Compensation Management

MBA Second Year
(Human Resource Management)

School of Distance Education
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COMPENSATION MANAGEMENT

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UNIT I

LESSON

1

WAGE AND SALARY MANAGEMENT

CONTENTS

1.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the theories related to wage and salary administration
- Attempt on the nature and scope of wage and salary administration
- Analyze the theory of compensation
- Learn about the wage determination process
- Know the concept of wage surveys
- Understand the preparation of a wage structure
- Understand the factors influencing wage and salary administration

1.1 INTRODUCTION

Formulation of rational wage policy has always been one of the most significant social/ political demands. Initially as an economic issue it was mainly the concern of the employer. State was adopting laissez faire policy. But, with the industrial progress and subsequent industrial balance between employers and employees, wage bargain has become a matter for the three-fold concern of the employer, employee, and the state.

Any rational wage policy has to be woven into the socio-economic texture reflecting the objectives and aspirations of the people of a particular country. It cannot be dealt with on purely economic considerations in isolation from the social policy and political culture of that particular community.

Problems of wage policy should be of great concern to employees, management and the government alike. The pressures of rising prices encroach on the living standards of employees; the demand for higher wages and better working conditions creates prices, market and production problems for the management; and the final burden of finding a solution to the problems of wage policy ultimately falls on the government.

1.2 NATURE AND SCOPE OF WAGE AND SALARY ADMINISTRATION

The Human Resources Department is responsible for assisting in the provision and maintenance of a working climate for all organization employees, which will foster achievement of the organization's primary goals of teaching and research through excellent client service. In addition, Human Resources supports the opportunity for employees to reach their potential and achieve excellence through the effective administration and interpretation of corporate policies and practices, applicable federal and provincial legislation as well as its involvement in the administration and delivery of programs for personal and professional growth.

This responsibility begins with an emphasis on excellent staff relations. The Manager, Salary Administration is expected to establish and maintain a good working rapport with all employee groups on campus which contributes to a constructive relationship in an atmosphere of trust.

Specifically, the department provides service to the campus community in the areas of salary administration, pension and benefit administration, recruitment, payroll services, career counselling and training and development. Human Resources bases its service on the principles of equity and confidentiality with an emphasis on excellence in both customer service and employee relations.

Reporting to the Director, Staff & Labour Relations, the Manager, Salary Administration is responsible for the Organization's overall compensation and government legislated equity programs. Specifically this includes the annual staff wage and salary increase programs and the faculty salary increase process, ongoing review and maintenance of the Organization's Pay Equity plan, salary/grade reclassification program, maintaining a current employment equity database and preparation of the Organization's Employment Equity plan for the federal government.

Through the administration of the compensation program, the Manager, Salary Administration responds to the changing and diverse needs of the Organization community. The Manager, Salary Administration also supports the Director by overseeing the daily workload of the Staff Relations Coordinators as it relates to recruitment and reclassification issues.

The Manager, Salary Administration is a part of the Staff Relations group, which is comprised of generalists, and support staff at various levels of training and professional expertise. This Staff Relations group provides recruitment, salary administration, management and staff counselling, mediation, staff training and development and union contract management to the Organization community.

Reporting to the Manager, Salary Administration are the Compensation Analyst and the Human Resources Department Assistant and the Human Resources Assistant. Four Staff Relations Coordinators are also accountable to the Manager, Salary Administration with respect to the compensation issues within the scope of their responsibilities to their respective client groups.

The Manager, Salary Administration is accountable for the overall direction and integrity of the staff compensation program. Within the scope of the above, the Manager, Salary Administration assumes direct responsibility for various annual programs that are processed and administered by Human Resources on behalf of the organization. These are the annual staff merit evaluation program, the annual staff increase program, the faculty increase program, providing Senior Executive salary data and for assisting other Ontario universities and other institutions with salary survey data and comparisons.

The Manager, Salary Administration also serves as a key resource to one of the major Organization committees, the Provost's Advisory Committee on Staff Compensation, and provides statistical data and information regarding current trends in compensation for the Committee's consideration. This committee is comprised of members of the Organization Administration and members of the Staff Association and represents the core of the Organization's philosophy of collegial decision-making and emphasis on Staff Relations.

In this role, the Manager may interact with members of management and staff who may be unhappy with a job classification or salary decision. This may involve conflict with both management and staff who may have strong feelings about job classifications and salaries. The Manager must attempt to resolve these disputes while ensuring that overall internal equity is maintained and policies are followed.

In order to oversee this work, the Manger must have an advanced knowledge and understanding of best compensation practices, a thorough understanding of the campus community and the relevant policies and procedures for both staff and faculty. The Manager must also understand the process in the administration of the above programs to the extent required to effectively manage the work being performed by the Compensation Analyst and others.

The Manager, Salary Administration is also responsible for the Organization's Pay Equity plan under the Pay Equity Act of Ontario and the Organization's Employment Equity plan under the Federal Contractors Act. The Manager, Salary Administration is responsible for the accurate documentation of all related data, its analysis and formal reporting when required by the appropriate agency. The Compensation Analyst will assist the Manager, Salary Administration with the maintenance and reporting of this data and will also support the Manager in the preparation of the reports to the provincial and federal governments on the status and progress of each plan. This work requires an understanding of the relevant legislation and its interpretation and application as well as a demonstrated commitment to the goals and objectives of the Organization of Waterloo in meeting the legal requirements involved.

The Manager, Salary Administration also represents the department's interest as a functional expert in various special projects associated with the HRMS such as Budget/ Encumbrance, Faculty data, Salary Increase programs for staff and faculty, and work processes and workflows with respect to employment data and reporting. The Manager, Salary Administration also provides input on behalf of Human Resources regarding committee efforts to improve work flow across campus between various departments. This requires an extensive knowledge of the Organization, its work processes and its culture in order to make an effective contribution to these projects.

The Manager, Salary Administration is a member of the senior management team in Human Resources and as such, provides input and advice regarding all issues that impact the work of Human Resources staff. The Manager works very closely with all the members of the Staff Relations group as well as other department staff in achieving the department's goals with respect to customer service.

The Manager directly supervises the work of the Compensation Analyst, the Human Resources Department Assistant, the Human Resources Assistant and shares joint responsibility with the Assistant Director, Information Support Systems for managing the work of the Faculty Data Administrator. The Manager, Salary Administration is also responsible for the compensation related work done by the Staff Relations Coordinators. The Manager, Salary Administration also assumes a lead role in the provision of advice and guidance to the Staff Relations Coordinators.

As a member of the management group within the Human Resources department, the Manager, Salary Administration will participate in decisions which affect the members of the department as well as plan for its future directions and activities. Although the Manager's specific expertise is in Salary Administration, she/he will participate fully in all issues affecting Staff Relations at the Organization of Waterloo.

Because the Staff Relations Group is a group which exists to provide a comprehensive Human Resource service to the Organization Community, its members are fully versed in all staff relations issues. The Manager, Salary Administration must be able to operate effectively within both the Salary Administration and Staff and Labour Relations functions and provide leadership to the Staff Relations Group which is both specialized and informed in all aspects of the Staff Relations service.

The Staff Relations Coordinators are responsible for the activities associated with recruitment, compensation, staff and management counselling, union contract administration and initial handling of both official and non- official grievances. These activities are provided to each department on a client basis with each Coordinator assigned to provide all services to a number of individual departments and faculties. The Manager also provides these services to a limited number of clients although the "client load" is much smaller.

As a part of their responsibility for compensation, the Coordinators review and evaluate new and existing staff positions to ensure they are appropriately graded and are consistent with like positions across campus. The role of the Manager is to provide direction and advice to the Coordinators in their day to day activities particularly as they relate to salary administration and to monitor the services which this group provides to the community.

Using the Hay evaluation tool, the Coordinators, rely on the advice and guidance of the Manager, Salary Administration to maintain the consistency and integrity of the staff salary administration program for the Organization and in maintaining internal equity in the system as mandated by the Provost's Advisory Committee on Staff Compensation.

The Compensation Analyst is responsible for the evaluation of new positions and the re-evaluation of existing Organization staff positions through the use of the Hay evaluation tool. This role supplements the salary administration work being done by the Staff Relations Coordinators who, in addition to their responsibilities for recruitment, staff counselling and training and development, also review reclassification requests from their respective client areas.

The Manager, Salary Administration is also responsible for providing wage and salary support by conducting and responding to surveys, data collection and analysis, the development of statistical reports and research into new developments in methods of compensation. Also included is researching best practices information relevant to human resource initiatives in support of both the Human Resources Department's and the Organization of Waterloo's mission. This may involve library research, conducting interviews with local and organization employers as well as contact with service providers such as insurance companies and the development of presentation materials.

The Human Resources Department Assistant provides secretarial support to the Staff Relations Coordinators as well as providing a reception function for the entire department. The Department Assistant is responsible for the flow of work in the recruitment process from the preparation and advertisement of all internal and external ads to internal Budget and Office of Research approvals. In addition, the Manager, Salary Administration is responsible for the distribution and tracking of all applications to specific positions providing the Staff Relations Coordinators with candidate's resumes and/or files. The Human Resources Department Assistant also assists the Coordinators with scheduling of appointments for employment interviews and generates reports on turnover and recruitment statistics for internal department use and provides a backup for position management on the HRMS database system.

This is a key position in that the Human Resources Department Assistant is often the first point of contact that the public has with the Organization of Waterloo. It is therefore important that the Manager, Salary Administration provides excellent customer service in a friendly, professional manner.

Finally, the Manager of Salary Administration is expected to provide advice and support to the Director, Staff and Labour Relations in all matters relating to staff relations, and salary administration, and to suggest creative and innovative methods for improving the workplace. To this end, it is essential that the Manager of Salary Administration maintain a current knowledge of the changing methods in Human Resources management practices and provide advice to the Director regarding suggestions for revisions or new directions in matters of salary administration and staff relations.

The Human Resources Assistant provides administrative assistance and support to both the Human Resources department as well as the Staff Training and Development Committee. This commitment is 50% FTE for each area. The Manager, Salary Administration monitors the budgets for both units, arranges for payment of all invoices, orders supplies, and manages the key control requirements.

Specifically for Human Resources, the Manager, Salary Administration maintains the department's petty cash fund, and liaisons with many departments on campus such as Graphics, Food Services, Finance within the scope of the position responsibilities.

In addition to the above, the Manager, Salary Administration is responsible for coordinating the annual 25 Year Club event which is regarded by Human Resources as one of the premier events of the year. This annual event attracts many existing and new members of the 25 year and 35 year clubs, consisting of both active and retired employees. The Manager, Salary Administration sits on a 25 Year Coordinating Committee and works in conjunction with Food Services, Central Stores, Athletics, Audio Visual and other key departments to ensure a enjoyable and efficiently run event.

The Manager, Salary Administration is also designated as the primary back up for the Human Resources Department Assistant and will manage the work flow of the main reception desk by providing coverage for vacations, illness and meetings.

Front desk responsibilities include greeting the public and providing basic Human Resources related information, receiving applications for employment, handling incoming telephone inquiries, mail and cheque distribution and processing the appropriate authorizations for new hires and promotions and transfers to and within the Organization community.

1. To ensure a consistently high quality of human resource services relating to compensation through the effective day to day management of the salary administration activities of the Staff Relations Group.
2. To provide a high quality salary administration service to the Organization through the effective supervision of job classifications, salary surveys, compensation issues and participation of the Compensation Committee.
3. To contribute to the maintenance of the Organization's positive staff relations climate through advice, counsel and policy interpretation to management regarding salary administration and staff relations issues.

1.3 COMPENSATION

Compensation includes direct and indirect monetary and non-monetary rewards given to employees on the basis of the value of the job, their personal contributions, and their performance. These rewards must meet both the organization's ability to pay and any governing legal regulations.

As per law, compensation is a pecuniary remedy that is awarded to an individual who has sustained an injury in order to replace the loss caused by said injury, such as workers' compensation. Wages paid to an employee or, generally, fees, salaries, or allowances. The payment a landowner is given to make up for the injury suffered as a result of the seizure, when the government through eminent domain takes his or her land.

Compensation basically is the act or state of compensating. The most well known form of compensation is Worker's compensation, which is a type of insurance, which offers compensation for workers who have been injured in the course of employment.

Though methods vary among jurisdictions, provision can be made for weekly payment in the for of wages, compensation for economic loss, reimbursement and payment of medical bills, general damages for pain and suffering and benefits payable to the family of the employee killed during work.

Cash benefits are recognized according to state formulas like utmost benefit level. These benefits are managed on a state level, mainly by the state department for labour. The laws of compensation are a characteristic of highly advanced industrial societies, put into practice after long and hard fought struggles made by trade unions.

Compensation has been an extremely important issue for both, the employer and employee. This is because money is a crucial incentive and directly or indirectly related with fulfillment of all human needs. Employees sell their hands and brain in order to fulfil their primary needs and employers hire them to achieve their organisational objectives. Therefore, the employer's and employee's perspectives vary on matters concerning compensation. From cost perspective alone, effective management of compensation becomes critical because of the total operating costs. Another perspective from employer's point of view is to assess its impact on wide range of employees' attitude, behaviours, and ultimately its effectiveness on organisation's success. Compensation directly influences key outcomes like job satisfaction, attraction, retention, performance, skill acquisition, co-operation, and flexibility, etc. While employer's objective is concerned with primarily productivity, the employee's emphasis may be on higher compensation to offset their increased cost of living and perhaps the price his skill will fetch in the competitive job market.

Compensation, therefore, remains one of the most strategic and important functions of human resource management. Over the years, compensation has become a complicated issue. Not only are the problems of internal equity and external parity important, but also the larger issues of the wider economy and society impinge on the problem of compensation. Therefore, students of management must develop a clear insight into the different facets of management of compensation, as also reward, so that they are able to appreciate the problem in its proper perspective.

Compensation is provided with basically two objectives – as a reward for the past services to the organisation and as stimulus to increase performance in future. The progressive organisations are utilizing compensation and rewards system as effective tools to develop, build and maintain "human capital" for competitive advantages by the following ways:

- Compensation can serve to attract qualified applicants to the organisation. Other things being equal, an organisation offering a higher level of pay can attract a larger number of qualified applicants than its competing units.
- Compensation helps to retain competent employees in the organisation. Although retaining competent workers is contingent on many factors, compensation policies help by maintaining a fair internal pay structure and by providing attractive benefits. Turnover is thus reduced, along with costs associated with recruiting, selecting, and training replacements.
- Compensation serves as an incentive to motivate employees to put forth their best efforts. Manufacturing and sales organisations, for example, use monetary incentives to attain higher levels of production or sales without hiring additional employees. When employees put forth their best efforts, average productivity of labour increases. With increased productivity, fewer employees are needed to achieve the same level of output. Thus, labour costs are reduced and organisational profitability is increased.

- Minimising the costs of compensation can also contribute to organisational effectiveness since compensation is a significant cost for most employers.

The objective of a compensation system is to create a system of rewards that is equitable to the employer and employee alike, so that the employee is attracted to the work and motivated to do a good job for the employer. Glueck (1978) cites Thomas Patten who suggests that in compensation policy, there are seven criteria for effectiveness. The compensation should be:

- ***Adequate:*** Minimum governmental, union, and managerial levels should be met.
- ***Equitable:*** Each person is paid fairly, in line with his or her effort, abilities, training, and so on.
- ***Balanced:*** Pay, benefits, and other rewards provide a reasonable total reward package.
- ***Cost effective:*** Pay is not excessive, considering what the enterprise can afford to pay.
- ***Secure:*** The employee's security needs relative to pay and the needs which pay satisfies are met.
- ***Incentive providing:*** Pay motivates effective and productive work.
- ***Acceptable to the employer:*** The employee understands the pay system and feels it is a reasonable system for the enterprise and himself.

1.3.1 Concept of Compensation

Compensation emphasizes on 'fair days pay' for fair days work. Generally, time is the basis for the payment. It is hourly, weekly, monthly, or yearly. If an employee works for more than the stipulated time, he gets overtime, and if he works less than the stipulated time, he is marked under time. In other words, the employer buys the time of the employees. It is simple and measurable.

Compensation is purely extrinsic - a 'quid-pro-quo' arrangement. It contains all forms of financial incomes and tangible services and benefits that an employee receives as part of the employment relationship. There are direct types of compensation and indirect types of compensation. It connotes cash compensation – base pay, dearness allowance, short-term incentives, long-term incentives (equity incentives) benefits and services, allowances, income-tax protection and devices meant for work-life protection. It also includes bonuses (attendance, shifts, supplements, and performance etc.). It also includes benefits like employer paid insurance and vacations. It is a danger money, dirt money. The perspective is the immediate focus – a trade off between pay and efforts.

Compensation refers to all forms of financial returns and tangible service and benefits employees receive as part of an employment relationship.

The term 'compensation' is used to mean employees' gross earnings in the form of financial rewards and benefits as part of employment relationship.

Compensation may also be viewed as (a) a system of rewards that motivates employees to perform, (b) a tool used by organisations to foster the values, culture and the behaviour they require, and (c) an instrument that enables organisations to achieve their business objectives.

Compensation is typically divided into direct and indirect components. The term 'direct compensation' is used to describe financial remuneration usually cash and includes such elements as basic pay, dearness allowance, overtime pay, shift allowance, incentive, bonus, profit-sharing bonus and commissions, etc. Indirect compensation or wage supplements or fringe benefits refer to such benefits as provident fund, pension scheme, medical and health insurance and sick leave and various other benefits and perks.

Check Your Progress 1

1. What are the criteria for effective compensation?

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2. Distinguish between direct and indirect compensation?

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1.3.2 System of Compensating

Monetary claims on goods and services are wages or salaries paid to an employee in the form of money or a form that is quickly and easily transferable to money at the discretion of the employee. As a medium of exchange, money enables an employee to purchase certain kinds and amounts of a wide variety of goods and services available in the market place. The actual kinds and quantity of purchase made depend on the individual mechanisms that motivate choice behaviour. Wages and salaries in the form of money may be subdivided further into payments earned and acquired at the present time and payments earned but not acquired until some future time-deferred payments.

In kind, claims are made on goods and services made available and paid for either totally or in some percentage by the employer. Employees often have little or no opportunity for immediate monetary gain from an in-kind payment. Many employer—provided in-kind payments, however, replace monetary payments of some amount of the employees' income should the employees obtain similar goods and services elsewhere. Organisations purchase these required and usually desired goods and services for their members to take advantage of (1) economics of scale available through group purchasing (2) the benefits available through tax laws and regulations, and (3) government laws requiring certain services.

The value of any in-kind payment to a specific employee depends directly on the employee's perception of its worth. Individual perception relates to a range of demographic characteristics (age, gender, marital status, education, number and age of dependents, length of service, level in the organisation, current wealth, other income), as well as to the physical and emotional state of the employee.

The total compensation package may be described in many ways, but the classification scheme used in this book is based on eight dimensions. Each dimension has a number of compensation components. Each component has a variety of features. Because of different features, one component may relate to more than one dimension. The structuring of features, component may relate to more than one dimension. The structuring of features, components, and dimensions into a compensation system is a job for the compensation specialist.

1.3.3 Compensation Dimensions

Pay for Work and Performance: Pay for work and performance includes money that is provided in the short-term (weekly, monthly, and annual bonuses/awards) and that permits employee to pay for and contract for the payment of desired goods and services. The amount of money payments provided to employees normally depends on specified job requirements; outputs that meet or exceed quantity, quality, or timeliness standards; innovations that might lead to improved productivity; dependability; loyalty; and some combination of these items. Typical components within this dimension are base pay, premiums and differentials, short-term bonuses, merit pay, and certain allowances.

Pay for Time not Worked: Over the years, the number of hours worked per week and the number of days worked per year have decreased. During the past 40 years, workers have enjoyed more days off with pay for holidays, longer paid vacations, and paid time off for a wide variety of personal reasons. These components of pay for time not worked significantly increase labour costs and also enhance quality-of-work-life opportunities for most employees.

Disability Income Continuation: The possibility always exists that a worker will incur health or accident disability. Because of these disabilities, employees are frequently unable to perform their normal assignments. Even so, individual and family living expenses continue, and medical, hospital, and surgical bills create additional burdens. Social security, workers' compensation, sick leave, and short and long-term disability plans are examples of components that provide funds for employees who are unable to work for health-related reasons.

Differed Income: Various kinds of programmes, such as social security, employer-provided pension plans, savings and thrift plans, annuities, and supplemental income plans provide income after retirement. Tax laws and regulations make deferred income plans more appealing to many employees. Because of tax regulations, employers can often take immediate deductions and employees can defer tax obligations until income tax rates are possibly more favourable. In addition, funds invested in many of these deferred plans draw tax-free interest, significantly increasing the amount of money available upon retirement. Stock purchase, option, and grant plans are components commonly used to achieve tax deduction, estate building, and deferral goals.

Spouse (Family) Income Continuation: Most employees with family obligations are concerned with what might happen if they are no longer able to provide money that will allow their families to maintain a particular standard of living. Certain plans are designed to provide dependents with income when an employee dies or is unable to work because of total and permanent disability. Specific features within Life Insurance plans, Pension plans, social security, workers' compensation, and other related plans provide income for the families of employees when these conditions arise.

Health, Accident and Liability Protection: When a health problem occurs, employees must be concerned not only with income continuation, but also with payment for the goods and services required in overcoming the illness or disability. Organisations provide a wide variety of Insurance plans to assist in paying for these goods and services. In recent years, the cost of medical-related goods and services has increased at a greater rate than almost any other goods or services desired or required by the employees.

Income Equivalent Payments: A final set of compensation components may be grouped under the title of income equivalent payments. Many of these components are frequently called perquisites', or "perks". Employees usually find them highly desirable, and both employers and employees find certain tax benefits in them. Some perks are tax free to employees and tax deductible to employers. In recent years, the Internal Revenue Service (IRS) has required that employer costs for a specific portion of certain perks be considered earned income to employees. In most cases when this occurs, the earned income charge to employees is significantly less than the amount employees would have been required to pay if they had purchased the goods or services in the market place. Some of the more desirable perks are the use of a company car or a company credit card, payment for expenses to professional meetings, subsidized food services, and child care services.

Organisations Develop Compensation Policy: The compensation system hinges on sound principles of compensation administration. Some of them are as under:

D.S. Beach in his book, 'The Management of People at Work' provides seven principles of compensation administration.

1. The enterprise should have a clear-cut plan to determine differential pay level in terms of divergent job requirements involving varied skill, effort, and responsibility and working conditions.
2. An attempt should be made to keep the general level of wages and salaries of the enterprise in line with that obtained in the labour market or industry.
3. Adequate care should be taken to distinguish people from the jobs.
4. Irrespective of individual considerations, care should be taken to ensure equal pay for equal work depending upon flexibility of jobs – of course, variations may be permitted within a pay range.
5. There should be a plan to adapt equitable measure for recognizing individual differences in ability and contribution.
6. Attempt should be made to provide some procedure for handling wage grievances.
7. Adequate care should be taken to inform the employees and the union, if any, about the procedure followed in determining wage rates.

Methods of Payment

Compensation is the price of labour hence it has to be in harmony with other price systems in the economy.

You may compensate your employees on the basis of time rate system, payment by results or measured day work. Let us look at each of these systems.

1. ***Time Rate System:*** Under this system the employees are simply paid a predetermined rate per week, or hour for the actual time they have worked. The basic rate for the job can be fixed by negotiation, by reference to local rates, or by job evaluation. This system is prevalent in the engineering and processing industries and among clerical, supervisory and managerial personnel where there is no rigid standardization of work, and a certain amount of skill is involved. Within the time paid for, a minimum standard of performance is expected.

   From the point of view of employees, the advantages of time rates are that earnings are predictable and steady. Moreover, they need not argue with supervision and rate-fixers about piece rate or time allowances.

   The disadvantage of time rates is that they do not provide the motivation of a direct incentive relating the reward to the effort. You can overcome this problem of incentive by adopting a system of measured day work. Alternatively, you may also use some form of merit award. Merit awards may be in the form of additions to the base rate of so much per hour, usually with an upper limit. They may be awarded on the basis of the purely subjective judgement of a superior, or determined by reference to systematic merit assessment procedures which will review the workers' performance in terms of output, skill, versatility of organisation time keeping.

2. ***Payment by Results System:*** Under this system, the pay or part of the pay is related to the number of items a worker produces or the time he takes to do a certain amount of work. It is applicable to simple manual operations, where the effort of an individual can be measured in terms of quantity or quality. This may be through a straight piecework or a differential piecework system.

   (i) *Straight Piecework:* It is payment of a uniform price per unit of production. This is most appropriate where production is repetitive in character and can easily be divided into similar units. In this system, you can pay a worker a flat money price for each piece or operation completed (money piecework), or you can pay him for the time allowed to complete a task (time piecework). In the latter case, if the worker completes the job in less than the allowed time he gains the advantage of time saved.

   (ii) *Differential Piecework:* Systems allow you to adjust wage cost per unit in relation to output. In this system, the wages cost per unit of production falls as output increases. At the same time the hourly rate of workers' earnings still increases, although not in proportion to the increased output. This system is possible where it is early to relate effort to production and the work is standardized, repetitive and measurable. You should keep quality in mind while adopting the piece rate system.

3. ***Measured Day Work:*** In this system, the pay of the employee is fixed on the understanding that he will maintain a specified level of performance. The pay does not fluctuate in the short-term with performance. You can define the required level of performance and monitor the actual level with the help of work measurement methods. What distinguishes this system from the time rate system is the concept of an incentive level of performance. You are putting the employee under an obligation to perform at the effort level required by the guaranteeing the incentive payment in advance.

   Measured day work offers enhanced earnings in exchange for an incentive level of performance.

Peffer (1998) lists six dangerous myths about compensation:

- Labour costs and labour rates are the same thing. They are not. Labour rates are straight wages divided by time. Labour costs are a calculation of how much a company pays.
- You can lower your labour costs by cutting labour rates. Not necessarily. One must address productivity, not wage rates. Decreasing wage rates may increase wage costs.
- Labour costs constitute a significant proportion of total costs. This is true sometimes. Labour costs very widely by industry and company.
- Low labour costs are a potent and sustainable competitive weapon. Even if it is, it is not sustainable.

- Individual incentive pay, in reality, undermines performance of both the individual and the organisation. It might undermine teamwork. Pay is not often related to performance.
- People work for money. But they work even more for meaning in their lives.

Check Your Progress 2

Describe in brief, the time rate system of employee's compensation.

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1.4 NON-FINANCIAL COMPENSATION SYSTEM

Non-financial compensation rewards are all situation-related rewards not included in the compensation package. These rewards have an almost-infinite number of components that relate to the work situation and to the physical and psychological well-being of each worker. In fact, any activity that has an impact on the intellectual, emotional, and physical well-being of the employee and is not specifically covered by the compensation system is part of the non-compensation reward system.

The non-compensation system contains many of the reward components that behavioural scientists have been describing for the past 50 years as critical for improving workplace performance. An in-depth analysis of the seven non-compensation dimensions have been identified in a close interrelation between compensation and non-compensation rewards. The line between these two major reward categories might at first glance appear to be sharply defined, but it soon blurs as they interact and blend together.

Enhance Dignity and Satisfaction from Work Performed: Possibly the least costly and one of the most powerful rewards an organisation can offer to an employee is to recognize the person as a useful and valuable contributor. This kind of recognition leads to employee's feelings of self-worth and pride in making a contribution. Few people simply want to be given something. They would much prefer to know that through their own efforts, they have earned and deserved rewards. Every compensation and non-compensation reward component should carry with it the message, "we need you and appreciate your efforts."

Enhance Physiological Health, Intellectual Growth and Emotional Maturity: Considering the number of hours a person spends on the job, on travel to and from the work site, and off the job in attempting to resolve job-related problems frequently receive minimal attention until a serious problem occurs. Once this happens, however, it overrides all other employee concerns and activities. Modern health practices recognize the direct relationship between the physiological health and intellectual and emotional well-being of each individual.

Promote Constructive Social Relationships with Co-workers: An old adage states that "One man is no man." Although there are constant reminders of what one dedicated person can achieve, there are even more reminders that one human alone is weak. However, with concerted action, people can accomplish almost anything. In this world of extreme specialization, people need and rely on other people more than ever. One of the most valued rewards gained from working is the opportunity to interact in a socially constructive manner with other people, to enjoy the comradeship of work-place associates.

Design Jobs that Require Adequate Attention and Effort: Over the past 40 years, organisational scientists have discussed at length the problems arising from boredom related to work assignments that were developed in the last quarter of the nineteenth century. Jobs were designed so that workers could be taught quickly how to perform a few highly repetitive tasks. Workers then were required to perform these few tasks for as long as they remained on the job. What first appeared to be an efficient way of melding human resources with machine technology proved to have serious drawbacks.

Allocate Sufficient Resources to Perform Work Assignments: Requiring employees to perform assignments for which they have neither the knowledge nor the skills, opens the door to problems. Not only is the organisation likely to suffer because of outcome failures, but employee job-related interest and satisfaction are apt to break down because of the likelihood or inevitability of failure. Most employees seek a sense of accomplishment from their work. They want some degree of challenge, but they also want to feel reasonably sure that they can succeed.

Grant Sufficient Control over the Jobs to Meet Personal Demands: From the 1950s to the present time, behavioural scientists have discussed the need to grant employees greater opportunity to participate in organisational decision-making processes. One problem with this participation concept is that organisations are composed of all types of people with all kinds of decision-making desires. Some people simply want to be told what to do, to be shown what is an acceptable level of performance, and then to be left alone to do their jobs. A few people in every organisation want to tell top management how to run the organisation. Between these two extremes is a wide variety of demands for a greater voice in determining how to perform assignments.

Offer Supportive Leadership and Management: This dimension is difficult to separate from all other non-compensation rewards, but it is so important that it must be recognized as a unique dimension of the non-compensation rewards and not just a component of the other factors.

1.5 NEW TRENDS IN COMPENSATION MANAGEMENT

1. In the contemporary environment characterized by, among others, (a) globalization, (b) disinvestment and privatisation, (c) liberalization, (d) recession in business, (e) (employer) shift from a sellers' market to a buyers' or customer-oriented market, (f) focus on quality, (g) changes in tax policy, (h) stakeholders' expectations, and (i) fast changes in technology, the traditional incentive schemes linked to physical productivity or its parameters such as capacity utilization and material utilization are on the wane. The trend appears to be towards adopting Economic Value Added (EVA) as a measure of organisational and group performance and using it to determine the quantum of performance-based bonus for employees. Individual employees can get their share on the basis of KPA-based performance measurement. In this way, individual, group and company performance, linked to organisational strategy, determines the quantum organisation incentive bonus.

2. The incentive value of fringe benefits needs to be reviewed in the light of tax policies. Tax saving through tax planning, specially in fringe benefits is possible and can enhance the incentive value. An employee's fringe benefits, for instance, includes attendant allowance, welfare allowance, conveyance reimbursement, academic pursuance allowance, gift vouchers up to Rs. 5,000, and car washing for senior executives. A detailed exercise needs to be carried out on the tax provisions vis-à-vis fringe benefits to enhance their monetary value to the employees.

3. For the effectiveness of incentives, a change in work culture is necessary. Organisations should identify the extent of the gap between the present and desired work culture and work out policies and practices for reducing the gap. This can be done through a diagnostic exercise with professional help, if necessary.
4. An organisation should adopt a package of monetary and non-monetary incentives based on the motivational needs profile of its employees. A diagnostic exercise can be carried out to determine the motivational needs profile and the relative strength of different motivational needs. The data thus generated may be used to evolve reward policies and determine a package of monetary and non-monetary incentives within the boundaries of the wage and salary system.
5. Some of the non-monetary incentives in the offing are:
   - Gift voucher
   - Citation
   - Dinner with the Chief Executive Officer (CEO)
   - Quality award
   - Timeliness award
   - Best R&D technique award
   - Sportsman of the year award
   - Good health award
   - Long service award
   - Creativity award
6. There is a need to excel in the fiercely competitive current environment. In this context, the Excel Award Scheme of Bharat Heavy Electricals Ltd. and its experience in implementing it could be used as a benchmark by organisations for evolving and devising their own award schemes for excellence.

   Measurement of performance of individual executives based on KPAs linked to Memorandum of Understanding (MoU) parameters may be used as a basis for designing a performance-linked incentive scheme for the individual executives. The performance bonus could be given in cash or ESOPs or in a combination of the two. EVA was, however, perceived as a better measure of organisational performance than the current MoU parameters. EVA has unlimited potential for earnings, since the additional performance-linked earnings are funded through the value generated by the employees. Also, EVA reflects the true picture of a company's value addition.
7. Variable pay or performance-linked incentive should comprise a sizeable part of the compensation package. Variable pay should be linked to KPAs/EVA.
8. Where possible, a cafeteria approach for compensation to the employees may be adopted, within the framework of the wage and salary structure of the organisation.
9. The new compensation strategy should be external market-sensitive based pay and not internal alignments.
10. It should be variable performance-based pay and not annual increments.
11. It should be risk-sharing partnership and not entitlement.
12. It should provide flexible opportunity to contribute, and not tied to a fixed job.

13. It should provide for lateral promotions and not career parts.
14. It should ensure employability and not job security or pay security.
15. It should encourage team working and not individual working.

Table 1.1: Best Practices Options

The New Pay*	High Commitment**
• External market-sensitive based pay, not internal consistency • Variable performance-based pay, not annual increases • Risk-sharing partnership, not entitlement • Flexible opportunities to contribute, not jobs • Lateral promotions, not career path • Employability, not job security • Teams, not individual contributors	• High wages: You get what you pay for • Apply incentives; share gains, not risks employee ownership • Participation and empowerment • Teams, not individuals, are base units • Smaller pay differences • Promotion from within • Selective recruiting • Enterprise wide information sharing • Training, cross-training and skill development are crucial • Symbolic egalitarianism adds value • Long-term perspective matter • Measurement matters

**Source:* J.R. Schuster, The New Pay: E. LAWLER, New Pay

***Source:* Peffer, Competitive Advantage through People.

This new system of compensation works on a very simple premise - "If you measure it, people will do it. If you measure it and pay for it, people will do it in spades. If what you measure matches corporate goals and strategies, the company will be successful." This points to designing appropriate reward programmes linked to performance.

Charles Handy - *"The new organisation equation for success is that profit and productivity are best created by half of the workforce, paid twice as well and producing three times as much."* This can be achieved through performance linked incentive and reward system.

The new concept of compensation emphasizes on high payment to attract, retain and motivate high talents. If you pay peanuts, you can get only monkeys. You get the employee what you pay for.

1.5.1 The 3-P Compensation Concept

The concept of paying for the 3 P's consists of three parameters that are considered by the management of any organisation while deciding the salary as well as the incentives of employees. It is to pay for the Position, the Person and the Performance.

Pay for Position

The focus of the compensation policy translated into the width of the grade, in relation to Pay for Position. The width of the grade is the degree to which jobs of different size are included in the same grade. Therefore, a wide grade, in effect, reduces the emphasis on Position since many jobs of varying job sizes are encompassed in the same grade. In such instances, other factors, such as person's capabilities or competency (i.e. Pay for Person) or an individual's achievement of objectives (i.e. Pay for Performance) will have a much greater impact on the total pay level than the grade level. Broad-banding is an example of this type of approach. By contrast, narrow grades emphasis positions since a small increase in responsibility would lead to a promotion and an increase in grade. A grade width not only determines the overall importance of Position to pay but also can be used to vary the emphasis of the three pay elements-position, person, and performance at different levels of the organisation.

Creating a grading structure: The ranking of positions as a result of position evaluation can be concerted into grades based on the unique requirements of each organisation. This process is called the Internal Position Evaluation (IPE). These grades are created from IPE by answering three questions: One, how many employee groups are there in the organisation? Two, how many levels are there within each employee group? Three, how many levels are there within each employee group? The entire organisation is first divided into broad classifications depending on designations or levels. Consistent policies are then designed for each of the groups.

