

Theoretical perspective of compensation management in organizations

Dr. Supriya Choudhary

Maharaja Surajmal Institute, Guru Gobind Singh Indraprastha University, C-4, JanakPuri, Delhi, India

Abstract

Human Resources are the key drivers of the prosperity and success of any organization. Unless and until the organization does not offers salary, rewards and due benefits according to its employees needs and wants, it would not be able to conquer the highest level of efficiency and competence of the recruits. Compensation Management is one of the most complex and dynamic issues in the field of human resource management. The ability of a manager to achieve its stated objectives to a large extent depends on the effective implementation of compensational packages in order to motivate the subordinates and employees within and beyond their expectation. Compensation is a key element of the employment relationship and, in addition to being the single greatest operating cost for many organizations; it has been advocated as a tool for enhancing organizational performance and sustained competitiveness. Compensation management is one of the strapping feature that organizations use to attract and retain its most valuable and worthy assets. The present study is an attempt to identify the various factors affecting employee compensation and to study the relationship between compensation and job satisfaction, motivation and organisational organisational commitment of employees.

Keywords: Compensation, Human Resources, job satisfaction, motivation, commitment

1. Introduction

“If you pick the right people and give them an opportunity to spread their wings and put compensation as a carrier behind it you almost don't have to manage them.” - Jack Welch

Human Resource is the most vital resource and the precious asset for any organization. They are the corner stone of any working place. They are responsible for each and every decision taken, each and every work done and each and every result. They carry out everyday operations including the customer dealing, managing the cash flows, running the machines, decision making, counselling of their subordinates, and including many other vital functions of the organization. People make machines and people run machines. Human Resources are the employees of the organization who can take an organization towards prosperity with their hard work and determination and they can also lead an organization towards the downfall if their needs are not being identified and satisfied. One of the early and foremost practices for retaining and motivating human capital in an organization is compensation management which deals with compensating the employees of any organization according to the duties they perform and responsibilities they cope up with. Employees should be managed properly and motivated by providing best remuneration and compensation as per the industry standards. The lucrative compensation will also serve the need for attracting and retaining the best employees. An ideal compensation management system will help to significantly boost the performance of employees and create a more engaged workforce that's willing to go the extra mile for an organization.

In a layman's language the word Compensation means something, such as money, given or received as payment for a service or loss. Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of employment relationships (Bernadin, 2007) ^[5].

Compensation comprises of all the benefits provided to employees in return of the services given by employees. Compensation directly or indirectly affects the performance of the employees. Today's employees not only require money to fulfil their basic needs, but they also necessitate various non-financial rewards and benefits, often known as the Fringe Benefits. These fringe benefits include bonus, retirement benefits, gratuity, educational and medical facilities etc. Compensation not only satisfies employees but also motivates employees.

Every organization must offer good wages and fringe benefits to attract and retain talented employees with the organization. If at any time, the wages offered by a firm are not competitive as compared to other firms, the efficient workers may leave the firm. Therefore, workers must be remunerated adequately for their services. Compensation to workers will vary depending upon the nature of job, skills required, risk involved, nature of working conditions, paying capacity of the employer, bargaining power of the trade union, wages and benefits offered by the other units in the region or industry etc. The system of compensation should be so designed that it achieves the following objectives.

- Attract employees who are qualified, experienced and interested in international assignments.
- Facilitate the movement of expatriate's from one subsidiary to another, from home to subsidiary, and back from subsidiary to home.
- Provide a consistent and reasonable relationship between the pay levels of employees at headquarters, domestic affiliates and foreign subsidiaries.
- Be cost effective by reducing unnecessary expenses.
- Should be easily understood and easy to administer.

Effective implementation of favourable compensation management will not only aid in stabilizing and retaining

employees but also helps in reducing labour turnover within the organization.

Table 1: Objectives of sound compensation structure

For employees	To Employers
1. Employees are paid according to requirements of their jobs and thus eliminate inequalities.	1. It helps to control the employee turnover in the organization.
2. The chances of favouritism are greatly minimized.	2. The likelihood of friction and grievances over remuneration is reduced.
3. Job sequences and lines of promotion are established	3. It attracts qualified employees in a competitive market.
4. Employees' morale and motivation are increased	4. Employee performance is improved as money is an effective motivator.

1. Literature review

Belcher (1974) [4]. The compensation the individual receives from his employment serves as a symbol of status both within the organization and in society.

