 11.4 PROCEDURE OF A VRS SCHEME

The employer issues a circular mentioning the company's decision of offering VRS while elaborating the following:

1) Reasons for retrenchment.

2) Eligibility criteria for applying VRS. Generally employees who are 40 and above and those who have completed minimum 10 years of service in the concerned business. It does not apply to directors of a company or a cooperative society.
3) The benefits that will be offered- Voluntarily retiring employees are entitled as per law to the benefits of Provident Fund, Gratuity and salary for balance of privilege leave up to the date of their retirement, besides other VRS benefits.
4) The right of an employer to accept or reject employees application for the scheme.
5) The opening and closing date for applying.
6) Indication of income tax incidence on any VRS benefits which are in excess of Rs. 5 lacs which is the maximum tax free benefit.

Once the procedure lays the background for the VRS, the following steps are taken for the implementation of the scheme:

1) If the company is a public sector undertaking, prior Government approval is to be taken.
2) Employees to whom the VRS will be offered are to be identified.
3) In case of unionized establishments, business must do away with the union oppositions and must clearly communicate to them the plan for the scheme. Union may bargain for better package for the employees.
4) Employees must be well informed of the criteria for and the benefits out of the scheme.
5) The employees applying for VRS are scrutinized and decided who are to be put under the scheme and who are to be retained by the concern.
6) For the employees whose are listed under the VRS a worksheet is prepared showing the benefits each will receive and their PF, Gratuity and earned leave wages and tax incidence if VRS amount exceeds 5 lacs.
7) Finally counseling employees is the most important part of the implementation regarding what the employee can do in future (post retirement) and how he can manage the funds.

## 11.5 CHALLENGES OF VRS IMPLEMENTATION

The following are the challenges of VRS implementation:

1) Employees staying back with the business will be surrounded with doubts and apprehensions. Motivating them to continue with the organisation is a challenge.
2) Employees put under the VRS scheme should be given a complete outline of their post retirement benefits.
3) The scheme for reducing surplus staff must align with organizational strategy.
4) The after effects of downsizing will rope in many different and unforeseen situations. The organization should be prepared to handle these matters.
5) The organization must take utmost care to make the scheme transparent by making all managers and employees participate in the VRS decisions.
6) Sometimes organizations have to face a situation where severance costs outweigh the possible gains.
7) Management must take due concern to see that competent employees who are assets for the organisation do not move out through this retrenchment policy.
8) Organisation has to arrange for funds for VRS.

Though VRS is an answer to manpower redundancy but the removal of surplus staff must be decided when all other alternatives to utilize this excess manpower become unfunctional. The management must explore all alternatives to manpower reduction and try to retain employees productively. Some companies have set examples by introducing new products and services just to retain their employees.



**CHECK YOUR PROGRESS**

**Q.1:** What is VRS?

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**Q.2:** What steps are to be followed for VRS implementation?

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## 11.6 APPROACHES TO DEAL WITH WORKFORCE REDUNDANCY

Redundancy is the situation where the employment of a worker is terminated because of any of the following reasons:

- a business is closing down, either completely or at a particular site, or
- the employee is becoming a victim of corporate cost cutting or a slow down or restructuring.

The same employees who were valued and recruited to become an asset for the organization now becomes a burden and the organisation has to offer them the option to leave or show them the exit. This is a sensitive situation for not only the employees who are asked to leave but also those who continue to stay on. Many soft initiatives can improve the redundancy process for both the categories of employees. Much can be gained from staff leaving on good terms and their staying in contact with the organization and its remaining employees long after they leave.

The following steps are to be followed to implement the exit process in a humane and dignified manner.

1) Consultation with employee: Consulting with employees about major workplace changes is a must. When a decision is made to restructure, M & A, or make changes to the business that are likely to result in redundancies it should be disclosed to the employees. There has to be a clear communication between management and employees on the cause, process and benefits of VRS. The decision of redundancy must be made from the office of a senior executive who is visible throughout the process so that both existing and outgoing employees have faith in the process and there are no communication loopholes.
2) The notice period to be given: If employee is given an insufficient notice period, this may be a breach of a workplace agreement. If

individuals on long-term leave (such as parental or long service leave) are being retrenched, it is necessary to ensure the process for selection is documented and transparent, and not based on discriminatory grounds.

3) Consultation with trade union: Consultation with trade unions or other elected employee representatives on the decision for redundancy is a priority in VRS implementation. Workers would have the right to appeal against their dismissal due to redundancy. The right of appeal and the procedure thereof should be clearly communicated to the employee at the time they are notified of the layoff. And the employees who appeal will have the right to be accompanied by a trade union representative.
4) Engagement of redundant staff: During the notice period employees are generally excluded from important meetings and discussions. It can be mentally tormenting for redundant employees to be isolated at work and to be given the feeling of sudden exemption from corporate activities. It is important to keep them engaged and active.
5) Mentoring: A senior manager can mentor exiting employees on VRS and after VRS. They can give the departing employees a patient hearing on all their VRS related apprehensions, give career advice and be a contact source long after the employees leaves the organisation.
6) Exit interview: Exit interview is a good way to make the outgoing employees feel they are still valued by the organisation. They comprehend their feedback will be taken into consideration by the organisation.
7) Alumni networks: Keeping in touch with departing employees long after they leave the organisation earns the goodwill of both the existing and exiting employees for eg, giving them an annual update of the firm, or an occasional event arranged for them to make them feel remembered etc.
8) Employees' final pay: There should be a hassle free and prompt process for the final payment. It could be:
   - outstanding wages
   - accrued annual leave

- accrued or pro-rata long-service leave (if applicable)
- redundancy pay entitlements (if applicable).

9) The farewell: Finally, the gesture of bidding farewell has to be handled by HR personnel by making the farewell commensurate with the departing employee's standing within the firm and for all the service he or she has give.

Downsizing should be the last resort after all alternatives have exhausted. Other proactive ways to stall downsizing can be as follows:

1) Developing a multiskilled, flexible, adaptive and willing workforce for the acceptance of internal work related changes and location rearrangements (departmental or vocational transfers etc.), numerical flexibility (flexible team size), and functional flexibility (ability to perform multiple tasks).
2) Revising of job specifications at regular intervals to equip employees with skills focused on the current and future needs. If the employees acquire new skills they do not become obsolete.
3) Focusing on entrepreneurship, self-employment and livelihood programmes as other practical options. But these must be preceded by necessary and adequate training and appropriate follow-up .
4) Understanding the fact that cost cutting can be achieved not only through cutting labor costs but also through cutting the costs of other inputs. It is a known fact that other input costs exceed labor costs.

The part of the workforce that is left behind is important in the sense that they are the ones who carry on with the operations after the golden handshake period has been over. They go through the survivor syndrome ie the fear of them being redundant in the next turn. So it is required to keep up their morale and give them the reassurance that they are safe.



**CHECK YOUR PROGRESS**

**Q.3:** ..... is a situation where the employment of a worker is terminated by the employer due to circumstantial situation faced by the business.

**Q.4:** Why do you think keeping an open communication with employees is vital during VRS?

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## 11.7 COSTS AND BENEFITS TO THE COMPANY

A company introduces VRS with a view to reduce its surplus labour and hence labor costs.On the contrary, it has to pay compensation to the retrenched employees and also go through many other allied problems.

The VRS process needs government approval. Governments rarely give permission to closure, lay off or retrenchment. Therefore companies in order to reduce surplus labor began to introduce schemes so as to induce workers to retire voluntarily. Such inducement has to be, in monetary terms, generally much higher than the normal retrenchment compensation.

Let us see the cost and benefit factor in VRS from the following:

1) The financial health of the enterprise along with the VRS costs may be a trouble for the enterprise if the enterprise is chronically sick and has a record of not paying salaries and other statutory dues like earned wages, and accumulated benefits under provident fund and gratuity legislations, workers are losing their jobs. In such case, the general tendency of workers in such enterprises could well be that something is better than nothing and thus opt for VRS scheme.
2) The real cost to the company is not only the amount spent on VRS. The real cost is intangible to be expressed in monetary terms. Firstly, for example, if the scheme is not well planned, the company may, instead of losing the targeted redundant workers, be actually losing workforce that is critical to the continuance of the operations of the organizations. Thus to carry on with the operations the company may have to recruit workforce again to fill these critical manpower (skill and competency) shortages. Such an execution of a VRS

scheme adds to the company costs and contrary to any saving or benefit to the company.

3) Usually it is seen that it is the better skilled employees who opt to leave voluntarily because they know they can market their skills. The under-performers by trend do not opt for VRS because they cannot get better opportunities elsewhere as their marketability is low. This may show a fall in the company's competitiveness with the average quality of its employees in the post-VRS scene being lower than before.

4) Again, in the public sector VRS is usually voluntary, but it is not so in most private sector enterprises. When a company introduces VRS or when it coerces some of its employees to compulsorily go for VRS, it might affect the morale and motivation of the employees who remain in the company which will affect the company's productivity.

Thus it is seen that, when we analyze the cost benefit factor of VRS, apart from the objectives attained there could be more potential loss than gain.



**CHECK YOUR PROGRESS**

**Q.5:** Do you think VRS always brings cost benefits?

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## 11.8 VRS FOR CENTRAL PUBLIC SECTOR

**VRS for sick central public sector employees (CPSEs):** Retirement Scheme (VRS) in Central Public Sector Enterprises (CPSEs) was introduced by the Government in May, 2000 In an answer to a question in Parliament, Minister of State for Heavy Industries and Public Enterprises Shri P. Radhakrishnan said, the revised Voluntary. The salient features of the revised VRS Policy are as under:

**VRS in CPSEs that can sustain a VRS with their own Surplus Resources:** Enterprises, which are financially sound and can sustain VRS on their own, can frame their own schemes of VRS and make it attractive enough for employees to opt for it. They may offer as compensation upto 60 days salary (only Basic Pay + DA) for every completed year of service. However, such compensation will not exceed the salary for the balance period of service left.

**VRS in Marginally Profit or loss Making and Sick and Unviable CPSEs:** Marginally profit /loss making CPSEs as well as sick and unviable units may adopt either:

I) the Gujarat Model, under which the compensation is computed by allowing 35 days salary for every completed year of service and 25 days for each year of the balance service left until superannuating, subject to the condition that the compensation shall not exceed the sum of salary for the balance period left for superannuation,

II) or the VRS package of Department of Heavy Industry (DHI model), under which ex-gratia payment equivalent to 45 days emoluments (Pay + DA) for each completed year of service or the total emoluments for the balance period of service, whichever is less, is applicable.

The employees who have completed not less than 30 years of service will be eligible for a maximum of 60 (sixty) months salary/wage as compensation and this will be subject to an amount not exceeding the salary/ wage for the balance period of service left.

Implementation of the VRS Scheme in different categories of CPSEs, including unviable or sick units of Central Public Sector Enterprises (CPSEs), as per the provisions of revised VRS Scheme, is monitored by the administrative Ministries/Departments concerned.

Department of Public Enterprises is implementing Counselling, Retraining & Redeployment (CRR) Scheme to provide opportunities of redeployment through counselling and retraining to separated employees of CPSEs rendered surplus as a result of modernization, technology upgradation and manpower restructuring in CPSEs. The basic aim of the Scheme is to re-orient VRS optees through short duration training programmes to enable

them to adjust to their new environment and adopt new vocations after their separation from CPSEs due to VRS/VSS or retrenchment due to closure/ restructuring of the enterprise. The objective is to equip them with skill/ expertise enabling them to be deployed in self-employment activities mainly.



**CHECK YOUR PROGRESS**

**Q.6:** List the schemes being designed for the employees separated from CPSEs?

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## 11.9 LET US SUM UP

After going through the unit, we have come through the following:

- VRS is a scheme allowed by the Government to the business and industrial establishments to reduce their workforce that has become redundant due to any or some of the following:
  - Adoption of new technology.
  - Increasing technology costs
  - Obsolescence of employee skills
  - Reshuffling of manpower due to joint ventures ,collaborations, mergers and takeovers etc.
  - Costs exceeds sales
  - Slowdown of economy
- The circular notifying VRS mentions the following:
  - Reasons for retrenchment
  - Eligibility criteria for applying VRS
  - The benefits that will be offered
  - The authority of the employer to accept or reject the application
  - The opening and closing date for applying.
  - Indication of income tax incidence on any VRS benefits

- Steps for VRS are: Government approval (in case of PSU), Identification of employees, Union considerations, Employee communication, Employee selection and Employee counseling.
- Challenges of VRS implementation are Motivating existing employees, Elaborating redundant employees their post retirement benefits, Aligning VRS with organizational strategy, Preparing to handle potential problems post VRS, Creating and maintaining transparency throughout the process, Ensuring that competent employees do not go for VRS and Arranging funds for VRS.
- VRS costs could be more not only in monetary terms but also in non monetary terms. The organization could be actually losing more benefits than gaining.
- Voluntary Retirement Scheme for Central Public Sector are different in CPSEs that can sustain a VRS with their own Surplus Resource and in Marginally Profit or loss Making and Sick and Unviable CPSEs.