Pay for Person

The second P in this model is the “Person”- considered one of the hardest and most subjective part of compensation management. Pay for Person takes into account, a person’s capabilities and experience in setting a pay level that is both equitable and competitive. It also considers the market demand of a person’s unique skills and experience. Pay for Person is most commonly associated with “competency-based pay”. However, it also incorporates a market-based pay approach.

The starting point for this approach is the position. An individual’s assessment looks at the person’s capabilities and experience relative to the position requirements. Thus, the first step in Person for Pay is to determine the position requirements for competencies and experience. This “position competency profile” lays out the experience and competencies (aptitudes, attitudes, skills, and knowledge) that the organisation ideally wants in a person for a given position.

Organisations should be looking for a process that assesses position and people against the same competency criteria within the framework of the organisation’s philosophy, image, value, and identity. The 3-P competency profiling forms and process are designed to ensure that competencies are carefully identified, defined and weighted for the specific culture and need of the organisation. Each position and person has their own profile, which enables the organisation to match positions and persons against each other.

The linchpin between Pay for Positions and pay for Person is the Reference salary which is a set based on the market-competitive pay for someone who fulfils the position’s requirements for competency and experience. In the 3-P system, the actual salary varies relative to the Reference Salary based on the Position/Person ratio and the number of years that the individual has been in the position. Each grade has its own range of Person for Pay. The minimum pay for each grade is based on the minimum competency acceptable for the position and the corresponding market pay level required to attract a person with that level of competency. On the other hand, the maximum pay for the range of each grade is close to the Reference Salary the logic being that an organisation should pay for only those competencies required to fulfil a position’s responsibility.

Table 1.2: Who Gets What

	Position/Person Ratio	Pay for Person	Titling	Training	Development
Maximum	The person demonstrates unique capabilities for the selected criteria.	Pay slightly above the reference salary until promotion	Senior title (for example, senior engineer).	Enrich & broaden the scope capabilities.	Explore promotion options.
Meets Requirement	The person demonstrates the necessary level of competency for the selected criteria.	Pay at or near reference salary Pay below Reference salary but, increasingly closer. Based on position/ person Ratio.	Generic title (for example, engineer).	Focus on new training. Develop capabilities upto position requirements.	Guide into new development plans. Identify hidden talents and potential.
Minimum	The person demonstrates a need to improve in some or all selected criteria.	Pay at lower end of person pay range.		Train in areas that are far below position requirements.	

The Position/Person profile and ratio provides a basis not just to evaluate the Pay for Person (i.e the actual salary) but also provides guidance in titling, training, and development. An organisation can set the titles within a grade based on the person's competencies relative to the position requirements. Companies can arrange training for the person based on the areas where the person's competencies have fallen short of the position requirement and determine the person's development plans and potential for promotion based on a simulation of profile.

Pay for Person may also include a market premium in case the competencies related to the position are rare and under market pressure. Usually market pressure is temporary since over time, supply & demand equalizes pay levels for jobs of the same size. Thus, market premiums should be paid separately from salary and adjusted up or down based on changes in market conditions. In the present day market scenario, it is the skills and the talents that matters the most. Companies are paying the least attention towards the sky-rocketing remunerations of the deserving employees. IIM graduated drawing astronomical packages and breaking their own records year after year are perhaps the biggest example of this.

There are two exceptions that may warrant a permanent premium incorporated into the Pay for Person. These include permanent shortages of skills, capabilities competencies and experience linked to a specific individual. Permanent shortages of skills and capabilities are usually due to controlled and limited supply. This may be the case when a qualification is required to assume a position and the qualifications are limited regardless of demand. This can happen for positions such as doctors, lawyers, actuaries and certified public accountants. In these cases, an organisation may pay position holders a salary that incorporates a permanent premium over other jobs in the same grade.

At senior levels within an organisation, an individual may possess specific experience and capabilities that uniquely qualify that person for the position. In such cases, an organisation may be willing to pay far above the market to secure and retain the individual.

Pay for Performance

The third prefers to Pay for Performance. In 3-P compensation management, the performance of the individual is not the only consideration in setting the salary or granting a salary increase. The logic is that since performance is variable and fluctuates from year to year, so should performance pay be variable and fluctuate from year to year. Granting a salary increase based on one year's performance is equivalent to repeatedly paying a bonus year after year for performance delivered in a single year.

In this new form, an individual's performance is managed through a "performance contract" which comprises the clarification of the role, the setting of objectives, and the review of performance. As an outcome of the performance contract process, a measure of performance at the corporate, unit and individual level becomes the basis for setting the performance pay.

The purpose of Pay for Performance is to define all incentive schemes – short-term or long-term and efficiently reward the employee's contribution to its immediate and long-term results. An efficient scheme implies that it includes agreed-upon, challenging, and realistic targets, that it motivates the employee by linking targets to sizeable rewards, and that it openly and clearly recognizes the employee's contribution.

The management chooses from all possibilities one or several types of plans that are in line with the organisation's activities, the types of objectives assigned to the employees, and the corporate culture. Rules of eligibility should then be established for each plan. It is very important to remember that for whatever plan each category of employee is eligible, the total amount of possible rewards should be equitable from one person to another. In other words, a similar performance evaluation should bear similar amounts or value of rewards, even if the nature of the incentive plan is different. Finally, in assessing who should be eligible for what plan, it is useful to remember how each plan is funded.

Check Your Progress 3

What do you understand by the 3Ps compensation concept?

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1.6 WAGE DETERMINATION PROCESS

A "wage determination" is the listing of wage rates and fringe benefit rates for each classification of laborers and mechanics, which the Administrator of the Wage and Hour Division of the Department of Labor has determined to be prevailing in a given area for a particular type of construction (e.g., building, heavy, highway, or residential).

The Wage and Hour Division issues two types of wage determinations: general determinations, also known as area determinations, and project determinations. The term "wage determination" is defined as including not only the original decision but any subsequent decisions modifying, superseding, correcting, or otherwise changing the rates and scope of the original decision.

1.6.1 General Wage Determinations

General wage determinations reflects those rates determined by the division to be prevailing in a specific geographic area for the type of construction described. General wage decisions and modifications and supersedeas decisions thereto, contain no expiration dates and are effective from their date of notice in the Federal Register, or on the date written notice is received by the agency, whichever is earlier. If a contracting agency has a proposed construction project to which a general determination would be applicable, the published determination may be used by the contracting agency without consulting the Department of Labor, provided that questions concerning its use shall be referred to the Department of Labor.

Project wage determinations are issued at the specific request of a contracting agency; each is applicable to the named project only; and expires 180 calendar days from the date of issuance unless an extension of the expiration date is requested by the agency and approved by the Wage and Hour Division. If such a determination is not used in the period of its effectiveness, it is void. Project determinations are issued in response to contracting agencies submitting to the Wage and Hour Division a Standard Form 308 requesting a wage determination.

Modifications of general and project wage determinations are issued to update data in the original determination. Where a contract will be entered pursuant to competitive bidding procedures, a modification, notice of which is published in the Federal Register less than 10 days before the opening of bids shall be effective unless the agency finds that there is not a reasonable time still available before bid opening to notify bidders of the modification and a report of the finding is inserted in the contract file. (For projects assisted under the National Housing Act, and for projects to receive housing assistance payments under section 8 of the U.S. Housing Act of 1937, dates other than bid opening apply. If the contracting officer chooses to disregard a modification, a report of this action shall be inserted in the contract file and made available to the Wage and Hour Division upon request.

If a contract has not been awarded within 90 days after bid opening, modifications prior to award to a general wage determination in the contract shall be effective with respect to that contract unless the agency requests and obtains an extension of the 90-day period from the Wage and Hour Division.

1.6.2 Supersedeas Wage Determinations

Supersedeas Wage Determinations are issued annually to replace general decisions issued in the previous edition of the publication entitled General Wage Determinations Issued Under the Davis-Bacon and Related Acts. Supersedeas project wage determinations may also be issued. Supersedeas decisions affecting determinations are effective under the same circumstances as "modifications." Whereas a modification to a wage determination may make changes in only selected provisions of the wage determination, a supersedeas determination replaces the entire existing wage decision.

Notice is published in the Federal Register each week (usually on Friday) to advise the public of the publication of general wage determinations, modifications, supersedeas actions, withdrawal actions, and corrections affecting such wage determinations.

1.6.3 Extensions of Wage Determinations

When a general wage determination has not been awarded within 90 days after bid opening, the head of the contracting/assisting agency may request an extension of the 90 day period from the Wage and Hour Administrator. When, due to unavoidable circumstances, a project wage determination expires before award but after bid opening, the head of the contracting/assisting agency may request an extension of the expiration date of the project wage determination in the bid specifications instead of issuing a new wage determination. (For projects assisted under the National Housing Act, and for projects to receive housing assistance payment under Section 8 of the U.S. Housing Act of 1937, dates other than bid opening apply.

Extension requests should be supported by a written finding including a brief statement of the factual support, that extension of the expiration date of the determination is necessary and proper in the public interest to prevent injustice or undue hardship or to avoid serious impairment in the conduct of Government business.

The Administrator will either grant or deny the request for an extension after consideration of all the circumstances, including an examination to determine if the previously issued rates remain prevailing. If a request for the extension of a project wage determination is denied, a new wage determination will be issued to replace an expired project wage determination.

1.6.4 How to Interpret General Wage Determinations

A. ***Wage Determinations are Structured according to the following format:*** Each wage determination begins with a cover sheet that defines its applicability. Included on this sheet are:

- The decision number.
- The number of the decision superseded, if applicable.
- State(s) covered.
- Type of construction (building, heavy, highway, and/or residential).
- County(ies) or city(ies) covered.
- Description of the construction to which the wage determination applies and/or construction excluded from its application.
- Record of modifications, including the initial publication date, modification numbers and dates.

In the body of each wage determination is the listing of classifications (laborers and mechanics) and accompanying basic hourly wage rates and fringe benefit rates that have been determined to be prevailing for the specified type(s) of construction in the geographic area(s) covered by the wage determination. Classification listings may also include classification groupings, fringe benefit footnotes, descriptions of the geographic areas to which subclassifications and different wage rates apply, and/or certain classification definitions.

In wage determination modifications, an **asterisk ("*")** is used to indicate that the item marked is changed by that modification.

The wage determination appeals process is explained at the end of the wage determination. The explanation includes a description of the criteria for appeal and where to file the appeal.

The last page of each wage determination ends with "END OF DECISION" centered above the last page number for the determination. Users can refer to the page number at the bottom of that page to check back to be sure that they have all the preceding pages of the determination.

B. ***How to find the Wage Rate for a particular classification and understand the Basis for the Wage Rate:***

Review the wage determination in light of the following information:

1. The body of each wage determination lists the classifications and wage rates that have been found prevailing for the cited type(s) of construction in the area covered by the wage determination.

The classifications are listed in alphabetical order of "identifiers" that indicate whether particular rates are union or non-union rates.

Many wage determinations contain only non-union wage rates, some contain only union-negotiated wage rates, and others contain both union and non-union wage rates that have been found prevailing in the area for the type of construction covered by the wage determination.

Determination of an equitable wage and salary structure is one of the most important phases of employer-employee relations.

For good industrial relations, each employee should:

1. Receive sufficient wages and salaries to sustain himself and his dependents.
2. Feel satisfied with a relationship between his wages and wages of other people performing the same type of work in some other organization.

The primary objective of wage and salary administration program is that each employee should be equitably compensated for the services rendered by him to the enterprise on the basis of:

- The nature of the job.
- The present worth of that type of job.
- The effectiveness with which the individual performs the job.

Usually, the steps involved in determining wage rates are: performing job analysis, wage surveys, analysis of relevant organizational problems forming wage structure, framing rules of wage administration, explaining these to employees, assigning grades and price to each job and paying the guaranteed wage.

Results in job descriptions which lead to job specifications. A job analysis describes the duties, responsibilities, working conditions and inter-relationships between the job as it is and the other jobs with which it is associated.

It attempts to, record and analyze details concerning the training, skills, required efforts, qualifications, abilities, experience, and responsibilities expected of an employee. After determining the job specifications, the actual process of grading, rating or evaluating the job specifications, the actual process of grading, rating or evaluating the job occurs.

A job is rated in order to determine its value relative to all the other jobs in the organization which are subject to evaluation. The next step is that of providing the job with a price. This involves converting the relative job values into specific monetary values or translating the job classes into rate ranges.

1.6.5 Wage Surveys

Once the relative worth of jobs has been determined by job evaluation, the actual amounts to be paid must be determined. This is done by making wage or salary surveys in the area concerned.

Such surveys seek to answer questions like what are other firms paying?

What are they doing by way of social insurance?

What is the level of pay offered by other firms for similar occupations? etc, by gathering information about 'benchmark jobs', which are usually known as good indicators. There are various ways to make such a survey. Most firms either use the results of "packaged surveys" available from the research bodies, employer's associations, Government Labour Bureaus, etc., or they participate in wage surveys and receive copies of results, or else they conduct their own.

These surveys may be carried out by Mailed questionnaire, telephone, or personal interviews with other managers and personnel Agencies. A wage survey to be useful, must satisfy these points:

a. ***Frequency:*** Affected by rapidity of changes, current and contemplated. Once per year is common.

b. ***Scope:*** (number of firms) Influenced by the geographic area from which people are drawn, the number of units competing for this labor, accuracy requirements, and willingness of organizations to share information.

c. ***Accuracy:*** The diversity in job titles and specific job duties is staggering. The greater the accuracy and detail needed, the greater the requirements for careful description and specification and surveyor's reliance on person-to-person 'interviewing rather than mailed questionnaires.

Such wage surveys provide many kinds of useful information about differences in wage levels for particular kinds of occupations. This can have a great influence on an organization's compensation policy.

In addition to the results of job analysis and wage surveys, several other variables have to be given due consideration in establishing wage structure. For example, whether there exists well-established and well accepted relationships among certain jobs which can upset job evaluation, whether the organization would recruit new employees after revised wage structure; are the prevailing rates in industry or community inconsistent with the results of job evaluation?

What will be the result of paying lower or higher compensation; and what should be the relationship between the wage structure and the fringe benefit structure? Belcher has listed 108 variables which can affect levels of compensation and the wage structure.

1.6.6 Preparation of Wage Structure

The next step is to determine the wage structure. For this, several decisions need be taken, such as:

a. whether the organization wishes, or is able, to pay amounts above, below, or equal to the average in the community or industry;

b. whether wage ranges should provide for merit increases or whether there should be single rates;

c. the number and width of the 'pay grades' and the extent of overlap;

d. which jobs are to be placed in each of the pay grades;

e. the actual money value to be as signed to various pay grades.

f. differentials between pay plans; and

g. what to do with salaries that are out of line once these decisions have been made.

There are though no hard and fast rules for making such decisions, and procedure commonly used is the two dimensional graph on which job evaluation points for key jobs are plotted against actual amounts paid or against desired levels. Plotting the remaining jobs then reveals which jobs seem to be improperly paid with respect to the key jobs and to each other.

The 'wage curve' shows the relationship between:

i. the "value" of the job; and

ii. the "average wage rates" of these grades (or jobs).

The following steps are involved in drawing a wage curve:

1. Finding out the average pay rate for each pay grade, for each pay grade may have several jobs and chances are that each of these jobs is currently being paid a different rate.

2. Plotting the wage rate for each pay grade.

3. Drawing "Wage Lines" through the points plotted. These lines may be straight or curved; if the pay grade comprise a single job cluster, a straight line is usually employed.

4. ***Pricing jobs:*** Wages along the "wage line" are target wages or salary rates for the jobs in each pay grade. It is possible that some of the plotted points may fall off the wage line.

This will mean that average for that grade is too high (or too low), given the pay rates for other grade. If the plot falls below the line, raises for jobs in this pay grade may be required. Such a raise may be given either immediately or in one or two steps. If the plot falls above the wage line, that indicates rates are high and the over paid employees are often called "red circle," "flagged," or "overrates." This will necessitate either:

i. To freeze the rate paid until general salary increases bring the other jobs into line with it, or

ii. To transfer or promote the employee to a job where -he can legitimately be paid his current rate; or

iii. To cut to the maximum in the pay grade. It is a standard practice to establish 'pay grades' or equal width or 'point spread,' i.e., each grade might include all those jobs falling between 50 to 100 points, 100 to 150 points, 150 to 200 points, and so forth. Since each grade is of the same width, it is necessary to determine how many grades there should be. In an industry, the number varies from as few as five to as high as thirty.

Two points need consideration when deciding the number of grades. They are mentioned below:

1. the size of the organization, i.e., if there are 1,000 jobs to be graded, more 'pay grades' will be needed, than where the jobs are few, say 100.

2. the broadness of the grades. For instance, in the case of hourly jobs, the maximum of individual pay grades may vary from 10 to 20% above the minimums; while in case of salaried employees the maximum of pay grades may vary from 15 to 75% above the minimum.

Some authorities feel that there should be only one comprehensive 'pay grade' for each organization. But it is probably more realistic to have several pay grades/ranges Several wage structures are developed - one for each type of job or "job cluster Certain job clusters may be more closely related to some rather than to other clusters. In this sense, clerical rates as a whole may be closely related to other clerical rates than to managerial or factory rates.

While determining pay ranges the following consideration should be Attended to:

1. It is important to keep in mind that there is an adequate differential, between superiors and subordinates - whether they are paid under the same pay plan or under different ones.

2. When the pay-range of one group is changed, equal attention must be given to the pay-level of the other.

3. Because of the continuous rise in wage and salary levels, a rise resulting from a variety of environmental pressures, considerable attention must be given to handling upward changes in wage-structure.

   Some firms give general percentage or "across the board" pay increases shortly after wage increases are negotiated. Others give increases based on merit or length of service. The sound thing is to make general adjustments in wage structure according to the price index number.

4. The existing pay structure should be regularly reviewed and revised. This will make job evaluation programme more acceptable to employees.

5. Regional differences in wages should invariably be maintained. Forces that favour regional differences are: low mobility; lower skill jobs; major cost of living differences between areas; added sources of income or characteristics (rural versus urban or industrial); seasonal occupations as in agriculture versus stable occupations.

   However, several forces work to level these differences. The forces that favour uniformity in wages are: High mobility between regions and/or employees; access to timely, reliable information, wide spread unionization efforts, (often along industry/ occupational lines).

Check Your Progress 4

What are the steps involved in determining wage rates?

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1.6.7 Rate Ranges

'Rate ranges' can be developed in various ways. The one usually adopted approach is to use the "Wage Curve." A maximum and minimum rate for each grade, such as 15% above and below the wage line, may be arbitrarily decided.

1.6.8 Setting of Rate Ranges

Lines may then be drawn on the curve; the 'range' may be allowed to become wider for the higher pay grades. This reflect the greater demands (and performance variability) inherent in jobs in these grades. Most organizations structure their rate range to overlap a bit. Thus, a person who has been on the job larger and is more experienced may earn more than a fresh employee in the next higher pay grade.

The major way in which organizations allow for factors other than the job to enter into the determination of an individual's pay is to develop a range of pay for each job or grade of jobs. A rate range is a range of pay determined by the organization to be appropriate for anyone who occupies a particular job.

A rate range consists of a minimum pay rate (the beginning hire rate), a midpoint (the market or job rate), and a maximum (the highest rate the organization is willing to pay for the job). Now let us study further single-rate wage systems, the rationale for rate ranges, two types of rate ranges, the manner in which a pay rate is set for individuals within a range, and the dimensions of range rates.

1.6.9 Single-Rate Wage Systems

Before discussing various aspects of rate ranges we should first consider situation in which there is no range. There a single rate is paid for the job and the individual receives just that rate. This pay rate is the market rate and may be paid to either a job or a pay grade.

If a job rate is used, the wage line provides the job rate. The individual is paid in accordance with the number of points assigned the job by the job evaluation system, by the competitive value discovered in a review, a salary survey, or by the competitive value provided by a research analysis product. Where the grade rate prevails, the individual is paid in accordance with the grade level assigned to the job.

This type of system is useful where performance variation and/or other personal characteristics are nonexistent or unimportant. Not all jobs allow for a significant difference in performance.

Dimensions of Ranges

Any wage structure has a number of rate ranges and pay grades. This number can be a matter of the policy of the organization. Small organizations tend to have a small number of pay grades accompanied by wide pay ranges, broad definition of job titles, a great deal of movement within pay grades, little overlap between grades and limited promotion to higher grades. Some organizations have many grades, which tends to create an opposite set of characteristics.

When examining pay ranges we can determine the total wage structure with the help of three characteristics: the breadth of the rate range, the number of pay grades and the overlap. If one knows the bottom and top of the wage structure, the slope of the pay line, and any two of the three characteristics just cited, the third will be determined.

Factors other than potential performance differences may also affect range breadth. Organizations that promote intentionally fast encourage narrow ranges, since people do not stay within one grade very long. A wide range is encouraged if adjustments need to be large to be noticed by employees.

Higher grade levels tend to have broader ranges for this reason. Broad ranges can accommodate a wide variety of jobs, as well as variable starting rates among jobs.

These broad ranges indicate that the process of determining the market rate is not a precise one.

Establishing range maximums is particularly difficult. There is some logical maximum value for any job, regardless of how well it is performed. Ideally when this point is reached the person is promoted, either to a new job or by upgrading the tasks of the present job.

Unfortunately, this may not be possible at the appropriate time. Realistically the person should be told that this is as high as he or she can go in the rate range and that any further salary adjustments will come from general increases. Some organizations provide steps beyond the maximum of the range. There are usually two rationales for this - seniority and recruiting. Long-term employees who will never be promoted and whose performance remains good are sometimes granted longevity increases beyond the maximum of the range.

These usually take place after five or ten years at the top of the grade. Trouble in recruiting and retaining professional and managerial employees can be ameliorated by starting these people quite a ways up in the rate range; in order to retain them the organization must go beyond the maximum to provide any significant movement in grade.

1.6.10 Number of Grades

The total number of pay grades in the wage structure can be a result of other calculations (mainly range breadth and overlap) or a conscious decision that forces the other two variables to adapt.

At one extreme, a structure with a single pay grade would have a minimum and maximum embracing the total wage structure and would include all jobs. At the other extreme, each job evaluation point on the horizontal axis would constitute a separate pay grade.

In the latter circumstance two jobs would occupy the same pay grade only if they had identical job evaluation points a situation that would assume a very accurate job evaluation plan.

A large number of pay grades often coincides with a narrow range, permitting a large number of promotions and multiple classifications in job families in the organization. A small number of pay grades allows for flexibility, in that it assigns people to a wide range of jobs without changing their pay grade. Not surprisingly, number of pay grades is associated with size and number of levels in the organization. It also seems reasonable that organizations with a fluid, organic structure would have a minimum of pay grades whereas more structured and bureaucratic ones would have more.

Clearly there is no optimum number of pay grades for a particular job structure. In practice, the number of pay grades varies from as few as 4 to as many as 60. But 10 to 16 seems to be most common. With few grades there are many jobs in each grade and the increments from one grade to another are quite large. The presence of many grades has the opposite characteristics.

A number of considerations help to determine the appropriate number of grades. One is organization size: the larger the organization, the more pay grades. A second is the comprehensiveness of the job structure. A structure that covers the whole organization will tend to have more pay grades than one that deals only with one job cluster. Third, the type of jobs in a structure makes a difference. Production jobs whose pay policy line is relatively flat will tend to have fewer pay grades than a managerial structure that has a steep slope.

The last determinant is the pay-increase and promotion policy of the organization. A large number of pay grades allows for many promotions but entails narrow ranges and a narrow classification of jobs. A small number of pay grades, accompanied by wide ranges was traditionally thought of as unreasonable in that cost control of salary administration would be lost. In the late 1980's, this reasoning was badly shaken.

1.6.11 Overlap

The final pay range determinant is the degree of overlap between any one pay grade and the adjacent grade. Overlap allows people in a lower pay grade to be paid the same as or more than those at a higher grade.

The rationale for such a phenomenon is that a person at a lower pay grade whose performance is very good is worth more to the organization than a new person at the higher pay grade who is not yet performing effectively. This reasoning seems to work: seldom are there complaints about overlap. As with the number of grades, overlap can be either a determining variable or the determined variable. Overlap will work well where there are many wide pay grades. A conscious decision to keep overlap to some maximum (such as 50 percent) will reduce one of the other two variables.

Some overlap is desirable, but there are problems. The main one comes about in promotions. A person high up in a rate range who is promoted may start in the new rate range higher than the job rate of the new grade. But not to give the promoted person a pay raise is hardly to have promoted him or her.

Organizations generally set some policy that any promotion be accompanied by some specified minimum increase, such as one step in the new rate range or a specified percentage. The designers of career paths in some organizations reduce this problem by placing the next job in the sequence more than one pay grade above the present one.

1.6.12 Moving Employees through Rate Ranges

Rate ranges make possible different pay rates for individuals in the same job and/or grade level. Operating such ranges calls for some method that differentiates between employees. Such a method must provide a decision framework for positioning each person within the range.

Open rate ranges facilitate a pay-for-performance approach to individual pay determination. The present section will focus on movement within grades in a step system.

1.6.13 Rate Ranges and Recruitment

To this point we have assumed that the organization has been hiring people who are just qualified and moving them up in the range as they learn the job. But what if it hires a person who can do the job from the beginning? Clearly this person should be hired at the market rate (the midpoint). In actuality, then, people are likely to be brought into the organization anywhere up to the midpoint of the range, based upon their qualifications. Thus a system that ends at the market rate has a flat rate for hiring fully qualified employees.

The labor market may complicate the rate range when there is a shortage of applicants. When it is hard to recruit, one way organizations adjust is to raise the starting pay to wherever in the range it must go in order to obtain people. This may result in hiring rates at the top of the rate range or above. This extreme situation makes any upward movement within the grade difficult or impossible for the person. A person, who is then expected to stay in the grade for three or more years before promotion can only look forward to general increases.

Check Your Progress 5

State whether the following statements are True or False:

1. Administrative procedure includes establishing and supervising wage levels and operations in an organization.
2. The Manager, Salary Administration is accountable for the overall direction and integrity of the staff compensation program.
3. In 3 Ps compensation management, the performance of the individual is not the only consideration in setting the salary or granting a salary increase.
4. Variable pay or performance - linked incentive should comprise a sizeable part of the compensation package.
5. For the effectiveness of incentives, a change in work culture is necessary.

1.7 FACTORS INFLUENCING WAGE AND SALARY ADMINISTRATION

Administrative procedure includes establishing and supervising wage levels and operations in an organization. In most organizations, wage and salary administration is performed in the personnel department, although larger organizations often have a payroll or wage and salary administration department. Compensation management is about a range of interconnected processes that aim through both financial and non-financial means to address what employees value in the employment relationship. It is not just a set of techniques. Factors affecting compensation in an organization are:

- Corporate business strategy
- Corporate HRM strategy
- Demand and Supply of human talent
- Organization values
- Market Rates
- Industry Trends
- Performance Related
- Flexibility / responding to changes.
- Motivation oriented
- Work related
- Productivity based
- Budget factor
- Competence based
- Contribution factor
- Organization grade structure
- Job evaluation [relative size of jobs]
- Non financial benefits
- Employee benefits.

- Internal job value.
- External job value.
- Perceived value of an employee at a given time.
- Affordability.
- Trade Union factor, etc.

Any combination of factors would be applicable in a given period of time.

1.8 LET US SUM UP

The compensation policy and the reward system of an organization are viewed by the employees as indicators of the management's attitude and concern for them. Traditionally, pay scales in companies reflected the importance of the work and the responsibility level. Today, organizations try more to assess the worth of an individual in terms of his performance and contribution to the organization. There is importance of a compensation system that is competitive and attractive for the employees and at the same time, profitable for the organization.

1.9 LESSON END ACTIVITY

Write a study note on the compensation and wage administration. Also write about the factors influencing wage and salary administration.

1.10 KEYWORDS

Compensation: Direct and indirect monetary and nonmonetary rewards given to employees on the basis of the value of the job, their personal contributions, and their performance. These rewards must meet both the organization's ability to pay and any governing legal regulations.

Salary: Regular wages received by an employee from an employer on a weekly, biweekly, or monthly basis.

Wages: Payment received by an employee in exchange for labor. It may be in goods or services but is customarily in money.

Wage Determination: A "wage determination" is the listing of wage rates and fringe benefit rates for each classification of laborers and mechanics.

Straight Piecework: It is payment of a uniform price per unit of production.

Differential Piecework: Systems allow you to adjust wage cost per unit in relation to output.

1.11 QUESTIONS FOR DISCUSSION

1. Discuss the factors affecting wage determination.
2. Explain wage determination process in detail.
3. What do you understand by rate range? Discuss the types of rate ranges.
4. Discuss the importance of wage administration rules in organizations.

Check Your Progress: Model Answers

CYP 1

1. The compensation should be:
   a. *Adequate:* Minimum governmental, union, and managerial levels should be met.
   b. *Equitable:* Each person is paid fairly, in line with his or her effort, abilities, training, and so on.
   c. *Balanced:* Pay, benefits, and other rewards provide a reasonable total reward package.
   d. *Cost effective:* Pay is not excessive, considering what the enterprise can afford to pay.
   e. *Secure:* The employee's security needs relative to pay and the needs which pay satisfies are met.
   f. *Incentive providing:* Pay motivates effective and productive work.
   g. *Acceptable to the employer:* The employee understands the pay system and feels it is a reasonable system for the enterprise and himself.
2. Compensation is typically divided into direct and indirect components. The term 'direct compensation' is used to describe financial remuneration usually cash and includes such elements as basic pay, dearness allowance, overtime pay, shift allowance, incentive, bonus, profit-sharing bonus and commissions, etc. Indirect compensation or wage supplements or fringe benefits refer to such benefits as provident fund, pension scheme, medical and health insurance and sick leave and various other benefits and perks.

CYP 2

Under this system the employees are simply paid a predetermined rate per week, or hour for the actual time they have worked. The basic rate for the job can be fixed by negotiation, by reference to local rates, or by job evaluation.

CYP 3

The concept of paying for the 3 P's consists of three parameters that are considered by the management of any organisation while deciding the salary as well as the incentives of employees. It is to pay for the Position, the Person and the Performance.

CYP 4

Usually, the steps involved in determining wage rates are: performing job analysis, wage surveys, analysis of relevant organizational problems forming wage structure, framing rules of wage administration, explaining these to employees, assigning grades and price to each job and paying the guaranteed wage.

CYP 5

1. True
2. True
3. True
4. True
5. True

1.12 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

LESSON

2

THEORY OF WAGES

CONTENTS

2.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand important economic theory pertaining to wages
- Apprise the relevance of the motivational theories with employees reward system
- Give an overall view of the theoretical aspects of the economic/ behavioural theories impacting on formulation of compensation and reward system
- Understand various types of wages
- Learn about time rate and price rate theories
- Understand debt market and related theories
- Analyze wage differentials

2.1 INTRODUCTION

We have several economic theories of wages and they have been providing guide in formulation of wage policies. Though these theories have important policy implications and some relevance for certain occupations or in certain regions, none of these is adequate as a general theory having universal applicability. The economic theories of wages fail to provide a complete explanation of the problems of wage determination. Thereafter, studies conducted by behavioural scientists are filling the gap to some extent theories. These behavioural science oriented theories highlight the importance of psychological and sociological factors on formulation of compensation and reward. Therefore, readers must have some idea about these theories in order to develop holistic insight.

2.2 THEORIES OF WAGES

2.2.1 Economic Theory of Wages

(i) ***Subsistence Theory- (David Ricardo):*** This theory (1817) states that: "The labourers are paid to enable them to subsist and perpetuate the race without increase or diminution." The theory was based on the assumption that if the workers were paid more than subsistence wage, their numbers would increase as they would procreate more; resulting in spurt in supply of labour and this would bring down the rate of wages. If the wages fall below the subsistence level, the number of workers would decrease - as many would die of hunger, malnutrition, disease, cold, etc. and many would not marry, when that happened the wage rates would go up.

(ii) ***Wages Fund Theory- (Adam Smith):*** Adam Smith developed this theory. His basic assumption was that wages are paid out of a pre-determined fund of wealth which lay surplus with wealthy persons - as a result of organisation savings. This fund could be utilized for employing labourers for work. If the fund was large, wages would be high; if it was small, wages would be reduced to the subsistence level. The demand for labour and the wages that could be paid them were determined by the size of the fund. Francis A. Walker attacked the wage fund theory. He argued that wages were paid out of the product of labour and not from some previously accumulated capital. It is production that furnishes true measure of wages.

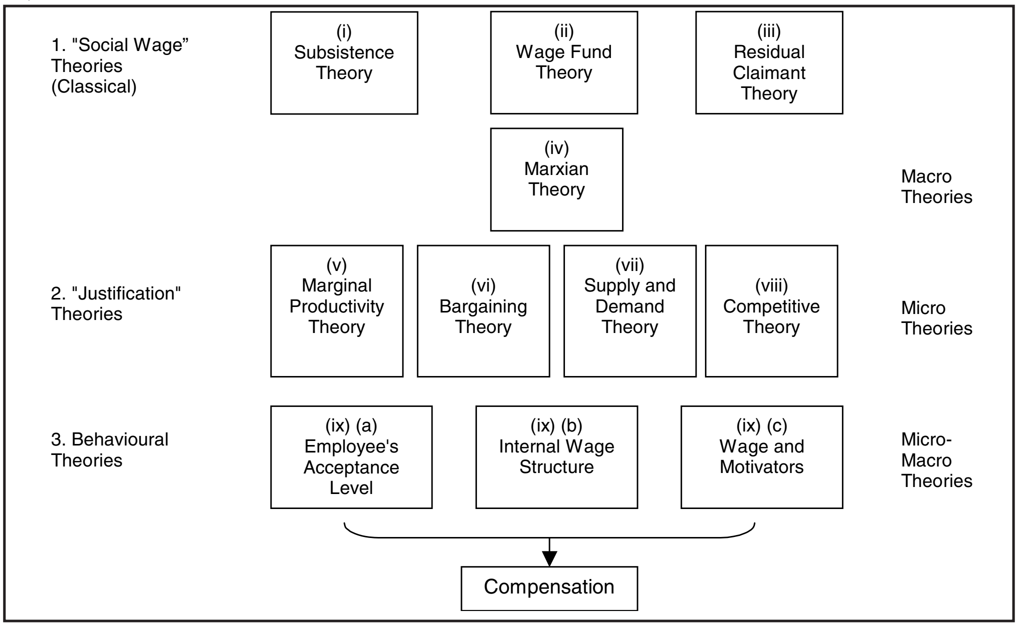

Figure 2.1: Model of Economic Theories

(iii) ***Residual Claimant Theory (Francis A. Walker):*** According to walker, there are four factors of production/business activity, viz. land, labour, capital and entrepreneurship. Wages represent the amount of value created in the production, which remains after payment has been made for all these factors of production. In other words, labour is the residual claimant. This theory does not explain how trade unions are able to increase the wages, it does not consider role of labour in productivity.

(iv) ***Surplus Value Theory of Wages (Marxian):*** This theory owes its development to Karl Marx (1818-1883). According to this theory, the labour is an article of commerce, which could be purchased on payment of 'subsistence price'. The price of any product is determined by the labour time needed for producing it. The labourer is not paid in proportion to the time spent on work, but much less, and the surplus went over, to be utilized for paying other expenses.

(v) ***Marginal Productivity Theory (Philips Henry & Bates Clark):*** This theory was developed by Philips Henry (England) and John Bates Clark (USA). According to this theory, wages are based upon an entrepreneur's estimate of the value that will probably be produced by the last or marginal worker. In other words, it assumes that wages depend upon the demand for, and supply of, labour. Consequently, workers are paid what they are economically worth. The result is that the employer has a larger share in profit as has not to pay to the non-marginal workers. As long as each additional worker contributes more to the total value than the cost in wages, it pays the employer to continue hiring; where this becomes uneconomic, the employer may resort to superior technology.