Barry et al, (1995) [3]. Compensation Management plays a crucial and functional role because it is the heart beat of human resource management. It is also vital to both employees and the employer. This is because employees typically depend on wages and salaries, and must be equivalent to the work done. However, to managers, compensation decisions influence the cost of doing business and thus, their ability to sell at a competitive price in the product market.

Mc.Namara (2008) [14]. Compensation includes issues regarding wage and/ or salary programs and structures accruing from job descriptions, merit-based programs, bonus-based programs, commission based programs and so on, while benefits typically refers to retirement plans, health life insurance, disability insurance, vacation, employee stock ownership plan and so on.

Hewitt (2009) [11]. Compensation Management as the name suggests, implies having a compensation structure in which the employees who perform better are paid more than the average performing employees. This encourages top-performers to work harder and helps to build a competitive atmosphere in the organization.

Pearce (2010) [16]. Compensation implies having a compensation structure in which the employees who perform better are paid more than the average performing employees.

Adeniji & Osibanjo (2012) [1]. Compensation can best be described as including direct and indirect compensation individuals receive in an organization plus various aspects of the pleasant work environment that serve as entrance their self-respect and esteem e.g. provision of car parking facilities, sound policies, competent supervision, comfortable working conditions, flexitime, job sharing, cafeteria compensation etc.

2. Objectives of the study

1. To understand the conceptual framework of compensation management.
2. To study the significance of compensation in organisations.
3. To evaluate the relationship between job satisfaction and motivation of employees.
4. To study the various types of compensation prevalent in organisations to motivate employees.
5. To identify the various internal and external factors affecting compensation.

6. To explore the relationship between compensation management and organisational commitment of employees.

2.1 Significance of compensation management

Compensation is a tool used by management for a variety of purposes to further the existence of the company. Compensation may be adjusted according the business needs, goals, and available resources. Compensation may be used to:

- Recruit and retain qualified employees.
- Increase or maintain morale/satisfaction.
- Reward and encourage peak performance.
- Achieve internal and external equity.
- Reduce turnover and encourage company loyalty.
- Modify (through negotiations) practices of unions.

Recruitment and retention of qualified employees is a common goal shared by many employers. To some extent, the availability and cost of qualified applicants for open positions is determined by market factors beyond the control of the employer. While an employer may set compensation levels for new hires and advertise those salary ranges, it does so in the context of other employers seeking to hire from the same applicant pool.

Morale and job satisfaction are also affected by compensation. Often there is a balance (equity) that must be reached between the monetary value the employer is willing to pay and the sentiments of worth felt by the employee. In an attempt to save money, employers may opt to freeze salaries or salary levels at the expense of satisfaction and morale. Conversely, an employer wishing to reduce employee turnover may seek to increase salaries and salary levels. Compensation may also be used as a reward for exceptional job performance. Examples of such plans include: bonuses, commissions, stock, profit sharing and gain sharing.

One of the indispensable functions of compensation policy of any company is to provide growth opportunities to its employees and to create a vigorous competition among the employees in order to have an urge to work more efficiently and proficiently.

2.2 Types of Compensation

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

Compensation can be defined as all of the rewards earned by employees in return for their labour. This includes:

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

2. Indirect financial compensation including all financial rewards that are not included in direct compensation and can be understood to form part of the social contract between the

employer and employee such as benefits, leaves, retirement plans, education, and employee services.

3. Non-financial compensation referring to topics such as career development and advancement opportunities, opportunities for recognition, as well as work environment and conditions.

In determining effective rewards, however, the uniqueness of each employee must also be considered. People have different needs or reasons for working. The most appropriate compensation will meet these individual needs. To a large degree, adequate or fair compensation is in the mind of the employee.

Table 2: Types of Compensation

Direct (Base) compensation	Indirect (Supplementary) compensation
Basic Salary House Rent Allowance Conveyance Leave Travel Allowance Medical Reimbursement Bonus Special Allowance (overtime, mobile allowances, meals, commissions, travel expenses, reduced interest loans; insurance, club memberships)	Leave Policy (casual leaves, medical leaves and maternity leaves etc.) Overtime Policy Hospitalization Insurance Leave Travel Allowance Retirement Benefits Holiday Homes Flexible Timings

2.3 Factors affecting employee compensation

The compensation is the monetary and non-monetary rewards given to the employees in return for their work done for the organization. Basically, the compensation is in the form of salaries and wages. Employers decide on what is the right compensation after taking into account the several internal and external factors. Thus, all HR professionals and managers must take the various aspect (table3) into account when they determine the compensation to be paid to employees.