## 11.10 FURTHER READING


1) Bhattacharyya, Dipak Kumar. (2014*). Compensation Management*. (2nd Edition). Oxford.
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4) Goel, D. (2012). *Performance Appraisal and Compensation Management: A Modern Approach*. Prentice Hall India Learning Private Limited.
5) Singh, B. D. (2017), *Compensation and Reward Management*. Excel Books.




## 11.11 ANSWERS TO CHECK YOUR PROGRESS

**Ans. to Q. No. 1:** VRS is a method allowed by the Government to the business and industrial establishments to reduce their surplus staff.

**Ans. to Q. No. 2:** Government approval, Identification of employees, Communicaton with union, Information to employees about their benefits, Selection of employees for VRS, Listing of employee benefits and Counselling employees

**Ans. to Q. No. 3:** Redundancy

**Ans. to Q. No. 4:** There has to be a clear communication between management and employees on the cause, process and benefits of VRS. Such a transparent process removes doubts and fears from the minds of the employees on their termination. It makes clear that VRS is launched only because of situational circumstances of the business and not any other personal or work related matter of the employee.

**Ans. to Q. No. 5:** Amount on employee compensation puts a heavy financial burden on the organization. Again, company may face a situation where rather than the obsolete employees the more skilled and above average performers with greater market demand of their skills may be leaving the organsation. Further, the company now having to do with the average or below average employees might suffer in its overall performance.

**Ans. to Q. No. 6:** Counselling, Retraining & Redeployment (CRR) Scheme to equip them with skill/expertise to enable them to be deployed in self-employment activities.



## 11.12 MODEL QUESTIONS

**Q.1:** Why VRS is considered a soft option for employee retrenchment?

**Q.2:** Do you value VRS as a 'humane way' to deal with retrenched employees?

**Q.3:** What are the salient features of the revised VRS Policy?

**Q.4:** List the advantages and disadvantages of VRS?

**Q.5:** What are the alternatives to VRS?

**Q.6:** Elaborate the VRS procedure?

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# UNIT 12: PAY STRUCTURES

## UNIT STRUCTURE


12.1 Learning Objectives

12.2 Introduction

12.3 Pay based and Performance Based Structures

12.4 Designing Pay Structures

12.5 Comparison in Evaluation of Different Types of Pay Structures

12.6 Designing Pay Ranges and Bands

12.7 Significance of Factors Affecting Pay Levels

12.8 Let us sum up

12.9 Further Reading

12.10 Answers to Check Your Progress

12.11 Model Questions


## 12.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- describe the meaning of performance based and pay based structures
- outline the design of a pay structure
- discuss the comparison in evaluation of different types of pay structures
- explain the designing of pay ranges and bands
- list the significant factors that affect pay levels.

## 12.2 INTRODUCTION

The 12th unit of this paper on Compensation Management is about the two structures of employee compensation in an organization – pay based structures and performance based structures and the basic foundation of these pay based structures and performance based structures. The unit will help us as a guide in designing organizational pay structures in practice. The unit will help us know the basics of different types of pay structures after

making a comparison in evaluation of the different types of pay structures and listing out their practical implications (both advantages and disadvantages). The unit also deals with the aspect of designing pay ranges and bands. In this unit we are also going to discuss the significance of some of the factors that have great influence in designing pay structures.

## 12.3 PAY BASED AND PERFORMANCE BASED STRUCTURES

A) **Pay based structures:** Pay based structures are the result of job evaluation. Job evaluation finds out the relative worth of jobs in an organization based on the job's content and significance to the organization. The jobs are then arranged according to their relevance, and related with a financial scale. That financial scale is the salary levels consisting of salary ranges/grades for the single jobs or group of jobs. This gives the basic outline of a pay structure based on a fair differential in payments with respect to job content. This apart, salary structure has to be at par with the prevailing market rates, consider competitive rates of pay, and maintain internal equity in payments and above all foster employee motivation.

A salary structure has graded job levels and corresponding levels of salary grades/ranges. Each salary grade/range will have a well defined minimum and maximum bracket. A job holder will move through the grade (minimum to maximum) based on his performance. Ultimately performance is the deciding factor even when jobs are graded. Going above the maximum, will mean a shift from the current grade to the next grade above as no extensions beyond the maximum will be entertained in any grade/range unless in very rare instances exceptional performance is acknowledged with more than the grade maximum when there is no scope of promotion to the next grade. Proportionate increases in the maximum and minimum occur only when the cost of living increases. Salary grades/ranges corresponding to job grades in the salary structure have to be wide to avoid internal discrepancies and employee demotivation because people in the

same grade will perform differently and will have to be paid differently. A fair differential between the mid points of each salary grade is necessary to recognize it as a reward for promotion. The number of salary grades/ranges will be determined by the number of job grades. But there can be an overlap of salary grades acknowledging an experienced person as an asset to the organization than a new entrant to the above grade.

B) **Performance based structures:** Today's business is driven by competition. Every business concern will expect more and better performance from their employees to survive in an era of globalization with less trade barriers and hence with more competitors. The challenge now for every business concern is to thrive with continuous and improved performance. Therefore, to motivate employees to continue with their best and to be above the rest 'performance enhancement techniques' have become widely common. One such system is the Performance-based pay. Here the pay received by the employee gets varied according to his performance. This also known as the variable pay or incentive pay is the variable dimension of the employee compensation which is proportionate to his performance. For performance pay to be result oriented, a performance measurement yardstick needs to be established. This is easy to ascertain when performance is tangibly obvious for ex, sales, production etc. In case the performance is intangibly hidden then organizations use one or a combination of these four measuring parameters– Well designed performance indicators, On job acquisition or utilization of competencies, Degree of achievement of job objectives and Timely appraisal rating.

This is followed by developing a mechanism to measure employee performance against these measuring systems. It is to be noted that in case of intangible performance measurement it can be subjected to human error because of the element of biasness that can be present on the part of the assessor.

Because of the emerging trend in performance based pay, in the context of ever increasing market competition, it is said that employers are in doubt on 3 fundamental questions related to pay for performance.

1) Should the pay for performance be administered as base salary or a periodic incentive after performance review of the employee?
2) Should pay for performance be individual performance or group performance oriented or a combination of both?
3) Should Pay for performance be focused on the job or the job performer?

Just as market survey and job evaluation results lead to a pattern of job based pay structures, similarly these multiple questions lead to a design of a performance based compensation structure.



**CHECK YOUR PROGRESS**

**Q.1:** Pay based structure is based on the result of .....

**Q.2:** What is the objective of a pay based structure?

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**Q.3:** What is the objective of a performance based structure?

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## 12.4 DESIGNING PAY STRUCTURES

The following steps lead us to design a pay structure:

1) Market surveys to be done on pay structures prevailing in the same industry and the pay differentials among the two ends of the graded pay structure. Market rates generally do not show definite figures but only a range of similar rates.
2) Jobs to be evaluated to be identified and to find out their relative worth with other jobs in the organization and accordingly grade them.
3) Graded salary structure to be figured out with fixed upper and lower limits as shown by step 1. Further the width of the salary grades/ ranges across the salary levels, the size of overlap between the grades

(if any) and all salary related policies that has to be adhered to has to be considered at this stage.

4) Jobs to be linked with salary grades based on their relative worth derived from job evaluation and ongoing trend derived from market surveys.



**CHECK YOUR PROGRESS**

**Q.4:** List the steps in designing a pay structure?

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## 12.5 COMPARISON IN EVALUATION OF DIFFERENT TYPES OF PAY STRUCTURES

The following are the types of pay structures:

- **Job based pay:** In job based pay structure the basic pay is fixed for a job on a specific pay range/grade. The pay range/grade is wide to accommodate annual performance increments till the next higher pay grade/range on promotion of the employee. Though performance counts in a job based structure, there are certain limitations to this method of compensation especially in today's changing business scenario. Jobs duties and responsibilities now cannot be firmly demarcated and related to a financial pay scale. A job holder has to perform far beyond the job he holds. Since his performance range goes far beyond his job boundaries his compensation is difficult to be tied to a specific scale. What can be measured is his total contribution (skill, knowledge, and experience) to the entire business process individually and as part of a team.
- **Performance based pay:** Performance based pay is an extension of job based pay in that it combines job based pay, performance based periodic increments (generally annual) and periodic performance incentive based on individual or group performance. The objective here is to combine a fixed component represented by basic pay and

a variable component solely determined by individual or group performance. The variable component can be assumed to be the motivating factor to drive employee behavior towards performance.

- **Competency based pay:** Competency based pay system links basic pay to the competencies of the employee and not the differential worth of the job the employee holds (as in job based pay) or the performance of the employee as an individual or as a group member (as in performance based pay). Appropriate competencies of an employee are assumed to bring superior performance and even competencies not in current use in his current job are regarded as an asset for the business to fall back on when the need emerges according to the changing strategies of the business. Competency based pay holds a prospective approach than a retrospective approach.



**CHECK YOUR PROGRESS**

**Q.5:** In job based pay structure the basic pay is fixed on .....

**Q.6:** Variable component in a performance based pay structure is determined by .....

**Q.7:** Competency based pay is based on .....

## 12.6 DESIGNING PAY RANGES AND BANDS

There may be invariable number of jobs in a business concern. To fix a wage rate for each individual job is a tremendous task and it is also meaningless as the wage differential between the jobs would be minimal if the business has to keep itself restricted within the compensation budget. So similar jobs are grouped into job classes and the job classes are then linked to a graded financial scale. This means that all jobs belonging to the same class will be entitled to the same rate of pay. It is to be noted that had the rates been linked individual jobs then there would have been slight variations in their pay. Further, according to B. D. Singh “too many grades defeat the purpose of grouping and too few grades result in jobs of widely varying importance receiving the same pay”.

Also it can be said that, if a flat rate is fixed for each job class, then with every improved performance (periodically), shown by the employee he has to be promoted to the next higher job class to reward him with increased pay. This imbalances internal equity and also creates problem in a flat organization with less hierarchies. This problem is also solved by establishing pay ranges for each job class. This can be understood with the help of the following illustration.

A particular job class with a flat rate of Rs. 10/- per hour means all job holders in that job class are entitled to Rs. 10/-. On establishing a rate range of Rs. 1/-, instead of a flat rate, a new or average performer will be paid Rs. 9.5/- considering him at the minimum range. An average performer will get Rs. 10/- being placed in the midpoint of the pay range. An extraordinary performance can fetch an employee a performance reward of 25 paise per hour. With recurrent better performance, when the employee reaches the maximum on the pay range and there is now no scope for pay increases a promotion or a general across the board pay raise becomes necessary.

According to B. D. Singh, "the pay range reflects the approximate differences in both performance and experience the employer wishes to pay for a given level of work. From an external competitiveness perspective, the range also acts as a control device. A range maximum sets the lead on what the employer is willing to pay for that work. The range minimum sets the floor".



## CHECK YOUR PROGRESS

**Q.8:** Why do we need to establish pay ranges for each job class rather than a flat rate for each job?

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## 12.7 SIGNIFICANCE OF FACTORS AFFECTING PAY LEVELS

Wage as already has been discussed is acknowledgement of labor invested. It is the most vital factor that determines the relation between the employee and the employer. There is no end to employee needs and they will want the wage to be at the maximum possible. From the employer end the cost control factor is paramount to check increase in cost of production and consequent decrease in profits.

The various factors triggering an influence on the determination of wage rates are as follows: (1) Ability to Pay, (2) Demand and Supply, (3) Prevailing Market Rates, (4) Cost of Living, (5) Productivuty, (6) Managerial attitude, (7) Bargaining Power of Trade Unions, (8) Job requirements, (9) Psychological and social factors.