(vi) ***Bargaining Theory of Wages (John Davidson):*** According to this theory, wages are determined by the relative bargaining power of workers or trade unions and of employers. When a trade union is involved, basic wages, fringe benefits, job differentials and individual differences tend to be determined by the relative strength of the organisation and the trade union.

(vii) ***Employment Theory (Supply and Demand Theory):*** It is based on the inter-relation between wages and employment. According to it, unemployment would disappear, if workers were to accept a voluntary cut in wages, pleaded for wage flexibility for promoting employment at a time of organisation depression. These wage cuts would bring down costs and thereby fall in price. This lowering in prices would cause additional demand, which will increase production. This will increase employment of workers.

(viii) ***Competitive Theory:*** The force on which economists have traditionally laid the greatest stress in wage determination is demand and supply. Adam Smith, argued that if wages were fixed in accordance with demand and supply, workers would be attracted by high wages to industries, occupations and localities, where they were most needed and would tend to leave industries and places where the supply of labour was greater than demand. More precisely, the basic assumption of competitive theories of pay is that employers compete among themselves by offering a higher wage to attract employees; while the employees compete with one another for jobs by offering their services for a lower wage. Competition, then, is essentially a disequilibrium process by which excess demand and excess supply cause changes in wages.

(ix) ***Behavioural Theories:***

(a) *Employee's Acceptance of a Wage Level:* This type of thinking takes into consideration the factors, which may induce an employee to stay on with a company. The size and prestige of the company, the power of the union, the wages and benefits that the employee receives in proportion to the contribution made by him - all have their impact.

(b) *Internal Wage Structure:* Social norms, traditions, customs prevalent in the organisation and psychological pressures on the management, the prestige attached to certain jobs in terms of social status, the need to maintain internal consistency in wages at the higher levels, the ratio of the maximum and minimum wage differentials, and the norms of span of control, and demand for specialized labour, all affect the internal wage structure of an organisation.

(c) *Wage and Motivators:* Money often is looked upon as means of fulfilling the most basic needs of man. Food, clothing, shelter, transportation, insurance, pension plans, education and other physical maintenance and security factors are made available through the purchasing power provided by monetary income-wages, merit increases, bonuses are based on performance.

We note, wage theories reveal that each theory contains some truth but none of them is a complete one covering all aspects.

2.2.2 Limitations of Economic Theories

1. Economic theories assume that wages and prices are either fully fixed (Keynesian paradigm) or fully flexible (neo-classical liberalists). The reality lies somewhere in between.

2. Most wage theories are based on the assumption of full employment. In most developing countries this is not really the case.

3. Labour is not as mobile as capital and products are. Therefore, wage rates could be influenced by the changes in the demand for and supply of factors other than labour too.

4. In several industries labour costs are less critical than other costs. Also, fluctuations in interest rate and exchange rates as well as relative intensity of capital and technology, influence the demand for, and may cause the substitution of, both the

input and the output of labour as well as the proportionate costs of labour in the total cost of production.

5. Wages and benefits reflect industry characteristics and personal characteristics (including skill differentials) as well as societal preferences and prejudices.
6. Interference by government and trade unions could minimize the influence of the market forces organisation demand and supply of labour.
7. Technology and productivity are major determinants. Low wages may not mean low wage costs. Similarly high wage rates may not mean high unit labour costs.
8. With the growing pressure for linking labour standards with international trade, increasingly it will become difficult (for countries, industries and companies) to compete on the basis of comparative advantage of cheap labour.

Check Your Progress 1

1. What do you understand by subsistence theory of wage?

   ....

   ....
2. What is marginal productivity theory of wage?

   ....

   ....

2.2.3 Behavioural (Motivational) Theories

Every reward or element of compensation/reward has a behavioural objective and seeks to fulfil a need (physiological or psychological) and achieve a goal. Luthans argues that motivation is a process that starts with a physiological or psychological deficiency or need that activates a behaviour or a drive that is aimed at a goal.

Reward systems are aimed at compensating people for their skill, effort, responsibility and working conditions and motivating them for higher performance.

There are two groups of motivation theories. These are: (see Figure 2.2)

- Content Theories,
- Process Theories.

1. ***Content:*** What motivates people at the workplace? Content theories of motivation focuses on the needs of individuals and attempts to satisfy and influence various kinds of actions or behaviours. Non-cognitive theories, sometimes called content theories, include the theory of needs hierarchy, achievement motivation theory, and motivation-hygiene theory. These are discussed in Figure 2.2.

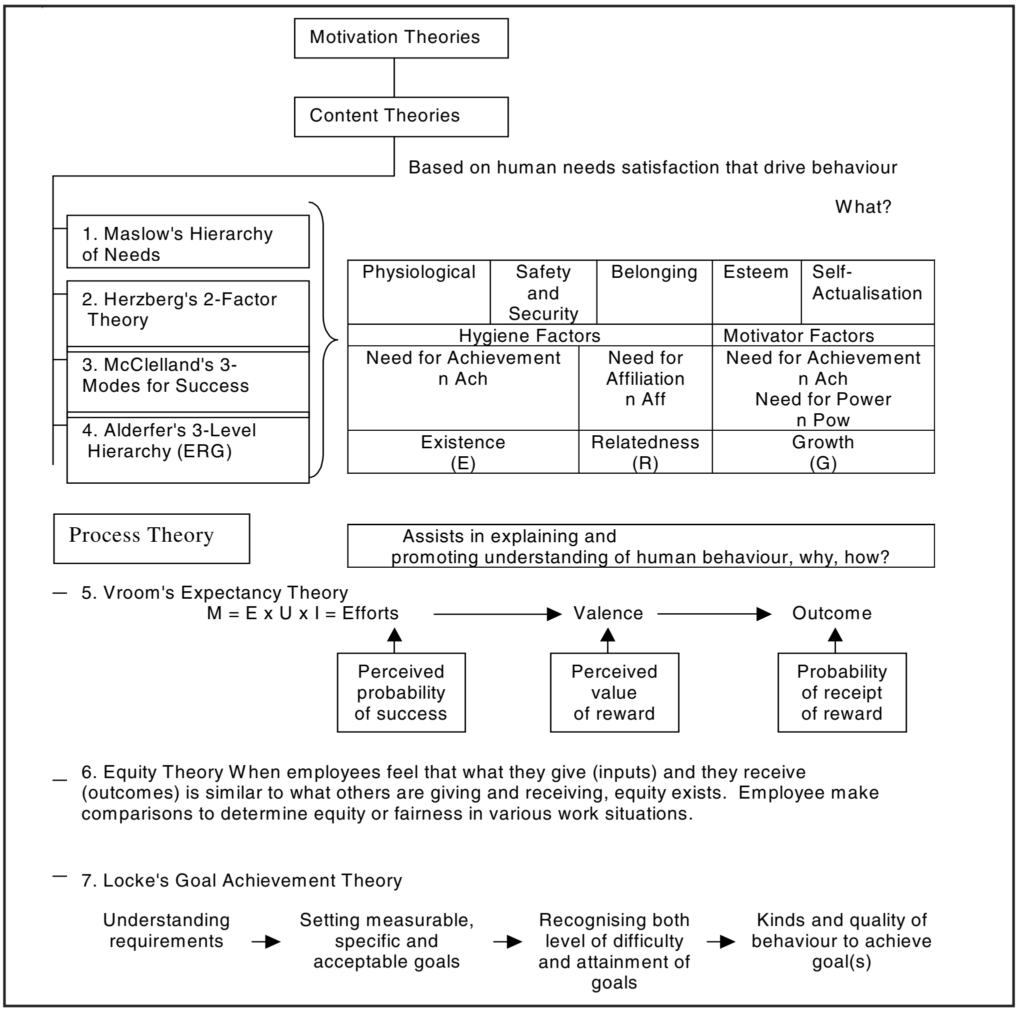

Figure 2.2: Motivation Theories

(i) *Maslow's Need Hierarchy:* The Maslow hierarchy of needs theory holds that humans are "wanting" animals motivated to satisfy their want or needs. Once a need has been fulfilled, it is no longer a source of motivation until the need arises again. According to this theory, needs are hierarchical in nature. Dr. Abraham Maslow ranked needs in order of their ascending importance as follows:

(a) Physiological

(b) Safety

(c) Belonging

(d) Esteem

(e) Self-actualisation

As lower-order needs are satisfied, the individual is motivated to satisfy the next level of needs. In American culture, the basic physiological and safety needs are generally fulfilled for the working population; therefore, higher-order needs are more closely related to motivation and performance. According to this theory, supervisors of employees with a need for self-esteem should praise and recognise performance. The person with self-actualisation needs may not need such praise; he or she will be motivated merely by the feeling of accomplishment of a job well done.

(ii) *Herzberg's Motivation-Hygiene Theory:* Frederick Herzberg developed a motivation-hygiene theory applicable to the work setting. According to Herzberg, factors contributing to job satisfaction are called motivators. They are separate and distinct from factors that may sometimes lead to job dissatisfaction. Job satisfaction may be defined as a favourable reaction or feeling towards work. Good feelings about work result when needs are met by the job. Job satisfaction may come from the job itself, through intrinsic job satisfaction factors (motivators). Factors that are outside the job itself in the work environment and that affect job satisfaction levels are called extrinsic or hygiene factors. Herzberg's research indicates that intrinsic factors lead to job satisfaction, whereas extrinsic factors may or may not contribute to it.

Herzberg repacked Maslow's hierarchy of needs and developed the concepts of hygiene factors and motivators creating the two factory theory of motivation. In conjunction with these efforts, he promoted the idea of intrinsic and extrinsic motivators. Herzberg's hygiene factors related to the first three levels of Maslow's hierarchy, and his motivators related to the upper two levels of the hierarchy. Herzberg developed the hypothesis that positive job satisfaction can occur only when job content makes it possible for the motivator factors to come into play (the job itself promotes employee responsibility, achievement, recognition, growth).

The concepts of intrinsic and extrinsic motivators added to the understanding and usefulness of motivators. Intrinsic motivators are those drives, generated from within the individual; extrinsic motivators come from outside the individual. Self-esteem and increased responsibility coming from a well-designed job are intrinsic motivators. Pay that comes from the organisation and the pat on the back from the supervisor in recognition of a job well done are examples of extrinsic motivators, or in Herzberg's terms, hygiene factors.

Intrinsic Factors	**Extrinsic Factors**
Ability utilization	Company policies and practices
Achievement	Compensation
Activity	Co-workers
Advancement	Recognition
Authority	Security
Creativity	Social service
Independence	Social status
Moral values	Supervision - human relations
Responsibility	Supervision - technical Working conditions

Leadership style may be affected when the supervisor recognises that letting subordinates use their unique job skills or giving them responsibility will increase their job satisfaction levels. Job design should also take into consideration job satisfaction. Research on job satisfaction supports the proposition that good pay does not guarantee satisfaction.

(iii) *David C. - McCelland's Achievement Motivation Theory:* McCelland deals primarily with the need for achievement, secondarily with power and affiliation needs. According to this research, a high need for achievement correlates positively with high levels of performance. McCelland places a great emphasis on needs and individual differences. He focuses on three needs.

(i) *Need for Achievement (n Ach):* It is a drive to excel, to achieve in relation to a set of standards, and desire to succeed. Specific characteristics of high achievers are:

(a) Moderate risk taking and they prefer situations where there are 50:50 chances for success or failure.

(b) They prefer activities, which provide immediate and precise feedback information on how they are progressing towards the goal. They are frustrated where feedback on performance is imprecise, vague and long-range.

(c) High achievers derive greater satisfaction with accomplishment from solving complex problem rather than accompanying money rewards.

(d) Preoccupation with tasks and desire for improvement and better performance. They concentrate on goal until successfully completed.

McCelland feels that attempt be made to detect n Ach in individuals or nations and this can expedite economic development in underdeveloped countries like India.

He emphasises that need for achievement can be acquired and increased with training and experience.

(ii) *Affiliation Need (Motivation) (n Aff):* The desire for friendly and close interpersonal relations, to be linked by them, to belong to and be accepted by different groups. It is related to social aspect which helps in making job more bearable. When such interaction takes place, morale is higher and productivity better. However, when social interaction is denied, workers tend to fight the system by restricting the output. Allowing employees to fulfil social needs on the job, helps in preventing these negative behaviours.

High affiliation motivation must be accompanied by high achievement motivation in the leader, otherwise, he is likely to sacrifice standards of performance for the sake of popularity and be exploited by the subordinates.

(iii) *Power Motivation (n Pow):* It is the power, that affects the behaviour of others and helps to control and manipulate the surroundings. It is drive for superiority.

Power motivation becomes strong in people who feel themselves inadequate to achieve respect and recognition and then go out of the way to seek attention of others. McCelland emphasises that 'n Pow' is closely related to managerial success.

However, sometimes 'n Pow' may tend to be negative orientation and individual may adopt autocratic style, whereas those with low power motivation may resort to laissez faire style. With high power motivation involving positive orientation, that leads to participative leadership style.

The needs for n Ach, n Aff and n Pow can be harnessed for the benefit of the organisation, if managers know how to identify the needs in their subordinates.

(iv) *Alderfer's ERG Theory:* Alderfer modified Maslow's five levels of needs to three levels and called them - 'E' for existence; 'R' for relatedness; 'G' for growth.

'Existence' needs comprise Maslows Physiological as well as safety and security.

'Relatedness' needs affection.

'Growth' needs desire for personal development, i.e. self-actualisation and intrinsic component of Maslow's esteem needs.

(i) ERG needs are not rigidly hierarchical.

(ii) Maslow believes that once need is satisfied, it no longer motivates an individual. 'A' suggests that satisfaction of need may increase its intensity, e.g. if a job affords a great deal. Challenge, autonomy, creativity, the growth needs instead of being fulfilled, might get stronger, necessitating additional autonomy and challenge for satisfaction.

(iii) ERG theory suggests that more than one need may be activated at the same time and may be operating simultaneously.

Alderfer's theory is appealing and is seen as directly applicable to motivation of people at work.

(iv) Process Theories: The most recent theories of motivation are based on the assumption that much human behaviour results from conscious, planned, decision-making. Humans are thoughtful and deliberative in their choice of actions. Motivational theories based on this premise are known as cognitive theories. Among them are: equity theory, Expectancy-valence theory and Goal-setting theory.

(v) *Vroom's Expectancy-Valence Theory:* Like equity theory, this theory is based on the assumption that people usually make rational decisions about how to behave. This theory maintains that there are several elements in the motivational process. The level of performance is heavily dependent upon the amount of effort expended. Individuals expect that particular outcomes will occur as a result of their performance, and the importance (valence or value) of those outcomes to them will in turn influence the degree of effort they expend. Expressed arithmetically, this theory states that effort is equal to expected outcome multiplied by the value of that outcome to the individual.

Some illustrations may clarify these theoretical concepts. You, a supervisor in your first management position, feel that by working hard and doing your job well you will be promoted to higher managerial ranks (expectancy), a challenge that is of utmost importance to you (high-valence outcome). Your best operator is a working mother whose job interests are secondary to her family interests. The prospect of required overtime work (expectancy) has a negative motivational effect on her as she anticipates a decrease in the time available for her family (low-valence outcome). Her performance level may decrease. Another operator and his wife are working hard to accumulate funds necessary for a down payment on a house (expectancy). Overtime may be an appealing motivational factor for this individual (high-valence outcome). A person who has a high need for money will be more motivated to perform in a situation that provides monetary rewards. Individuals will behave in a way that will lead to rewards they value and are attractive.

Expectancy-valence theory explains well, the importance of money as a motivating factor. People are willing to work hard not necessarily because they enjoy their work but because they want monetary rewards that can be used to achieve other important goals. The expectancy theory model (see Figure 2.3) suggests the conditions necessary for employee motivation.

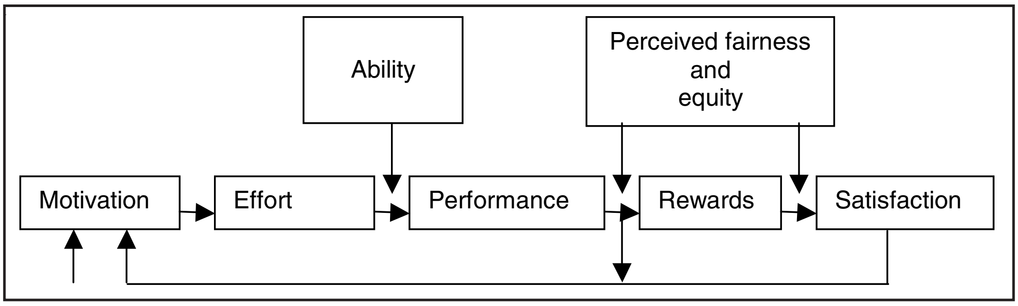

Figure 2.3: Expectancy Theory Model

A person's motivation is a function of:

1. Effort to performance expectancies
2. Performance-to-reward expectancies
3. Perceived attractiveness of rewards

(vi) *J.Adams Equity Theory:* Adams argues that a major input into job performance and satisfaction is the degree of equity (or enquiry) that people perceive in their work situation. Inequity occurs when a person perceives that the ratio of his or her outcomes to inputs and the ratio of a relevant other's outcomes to inputs are unequal.

People feel unhappy not only when they receive less than what they consider they deserve, but also when they receive more than what they consider they deserve. When an employee receives more than what he/she considers is fair, the employee begins to wonder whether others too, are receiving more than what they deserve. If it is indeed the case, the next question that comes to the mind is compared to what they are getting, whether others are receiving much more than what they deserve.

Adams proposal can be represented as follows:

$$\frac{\text{Person's outcomes}}{\text{Person's inputs}} < \frac{\text{Other's outcomes}}{\text{Other's inputs}}$$

$$\frac{\text{Person's outcomes}}{\text{Person's inputs}} < \frac{\text{Other's outcomes}}{\text{Other's inputs}}$$

Equity occurs when

$$\frac{\text{Person's outcomes}}{\text{Person's inputs}} = \frac{\text{Other's outcomes}}{\text{Other's inputs}}$$

Related Issues: Equity can be internal or external. Internal equity refers to the pay differential between and among the various skills and levels of responsibility. For instance, a skilled worker could get more than the unskilled worker. Whether a blue-collar worker should get less or more than the white collar depends not only on relative skill differentials and difficulties in working conditions, etc., but also on the demand and supply of those skills and the dominant occupational preferences of people in the society. When in one engineering fabrication industry, gas cutters (welders) were getting less than grass cutters (gardeners) it was perceived by the technical staff that it was a glaring instance of a lack of internal equity because in that industry, welding is considered to be a highly rated technical trade and should command higher wage rate. Internal equity is established through job evaluation. Pay satisfaction surveys also provide insights into it. Job evaluation can be done not only for manual jobs, but also for managerial jobs. Collective bargaining pressures have, however, substantially eroded pay differentials based on skill differentials. In many industries, dearness allowance and other employee benefits constitute bulk of the pay packet and basic pay, which is supposed to be based on job, evaluation constitutes only a small portion of the total pay packet.

External equity refers to concerns how wage/pay levels for similar skill levels in one firm compare with those in other firms in similar or same industry and location/region. For instance, if welders in one firm get the same as welders in the other firms in the industry/region, there is perceived external equity. External equity is assessed usually through pay surveys and pay satisfaction surveys. Companies, which pay significantly less than the market rates, would find it difficult to attract, retain and motivate people to perform better. Therefore, it is possible that low wage rates may not always be associated with low wage costs.

Non-discrimination should be an important consideration in pay policies. International Labour Organisation (ILO) Convention No. 100 concerns equal remuneration for work of equal value. For similar skill, effort, responsibility and working conditions, pay should be similar. It is difficult to translate this principle into action because in reality pay differentials are based not only on these four factors but also on the demand for and supply of labour with relevant skills, the relative power of trade unions in collective bargaining which varies widely across sectors/industries and regions, the capacity to pay of the firm/ industry and the employer policies concerning pay on whether to lead or lag the average pay trends in the industry/location.

Alfred Marshal's iron laws of wages suggest that the relative power of unions is dependent on four factors: (a) the substitutability of the input of labour, (b) the substitutability of the output of labour, (c) the proportionate cost of labour, and (d) the cumulative impact of the preceding three factors. As a result, for instance, the textiles workers power to obtain higher wages could be less than that of, say, airline pilots.

In India, the principle of equal remuneration is upheld, partly through Equal Remuneration Act, 1976. The legislation is aimed at ending discrimination in remuneration based on sex. It does not, however, speak about equal remuneration for equal work. The legislation affords protection against discrimination for women workers, who are covered by the definition of 'workman' under the Industrial Disputes Act, 1947. Numerous judgments by courts limited the application of the concept of non-discrimination only to men and women doing similar work with similar qualifications in the same organisation.

(vii) *Goal-Setting Theory:* Proponents of this theory maintain that all individuals have values and goals. Values reside in emotions and desires, which in turn lead individuals to set goals, to satisfy them. These goals then determine behaviour and performance.

The supervisors may recognise the application of this theory in Management by Objectives (MBO) programmes that exist in many organisations. Such programmes have proved motivationally effective, and they may produce even better results when managers involve in establishing them have improved heir understanding of criteria for goal setting. For instance, an employee with a high need for achievement may need to set very challenging goals to be motivated, whereas a low achiever could be frustrated by a challenging goal that appears overwhelming. The supervisor who uses goal-setting techniques should be sure that participants accept the idea, that it does not lead to job dissatisfaction, and that it does not become stale as a motivator.

(viii) *Agency Theory:* The agency theory focuses on the divergent interests and goals of the organisation's stakeholders and the way that employee remuneration can be used to align these interests and goals. Employers and employees are the two stakeholders of a business unit, the former assuming the role of principals and the latter the role of agents. The remuneration payable to employees is the agency cost. It is natural, that the employees expect high agency costs while the employers seek to minimize it. The agency theory says that the principal must choose a contracting scheme that helps align the interest of the agents with the principal's own interest. These contracts can be classified as either behaviour-oriented (e.g. merit pay) or outcome-oriented (e.g. stock option schemes, profit-sharing, and commissions).

At the first sight, outcome-oriented contracts seem to be obvious solution. As profits go up, rewards also increase. Remuneration falls when profits go down.

Check Your Progress 2

Mention the different types of needs in order of their ascending importance, as propounded by Maslow.

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2.2.4 Rewards Influence Behaviour

Process theories seek to explain why and how work behaviour is stated, energized, directed, sustained and stopped. Various process theories – Expectancy, Equity, Reinforcement – have identified four critical elements to work motivation – 1. Ability, 2. Contingency, 3. Valued and Equitable Reward and 4. Saliency.

Table 2.1: Work Behaviour and Incentives

Conditions	Organisation Incentives
• Employees must have the ability, skill to perform at the desired level – otherwise Reward cannot help	• Ensure this through proper Recruitment, Placement & Training.
• Reward must be contingent to Performance (Performance-Linked Reward)	• Performance-based Reward/Promotion systems.
• The Reward should be Valued and Equitable	• Design and administer employees Rewards which are instrumental in satisfying employees needs. They must be objective, rational and non-arbitrary.
• Reward must be Salient in the sense that it must be uppermost in the mind of the employees	• Need-based Rewards based on surveys.

In order to be effective in influencing behaviour, reward systems should satisfy three key design requirements according to Dr. Naresh C. Agarwal (McMaster University, Canada). These requirements are derived from established behavioural science theories and research.

(i) ***Contingency:*** The first requirement is that appropriate behaviour-reward contingencies be established i.e. rewards should be made contingent upon specific behaviours that are of importance to the organisation. Reinforcement theory suggests that a response followed by a reward is more likely to occur in the future. Applied to organisational settings, the theory implies that employees learn to behave in ways that get rewarded and avoid behaviour that does not get rewarded (Lawler, 1981). The basis of learning here is, the employee actually experiencing rewards following desired behaviour. Expectancy theory (Lawler, 1973; Vroom, 1995) also emphasises the importance of behaviour-reward relationships as a key motivational factor but it focuses more on expected rather than experienced rewards. The perceived link between behaviour and rewards is called instrumentality in expectancy theory and is often referred to as "line of sight" design requirement in the compensation literature (Gerhart, Minkoff and Oisen, 1995). Many organisations foul-up this design requirement because they fall prey to the "folly of rewarding A, while hoping for B" (Kerr, 1995). Some examples of such incongruence in reward systems are as follows: rewarding employees for attendance but hoping that they will maximise performance: rewarding the team members with best individual performance but hoping for teamwork and collaboration; paying sales staff on straight commissions while hoping that the senior salespersons will mentor and train the newly hired junior sales staff; and, rewarding and recognising university professors almost entirely for their research and publications while hoping that they will not neglect their teaching responsibilities.

(ii) ***Equitable:*** The second requirement for designing effective reward systems is that employees should perceive their rewards to be equitable. In employment relationship, the employee provides inputs to the organisation and in return receives outcomes (rewards) from the organisation. According to equity theory (Adams, 1965), the employee judges the fairness of this exchange by comparing the ratio of his/her outcomes to inputs of some other relevant person. If the comparison reveals the two ratios to be equal, the employee experiences equity which in turn contributes to his/her job satisfaction. If the comparison shows the ratios to be unequal, the employee will experience inequity, which will cause him/her to take corrective action. Two possible corrective actions postulated in equity theory are altering inputs (e.g. lowering performance) and leaving the organisation. Research studies show that when individuals perceive underpayment, they tend to lower their inputs which enables them to raise their outcomes-to-inputs ratio to attain equity (Mowday, 1987; Greenberg, 1990; Cowherd and Levine, 1992).

(iii) ***Value:*** The third requirement for designing effective reward systems is that the rewards provided by the organisation should be of value to the employees. Only then, will rewards satisfy employees and influence their organisation behaviour. The logic of this requirement is derived from need theory (Maslow, 1954) and expectancy theory (Lawle, 1973; Vroom, 1995). These theories argue that individuals engage in behaviours which produce outcomes (rewards) that satisfy their salient needs. Thus, rewards attain their value or attractiveness from their perceived instrumentality to satisfy salient needs. Different needs can be salient for different individuals at the same time and for the same individual over time. Consequently, the value of a given reward can vary from one individual to another and for the same individual over time.

The design requirements discussed above are relevant to the effective development and administration of all potential rewards that employees can receive from working for organisations. Some behavioural scientists have developed a dual-factor theory of job satisfaction/motivation which distinguishes between two kinds of rewards; intrinsic or extrinsic (e.g., Herzberg, 1966; Deci, 1972; Kohn, 1993). Intrinsic rewards are the feelings of achievement, self-esteem, and growth experienced by the employee from performing the job itself. The scope for deriving these rewards, therefore, depends upon job content factor such as variety, challenge autonomy, and opportunities for development. Extrinsic rewards are external to the job and include such thing as pay, benefits, working conditions, supervisory praise and good interpersonal relationships. The dual-factor theory argues that intrinsic rewards are the only real motivators of work behaviour. Extrinsic rewards are needed to prevent job dissatisfaction among employees but these rewards have very little motivational effect on work behaviours. Underlying the dual-factor theory, although not expressly stated, is the belief that a reward has, in itself, a specific potency to produce the desired behaviour (Kanungo and Medonca, 1988). The theory ignores the key design requirements - namely, rewards will influence behaviour only when they are expected to be received as a consequence of that behaviour and are perceived to be equitable and valiant by the recipient.

(iv) ***Saliency:*** Pay is important to individuals. Virtually every study on the relative importance of pay to other potential rewards (extrinsic and intrinsic) has shown that pay is important; it is consistently ranked among the top five rewards. Pay and benefits were ranked first or second in importance by employees in every job classification. Because it is so important, pay has power to influence people's membership behaviour (where they go to work and whether they stay) and their performance.

However, the importance of pay and other rewards is affected by many factors. Money, for example is likely to be viewed differently in early, middle and later career because needs to money versus other rewards (status, growth, security, etc.) are different in each stage. Another important factor is national culture. United States managers and employees apparently place much more emphasis on pay for individual performance than do their European counterparts. High inflation tends to encourage people to emphasize the importance of money, while periods of slow growth or unemployment place a greater premium on intrinsic rewards or employment security.

(v) ***Rewards and Employee Satisfaction:*** The relationship between rewards and employee satisfaction. It is a function involving a number of factors, which organisations must learn to manage:

(a) The individual's satisfaction with rewards is, in part, a function of what is expected and how much is received. Feelings of satisfaction or dissatisfaction arise when individuals compare the nature of their job skills, education, effort, and performance (input) with the mix of extrinsic and intrinsic rewards they receive (output).

(b) Employee satisfaction is also affected by comparisons with other people in similar jobs and organisations. In effect, employees compare their own input/output ratio with that of others.

(c) The misperception of the rewards of others is a major source of dissatisfaction.

(d) Overall satisfaction is the result of a mix of rewards, rather than any single reward. The evidence seems to be clear that intrinsic rewards and extrinsic rewards are both important, and that they are not directly substitutable for each other.

(e) High total compensation does not, however, ensure that the best employees are retained. To do this, a company must also pay its better performers more than it pays the poorer performers, and the difference must be significant (recognizing that the significance of the difference is a subjective judgement on the part of individual employees). A less than significant differential will result in feelings of inequity when better performers compare their input-output ratio with that of poorer performers. A well-constructed and administered pay-for-performance system will then result in retention of better performers and the turnover of the poorer performers.

2.3 TYPES OF WAGES

A wage is a compensation workers receive in exchange for their labor. In labor and finance settings, a wage may be defined to include cash paid for some specified quantity (measured in units of time) of labor. Wages may be contrasted with salaries, with wages being paid at a wage rate (based on units of time worked) while salaries are paid periodically without reference to a specified number of hours worked. Once a job description has been established, wages are often a focus when negotiating an employment contract between employer and employee.

Economists define wages more broadly than just cash compensation and include any return to labor, such as goods workers might create for themselves, returns in kind (such as sharecroppers receive), or even the enjoyment that some derive from work. For economists, even in a world without others, an individual would still acquire wages from labor: food hunted or gathered would be considered wages and any returns resulting from an investment in tools (such as an axe or a hoe) would be deemed Profits (a return to real capital). The need to sell one's labor for wages in order to survive and prosper was described as wage slavery by the Lowell Mill Girls, Karl Marx and various thinkers in the socialist and anarchist traditions.

2.3.1 Determinants of Wage Rates

Depending on the structure and traditions of different economies around the world, wage rates are either the product of market forces (Supply and Demand), as is common in the United States, or wage rates may be influenced by other factors such as tradition, social structure and seniority, as in Japan. Several countries have enacted a statutory minimum wage rate that fixes the price of certain kinds of labor.

There are two major kinds of wage and salary payment plans: those under which remuneration does not vary with output or the quality of output, but depends on the time unit consumed in performing work. These are known as time wage plans. The time unit may be the day, week, fortnight or month. Time plans are non-incentive in the sense that earnings during a given time period do not vary with the productivity of an employee during that period.

The second kind is concerned with the output or some other measure of productivity during a given period of time. To earn more, an employee is required to put in more labour and produce more. This Kind is known as the piece or output wage plan. It is a direct financial incentive plan, Thus, the "time" and the "output" wage plan are the two basic systems. All the other plans are simply variations of these two.

2.4 TIME RATE

This is the oldest and the most common method of fixing wages. Under this system, workers are paid according to the work done during a certain period of time, at the rate of so much per hour, per day, per week, per fortnight or per month or any other fixed period of time. The essential point is that the production of a worker is not taken into consideration in fixing the wages; he is paid at the settled rate as soon as the time contracted for is spent.

2.4.1 Merits

The merits of the system are:

(1) It is simple, for the amount earned by a worker can be easily calculated;

(2) As there is no time limit for the execution of a job, workmen are not in a hurry to finish it and this may mean that they will pay attention to the quality of their work;

(3) As all the workmen employed for doing a particular kind of work receive the same wages, ill will and jealousy among them are avoided;

(4) Due to the slow and steady pace of the worker, there is no rough handling of machinery, which is a distinct advantage for the employer;

(5) It is the only system that can be used profitably where the output of an individual workman or groups of employees cannot be readily measured. The day or time wage provides a regular and stable income to the worker and he can, therefore, adjust his budget accordingly.

2.4.2 Advantages

The main advantages of time-rate pay are:

- Time rates are simple for a business to calculate and administer
- They are suitable for businesses that wish to employ staff to provide general roles (e.g. financial management, administration, maintenance) where employee productivity is not easy to measure
- It is easy to understand from an employee's perspective
- The employee can budget personal finance with some certainty
- Makes it easier for the employer to plan and budget for employee costs (e.g. payroll costs will be a function of overall headcount rather than estimated output)

This system is favored by organized labour, for it makes for solidarity among the workers of a particular class. It requires less administrative attention than others because the very basis of the time wage contract is good faith and mutual confidence between the parties.

Time rates are used when employees are paid for the amount of time they spend at work. This is the most common method of payment in some developed countries. The usual form of time rate is the weekly wage or monthly salary. Usually the time rate is fixed in relation to a standard working week (e.g. 35 hours per week).

The employment contract for a time-rate employee will also stipulate the amount of paid leave that the employee can take each year (e.g. 5 weeks paid holiday). Time worked over this standard is known as overtime. Overtime is generally paid at a higher rate than the standard time-rate - reflecting the element of sacrifice by an employee. However, many employees who are paid a monthly salary do not get paid overtime. This is usually the case for managerial positions where it is generally accepted that the hours worked need to be sufficient to fulfil the role required.

2.4.3 Demerits

The main drawbacks of this system are:

(i) It does not take into account the fact that men are of different abilities and that if all the persons are paid equally, better workmen will have no incentive to work harder and better. They will therefore be drawn down to the level of the least efficient workman. Halsey observes: "Matters naturally settle down to an easygoing pace in which the workmen have little interest in their work and the employer pays extravagantly for his product." Taylor says: "The men are paid according to the position which they fill and not according to their character, energy, skill and reliability."

(ii) The labour charges for a particular job do not remain constant. This puts the authorities in a difficult position in the matter of quoting rates for a particular piece of work.

(iii) As there is not specific demand on the worker that a piece of work needs to be completed in a given period of time, there is always the possibility of a systematic evasion of work by workmen.

(iv) This system permits many a man to work at a task for which he has neither taste nor ability, when he might make his mark in some other job.

(v) As the employer does not know the amount of work that will be put in by each worker, the total expenditure on wages for turning out a certain piece of work cannot be adequately assessed.

2.4.4 Disadvantages

The main disadvantages of time-rate pay are:

- Does little to encourage greater productivity - there is no incentive to achieve greater output.
- Time-rate payroll costs have a tendency to creep upwards (e.g. due to inflation-related pay rises and employee promotion.

As no record of an individual worker's output is maintained, it becomes difficult for the employer to determine his relative efficiency for purposes of promotion.

2.5 PIECE RATE PAY

Piece-rate pay gives a payment for each item produced - it is therefore the easiest way for a business to ensure that employees are paid for the amount of work they do. Piece-rate pay is also sometimes referred to as a "payment by results system".

Piece-rate pay encourages effort, but, it is argued, often at the expense of quality. From the employee's perspective, there are some problems. What happens if production machinery breaks down? What happens if there is a problem with the delivery of raw materials that slows production? These factors are outside of the employee's control - but could potentially affect their pay.

The answer to these problems is that piece-rate pay systems tend, in reality, to have two elements:

- A basic pay element - this is fixed (time-based)
- An output-related element (piece-rate). Often the piece-rate element is only triggered by the business exceeding a target output in a defined period of time.

Under this system, workers are paid according to the amount of work done or the number of units completed, the rate of each unit being settled in advance, irrespective of the time taken to do the task. This does not mean that a worker can take any time to complete a job because if his performance far exceeds the time, which his employer expects he would take, the overhead charge for each unit of article will increase.