Table 3: factors considered in deciding the compensation

Internal Factors	External Factors
1.Capacity to pay	1.Compliance with the law of land
2.Top Management Philosophy	2.Demand and Supply of labour
3.Job Requirements	3.Cost of living
4.Organisational Politics	4.Government
5.Employee Related Factors	5.Prevailling wage rates
6.Productivity of workers	6.Labour Union and Collective Bargaining

2.4 Relationship of compensation to job satisfaction, motivation and organisational commitment

The management of human resources at work is a vital component of the management process. To realize the critical importance of people in the organization it is imperative to recognize that the human element and the organization go together. One way of achieving this goal and to realize the critical importance of the people in the organization is to keep them motivated. In the field of management the key to understanding the process of motivation lies in the meaning of, and relationship among, needs, drives, and incentives. Low satisfaction from the job and increased absenteeism rate are the consequences arising from the insufficient and inadequate benefits (DeCenzo and Robbins, 2006)⁷. Among the 4 M's i.e.

Men, Money, Machine and Material, men are the most important. Employees working in any organization are the building blocks of that organization. To keep them happy, satisfied and to retain them in the organization, money given to them in the form of wages should essentially be adequate. An effective management is that which makes a comparison of its compensation plans with the other jobs in the industry or with the established benchmark.

For as long as organizations have existed, compensation has been recognized as a major motivator of employees as well as an important tool and expense for organizations. Understanding the construct of compensation systems, its impact upon the organization's structure, strategies, and employees has been an important area. To use compensation as a motivator effectively, personnel managers must consider four major components of a pay structures in an organization (Popoola and Ayeni, 2007)¹⁷. These are:

- a. Job rate, which is the importance the organization attaches to each job;
- b. Payment, which encourages employees by rewarding them according to their performance;
- c. Personal or special allowances; and
- d. Fringe benefits such as holidays with pay, pensions, and so on. The desire to be promoted and earn enhanced pay may also motivate employees.

Allen and Meyer (1990) ^[2] identified a link between organisational commitment and employee salary levels, benefit packages and turnover and concluded that organizations that have better compensation systems cum policies in place put a very positive impact on their employees thereby them committed to the organisation and were less likely to leave it.

Financial reward is one of the factors that produce job satisfaction as mentioned in need fulfillment model by Kreitner and Kinicki, (2006) ^[13]. They revealed that pay,

benefit packages and security were greater motivators for employees. Also, Grace and Khalsa (2003) ^[10] admitted that professional development opportunities, salary packages, benefits are of great importance that create job satisfaction factors. Compensation systems may affect employees' job satisfaction and thus influence intentions to quit but higher compensation level cum benefit packages leads to higher job satisfaction and retention rates will also be higher.

2.5 Principles of effective compensation policy

- Differences in pay should be based on differences in job requirements.
- Wage and salary level should be in line with those prevailing in the job market.
- Follow the principle of equal pay for equal work.
- Recognize individual differences in ability and contributions.
- The employees and trade unions should be involved in while establishing wage rates.
- The wages should be sufficient to ensure for the worker and his family reasonable standard of living.
- There should be a clearly established procedure for redressal of grievances concerning wages.
- The wage and salary structure should be flexible.
- Wages due to employees should be paid correctly & promptly.
- A wage committee should review & revise wages from time to time.

3. Conclusion

In the 21st century organizations, by and large, people pay much more attention to their life style and the money they earn from the work than their predecessors. Compensation, in the organizations of today is a major consideration in Human Resource Management (HRM), and how it is allocated sends a message to employees about what the organizations believe to be important and worth encouraging. Today's compensation systems have come from a long way. With the changing organizational structures, workers' need and compensation systems have also been changing. From the bureaucratic organizations to the participative organizations, employees have started asking for their rights and appropriate compensations. The higher education standards and higher skills required for the jobs have made the organizations provide competitive compensations to their employees. Compensation strategy is derived from the business strategy. The business goals and objectives are aligned with the HR strategies. Then the compensation committee or the concerned authority formulates the compensation strategy. It depends on both internal and external factors as well as the life cycle of an organization. Thus, Compensation management is a strategic management decisions and play a key role in achieving performance and sustainable competitive advantages for national as well as international firms.

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