Let us now discuss these factors in detail:

1) **Organization's Ability to Pay:** The wage policy will vary from business to business because the ability of a business concern to pay will influence wage rate to be paid to its employees. A profitable business will pay higher wage (to attract and retain the best talent to keep its tradition of generating better performance) compared to a loss making business (though it has to adhere to labor legislations and government regulations).
2) **Demand and Supply of Labour:** The ongoing wage and salary rates are determined by the demand and supply of labor in the labor market. If the demand for labor is more and supply is less then there is an increase in wage rate. Contrarily, If the demand for labor is less and supply is more then there is a decrease in wage rate.
3) **Prevailing market rate:** Organizations cannot fix a wage and salary structure in isolation. It has to go by the prevailing rates in other organizations in the industry and geographical area. This is because of trade unions demand for equal rates for equal work, government regulations on equal wage rates, and to retain the workforce rather than losing them to competitors with higher pay for the same job.

4) **Cost of Living:** It means the wage rates have to be adjusted with the cost of living index so that the employees can have a decent and comfortable life. When the cost of living increases necessary adjustments are made in the wage rates.
5) **Productivity:** When productivity increases wages also increase. Productivity cannot be implied only by labor productivity. The other factors contributing to productivity are technological improvements, better management and process control. It is the sum total of the contributions by all the factors of production– man, machine, methods, materials and management.
6) **Managerial Attitude:** Managerial attitude also influence the wage and salary rates of an organization. According to R. A. Lester, the desire of the top management to maintain or enhance the prestige of its organization is major factor in the wage policy of many organization.
7) **Bargaining Power of Trade Union:** The bargaining strength of the trade union is a decisive factor on the rate of wages. The greater the bargaining power the more the scope for increased wages and higher wage structure.
8) **Job Requirements:** It is seen that the more complex the requirements on a job the greater is the wage rate. The demands of a job are ascertained by a job evaluation exercise to find the job differentials and fix the corresponding wage rates.
9) **Psychological and Social Factors:** Psychologically employees feel wages are a yardstick to measure success in life and take pride in their trophy value. Sociologically they would welcome wages to commensurate with their efforts and in no circumstance to be unduly varied on grounds of caste, creed, race, religion. So compensation rates must take into consideration these social, and psychological factors of the employees.



## 12.8 LET US SUM UP

- There are basically two types of compensation structures– Pay based structures and performance based structures
- Pay based structures are founded on the results of job evaluation. Job evaluation finds out the relative worth of all jobs in an organization, grades the jobs on their relevance and links them to a graded salary structure. That will mean all jobs in the same job grade will be linked with the same salary grade having a minimum bracket and a maximum bracket. A horizontal shift from the minimum to the maximum is determined by employee performance .However a vertical shift from one salary grade to the next above salary grade is also determined by performance but comes only through promotion to the next job grade.
- The number of salary grades/ ranges existent in a pay based structure will be determined by the number of job grades and there is no specific number assigned to it as such. However there can be sometimes an overlap of salary grades acknowledging an experienced person as an asset to the organization than a new entrant to the above grade.
- Performance based pay is structured exclusively on the results of performance either individual or in group. Performance based pay are the emerging trend in compensation management to motivate employees to boost continuous performance and survive through competition.
- Performance is easy to measure when the results are tangible and in case of intangible results there are several devices which can be employed to measure performance.
- Designing a pay structure consists of the following steps–
  1) Market surveys to find out the existing pay rates
  2) Job evaluation to grade jobs
  3) Graded salary structure to distinctly define minimum and maximum ranges of pay at each grade.
  4) Finally a pay based structure to correspond with pay grades/ ranges.

- Performance based pay combines job based pay, performance based periodic increments (generally annual) and also a component of periodic performance incentive based on individual or group performance. The advantage here is that it has a stimulating factor on employee performance because of the variable pay component based on performance.
- Competency based pay system links basic pay to the competencies of the employee. Appropriate competencies of an employee are assumed to bring superior performance. The greatest advantage of this system is that it gives value to person's competencies (whether or not in use in his current job).
- The various factors influencing the determination of wage rates are as follows: (1) Ability to Pay, (2) Demand and Supply, (3) Prevailing Market Rates, (4) Cost of Living, (5) Productivuty, (6) Managerial attitude, (7) Bargaining Power of Trade Unions, (8) Job requirements, (9) Psychological and social factors.



## 12.9 FURTHER READING


1) Bhattacharyya, Dipak Kumar. (2014*). Compensation Management*. (2nd Edition). Oxford.
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4) Goel, D. (2012). *Performance Appraisal and Compensation Management: A Modern Approach*. Prentice Hall India Learning Private Limited.
5) Singh, B. D. (2017), *Compensation and Reward Management*. Excel Books.



## 12.10 ANSWERS TO CHECK YOUR PROGRESS

**Ans. to Q. No. 1:** Job Evaluation

**Ans. to Q. No. 2:** Objective of pay based structure is to compensate the job performer based on job content and the job's relative worth in the organization.

**Ans. to Q. No. 3:** The objective of performance based structure is to compensate the job doer based on his performance either individually or in group through a variable component in the compensation package.

**Ans. to Q. No. 4:** Steps in designing a pay structure: Market surveys, Job evaluation, Pay grades and Jobs to correspond with pay grades.

**Ans. to Q. No. 5:** Specific pay range / grade

**Ans. to Q. No. 6:** Individual or group performance

**Ans. to Q. No. 7:** Employee competencies

**Ans. to Q. No. 8:** a) It is difficult to establish a wage rate for each individual job in an organization when there are unlimited number of jobs.

b) The wage rate differential between jobs will be minimal taking into consideration the budget for the wages.

c) It is impossible to put a promotion on every performance in a flat rate structure.



## 12.11 MODEL QUESTIONS

**Q.1:** Can performance be a deciding factor in a job based pay structure? Justify.

**Q.2:** Why is performance based pay gaining importance in today's competitive business market? Enumerate

**Q.3:** Explain the process of designing a pay structure?

**Q.4:** Compare the different types of pay structures?

**Q.5:** Give reasons in support of a graded pay structure over a flat pay structure?

**Q.6:** List the factors influencing wage rates?

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# UNIT 13: PERFORMANCE LINKED COMPENSATION

## UNIT STRUCTURE


13.1 Learning Objectives

13.2 Introduction

13.3 Performance Management System (PMS)

13.4 Importance of a Performance Management System (PMS) in an Organisation

13.5 Performance Appraisal

13.6 Purpose and Use of Performance Appraisal (PA)

13.7 Performance Appraisal Measurement System

13.8 Balancing Internal and External Equity

13.9 Pay for Performance

13.10 Pay for Performance Plans

13.11 Let Us Sum Up

13.12 Further Reading

13.13 Answers to Check Your Progress

13.14 Model Questions


## 13.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- learn the meaning of performance management system (PMS)
- outline the important features of PMS
- discuss the performance appraisal component in a PMS
- elaborate the performance appraisal system and its usefulness in an organization
- outline the important performance appraisal methods
- discuss the 'performance linked pay component' in compensation structure
- outline important issues in Performance based pay.

## 13.2 INTRODUCTION

This unit is about the Performance Management system in an organization. This unit will help us know all the important features of a Performance Management System and how instrumental it is in making an organization sustain itself in the competitive business environment.

In this unit we are also going to discuss in detail the Performance Appraisal component within the larger system of Performance Management; what the Performance Appraisal is all about; how the Performance Appraisal helps an organization in making HR decisions. The unit also lists the various Performance Appraisal measurement methods traditionally and in the modern context.

The unit will help us understand 'Performance linked Pay' in employee compensation along with other components of compensation. It will also touch upon the requirements, advantages and challenges of a performance based pay in an organization. This unit lists out the various Performance related Pay plans that have been introduced at the individual level, group level,and through the factory level.

## 13.3 PERFORMANCE MANAGEMENT SYSTEM (PMS)

Performance Management System is an organisation's way of managing a chain of planned HR events; with the objective of improving the organizational performance through its employees.

Organizations are subject to market competition in the business environment. An organization has to constantly endeavor to leverage its performance to sustain in a competitive environment. So a system like the Performance Management system is necessary to plan, implement and review the organizational performance from time to time. According to Bevan and Thompson model (1992) the main features of a Performance Management System are:

a) Goal Setting: One of the important features of the Performance Management System is that, the individual objectives which the employees have to achieve are set in line with the organizational objectives which have already been set out at the corporate level.

b) Review of Objectives: This is a periodic check to see if the objectives which have been set are attained. A periodic review of objectives helps take care to correct any deviation from desired performance and sometimes revise the goals itself.

c) Personal improvement plans: An employee may underperform or overperform, the performance standard fixed for him by the organization. If the employee underperforms an individual improvement plan is designed for him. This will contain T&D and or counsellling. If the employee overperforms then he is rewarded with a performance linked compensation.

d) Designing T&D Programs: After identifying the T&D needs, individual need based training and development programs are designed for the employee.

e) Performance Appraisal: The organization selects an appraisal system to appraise employee's performance and give him the feedback on his performance. The selection of the appraisal method is the organization's own discretion.

f) Pay Review: The objective of pay review is to establish performance based pay systems to reward the performers and to reduce the variable pay for the non-performers.

g) Competence based organisational capability: This is the most important feature of a PMS because it enables the organization to know its position in the competitive environment. From the appraisal results an organization can map the competency level of its employees and check its capability and positioning in the competitive macro environment and make necessary organizational and strategic changes for its sustenance.

## 13.4 IMPORTANCE OF PERFORMANCE MANAGEMENT SYSTEM (PMS) IN AN ORGANIZATION

The following are the importance of performance management system (pms) in an organization:

- A PMS helps the organization to know its positioning in terms of employee capability in the business environment. It also helps the organization to adopt appropriate strategies for organizational changes necessary for survival in the business environment.
- A PMS enables the organization to identify and implement need based T&D programs.
- A PMS makes it essential upon the organization to review employee performance and also make the employee know his performance through periodic feedback.
- A PMS motivates employees by institutionalizing a performance based pay system.
- A PMS establishes the manpower planning system for the organization like proper employee selection and placement, employee career management (Promotion and Transfer) and succession planning.

Manpower planning is vital for the organisation's sustenance in the competitive business environment. Because it maps the right person on the right job followed by optimum utilization of his skills, knowledge, and experience.



**CHECK YOUR PROGRESS**

**Q.1:** Define PMS.

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**Q.2:** List the importance of PMS in an industry.

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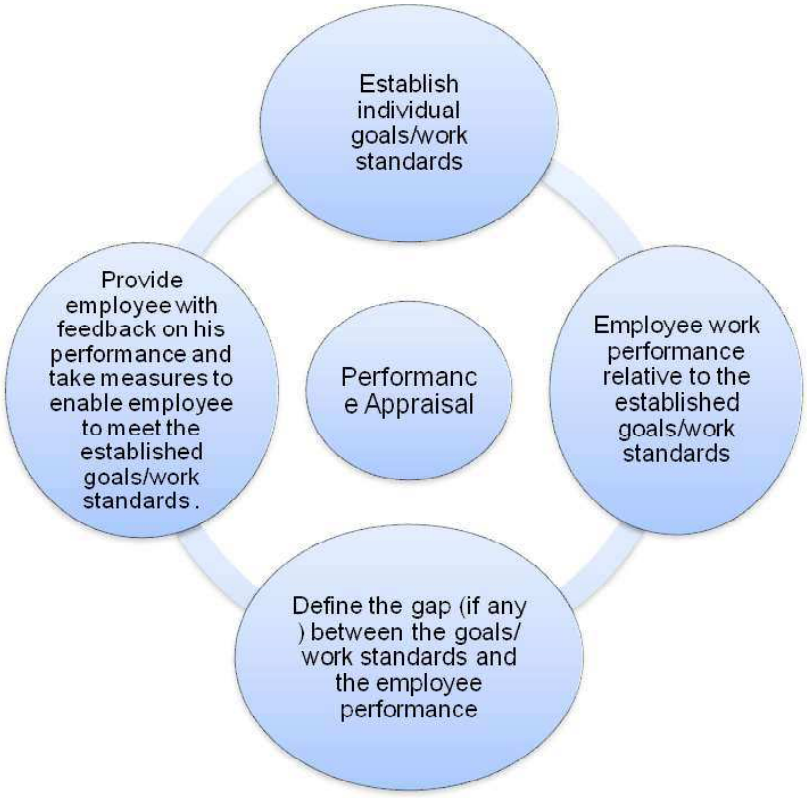
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## 13.5 PERFORMANCE APPRAISAL

Performance Appraisal, as can be seen from unit 13.3 is an integral component of the PMS. Performance Appraisal is a method where the performance of an employee on his job is reasonably assessed or evaluated by his supervisor or manager. Performance Appraisal also brings to light an employee's strength, weakness and potentialities as these individual capabilities directly influence his work performance. Performance Appraisal thus, justifies the reason either to maintain or enhance the employee's performance on his job. In the former case, where it is necessary to maintain the high performance level an employee can be motivated through performance based pay. In the latter case, where it is necessary to enhance the current performance level, an employee may be given counseling sessions or Training & Development along with the motivation for the performance linked pay. But in some cases, Performance Appraisal may necessitate the requirement for a change in manpower Planning.