There is indirect implication that a worker should not take more than the average time. If he consistently takes more time than the average time, he does it at the risk of losing his job.

Under this plan, a worker, working in given conditions and with given machinery, is paid exactly in proportion to his physical output. He is paid in direct promotion to his output, the actual amount of pay per unit of service being approximately equal to the marginal value of his service in assisting to produce that output.

This system is adopted generally in jobs of a repetitive nature, where tasks can be readily measured, inspected and counted. It is particularly suitable for standardized processes, and it appeals to skilled and efficient workers who can increase their earnings by working to their full capacity.

In weaving and spinning in the textile industry, the raising of local in the mines, the plucking of leaves in plantations, and in the shoe industry, this system can be very useful. But its application is difficult where different shifts are employed on the same work or where a great variety of different grades of workers are employed on different and immeasurable services, as in the gas and electricity industries.

A worker's earnings can be calculated on the basis of the following formula: WE=NR, where WE is the worker's earning, N stands for the number of pieces produced and R for the rate per piece.

2.5.1 Merits

This system has many advantages:

(i) It pays the workman according to his efficiency as reflected in the amount of work turned out by him. It satisfies an industrious and efficient worker, for he finds that his efficiency is adequately rewarded. This gives him a direct stimulus to increase his production.

(ii) Supervision charges are not so heavy, for workers are not likely to while away their time since they know that their wages are dependent upon the amount of work turned out by them.

(iii) Being interested in the continuity of his work, a workman is likely to take greater care to prevent a breakdown in the machine or in the workshop. This is a point of considerable gain to the management, for it reduces plant maintenance charges:

(iv) As the direct labour cost per unit of production remains fixed and constant, calculation of costs while filling tenders and estimates becomes easier.

(v) Not only are output and wages increased, but the methods of production too are improved, for the worker demands materials free from defects and machinery in perfect running conditions.

(vi) The total unit cost of production comes down with a larger output because the fixed overhead burden can be distributed over a greater number of units.

2.5.2 Demerits

The demerits of the system are:

(i) In spite of the advantages accruing to the management as well as to the workmen, the system is not particularly favoured by workers. The main reason for this is that the fixation piece rate by the employer is not done on a scientific basis.

In most cases, he determines the rate by the rule-of-thumb method, and when he finds that the workers, on an average, get higher wages compared to the wages of workers doing the same task on a day-rate basis, pressure is brought to bear upon the workers for a cut in the piece rate. Halsey observes: "cutting the piece price is simply killing the goose that lays the golden eggs. Nevertheless, the goose must be killed. Without it, the employer will continue to pay extravagantly for his work; with it he will stifle the rising ambition of his men."

(ii) As the workers wish to perform their work at breakneck speed, they generally consume more power, overwork the machines, and do not try to avoid wastage of materials. This results in a high cost of production and lower profits.

(iii) There is a greater chance of deterioration in the quality of work owing to over zealousness on -the part of workers to increase production. This over-zealousness may tell upon their health, resulting in a loss of efficiency.

(iv) It encourages soldiering; and there "arises a system of hypocrisy and deceit, because to escape further cuts they begin to produce less and also regard their employers and their enemies, to be opposed in everything they want.

(v) Excessive speeding of work may result in frequent wear and tear of plant and machinery and frequent replacement. Trade unions are often opposed to this system, for it encourages rivalry among workers and endangers their solidarity in labour disputes.

Case Study

Case 1 : Piece-rate Pay in Practice in the UK - Home-based Workers

In the UK, many thousands of people engage in what is known as "home-based work". This refers to work:

- In the home, or near the home in premises that are not those of an employer
- For a cash income (i.e. not unpaid household work)

Whilst there are many successful business people and well-paid professionals working from home, the use of piece-rate pay is focused is on those at the other end of the scale - home-based workers, mainly women, who earn only a subsistence level income.

Subsistence level home-based workers fall into two broad categories:

- Those who work for an employer, intermediary or subcontractor for a piece-rate, who are not responsible for designing or marketing the product, but simply contribute their labour. These workers are often called subcontracted or dependent home-workers
- Workers who design and market their own products, but who cannot be considered to be running small businesses - known as own-account workers.

The majority of home-based workers are women who do home based work in order to combine earning cash with other responsibilities, such as child-care and household management. Many earn well below the local minimum wage or average earnings. Most dependent workers work informally, without a proper employment contract. They are rarely organised or supported by formal trade unions.

Home-based work is found in most sectors of the economy, both modern and traditional industries. Good examples include:

- Production of garments and shoes
- Assembly of electronic, plastic and metal components
- Many kinds of packing work
- Weaving and dyeing of textiles in the traditional sectors
- Handicraft work
- Sewing and knitting garments
- Assembling toys
- Data-processing

It used to be thought that home-based work was an old-fashioned form of employment that would die out with the rise of modern industry. However, over the last 20 years much large-scale industry has reorganized its production, subcontracting work to smaller companies, often in other countries. At the end of the chain there are often informal workshops and home-based workers.

Contd....

Subcontracted homework is a form of production, which allows companies to reduce their costs by:

- Outsourcing production to lower-paid workers, usually without formal contracts, employment and social protection or even a regular supply of work
- Passing on some of the costs of heating, lighting and storage to the workers themselves
- Avoiding responsibility for health and safety for these workers
- Using home-based workers as a source of flexible labour

Some of the problems faced by home-based workers include:

- Irregular work - and therefore irregular income
- Earnings well below average
- No economic or social security for sickness, maternity or old age
- Long working hours
- Potential health problems caused by repetitive processes and inadequate health and safety.

2.6 BALANCE OR DEBT METHOD

This method is a combination of time and piece rates. The worker is guaranteed an hourly or a day-rate with an alternative piece rate. If the earnings of a worker calculated at the piece rate exceed the amount, which he would have earned if paid on time basis, he gets credit for the balance, i.e., the excess piece rate earnings over the time rate earnings.

If his piece rate earnings are equal to his time rate earnings, the question of excess payment does not arise. Where piece rate earnings if less than time rate earnings, he is paid on the basis of the time rate; but the excess which he is paid is carried forward as a debt against him to be recovered from any future balance of piece work earnings over time work earnings. This system presupposes the fixation of time and piece rates on a scientific basis. Let us suppose that the piece rate for a unit of work is Re. 1.00 and the time rate Rs. 0.37V2 an hour, the weekly work hours are 40 and the number of units to be completed during these 40 hours is 16.

It will be seen that the debit during the second week completely eliminated the edit of Re. 1.00 obtained during the first week. The worker will be paid his guaranteed time rate, in this case Rs.15.00, in the first week and the same amount in the second week, although his earnings during the first week are Rs.16.00 and during the second week they are Rs.14.00. An adjustment will be made periodically to find out the balance be paid to him.

The obvious merit of this system is that an efficient worker has an opportunity to increase his wages. At the same time, workers of ordinary ability, by getting the guaranteed time wage, are given a sufficient incentive to attain the same standard, even though the excess paid to them is later deducted from their future credit balance.

Check Your Progress 3

State whether the following statements are True or False:

1. Economists have long known that individual wages depend on a combination of employee and employer characteristics, as well as the interaction of the two.
2. Wage differentials are due to the lack of micro data which links individuals to the establishments where they work, but also due to technical difficulties associated with separating out employee and employer effects.
3. Piece -rate pay gives a payment for each item produced - it is therefore the easiest way for a business to ensure that employees are paid for the amount of work they do. Piece-rate pay is also sometimes referred to as a "payment by results system".
4. Under the time rate system, workers are paid according to the work done during a certain period of time, at the rate of so much per hour, per day, per week, per fortnight or per month or any other fixed period of time.
5. Balance of debt method is a combination of time and piece rates. The worker is guaranteed an hourly or a day-rate with an alternative piece rate.

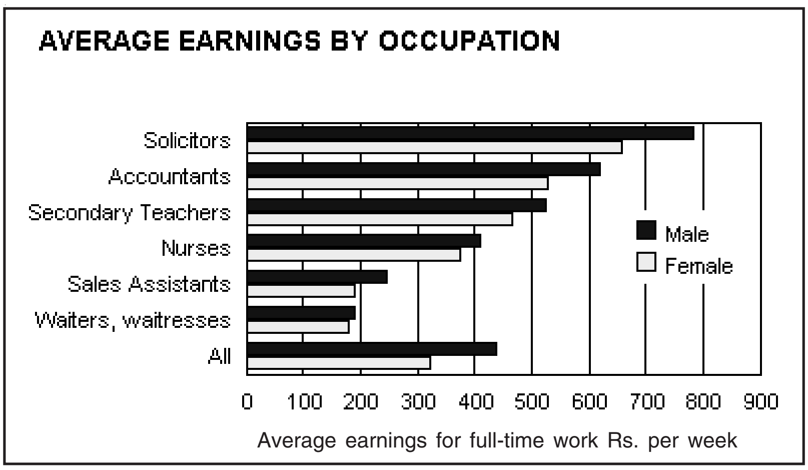
2.7 WAGE DIFFERENTIALS

Economists have long known that individual wages depend on a combination of employee and employer characteristics, as well as the interaction of the two. Although understanding whether establishment wage differentials, which say that an individual's pay is determined in part by the establishment at which they work, is important for labor economics and theories of the firm, little is known about the order of magnitude of this effect. This is primarily due to the lack of micro data which links individuals to the establishments where they work, but also due to technical difficulties associated with separating out employee and employer effects. Here we provide new information on establishment wage differentials by using data that permit both of these issues to be addressed. We exploit nationally representative micro data from the Occupational Employment Statistics program at the Bureau of Labor Statistics to calculate occupational and establishment wage differentials, the degree of occupational sorting across establishments, the importance of employer specific wage progression policies, and the importance of residual individual heterogeneity. These data contain information from more than half a million establishments, in all sectors of the economy, with wages reported for over 34 million individuals in more than 800 occupations. We believe that the discussion here contributes to the growing literature that seeks to understand the interactions between workers and their employers, and specifically the topic of employer effects on wages.

The important point here is the empirical estimates of how wages are influenced by the establishment at which the individual works. The decomposition of wages into employee and employer effects, which is based on similar work by Groshen (1991b) and Bronars and Famulari (1997), uses OLS regressions to partition the sum of squares of wages into worker and establishment components. Our results show that employer effects contribute substantially to earnings differences -- the results from our basic model show that controlling for detailed occupation, establishment dummies account for 21 percent of individual wage variation. These employer effects can only be partially explained by observable establishment characteristics such as location, size, age, and industry.

The theoretical literature has predicted that team production will result in the sorting of workers of similar skill within establishments (Kremer, 1993). We examine this by examining the correlations of occupational wages within establishments. The theoretical motivation for this analysis is based on team production models, such as Kremer (1993), which predict that workers of similar skill will match together in establishments. The goal of our correlation analysis is to examine the breadth of the establishment wage differentials across occupations. Our results are striking -- we find that establishments that pay well for one occupation also pay well for others. Even after controlling for observable establishment characteristics, we find positive wage correlations within establishments for occupations that are closely related, as well as for occupations that one would not expect to be closely related in the production process.

2.7.1 Wage Differentials between Occupations



Source: New Earnings Survey 1999

No one factor explains the gulf in pay that exists and persists between occupations and within each sector of the economy. Some of the relevant factors are listed below:

- ***Compensating differentials:*** higher pay as a reward for risk-taking, working in poor conditions and having to work unsocial hours.
- ***Differences in accumulated human capital:*** wages and salaries should help to compensate people for making an investment in education. There is an opportunity cost in acquiring qualifications - measured by the current earnings foregone by staying in full or part-time education. The private rate of return on achieving A levels or a university degree should be sufficient to justify the investment made.
- ***Different skill levels***: the gap between poorly skilled and highly skilled workers gets wider each year. One reason is that the demand for skilled labour (in both manufacturing and service sectors) grows more quickly than the demand for semi-skilled workers. This pushes up average pay levels. highly skilled workers are often in inelastic supply and rising demand forces up the "going wage rate" in a particular industry.
- ***Differences in productivity and revenue creation*** - workers whose efficiency is highest and ability to generate revenue for a firm should be rewarded with higher pay. City economists and analysts are often highly paid not least because they can claim annual bonuses based on performance. Top sports stars can command top wages because of their potential to generate extra revenue from ticket sales and merchandising.
- ***Employer discrimination:*** a factor that cannot be ignored despite over twenty years of equal pay legislation in place.

- ***Trade Union protection:*** many workers in low paid jobs do not have trade unions acting on their behalf to protect them from the power of employers.

  Wages will tend to rise fastest when final demand for the output that workers are producing is rising - i.e. people will enjoy higher pay in industries where output is rising, as revenues and profits are high. The demand for labour shifts out to the right, and the market equilibrium wage increases. This is shown in the diagram below:

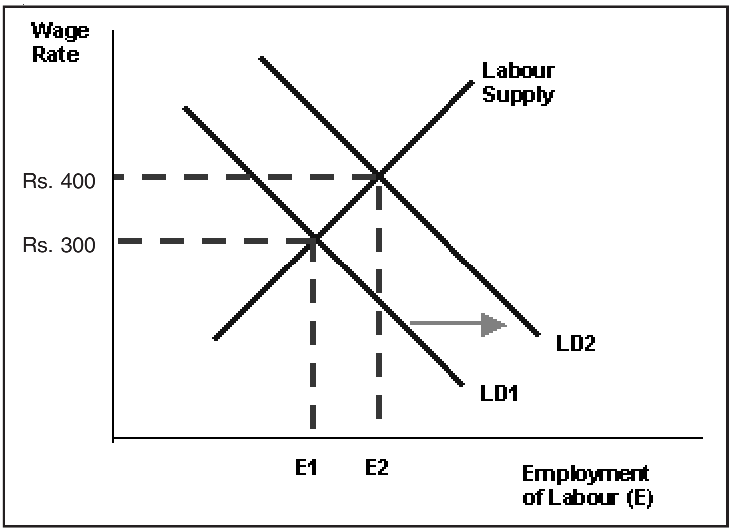


Figure 2.4: Demand for Labour

2.8 LET US SUM UP

There are two major kinds of wage and salary payment plans: those under which remuneration does not vary with output or the quality of output, but depends on the time unit consumed in performing work. Several countries have enacted a statutory minimum wage rate that fixes the price of certain kinds of labour. These are known as time wage plans. The time unit may be the day, week, fortnight or month. Time plans are non-incentive in the sense that earnings during a given time period do not vary with the productivity of an employee during that period. The second kind is concerned with the output or some other measure of productivity during a given period of time. To earn more, an employee is required to put in more labour and produce more.

Although understanding whether establishment wage differentials, which say that an individual's pay is determined in part by the establishment at which they work, is important for labor economics and theories of the firm, little is known about the order of magnitude of this effect.

2.9 LESSON END ACTIVITY

Write a short note on the theories and types of wage.

2.10 KEYWORDS

Piece-rate Pay: Piece -rate pay gives a payment for each item produced - it is therefore the easiest way for a business to ensure that employees are paid for the amount of work they do. Piece-rate pay is also sometimes referred to as a "payment by results system".

Time Rate: This is the oldest and the most common method of fixing wages. Under this system, workers are paid according to the work done during a certain period of time, at the rate of so much per hour, per day, per week, per fortnight or per month or any other fixed period of time.

Balance or Debt Method: This method is a combination of time and piece rates. The worker is guaranteed an hourly or a day-rate with an alternative piece rate.

2.11 QUESTIONS FOR DISCUSSION

1. Discuss the theories of wages.
2. What are different types of wages?
3. What is the role of time rate, piece rate and debt rate in the determination of wages?
4. What do you understand by the wage differentials?

Check Your Progress: Model Answers

CYP 1

1. This theory (1817) states that: "The labourers are paid to enable them to subsist and perpetuate the race without increase or diminution."
2. According to this theory, wages are based upon an entrepreneur's estimate of the value that will probably be produced by the last or marginal worker.

CYP 2

Dr. Abraham Maslow ranked needs in order of their ascending importance as follows:

(a) Physiological

(b) Safety

(c) Belonging

(d) Esteem

(e) Self-actualisation

CYP 3

1. True
2. True
3. True
4. True
5. True

2.12 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

UNIT II

LESSON

3

PLANNING FOR IMPROVED COMPETITIVENESS

CONTENTS

3.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the concept of planning for improved competitiveness
- Learn the concept of diagnosis and bench marking
- Know about the method of obtaining commitment

3.1 INTRODUCTION

The increasing competitiveness of the labour market and turnover of employees had resulted in nightmare in compensation planning. Apart from this, the growing demands of the employees and competitive salaries offered by multinational companies had almost resulted in a compensation war in certain industries.

Therefore, the human resources managers and tax experts have to evolve proper compensation planning for High end and qualified employees. The components of compensation have to be devised in such a way that, it focuses on the growing demands of employees while retaining the competitiveness and profitability of the company.

3.2 COMPONENTS OF COMPENSATION PLANNING

There are also certain driven factors that influence the compensation planning. The compensation packages of knowledge workers are different from that of manufacturing sector. The employees working in call centers are compensated differently (vs) employees of technology driven companies.

Some notable examples are:

a) Compensation paid in IT/ITES,

b) Investment banking/Equity research,

c) Software companies,

d) High-end industries having high technology content like Bio/Nano technology.

e) Private research and related fields.

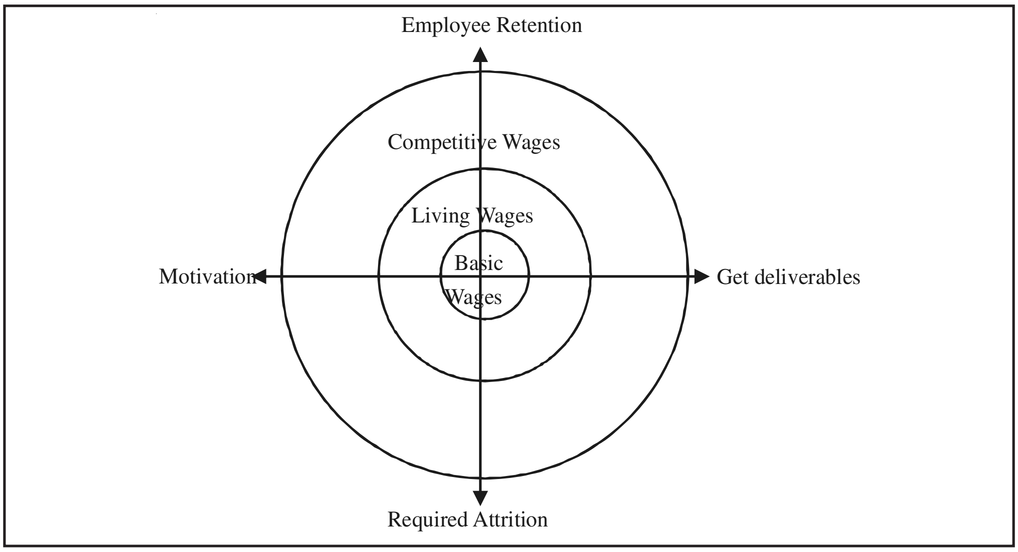


Figure 3.1: Compensation Oval

3.2.1 Basic Wages/Salaries

These refers to the cash component of the wage structure based on which other elements of compensation may be structured. It is normally a fixed amount which is subject to changes based on annual increments or subject to periodical pay hikes. It is structured based on the position of an individual in the organization and differs from grades to grades.

3.2.2 Dearness Allowance

The payment of dearness allowance facilitates employees and workers to face the price increase or inflation of prices of goods and services consumed by him. The onslaught of price increase has a major bearing on the living conditions of the labour. The increasing prices reduce the compensation to nothing and the money's worth is coming down based on the level of inflation.

The payment of dearness allowance, which may be a fixed percentage on the basic wage, enables the employees to face the increasing prices.

3.2.3 Bonus

The bonus can be paid in different ways. It can be fixed percentage on the basic wage paid annually or in proportion to the profitability. The Government also prescribes a minimum statutory bonus for all employees and workers.

There is also a bonus plan which compensates the Managers and employees based on the sales revenue or Profit margin achieved. Bonus plans can also be based on piece wages but depends upon the productivity of labour.

3.2.4 Commissions

Commission to Managers and employees may be based on the sales revenue or profits of the company. It is always a fixed percentage on the target achieved. For taxation purposes, commission is again a taxable component of compensation.

The payment of commission as a component of commission is practised heavily on target based sales. Depending upon the targets achieved, companies may pay a commission on a monthly or periodical basis.

3.2.5 Mixed Plans

Companies may also pay employees and others a combination of pay as well as commissions. This plan is called combination or mixed plan. Apart from the salaries paid, the employees may be eligible for a fixed percentage of commission upon achievement of fixed target of sales or profits or Performance objectives.

Nowadays, most of the corporate sector is following this practice. This is also termed as variable component of compensation.

3.2.6 Piece Rate Wages

Piece rate wages are prevalent in the manufacturing wages. The laborers are paid wages for each of the Quantity produced by them. The gross earnings of the labour would be equivalent to number of goods produced by them.

Piece rate wages improves productivity and is an absolute measurement of productivity to wage structure. The fairness of compensation is totally based on the productivity and not by other qualitative factors.

The GANTT productivity planning and Taylor's plan of wages are examples of piece rate wages and the related consequences.

3.2.7 Sign on Bonuses

The latest trend in the compensation planning is the lump sum bonus for the incoming employee. A person who accepts the offer, is paid a lump sum as a bonus.

Even though this practice is not prevalent in most of the industries, Equity research and investment banking companies are paying this to attract the scarce talent.

3.2.8 Profit Sharing Payments

Profit sharing is again a novel concept nowadays. This can be paid through payment of cash or through ESOPS. The structuring of wages may be done in such a way that, it attracts competitiveness and improved productivity.

Profit sharing can also be in the form of deferred compensation at the time of retirement. At the time of retirement the employees may be paid a lump sum or retiral benefits.

3.2.9 Fringe Benefits

The provision of fringe benefits does not attract any explanation. These includes:

a) Company cars

b) Paid vacations

c) Membership of social/cultural clubs

d) Entertainment tickets/allowances.

e) Discounted travel tickets.

f) Family vacation packages.

3.2.10 Reimbursements

Employees, depending upon their gradations in the organization may get reimbursements based on the Expenses incurred and substantiated. Certain expenses are also paid based on expenses incurred during the course of business.

In many cases, employers provides advances to the employees for incurring certain expenses that are incurred during the course of the business. Some examples are:

a) Travel expenses

b) Entertainment expenses

c) Out of pocket expenses

d) Refreshments expenses during office routine outside office premises.

3.2.11 Sickness Benefits/Pregnancy

The increasing social consciousness of corporates had resulted in the payment of sickness benefit to the Employees of companies. This also includes payments during pregnancy of women employees.

The expenses incurred due to injury or illness are compensated or reimbursed to the employees. In certain companies, the death of an employee is compensated financially.

Companies are also providing supporting financial benefits to the family of the bereaved employees. However, companies covering these cost through appropriate insurance policies like, medical and life insurance.

To conclude the whole idea of compensation management can be better understood through the following Pyramid structure.

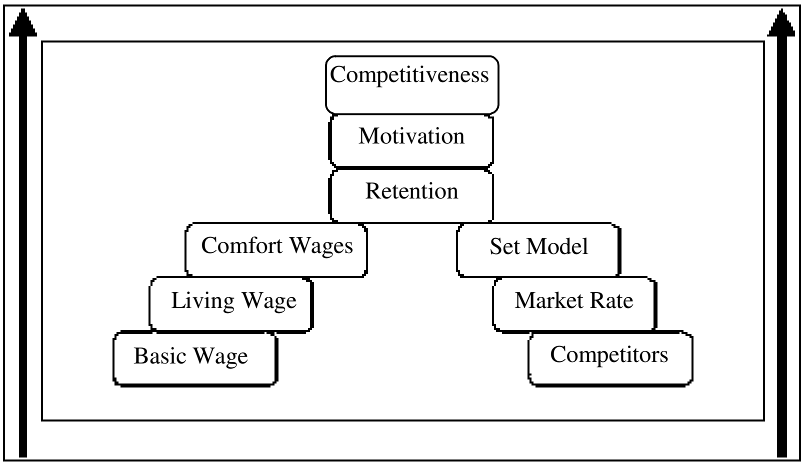


Figure 3.2: Compensation Management

Check Your Progress 1

Define the following:

1. Basic Salary

   ....

   ....

2. Bonus

   ....

   ....

3.3 DIAGNOSIS

The special theme of industrial diagnosis, planning and simulation is structured around a selection of industrial problems rather than a particular type of technology or methodology.

The initiative behind the formation of this group came from the observation that methods and techniques from these scientific disciplines often have the potential to improve both the efficiency of resource usage and the quality of products and services, as well as reducing the costs associated with production.

On the other hand, not all methods proposed by researchers scale well to the size and diversity of industrial problems.

The fact that techniques and methods developed in science are used to solve practical problems is, of course, nothing new. However, while this is the basis of all technology, the quality of the interplay between science and technology within a society determines to a large extent its potential for growth and development. In the case of computing science, which is the study of algorithms, their properties and use, one must always be careful to verify results against practical problems. This is a timeconsuming and, at times, frustrating experience for many researchers, since their experience lies in a different field to that in which the problem occurs. Even so, this process is essential for the growth of technology and provides valuable feedback to the research discipline.

For example, within the field of optimisation and combinatorial reasoning there exist many elegant and highly applicable results for a wide selection of specific problems. In a few cases, an industrial problem will exactly match a certain problem idealisation and the mathematical model used to study the properties of a particular class of algorithms. This is, however, only rarely the case. Real practical problems in, for example, industrial production, are invariably complex combinations of several smaller problems and may have numerous related idiosyncratic conditions. The ability to understand and describe a practical problem in terms of the types of models and methods used in this field is usually referred to as 'modelling expertise'.

Interestingly, this expertise is rarely described in the scientific literature. The ability to use outside a scientific field the algorithmic methods developed within that field exists in parallel with the science, and is indeed rather more of an art form. A systematic method for solving a class of practical problems is called a methodology. However, most methodologies used in computing science are based around a fairly limited set of algorithmic methods and quickly become useless whenever the problem changes too much or is combined with other problems into a more complex situation. This raises issues of method generality and scalability, which should be of prime concern to the scientific field developing the method as well as of great practical importance to the society in which the scientist works.

A systematic study of these issues will lead to two types of results:

- better understanding of typical models for a selection of important real-life industrial problems
- better understanding of the properties of a selection of practically useful algorithmic methods.

Industrial applications of state-of-the-art techniques and methods in computing science allow researchers to test, in practice, the flexibility, scalability and utility of their techniques and methods. In addition, it is an opportunity to push the mature parts of the scientific field out into practical use for the benefit of the industry and society at large, be it in manufacturing, transportation, processing, telecommunications, biotechnology or the service industry. This is true for many fields of computer science, but particularly for those directly involved in the modelling and solving of typical problems occurring in industry, e.g. process simulation, monitoring and prediction, capacity analysis and allocation, fault detection and diagnosis, production planning, flow optimisation, resource scheduling and allocation, structure detection and matching. We believe there is a strong and fundamental need to systematically study the practical utility of such methods by applying them to a large number of real cases.

For the special theme we have aimed to highlight successful or promising applications of advanced techniques from these fields, including some in full-scale industrial settings, which we hope will contribute to our understanding of the strengths and weaknesses of the various techniques and methods. The diagnosis have been grouped into four sections:

1. Electronics and Networks
2. Process Monitoring and Optimisation
3. Transportation and Logistics
4. Process Design and Management.

The first section contains two articles on the use of magnetic field models in the electronics industry, one on the management and optimisation of communications network resources, and a fourth on intrusion prevention.

The second - and largest - contains articles on monitoring, diagnosing and optimising production processes. Of these, several are concerned with the detection of deviations from normal process parameters, while others address issues in connection with identifying the cause of, and correcting, faulty behaviour. In a few cases, optimisation of process parameters and redundancy of monitoring systems are also relevant.

The third section contains articles on problems in transportation and logistics. This type of issue often contains instances of specific problems that are comparatively well understood, but in practice are frequently made very difficult to solve by combinations of sub-problems such as resource allocation, routing and scheduling. One of the articles describes an analytical method for capacity analysis and assessment using techniques from discrete event systems. Three are concerned with management and routing of vehicles, which is one of the most cost-intensive operations in transportation. Others describe approaches to solving packing, placement and storage problems.

3.4 BENCHMARKING

Benchmarking (also "best practice benchmarking" or "process benchmarking") is a process used in management and particularly strategic management, in which organizations evaluate various aspects of their processes in relation to best practice, usually within their own sector. This then allows organizations to develop plans on how to adopt such best practice, usually with the aim of increasing some aspect of performance. Benchmarking may be a one-off event, but is often treated as a continuous process in which organizations continually seek to challenge their practices.

Benchmarking in simplistic terms is the process where you compare your process with that of a better process and try to improve the standard of the process you follow to improve quality of the system, product, services etc.

A process similar to benchmarking is also used in technical product testing and in land surveying. See the article benchmark for these applications.

In South Korea, the imitation brand commodity etc. are called "Me Too Commodity", and there is an opinion assumed that it is a result of the benchmarking.

3.4.1 Advantages of Benchmarking

Benchmarking is a powerful management tool because it overcomes "paradigm blindness." Paradigm Blindness can be summed up as the mode of thinking, "The way we do it is the best because this is the way we've always done it." Benchmarking opens organizations to new methods, ideas and tools to improve their effectiveness. It helps crack through resistance to change by demonstrating other methods of solving problems than the one currently employed, and demonstrating that they work, because others are using them.

3.4.2 Collaborative Benchmarking

Benchmarking, originally invented as a formal process by Rank Xerox, is usually carried out by individual companies. Sometimes it may be carried out collaboratively by groups of companies (e.g. subsidiaries of a multinational in different countries). One example is that of the Dutch municipally-owned water supply companies, which have carried out a voluntary collaborative benchmarking process since 1997 through their industry association. Another example is the UK construction industry which has carried out benchmarking since the late 1990's again through its industry association and with financial support from the UK Government.

Procedure

There is no single benchmarking process that has been universally adopted. The wide appeal and acceptance of benchmarking has led to various benchmarking methodologies emerging. The most prominent methodology is the stage methodology by Robert Camp (who wrote the first book on benchmarking in 1989).

The 12 stage methodology consisted of 1. Select subject ahead 2. Define the process 3. Identify potential partners 4. Identify data sources 5. Collect data and select partners 6. Determine the gap 7. Establish process differences 8. Target future performance 9. Communicate 10. Adjust goal 11. Implement 12. Review/recalibrate.

The following is an example of a typical shorter version of the methodology:

1. ***Identify your problem areas:*** Because benchmarking can be applied to any business process or function, a range of research techniques may be required. They include: informal conversations with customers, employees, or suppliers; exploratory research techniques such as focus groups; or in-depth marketing research, quantitative research, surveys, questionnaires, re engineering analysis, process mapping, quality control variance reports, or financial ratio analysis. Before embarking on comparison with other organizations it essential that you know your own organization's function, process; base lining performance provides a point against which improvement effort can be measured.
2. ***Identify other industries that have similar processes:*** For instance if one were interested in improving hand offs in addiction treatment s/he would try to identify other fields that also have hand off challenges. These could include air traffic control, cell phone switching between towers, transfer of patients from surgery to recovery rooms.
3. ***Identify organizations that are leaders in these areas:*** Look for the very best in any industry and in any country. Consult customers, suppliers, financial analysts, trade associations, and magazines to determine which companies are worthy of study.
4. ***Survey companies for measures and practices:*** Companies target specific business processes using detailed surveys of measures and practices used to identify business process alternatives and leading companies. Surveys are typically masked to protect confidential data by neutral associations and consultants.
5. ***Visit the "best practice" companies to identify leading edge practices*:** Companies typically agree to mutually exchange information beneficial to all parties in a benchmarking group and share the results within the group.
6. ***Implement new and improved business practices*:** Take the leading edge practices and develop implementation plans which include identification of specific opportunities, funding the project and selling the ideas to the organization for the purpose of gaining demonstrated value from the process.

3.4.3 Cost of Benchmarking

Benchmarking is a moderately expensive process, but most organizations find that it more than pays for itself. The three main types of costs are:

- ***Visit Costs:*** This includes hotel rooms, travel costs, meals, a token gift, and lost labor time.

- ***Time Costs***: Members of the benchmarking team will be investing time in researching problems, finding exceptional companies to study, visits, and implementation. This will take them away from their regular tasks for part of each day so additional staff might be required.
- ***Benchmarking Database Costs***: Organizations that institutionalize benchmarking into their daily procedures find it is useful to create and maintain a database of best practices and the companies associated with each best practice now.

The cost of benchmarking can substantially be reduced through utilizing the many internet resources that have sprung up over the last few years. These aim to capture benchmarks and best practices from organizations, business sectors and countries to make the benchmarking process much quicker and cheaper.

3.4.4 Technical Benchmarking or Product Benchmarking

The technique initially used to compare existing corporate strategies with a view to achieving the best possible performance in new situations, has recently been extended to the comparison of technical products. This process is usually referred to as "Technical Benchmarking" or "Product Benchmarking'. Its use is particularly well developed within the automotive industry ("Automotive Benchmarking"), where it is vital to design products that match precise user expectations, at minimum possible cost, by applying the best technologies available worldwide. Many data are obtained by fully disassembling existing cars and their systems. Such analyses were initially carried out in-house by car makers and their suppliers. However, as they are expensive, they are increasingly outsourced to companies specialized in this area. Indeed, outsourcing has enabled a drastic decrease in costs for each company (by cost sharing) and the development of very efficient tools (standards, software).

3.4.5 Types of Benchmarking

- ***Process benchmarking***: The initiating firm focuses its observation and investigation of business processes with a goal of identifying and observing the best practices from one or more benchmark firms. Activity analysis will be required where the objective is to benchmark cost and efficiency; increasingly applied to back-office processes where outsourcing may be a consideration.
- ***Financial benchmarking:*** This includes performing a financial analysis and comparing the results in an effort to assess your overall competitiveness.
- ***Performance benchmarking:*** It allows the initiator firm to assess their competitive position by comparing products and services with those of target firms.
- ***Product benchmarking:*** It is the process of designing new products or upgrades to current ones. This process can sometimes involve reverse engineering which is taking apart competitors products to find strengths and weaknesses.
- ***Strategic benchmarking:*** It involves observing how others compete. This type is usually not industry specific meaning it is best to look at other industries.
- ***Functional benchmarking:*** A company will focus its benchmarking on a single function in order to improve the operation of that particular function. Complex functions such as Human Resources, Finance and Accounting and Information and Communication Technology are unlikely to be directly comparable in cost and efficiency terms and may need to be disaggregated into processes to make valid comparison.

Check Your Progress 2

1. What do you understand the benchmarking?

 ....

 ....

2. What is financial benchmarking?

 ....

 ....

3.5 OBTAINING COMMITMENT

Obtaining commitment - or getting buy in - from your associates on new goals, procedures or methods remains one of the greatest day-to-day challenges for most managers.

Miller writes that, "Your employees will have one of four responses toward their goals: buy-in, commitment, acceptance, or rejection." He advises that you not settle for "mere acceptance of the goal without commitment" because that doesn't allow you to hold your employees accountable.

To move your colleagues to commitment, Brian Cole Miller suggests you follow this four-step process.

1. Ask your employees to buy in to the goals: "Can you make these goals your own?" "Which of these goals do you already feel are personal for you?" "Which goals get you most excited?"

2. If your employees don't buy in, ask them to commit to the goals: "Will you commit to achieving all of these goals?" "Will you work to accomplish each and every goal?" "Can I count on you to achieve all of this?"

3. Do not allow your employees to reject or merely accept the goals. Neither of these responses will permit you to hold them accountable.

