

## **COURSE: REWARD MANAGEMENT**

### **LECTURE 9: Factors influencing Compensation management**

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#### **Lecture learning outcomes:**

##### **At the end of the lecture, you will be able to:**

- i. Discuss the factors influencing compensation
- ii. Examine internal factors influencing compensation
- iii. Determine external factors influencing compensation

#### **Factors Influencing Compensation management**

Compensation is the remuneration received by an employee in return of their contribution to the organization. The compensation management is an organized practice which is important for balancing the work and employee relationship by providing monetary and non-monetary compensation to employees. Compensation includes all forms of pay given to the employees which arise from the employment. One of the striking features of organizations is compensation management and they use it to attract and retain the most important and worthy assets. The compensation management is considered to be a complex process which requires accuracy and precision and if not carried out properly may lead to employees' dissatisfaction. An ideal compensation policy motivates the employees to work harder and with more determination. It also helps the organizations to set the standards for jobs that are related, realistic and measurable. Compensation policies should have a sound integration with HRM practices. One of the key functions of compensation management of any company is to create a healthy competition among the employees in order to attain more efficiently and provide growth opportunities to its employees (Khan, Aslam, Lodhi, 2011).

According to Jain, the number of factors influencing the remuneration payable to employees can be categorized into external and internal factors (management study, 2014; management paradise, 2014).

#### **External Factors**

External factors are those beyond the control of the organization.

#### **Labor Market**

Demand and supply of labor influence the fixation of wage and salary. A lower wage is fixed when labor demand is less than labor supply. A higher wage will have to be paid when labor demand is more than labor supply, as in the case of skilled labor. Mostly, excessive unemployment is juxtaposed with a shortage of skilled labor.

Going rate of pay is another labor-related factor influencing employee remuneration. Going rates are those that are paid by different units of an industry in a locality and by comparable units of the same industry located elsewhere. This is the only way of fixing salary and wage in the initial stages.

of plant operations. Subsequently, a comparison of going rates would be highly useful in resolving wage-related disputes.

### **Technological changes**

Technological changes also influence the fixation of wage levels. Due to the advancements in the technology there may be shortage of skilled manpower in that area. So, the organisation will provide high wages for skilled personnel. For example, information technology (IT) is suffering from the shortage of IT experts and is therefore paying them higher wages.

### **Prevailing Wage Level**

Most of the organizations fix their pay in keeping with the level for similar jobs in the industry. They frequently conduct wage survey and accordingly seek to keep their wage level for different jobs. If a particular firm keeps its pay level higher than those of others in the industry, its employee cost becomes heavier which may escalate the end cost of the products. This will affect the competitiveness of the firm. On the other hand, if a firm keeps its pay level lower than the prevailing rates, it may not recruit the skilled and competent manpower.

### **Cost of Living**

This matters is criterion during periods of rising prices but it is forgotten when prices are stable or falling. When the cost of living is rise and it required to be remunerated by payment of dearness allowance, basic pay to continue uninterrupted. The justification for cost of living as a criterion for wage fixation is that the real wages of workers should not be allowed to be whittled down by price increases. Increase in the prices of commodities and decrease in value of the money is called inflation also affects wage rates. The causes of inflation are many which are raising costs; fall in the currency value in international markets, raising taxes by government and stagnation in the development of economy, et

### **Labor Unions**

The labour unions attempt to work and influence the wages primarily by regulating or affecting the supply of labour. The unions exert their influence for a higher wage and allowances through collective bargaining with the representatives of the management. If they fail in their attempt to raise the wage and other allowances through collective bargaining, they resort to strike and other methods where by the supply of labour is restricted. This exerts a kind of influence on the employees to concerned test partially the demands of the labour unions. The employers of strongly unionized employees therefore have no freedom in wage and salary fixation due to pressure of labour representatives in determining and revising pay scales. Employers in non-unionized factories enjoy the freedom to fix wages and salaries as they please. Because of large-scale unemployment, these employers hire workers at little or even less than legal minimum wages.

The presence or absence of labor organizations often determine the substantial wages paid to the employees. Employers of non-unionized organization enjoy the liberty to fix wages and salaries as they want. Because of larger-scale unemployment, these employers hire workers at little or even less than legal minimum wages. An individual nonunionized company may be pay more to its

employees if they want to discourage them from forming one. The employees of strongly unionized companies too have no freedom in fixation of wage and salary. They are forced to vintage the pressure of labor representatives in revision and determination of pay scales.

### **Union Influences on Compensation Decisions**

Unions and labor relations laws also influence compensation design. The various labor legislations and court decisions were legitimized the labor movement.

### **Labor Laws and wage laws**

We have a various labor laws at the central and as well as at the state levels. These legislations are for protection of employees interests.

