

# Compensation Management

## Module 4\_Session 1

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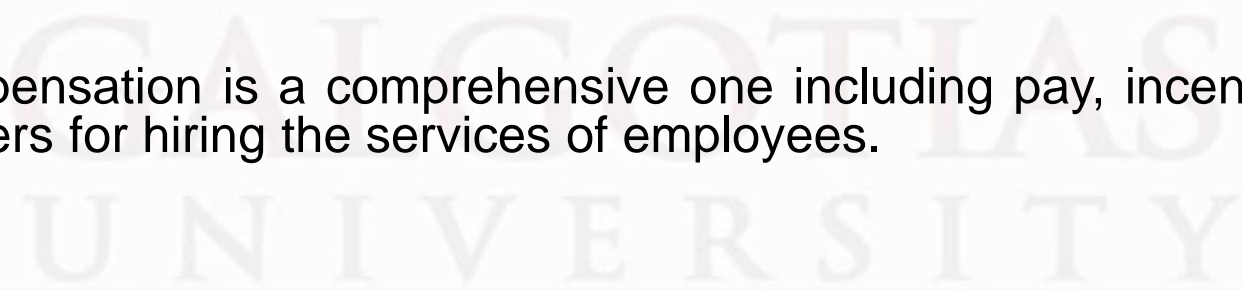
# Content to be covered

- Meaning of compensation
- Nature
- Objective of compensation management
- Factors

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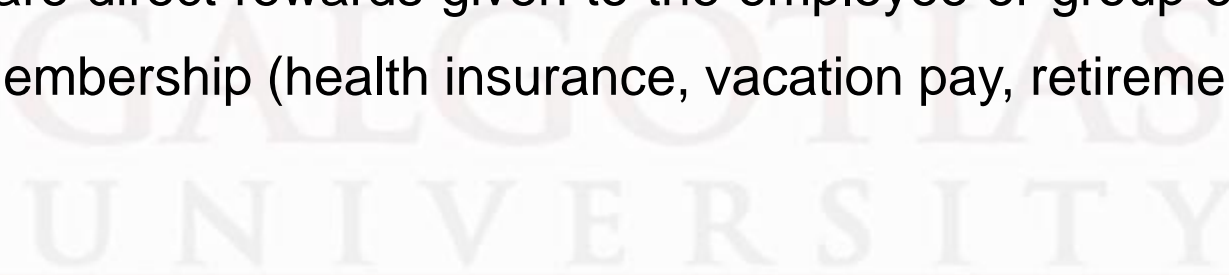
## What is Compensation?

- Compensation is what employees receive in exchange for their contribution to the organization.
- Generally, employees offer their services for three types of rewards.
- Pay refers to the base wages and salaries employees normally receive.
- Compensation forms such as bonuses, commissions and profit sharing plans are incentives designed to encourage employees to produce results beyond normal expectation.
- Benefits such as insurance, medical, recreational, retirement, etc., represent a more indirect type of compensation.
- So, the term compensation is a comprehensive one including pay, incentives and benefits offered by employers for hiring the services of employees.



## Nature of Compensation

- Compensation offered by an organisation can come both directly through base pay and variable pay and indirectly through benefits.
- ❖ **Base Pay:** It is basic compensation an employee gets, usually as a wage or salary.
- ❖ **Variable Pay :** It is the compensation that is linked directly to performance accomplishments (bonuses, incentives, stock options).
- ❖ **Benefits:** These are direct rewards given to the employee or group of employees as a part of organizational membership (health insurance, vacation pay, retirement pension etc.)



## Objectives of Compensation Management

- Some of the important objectives that are sought to be achieved through effective compensation management are listed below:
  1. **Attract talent** – compensation needs to be high enough to attract talented people. Since many firms compete to hire the services of competent people, the salaries offered must be high enough to motivate them to apply.
  2. **Retain talent** – if compensation levels fall below the expectations of employees or are not competitive, employees may quit in frustration.
  3. **Ensure equity** – pay should equal the worth of a job. Similar jobs should get similar pay. Likewise, more qualified people should get better wages.



4. **New and desired behaviour** – pay should reward loyalty, commitment, experience, risks taking, initiative and other desired behaviours. Where the company fails to reward such behaviours, employees may go in search of greener pastures outside.
5. **Control costs** – the cost of hiring people should not be too high. Effective compensation management ensures that workers are neither overpaid nor underpaid.
6. **Comply with legal rules** – compensation programmes must invariably satisfy governmental rules regarding minimum wages, bonus, allowances, benefits, etc.
7. **Ease of operation** – the compensation management system should be easy to understand and operate. This will promote understanding regarding pay-related matters between employees, unions and managers.

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# Factors Influencing Compensation levels

- 1. Job Needs** - jobs vary greatly in their difficulty, complexity and challenge. Some need high levels of skills and knowledge while others can be handled by almost anyone. Simple, routine tasks that can be done by many people with minimal skills receive relatively low pay.
  - on other hand, complex challenging tasks that can be done by few people with high skill levels generally receive high pay.
- 2. Ability to pay** – projects determine the paying capacity of a firm. High profit levels enable companies to pay higher wages. IT Sector jobs have higher pays.
- 3. Cost of Living** – inflation reduces purchasing power of employees. To overcome this, unions and workers prefer to link wages to cost of living index. When the index rises due to rising prices, wages follow suit.
- 4. Prevailing Wage Rates** – prevailing wage rates in competing firms within an industry are taken into account while fixing wages. A company that does not pay comparable wages may find it difficult to attract and retain talent.

## Factors Influencing Compensation Levels

5. **State Regulation** – the legal stipulations in respect of minimum wages, bonus, dearness allowances, etc. determine the wage structure in an industry.
6. **Demand and Supply of Labour** – the demand for and the supply of certain skills determine prevailing wage rates. High demand for software professionals, R& D professionals in drug industry, telecom, management consultants ensures higher wages.
7. **Unions** – highly unionized sectors generally have higher wages because well organized unions can exert pressure on management and obtain all sorts of benefits and concessions to workers.

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