4. Once your employees buy in or commit, discuss briefly how they might go about attaining the goals. This discussion will help you determine if they really understand what they are getting into.

   Miller's book takes a very practical approach to obtaining commitment from employees; its many short, readable lessons are organized into a framework of six basic processes for obtaining commitment and holding employees to account:

   - Setting expectations
   - Inviting commitment
   - Measuring results
   - Providing feedback
   - Linking results to consequences
   - Evaluating your own effectiveness

Check Your Progress 3

State whether the following statements are True or False:

1. Financial benchmarking means performing a financial analysis and comparing the results in an effort to assess your overall competitiveness.
2. Performance benchmarking allows the initiator firm to assess their competitive position by comparing products and services with those of target firms.
3. Product benchmarking is the process of designing new products or upgrades to current ones.
4. Strategic benchmarking involves observing how others compete. This type is usually not industry specific meaning it is best to look at other industries.
5. Miller's book takes a very practical approach to obtaining commitment from employees.

3.6 LET US SUM UP

The increasing competitiveness of the labour market and turnover of employees had resulted in nightmare in compensation planning. Apart from this, the growing demands of the employees and competitive salaries offered by multinational companies had almost resulted in a compensation war in certain industries.

The special theme of industrial diagnosis, planning and simulation is structured around a selection of industrial problems rather than a particular type of technology or methodology.

Benchmarking may be a one-off event, but is often treated as a continuous process in which organizations continually seek to challenge their practices. Benchmarking in simplistic terms is the process where you compare your process with that of a better process and try to improve the standard of the process you follow to improve quality of the system, product, services etc. A process similar to benchmarking is also used in technical product testing and in land surveying. The use of technical Benchmarking" or "Product Benchmarking' is particularly well developed within the automotive industry ("Automotive Benchmarking"), where it is vital to design products that match precise user expectations, at minimum possible cost, by applying the best technologies available worldwide. Many data are obtained by fully disassembling existing cars and their systems. Such analyses were initially carried out in-house by car makers and their suppliers.

The benchmarking is a search for industry best practices. A benchmarking can be a source of best practice or a desired result or outcome. Many agencies do comparative benchmarking to identify improvement opportunities. However, benchmarking data from one departments to another or from one organization to another is useful only if data are collected and reported in such a way that allows meaningful comparisons. Like the nursing process, the benchmarking process has sequential steps. In the nursing process, the phase that follows data analysis is diagrams. In benchmarking the phase that follows data analysis is discovery, which then leads to opportunities for CQL.

3.7 LESSON END ACTIVITY

Write a study note on the importance of planning for improved competitiveness.

3.8 KEYWORDS

Process Benchmarking: The initiating firm focuses its observation and investigation of business processes with a goal of identifying and observing the best practices from one or more benchmark firms.

Financial Benchmarking: This includes performing a financial analysis and comparing the results in an effort to assess your overall competitiveness.

Performance Benchmarking: It allows the initiator firm to assess their competitive position by comparing products and services with those of target firms.

Product Benchmarking: It is the process of designing new products or upgrades to current ones. This process can sometimes involve reverse engineering which is taking apart competitors products to find strengths and weaknesses.

Strategic Benchmarking: It involves observing how others compete. This type is usually not industry specific meaning it is best to look at other industries.

Functional Benchmarking: A company will focus its benchmarking on a single function in order to improve the operation of that particular function.

3.9 QUESTIONS FOR DISCUSSION

1. Discuss the concept of planning for improved competitiveness.
2. What do you understand by the concept of diagnosis and bench marking?
3. What do you know about the method of obtaining commitment?

Check Your Progress: Model Answers

CYP 1

1. These refers to the cash component of the wage structure based on which other elements of compensation may be structured. It is normally a fixed amount which is subject to changes based on annual increments or subject to periodical pay hikes. It is structured based on the position of an individual in the organization and differs from grades to grades.
2. The bonus can be paid in different ways. It can be fixed percentage on the basic wage paid annually or in proportion to the profitability. The Government also prescribes a minimum statutory bonus for all employees and workers.

CYP 2

1. Benchmarking (also "best practice benchmarking" or "process benchmarking") is a process used in management and particularly strategic management, in which organizations evaluate various aspects of their processes in relation to best practice, usually within their own sector.
2. Performing a financial analysis and comparing the results in an effort to assess your overall competitiveness.

CYP 3

1. True
2. True

Contd....

3. True
4. True
5. True

3.10 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

LESSON

4

INTERNAL AND EXTERNAL EQUITY IN COMPENSATION

CONTENTS

4.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the determination of inter and intra - industry compensation differentials
- Learn about internal and external equity in compensation systems

4.1 INTRODUCTION

Compensating differential is a term used in labor economics to analyze the relation between the wage rate and the unpleasantness, risk, or other undesirable attributes of a particular job. A compensating differential, which is also called a compensating wage differential or an equalizing difference, is defined as the additional amount of income that a given worker must be offered in order to motivate them to accept a given undesirable job, relative to other jobs that worker could perform. One can also speak of the compensating differential for an especially desirable job, or one that provides special benefits, but in this case the differential would be negative: that is, a given worker would be willing to accept a lower wage for an especially desirable job, relative to other jobs. The idea of compensating differentials has been used to analyze issues such as the risk of future unemployment, the risk of injury, the risk of unsafe sex, and the monetary value workers place on their own lives.

The terms compensation differential, pay differential, and wage differential are also used in economics, but normally have a different meaning. They simply refer to differences in total pay (or the wage rate) in any context. So a 'compensation differential' can be explained by many factors, such as differences in the skills of the workers in those jobs, the country or geographical area in which those jobs are performed, or the characteristics of the jobs themselves. A 'compensating differential', in contrast, refers only to differences in pay due to differences in the jobs themselves, for a given worker (or for two identical workers).

In the theory of price indices, economists also use the term compensating variation, which is yet another unrelated concept. A 'compensating variation' is the change in wealth required to leave a consumer's well-being unchanged when prices change.

Check Your Progress 1

What do you understand by wage differential?

....

....

4.2 INTER AND INTRA INDUSTRY WAGE DIFFERENTIALS

Inter-industry wage disparity has received the utmost attention in many countries, with a host of controversies arising from the abnormally high wages prevalent in such monopoly sectors as telecom and electric power. When analyzing differential determining factors using econometric techniques, the author finds that human capital can only explain about 60% of the Coefficient of Variables (CVs) used to measure inter-industry average earning differentials. Based on a more detailed industry analysis, the author attributes the remainder of CVs to monopoly rent sharing. The existing inter-industry wage differentials are an ongoing ubiquitous phenomenon, according to overseas scholars. In addition to regular discussions, the efficiency wage hypothesis and rent-sharing hypothesis offer further explanations. Overseas studies on inter-industry wage differentials are mostly based on individual sample data, and by controlling regular variables an assessment of pseudo-variables for interindustry wage differentials can be made, thereby lending support to the efficiency wage or rent sharing hypothesis. For example, wage premiums usually exist in the large-scale industries and those with high profitability.

Various reasons may explain the inter-industry wage differentials. They may, of course, reflect the fact that the non-observed individual characteristics of the employees are not distributed randomly among industries. In this case, the most well paid sectors would simply be those in which the non-observed quality of the labour force is the highest. However, they may equally stem from the specific characteristics of the employers in each sector. Gibbons and Katz (1992) support the existence of significant sectoral effects on workers' wages. Their study, relating to the USA, in fact indicates that workers changing industry claw back a significant part of the inter-industry wage differential after their move. Conversely, Goux and Maurin (1999) and Abowd et al. (1999) show that in the case of France, the non-observed productive capacities of workers account for a substantial part of the inter-industry wage differentials.

In sum, there is no consensus regarding the exact scale of the inter industry wage differentials. However, their existence highlights the influence of the characteristics of the employers in each sector on workers' wages.

Economic theories supporting the existence of an effect of the employers' characteristics on wages have proliferated over recent years (e.g. efficiency wage theory, insider-outsider theory). They provide a very interesting framework for analysis for anyone trying to gain an understanding of why, in equilibrium, two agents with identical productive characteristics, placed in the same working conditions, may be paid differently. Among these, the rent-sharing theory suggests that because of their bargaining power, unions can obtain a wage differential for their members, which is greater than the competitive level. According to this theory, inter-industry wage disparities would therefore result in part from the heterogeneity of the bargaining power of the unions in the various industries.

4.3 INTERNAL AND EXTERNAL EQUITY IN COMPENSATION SYSTEM

4.3.1 Concept of Internal Equity and External Equity

The basic binding factor for an employee with the organization is the compensation & recognition he gets for the contribution/service he renders to accomplish the desired output or goals of the enterprise. We all know that salary (including allowances) or wages is the prime compensation to an employee in primarily associating and motivating him to work. Being a social animal, he also compares his take home-pay with others working along at the work-place and expects an equitable compensation in relation to similar tasks performed within his organization. And also the approach is to compare the compensation levels of similar jobs/ tasks in the industry or the region or locality.

This is how the concept of Internal Equity and External Equity have come about. The basic tenets of Taylor’s Scientific Management with respect to human resource.

The method of determining the internal worth of the jobs is known as Job Evaluation, which establishes the rational differentials that are required between jobs, ultimately leading to a wage-structure across the jobs in the organisation. Accordingly, Pay/wage-surveys in the industry/region attempt to compare the internal wage structure of an organization with those prevailing in the market. Such an External Equity enables the management to evolve a suitable wage structure to attract required skills/talent and retain them within the organization. Similarly, Employers develop suitable instruments to evaluate performance of the employees Performance-Appraisal System – 1. To find out the worth of the job-holders 2. Determine suitable reward and incentive for superior performance 3. How well an employee is doing/will do on assigned/future jobs.

- Right Man for the Right Job
- Right Pay for the Right Job

Thereby the man on the job is kept highly motivated to associate himself with the work through suitable (right) training and placement as well as attractive (equitable) compensation, so that skill and attitude (motivation) of the employee is most optimum for discharging his duties. This is where the issue of determining the relative worth of a job within his organization to establish internal equity assumes relevance. The method of determining the internal worth in the industry of the jobs is known as Job Evaluation, which establishes the rational differentials that are required between jobs, ultimately leading to a wage-structure across the jobs in the organization. Accordingly, Pay/wage-survey in the industry/region attempt to compare the internal wage structure of an organization with those prevailing in the market. Such an External Equity enables the management to evolve a suitable wage structure to attract the required skills/talent and retain them with the organization.

In conclusion, it may be observed that Job-Evaluation is a means to establish the internal worth of a job relative to others. Whereas pay/wage-surveys are the means to evolve suitable wage structure to attract/motivate and retain employees by establishing External Equity. These two techniques of scientific management would enable the management to locate the right man and retain him suitably motivated through pay or wages.

4.3.2 Job Evaluation

Job evaluation is over 100 years old. According to a source, first attempts at the job evaluation were made in 1871 by US Civil Services Commission. (Patton, little Field & Self, 1964). With the advent of scientific management and Industrial engineering it is used widely till today, for purposes of determining differentials in remuneration, particularly for manual jobs and related activities. Defined by British Standard Institution (1969), Job Evaluation is "A generic term covering methods of determining the relative worth (Equity) of jobs." Job Evaluation is a systematic (Quantitative and qualitative) method, for determining the relative worth of a job in comparison within and outside the organisation. It helps to eliminate wage inequities and to establish a basis for sound salary and wage-structure. Job Evaluation consists of the following:

- ***Job Analysis:*** The process of examining the content of a job, breaking it down into it's task, functions, processes, operation and elements.
- ***Job Description:*** Description of a job based on job analysis.
- ***Job Specification:*** The statement of the content of job based on job description and job grading.
- ***Job Grading:*** Ranking of job as a result of job analysis.
- ***Job Classification:*** Grouping jobs according to their worth.
- ***Job Assessment/Job Pricing:*** The ascription of a monetary value on the basis of job grading.

The methods used for Job Evaluation of workers and managers are marginally different at the grading and assessment stages, while the above generic process is usually followed. Job Evaluation is concerned with the evaluation of the job in terms of its requirement of skill, responsibilities, effort and other factors in performing the job. It does not evaluate the man performing the job and it is not related with the quality or quantity of the output or the speed of working. These are subject matter of merit rating and work-study.

Table 4.1: Determining an Internally Consistent Job Structure

Internal Consistency Work Relationships within the organisation →	Job analysis →	Job description →	Job evaluation →	Job structure

Some Major Decisions in Job Evaluation

- Establish purpose of evaluation.
- Decide whether to use single or multiple plans.
- Choose among alternative approaches.
- Obtain involvement of relevant stakeholders.
- Evaluate plan's usefulness.

Rationale

There are a number of reasons for its extended usage. Organizations are becoming more scientific and systematic through the introduction of various management strategies and techniques i.e. growth, amalgamation, take-over, stiff competition, and in many cases shortage of skilled manpower. All combine to cause a critical appraisal of the workforce and subsequent rationalization with the ongoing social, technological and economic change, the content of jobs are created every day. Even the shape of traditional jobs have also changed in due course. Jobs have become de-skilled and more of systematic and new specialists have proliferated with the march of "change". The problem is further exacerbated where traditional notions of skilled, semiskilled and unskilled work still forms the basis of remuneration. The technology of today has changed the degree of skill required and redistribute the same to wider exhaust. And the addition of white collar workforce to traditional workforce has changed the traditional worker to sophisticatedly manage his own job work.

Today the jobs are not what they are named and the work is not what it is paid for. So this is the plinth of pay determination problem – assessing and agreeing the fairness of pay differentials. Wage or Pay in equities do creep in due to a number of reasons in our organizations namely:

i. Favouritism by the supervisor/manager.

ii. Pressures from employee groups/unions.

iii. Scarcity of skills.

iv. Unsystematic approach to pay-structure.

Job Evaluation as a systematic approach that brings in better rationalization in the Pay/ Wage-structure.

Objectives

The purposes that are served by Job Evaluation remultifold considering the issues facing the organization at a point of time. However, the primary and secondary objectives Job Evaluation serves are as follows:

1. ***Primary Objectives***

   ❖ To establish wage level of a plant

   ❖ To establish relative wage level in a plant

   ❖ To bring new jobs to their proper relative parity with existing jobs

   ❖ To facilitate wage negotiations

2. ***Secondary Objectives***

- ❖ To determine qualities (Job-specification) for new jobs for employee selection
- ❖ To determine criterion for merit rating and promotions
- ❖ To analyse wage rates
- ❖ To find scope of automation and improvement
- ❖ To train new supervisors
- ❖ To improve working conditions as better compensation in lieu of that

Table 4.2: Aspects of Job Evaluation

Job evaluation is:	Assumption
A Measure of Job Content	Content has innate value outside of external market
A Measure of Relative Value	Relevant group can reach consensus on relative value
Link with External Market	Job worth cannot be specified without external market information.
Measurement Device	Honing instruments will provide objective measures
Negotiation	Puts face of rationality to a social/political process Establishes rules of the game Invites participation

3. ***Job Evaluation Procedure***

The general step-wise procedure for job evaluation is as under:

(i) *Select the group of jobs:* Such as workmen category office staff, supervisory or managerial as distinct groups.

(ii) *Study the job (job analysis)*

(a) The jobs are studied by (a) Getting information from the employee about his work, (b) Observing the work, and (c) Consulting the supervisors of the employees.

(b) The information gathered from different sources regarding a particular job is recorded on the Job Analysis Sheet. Full details regarding the content of work, equipment used, working conditions, qualifications needed to do the work, time taken to learn the job, supervision received and given, and responsibilities involved are noted down on the Job Analysis Record.

(iii) *Prepare job-description–approval:* On the basis of detailed information, recorded in the Job Analysis Sheet, Job descriptions are prepared. These job descriptions state simply and clearly a comprehensive picture of the job.

(iv) *Device an evaluation plan–common characteristics/traits:* A set of key factors such as education, experience, responsibilities and working conditions are selected and weightages given to all these factors. Each factor is generally divided into degrees which indicate the extent to which the factor is required for successful performance of the job. This constitutes the job evaluation plan. It is known as the point plan as it involves giving points to each of the jobs to indicate their relative values.

(v) *Establish a committee of raters and rate/evaluate:* A committee of raters jointly rate the jobs by applying the point plan to the job description. In case of any difference of opinion among the raters, efforts are made to arrive at a conclusion by referring to facts stated in the job description, the job analysis, and in some cases by going back to the work spot.

(vi) *Group or classify the jobs:* The point values given to the job on various factors are totalled up and the total points secured by different jobs are classified into grades. The number of grades into which they can be classified depends upon the policies of the organisation, the view of Management and Union, and the experience and judgement of the raters.

(vii) *Convert job grades to money value along with Wage Survey:* The point values of the jobs are converted into money values on the basis of the wage survey results and finances available for establishing a Management are equitable wage differential in the organisation.

(viii) Obtain approval from Union and Management

(ix) *Establish a suitable grievance procedure:* A report on the job evaluation containing full details regarding the work done and a set of recommendations is prepared for use, at the time of implementation and in dealing with any appeals from the employees.

Check Your Progress 2

What are the primary objectives of job evaluation?

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4.3.3 Methods and Systems of Job Evaluation

The methods and systems of Job Evaluation are divided into different categories which are as follows:

A. ***Conventional:*** A variety of job evaluation systems are in use and all of them are modifications of four basic systems. These are the ranking system, the grading system, the factor comparison system, and the point system. All of them are similar to each other in certain respects and are applicable to all types of jobs at all levels.

I *Non-quantitative*

a. Ranking method

b. Classification method

II *Quantitative*

a. Points Rating method

b. Factor Comparison method

B. ***Innovative/Non-Conventional:*** These systems are quite innovative and use concepts of management decision-making and related aspects as factors for establishing internal equity. These are:

1. Time span of discretion method
2. Decision Band method
3. Direct Consensus method

4. Guide Chart Profile method
5. Urwick Orr Profile method

Ranking Method

In this method, simple and easy job-descriptions are made and sorted in the sequential order of their worth as a whole. The jobs common in various organizations are checked and are ranked/rated by interpolation. All the jobs in an organization are ranked in the order of complexity, responsibility and demands they make on the respective employees. Ranking of all the jobs is made easier by first identifying those that come at two extreme ends of the scale and locating the rest in the middle-region. A committee carried out this ranking more than once and the results of repeated ranking are pooled to arrive at the final ranking. Wherever there is significant discrepancy in rankings by members of the Evaluation Committee, the matter is settled by mutual discussion. The final ranking of jobs is based on the average ranking of all members and the times ranked.

Advantages

- It is simplest of all procedures.
- It is less time-consuming.
- It leaves more room for Unions to bargain disadvantages.
- Sometimes equal differentials are assessed to adjacent ranks.
- None of the committee member is likely to be familiar with all jobs.

Classification Method

This method is sometimes called as predetermined grading method. A limited number of job grades are established on the basis of knowledge about the existing jobs in the organisation. Each of these grades is defined in terms of general functions and qualifications required. This is followed by development of job descriptions, which briefly state the nature of duties of each job. These global job descriptions are matched with the grades, and jobs are classified into one or the other grades.

Advantages

- It is comparatively an easier method.
- It is less time-consuming.

Disadvantages

- It is irrational in absence of logic, and nearby jobs are sometimes put in different classes.
- It is very hard to determine the pre-requisites of classes.

Point Rating Method

In this method, the whole job is analysed through 5-8 factors and over 20-50 sub-factors based on requirements. These factors/sub-factors are given points which total out as the overall position of the jobs. Though it is not scientific it is systematic method. It is the most popular method in use today in judging the relative of worth of jobs factors. The steps involved in this system so far described are:

a. Job analysis through interview/questionnaire and actual observations.

b. Writing the job description from the data collected through job analysis and checking them up with departments supervisors concerned for accuracy.

The next important step is the selection of an appropriate plan for the jobs to be evaluated. A plan should contain such job characteristics or factors divided into a number of degrees which would provide suitable scales for measuring the extent of a particular characteristic present in the job being evaluated. Further, a plan should be developed or adopted in such a way as to cover the types of jobs which are to be evaluated, thus, a plan for clerical employees is not suitable for factory operatives. In such a plan, the inclusion of the factor of physical effort may not be necessary because of the sedentary nature of the job, but physical effort is an important factor in almost all factory jobs. After factors that have been decided upon should be defined to make their meanings clear and unambiguous. Due weightage should be given to them. Here again, one has to be careful in judging the relative weightage of factors. Thus in a sophisticated process plan the factor of mental/visual effort will have a higher weightage than the factor of physical effort, because the job of the operator is mainly to keep a watch on instruments and meters at the control panel rather than to go for heavy physical exertion. Factors are then divided into a suitable number of degrees between their extremes and each degree is defined to make its meaning clear. Thus the factor of education may, in a plan to evaluate factory operatives, have three degrees between the lowest (which may be defined as ability to follow instructions) and the highest (a certificate of proficiency in trade from an institution). Point values are then assigned to each degree. Summing up, it may be stated that this step would involve:

c. Development of an appropriate plan which involves:-

i. Selection and definition of factors and giving due weightage to them.

ii. Deciding on the number of degrees and defining them, and

iii. Assigning point values to degrees.

An example of the factors, degrees and points used in a job evaluation plan for the daily-rated workers of a paper mill is given below:

Table 4.3: Job Evaluation Plan for Daily-rated Workers

Factors	Degrees and Points				
	I	II	III	IV	V
SKILL (42%)					
1. Education	14	28	42	56	70
2. Experience	20	40	60	80	100
3. Initiative and Ingenuity	8	16	24	12	40
EFFORT (18%)					
4. Physical effort	10	20	30	40	50
5. Mental & Visual Demand	8	16	24	32	40
RESPONSIBILITY (20%)					
6. Responsibility for Materials/ Product/Process	8	16	24	32	40
7. Responsibility for Tools & Equipment	4	8	12	16	20
8. Responsibility for Work of others	4	8	12	16	20
9. Responsibility for Safety of others	4	8	12	16	20
10. Surroundings	12	24	36	48	60
11. Hazards	8	16	24	32	48

Check Your Progress 3

What are the different types of conventional methods for job evaluation?

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4.3.4 Factors and Degrees Defined for Education

This factor appraises the educational requirement considered necessary to perform the job satisfactorily. A formal education or schooling may not be essential, but such requirement is expressed in terms of equivalent years of schooling. The knowledge might have been acquired by self-study or practical knowledge.

i. ***Degree:*** Ability to follow verbal instructions in local language for performing manual tasks of either repetitive or closely supervised non-repetitive nature and also to count numbers.

ii. ***Degree:*** Ability to read and write words in English and to perform simple arithmetical calculations. Some trade knowledge in paper-making finishing, etc. , equivalent to primary school education.

iii. ***Degree:*** Ability to read and write simple English, perform arithmetical calculations involving use of fraction, decimals, etc; use shop tools and understand simple drawings, good trade knowledge in beating, chalk mixing, etc., equivalent to class VIII standard in high school.

iv. ***Degree:*** Ability to read and write; perform mathematical calculations; understand detailed sketches and proficiency in a trade like fitting, welding, etc., equivalent to matriculation standard.

v. ***Degree:*** Background education suitable for understanding all aspects of a trade which may be considered equivalent to a certificate course from Industrial Training Institute or a first-class certificate of competency from a government department.

Similarly, factor and degree definitions are prepared for all other factors in the plan.

The next step in the process is the actual evaluation of jobs. Appropriate degree for each factor is determined for each job, and point values are assigned to each degree. The total of these point values represents the worth of an individual job. All types of jobs covered by the plan (daily-rated in the example) are thus evaluated and finally grouped into classes according to the ranges of values between jobs having minimum and maximum values and their clustering.

Continuing with the illustration cited earlier, two jobs are evaluated below:

Table 4.4: Evaluation of Jobs

	Sweeper		Turner	
	Degree	**Point**	**Degree**	**Point**
Education	1	14	4	56
Experience	1	21	3	60
Initiative & Ingenuity	1	8	4	32
Physical effort	2	20	2	20
Mental demand	2	16	4	32
Responsibility for Mat./Prod./Process	1	8	3	24
Responsibility for Tools & Equipment	1	4	4	16
Responsibility for Work of others	1	4	2	8
Responsibility for Safety of others	1	4	2	8
Surroundings	3	36	3	36
Hazards	2	16	3	24
Total Points		**151**		**316**

According to the classification indicated below, the above jobs fall in classes A and D respectively.

Table 4.5: Classification

Class	Point range
A	140-190
B	191-240
C	241-290
D	291-340
E	341-390
F	391 & over

The point values finally arrived at are then covered to monetary values for determining the wage rates of the jobs. A minimum wage rate can be decided upon (may be after negotiation with union) for jobs having the lowest point values and a maximum rate for those with highest point values. Wage rates for all jobs can be fixed between this rate range. Similarly, suitable wage grades or scales can be worked out for other classified jobs after evaluation. The resulting wage structure will reflect the true differential in the worth of jobs.

It may be stated that though at times criticisms are levelled against job evaluation, as the process involves certain amount of subjective judgement, nevertheless, this is perhaps the best technique evolved so far to reduce wages inequities.

Advantages

- It is the most sophisticated system.
- All the outcome is in hard fact numbers.

Disadvantages

- It is time-consuming.
- Satisfying benchmark jobs for the degrees are required to be put forth for rating effectively.

Factor Comparison Method

This method was originally developed in 1926 as an offshoot point rating. This method therefore incorporates some of the principles of point rating but differs substantially from it in its use of benchmark jobs and its method of comparing jobs and fixing wage rates.

The first task in applying this method is to select and describe clearly the factors to be used. The choice of factors is generally much more limited than in point rating. For manual workers, the following factors are generally recommended:

1. Mental requirements;
2. Skill requirements;
3. Physical requirements;
4. Responsibilities;
5. Working conditions.

For clerical, technical and supervisory staff, all the factors mentioned above except working conditions are generally recommended.

The factor comparison method involves the following steps:

1. Selecting benchmark jobs;
2. Ranking benchmark jobs by factors;
3. Allocating money values to factors;
4. Ranking the other jobs, and wage fixing.

1. ***Selecting benchmark jobs:*** The jobs selected as benchmark jobs must satisfy a number of conditions. First, they should be capable of clear descriptions and analysis in terms of the factors used; second, they must be representative of the hierarchy, third, when the rates for the benchmark jobs are to be used as the standard for fixing the wages, these rates should be regarded as appropriate by all concerned.

2. ***Ranking benchmark jobs by factors:*** Once a number of benchmark jobs are chosen, they are ranked successively by reference to each of the factors chosen. When the ranking is done by a committee, each member must make his own ranking and the results then being averaged. A typical example of ranking of jobs by factors under the comparison method is given in Table 4.6.

Table 4.6: Ranking Jobs by Factors under the Factor Comparison Method

Job	Skill	Mental Requirements	Physical Requirements	Responsibility Requirements	Working Conditions
Toolmaker	1	1	2	1	4
Machinist (grade I)	2	2	3	2	3
Electrician (grade I)	3	3	4	3	5
Assembler (grade I)	4	4	5	5	2
Janitor	5	5	1	4	1

3. ***Allocating money values to factors:*** The factor comparison method may also be used for fixing up wages in money units by ranking the jobs according to a procedure different from the one shown above. The wage rate for each benchmark job is broken down and distributed among the factors in the proportions in which these are considered to contribute to the total price paid for each benchmark job in the

form of its wage rate. For example, if tool-making is a benchmark job and its wage rate is 20 money units, it may be decided to assign nine of these to skill, five to mental requirements, two to physical requirements, three to responsibility and one to working conditions. Similarly, if the wage rate for another benchmark job, for example that of a first grade machinist, amounts to 18 money units, eight of these may be allotted to skill, three to working conditions, and so on. When the rates for all benchmark jobs have been divided in this way the jobs have implicitly been ranked again with respect to each of the factors. In the example given, the toolmaker ranks above the machinist as regards skill requirements, but below the machinist if the jobs are ranked on the basis of working conditions.

After the results have been averaged by a committee in the manner described above, the allocation of wage rates and the ranking by factors of the jobs covered for Table 4.6 might work out as indicated in Table 4.7.

The two rankings of the benchmark jobs are undertaken independently of each other and need not coincide. Their respective results as illustrated by Tables 4.6 and 4.7 are compared in Table 4.8.

It will be noted that there are differences in ranking revealed in Table 4.8. These differences have to be removed either by increasing or decreasing the money value of the different factors for the jobs concerned or by examining the job contents again. If it is not possible to reconcile the ranking of a particular job, it is eliminated from the list of benchmark jobs.

4. ***Ranking other jobs:*** On the basis of job descriptions, each job is analysed and compared with the benchmark jobs in terms of each of the factors separately.

Table 4.7: Allocation of money values to the different factors and ranking of jobs under the factor comparison method

Job	Wage Rate In Money units	Skill		Mental Requirements		Physical Requirements		Responsibility		Working Conditions	
		Money value attributed	Ranking of job	Money value attributed	Ranking of job	Money value attributed	Ranking of job	Money value attributed	Ranking of job	Money value attributed	Ranking of job
Toolmaker	20	9.0	1	5.0	1	2.0	3	3.0	1	1.0	5
Machinist (grade I)	18	8.0	2	4.0	2	1.0	5	2.0	2	3.0	3
Electrician (grade I)	16	6.0	3	3.0	3	3.0	2	1.5	3	2.5	4
Assembler (grade I)	14	4.0	4	2.0	4	1.5	4	1.0	4	5.5	1
Janitor	12	2.0	5	1.0	5	4.0	1	0.5	5	4.5	2

Table 4.8

Job	Skill		Mental Requirements		Physical Requirements		Responsibility		Working Conditions	
	Ranking by Factor	Ranking of Money Value	Ranking by Factor	Ranking of Money Value	Ranking by Factor	Ranking of Money Value	Ranking by Factor	Ranking of Money Value	Ranking by Factor	Ranking of Money Value
Toolmaker	1	1	1	1	2*	3*	1	1	4*	5*
Machinist (grade I)	2	2	2	2	3*	5*	2	2	3	3
Electrician (grade I)	3	3	3	3	4*	2*	3	3	5*	4*
Assembler (grade I)	4	4	4	4	5*	4*	5*	4*	2*	1*
Janitor	5	5	5	5	1	1	4*	5*	1*	2*

* Different results obtained from ranking by factor and by money value.

Advantages and Disadvantages

Advantages

a) Factor comparison method permits a more systematic comparison of jobs than the non-analytical methods.

b) Evaluation is easier than by the point method, as a set of similar jobs are compared and ranked against each other.

c) Analysis of benchmark jobs is very comprehensive.

d) In a scheme that incorporates money values, determination of wage rates is automatic.

e) Reliance of the method on benchmark jobs guarantees that the scheme is tailor-made and that the ranking necessarily reflects the actual structure while eliminating anomalies.

Disadvantages

a) Factor comparison method permits a more systematic comparison of jobs than the non-analytical methods.

b) The wage rates for the benchmark jobs are presumed to be correct and definitive and all other rates are determined by reference to them.

c) It goes against the common belief that the procedures of evaluating jobs and fixing their wages should be kept separate.

The Urwick Orr Profile Method

This method was originated by the British firm of management consultants, Urwick Orr and Partners. It is another high hybrid method that combines the features of point rating and ranking methods. In a sense, this method is a simplification of point rating that uses paired comparison to determine weightings. The principal disadvantages of this method are that it uses a simple breakdown of factor degree for securing purposes and it stresses the importance of full participation by workers' representatives at various stages.

The Direct Consensus Method

This method developed by the firm of Inbucon AIC, relies on the paired comparison technique. An important feature of this method is that members of the valuation panel record their individual assessments of whole job rankings and these assessments are fed into a computer. In cases where the assessors do not agree on the job rankings, the computer programme establishes the best possible correlation between their assessments without the need for prolonged discussion in committee to reach a consensus.

Comparative Merits of Factor Comparison and Point Systems

- Both the systems are fundamentally analytical and quantitative in their approach. Unlike the ranking and grading systems, these are based on detailed analysis of jobs and assessment of the different factors of the job.

- Factor comparison system ranks jobs in relation to each other, while the point system relates each job to a descriptive scale and arrives at a numerical value. There is no clearly stated and defined scale used in factor comparison, whereas the point system defines the factors, their degrees and the point values, in specific terms.

- These stages are more clear in the case of the point system than in factor comparison.
- Money units are used as an integral part of the factor comparison system. It is difficult for the employees to understand the justification. The point system makes no reference to money units.
- The ranking of jobs is easier on the point system. The basis for ranking is the number of points obtained by each job. Such ranking is difficult in the factor comparison.
- While using the point system, it is fairly common to use a variety of factors depending upon the requirements of the organization.
- Both the systems recognise the need for giving weightages to factors. But the point system uses point values for giving weightages to different factors. Use of numerical values provides for greater flexibility and clarity.
- The factor comparison system can be applied to a wider range of jobs including the Executive positions, while the point system is applicable to a smaller range. The point system is usually restricted to evaluation of jobs at the operative level. In practice however, even the factor comparison system is restricted to this level. The essential nature of Executive jobs is such that the factors in either system cannot help in assessment.

Other Methods

These methods are sophisticated and are based on subtle aspects of management like decision-making etc. but are required to evaluate some managerial and/or special/ conceptional types of jobs. Well-known management consultancy organizations have evolved through innovation such systems, when confronted with Executive Compensation packages.

a. ***Time Span of Discretion Methods:*** This system uses the concept that all make decisions in their work and the effect of such a decision on the work/organisation is felt after a certain period for taking a follow-up action. Here "the longest possible time for which discretion (decision to fructify) could be exercised without direct managerial review" is considered, as the key factor in determining the levels. For example, a decision taken by a board member may get reflected after a few years, as against a supervisor's in a week and a worker's in a few hours similarly.

   Unskilled worker - few hours

   Marketing Manager - 2-3 years

   Board of directors - 10 years

b. ***Decision Band Method:*** Here, type of decision to be made by the job is considered and placed in the applicable band. The Bands are:

   Band E - Policy-Making decision i.e. Top Management

   Band D - Programming decisions i.e. by Senior Managers

   Band C - Interpretive decisions i.e. by middle managers

   Band B - Routine decisions i.e. by skilled operators on line

   Band A - Automatic decisions regarding when, how and where i.e. by semi-skilled operators

   Band O - Defined decision by unskilled workmen

c. ***Direct Consensus Method:*** Here the workman and evaluator reach the value by mutual consensus.

d. ***Guide Chart Profile Method:*** Hay Plan or Hay guide Chart Profile Method – This is for managerial pay. It emphasizes on three critical factors: 1. Know-how, 2. Problem- solving, 3. Accountability.

   1. Know-how
      a. Practical experience, (functional expertise) specialised expertise and technological depth
      b. Width of managerial knowledge
      c. Human relations
   2. Problem-Solving
      a. Thinking environment
      b. Challenging environment
   3. Accountability
      a. Freedom to act
      b. Impact on result
      c. Magnitude of success annually etc.

e. ***Urwick-Orr Profile Method:*** Here the point and ranking methods are applied with an addition of consensus method. It is not a new method but advancement in evaluation with the addition of employees/union to a very high degree.

f. ***Activity:*** Evaluate the jobs of a Constable in the Army, Police and Para-Military and Traffic Police by any two methods.

Check Your Progress 4

State whether the following statements are True or False:

1. While doing a pay survey, it may not possible to collect information for all the jobs that have been evaluated.
2. Competing organizations in respect of manpower requirement are also included in the job evaluation survey.
3. The method of determining the internal worth of the jobs is known as job evaluation.
4. When proper wage differentials are established and maintained on the proper worth of jobs then it is known as Internal equity.
5. The process of examining the content of a job, breaking it down into its task, functions, processes, operation and elements is called as job analysis.