To protect the working class from the exploitation of powerful employers, the Government has enacted several laws. Laws on minimum wages, hours of work, equal pay for equal work, payment of dearness and other allowances, payment of bonus, etc., have been enacted and enforced to bring about a measure of fairness in compensating the working class.

Thus, the laws enacted and the labour policies framed by the Government have an important influence on wages and salaries paid by the employers. Wages and salaries can't be fixed below the minimum level prescribed by the Government.

### **Society and social factors**

Society also affects remuneration in that remuneration paid to employees is reflected in the prices fixed by an organization for its goods and services. For this reason, the consuming public is interested in remuneration decisions. In addition, whether the wage is adequate and equitable depends not only upon the amount that is paid but also upon the perceptions and the views of the recipients of the wage. Even though the wage is above the going wage rate in the community if it is lower than that of fellow worker it may be deemed inferior, it will be regarded as inequitable in the eyes of the recipients of the wage. A man's perception of the equity of his wage will undoubtedly affect his behaviour in joining and continuing in the organization.

Compensation paid to employees is imitated the prices fixed by an organization for their goods and services. Courts adjudicate industrial disputes—particularly disputes relating to wages and allied problems of financial concern to the worker- an ethical and social outlook liberally interpreting the spirit of the Constitution.

### **The Economy**

The economy has its impact on wage and salary fixation is the state of the economy. While it is possible for some organizations to thrive in a recession, there is no question that the economy does not affect remuneration decisions.

### **Government legislation**

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prescribed by the government. The laws on minimum wages, hours of work, equal pay for equal work, payment of dearness and other allowances, payment of bonus, etc. have been enacted and enforced to bring about a measure of fairness in compensating the working class.

### **Globalization**

It has ushered in an era of higher compensation level in many sectors of the economy. The entry of multinational corporations and big corporates have triggered a massive change in the compensation structure of companies across sectors. There is a salary boom in sectors like information technology, hospitality, biotechnology, electronics, financial services and so on.

### **Cross Sector Mobility**

Contemporary companies find it difficult to benchmark the salaries of their staff with others in the industry thanks to mobility of talent across the sectors. For example, hospitality sector employees are hired by airlines, BPOs, healthcare companies and telecom companies.

### **Internal Factors**

Following are the internal factors which influence compensation:

#### **Ability to pay**

Ability to pay is one of the most significant internal factors influencing employee compensation. Generally, a firm, which is prosperous and successful, has the ability to pay more than the competitive rate. This way it can attract a superior caliber of personnel. Often the labour unions also demand an increase in compensation on the grounds that the organisation is prosperous and is able to pay more.

Those organizations which earn high profit and have a larger market share, a large business conglomerate and multinational companies can afford to pay higher pay than others. Besides, company's ability to pay higher pay is impaired by sector- specific economic recession and acute competition.

#### **Worth of a Job**

Organizations base their pay level on the worth of a job. The wages and salaries tend to be higher for jobs involving exercise of brain power, responsibility laden jobs, creativity-oriented jobs, technical jobs.

#### **Business Strategy**

The overall strategy of a company which pursue the determination of employees compensation. The strategy is to sustain and protect current profit because of the declining fortunes of the company the compensation level were needs to be average or even below average.

## **Performance Appraisal**

The Performance appraisal helps to reward, compensation hike for the employees who show better performance.

### **The Employee**

Several employee-related factors interact to determine his or her remuneration. These include performance, seniority, experience, potential, and even sheer luck.

Numerous employee-related factors also influence his or her compensation. These include performance, experience, seniority and potential. High performance is always rewarded with pay increase and as a result it motivates the workers to do better in future. Experience makes a person perfect by providing valuable insights and thus rewarded also. Employers presume that experienced candidate possess leadership skills which influence the other behavior and performance. Generally experience candidate perform the job without need of training which is time consuming and deals with matter of cost to company. Hence the experience candidates demand more pay than an inexperienced candidate.

### **Seniority and potential employee**

In today's environment seniority of employees also influences remuneration. Naturally senior employees demands for more salary than fresher because of their hold on related job and its functions. Today many companies are demanding senior employees for key positions by offering high pay and even sometimes offering retired employees handsome salary for key positions. Firms also pay their employees, especially young ones on the basis of their potential. Software companies are very good example for this, IT graduate just who completed his education having potential in the subject can gain a good job with high payment anywhere in the world.

### **Job requirements**

Wages are also influenced by the requirements of a job such as physical and mental requirement. Jobs, which demand more skill, responsibility, efforts and are of hazardous in nature, will carry high wage tag with them. Job evaluation establishes a consistent and systematic relationship among base compensation rates for all jobs. In other words, it establishes the satisfactory wage differentials.