Performance Appraisal by itself is an integrated loop, where one step is predetermined by the other. The Performance Appraisal loop is as follows:



We can define the Performance Appraisal loop in the following way. The Performance Appraisal process starts with establishing individual goals or work standards for all employees, making sure that the employees are aware of their job duties and job standards. After a determined period of time, the employee work performance is assessed, by benchmarking it against the established goals or work standard by his manager or supervisor. This assessment tells us the difference between employee's actual work performance and the established individual goals or work standard. Thereafter the employee is provided feedback on his performance and progress and plans are made for any development that is required.

It is to be noted here that although an employee's supervisor or manager appraises his performance the HR Department plays an important role in framing the policies for the Performance Appraisal process by working in coordination with the management of the organization.

## 13.6 PURPOSE AND USE OF PERFORMANCE APPRAISAL (PA)

- PA helps in identifying employee's weakness and this forms a basis for designing need based training& development programs to improve the employee's performance in order to contribute toward organizational effectiveness.
- PA provides inputs on decisions related to manpower planning like employee promotion and transfer. High performers will be promoted or transferred to enable develop their skills.
- PA helps in better and optimum utilization of human resources. By enlisting employee strengths and potentialities they can be placed on jobs which are best suitable for them and where they can best utilize their abilities and potentialities.
- PA aids in structuring a performance based compensation system.
- PA is vigilant on the organizational performance based on the collective performance of the employees.

## 13.7 PERFORMANCE APPRAISAL MEASUREMENT SYSTEM

Before going into the various methods of PA it is important for us to understand that first it is essential to identify the components of a particular job, then to transform these job components into a number of performance criteria on which the performance of an employee is measured by using any of the PA methods.

Performance Appraisal methods can be classified as:

A) Conventional methods B) Modern methods

**Performance Appraisal Methods**

| Some Traditional/Conventional Method | Some modern Methods |
|---|---|
| Graphic rating scale method | Assessment Centre method |
| Ranking method | BARS |
| Paired comparison method | MBO |
| CIM | 360 |
| Essay Appraisal | BOS |

The traditional methods of Performance Appraisal were used just for determining and justifying the salaries of employees. Later it was used for determining rewards and punishments based on past performance of employees. It did not consider any element of future development on performance.

In contrast, the modern methods of PA focus on the future development of employee performance as well.

Let us now discuss some traditional methods:

a) Graphic rating scale method: It is a simplest form of PA.This method lists the traits on a job and fixes a rating scale (with ratings for poor performance to ratings for excellent performance) for each job trait. The appraiser assigns the scale rating for each job trait based on the employee performance. The rating values for each job trait is totalled to know the performance value.

b) Ranking Method: It is the oldest form of performance measurement. This method lists all the job traits and then places employee names from the high performer to the low performer for each trait.

c) Paired Comparison Method: This method lists all the job characteristics to be measured and then compares every person in the work group with every other person on each job characteristic. E.g., if there are 4 persons in a group-ABCD

A will be compared with B

A will be compared with C

A will be compared with D

The more the number of times an employee emerges superior among his group he is the better performer.

d) CI Method: Under this method the appraiser lists all the critical factors for a job, and records an employee on all his on the job desirable and undesirable incidents for these factors. This method supports the appraisal with concrete examples of job performance and in the case of repeated unfavorable incidents it helps in identifying employee weaknesses.

e) Essay appraisal: This method is a long narrative generally written for assessing senior professionals.

Let us now discuss some modern methods:

a) Assessment Centre Method (ACM): Under this method an employee is assessed by a number of assessors by using a number of criteria-written test, interview, in basket exercise, business games, discussion etc.An ACM is used to assess the employee 's behavioral, emotional, strategic and social attributes.

b) BARS: It is a combination appraisal method using Critical Incidents and Graphic rating scales.In this method on job critical incidents of desirable and undesirable performance is listed. Incidents are then clustered and named with a performance dimension. Another group of people are also given the critical incidents and cluster dimensions and asked to reassign each critical incident under the dimension it best describes. Critical incidents under the same dimension is retained if some percentage of the second group assigns it to the same cluster as the previous group did. Generally the second group rates the behavior description as to how effectively or ineffectively it

represents performance on the appropriate dimension, typically using a 7 or 9 point rating scale.

c) MBO: Under this method of PA the supervisor sets measurable time bound goals for employees (generally the goals are jointly set by the supervisor and the employee). These goals are set by aligning them with the organizational and departmental long term goals. Next performance is reviewed when the actual performance of employee is benchmarked with his expected results and feedback is provided to the employee to work towards the expected results.

d) 360 degree appraisal: This is an all comprehensive and holistic method of measuring performance. Under this method the performance of an employee is appraised by his peers, superiors, subordinates, customers, and suppliers.

e) Behavioral Observation Scale (BOS) (Latham and Wexley-1981): This is a list of 'critical job behaviors' (desirable or undesirable) which the superior rates in terms of frequency, i.e., the number of times it has been exhibited.



**CHECK YOUR PROGRESS**

**Q.3:** Define Performance Appraisal?

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**Q.4:** Name some–

1) conventional method of PA
2) modern methods of PA

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## 13.8 BALANCING INTERNAL AND EXTERNAL EQUITY

Equity in pay in the context of compensation management means equal pay for the same type of jobs ie, jobs with the same set of components. There are 3 types of equity

a) Individual equity
b) Internal equity
c) External equity

Individual equity means establishing equal pay for equal job. (The term Individual equity is generally synonymously used with the term internal equity)

Internal equity means that there should be a fair & reasonable relation between wages and salaries of various positions throughout the length and breadth of an oragnisation. The difference has to be justifiable considering the factors determining the compensation of the manager and the factors determining the compensation of the assistant say for, e.g., Internal equity maintains balance in compensation structure within the organization. If there is imbalance in compensation structure it becomes a major cause of compensation related demotivation and employee grievances are bound to arise.

External equity means parity in rates of comparable jobs with other organizations or else it is difficult to attract and retain talent.

Therefore it is seen that in order to motivate, attract and retain talented employees an effective compensation planning ensuring individual, internal and external equity becomes necessary. Equity factors thus are very crucial in determining organizational pay structures.



**CHECK YOUR PROGRESS**

**Q.5:** How many type of equity influence pay structures?

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## 13.9 PAY FOR PERFORMANCE

Pay for performance is a strategic component of an employee compensation. This component of employee compensation gives a strategic approach to the computation of total compensation by making performance the key criteria. Total compensation involves base pay, variable pay (often called incentive pay or pay for performance) and indirect pay (often called benefits). Organisations try to fix base pay to match labor market conditions inorder to have competitively priced labor forces. Incentive or variable pay is used to reward performance improvements. We have discussed in the unit on PA that the performance of an employee is evaluated periodically and in case of any obvious productivity linked to performance the employee is recognized through this performance based pay concept. Employee benefits are the indirect pay that have changed over the years as many organizations now have moved toward flexible benefit packages that allow the employee to tailor the package to their individual situation.

Thus we can say that base pay is linked to labor market and variable pay or pay for performance is linked to performance of individual and organization as a whole.

**Key factors in placing a PRP System (benefits and challenges):**

- When performance and pay are linked together, it is reflected in employee behavior. The motivation factor through PRP enhances collective performance and hence corporate effectiveness in a competitive environment.
- An organization adopts different strategies time to time with respect to their business priorities. Different strategies have different implementation requirement. An organization always has to devise PRP in line with its current strategies.
- Introducing PRP is not alone sufficient. It is important to see how organisation benefits from PRP. So a proper monitoring and evaluating of the changes brought is essential.
- PRP may sometimes conflict with organization culture. Organisations with principles of equity may find difficult to introduce PRP as PRP introduces merit based variable pay system and hence differences

in pay structures. In some organizations relation between PRP and quantitative results is easily determined but relation between PRP and timely quantitative results cannot be easily acknowledged in some organisations. Further the compensation strategy of some organizations may give greater weightage on the fixed component reducing variables to bare minimum.These variables or incentives may be fixed at a proportion depending on hierarchical levels.

- Performance research says that for a PRP compensation it is necessary to identify performance objectives both for the individual employee and the organization as a whole. The objectives must be specific, measurable, time bound. This may be difficult for some jobs.
- Apart from the performance objective, it is also necessary for a PRP structure to have rational performance standards. Establishing too exaggerated performance standards requires the employee to overstretch and overstrain.

## 13.10 PAY FOR PERFORMANCE PLANS

Employees are motivated to work more when they are given more money over and above the regular wages.

This more money component is what is called the variable pay or pay linked to productivity. As such different pay for performance plans or incentive systems were introduced. Some of them are:

1) **Individual Incentive Systems:**
   a) Taylor's differential Piece Rate System: F. W. Taylor (father of scientific management) stressed the need to establish standards of work and performance through a time and motion study. According to this plan a worker is payed according to the number of pieces he produces at the rate fixed for each piece and the worker is payed a low piece rate upto a standard, a large bonus at the standard, and a higher piece rate above the standard. If a worker cannot reach the standard he is payed a guaranteed wage.
   b) Halsey Premium Plan: Under this plan a worker is assured his daily wage. This plan is also devised by fixing a standard output

in a standard time and bonus is fixed on the amount of time saved by the worker.

c) Gnatt Task and Bonus Plan: Under Gnatt Task and Bonus Plan fixed time rates are guaranteed.This plan also fixes a performance standard and a time standard for each job. If a worker completes the work in the standard time or less time he receives wages for the standard time and an extra allowance which can range from 20% to 50% of the time allowed and not time saved.

d) Emerson Efficiency Plan: Under Emerson efficiency plan, the daily wages of the workers are guaranteed. This plan also has a standard time for standard work. There is no sudden rise in wages on achieving the work standard. Efficiency bonus rises only gradually. Efficiency is determined by the ratio between standard time fixed for a job and the actual time taken by a worker.

2) **Group Incentive Plans:** Individual system of payment by result is not applicable when workers work in groups. Hence we have the group incentive plan. The group incentive plan focuses on the group achieving a certain standard output and thus qualifying for the incentive. The total earnings of the group are first determined and these earnings are equally divided among group members if they are of equal skill or else they are divided in proportion to their individual time rates or specified fixed percentages.

A type of group incentive plan is the Scanlon plan (1937). It is a plan that proposes to reduce labor cost through increased efficiency and to share the resulting savings among the employees. It is a gain sharing plan that pays a bonus to employees when they improve their performance as measured against a previously established standard. As performance improves employees share financially in the gain.

Scanlon plans have been successfully used by a variety of public and private companies. These plans combine employee participation with a reward system linked to group and / or organizational performance.

Such gain sharing plan is different from profit sharing in that it ties rewards to productivity gains rather than profit. Profit sharing plans can be applied to the factory as a whole. It determines the organizational profit and distributes at fixed interval a percentage of the profit to the workers qualified to share the earning.

Profit sharing may be current or differed.

| PROFIT SHARING | |
|---|---|
| CURRENT | DEFERRED |

In current profit sharing employee is payed in cash his share of the profit.

In deferred profit sharing employees share of profit is either credited to his PF Account or Pension account or is payed in the form of bonus shares.

A third type of profit sharing is combination method where a part of profit is payed in cash and a part is deferred and placed in employee accounts.

After the profit amount to be distributed among workers is decided next it is to be decided on their individual shares. This is done either on the length of service of the worker, or on the number of hours each worker has worked in a year or on the wages earned by each worker.

Another way of group or factory wide incentive plan is Labor co-partnership. In this way the worker is encouraged to invest in the shares of the establishment whatever he has achieved through bonus scheme or profit sharing scheme and thereby become a shareholder of the company.



**CHECK YOUR PROGRESS**

**Q.6:** Variable pay is linked to .....

**Q.7:** What do you understand by pay for performance plans?

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**Q.8:** What is the main objective of Pay for Performance plans?