4.3.5 External Parity

One of the major consideration in wage and salary administration is that proper wage differentials are established and maintained within an organisation on the basis of the relative worth of jobs. What is known as Internal Equity? Another factor, which should also be taken into account is, that individuals performing the same job may differ in their performance due to inherent capabilities, experience, etc. It would similarly be unfair if wages are fixed or wage increases are granted without giving due attention to these differences. This is where the aspect of rating and performance appraisals come in. Yet, another important consideration is that a wage structure should be built in such a way, that would be attractive enough to retain good and efficient employees. In other words, the structure should be built by comparing the prevailing wages in the area of the industry. Such comparison of internal wage-structure with the external system is known as establishing External Equity. Also known as determining the going rate. Ideally, the wage system should be devised as to increase the productive effort of the employee or productivity in general.

Determining Externally Competitive Pay Levels & Structure

					Merge	Competitive
External competitiveness:				Draw	internal&	pay levels,
Pay relationships	specify	select	design	policy	external	mix &
among organizations	policy	market	survey	lines	pressures	structures

Some Major Decisions in Pay-level Determination

- Specify pay-level policy
- Define purpose of survey
- Specify relevant market
- Design and conduct survey
- Interpret and apply result

Design grades and ranges or bands

Pay Surveys

One of the major issues in the area of labour market relates to the question of wages. Notwithstanding the ideals enshrined in the Constitution and the statements made in the successive plan documents, distortions in wages have been a major cause for concern resulting in inequalities and exploitation in the labour market. The absence of a proper data base comprising a long-term series on the trends of money and real wages with provision for timely and accurate analysis of wage share in national income, inter- and intra-sectoral/regional/industry wage differentials, impact of inflation, technological change and productivity on wages and earnings may have contributed to the failure of public policy in this respect accentuating the distortions over the years. Even at the firm level, much of the ad hocism could be traced to the absence of a sound data base. In most industrialized countries the world over, labour market surveys of different sorts provide the basis for rational and realistic decisions on pay and benefits.

Pay Survey system is costly, complex, and time-consuming.

Why Conduct a Survey?

A good place to start in developing a survey is to answer these two questions: (1) Is it necessary to conduct a survey? (2) If so, why? Some of the factors discussed next will help provide the answers.

1. ***Hiring & Retaining Competent Employees:*** The success of an organization depends on skilled employees who see in their jobs, the opportunity to promote their own self-interest as well as the interests of the organization. Contributing employees are those who help solve organizational problems and, thus, help improve output and reduce waste. Motivated, well-trained people are required. Turnover, absenteeism; and uncaring, uninvolved attitudes destroy the efficiency of any organisation. To survive, let alone grow, an organisation must search constantly for the best applicants and strive to keep those it has already hired and trained.

The survey enables the organisation to know what rates of pay the market demands and to direct its efforts toward maintaining and even improving upon these market participation rates.

2. ***Recognizing Pay Trends in the Marketplace:*** Possibly the greatest value of a survey is that it informs the user of what is happening in the marketplace. Above all, it identifies trends. After trends are recognized, the next step is to identify detailed information about specific changes in pay practices that may have occurred. Because it is important to be able to identify trends or recognize precedents, the methods used to collect and report compensation data must be consistent. Consistency also involves a survey participants – or when using third party surveys, the same survey each year. However, even when using third-party surveys, the user is at the mercy of the producers of the survey. The user must be able to recognize whether the survey collects data from the same sources or significantly similar sources each time.

3. ***Defending Pay Practices in a Court of Law:*** All employers must recognize the critical relationship between the important employees place with regard to their pay and the litigious nature of the American society. If an employee is to bring a lawsuit against an employer, there is significant likelihood that all or part of a lawsuit will consist of allegations of unfair or discriminatory pay practices. An employee can use such acts as Title VII, the equal Pay Act, age discrimination in employment, the Americans with Disabilities Act, or simply breach of contract as a legal basis for a lawsuit. In these kinds of lawsuits over the past two decades one of the best defenses available to an employer is that its pay practices are based on "market" considerations. Invoking the market claim has almost been enough to defend a pay discrimination case. However, as plaintiff attorneys and judges become more sophisticated in the acquisition and application of market pay data, employers will have to go to greater lengths in explaining (1) how they obtained the data; (2) how the raw data were summarized, analysed and interpreted; (3) the comparability of survey participants' jobs and jobs in their organisation; (4) how the organisation used the data in making pay policy in determining the pay of most if not all jobs in the organisation, not merely those involved in a lawsuit.

Data Collection Techniques

After making the decision to perform a survey, the next step is to decide how to collect the survey data. If the survey is informal and relates to one or a small number of jobs, the telephone is the simplest and most widely used approach for gathering data. Other increasingly complex techniques include the questionnaire, on-line, the face-to-face interview, and group conferences.

Telephone: Telephone surveys are useful for collecting data on a relatively small number of easily identified and quickly recognised jobs. Telephone contact can be made quickly with compensation specialists in comparable organizations throughout a particular region or even on a nationwide basis. These contacts can provide data for immediate or emergency use. The telephone technique is also useful for clarifying issues, checking discrepancies, or obtaining data overlooked by other collection methods. One drawback is that it places a great burden on respondents because it requires their immediate time and attention, which might be in demand elsewhere. Because of this type of imposition, the telephone survey should be as concise as possible and, when possible, scheduling of the call should be prearranged.

Mailed Questionnaire: The mailed questionnaire is the most common technique for collecting formal survey data. It not only permits respondents to complete it at their discretion, but it allows time for careful thought and deliberation in job matching. The questionnaire is useful for collecting data on 100 jobs or on 10 jobs. However time is money, and time as well as the costs incurred in preparing, producing, distributing, completing, and analyzing questionnaires require that no more data be requested than absolutely necessary.

On-line: A widely used source of pay data is the Internet. Anyone with a computer and Internet access can obtain pay data on-line. With this readily available source, employees in any job at any level in an organization can obtain pay data for their jobs for comparison purposes. Like any survey, the accuracy of the data and comparability of the data to the job of the on-line user may be a suspect. Limited amounts of information are available on the accuracy of matching website job data. On-line sources of pay data could be cause of employee dissatisfaction.

Face-to-Face-Interview: Probably the best technique for collecting data is the completion of a questionnaire during a face-to-face interview. A well-trained interviewer who knows every aspect of the survey intimately and is especially conversant with the functions of the jobs included in the survey is invaluable for collecting valid and reliable data.

In the job matching process, the interview may review relevant organizational records (job descriptions, pay structures, organisation charts) and possibly even observe a job in action. The interviewer may personally record pay data from payroll or other records provided by the selected respondents. This process relieves the respondents of much of the clerical work and the necessity of making subjective judgments from limited descriptive data.

Conference: Although the conference is one of the least-used techniques for collecting compensation data it has certain strengths. If a group of specialists has common data requirements and if location is not a problem, this technique can be ideal.

Prior to the meeting, one individual must prepare an agenda detailing its purpose, the kind of compensation data to be reviewed, and the jobs (with their descriptions) to be matched. When attendees have done their homework and come well prepared, the quality and the quantity of data developed in a fairly short time can be remarkably good.

The conference technique also promotes closer understanding among those responsible for compensation management, a greater awareness of business similarities and differences, and an increased willingness to cooperate when interaction and data flow are vital.

Pre-requisites

To build up a competitive wage structure, it is necessary to know what are the rates prevailing for similar jobs in the same industry in the area. Unless the wage structure is competitive, it will be difficult to get and retain efficient workforce. The purpose of a pay/wage survey is to obtain the desired information (particularly, before negotiations with the union).

Prerequisites before Pay survey: One has to decide on (a) what is the information to be sought, (b) selection of jobs about which information should be sought, and (c) the units which should be approached to furnish the desired information. Moreover, one has to ensure that information sought through survey should be for jobs having identical job content.

a. Information is usually sought about basic wage rate or scale, different allowances, admissible, incentive, mode of increment, shift working, etc.

b. The important considerations which should govern the selection of jobs are that, the jobs selected must cover the range of jobs evaluated, and jobs which are to be found in other units in the area.

c. Units selected should be on the basis of similar size and be in the same locality as the firm conducting the survey.

When the information is gathered from different units, a summary should be prepared from the data so collected and comparison made with the company's existing wage structure so that future rates are constructed accordingly.

Types of Pay Surveys

External Equity is the comparison of both intra and inter-industry pay rates. Most frequent the payer says that, they are paying as per the on-going rates. For that very need, we go for the comparison between the similar jobs in the industry and out of the industry. There are three main types of pay surveys i.e. informal, external and commissioned.

1. ***Informal Surveys:*** These are conducted in an informal way and can vary from personal contacts to specific arrangements for exchanging information with a number local companies, or with companies in a particular industry, as even with a wide cross section of firms.

   The exchange method of obtaining data has major advantages. It can provide exactly the type of reliable information on existing rates of pay which firms seek, as well as giving them an indication of the likely trends in increases of pay during the year. But real usefulness depends on the types of arrangements for exchange and on the information obtained.

2. ***External Survey Method:*** Whether the pay survey is commissioned through a consultant or by the enterprise itself, the approach is the same. There are three methods of wage survey: (i) by job title (ii) by job description, and (iii) by job evaluation.

   (i) *Job Title Method:* In the job title method, the company collecting information gets the pay details for similar job titles in other companies. For example, the information with regard to wages may be collected for job titles like "turner", "fitter", and "welder". The information obtained from various companies in respect of each job title is tabulated and compared with the wages paid to each of these jobs in the company in question.

   This method is easy and quick, but not accurate. Many companies will have the same job titles, but the job contents may vary considerably. For example, the job duties of a welder in one company may be entirely different from a welder in another company. Similarly, a pattern maker's job in one foundry may be far easier than another pattern maker in another factory. There may be variation in skill, working conditions, and other factors. Thus a wage survey based on job titles does not provide accurate information. The job title method may be used in those cases where the job content and the titles are more or less standardized. Some examples are "Driver" and "Conductor" in a transport company.

   (ii) *Job description Method:* This is the most common method used in the pay survey. The comparison is made on the basis of the job description. The wage data in other industries are collected for these jobs, which have the same job descriptions in the company doing the pay survey. This provides a more realistic basis since the comparison is made job content wise. The wage differences if any due to variation in job contents can be easily traced.

(iii) *Job Evaluation Method:* This is an improvement over the job description method. The descriptions are collected for the jobs selected for wage survey in other industries. These jobs are evaluated under the same plan that was used by the company undertaking the wage survey. If the points obtained by the similar jobs in other industries are the same as the ones for the company, then the jobs are deemed to be identical and a comparison of wages for these jobs would be made. Though this may give accurate results, it is time-consuming, the details need to be collected personally by the job analyst. This method is not normally used in wage surveys.

Selection of Jobs for Wage Survey: While doing a pay survey, it may not be possible to collect information for all the jobs that have been evaluated. It is sufficient if the information is collected for certain representative jobs from which it would be possible to derive the wage curve. These jobs are known as key-jobs or benchmark jobs and are commonly understood in the industry. However, a careful selection of these key jobs would be necessary. Some of the considerations which need to be given are (Smyth & Murphy):

a. These jobs should be distributed over the whole range of jobs.

b. Jobs should have remained relatively stable in recent years.

c. The jobs should exist in nearby or competing companies.

d. The jobs should be filled by as large a number of workers as possible.

e. There should not be an unusual shortage or surplus of workers qualified to fill the jobs.

Organisations to be included: In practice, similar units and units which have similar jobs are selected for wage survey. As far as possible, units situated in and around the same locality should be selected since location may have an important bearing on the wages paid, in fact so also the size of the unit and type of ownership, etc. But this is not always practicable since there maybe only one such organisation in a locality or a state. Hence a transport or an electricity undertaking in one State may collect information from all the similar undertakings in other states. Competing organisations in respect of manpower requirement are also included. For example, a paper industry may include all the paper factories throughout the country in its wage survey. If carefully selected, about ten organisations may be an adequate number to be included in the survey.

Information to be collected: Collection of information is the most important aspect in a wage survey, and requires careful planning. The information is to be collected through a suitably designed questionnaire. The information gathered should include all the fringe benefits in addition to wages. Information may be collected either by getting the questionnaire filled up by the participating companies, or the job analyst himself may collect the information by personal visits and record in the questionnaire, both may be necessary in some cases.

The type of information to be collected in a pay survey is as follows:

1. General information including:

   a. Name of the company

  b. Products manufactured
  c. Type of ownership
  d. Number of employees.

2. Number of weekly and daily working hours, lunch and tea-breaks.
3. ***Holiday:*** General paid holidays, casual leave, earned or privilege leave, sick leave, etc.
4. Basic wages, scales of pay.
5. ***Allowances:*** Dearness allowances, house rent allowance, city allowance, conveyance allowances, shift allowance, etc.
6. Incentives, bonuses, overtime payments.
7. Facilities such as conveyance, housing, children's education, free services like electricity, water, fuel, uniform, and canteen.

It is not as though we in India lack in efforts to gather information and data. As we shall note here, there is indeed often a duplication organization effort, albeit piecemeal:

(i) The labour bureau and various other government organizations meticulously compile data on the implementation of various legislations such as Minimum Wages Act, Payment of Wages Act etc. , and bring out periodical reports. Additionally, information on wages is covered in the course of monitoring implementation of various other legislations. The Reports on Annual Survey of Industries, the various occupational surveys and the data furnished by the National Sample Survey organisation and the Central Statistical Organisation also seek to provide information on this subject. Surveys on labour conditions and on special groups of labour such as contract, bonded, women, child and unorganized labour also shed light on this aspect.

(ii) From time to time, pay commissions are set up to review the pay in public sector in the Centre and in the States and wage boards are constituted for certain industries. Usually the pay commissions and wage boards take a minimum of 3-4 years time to come out with recommendations which more often than not, are subject to government intervention and intense negotiations by affected groups. Invariably these commissions and wage boards seek to collect once again and all over a plethora of past and current information and data. They even appoint committees and consultants to prepare studies and to provide analytical information and inputs. They send out questionnaires and hold public sessions at different places across the country depending on the scope of enquiry.

(iii) At the industry and firm level almost without exception each time a collective agreement is negotiated, both the union and the management send out their representatives to collect comparable information and data on wages, fringe benefits, etc. , and spend a lot of resources and effort in putting together the bits and pieces of information and in trying to identify the discrepancies in the presentations by other parties, to serve their partisan ends. Frequently, they appoint committees and commissions to conduct wage surveys for themselves, but unfortunately such surveys fail to give the correct information. Competitive considerations persuade them especially employers, to keep their information secret even as they expect others to share similar information openly. With the result, such surveys particularly when they relate to the remuneration of managerial cadres often prove to be dysfunctional.

(iv) Of late, the Union Research Group in Mumbai, has started collecting information across firms in and around Mumbai and to disseminate information to unions. For the employers, organisations like the Mumbai Chamber of Commerce and the Confederation of Engineering Industries began to carry out wage surveys of member firms once in a while. Local lessons of some professional bodies like National Institute of Personnel Management also conduct surveys of member firms on collective agreements, fringe benefits, etc. Multinational companies for their part, have formed a multinational remuneration club to privately exchange information on remuneration packages for their employees at regular intervals.

(v) In central public sector, the Bureau of Public Enterprises supposedly monitors wage trends and issues guidelines periodically. It is common knowledge that a number of public enterprises flout these norms overtly or covertly and unions have challenged some of these in the Supreme Court which led to the setting up of a High Power Pay Committee for Public Sector (Chairman: R.B. Mishra) in 1986. The Committee submitted its report in November, 1988 while some unions have again moved the Court (in April 1989). The latter finally persuaded the government to implement the recommendations of the Committee set up under its directives.

(vi) In individual firms, innumerable problems and vexatious delays surface in translating the wage agreements signed to action for individual employees by way of correct fitment, determination of new pay-scaled, calculation of arrears, etc. The slow and inept official communication network breeds grapevine and often results in industrial strife and litigation before the issues, many of which could normally be redundant are settled somehow or the other!

The effect of the exercises such as those mentioned above had been to create a data base which is weak and incomplete in many respects. It suffers additionally from problems for a variety of reasons such as:

(i) Data being selective and serving partisan purposes.

(ii) The data being often considered in isolation without regard to parameters relating to individual firms, industry or labour market characteristics.

(iii) Incomparability over time.

(iv) Time lag.

(v) Conflict over secrecy vs. transparency.

(vi) Non/poor response from target groups.

(vii) Difficulties in standardization and disaggregation of doubts and distrust among constituents over the data/information.

(viii) Doubts and distrust among constituents over the data/information.

4.4 LET US SUM UP

The lesson presents a study of the influence of product market monopoly, and union strength on market wage differentials. Accordingly, the related theoretical propositions are examined, synthesized and extended to explain more fully observed variations in local labor market wages. In contrast to previous investigations, this study considers several varied occupations at once, encompasses nineteen different two-digit SIC industries, and computes market wage data using observations on individuals from the 1970 census. The results indicate that the extent of unionism and employer monopsony contributes significantly to the explanation of market wage differentials, while the product market concentration, and its interaction with unionism does not.

4.5 LESSON END ACTIVITY

Write a study note on the internal and external equity in compensation system.

4.6 KEYWORDS

Job Analysis: Job analysis is the process of examining the content of a job, breaking it down into its task, functions, processes, operation and elements is called as job analysis.

Job Evaluation: Job evaluation is the method of determining the internal worth of jobs in an organization.

Job Description: Description of a job based on job analysis.

Job Specification: The statement of the content of job based on job description and job grading.

Job Grading: Ranking of job as a result of job analysis.

Job Classification: Grouping jobs according to their worth.

Job Assessment/Job Pricing: The ascription of a monetary value on the basis of job grading.

Time Span of Discretion Methods: This system uses the concept that all make decisions in their work and the effect of such a decision on the work/organisation is felt after a certain period for taking a follow-up action.

Decision Band Method: Here, type of decision to be made by the job is considered and placed in the applicable band.

Direct Consensus Method: Here the workman and evaluator reach the value by mutual consensus.

Urwick-Orr Profile Method: Here the point and ranking methods are applied with an addition of consensus method. It is not a new method but advancement in evaluation with the addition of employees/union to a very high degree.

Mailed Questionnaire: The mailed questionnaire is the most common technique for collecting formal survey data.

Face-to-Face-Interview: Probably the best technique for collecting data is the completion of a questionnaire during a face-to-face interview.

Informal Surveys: These are conducted in an informal way and can vary from personal contacts to specific arrangements for exchanging information with a number local companies, or with companies in a particular industry, as even with a wide cross section of firms.

Job description Method: This is the most common method used in the pay survey. The comparison is made on the basis of the job description.

Job Evaluation Method: This is an improvement over the job description method.

4.7 QUESTIONS FOR DISCUSSION

1. Discuss the methods of determining the inter and intra - industry compensation differentials.
2. What do you understand by the internal and external equity in compensation system?
3. What is the concept of internal equity? What is its importance in the compensation management?

Check Your Progress: Model Answers

CYP 1

The terms compensation differential, pay differential, and wage differential are also used in economics, but normally have a different meaning. They simply refer to differences in total pay (or the wage rate) in any context.

CYP 2

- To establish wage level of a plant
- To establish relative wage level in a plant
- To bring new jobs to their proper relative parity with existing jobs
- To facilitate wage negotiations

CYP 3

I Non-quantitative
   a. Ranking method
   b. Classification method

II Quantitative
   a. Points Rating method
   b. Factor Comparison method

CYP 4

1. True
2. True
3. True
4. True
5. True

4.8 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

UNIT III

LESSON

5

INCENTIVES

CONTENTS

Contd....

5.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the definition and types of incentives
- Learn about the theory of individual incentives
- Define the concepts of measured day work, piece work, standard hour
- Know about the concept of gain sharing, its advantages and disadvantages
- Understand organization wide incentives
- Analyse the Scanlon Plan, Kaiser plan, Profit sharing
- Learn about the concept of non-financial incentives

5.1 INTRODUCTION

In economics, an incentive is any factor (financial or non-financial) that provides a motive for a particular course of action, or counts as a reason for preferring one choice to the alternatives. Since human beings are purposeful creatures, the study of incentive structures is central to the study of all economic activity (both in terms of individual decision-making and in terms of co-operation and competition within a larger institutional structure). Economic analysis, then, of the differences between societies (and between different organizations within a society) largely amounts to characterizing the differences in incentive structures faced by individuals involved in these collective efforts. Eventually, incentives aim is providing value for money and contributing to organizational success.

5.2 INCENTIVES

Incentives can be classified according to the different ways in which they motivate agents to take a particular course of action. One common and useful taxonomy divides incentives into three broad classes:

1. ***Remunerative incentives*** (or ***financial incentives***) are said to exist where an agent can expect some form of material reward - especially money - in exchange for acting in a particular way.

2. ***Moral incentives*** are said to exist where a particular choice is widely regarded as the right thing to do, or as particularly admirable, or where the failure to act in a certain way is condemned as indecent. A person acting on a moral incentive can expect a sense of self-esteem, and approval or even admiration from his community; a person acting against a moral incentive can expect a sense of guilt, and condemnation or even ostracism from the community.

3. ***Coercive incentives*** are said to exist where a person can expect that the failure to act in a particular way will result in physical force being used against them (or their loved ones) by others in the community - for example, by inflicting pain in punishment, or by imprisonment, or by confiscating or destroying their possessions.

There is another common usage in which incentive is contrasted with coercion, as when economic moralists contrast incentive-driven work-such as entrepreneurship, employment, or volunteering motivated by remunerative, moral, or personal incentives-with coerced work-such as slavery or serfdom, where work is motivated by the threat or use of violence. In this usage, the category of "coercive incentives" is excluded.

These categories do not, by any means, exhaust every possible form of incentive that an individual person may have. In particular, they do not encompass the many other forms of incentive-which may be roughly grouped together under the heading of personal incentives-which motivate an individual person through their tastes, desires, sense of duty, pride, personal drives to artistic creation or to achieve remarkable feats, and so on. The reason for setting these sorts of incentives to one side is not that they are less important to understanding human action-after all, social incentive structures can only exist in virtue of the effect that social arrangements have on the motives and actions of individual people. Rather, personal incentives are set apart from these other forms of incentive because the distinction above was made for the purpose of understanding and contrasting the social incentive structures established by different forms of social interaction. Personal incentives are essential to understanding why a specific person acts the way they do, but social analysis has to take into account the situation faced by any individual in a given position within a given society-which means mainly examining the practices, rules, and norms established at a social, rather than a personal, level.

It's also worth noting that these categories are not necessarily exclusive; one and the same situation may, in its different aspects, carry incentives that come under any or all of these categories. In modern American society, for example, economic prosperity and social esteem are often closely intertwined; and when the people in a culture tend to admire those who are economically successful, or to view those who are not with a certain amount of contempt (see also: classicism, Protestant work ethic), the prospect of (for example) getting or losing a job carries not only the obvious remunerative incentives (in terms of the effect on the pocketbook) but also substantial moral incentives (such as honour and respect from others for those who hold down steady work, and disapproval or even humiliation for those who don't or can't).

Check Your Progress 1

Describe in brief the following:

1. Remunerative incentives

   ....

   ....

2. Moral incentives

   ....

   ....

5.3 DEFINITIONS

Incentive is a reward for a specific behaviour, designed to encourage that behaviour. It is also called inducement factor that motivates a person to achieve a particular goal. Incentive moves or influences the mind, or operates on the passions; that which incites, or has a tendency to incite, to determination or action; that which prompts to good or ill; motive; spur; as, the love of money, and the desire of promotion, are two powerful incentives to action.

People need positive incentives to encourage them to exercise regularly and to eat healthily. Incentives are especially important for competitive sports people who have to train intensively and strictly regulate their diets to achieve success. Incentives vary from individual to individual, but most people are attracted towards activities which offer the following:

- pleasant sensations (sensory incentive)
- novel situations, providing varied and exciting stimuli (curiosity incentive)
- reassurance and support from a group (affiliation incentive)
- an opportunity to work independently (independence incentive)
- a feeling of self-control and not being dominated by others (power incentive)
- low levels of frustration and hostility (aggression incentive)
- a strong sense of achievement and success (achievement incentive).

A particular incentive will direct a person's immediate behaviour towards a particular goal only if it is the strongest of all competing incentives. Sport psychologists generally agree that the achievement incentive is often the greatest driving force for competitive athletes. Psychologists also recognize that in order to reach long-term goals, a sense of achievement must be reinforced continually by successful completion of short-term intermediate goals.

5.4 TYPES OF INCENTIVES

A strong incentive is one that accomplishes the stated goal. If the goal is to maximize production, then a strong incentive will be one that encourages workers to produce goods at full capacity. A weak incentive is any incentive below this level.

1. ***Straight piece rate:*** In the straight piece rate system, a worker is paid straight for the number of pieces which he produces per day. In this plan, quality may suffer.
2. ***Straight piece rate with a guaranteed base wage :*** A worker is paid straight for output set by management even if worker produces less then the target level output. If worker exceeds this target output, he is given wage in direct proportion to the number of pieces produced by him at the straight piece rate.
3. ***Halsey Plan:*** W = R.T + (P/100) (S-T).R where W : wage of worker, R : wage rate, T : actual time taken to complete job, P : percentage of profit shared with worker, S : std. time allowed. Output standards are based upon previous production records available. Here management also shares a percentage of bonus.
4. ***Rowan Plan:*** W=R.T + ((S-T)/S).R.T Unlike Halsey Plan gives bonus on (S-T)/S, thus it can be employed even if the output standard is not very accurate.

In modern societies, the study of economics is mostly concerned with remunerative incentives rather than moral or coercive incentives - not because the latter two are unimportant, but rather because remunerative incentives are the main form of incentives employed in the world of business, whereas moral and coercive incentives are more characteristic of the sorts of decisions studied by political science and sociology. A classic example of the economic analysis of incentive structures is the famous Walrasian chart of supply and demand curves: economic theory predicts that the market will tend to move towards the equilibrium price because everyone in the market has a remunerative incentive to do so: by lowering a price formerly set above the equilibrium a firm can attract more customers and make more money; by raising a price formerly set below the equilibrium a customer is more able to obtain the good or service that she wants in the quantity she desires.

5.5 INDIVIDUAL INCENTIVES

The discussion till now has covered incentive schemes for individual direct workers. A fundamental assumption common to all individual schemes is that the output of each worker can be accurately measured. But in some cases, for example, in the grinding and wielding works in the electrical industry, the operations are performed by the group as a whole, and the contribution of each worker in the group cannot be accurately measured. In such cases, the group-incentive scheme is followed. Group incentives are as common as individual plans in industrial establishments.

Any individual scheme which has already been discussed may be applied to a group of workers. But the most common is the piecework system. The total earnings of a group are first determined in accordance with the incentive method which is followed, and the earnings are then distributed among the members of the group on some equitable basis. If the group consists of members with equal skills, the earnings are divided equally among them. When the members are of unequal skill, the earnings of the group may be divided among the members in proportion to their individual time-rates, or according to specified percentages, or in some cases among only a certain number of members of the group.

Some of the advantages of group incentives are:

1. Better co-operation among workers.
2. Less supervision.
3. Reduced incidence of absenteeism.
4. Reduced clerical work.
5. Shorter training time.

The disadvantages are:

1. An efficient worker may be penalised for the inefficiency of other members in the group.
2. The incentive may not be strong enough to serve its purpose.
3. Rivalry among the members of the group defeats the very purpose of teamwork and co-operation.

5.5.1 Incentives for Indirect Workers

Indirect workers such as crane operators, helpers, charge hands, canteen staff, security staff, employees in purchasing, sales and accounts, and maintenance staff also deserve incentives at par with direct workers. Incentives should be paid to such workers either on the ground that they contribute to the increased production which the direct workers may achieve or on the ground that their work has increased because of increased production, or both. Such payments are desirable to avoid dissatisfaction and dissension among the workers in a plant, organisation even strikes, which may result if indirect workers are paid at time-rates while direct workers receive substantial bonus.

The payment of bonus to indirect workers poses a serious problem because the output of many of them cannot be accurately measured. For example, it is extremely difficult to measure the output of maintenance staff, security personnel, or canteen employees, though it is possible to assess the performance of inspectors, sweepers and packers.

But whether the output of indirect staff can be measured or not, a single system of bonus payment is made applicable to all of them. In some cases, the bonus is calculated according to some agreed percentage on the output of the plant or of a department. In others, the bonus is a specified percentage of the incentives of all or some of the direct workers. Many managements, however, prefer to apply a merit-rating system to indirect workers, which rewards these workers for other qualities, in addition to their output.

5.5.2 Wage Incentive Plans

Wage incentive plans may be discussed as (i) plans for blue-collar workers; (ii) plans for white-collar workers; and (iii) plans for managerial personnel. Each of these categories of employees have separate and distinct needs and hence specific tailor-made incentive plans have to be devised to meet their requirements. Therefore, correct measurement of performance for the purpose of incentive payment is very important. The four critical performance indices are: (a) the standard index; (b) the reference index; (c) the base index; and (d) the incentive index. Various wage incentive schemes reformulated on the basis of these indices.

1. ***Incentive Plans for Blue Collar Workers***: Short-term incentive plans for blue collar workers may be broadly classified into three categories:

    a. Plans under which the rate of extra incentive is in proportion to the extra output;

    b. Plans under which the extra incentive is proportionately at a lower rate than the increase in output; and

    c. Plans under which the rate of incentives is proportionately higher than the rate of increase in output.

    Every employer wants his workman to do the maximum work they are capable of doing. On the other hand, there is a feeling among the workers that an increasing effort benefits only the employer even when they are employed on a piece-rate basis. The result is that they never produce to their full capacity, and, in most cases, put in the minimum necessary work. This feeling on the part of the workers may be removed either through fear or through expectation of gain. It has been found that fear can never produce the desired effect; but a hope of earning a bonus does induce them to work harder and produce more. Incentive plans are, therefore, known as premium plans because they offer a premium for outstanding performance.

    All bonus or premium plans relate to two factors: one, they set a standard time for the completion of a definite output or piece of work for a fixed wage; two, the fixing of rate of percentage by which bonus would be earned by a worker over and above his set wage, if the standard time is saved or the standard output is exceeded Indirect workers such as crane operators, charge hands, canteen staff, helpers, security staff, employees in purchasing, sales and accounts, and maintenance staff also deserve incentives at par with direct workers. Such payments are desirable to avoid dissatisfaction and dissension among the workers in a plant.

The payment of bonus to indirect workers, however, poses a serious problem because the output of many of them cannot be accurately measured. For example, it is extremely difficult to measure the output of maintenance staff, canteen employees, or security personnel, though it is possible to assess the performance of inspectors, sweepers and packers. Many managements, therefore, prefer to apply a merit rating system to indirect workers, which rewards these workers for other qualities, in addition to their output.

2. ***Incentive Plans for White Collar Employees/Salesmen:*** The salesmen are usually given incentives in the form of sales commission. One study reported that almost 75% of the organisations surveyed paid salesmen on some type of incentive basis. This is due to three factors: (i) the unsupervised nature of most sales work; (ii) tradition in the market; and (iii) the assumption that incentives are needed to motivate salesmen.

There are several incentive plans for sales staff, each appropriate for different markets, products, but all plans are basically variations of three types of plans: straight salary, straight commission, and combination plans.

The straight salary method is not an incentive plan; the salesman is simply paid on weekly, monthly, or on yearly basis. The advantages of this method are that: (i) the salesmen know in advance what their income will be; and (ii) the expenditure on salesmen is known beforehand. The disadvantages are: (i) this method tends to shift salesman's emphasis to just making the sale rather than prospecting and cultivating long-term customer; and (ii) pay is not related to results. This lack of relationship reduces salesmens' performance.

Under the straight commission, the salesmen are paid on the basis of sales effected, i.e., they are paid for results and only for results. Therefore, high performance salesmen are generally attracted. But the disadvantages are: (1) Salesmen focus on making a sale on high volume items and as a result cultivating dedicated customers and working to push hard-to-sell items are often neglected; (2) Salesmen tend to be less company-oriented and more money-oriented, and the company has less control over them; (3) Salesmens' income generally fluctuates widely.

Under the combination method of salary and commission, salesmen not only get a fixed salary but also a commission in proportion to the sale effected. The advantages of this method are: (1) Since salesmen are assured of minimum earnings, they are relived of financial worries; (2) The company has more control over its salesmen, as there is sizable salary component in most combination plans. But the main disadvantage is that salary is not related to performance; only incentive value of money is being traded off for its security value.

Incentives for Management: In many organisations, the managers are paid bonus. There are two types of bonus plans: one determined by formula (i.e., some criteria like increased sales) and other determined by some discretion used in allocation of bonus (i.e. paid on more or less permanent basis). The bonus plans are generally reviewed annually to make them more effective. For top level management, bonuses are generally tied to overall corporate results. The bulk of bonus is much higher for top level executives and lower for the lower level executives.

At the top management level, incentive payments are mostly in the form of bonuses which are usually a percentage of base salary that depends upon the level of performance and company profits. Mostly bonuses are paid in cash but in some cases the company may use stock plans that offer the executive, the company's stock at a fixed purchase price. Such plans are designed to encourage ownership in the company and indirectly serve as an incentive for good work and represent a form of saving.

In the manufacturing and retailing fields, where year-to-year results are largely a reflection of management performance, it is common for executive and managerial personnel to be compensated partly in the form of a base salary and partly in the form of a year-end bonus. The decision of whether to install an incentive bonus plan for executives and, if so, what kind of plan to install should be made appropriately. On the one hand, a bonus is a more immediate and flexible form of compensation than salary and thus has greater motivational potential. On the other hand, the bonus plan that is poorly conceived and administered can have a negative motivational impact. If a bonus plan seems appropriate, careful attention should be paid to what kind of plan would be most effective.

5.5.3 Working of Incentive Schemes

Incentive schemes are regarded as beneficial to both employers and workers. They are accepted as a sound technique for the achievement of greater productivity and good performance. The main advantage of any wage incentive scheme is that for a little expenditure of capital, there can be sizable gains in productivity; the gestation period is also small. The role of supervisors changes to that of managers of machines and materials from that of being watchdogs. The workers chase the supervisors for material, tools, etc., instead of supervisors chasing the workers. The experience gained in India and in other countries indicates that wage incentives have resulted in raising productivity, increasing output and earnings, reducing direct labour costs, and curtailing absenteeism. The NCL has reached the conclusion that, under our conditions, wage incentive is the cheapest, quickest and surest means of increasing productivity.

Despite certain merits of incentive schemes, their actual working is not quite happy. Some critics point out that the output of modern industry does not depend so much on individual human effort as on the capacity of machines and on good organisation. The most effective incentive, they claim, is a combination of good regular wages, good working conditions, and good human relations. There is a tendency for the quality of the products to deteriorate unless steps are taken to ensure the maintenance of quality through a stricter system of checking and inspection. Their application in some cases has not only failed to increase production over a period of time but has caused an actual reduction in employee productivity. One company, for instance, found that a substantial increase in pay through wage incentive systems merely resulted in higher absenteeism, restricted output and lower work standards. Some studies indicate that incentive schemes have a dubious value for increasing output. It may generate tensions among the different parts of an organisation. Such tensions often create difficult managerial problems, increase administrative costs, and may eventually affect the employer-employee relations and output.

Employees are paid incentives in addition to wages and salaries. Incentives are linked to performance. This leads to better motivation of employees. Reduced cost, reduced supervision, reduced wastage and the like are other benefits of the incentives. There are problems, nevertheless. Quality of products is likely to decline. In many cases, management of an incentive scheme is also difficult. However, problems associated with incentive schemes may be overcome and the plans may be made more effective for improving productivity. Productivity-linked incentive schemes are to be encouraged in the interest of the workers, employers and the society. Any incentive scheme, however has to be adapted to the conditions of each industry and even within similar industry from plant to plant.

Check Your Progress 2

What are the advantages of group incentives?