### **Compensation Policy of the Organization**

Firm's policy regarding pay i.e., attitude to be an industry leader in pay or desire to pay the market rate determines its pay structure. The former can attract better talent and achieve lower cost per unit of labour than the ones that pay competitive pay.

It provides general guidelines for making compensation decisions. The first thing employers should consider when developing compensation package is fairness. It should be vital and maintain internal and external equity. The policy should include the company's philosophy related to the major components of incentive compensation, including the strengths and

weaknesses of each and how the overall plan provides optional alignment of interest with shareowners.

The policy should provide broad guidelines by which the company will use alternative forms of compensation, and the relative weight in relation to overall compensation if “others” form of compensation will be utilized. An organization often, formally or informally, establishes compensation policies that determine whether it will be a pay leader, a pay follower, or strive for an average position in the labour market.

(a) Pay leaders – They are organizations that pay higher wages and salaries than competing firms. This helps to retain and attract high quality and productive employees.

(b) The market rate – These are the average pay that most employers provide for a similar job in a particular area or industry, it is also known as going rate.

(c) Pay followers – These are companies that choose to pay below the market rate because of poor financial condition or a belief that they simply do not require highly capable employees.

### **Productivity**

The employee’s salary at times is directly related to their level of productivity. Every good management would try to bring equity between the results and rewards of an employee. Employee’s productivity results in increasing turnover for the organisation resulting in better revenues and ultimately an increase in the salary of its employees.

### **Compensation Survey**

A compensation survey strives to obtain data regarding what other firms are paying for specific jobs within a given labour market. The surveys may be either outsource to a consulting firm or conducted by the organization itself. In this, market rates remain the most important standard for determining pay.

Most big organizations provide low, high and average salary for a given position with the help of compensation survey. It provides information for establishing both direct and indirect compensation. A firm should take the determinants such as the geographical area of the survey and the specific firms to contact before conducting a compensation survey.

### **Job Analysis and Job Description**

It is found that the more difficult and challenging a job, the higher are the wages. For this, the particular job is analyzed and then the relative value of a job is determined. Job analysis is the systematic process of determining the skills and knowledge required for performing job.

- (a) Determine what tasks must be accomplished by whom.
- (b) Decide which job classifications should be exempt and which should be non-exempt.
- (c) Develop model job descriptions for exempt and non-exempt positions and distribute the models to incumbents for reviews and comment; adjust job descriptions if necessary.
- (d) Finalize and document all job descriptions.
- (e) Evaluate jobs.
- (f) Also a general task analysis is conducted by major departments to the jobs within each seniors, vice president's and manager's department and then rank jobs between and among departments.
- (g) Verify ranking by comparing it to industry market data concerning the ranking and adjust if necessary.
- (h) Prepare a matrix organizational review.
- (i) Determine grades.
- (j) Establish the number of levels – senior, junior, intermediate and beginner for each job family and assign a grade to each level.
- (k) Determine the number of pay grades or monetary range of position at particular level and establish the salary range.

### **Bargaining Power**

Bargaining power of trade unions or organised workers affects the wages. The stronger, more powerful the trade unions; the greater will be the effect on wages. Strength of trade union depends on the number of members in trade union, financial position and leadership qualities of leader. Trade unions have the weapons of strike, lock out or gherao to get their demands accepted.

### **Attitude of Managers**

Attitude of managers has a decisive influence on the compensation decision. Thinking, experience, perception, etc., of manager affects this decision.

A manager may support higher wage policy to motivate employees, another may oppose higher wage policy because it can make employees lazy and lethargic.

## Criteria of Effective Compensation Program

There were seven criteria to judge the effectiveness of compensation: [Jain, 2014; Bhattacharay, 2009)

- a. Adequate: Minimal governmental, union, and managerial levels should be met.
- b. Equitable: Each person should be paid fairly, in line with his or her effort, abilities and training.
- c. Balanced: Pay, benefits and other rewards should provide a reasonable in total reward package.
- d. Cost Effective: Pay should not be excessive, considering what the organization can afford to pay.
- e. Secure: Pay should be enough to help an employee feel secure and aid him or her in satisfying basic needs.
- f. Acceptable to the Employee: The employee should understand the pay system and feel it is a reasonable system for the enterprise and himself or herself.
- g. Incentive providing: Pay should motivate effective and productive work.
- h. Ability to pay

This is one of the most significant factor influencing employee compensation. Generally, a firm, which is prosperous and successful, has the ability to pay more than the competitive rate. This way it can attract a superior caliber of personnel. Often the labour unions also demand an increase in compensation on the grounds that the organisation is prosperous and is able to pay more.

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