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**Q.9:** Name–

Individual incentive plan

Group incentive plan

Factory wide incentive plan

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## 13.11 LET US SUM UP

- PMS is a consolidated system of HR activities that are intended to improve the organizational performance
- The main features of a PMS

  Goal setting

  Review of objectives

  Personal improvement plan

  Designing T&D

  Performance Appraisal

  Pay review

  Competence based organization capability
- Importance of a PMS in an organization

  Helps the organization know its stand in the business environment

  Helps the organization implement need based training programs

Helps the organization review employee performance and give feedback

Helps the organization establish a performance pay plan

Helps the organization make essential HR Planning

- Purpose of PA is
  - identifies employee strength & weakness
  - provides input for T&D
  - establishes pay for performance incentives
  - plans promotion and transfer
  - maps manpower planning by placing the right worker on the right job.
- DIFFRERENT PA methods are:

| **Performance Appraisal Methods** | |
|---|---|
| **Some conventional Method** | **Some modern methods** |
| Graphic rating scale method | Assessment Centre method |
| Ranking method | BARS |
| Paired comparison method | MBO |
| CIM | 360 |
| Essay Appraisal | BOS |

- Pay for Performance is an incentive scheme to motivate employees by recognizing their performance improvements through performance linked pay.
- Important features of a performance based pay:
  - It has to motivate employees
  - It has to align with organizational strategy
  - It has to be monitored and evaluated for better implementation
  - It has to match with organisatonal culture ( as far as possible)
  - It has to establish performance objectives
  - It has to establish rational performance standards
- Different pay for performance plans are:

  Individual incentive systems–
  - Taylor's differential piece rate system
  - Halsey Premium Plan
  - Gnatt Task and Bonus Plan
  - Emerson efficiency plan

Group incentive system

Scanlon plan

Plant wide incentive system

Current

Deferred

Combination

- The employee compensation has to be equitable ie equal pay for jobs of same nature–
  - Individual equity is equal pay for equal job.
  - Internal equity is a fair relation between wages and salaries of different positions within the organization.
  - External equity is equity in the rates of comparable jobs within the industry.



## 13.12 FURTHER READING

1) Goel, D. (2012). *Performance Appraisal and Compensation Management: A Modern Approach*. Prentice Hall India Learning Private Limited.

2) Gupta, Sashi K. and Joshi, Rosy. (2014). *Human Resource Management*. Kalyani Publishers.



## 13.13 ANSWERS TO CHECK YOUR PROGRESS

**Ans. to Q. No. 1:** PMS is a consolidated system of HR activities intended to improve organizational performance in order to make the organization sustain in a competitive business environment.

**Ans. to Q. No. 2:** Importance of PMS are:

- It makes the organization aware of its position in the business environment and enable it to adopt strategies necessary for its sustainability.

- It designs need based training and development programs by identifying training needs.
- It reviews employee performance periodically and gives feedback to employee.
- It introduces performance linked pay and motivates employee to work for incentives.
- It establishes proper HR planning like employee placement, promotion and transfer so that the right person is placed on the right job.

**Ans. to Q. No. 3:** PA is a process of evaluating employee performance on the job by his supervisor or manager periodically and giving feedback to him on his work performance. It establishes work standard and the relative gap between the standard and actual performance and takes necessary step to reduce this gap by enhancing employee work performance.

**Ans. to Q. No. 4:** PA methods can be classified as–

(A) Conventional methods, (B) Modern methods

| **Performance Appraisal Methods** | |
|---|---|
| **Some conventional Method** | **Some modern methods** |
| Graphic rating scale method | Assessment Centre method |
| Ranking method | BARS |
| Paired comparison method | MBO |
| CIM | 360 |
| Essay Appraisal | BOS |

**Ans. to Q. No. 5:** Individual equity, Internal equity and external equity.

**Ans. to Q. No. 6:** Variable pay is linked to performance.

**Ans. to Q. No. 7:** Pay for performance plans are initiated to take care of the variable pay component of compensation. This variable pay or employee incentives is used to reward an employee‘s performance improvements.

**Ans. to Q. No. 8:** The main objective of pay for performance plan is to motivate employees to enable them to improve on their work performance and be entitled for the performance linked incentives.

**Ans. to Q. No. 9:** Different pay for performance plans are:

Individual incentive systems–

a) Taylor's differential piece rate system
b) Halsey Premium Plan
c) Gnatt Task and Bonus Plan
d) Emerson efficiency plan

Group incentive system

Scanlon plan

Plant wide incentive system

Current

Deferred

Combination



## 13.14 MODEL QUESTIONS

**Q.1:** Discuss the main features of a PMS according to Bevan and Thompson?

**Q.2:** Explain the relevance of PA in an organization?

**Q.3:** Explain any 2 conventional and modern methods of PA?

**Q.4:** What factors influence a pay for performance system?

**Q.5:** Explain one of each group:

Individual incentive plan

Group incentive plan

Factory wide incentive plan

**Q.6:** Explain Taylor's Differential Piece Rate System?

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# UNIT 14: COMPENSATION STRATEGY: NEW THINKING FOR THE NEW MILLENNIUM

## UNIT STRUCTURE


14.1 Learning Objectives

14.2 Introduction

14.3 Pay the Person

14.4 Reward Excellence

14.5 Individualizing the Pay System

14.6 Organizational and External Factors Affecting Compensation Strategies

14.7 Compensation Strategies as an Integral Part of HRM

14.8 Compensation Policies

14.9 Let Us Sum Up

14.10 Further Reading

14.11 Answers to Check Your Progress

14.12 Model Questions


## 14.1 LEARNING OBJECTIVES

After going through this uni,t you will be able to:

- discuss the concept of 'pay the person'
- describe Rewarding excellence
- learn individualizing the pay system
- outline organizational and external factors affecting compensation strategies
- explain compensation strategies as an integral part of HRM
- describe compensation policies.

## 14.2 INTRODUCTION

This unit is about hiring and paying the person for his skills and rewarding him on his exemplary performance. The unit also explains how a compensation package can be individualized based on performance. The

unit helps us understand the various internal and external factors to the organization that affect its compensation. The unit helps us understand compensation policies how all the strategies related to compensation fall within the domain of HR.

## 14.3 PAY THE PERSON

The philosophy underlying all compensation policy is equity. It means equal pay to all job holders of all equal jobs. Jobs across the length and breadth of the organization are analyzed to know their contents and required appropriate skill, knowledge and ability to do them. Then they are evaluated in terms of their significance and co-related with a financial scale to determine their salary and wage. It is legally compulsory to pay the person the right wage and salary according to the worth of the job.

'Paying the person' means paying for the skills the person possesses (whether or not all the skills are used on the job currently). Employees who have a variety of skills may have to apply some skills on the current job while some skills may have to be used in future. They cost more money to the company in the short run, but the investment pays off in the long run when the company can do without hiring new manpower but with the additional skills of the existing employees it can better company performance.

Organizations (HR Department) should invest their efforts to be able to acquire people with different types of skills. In today's competitive scenario, ability to change and adapt, ability to multi skill, is of prime importance as skill demands will change with times. If an employee doesn't want to acquire new skills, or use his untapped skills, he may need to leave the organization as business today cannot afford to be average or mediocre with stagnancy.

Pay for person is almost equivalent to pay for performance as one can perform only if he has the skills.

Paying the person or paying for his skills is of worth because:

- It will attract people with multiple skills. Paying for his skills might initially seem to cost much to the company but could possibly create money for the organization in the long run as they will provide the least chance to the company to stop its business because of want

of skills. With them the company will also not have to hire new people or train them.

- These special skilled individuals can market their role and will look for a position that compensates them adequately. The pay that the company offers to the employee reflects the fact that the company wants them to be partners in their business.
- Employees no longer wait for moving up the hierarchy on grounds of experience and seniority. They expect much more for their skills acquired through experience, education and training. The skills of the individuals now dictate their role and their corresponding pay rather than the number of years they have been with the organization. Such kind of a pay system also motivates them as their latent skills are given value (even though they are not used in the current job).
- Pay for person is almost equivalent to pay for performance as one can perform only if he has the skills. Performance is a result of skill, ability, competence. Rewarding performance is acknowledgement of this employee prowess and employees tend to offer a long term commitment to the organization.

Organizations should devise a compensation package that attracts and keeps these people. It may be salary plus a performance bonus or it may be a flat salary, whatsoever suits the organization strategy. Employees perform better if their efforts are valued. So organizations should pay the person, rather than their role.



**CHECK YOUR PROGRESS**

**Q.1:** Pay the person is .....

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**Q.2:** What are the advantages of 'pay the person'?

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## 14.4 REWARD EXCELLENCE

The business scenario today is characterized by hard competition and constant change. Rapid change in market demands, tough competition played by partners in the industry, transformation of global business and economic policies makes the organizations do a tough rope walk. All these pressures though posed by external forces, the organization has to make internal adaptations for its survival. The players in this survival game are the employees. They have to make efforts and standardize their work toward attainment of organizational goals shaped by the organization to respond to timely demands. In order to promote and develop a culture that values such employee effort and merit, organization must create incentives to reward them. This is what we call reward excellence meaning if we want exceptional performance then we have to treat exceptional people in an exceptional way. On the contrary, if there is no recognition of effort and merit, mediocrity will be the norm in the organization.

There can be many dimensions to this excellence which we measure and acknowledge through rewards.

1) Output /result dimension: An output is the transformation of the inputs into product or service. The output shows the standard of performance (excellent, mediocre or sub standard). It is the most easily seen and measurable index of employee performance. An output of an employee will be fixed by the organization which is invariably linked with the ultimate organizational goal. An excellent performance has to be rewarded to make the organization thrive with continuous and increasing excellence in performance.
2) Input dimension: Inputs are feeders that lead to the results. It will include the activities that will be undertaken by the employee, the timeframe for accomplishment of the activities, the quality of the activities etc. An ideal performance management will monitor the inputs through proper employee communication and feedback.
3) Time dimension: It is the time frame in which the activities are to be performed to convert the inputs into outputs. It is very important

factor as business today is focused on timely achievements maybe a month, quarter, year etc.

4) Focus dimension: Focus dimension is related to the area of employee activities. For e.g., a marketing person's focus at a point of time may be increased market share or increased profits etc.

Anyone who can achieve all these performance dimensions we call them high end achievers. Organizations cannot afford to lose them and will retain them through rewards.

Organizations evaluate performance to link it with a reward program in the form of bonus and incentives.



**CHECK YOUR PROGRESS**

**Q.3:** List the 4 factors necessary for excellence.

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## 14.5 INDIVIDUALIZING THE PAY SYSTEM

This is a concept coming into trend in the area of Compensation Management. It recognizes employee performance, and improves motivation to perform through performance incentives. Since it creates pay inequity, to make such kind of a pay system acceptable it has to be made to be perceived as a fair system of pay based on incentives coming through performance. Fairness can be assured through proper employee communication on the performance index and pay criteria and the relation between the two. Thus we see that fairness in all pay related judgments is vital in individualizing the pay system. If employees perceive it to be unfair, that it does not commensurate with their efforts then the organization is infested with large scale dissatisfaction and turnover.

According to Teresia Stråberg (Stockholm 2010) in a study on Employee perspectives on individualized pay attitudes and fairness perceptions she comments that "to understand how the concept of organizational justice and the various dimensions of justice came into being, and how they have been

and can be applied in relation to pay" can be understood form the following theories:

- **Distributive Justice:** Employees expect pay to commensurate with their efforts and when this happens a sense of (distributive) justice arises. When this expectation is not met, a sense of injustice arises. The feeling of justice or injustice in the individual is exclusively subjective. If they see it as fair they are motivated to perform and if they see it as unfair they will reduce their efforts or demand for higher bonus to remove the work pay imbalance.
- **Procedural Justice:** This relates to the justice in the processes and procedures involving compensation payments. Research has shown the importance of pay rules and regulations fixed by an organization influence the employee's fair and unfair perception on pay.
- **Interactional Justice:** This perception of justice is influenced by social interactions at the workplace between the workers and the supervisors or employers. It suggests that supervisors must treat employees in a humane way and must show transparency in all their decisions so that there is no scope for perception of unfairness related to their work, behavior and pay.

Thus in individualizing the pay system these elements of justice create feelings (positive or negaqtive) in the minds of the employees.

Individualized pay system is result oriented. In order to enable the employee acquire advantage of the system he has to know his performance criteria and the subsequent pay rises. Most important the performance appraiser has to give periodic feedback on how far he is away from his benchmark performance. Clear and complete feedback is important for the perception of justice toward all pay related matters. According to Kohn (2001) "With individualized pay setting, in contrast to many traditional pay systems, interpersonal interaction between supervisor and employee is fundamental to the process, which may increase the likelihood of disagreement and potentially turn it into a breeding ground for perceptions of unfair treatment". If they perceive inequitable pay raises or biased methods of work performance evaluation or disowning of prior settled pay policies employees may quit the organization.