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5.6 CREATING AN INDIVIDUAL INCENTIVE PAY PLAN

The basic ideas of variable pay have been around for years under different labels. One of these labels is that of pay for performance. The focus of this idea is on performance, however measured. A second and much older concept is that of the incentive pay plan. The focus in this case is on the motivational content, that of obtaining more effort from the employee. A third term used is that of payment for results. This is defined as: "a payment system under which money rewards vary with measured changes in performance according to predetermined rules." This type of compensation program makes the basic assumption that employees are interested in money and are willing to put forth more effort for more money.

5.6.1 Traditional Pay

These concepts are very different from the traditional compensation plan based upon payment for the job. In the traditional program, the employee who desires more compensation or the supervisor who wishes to pay his/her employee more has to somehow redescribe the job to be at a higher level in order to be worth more. Incentive pay plans allow the employee to earn more for improvement in the measures of results without having to change jobs or get them reclassified. All is not wonderful with this concept, because the possibility of gain is tied to the possibility of loss. In incentive pay plans some proportion of the employee's pay is put at risk. If things go well he/she will make more money, but if things go poorly, the employee's pay suffers. Not all people find this prospect comfortable. For instance, people who are inner-directed and feel they control their world find incentive pay attractive. But those who are outer-directed and feel that the world controls them are not motivated by this type of compensation plan.

5.6.2 Rise of Incentive Pay

Why has industry so embraced the idea of incentive pay? There are a number of reasons. The first is an economic one. Economic Theories of Benefit and Compensation Administration, wages are sticky on the downside. When the company faces hard times it is hard or impossible to lower the wages of current employees. In this way wages become a fixed cost. The only way the employer has to lower this cost is to lay off workers. For the past twenty years this has been a way of life for American business. Incentive pay can soften this necessity to lay off large numbers of workers by lowering the wage bill for all workers to some degree.

A second reason is contained in the payment for results or performance concept. If the company relates pay to the desired outcome then this will increase the probability of obtaining that outcome. This may be through the employee working smarter, faster, or longer. As companies have laid off employees they have had to become leaner and more efficient. Getting more accomplished with fewer people makes the promise of incentive pay very attractive to companies today.

Third, as union influence has declined and the ideas of participative management has spread, there is a significant desire to tie the employee into not only doing better on their job but being interested in how well the total organization is doing, including contributing to the overall company success.

5.7 MEASURED DAY WORK

Another form of time rate is measured daywork. Under this plan, formal production standards are determined for the job, and employee performance is judged relative to those standards. Evaluation is done at least quarterly, and the employee's pay rate may be adjusted according to how well he or she has performed in comparison with the standard. This plan looks very much like the pay-for-performance system. The real differences are in the measured daywork formality of production standards and shorter period of performance review. However, with the measured daywork plan, pay rates may go down as well as up. Measured daywork is advantageous where there are numerous non-standardized conditions in the work that make judgment of performance more important. Sometimes measured daywork utilizes the time standards but does not include the incentive feature.

Measured daywork and the standard hour plan also lend themselves to the use of bonuses. A bonus is a one-time payment to the employee that is not built into his or her pay rate. The basis of the bonus may be any performance desired by the organization, and the payment schedule can be designed like that of the standard hour or measured day work. But a bonus system can be used in much broader circumstances. An advantage to a bonus is that it may be a reward for any behaviour or outcome deemed important to the organization; it does not have to cover all relevant parts of the job. An example of this is a series of programs designed to reduce absenteeism in organizations through the use of behaviour-modification principles.

5.8 PIECEWORK

Straight piecework can intimidate employees because it places them under considerable pressure to produce, which they may have difficulty doing consistently. Also, since failure to meet the standard may cause the employee to earn below the minimum wage, most piecework plans establish a minimum standard for a set wage and pay a premium for units produced above that minimum. Employees who regularly do not make the standard are reviewed to see if they are properly placed.

5.9 STANDARD HOUR

The most common form of a time rate individual incentive is the standard-hour plan. As in piecework, the employee is paid according to output. However, in the standard hour plan a standard time is allowed to complete a job and the employee is paid a set amount for the job if completed within that time. For instance, an auto mechanic may be assigned to tune an automobile, a task for which the standard time is two hours. If the mechanic completes the task in an hour and a half, he or she is paid for two hours. If the job takes two and a half hours, the mechanic is paid for that time. Continually failing to make the standard time would result in examination of either the time standard or the employee.

5.9.1 Multiple Performance Dimensions

Any incentive pay plan is designed to focus the employee on particular desired outcomes or activities. The effect of this is that any job dimensions not included in the definition of performance are not likely to be performed. Thus, it is important to include all important job dimensions in performance definition. A single dimension, such as units produced in a piecework plan, is appealing in terms of simplicity and clear performance-reward connections but is often dysfunctional when it comes to genuine productivity. The clearest example of this is the problem of quality in a piecework plan. If the number of units is the only performance standard, the employee is encouraged to turn out a lot of units, but the units will likely be substandard.

Many incentive pay plans, then, employ multiple performance definitions, and the question becomes how to combine them. The simplest way, if possible, is to use a composite score. The values of the various performance variables are added together. This in turn leads to the question of the weight each variable is accorded. This process is much like the use of a number of compensable factors in job evaluation. A second method is the multiple-hurdle approach, in which a minimum level must be reached on each performance dimension before any incentive is paid. A third approach is a series of mini-incentive pay plans, one for each performance dimension.

5.10 GAIN-SHARING, ITS ADVANTAGES AND DISADVANTAGES

This approach, broader than the use of output and time standards, rewards outcomes that are direct measures of the success of the organization as opposed to the success of the individual employee. As we have noted, gain sharing plans are more appropriate to organization-wide incentive pay plans. The purpose of gain sharing is to tie the employee to the performance measures by which top management is judged and by which society defines a successful organization. Although clear performance-reward connections can be made in these circumstances, it is difficult to make a performance-effort connection.

A number of different performance measures can be used in gain sharing, but all share a common dimension: a baseline standard must be established to determine where the organization is at the present time. The value of improvements in future measures of performance are then shared with the employees. One set of performance definitions rewards reductions in costs or improvements in productivity.

Gain-sharing: Gain-sharing is a formula based organisation or factory wide bonus plan which provides for employees to share in the financial gains made by a company as a result of its improved performance.

The formula determines the share by reference to a performance indicator such as added value or another measure of productivity. In some schemes the formula also incorporates performance measures relating to quality, customer service, delivery or cost deduction.

Gainsharing differs from profit sharing in at least three ways. First, under gainsharing, rewards are based on a productivity measure rather than profits. The goal is to link pay to performance outcomes that employees can control. Second, gainsharing plans usually distribute any bonus payments with greater frequency (e.g., monthly or quarterly versus annually), Third, gainsharing plans distribute payment during the current payment rather than deferring them as profit sharing plans often do.

Lawler (1971, 1990) has summarized some of the common results that have been found in research studies of gainsharing programme plans:

- Coordination, teamwork, and sharing of knowledge are enhanced at lower levels.
- Social needs are recognized via participation and reinforcing group behaviour.
- Attention is focused on cost savings, not just quantity of production.
- Acceptance of change due to technology, market and new method is greater because higher efficiency leads to bonuses.

- Attitudinal change occurs among workers, and they demand more efficient management, better planning, and good performance from their co-workers.
- Employees try to reduce overtime – to work smarter.
- Employees produce ideas as well as effort.
- When unions are present, more flexible administration of union-management relations occur.
- When unions support the plan, they are strengthened because better work situations and higher pay result.
- Unorganised locations tend to remain non-union.

There are, however, certain limitations of gainsharing plans. Perhaps the most important is differentially attracting and retaining the best performers. As gainsharing plans do not pay more for better performance, they do not necessarily motivate them to stay. Unlike profit sharing it pays bonus even when the organisation is not earning profits. Moreover, gainsharing plans do not fit in with every situation.

The concept of gainsharing is based on simple measurable improvement, for example, reduction of cost per unit. Unlike any other variable schemes, gainsharing is a group incentive scheme where a team or a group together is involved in increasing productivity, quality or customer service. Organisation has to provide a structure within which employees can work together to become responsive to customer's needs.

Gainsharing plans are based on a formula of sharing rewards in relation to measure performance. There are a number of different formulas; the traditional formulas of gainsharing are: the Rucker plan, Improshare, etc.

(i) ***The Rucker Plan:*** The Rucker plan is also based on employment costs. But they are calculated as a proportion of sales less the costs of materials and supplies (i.e. value added). Allen Rucker contended that the pay proportion of value added remains a near constant share unless the organisation suffers from severe mismanagement or a drastic change of policy. On the basis of this assumption, the Rucker plan determines a constant share of whatever added value is created by the joint efforts of management and employees.

(ii) ***Improshare:*** Improshare is a proprietary plan, which is based on an established standard, which defines the expected hours required to produce an acceptable level of output. The standard is derived from work measurement. Any savings resulting from an increase in output in fewer than expected hours are shared between the organisation and employees by means of a pre-established formula.

In addition to the above, there are few other plans, which come under the purview of gainsharing.

Value Added: Many versions of gainsharing are based on value added as the key performance measure. Value added is calculated by deducing expenditures on material and other purchased services from the income derived from sales of product. It is infact the wealth created by people in business.

Why organisations introduce gainsharing?

Organisations introduce gainsharing for a number of reasons. Perhaps the most important is the feeling that it is right time to link pay to organisational performance, coupled with a belief in the desirability of communicative organisational objectives, creating team spirit, breaking down organisational barriers, increasing the flow of innovative ideas from employees, improving commitment and educating employees in business economics.

Gainsharing can be introduced as a change agent in association with other structure and process initiative designed to achieve cultural change.

Increased competition – national and global or declining productivity are reasons for introducing gainsharing. It is a device for more creative pay arrangements, which stimulate both productivity and quality and keep employment cost under control.

Another reason for introducing gainsharing is that organisations have become dissolution with traditional incentives and bonus schemes.

Gain-sharing is a potentially valuable component in an organisation's overall reward strategy. It has, however, to be developed and maintained as part of a integrated process of reward management and compensation management – it cannot work in isolation. It should also be kept in mind that gainsharing is essentially a participative process. It is not, like more profit sharing schemes, simply a matter of handling out money for reasons that are beyond the control of employees. The success of gainsharing details largely on the opportunities it presents for involvement so that employee can establish a clear link between their performance and their reward – an essential requirement for success in any pay-for-performance scheme.

Check Your Progress 3

1. What do you understand by gainsharing?

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2. What is Rucker Plan?

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5.11 ORGANISATION WIDE INCENTIVES: SCANLON PLAN

The most popular gain sharing plan is the Scanlon Plan. In this plan employees are paid a bonus if costs remain below pre-established standards. The standards have been set by studies of past cost averages. Ways to reduce costs are developed by a series of committees throughout the organization and a plant-wide screening committee that reviews and implements changes. Although Scanlon developed this plan in 1937, these committees look much like pay out profit shares at regular intervals as earned. Deferred plans put the profits to be distributed in the hands of a trustee, and distribution is delayed until some event occurs. This type of plan is ordinarily tied into a retirement plan. Combination plans distribute part of the profit share as earned and defer distribution of the balance.

Scanlon Plan: The Scanlon formula measures employment cost as a proportion of total sales. Standard ratio, say 50%, is determined and if labour costs fall below the proportion, the savings are distributed between employees and the companies on the basis of a pre-established formula. In other words, this plan calculates gains based on standard cost reduction. It relies on employees' participation through a system of committee, to solicit, develop, evaluate and implement suggestions of work unit.

5.12 KAISER PLAN

The Scanlon Plan is not the only organization-wide plan, but it is the best known. Others that have been successful in the United States include the Rucker Share-of-Production, Kaiser, and Nunn-Bush plans. A more recent plan is Improshare, of which more than 100 had been adopted as of the early 1980s. Although these plans differ in details, all rely on a definition of productivity improvements wholly measured by some time period and pay bonuses for savings. Further, most depend upon labour-management cooperation that represents a change in the relationship between management and labour.

5.13 PROFIT SHARING

Profit sharing is another popular organization-wide program that is often classified as a gainsharing plan. This type of plan can be made much more simple than a cost-savings plan. Nor does it require the revolution in employee-management relationships that cost-savings plans do. With profit sharing, management hopes to change employee attitudes toward the organization without a concomitant change in managerial attitudes toward the employee. The idea behind profit sharing is to instill in the employee a sense of partnership with the organization. But most plans go beyond this and use profit sharing as a way to keep valuable employees and to encourage thrift in employees.

Clearly the relationship between effort and performance becomes very tenuous in any organization-wide incentive plan. Even if the performance (profit or cost savings) and the reward (an amount of the profit or savings based on salary) are clear, their connection with what the employee does every day is not clear. In fact, most organization-wide plans fit the membership model better than they do the performance-motivation model.

This enhanced membership motivation appears to be the greatest strength of profit sharing. The profit sharing objective of instilling a sense of partnership is met to the extent that employees want to continue their membership and to make the additional contributions that enhanced membership implies. Improved performance may result not because employees see a performance-reward relationship but because they want to broaden and deepen the employment exchange by increasing their contributions in return for more intrinsic and perhaps extrinsic rewards.

A further attempt to tie employees to the economic success of the organization is to grant them a share of the profits of the organization. Obviously, this type of incentive is useful only in a for-profit organization. Profit sharing has not always been carefully delineated. The Council of Profit Sharing Industries categorizes plans for cost-savings sharing as profit sharing, although they pay off whether or not the organization makes a profit.

Increased production has been cited as one of the goals of profit sharing, and reported results include increased efficiency and lower costs. Many early reports of profit sharing results attributed large increases in production to the plan. More recent reports find profit sharing companies more successful financially than non-profit sharing companies but are more careful in attributing the difference to profit sharing. Profit sharing is popular for organizations, from both a practical standpoint and a philosophical one. Management often feels that having the employee focus on profits is useful and will lead to higher organizational profits. In recent years, the Employee Retirement Income Security Act (ERISA), variations in profits, and the advent of employee thrift plans have blunted the growth of profit sharing plans.

Profit sharing plans are typically differentiated on the basis of when profit shares are distributed. Cash plans (known also as current-distribution plans) pay out profit shares at regular intervals. Deferred plans put the profits to be distributed in the hands of a trustee, and distribution is delayed until some event occurs. This type of plan is most often tied into a retirement system. Combination plans distribute a part of the current profits and defer the rest.

Profit sharing plans vary widely in provisions concerning organization contributions, employee allocation, eligibility requirements, payout provisions, and other administrative details. Two-thirds of the plans define the contribution of the organization by a formula; in the balance the board of directors determines the amount. Most formulas specify a straight percentage of before-tax profit, after reservations for stockholders and reserves. The amounts allocated to employees or their accounts are usually based on their compensation but may also be influenced by their length of service, contributions, performance, or responsibility. In most plans all full-time employees are eligible immediately or after a short waiting period, but a substantial minority of plans exclude union employees or are limited to specific employee groups. Payout provisions are usually determined by plan designation (cash, deferred, or combination), but deferred and combination plans are increasingly incorporating vesting provisions and payout under a wide variety of circumstances.

Our discussion of profit sharing suggests that it does not closely fit the performance-motivation model. Profits are influenced by so many variables that it is very difficult for an individual to feel that his or her contributions have organization-wide results. Thus, it is difficult for employees to believe that their profit share is related to their performance. It may be possible for small organizations with cash plans and continuous communication efforts to maintain their employees' belief in the performance-reward relationship, but such a belief is vulnerable to any reduction in profits that occurs while the employee is maintaining his or her performance level. Larger organizations with cash plans are less likely to be able to foster this belief in the first place and may be even more vulnerable to changing circumstances. Deferred plans involve the additional hurdle of payment that is delayed, often for years. Under such plans employee belief in the performance-reward relationship may be impossible, even in small organizations.

On the other hand, profit sharing may closely fit the membership-motivation model even in large organizations, at least for certain groups of employees. Two things serve to increase both the numerator and the denominator of the membership-motivation model: (1) the promise to provide additional economic rewards when profits of the organization permit it, and (2) the implied acceptance of all employee contributions that will advance the profit goal. In this way employees may enlarge their commitment to the organization.

Profit Sharing: Profit sharing means paying employees a share of the net profit in addition to their wages or salary. It is payment of a dividend or a sum based on basic wage or salary, grade or seniority. It is supposed to be a stimulus for higher performance.

Profit sharing is a plan under which an employer pays to eligible employees, as an additional to their normal remuneration, a special sum in form of cash or shares in the company related to profits of the business. The amount shared is determined either by an established formula, which may be published, entirely at the discretion of management. Profit sharing schemes are generally extended to all employees of the company.

Objectives of Profit Sharing

1. To encourage employees to identify themselves more closely with the company by developing a common concern for its progress.

2. To stimulate a greater interest among employees in the affairs of the company as a whole.

3. To encourage better co-operation between the management and the employees.
4. To recognise that the employees have a moral right to share in the profit they have helped to produce.

There are three basic requirements for profit sharing schemes:

1. That the profit sharing reward should bear a direct relation to the effect/result.
2. That the payment should follow immediately after the efforts.
3. That the method of calculation should be simple and transparent.

Profit sharing is different from shareholding. Employees can become shareholders in a company by either or both of the following two ways: (a) when they are offered and buy shares in the company where they work; (b) when they are offered shares as a reward or incentive for better performance or seniority/loyalty or both.

Profit sharing is also different from gainsharing. Gainsharing of the kind proposed by Joe Scanlon is called the Scanlon Plan provided for a share to the workers of the savings in input costs. This combines incentive payments with worker participation in decision-making and rewards people not necessary for working hard, but for working smart.

The main types of profit sharing schemes are:

1. ***Cash:*** A proportion of profits is paid in cash direct to employees. This is the traditional and still the most popular approach.
2. ***Stock:*** A proportion of profits is paid in shares. This is much less popular, especially since the advent of the approved deferred share trust scheme with its considerable tax advantages.
3. ***Approved Profit Sharing Share Schemes (PSSS):*** The company allocates a proportion of profit to a trust fund, which acquires shares in the company on behalf of the employees.
4. ***Mixed schemes:*** A PSSS scheme is sometimes offered in addition to a cash scheme, or the latter is made available to staff before they are eligible for PSSS shares, or as an alternative to PSSS shares.

Profit sharing, like incentives, should be in addition to regular wage and should not be considered as a substitute for it. However, economists like Weitzman consider that expected profit-sharing bonuses will substitute for the basic wage, lower wage rates and wage costs, reduce marginal cost of hiring and increase employment. Profit sharing is considered as a useful tool in stabilizing wage costs, and yet rewarding workers when they and the company perform better. In some countries, particularly, the US, profit sharing schemes competed with or became complementary to pension schemes. Tax policies favoured and exempted differed payments at the time of retirement. The usual mechanism is the creation of different profit-payment trust, which invested the funds in interest carrying special bonds and released tax-free payments to workers upon retirement.

Profit sharing is supposed to contribute to productivity, worker motivation, worker participation and wage flexibility. The results may be reflected either in higher output or better financial performance through savings in input costs. When employees receive payments based on company's financial performance they become aware and concerned about factors contributing to business success and the commonality in goal with reduced mutual antagonism, if any. Thus, profit sharing is also considered to improve the general climate of employment and industrial relations.

To let employees feel and actually realize that they are getting their due share in profits requires transparency in bookkeeping practices. As of now in quite a few enterprises, both in the public and the private sectors, balance sheets are considered by their employees as excellent pieces of fiction. In some companies there is a feeling that their managements tell one thing to their shareholders and another to the union leaders and the workers. In the absence of trust and transparency, misgivings persist.

There are also some problems with profit sharing. Profit sharing being a group-based scheme could result in the problem of free riders. Some individual employees get reward without deserving it and a few others may feel that what they are getting as a share in the profits of the company is not in proportion to the contribution they made. Even though profit sharing is gravy, and not a substitute to the wages or salary, some trade unions also consider that profit sharing being a variable payment shifts risk to the employees. In the case of employee share-ownership, employees are putting not only their jobs and incomes at risk, but also their savings.

Companies Act in India provides for payment of up to 11 per cent of profits to the whole-time direction of the company. Justice Mohan Committee, which was set up to recommend pay revision for public sector executives, submitted its report in 1998 and recommended that perquisites and allowances beyond 50 per cent of pay should be linked to performance. It observed that these performances related payments should be a function of profitability at the level of a particular enterprise and emoluments at the level of the individual executive. While it is not possible to think or definitive stipulations or ceilings in these spheres, the Committee believes that some norms would be desirable. It would be appropriate to suggest that such performance related payment should not, as a norm, exceed 5 per cent of the distributable profits in an enterprise. However, there would be situations where distributable profits are not large enough for performance related payments that could suitably reward executives for turning around or significantly improving performance of an enterprise. Similarly, it would be appropriate to suggest that performance related payments should not, as a norm exceed 50 per cent of the basic pay of an individual executive. The Board should, of course, have the flexibility and discretion to go beyond this norm wherever necessary and appropriate but the justification for the relaxation should be explicitly recorded.

The major advantage associated with profit sharing plans is their impact on an organisation's culture. When profit sharing plan covers most members of the organisation, there is the potential for it to stimulate interest in the financial result of the organisation and to create a culture in which attention is focused on performance. Although profit sharing may not be terribly motivated in the sense of driving people to work harder, it may motivate them to pay attention to financial results and to try to understand the business. The effect on employees can be a better understanding of organisation and thus, more knowledge and profit focused decision-making behaviour.

5.14 NON-FINANCIAL INCENTIVES

Not all-incentive pay plans focus on money as the reward. Time can be a significant reward to many people. Incentive pay plans can provide time off the job as well as more pay. To many people in our society, defining what needs to be done and then letting the person complete it in whatever time is comfortable provides not only free time but a sense of freedom as well.

Some incentive pay plans avoid any involvement with the pay system by developing contests in which employees receive prizes of value to them. These prizes can range from merchandise to vacation trips. Of course the prize must be something the recipient desires. Otherwise there is no incentive to perform. Incentives such as this can also be dysfunctional if the reward is for something that is peripheral to the job. The focus on the contest may remove attention from the basic purpose of the job.

5.14.1 Design

In the previous section, we discussed the two basic parts of an incentive pay the performance definition and the reward. In this section we discuss how these two are put together into an operating plan. Specifically, the jobs to be included, relating performance to reward, and the administration and control of incentive pay plans are examined.

5.14.2 Jobs to be Included

Not all people or all jobs should be placed under an incentive pay. Jobs in particular vary in appropriateness for incentive pay plans. Further, the variety of incentive pay plans and the variation in effectiveness of those in operation suggest that there are conditions under which a particular plan is applicable and conditions that make for the success or failure of incentive pay plans in general.

5.14.3 Job Conditions

The kind of work being performed is a major variable in choosing which incentive plan, if any, is the most applicable. A plan suited to highly repetitive, standardized, short-cycle manual operations is unlikely to fit less structured work. Highly variable, non-standardized work may make incentives unworkable.

The major job variables that need to be examined in determining the applicability of incentives are (1) standardization of the job, (2) repetitiveness of the operations, (3) rate of change in operations, methods, and materials, (4) control of the work pace, and (5) measurability of job outcomes. If these variables are placed at the ends of a scale as in figure 5.1, then the more each is true for the job, the more individual incentive pay plans that focus on job outcomes, such as piecework or standard-hour plans, are appropriate. If these conditions are not met and variability is introduced, group- or organization-wide plans are more appropriate. These types of plans can smooth out the variations that occur in jobs that fall between the two extremes, illustrated in figure 5.1.

INCENTIVE PLAN			
Individual	Group	Organization	None
1. Standardized jobs		1. Variable jobs	
2. Repetitive work		2. Novel work	
3. Stable methods		3. Changing methods	
4. Worker control of pace		4. Machine control of pace	
5. Measurable outcomes		5. Judged outcomes	

Figure 5.1: Applicability of Incentive Pay Plans to Work Conditions

At the other end of the scale are jobs that are largely inappropriate for the use of incentives because of their lack of standardization and repetitiveness, frequent changes in methods, lack of worker control, and difficulty in measurement.

Most organizations have jobs that fall into all of these categories. Thus an organization desiring to place all or most employees on incentives may find that a plant-wide plan is most feasible. Some organizations, because of the value of incentives, choose to invest a great deal of time in developing an individual incentive plan in a variable situation, but most choose to install a number of different plans, each geared to a limited segment of the organization, or an organization-wide plan.

Work often requires workers to cooperate rather than compete with one another and with other organization units. Such requirements, which are becoming the norm in complex organizations, argue against individual incentive pay plans and in favor of group and organization-wide plans. Obtaining cooperation among interdependent workers and among organization units is difficult under the best conditions and logically impossible when the reward system encourages competition.

5.14.4 Organisational Conditions

The size of the organisation may affect the chances of success of incentive pay plans. A large organization can typically make the administrative commitment required to support an individual plan. Plant-wide plans apparently require fairly small organizations in order to be successful. Thus large organizations would seem to be limited to individual or small-group incentive pay plans or to none at all, and small organizations with limited staff expertise would seem to be limited to plant-wide plans.

Also involved is the proportion of total costs represented by labour costs. If labour costs are a high proportion of total costs, placing labour costs on a variable-cost basis is worth considerable effort. But if labour costs are a small proportion of total costs, incentive pay plans will appear less attractive to management.

Management attitudes constitute a major variable in the success of incentive pay plans. Unless management is committed to maintaining the relationship between performance and pay and backs this commitment with the necessary administrative expenditures and organization of work, an individual incentive plan can fail or become obsolete very quickly. Management attitudes will depend in part on the nature of competition in the industry and on business conditions, but the real variable is the trust management has in employees to guide and direct their own activities. This is true of both individual and organization-wide incentive pay plans.

Relationships with employees, formal or informal, also determine the kind of incentive pay plan, if any, that is feasible. A hostile relationship argues against any incentive pay plan, because it will create an atmosphere of controversy. A formal, arms-length relationship suggests limiting incentive coverage to situations where sufficient objectivity can be achieved to preclude disagreement. If, however, the relationship is characterized by mutual respect and trust, incentive pay plans dictated by technical conditions may be employed. For example, a gain sharing plan based on imperfect measurement may be employed if the work requires it.

5.14.5 Incentive Pay Plan Applicability

There is a tendency to think of incentive pay plans as being applicable primarily to direct production jobs, while pay-for-performance plans are the appropriate method for other employees. This tendency applies primarily to individual and small-group incentives rather than to plant-wide or organization-wide plans, which ordinarily cover all employees.

The fact is, however, that individual and small-group incentive pay plans are applied to almost all varieties of work. What is required is a willingness to engage in the expense and administration required to make the program work. From this standpoint, there is scarcely any job that someone has not successfully measured, and applied a reasonably successful incentive pay plan to.

The premise for this reasoning may be simply stated. All tasks, jobs, or functions must have a purpose. Better performance of this purpose is worth money to the organization. Devising a yardstick to measure this improved performance will therefore permit rewarding the individual or group who achieves it.

The general approach in all these applications of incentive pay systems has been: (1) identifying measurable work as a yardstick of performance, (2) setting standards on the basis of this yardstick, (3) measuring performance against these standards, and (4) providing extra pay for performance above standard. It has been found in all of these applications that certain aspects of work results can be measured.

The widely varied applications of incentive pay plans prove that with diligence and ingenuity it is possible to find and measure aspects of work. But it may be useful to remember that the kind of behaviour measured is the kind of behaviour that people exhibit. Thus, organizations must be certain that incentive pay plans are based on measures of output that they require rather than merely on those that can be measured. If what is measured is related only peripherally to organization goals and if what is not measured remains undone and neglected by employees, the incentive pay plan impedes attainment of organization goals.

5.14.6 Relation of Performance to Reward

The central imperative in an incentive pay is that the person being paid understands that a particular outcome or behaviour, when compared successfully with the performance standard, will lead to a specified reward. In this section we will cover the development of this relationship.

In order to develop this relationship, the performance standard must be clearly stated and the ratio between it and the reward delineated.

5.14.7 Setting Performance Standards

An incentive pay must contain a clear performance standard. As we have seen, a number of definitions of performance are used in incentive pay plans. These include the output of the job, the time taken to complete a task, the efficiency with which the job or organization operates, and the profit derived from the operation of the organization.

Setting performance standards in terms of outputs would seem the easiest, since it taps the purpose of the job. But in many jobs, it is difficult or impossible to quantify the output. Further, output can be defined in terms of the number of units, the quality of those units, and / or the time taken to complete the units.

The most common way of determining a performance standard for production jobs is to conduct a time and motion study. This technique estimates the time normally required to produce a unit. In turn, a study of the job in operation in which the exact motions required to perform the task and the time required to do so is made. Thus, each activity or element that goes into producing the unit of production is timed and a total time is developed under which a normal worker working at a normal pace would complete a unit of production. The equitable relationship between the unit of production and pay can then be arrived at by finding the market rate for the job or through bargaining. The focus of a time and motion study can be either the output or the time taken to complete the task. Thus both piecework and standard-hour incentive pay plans tend to use this technique.

Non-production jobs can also be paid under an incentive pay based upon outputs. Sales jobs are a case in point: the salesperson is paid on the basis of sales volume. Regardless of the job, the major requirement of setting performance standards is to define the value of a unit of production or performance. In order to do this, there must be some idea of a normal output and an equitable wage for achieving that output.

Incentive pay plans focusing on efficiency or cost reduction involve defining a standard or normal cost and then rewarding employees on a schedule that is achieved at less than this standard cost. The cost definition varies with the plan. In a Scanlon Plan the typical cost standard is labour costs as a percentage of sales. The Rucker Plan uses value added by manufacture for each dollar of payroll costs measured by the difference between sales income from goods produced and the costs of materials, supplies, and services consumed in production. In Improshare, the focus is on the hours saved in producing a given output. Production standards are developed from past production records.

Profits are a clear-cut measure, but as a performance standard in a profit sharing plan they require two decisions. The first is to set the percentage of the profits that will go into the profit sharing plan in each time period allocated. This percentage can be fixed, such as 10 percent, or established anew for each period by management decision. The second decision is the proportion of the total allocation that each person receives (distribution). This is ordinarily done by calculating an employee's base pay as a percentage of total payroll and giving the employee that percentage of the total profit sharing allocation.

5.14.8 Proportion of Earnings

Incentive pay plans can range from being the basis for all of the employee's pay to being an insignificant percentage of it. In a straight piecework plan, the employee is paid for the number of units produced. There is no guarantee of how much the employee will make in a time period; that is up to the employee. A keypunch operator who is paid a certain amount for each 100 cards would be an example. At the other extreme might be a profit sharing plan that provides no additional money, beyond base pay, to the employees in a year in which the organization does not make a profit. Clearly, in these two cases, the importance of the incentive pay plan to the employee and its motivational effect is very different.

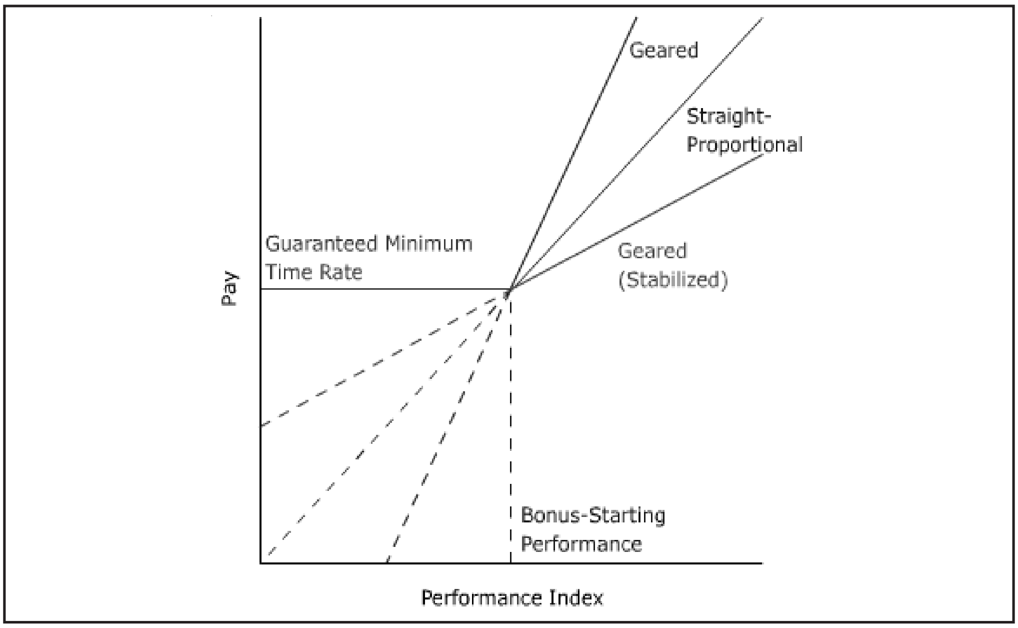
Both of these situations are likely to be unacceptable to the employee, but for different reasons. The straight incentive plan makes the employee feel insecure. In the second case there is supposed to be an incentive, but none is forthcoming or it is so small that it means nothing. The employee feels cheated. The lessons from this are that some guarantees should be built into the incentive plan on the one hand, and the incentive plan should be a significant proportion of the employee's total pay on the other.

Rather than a straight incentive plan, most plans contain a guaranteed base pay. This is usually the market rate or some proportion of the job's market rate. This guarantee is associated with an output standard that matches the guaranteed rate. The incentive plan then really operates only if the employee exceeds the performance standard; for all time periods in which he or she does not "meet standard," the pay is the base guaranteed pay. In this way employees are protected from circumstances beyond their control that limit production in a particular period. If an employee continually fails to meet standard, management must decide whether the standard is incorrect or whether the employee is not capable of performing the job.

As we have seen, for a reward to be of value to a person, it must be perceived as significant enough to expend effort on. Ordinarily, an incentive that yields a small proportion of the employee's earnings or a plan in which the probability of attaining the reward is low does not energize the employee to expend effort. Thus, it is unlikely that the organization will attain the performance it desires. One exception may be bonus plans that reward a very specific behaviour that is an out-of-the-ordinary outcome of the job.

5.14.9 Performance-Reward Ratio

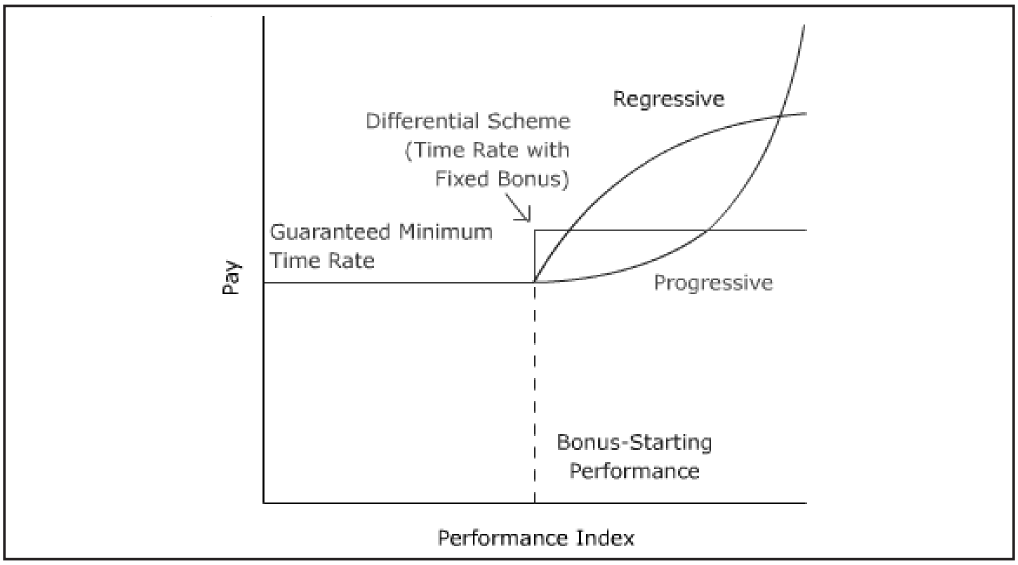
Basic to the performance-reward connection is the ratio of reward to performance. This ratio can take a number of forms. The most common is the straight-proportional ratio. This is the type used in piecework and standard-hour plans. It provides a one-for-one proportion between performance and reward. A second possibility is the geared ratio. In this case the ratio of reward to performance units varies at different levels of production. The proportional change may be less or more than the proportional change in output. These three possibilities are illustrated in Figure 5.2. Note that this illustration assumes that there is a base rate of production and reward after which the incentive pay system takes hold.