Thus a successful individualized pay system is based on the pillars of transparent and accurate communication, unbiased appraisal, timely feedback, delivery of promised rewards and more important a fair and humane treatment.



**CHECK YOUR PROGRESS**

**Q.4:** What is the basis of an individualized pay system?

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**Q.5:** Explain individualized pay system?

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## 14.6 ORGANIZATIONAL AND EXTERNAL FACTORS AFFECTING COMPENSATION STRATEGIES

Compensation is acknowledgement of labor. Acknowledgement may be monetary or non-monetary. Monetary comes in the form of wages and salary. Non-monetary comes in the form of benefits.

Compensation strategies or the strategies leading to the formulation of compensation structure are influenced by factors within the organization (organizational factors) and by factors outside the organization (external factors).

Organizational factors are specific to every organization and thus will impact the organizations in varying degrees.

Organizational factors also known as the internal factors are as follows:

- **Organization role in paying:** This is perhaps the most important of the factors influencing compensation strategies as it directly relates to the fund size and the generosity of the organization to pay. The profitable or big, and humane organization can pay higher compensation. The smaller companies sometimes pay even below

the industry standards. Higher paying organizations can retain employees while low paying organizations cannot but be compelled to lose their people to other high paying organizations. Also higher compensation will motivate workers to perform better.

- **Nature of the workforce:** If workforce is more of skilled labor compensation for them will be more than the prevailing rate. If workforce constitutes from among the available manpower, compensation will go as per the prevailing rates in the industry though fluctuation in rates will be apparent with fluctuations in the demand and supply of labor.
- **Performance and experience:** Organizations today are performance driven and compensation is linked with productivity, where high end performers are entitled to performance bonus but compensation sometimes in leadership positions of senior managerial cadre is determined by experience as their experience and their multitasking outweighs the cost of training and multiple labor costs.
- **Young potentiality:** Potentiality of the young labor force can also determine a higher compensation.
- **Compensable factors:** Jobs have their monetary worth determined by job evaluation, so holders of jobs with higher compensable factors in terms of skill, responsibility, efforts,danger will get high wages.
- **Organization objective:** Organizational objective influences compensation structure. It is because all policies and procedures align with objectives and compensation policies are a micro component of the total policies and procedures. For e.g., If the organization focus is fast growth it will pay more than the competitors and if it wants a stable growth it will go by the prevailing rates with more focus on fixed component.
- **Union role:** Labor unions work in favor of the workers. Such unions pressurize the management for the formulation of fair and equitable compensation plans. These organized unions ensure better wages for employees when they feel that the organizations are making profits and do have paying capacity. Unions are also more vocal on

compensation policies when supply of labor is less than the demand and when labor is engaged in hazardous jobs. The non-unionized units have more flexibility with respect to the fixation of the compensation plan.

- **Equity Considerations:** Compensation strategy should always abide by equity considerations meaning that the compensation should be fair and equitable. People doing the same type of job should be compensated equally within the organization. Also, it should be similar to what other people get for the similar job in the industry or area. This puts a check on employee dissatisfaction and turnover.
- **External Factors:** The factors outside of the organization are known as external factors.
  - **i) Labor Market:** The demand for and supply of labor influences the employee compensation. When the demand is less than the supply of labor wages are less and when demand is more than supply of labor wages are more.
  - **ii) Norm Rate:** The compensation is fixed on the basis of the rate that is prevailing in the industry and in the area. This means that all similar jobs existent in all the organizations under the same industry in the same area will more or less be consistent on compensation.
  - **iii) Cost of Living:** Organization must always ensure that compensation is reasonably adequate to survive the cost of living. Therefore, with the rise or fall in the general price level and the consumer price index, the wage or salary will fluctuate.
- **Labor Laws:** Almost all countries have laws influencing the labor compensation. There is a huge body of laws passed by the Government of India to safeguard the workers from the exploitation of employers. Some of them are The *payment of wages Act 1936*, The *Minimum wages act 1948*, The *payment of Bonus Act 1965*, *Equal Remuneration Act 1976*, *Payment of Gratuity Act 1972*, Factories Act(1948)
- **Government Regulations:** Government has established rules in the interest of the workers and to prohibit wage related harassment

by employers. Government Regulations emphasize on such issues as minimum wage, overtime, pay for time out of work, working hours, payment of bonus, etc.It is mandatory for the organizations to pay as per the Government guidelines.

- **Economy:** The country's economy also influences the wage and salary fixation. The difference can be seen between a stable economy and a depressed economy.



**CHECK YOUR PROGRESS**

**Q.6:** List the internal and external factors that influence compensation.

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## 14.7 COMPENSATION STRATEGIES AS AN INTEGRAL PART OF HRM

The management of human resources has to do with the management of every aspect related to the human resources (employees) right from the time they enter the organization to the time they leave the organization. The human resource management cycle consists of recruitment and selection, placement, training, appraisal, wage and salary, counseling, exit policy etc. Every organization will have its own objectives and all HR policies will be planned and implemented in such a way that it triggers the achievement of organizational objectives and does not deter it in any way. Similarly like all other HR policies compensation policies also are mapped in a way to attain the corporate objectives. Some of the ways which show that compensation policies are integral part of HR and that they are planned to aid the HR activities of the organization are:

- Job analysis and job evaluation are HR tasks to provide information regarding the nature of the job and to decide the relative worth of

each job in the organization. Jobs are then linked to a financial scale in order of their priority and significance. Equal wages and salaries for similar jobs are determined only after HR has provided information on the job constituents and job worth. This proves compensation is integral to HR.

- All organizations will want to attract and retain talent to stay ahead of their competitors.HRM will focus on employee motivation to prolong their tenure with the organization. Compensation strategies being integral to HRM will try to contribute toward this by establishing performance incentives and bonus whereby high end performers will be recognized and rewarded and in turn be motivated to stay with and perform for the company.
- HR plays the role of a watch guard while ensuring that all employees are not exploited by their employers. To safeguard the interests of the employees, HR adheres to all legal mandates legislated to protect the safety and security of the workers. Compensation policies help HRM in this end by regulating all wages and salaries as per the labor laws– Minimum Wages Act (1948), Payment of Bonus Act (1965), Payment of Wages Act (1936), Payment Of Gratuity Act (1972), Maternity Benefit Act (1961) etc.
- Organizations that want fast growth, will try to achieve through HR a high performance driven culture. Such a culture will demand additional skill requirements from the employees. Additional skills will have to be acknowledged through a proper compensation package. Compensation policies will have to be framed to pay the persons for their skills that have proved performance.

Organizations that want a stable growth will prefer reasonable compensation with more focus on the fixed component. These organizations will give more value to internal pay equity.

Succession planning of the companies is part of HR activities. Once HR identifies the potential leaders from among the employees, differentiation in compensation levels can be made by offering them higher pay.



**CHECK YOUR PROGRESS**

**Q.7:** List some compensation strategies that are integral to HR.

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## 14.8 COMPENSATION POLICIES

Compensation Policies are all procedures on every component related to the compensation program of an organization from how the compensation is to be computed to administering the compensation. Every organization has a time bound goal. All its policies in all spheres of activities will be established to achieve this goal. Similarly compensation policies will also be focused on organizational objectives. In fact it is said to be the most significant of all the internal policies as it gives shape the salaries of the employees. The salary policies interests the employee most as they spell out the structure of the salary and the potential total cash they can acquire through high end performance. An ideal compensation policy has to be transparent underlining every compensation factor used by the organization to gain the confidence of the employees in the compensation system.

Some of the components that can be cited as coming in the nature of compensation policies are as follows:

- Organization Pay Structure: These are decisions on issues as determination of pay grades (as per job evaluation),defining pay ranges, degree of difference in the pay structure across the length and breadth of the organization, differences in the ratio of base pay and variables, monitoring of all these compensation components by the compensation committee etc.
- Employee Incentives: Incentives are rewards given by employers to recognize employee achievement. All policies related to incentives like performance targets (to be achieved), level of incentive, time

period of incentive payment, nature of incentive has to be communicated to employees to avoid grievances later.

- Performance Appraisal: Appraisal is the way of evaluation of employee performance to rate them for incentives. It is usually done by the immediate supervisor or manger. All policies framed to determine individual goals (key performance areas), time frame for the goals, standard of performance, method of evaluation, identification of the evaluator, time between evaluation and incentives are an integral part of compensation policies.
- Market Survey: Organizations should ensure that their compensation policies are competitive in the industry and area. Thus a timely review of policies to ensure competitiveness especially for high skilled employees is necessary. Equally important in salary fixation is the cost of living factor, government regulations and legal mandates.



**CHECK YOUR PROGRESS**

**Q.8:** What are compensation policies?

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**Q.9:** Name some components of the compensation policies?

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## 14.9 LET US SUM UP

After going through the unit we have come through the following:

- Pay the person means paying him for his skills whether or not all the skills are being used in his current job.
- Paying for skills has the following advantages– company has existent manpower with multiple skills, company can retain them by acknowledging their marketability, only skills have an upper hand over seniority, and it gives considerable recognition to their skill abundance.

- Rewarding excellence means if we want exceptional performance then we have to treat exceptional people in an exceptional way and that comes by way of adequately rewarding them.
- There are four dimensions to measure performance– input, output, time and focus
- The pay system can be individualized through performance incentives based solely on individual performance parameters. Such a system might create pay inequities so the basis of such a pay system has to be clearly communicated to the individuals. All must know the performance index and pay criteria and the relation between the two so that there is no scope of doubt in anybody's mind.
- There are various Organizational and external factors affecting compensation strategies.

  Internal factors are– Organization role in paying, Nature of the workforce, Performance and experience, Young potentiality, Compensable factors, Organization objective, Union role, Equity Considerations

  External factors are– Labor Market, Norm Rate, Cost of Living, Labor laws, Government regulations
- Like all other HR policies compensation policies also are mapped in a way to attain the corporate objectives.So all compensation components are part of the integrated HR process.
- Compensation Policies are the body of policies and procedures on every component related to the compensation program of an organization from how the compensation is to be computed to administering the compensation.
- Components of compensation policy are Organization Pay structure, employee incentive, performance appraisal, market survey.



## 14.10 FURTHER READING

1) Bhattacharyya, Dipak Kumar. (2014*). Compensation Management*. (2nd Edition). Oxford.
2) Bhattacharya, Mousumi S. and Sengupta, Nilanjan. (2008). *Compensation Management*. Excel Books.

3) Deb, Tapamoy. (2008). *Compensation Management: Text and Cases*. Excel Books.

4) Goel, D. (2012). *Performance Appraisal and Compensation Management: A Modern Approach*. Prentice Hall India Learning Private Limited.

5) Singh, B. D. (2017), *Compensation and Reward Management*. Excel Books.



## 14.11 ANSWERS TO CHECK YOUR PROGRESS

**Ans. to Q. No. 1:** Pay the person is paying for the totality of skills he possesses whether or not they are of use in his current job.

**Ans. to Q. No. 2:** Advantages: Company is manned with people of multiple skills and these skills can be of use in future; company has greater probability of retaining them as such skills merit good rewards because of their marketability, skills only have an upper hand over seniority which is the need of the competitive environment, and it gives recognition to their skill abundance and thus motivates them.

**Ans. to Q. No. 3:** Output dimension, input dimension, time dimension and focus dimension

**Ans. to Q. No. 4:** Fairness and transparency

**Ans. to Q. No. 5:** Individualized pay system is result oriented. It recognizes only an individual's performance and pay. Thus the performance criteria, performance standard, performance time and performance objective has to be very clearly communicated to all employees by their performance evaluator and thus enabling each one of them to be eligible for the performance pay.

**Ans. to Q. No. 6:** Internal factors are: Organization role in paying, Nature of the workforce, Performance and experience, Young potentiality, Compensable factors, Organization objective, Union role and Equity Considerations

External factor are: Labor Market, Norm Rate, Cost of Living, Labor laws and Government regulations.

**Ans. to Q. No. 7:** Job evaluation, performance incentives, Compensation regulations and mandates,pay the person and succession planning related compensation

**Ans. to Q. No. 8:** Compensation Policies are all procedures regulating the compensation program of an organization.

**Ans. to Q. No. 9:** Organization Pay structure, Employee Incentives, Performance Appraisal and Market survey.



## 14.12 MODEL QUESTIONS

**Q.1:** Do you think pay the person is more effective than pay the position? Justify

**Q.2:** Do you honor the system of rewarding excellence? Explain

**Q.3:** Explain 3 each of external and internal factors that affect compensation strategies?

**Q.4:** Explain how compensation strategies are integral to the HRM function?

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# UNIT 15: REWARDS AND RECOGNITION

## UNIT STRUCTURE


15.1 Learning Objectives

15.2 Introduction

15.3 Concept of Reward Management

15.4 Reward and Recognition Policies

15.5 Reward Strategy

15.6 Total Reward Approach

15.7 Reward Management in Service Sector

15.8 Total Reward Framework of Service Industries in India

15.9 Factors Affecting Reward Management Policies in Service Sector

15.10 Designing Reward Strategy

15.11 Let Us Sum Up

15.12 Further Reading

15.13 Answers to Check Your Progress

15.14 Model Questions


## 15.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the concept of reward management
- outline the reward and recognition policies
- describe the reward strategy
- explain the total reward approach
- outline reward management in service sector
- discuss total reward framework of service industries in India
- describe Factors affecting reward management policies in service sector
- explain the Designing of a reward strategy.

## 15.2 INTRODUCTION

The concluding unit of this paper on Compensation Management is about the basic concept of reward management. The unit will help us know

reward and recognition policies, the reward strategy and the total reward approach. In this unit we are also going to discuss the management of reward in service sector, total reward framework of service industries in India and factors affecting reward management policies in service sector. The unit ends with a note on an effective way to design a reward strategy.

## 15.3 CONCEPT OF REWARD MANAGEMENT

It is said that the reward concept emerged ever since labor became a factor of production.

Any form of labor invested has to be acknowledged through financial return. This financial return takes the shape of Compensation and Benefits. But in the recent corporate structure of continuous performance driven work culture, Compensation and Benefits which gives more weight age on the fixed salary component is slowly giving way to performance related pay (reward) which gives more importance to the variable pay component.

The reward management program of any organization is a mixture of both cash and non- cash elements leading to greater employee motivation, better employee management and longer employee tenure. Thus term reward management is more in the nature of a strategic management program because Compensation and Benefit program is protective but reward program is productive. Compensation and Benefit management is based on pay for work but if Compensation and Benefit Management goes a step ahead to be fine tuned as Reward Management, it interests employees more as Reward element is based on performance. It is said that “getting pay as reward excites employees more than getting pay for the services they render”.

So, we can see that reward management in some organizations has a broader meaning than being simply stated as Compensation and Benefit Management. It means what a person gets from work apart from his due and eligible financial gains. It may also be in the form of career opportunities, work-life balance, progressive work culture, or even club membership, pension plans, vacation holidays etc.

Reward and Recognition is always a type of add on compensation in cash or non-cash form to the basic compensation program. So it has better

employee motivational effect which makes it more strategic in nature than just a basic HRM component.

To sum up reward concept we can say that, organizations may synonymously use the two terms– compensation and benefit management or rewards management or may use the term total rewards over compensation and benefits. Whatever so rewards have the following characteristics:

1) It includes monetary and non-monetary aspects, taking into consideration employee needs while compensation and benefits is more focused on payment for work.
2) It has an investment perspective rather than traditional HR costs. An HR investment in the nature of getting returns in the form of employee motivation and retention.
3) Rewards have greater motivational thrust on the employee as it is employee centric. It can even include employee in designing training programs.
4) Rewards ( both monetary and non monetary as career development, recognition, meaningful work etc.) incur greater costs. Therefore organizations need to consider the interests of different stake holders.
5) Rewards must go along with all HR strategies attached with organizational strategies.



**CHECK YOUR PROGRESS**

**Q.1:** Why reward management is considered as part of strategic management?

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## 15.4 REWARD AND RECOGNITION POLICIES

Reward and recognition policy is the implementation procedure of the reward and recognition program of the organization. A reward and

recognition policy is existent when organizations have a distinct and identifiable reward and recognition program. The differentiation between “reward and recognition” and “compensation and benefits” is so thin specially in Indian organizations that either two are synonymously used or reward and recognition is part of the macro compensation and benefits program. In such a case a well figured so to say reward and recognition policy is still a distant possibility. What is seen is only an all comprehensive HR policy with rewards and recognition and compensation and benefits all embedded together.

However if a reward and recognition policy is to have an independent existence the following specifics are expected out of it:

1) Grounds for rewards and recognition
2) Time period for rewards and recognition
3) Manner for giving out the rewards and recognition
4) Integration of the monetary and non-monetary rewards and recognition component
5) Management of the program.



**CHECK YOUR PROGRESS**

**Q.2:** What are the essentials of a proper reward and recognition policy?

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## 15.5 REWARD STRATEGY

The objective of reward strategy is to obtain desired behavior from employees. Behavior that can reach the organization objectives such as customer service, quality, on time delivery, innovation, after sales service etc. has to be rewarded. Therefore organization must be very specific on what they want to achieve and where they want to reach in terms of organization

objectives and thereby shape employee behavior in that direction using reward as a motivation tool to that end.

According to Lawler (1995) an effective reward strategy must comprise specified reward elements (reward values, reward process, and reward features). According to Armstrong and Murlis (Reward Management, 5th edition, 2007) direction is also an element of reward strategy.

"Reward strategy determines the direction in which reward management innovations and development should go to support the business strategy, how they should be integrated, the priority that should be given to initiatives and the pace at which they should be implemented.'' In other words reward strategy must go along with other organization strategy or one of its micro components– the HR strategy.

According to Duncan Brown (Reward Strategy: From Intent to Impact, 2001) "Reward strategy is ultimately a way of thinking that you can apply to any reward issue arising in your organization, to see how you can create value from it.''

A reward strategy must also be properly designed and communicated to give a positive perception in the employees. E.g., rewards for long service can be communicated as reward for loyalty to the organization which will send a strong message that loyalty is related to rewards and will motivate employees for longer tenure of service.

Reward strategy must be focused on what employees value most and reward must then be linked to what motivates them to work and behave to enable them eligible for what they value.

Like all strategies, adapt to internal and external changes, reward strategy must also go with the times tuning itself each time with the adapted organization strategy.

Reward incurs one of the major HR costs. In order to make the right investments, organization has to strategize on a right mix of salary, incentives and benefits depending on the organizational culture.Thus reward strategy has to be customized to each individual organization. It is said that rewards and culture go hand in hand. This alignment will make reward strategy meaningful as an HR strategic tool.



**CHECK YOUR PROGRESS**

**Q.3:** The objective of reward strategy is .....

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**Q.4:** Why reward strategy must consider employee needs?

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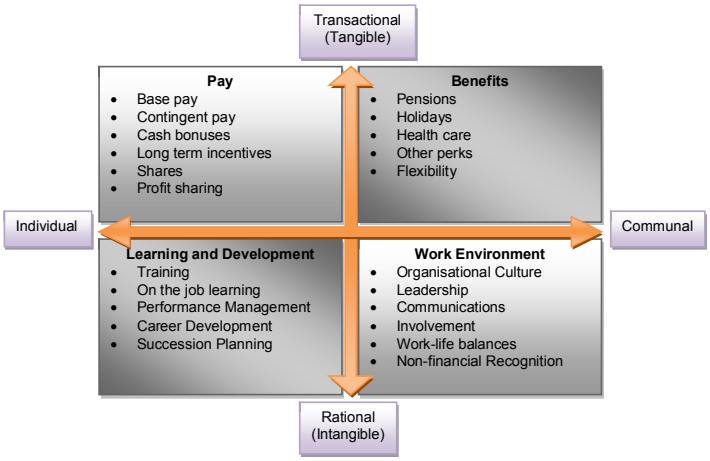
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## 15.6 TOTAL REWARD APPROACH

Total reward is synonymously used with reward and recognition, and is a more oft spoken term in modern connotation. All total reward models integrate reward strategy, HR strategy, business strategy and organization culture (micro units leading to a macro unit). The idea behind this is, any organization will have an individual culture. Within this frame work of culture it will fix its business strategy shaped by internal and external change forces. HR strategy will be defined to profitably contribute to the business strategy. Reward and recognition strategy will be one of the attached elements in the HR continuum like all other HR elements. So an integration of all these is vital to the Total Reward approach.

There are 5 elements of HR in the total rewards approach according to World at Work (HR Consulting firm)– Compensation, benefits, work life, performance and recognition, development and career opportunities.

Towers Perrin model of Total Rewards is as follows:



The fig above shows that there are 4 types of rewards as has been stated by Armstrong (2007). They are:

- Transactional– tangible rewards
- Relational– intangible rewards
- Individual– emphasize on individual performance
- Communal– emphasize on organizational performance

Prof. Dipak Kr. Bhattacharyya recommends some steps for designing a total rewards strategy:

1) Understanding of organizational context and issues
2) Understanding of the influence of total reward on organizational efficiency
3) Accomodating flexibility in total rewards to make time based changes
4) Charting out effective total rewards plan based on employee feedback
5) Ensuring measurability between performance and reward.

According to Mercer "total rewards strategy is to ensure right reward to right people at the right time for the right reason".

Organizations want to attract and retain talent. This talent pool can be attracted and drawn by any organization through a competent compensation package. So competition in terms of compensation being endless, organizations are focusing more and more on intangible rewards, leadership possibilities, challenging work assignments, progressive career development etc**.** Total Rewards is a comprehensive package of monetary and non-monetary elements.



**CHECK YOUR PROGRESS**

**Q.5:** What does total rewards consist of?

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**Q.6:** List the steps for designing total rewards.

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## 15.7 REWARD MANAGEMENT IS SERVICE SECTOR

The growth of service sector depends on incremental customer satisfaction. Such growth in any kind of a service sector can be measured from the customer satisfaction index. However, it is noteworthy that customer satisfaction increases when their services are rendered only by a satisfied and motivated workforce. There are many aspects leading to employee motivation. But the grossly contributing factor to employee motivation is the compensation factor with the reward element integrated into it. So we can say a well placed reward system and can be used to influence employee behavior.

**Rewards** are positive recognition of an employee's performance. When an employee through his performance takes an organization ahead to reach its goals, a reward often follows for that matter. And Reward Management, in the service sector is the formulation, administration and execution of relevant reward strategies and policies that will reward employees fairly, equitably and consistently to keep them satisfied, happy so that they can serve customers better.

A bulk of research literature on rewards has shown that they may have a tremendous impact on employees' attitudes towards their jobs and the organization for they work for (Lincoln & Kallerberg 1990).

Rewards can either be intrinsic to satisfy the intrinsic needs or extrinsic rewards to satisfy the extrinsic needs of the employees. Therefore, a proper distinction between intrinsic and extrinsic rewards becomes an inherent part of the organization's reward management program.

- Extrinsic rewards aim to satisfy basic physiological needs of survival, and security of the employees. They are tangible form of rewards given to the employees to recognize their achievement. They include pay and fringe benefits, promotion opportunities, and secured workplace conditions.
- Intrinsic rewards are meant to satisfy the higher order needs of esteem, development and self actualization of the employees. An intrinsic reward is intangible form of reward to recognize employee achievement. They exist within the job itself such as job variety, newer challenges and autonomy added to the job.

Though it may seem easy to differentiate rewards as intrinsic and extrinsic, but it is a grossly tremendous task to manage the reward system in a way to align it with specific employee needs as intrinsic or extrinsic.

Rewards in the service sector can come in the form of individual, group or organization rewards as service delivery may be individual or in groups.

- Individual reward will recognize individual employee performance and competence.
- Team rewards will recognize the employee's contribution as a team.
- Organization reward will acknowledge the organizational performance as a whole. It is generally in the form of profit-sharing, gain-sharing plans.



**CHECK YOUR PROGRESS**

**Q.7:** Growth of service sector depends on .....

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**Q.8:** Distinguish between intrinsic and extrinsic rewards?

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## 15.8 TOTAL REWARD FRAMEWORK OF SERVICE INDUSTRIES IN INDIA

The guarantee for the existence/survival of any organization in the service sector is the motivated employee force, because only a motivated employee can serve a customer to the optimum level of customer satisfaction. In the service sector employee motivation and customer satisfaction are directly proportional. Reward is one among the many tools of employee motivation. Thus, reward policies in the service sector need to be diligently framed. The term total reward provides a holistic approach to rewards and their management in order to mean that all aspects and components of rewards go into the same portfolio– Total Rewards.

The total rewards framework of service industries in India is to be guided not only by individual organizational HR strategic approach but also motivational theories in order to use monetary and non-monetary elements of the total reward as it is equally important to value what employees' desire as total rewards.

The total reward framework of service sectors (in India) can be said to be effective if it can fulfill the following:

1) Directs the organization to achieve its objectives through a motivated workforce.
2) Merges into the organization culture.
3) Upholds transparency, consistency and fairness & equity in the total reward implementation procedure.
4) Operates with data evident from a proper job evaluation process and job grading and rewards people according to their contribution.
5) Gives big impetus to performance through performance management system and rewards people according to the value they create.
6) Designs rewards that can attract and retain talent.
7) Maintains equitable but competitive rates of pay in the same industry in the service sector.
8) Manages and executes total rewards by obtaining value for money.
9) Evaluates reward policies periodically and takes corrective measures when and where necessary.
10) Clearly communicates the operational aspect of the total rewards to all employees.



**CHECK YOUR PROGRESS**

**Q.9:** List five requisites for total reward framework in service sector to be effective.

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## 15.9 FACTORS AFFECTING REWARD MANAGEMENT POLICIES IN SERVICE SECTOR

Compensation as has already been discussed is monetary and non-monetary acknowledgement for the labor (both physical and mental) invested on the part of the employee by the organization. Today's business environment driven by competition makes the survival of any organization, especially in the service sector, impossible unless it proves continuous performance to break through its competitors. Employees are the most important resources for any organization in the service sector. The right compensation is the most important factor for attraction of the right manpower, motivating them and retaining them. For this any organization would give priority to attract and retain performers and would value them as their human capital to be invested for business survival and profit. So the term reward is gaining emergence in today's corporate parlance to mean reward for performance. Rewards would mean anything (monetary or non-monetary) tied to performance. In some organizations reward means anything which comes exclusively by way of performance and in some organization's it is the alternative for compensation as the term reward has proved to be valued more generally by an employee.

The framing, administering and implementing of all strategies and policies tied to reward is called reward management. Reward management policies and strategies are subject to a number of influences. They can be listed as:

1) Contextual/environmental factors (factors emerging from internal and external organizational environment) and
2) Conceptual factors/internal factors (arising from theories and beliefs on strategic management with respect to total reward management, human capital management in the organization, and all strategic factors existent in the organization relating to its employee issues on pay, motivation, commitment, engagement and psychological factors).

Let us discuss the factors in the following ways:

1) Contextual Factors:
   a) Internal environment– Therese are factors with respect to organization culture in practise, and business practices,

technology implemented and people engaged that is all factors visibly present within the organization.

b) External environment– These are factors surrounding the organization and pressuring the organization from the organizational periphery like stiff competition, global business traditions and changes in employee demography and their employment (like age, nationality, race etc.)

2) Conceptual Factors: Strategic management puts an impetus on strategic reward to influence continuous performance through change adaptations with respect to business environment. Strategic management has been put as "the set of decisions and actions resulting in the formulation and implementation of strategies designed to achieve objectives of an organization''. Strategic management is never and cannot be a permanent, linear and continuous process. Strategies have to be framed and changed with time with overall changes in all the constituent factors at work in the organization. Like all business strategies, reward strategy is also best to be regarded as 'a pattern in a stream of activities'.



**CHECK YOUR PROGRESS**

**Q.10:** Explain conceptual factors with respect to reward management policies?

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## 15.10 DESIGNING REWARD STRATEGY

A successful reward strategy, foremost, must always be able to integrate all HR elements in practice in the organization and take forward the business strategy. In other words, a Reward strategy cannot align itself

with HR strategies and the overall business strategy. It cannot work in isolation.

Secondly, It should be able to reinforce that behavior through rewards which can bring improved business performance.

Finally, reward strategy is to be framed within the reward budget.

While designing a successful reward strategy these basic factors must be taken note of:

1) It should be able to figure out what behavior it wishes to reward and then design the reward strategy. Designing the strategy prior to configuring the desired behavior may not yield results. For e.g., if it wishes to reward individual behavior when actually teams are at work, the strategy will be ineffective.
2) It should be guided by a clear set of principles to judge how well it is performing in its contribution to the business goal.
3) It should be simple enough to drive home the simple meaning of performance and hence reward. In more recent times it is seen that, organizations have tried to put in too many variety of benefits in an employee's limited pay, overriding the basic relation between performance and reward and hence the objective of a reward strategy.
4) It should not be tied to fast and impossible business deadlines. This will only set the way for a reward system without making it go through a proper scrutiny.
5) It is said that the success of an organization depends on the efforts of the 80 percent of employees who work satisfactorily than the 10 percent of employees who work perfectly. It must reward the majority who bring improvement in performance than the minority who bring perfection.
6) All remuneration– (a) Base pay (based on market data survey and job evaluation), variable pay (performance based incentives either short term or long term), (b) all benefits (retirement, statutory & voluntary etc.) (c) recognition (recognition in order to elicit behavior that supports business strategies), (d) careers (career development opportunities) (e) rewards (financial and non-financial) should come within its domain.



**CHECK YOUR PROGRESS**

**Q.11:** What are the contributing factors to a successful reward strategy?

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## 15.11 LET US SUM UP

- The reward program is a mixture of cash and non- cash elements.
- Characteristics of reward are:
  1) It includes monetary and non-monetary aspects
  2) It has an investment perspective rather than traditional HR costs.
  3) Rewards are a strong motivational tool.
  4) Rewards must consider the interests of different stake holders as it bears a huge HR cost.
  5) Rewards must comply with all organization strategies.
- Reward and recognition policy is documentation on the implementation procedure of the reward and recognition program existent in the organization. Such documentation is possible when organizations have a transparently identifiable reward and recognition program.
- Reward strategies are HR efforts to link organizational objectives with employee behavior. They use reward as a motivational tool to direct employee behavior to attain organizational objectives.
- The nature of reward strategy should be:
  1) It must be properly designed and communicated.
  2) It must be focused on what employee needs.
  3) It must be flexible
  4) It must be accommodated within the organization culture.

- Some steps for designing a total rewards strategy:
  1) Understanding organizational culture
  2) Understanding its influence on total rewards
  3) Flexibility
  4) Accepting employee feedback
  5) Measurability between performance and reward
- Reward Management, in the service sector is the total management of reward strategies and policies to reward employees fairly, equitably and consistently which can motivate them to serve customers better.
- Rewards may be intrinsic or extrinsic by nature.
- Rewards can be awarded to individual, groups or organization as a whole.
- Reward strategy must be cost-effective.
- The total rewards framework of service industries in India is guided by individual organizational strategic approach, motivational theories, employee job engagement and commitment.
- Reward management policies are influenced by– contextual factors (internal and external environmental factors) and conceptual factors (strategic factors of the organization)
- A successful reward strategy must be able to integrate all HR elements, enforce desired employee behavior and be cost effective.



## 15.12 FURTHER READING

1) Bhattacharyya, Dipak Kumar. (2014*). Compensation Management*. (2nd Edition). Oxford.
2) Bhattacharya, Mousumi S. and Sengupta, Nilanjan. (2008). *Compensation Management*. Excel Books.
3) Deb, Tapamoy. (2008). *Compensation Management: Text and Cases*. Excel Books.
4) Goel, D. (2012). *Performance Appraisal and Compensation Management: A Modern Approach*. Prentice Hall India Learning Private Limited.

5) Singh, B. D. (2017), *Compensation and Reward Management*. Excel Books.



## 15.13 ANSWERS TO CHECK YOUR PROGRESS

**Ans. to Q. No. 1:** Reward management is more in the nature of a strategic management program because Compensation and Benefit program is protective(protecting employees due compensation for work) but reward program is productive(being related to better and progressive work apart from the due compensation for the work done).

**Ans. to Q. No. 2:** Essentials of a reward and recognition policy are:

1) Grounds for rewards and recognition
2) Time period for rewards and recognition
3) Manner for giving out the rewards and recognition
4) Designing of the rewards and recognition
5) Management of the program

**Ans. to Q. No. 3:** The objective of reward strategy is to obtain desired behavior from employees.

**Ans. to Q. No. 4:** Reward strategy must be focused on what employees need because a need based reward will always motivate an employee to direct all his efforts and behavior towards getting the reward.

**Ans. to Q. No. 5:** It consists of tangible monetary and intangible nonmonetary elements like new leadership possibilities, challenging work assignments, progressive career development etc that motivates an employee.

**Ans. to Q. No. 6:** 1) In depth reading of organizational issues.

2) Assessing the influence of total reward on employee efficiency
3) Accomodating flexibility in total rewards.
4) Designing total rewards plan through on employee feedback
5) Establishing a concrete relation between performance and reward.

**Ans. to Q. No. 7:** Growth of service sector depends on customer satisfaction.

**Ans. to Q. No. 8:** Extrinsic rewards satisfy physiological needs of the employees. They are tangible form of rewards– pay and fringe benefits,

promotion opportunities, and secured workplace conditions. Intrinsic rewards satisfy the higher order human needs– esteem, development and self actualization. They are intangible form of reward– job variety, challenge and autonomy.

**Ans. to Q. No. 9:** 1) Enables the organization achieve its objectives.

2) Adapts to the organization overall culture.

3) Values transparency, consistency and fairness & equity.

4) Gives big impetus to performance.

5) Designs rewards that can attract and retain talent.

**Ans. to Q. No. 10:** Conceptual factors are those associated with strategic factors. Strategic management positions strategic reward to influence employee performance. Strategic management policies change with changes in the business. Thereupon all strategic components including reward management will also change to achieve organizational goals.

**Ans. to Q. No. 11:** 1) Identification of behavior to be linked to reward.

2) Measurability of the identified behavior

3) Clarity between relation of this behavior and reward

4) Attainable results to be linked to rewards

5) Targeted for the majority

6) Consider all compensation component.



## 15.14 MODEL QUESTIONS

**Q.1:** Explain how a reward strategy can help attain organizational objectives?

**Q.2:** Explain reward strategy in the lines of Lawler and Duncan Brown?

**Q.3:** Explain the characteristics of a reward strategy?

**Q.4:** Explain why total rewards approach is an integration of other organizational strategies ?

**Q.5:** How can rewards influence employee behavior?

*** ***** ***



## REFERENCES


1) Bhattacharyya, Dipak Kumar. (2014*). Compensation Management*. (2nd Edition). Oxford.
2) Bhattacharya, Mousumi S. and Sengupta, Nilanjan. (2008). *Compensation Management*. Excel Books.
3) Deb, Tapamoy. (2008). *Compensation Management: Text and Cases*. Excel Books.
4) Goel, D. (2012). *Performance Appraisal and Compensation Management: A Modern Approach*. Prentice Hall India Learning Private Limited.
5) Gupta, Sashi K. and Joshi, Rosy. (2014). *Human Resource Management*. Kalyani Publishers.
6) Singh, B. D. (2017), *Compensation and Reward Management*. Excel Books.

Name of the Paper: .....
Course Code: .....

**Centre for Internal Quality Assurance (CIQA)**
**Krishna Kanta Handiqui State Open University**
**City Office: Housefed Complex, Guwahati-781006**

***Learner's Feedback on Course***

**Dear Learner,**

Regarding the course as mentioned above, we would like to know your opinions and comments so as to improve the quality of self learning materials in future. Please respond to the following statements by ticking the number you feel most reflect your opinion. After completion of the additional comments, please detach the page and send/mail the same to us at the address given below.

**The Director, Centre for Internal Quality Assurance, KKHandiqui State Open University**
**Housefed Complex, Dispur, Guwahati-781006**
**(E-mail id: ciqa@kkhsou.in)**

1) Approximately how many hours did you spend for studying the units in the course? ☐☐☐

2) Please give your opinions (by ✓ mark) to the following items based on your reading of the block:

| Sl. No. | Statements | Strongly Agree | Agree | Neither Agree nor Disagree | Disagree | Strongly Disagree |
|---|---|---|---|---|---|---|
| I) | The SLMs of the course fulfil the learning objectives set out in the beginning of each unit | | | | | |
| II) | The units of the SLM could satisfy my academic needs and expectations | | | | | |
| III) | The Unit writers have excellent knowledge about the course contents | | | | | |
| IV) | Language and contents of the units were presented at a level which I could readily understand | | | | | |
| V) | Ample opportunity for participation in the activities provided in the units | | | | | |
| VI) | Used enough Illustrations (Diagrams, tables etc.) for conceptual clarity | | | | | |
| VII) | Quality of content is engaging, relevant, and up-to-date | | | | | |
| VIII) | The self check questions are very helpful | | | | | |
| IX) | The Possible/model questions and the answers to check my progress have benefited me a lot | | | | | |

**Additional Comments:** *(Please feel free to provide your open comments)*

1) Which aspects of the SLM, according to you, worked well?

.....

.....

2) What sort of changes/improvements do you feel KKHSOU could implement to improve the overall quality of the SLM?

.....

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***Thank you for taking the time to complete this form.***