(*Source:* Payment by Results, International Labour Office, Geneva, 1984, p. 11.)

Figure 5.2: Performance-reward ratios

These three examples do not exhaust the types of performance-reward ratio. Three more, based on the geared ratio, are illustrated in Figure 5.3.



(*Source:* Payment by Results, International Labour Office, Geneva, 2007, p. 12.)

Figure 5.3: Three geared ratios

In a progressive ratio the reward increases with higher production. This type of system is most likely to be useful where higher levels of production become increasingly difficult to achieve. A regressive ratio is the opposite: higher levels of production lead to less proportionate reward. This may be appropriate where higher levels require help of others in the organization to achieve them. The final ratio is not really a ratio but a fixed amount if a standard is exceeded. This arrangement is often found in a fixed bonus system.

To some degree all incentive pay plans are based upon the principles of behaviour modification. Some organizations, however, have developed incentive pay plans that specifically use these principles. Emery Air Freight was one of the first to develop such a plan.

Many other companies have developed this kind of plan. A major use of these programs has been to reduce absenteeism. Although praise is the basic ingredient in many positive-reinforcement plans, there is increasing pressure to include money in them.

Check Your Progress 4

State whether the following statements are True or False:

1. Measured daywork and the standard hour plan also lend themselves to the use of bonuses. A bonus is a one-time payment to the employee that is not built into his or her pay rate.
2. Evaluation is done at least quarterly, and the employee's pay rate may be adjusted according to how well he or she has performed in comparison with the standard.
3. Straight piecework can intimidate employees because it places them under considerable pressure to produce, which they may have difficulty doing consistently.
4. Employees who regularly do not make the standard are reviewed to see if they are properly placed.
5. The most common form of a time rate individual incentive is the standard-hour plan. As in piecework, the employee is paid according to output.

5.14.10 Administration and Control

Careful attention to incentive pay policies and procedures is a necessary prerequisite for the installation and successful operation of any incentive pay plan. Wide participation in the development of these policies and procedures, including union-management negotiation, also increases the possibilities of success. A careful statement of policy goes far toward preventing situations in which rewards are offered for results not desired by either the organization or employees. Participation in policy making helps ensure both the commitment of resources and energy required by management, as well as the favorable attitudes of employees and the union.

5.14.11 Administrative Support

Incentive pay plans require expert staff support for proper operation, especially a heavy commitment of resources to industrial engineering. Unless the industrial engineers can carry out the standardization and measurement work as well as plan maintenance, the incentive pay plan will quickly become obsolete.

There is also likely to be pressure to expand incentive pay coverage to other workers in order to bring their earnings up to the level of those of incentive pay plan workers. Ensuring that such expansion is economically justified requires expert administrative support and upper-management decision making based upon the value of incentive pay plans and not upon other organizational political considerations.

5.14.12 Supervision

Incentive pay plans require good supervision. This requirement may mean selecting more capable supervisors. But it certainly means training supervisors to understand the workings of incentive pay and, equally important, showing supervisors that incentive pay is an important means of obtaining the quality, cost, and output objectives that are their responsibility and the basis of their rewards. Unless supervisors acquire the necessary skills and a strong interest in making the plan work, the incentive pay plan will quickly deteriorate.

The role of the supervisor changes when an incentive pay plan is installed. The control function is lessened since the incentive pay plan builds in a control mechanism. On the other hand, the supervisor must ensure that the production process runs smoothly, with a minimum of down time, so that the employees may produce according to the plan. Supervisors spend more time in liaison and training and less in directing their workers.

5.14.13 Employee Perceptions

Employees must accept the incentive pay plan as fair if it is to work. Obtaining this belief requires a continuing communications effort. Emphasizing the prospects for steady employment and allaying other fears of employees is necessary to obtain their belief in the fairness of the plan.

Employees must accept the conditions of the plan. Further, the conditions should not be changed except under agreed-on circumstances. Employee fear of rate cutting is the force behind restricted output and employee distrust of incentive pay plans. Accepted standards require capable administrative staff and supervisors who are not only technically competent but able to secure employee approval of standards and the standard-setting process. Successful incentive pay plans emphasize measurement rather than negotiation in the setting of standards. Obviously, acceptance of measurements requires confidence in management's fairness and good labour relations.

Keeping the incentive pay plan simple and understandable to employees is essential. All procedures should be as simple as possible. Complicated earnings formulas should usually be avoided. Employee trust requires that employees understand how the plan works and affects their pay.

5.14.14 Establishment of Performance Standards

As indicated, performance standards lie at the heart of any incentive pay plan. How these standards are set goes a long way toward achieving their acceptance. Participation is one way to aid in acceptance. There needs to be an established process for contesting standards. The solutions must be acceptable to employees and the organization.

Developing acceptable original standards is not as difficult as obtaining acceptance of changes in standards. Because of employees' fear of rate cutting and job loss, any change in standards is likely to be resisted, no matter how justified. But changes in materials, methods, and equipment require changes in standards if the incentive pay plan is not to become uneconomical for the organization. Still, any changes in standards should be a last resort and should be carefully explained to employees.

5.14.15 Failure to Meet or Exceed Standards

This should be carefully investigated, and the reasons found and corrected. The failure may be due to poor standardization of materials and equipment, in which case employees have the right to request a revision of the standard. Or it may be due to inadequate training or failure to follow the prescribed methods. Each of these cases calls not for a revision of the standard but for better supervision and training. Paying the worker "average earnings" if he or she fails to reach standard rather than finding and correcting the reason for the failure, weakens incentive pay plans.

As indicated, most incentive pay plans contain a base rate that guarantee the employee a base salary regardless of his or her production. The relationship among base rates should be determined by job evaluation and market rates, just as with any other job in the organization.

5.14.16 Organizational Pay Relationships

Pay relationships between jobs become more important when there is an incentive pay plan in the organization. If earnings of low-skilled employees on incentive pay exceeds those of high-skilled employees not on incentive pay, a perception of inequity is created that will lead to pressure for increases in wages for those not under the incentive pay plan, whether or not there is any basis for these increases. Under individual and small-group incentive pay plans, continually monitoring pay relationships involves an additional commitment of resources.

As we have noted, extra earnings under the plan must be sufficient to provide incentive for extra effort. With reasonable effort most workers should be able to attain some incentive earnings. The average worker on incentive pay is usually expected to earn a 25-30 percent bonus. Individual workers are expected to vary around the normal bonus rate. Theoretically, of course, there is no ceiling on earnings. Establishing one would, in essence, cut rates and reduce the plan's incentive value for high producers.

5.14.17 Incentive Pay Plan Maintenance and Audit

More incentive pay plans fail because of inadequate maintenance than for any other reason. There is a constant tendency for incentive pay plans to erode. Although changing the plan has its hazards, as just indicated, ignoring the constant changes that occur in the organization is most likely to lead to a situation where the standards are too loose and the incentive pay plan is costing too much and not providing the incentive for extra effort.

Many organizations with successful incentive pay plans audit all phases of their incentive pay plan operation at regular intervals of one year or less. Standards are audited by analyzing an operation selected at random, almost as if an original standard were being developed: materials, methods, operator proficiency, and equipment are checked and compared with the existing standard. The timekeeping and reporting systems are also audited, as are earnings relationships among individuals and groups. The latter are subjected to statistical analysis of earnings distributions.

An advantage of the periodic audit is the assurance that high earnings are not used as a signal to revise standards but that every standard is periodically audited and revised up or down as prevailing circumstances dictate. Union officials, recognizing the desirability of a consistent rate structure and the elimination of inequities, find the approach logical. Employees are less likely to resent changes wrought by an agreed-on system.

Although there is a great deal of evidence that incentive pay plans can improve employee performance, there is also much evidence that they have dysfunctional consequences. If this were not true, incentive pay plans would undoubtedly be more popular than they are. The problems of incentive pay plans fall into two categories...practicality and perception.

With incentive pay plans there are many things that might be possible to do but not worth doing because they cost too much, either directly or indirectly. There is a tremendous amount of evidence, for example, that incentive pay plans, especially individual ones, result in restriction of output. Such studies show that this phenomenon is widespread and results in productivity considerably below worker capability.

The reason for restriction of output has been shown to be worker beliefs that additional productivity will lead to a rate cut or to employees working themselves out of a job. These beliefs presumably result in group pressures to restrict output.

It has also been shown that the competition created by individual incentive pay plans can cause serious problems if the work calls for cooperative effort. People can be expected to exhibit behaviour that is rewarded, and cooperative behaviour is not rewarded or recognized under an individual incentive pay plan. In fact, it has been suggested that incentive pay plans cause employee resentment because they reward only effort, although employees know that many other contributions are required by the organization.

A problem implied above is the high administrative costs of an incentive pay plan. Although there is no question that determining standards, measuring output, and maintaining the plan are more costly than administering a pay-for-time-worked plan, there are no studies that accurately show the costs of installing and operating an incentive pay plan. Studies cited earlier concerning cost reductions under incentive pay suggests that productivity increases often offset the additional costs.

Another problem of incentive pay plans, noted earlier, is the tendency for internal wage and salary relationships to be distorted, such that lower-skilled incentive-based workers may earn more than high-skilled workers not under the plan. Interestingly, this problem as well as inter-group conflict has been credited with the move toward expanding incentive pay plans at the plant and organizational levels. Although the studies to date have not proved that these broader plans avoid these problems, there is evidence that they can encourage cooperation and offer suggestions (not proof) that output restriction is less likely. The numerous changes that accompany the installation of a company-wide plan make determining the source of results especially difficult. At any rate, there is no reliable evidence comparing the relative effectiveness of individual, group, and organization-wide plans.

The performance-motivation model is a perceptual model: it states that people will behave in a given way provided they perceive certain things. This section will reexamine this model to see what problems of perception incentive pay plans can have.

Incentive pay plans rely on pay as being an important reward for the employee. This is undoubtedly true. But pay is not the only reward that is important to employees. There are many non-financial rewards that employees need and desire in their work relationship. Incentive pay plans not only ignore most of these other rewards but often thwart their satisfaction. The discussion on restriction of output and its causes is a good example. The reasons that incentive pay plans have problems of this kind is that they prevent employees from satisfying their social needs. Where desires for different rewards come into conflict, the motivational strength of the plan is diminished.

As we have seen, the most important aspect of incentive pay plan design is the determination of the performance standards and the ratio of rewards to those standards. This is easy to say and hard to do. Performance is hard to define for all jobs. It is even harder to define all the performance variables and relate them to the rewards. What occurs is a dilemma. In order to include all the variables and make the connections, the plan becomes complex. This in turn violates the simplicity principle and increases the probability that the employee will not understand the plan.

Establishing performance standards is a continual problem. To the degree that it is done by management for the employee, its acceptance by the employee depends upon the faith that the employee has in management. The constant fear of the employee, as we have noted, is of rate cutting. Thus any change in the standards whether justified or not, will be viewed with suspicion. Again, incentive pay plans require trust between management and labour, something that is not common in our society. Even where there is trust, the process of setting standards is judgmental, suggesting that there is always the possibility of error. It is therefore wise to have a formal appeal system, whether there is a union or not. Further, employees see the definition of performance by management in some cases as breaking down the skill requirements of the job and thereby making the job less intrinsically appealing.

Although the connection between performance and reward is clear in the short run, it may not be so in the long term. As we have seen, the employee may perceive that to produce above the standard is to work oneself out of a job. This becomes a further reason to restrict output and to encourage others to do likewise. A further concern of employees may be that the proportion of the gain made under the incentive pay plan goes mostly to the organization and not to the employees.

The final part of the performance-motivation model is the connection between performance and effort. The purpose of incentive pay plans is to increase the effort of employees and thereby their output. Obviously, this assumes that the employee's effort makes a difference in the output, but this is not always true, at least not in a proportion that allows the performance-effort connection to operate.

Employees have concerns about attempts to increase effort. They may feel that management is trying to get more than a fair day's work for a fair day's pay. Or they may feel that incentive pay plans are excuses for a speedup by management. At the extreme, the pressure for more effort may lead to stress and fatigue.

In order to have high earnings, the employee under an incentive pay plan must put out a consistently high level of effort. This may not be a natural pace for people. Most of us are able to work faster at certain times of the day than at others, so a constant high level of effort is almost impossible to maintain. Employees who cannot keep up are going to feel a great deal of frustration and concern for their continued employment.

Furthermore, base rates in incentive pay plans that are established through industrial engineering assume that all people have the same ability to achieve the standard or higher. This is not true. Thus there are some employees for whom the performance-effort connection is low because they are easily able to meet the standard, and others for whom the connection is low because they must put forth too much effort to meet it. But it is impossible to have different standards, since that would be perceived as unfair.

All of these perceptual concerns by employees serve to lower the contingencies required for the performance-motivation model to operate and therefore reduce the effectiveness of an incentive pay plan. Management and the compensation staff need to recognize the possible presence of these concerns and deal openly with them through communication programs with the employees.

5.15 LET US SUM UP

After a considerable period of decline in their usage in some developed countries, new interest is being shown in developing incentive pay plans for a wide range of jobs, many of which were considered inappropriate jobs for incentive pay plans in the past. However, with the need to focus on productivity and the known positive results of incentive pay plans, many new ideas are being tried. The use of incentive pay plans comes the closest to using the performance-motivation model in the design of the compensation plan.

There are three essential elements to incentive pay plans. First, the unit of the incentive pay plan, called the level of aggregation, is determined. Incentive pay plans are ordinarily categorized into individual, group, or organization-wide (organizational). Each of these levels defines the level at which output or productivity is defined and the group that receives the rewards. Second, and most important, a performance standard is set. In individual and group plans the standard is usually some statement of output or time or both. In organizational plans, standards of performance are based on reductions in cost, improvements in overall productivity, increased profits, or a combination of all three factors. Third, rewards are offered. The rewards are usually money, but time can also be a potent reward. Money needs to be in significant quantity and received in a timely fashion, so the connection is clear.

Designing incentive pay plans requires making a further set of decisions. The first of these is the jobs to be included. This is important because some jobs are not amenable to incentive pay plans. The second set of decisions has to do with organizational conditions such as size of organization, labour costs, and managerial attitudes. Determining the applicability of incentive pay is a third decision. In general, in the past, applicability has been too narrowly defined. Another decision has to do with the manner in which performance and reward are connected. This requires a clear definition of performance, a ratio between performance and reward, and determination of the proportion of total pay controlled by the incentive pay plan. Finally, incentive pay plans require well-devised administration and constant surveillance for optimum operation.

Incentive pay plans are not always popular because they have problems that may make them not worth their advantages. The assumption that workers operate only on an economic level is not supported when one sees the restriction of output that often occurs in incentive pay plans. Incentive pay plans also require considerable administrative costs, take control away from supervisors, and require a supportive climate within management. Further, the inability to define performance in a way that is complete and acceptable often has doomed incentive pay plans. Changing the conditions of the plan once established is very difficult, as it is often seen as taking away things from the employee. Finally, other groups in the organization may perceive incentive pay plans for one group in the organization as inequitable.

5.16 LESSON END ACTIVITY

Write a study note on the incentives, types and profit sharing.

5.17 KEYWORDS

Incentives: Incentives are monetary benefits paid to workmen in recognition of their improved performance.

Incentive Scheme: It is a plan or programme to motivate individual or group performance.

Incentive Programme: It is most frequently built on monetary rewards (incentive pay or monetary bonus), but may also include a variety of non-monetary rewards or prizes

Halsey System: This system which was developed by F.A. Halsey provides for the fixation of a standard time for the completion of the task.

Rowan System: Under this system also, a standard time is allowed for a job, and bonus is similarly paid for any time saved.

Bedaux Point System: Under this system, the standard time set is divided into a number of points at the rate of one minute per point.

The Taylor Differential Piece-rate System: This system was introduced by Taylor with two objectives. First, to give sufficient incentive to workmen to induce them to produce up to their full capacity, and second, to remove the fear of wage cut.

Merrick Differential Piece-Rate System: This is a modification of the Taylor system, with three instead of two rates.

Profit-sharing System: The profit-sharing scheme is based on the same principle as the group system where incentive is related to the collective effort of the group.

5.18 QUESTIONS FOR DISCUSSION

1. What do you mean by the theory of individual incentives?
2. Define the concepts of measured day work, piecework, and standard hour.
3. What do you know about the concept of gain sharing, its advantages and disadvantages?
4. What do you understand by organization wide incentives?
5. Give an analysis of the Scanlon Plan, Kaiser plan and profit sharing as the form of incentives.
6. Define the performance variables of importance and conduct an audit to see how well the organization is doing.
7. How would you establish specific goals for each employee, using employee input?
8. What do you understand by the concept of profit sharing and non-financial incentives?

Check Your Progress: Model Answers

CYP 1

1. Remunerative incentives (or financial incentives) are said to exist where an agent can expect some form of material reward - especially money - in exchange for acting in a particular way.
2. Moral incentives are said to exist where a particular choice is widely regarded as the right thing to do, or as particularly admirable, or where the failure to act in a certain way is condemned as indecent.

CYP 2

1. Some of the advantages of group incentives are:
    a. Better co-operation among workers.
    b. Less supervision.

Contd....

c. Reduced incidence of absenteeism.

d. Reduced clerical work.

e. Shorter training time.

CYP 3

1. Gainsharing is a formula based organisation or factory wide bonus plan which provides for employees to share in the financial gains made by a company as a result of its improved performance.

2. The Rucker plan is also based on employment costs. But they are calculated as a proportion of sales less the costs of materials and supplies (i.e. value added). Allen Rucker contended that the pay proportion of value added remains a near constant share unless the organisation suffers from severe mismanagement or a drastic change of policy. On the basis of this assumption, the Rucker plan determines a constant share of whatever added value is created by the joint efforts of management and employees.

CYP 4

1. True
2. True
3. True
4. True
5. True

5.19 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

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S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

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LESSON

6

FRINGE BENEFITS

CONTENTS

6.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the theory of fringe benefits
- Attempt on the objectives and types of fringe benefits
- Learn about the individual group variable compensation
- Know about the pay for performance
- Analyse the concept of pay by seniority

- Understand the concept of group piece rate
- Learn about the concept of production sharing plan
- Understand the scheme of employee profit sharing
- Have an idea about the employee stock ownership
- Describe gain sharing as a concept of fringe benefits.

6.1 INTRODUCTION

Incentives and benefits are indirect compensation (as against direct compensation on critical job factors and performance) because they are usually extended as condition of employment or with intention of inducement or motivation and are not directly related to performance. Benefit is a generic word and used to describe a substantial elements of compensation which is unique and provided to the employee in non-cash form (there are some exception) and known as fringe benefits and services, other terms like perquisites perks, allowances etc., are also used. There is a distinction between benefits and services. Benefit applies to those items for which a direct monitory value to the employees, can be ascertained, as in the case of pension, insurance, holiday pay, etc. Services applies to such items as companies newspaper, companies holiday homes, etc., for which direct money value cannot be readily established by the employee. Perks is something in addition to the payment; car fuel etc. Allowance could be sum of money given at regular interval to cover some special circumstances like canteen allowance, clothing allowance, etc.

Fringe benefits are suppose to be benefit at the fringes, or edge of the main pay. Now this has been replaced by simple benefits which forms a substantial part of the total compensation.

Employee benefits and services include any benefits that the employee receives in addition to direct remuneration.

A formal definition is "Fringes embrace a broad range of benefits and services that employees receive as part of their total compensation package—pay or direct compensation—is based on critical job factors and performance. Benefits and services, however, are indirect compensation because they are usually extended as a condition of employment and are not directly related to performance."

Employee benefits are elements of remuneration given in addition to the various forms of cash pay. They provide a quantifiable value for individual employees, which may be deferred or contingent like a pension scheme, insurance cover or sick pay, or may provide an immediate benefit like a company car. Employee benefits also include elements, which are not strictly remuneration, such as annual holidays.

The terms 'fringe benefits' and perks (perquisites) are sometimes used derogatively, but should be reserved for those employee benefits which are not fundamentally catering for personal security and personal needs.

6.2 STRATEGIC PERSPECTIVES ON BENEFITS

From the employers' perspective, employee benefits represent a double-edged sword. On one side, employers know that in order to attract and retain employees with the necessary capabilities they must offer appropriate benefits. On the other side, they know the importance of controlling or even cutting costs. Benefits comprise a significant part of the total compensation package offered to the employees. Total compensation includes money paid directly (such as wages and salaries) and money paid indirectly (such as benefits). Too often, both managers and employees think of only wages and salaries as compensation and fail to consider the additional costs associated with benefits expenditures.

Total compensation costs for labour amounts to more than half of total operating costs in many organisations, even more in some service operations. For example, about 80% of the US Post office budget is labour cost. Because of their sizable proportion of organisational costs, the compensation components of base pay, variable pay, and benefits require serious and realistic assessment and planning.

Goals for Benefits

Benefits should be looked at as part of the overall compensation strategy of the organisation. For instance, an organisation can choose to compete for employees by providing base compensation, variable pay, or benefits, or perhaps all three. Which approach is chosen depends on many factors, such as the competition, organisational life cycle, and corporate strategy. For example, a new firm may choose to have lower base pay, and use high variable incentives to attract new employees, but keep the cost of benefits as low as possible for a while. Or an organisation that hires predominately younger female employees might choose a family-friendly set of benefits including on-site child care to attract good employees.

Benefits Needs Analysis

The benefits needs analysis includes a comprehensive look at all aspects of benefits in a firm. Done periodically, such an analysis is more than simply deciding what benefits employees might want. A benefits needs analysis to make certain the mix of benefits is doing what it should, might consider the following issues:

- How much total compensation, including benefits, should be provided?
- What part should benefits comprise of the total compensation of individuals?
- What expense levels are acceptable for each benefit offered?
- Why is each type of benefit offered?
- Which employees should be given or offered which benefits?
- What is being received by the organisation in return for each benefit?
- How do having a comprehensive benefits package aid in minimizing turnover or maximizing recruiting and retention of employees?
- How flexible should the package of benefits be?

Employee benefits and services are alternatively known as fringes, service programmes, employee benefits or hidden payroll.

The word fringe is not appreciated by management practitioners on the ground that nowadays benefits and service constitute substantial labour cost for any organisation. They are no longer mere fringe costs or fringe items. They are important to managements, employees and unions alike.

Similarly, the terms benefits and services are often used interchangeably by some writers. But some maintain distinction between the two. For these people, the term benefit applies to those items for which a direct monetary value to the individual employee can be ascertained, as in the case of pension, medical insurance, or holiday pay. The word service applies to such items as a company newspaper, company or purchasing service, for which a direct money value for the individual employee cannot be readily established. However we have used the two terms interchangeably in the lesson. We also have no objection against the use of the term fringes.

6.2.1 Classification of Employee Benefits

Employee benefits can be further classified under these seven major groups:

(1) Disability income continuation,

(2) Loss-of-job income continuation,

(3) Deferred income,

(4) Spouse or family income continuation,

(5) Health and accident protection,

(6) Property and liability protection, and

(7) A special group of benefits and services called perquisites.

Disability Income Continuation

Disability may be classified as regular, temporary, total, or partial. When employees are unable to work because of an accident or some health-related problem, disability income continuation payments assist them in maintaining their existing lifestyle without major modification. Various disability income continuation components provide weekly or monthly payments in lieu of the regular earned income paycheck. The following 11 components are among the more commonly available disability income continuation plans. Although all components will seldom be available to employees, components can be packaged to maximize employee protection while maintaining costs within reasonable limits for the employer. The major components are as follows:

1. Short-term disability
2. Long-term disability
3. Workers compensation
4. Non-occupational disability
5. Social security
6. Travel accident insurance
7. Sick leave
8. Supplemental disability insurance
9. Accidental death and dismemberment.
10. Group life insurance: Total Permanent Disability (TPD)
11. Retirement plans

Loss of Job Income Continuation

Loss-of-job-income continuation plans are designed to assist workers during short-term periods of unemployment due to layoffs and termination. The eight major compensation components that make up this group of benefits are as follows:

1. Unemployment Insurance (UI)
2. Supplemental Unemployment Benefit insurance (SUBI)
3. Guaranteed Annual Income (GAI)
4. Guaranteed Income Stream (GIS)

Deferred Income

Over the year employers have established the following kinds of compensation components to help employees accumulate capital and meet future financial goals.

1. Social Security
2. Qualified Retirement Plan
   - Pension plan
   - Profit-sharing plan
   - Stock bonus plan
3. Simplified Employee Pension Plans (SEPPs)
4. Supplemental Executive Retirement Plans (SERPs)
5. Supplemental and Executive Group Life Insurance Plans
6. Stock Purchase Plan
7. Stock Option Plan
8. Stock Grant

Spouse and Family Income Protection

Most employees attempt to ensure the future welfare of their dependents in case of their death. One component, life insurance, and a number of other components previously identified and described have specific features to assists a worker's dependents in the event of such a calamity. The major components available to protect workers' dependents are:

1. Life Insurance
2. Retirement Plans
3. Social Security and Medicare
4. Tax-sheltered Annuity
5. Workers' Compensation
6. Accidental Death and Dismemberment
7. Travel Accident Insurance
8. Heath Care Coverage

Health and Accident Protection

Organisations provide their employees with a wide variety of insurance services to help them and their families maintain a normal standard of living when unusual or unexpected health-related adversities occur. These health care related insurance plans cover medical, surgical, and hospital bills resulting from an accident or illness.

Feature of Health Care Insurance Plans: Medical coverage included in medical plans continues to expend every year. Basic medical coverage includes payments for diagnostic visits to the doctor's office, outpatient X-rays, and laboratory coverage. Recent additions include home visits by the doctor and ambulatory or outpatient surgery. Although still rated among medical benefits, the annual physical is beginning to appear in more health insurance programmes. Another recent addition to health care insurance plans is the extension of comprehensive health care benefits to include some of the survivors of deceased company employees retirees. A relatively new provision covers out patient and non-hospital psychiatric care.

Property and Liability Protection: Of rather recent vintage is the addition of compensation components that provide employees with personal property and liability protection. These property and liability protection components include the following:

1. Group auto
2. Group home
3. Group legal
4. Group umbrella liability
5. Employee liability
6. Fidelity bond insurance

Employees Services "Fringe"

Employer provides a wide array of services that enhance the lifestyle of employees. In some cases, these services grant employees time off with pay. In other cases, the services include highly valued in-kind benefits, which, if purchased by employees themselves, would require the expenditure of after-tax dollars. In providing these services, the employer usually receives a tax deduction and, in most cases, the good or service is not considered an earned income item. Even in cases in which employees may be charged with additional earned income for the receipt of the good or service, the charge to income is considerably less than the cost that would have been incurred by the recipient. The three major sets of components that constitute the employee services group are:

(1) pay for time not worked

(2) time off without pay and

(3) income equivalent payments and reimbursements for incurred expenses.

(i) ***Pay for Time Not Worked:*** Over the past 35 years the drive to reduce working hours and total time spent at work has focused on providing workers with more paid holidays and longer vacations. From an employee's perspective, possibly the most desired but frequently unrecognized benefit is time-off with pay. Numerous time-off with pay components have developed, and employees usually receive their daily base pay rate as the rate paid for these time-off opportunities. The more common time-off with pay components are these:

   1. Holidays
   2. Vacations
   3. Jury duty
   4. Election official
   5. Witness in court

6. Civic duty
7. Military duty
8. Funeral leave
9. Illness in family leave
10. Marriage leave
11. Paternity leave
12. Maternity leave
13. Sick leave
14. Wellness leave
15. Time-off to vote
16. Blood donation
17. Grievance and contract negotiations
18. Lunch, rest and wash-up periods
19. Personal leave
20. Sabbatical leave

(ii) ***Time-off from Work Without Pay:*** For years, some organisation have provided employees with sabbaticals without pay. In this case, an employee has an opportunity to pursue a special interest area. Although the employee is not paid, he or she continues to be covered by the employer's medical, life insurance, disability programmes.

(iii) ***Income Equivalent Payments and Reimbursements for Incurred Expenses:*** The ever-increasing diversity and population of employee benefits have given rise to a significant number of benefits that can be grouped under a category called nonstatutory benefits. The majority of benefits previously described are either mandated by legislation or permitted by statutes and given preferential tax treatment.

This group of compensation components includes some of the most diverse and most desirable kinds of goods and services employees receive from their employers. Many of these components and new ones that appear almost daily have been introduced in response to changes in the economic situation and to tax demands. This broad group of services provides employees with the opportunity for an improved and more enjoyable lifestyle. Some of the more common components are as follows:

Preferred Benefits of Services

1. Charitable contributions
2. Counselling
   - Financial
   - Legal
   - Psychiatric
   - Psychological
3. Tax preparation opportunities

4. Education subsidies
5. Child adoption
6. Child care
7. Elderly care
8. Subsidized food service
9. Discounts on merchandise
10. Physical awareness and fitness programmes
11. Social and recreational
12. Parking
13. Transportation to and from work
14. Travel expenses
    - Car reimbursement
    - Tolls and parking
    - Tool and entertainment reimbursement
15. Clothing reimbursement/allowance
16. Tool reimbursement/allowance
17. Relocation expenses
18. Emergency loans
19. Credit union
20. Housing

"Such services also give Income-tax".

6.2.2 Costing Benefits

1. Annual cost of benefits and services for all employees.
2. Cost per employee per year.
3. Percentage of payroll (annual cost divided by annual payroll).
4. Cents per hour (cost per employee per hour).

6.2.3 Factors Influencing Choice of Benefit Package

Employers Factors

1. Relationship to total compensation costs
2. Costs relative to benefits
3. Competitors offerings
4. Role of benefits in:
    a. Attraction
    b. Retention
    c. Motivation

5. Legal Requirements

Employees Factors

1. Equity (Internal + External) what others of same/similar status receive
2. Personal needs as linked to -
   a. Age
   b. Sex
   c. Marital status
   d. No. of dependents etc.

Benefit Package

Table 6.1: Fringe Benefits and their Effect

Benefit	Contribution to HRM Function	Contribution to Performance/Goodwill/ Security	Motivation or Hygiene
Pensions	Attraction, retention, motivation	Performance direct	Motivator
Company cars and fuel	Attraction, retention, motivation	Performance direct	Motivator
Work-related equipment (e.g. computers)	Attraction, retention, motivation	Performance direct	Depends
Training and education provided by employers (linked to career development)	Retention, motivation	(Goodwill) performance derivative	Motivator
Accommodation	Attraction, retention, motivation	(Goodwill) performance derivative	Motivator
Various allowances and expenses	Attraction, retention	(Goodwill) performance derivative	Motivator
Low interest loans and mortgages	Attraction, retention	(Goodwill) performance derivative	Motivator
House purchase and relocation assistance	Attraction, retention	(Goodwill) performance derivative	Motivator
Expenses	Attraction, retention	(Goodwill) performance derivative	Motivator
Childcare provision	Attraction, retention, motivation	Goodwill	Possible motivator or hygiene
Discounts on Company services and products	Attraction, retention	Goodwill	Possible motivator or hygiene
Enhanced leave arrangements	Attraction, retention	Goodwill	Hygiene
Sick pay	Attraction, retention	Goodwill, security	Hygiene
Health insurance	Attraction, retention	Security	Hygiene
Life insurance	Attraction, retention	Security	Hygiene

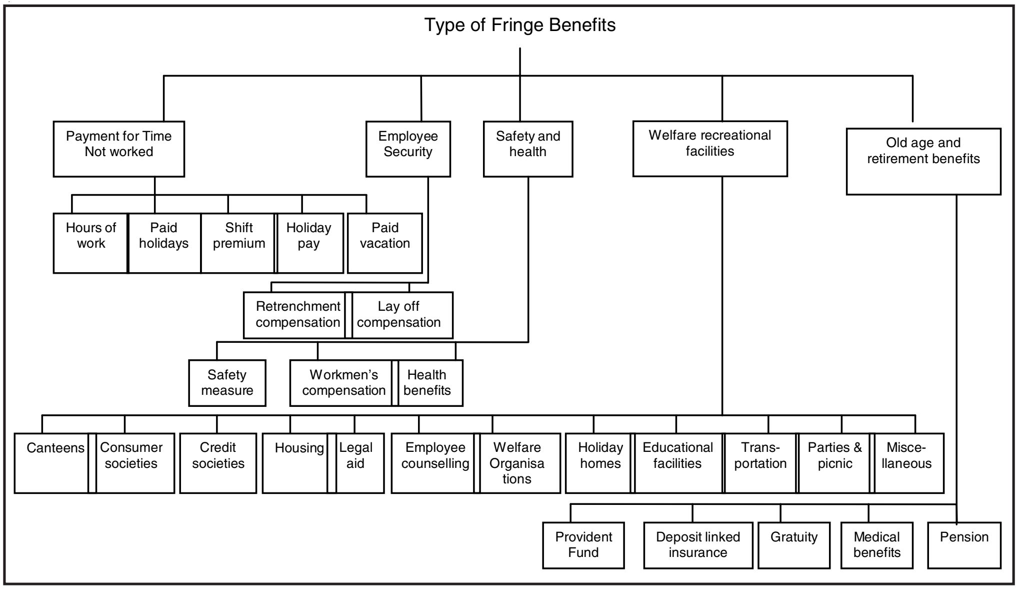

Figure 6.1: Type of Benefits

Broad Classification of Fringe Benefits - different perspective

1. ***Legally required:*** (a) Old-age, disability, health insurance (b) Unemployment compensation (c) State sickness benefits
2. ***Retirement Benefits***
    - Pension
    - Profit Sharing
    - Stock Bonus
3. Life Insurance
4. Medical
5. Paid rest period
6. Payment for time not worked
7. Miscellaneous + trends
    - Discounts on goods/services
    - Employees' education
    - Employees' meals
    - Child care
    - Elder care
    - Early retirement windows—golden offerings
    - Consulting services
    - EAP
    - Personal services - picnic, club
    - Job related services help employees to prefer their jobs better
    - Subsidized transport
    - Food service

- ❖ Education
- ❖ Family friendly benefits

Table 6.2: Some popular forms of non-monetary rewards

Treats	Knick-Knacks	Awards	Environment	Social Acknowledgement	Tokens	On-the-job Rewards
• Free lunches • Festival bashes • Coffee breaks • Picnics • Dinner with the boss • B'day treats	• Decoratives • Co. watches • Tiepins • Brooches • Diaries • Calendars • Wallets • T-shirts	• Trophies • Plaques • Certificates • Scrolls • Letters of appreciation	• Renovation • Music • Flexible hours • E-mail	• Informal recognition • Recognition at office get-togethers • Friendly greetings • Solicitation of advice/suggestion • Membership of clubs • Company facilities for personal projects	• Movie tickets • Vacation trips • Coupons redeemable at stores • Early time-offs • Anniversary birthday presents	• More responsibility • Job rotation • Special assignments • Training • Representing the company at public for

Merits of non-monetary rewards are:

1. Motivates employees to perform better.
2. Costs the organisation next to nothing.
3. Builds tremendous self-esteem among employees.
4. Makes employees more loyal to the company.
5. Creates an atmosphere where change is not resented.

The followings are the demerits of non-monetary rewards:

1. Demotivates people if processes are not transparent.
2. Could result in unhealthy competition among employees.
3. May lead to shortsighted, and hasty decision-making.
4. Work intrudes on the family life of employees.
5. Will never work if monetary rewards are inadequate.

Check Your Progress 1

1. Define fringe benefits.

   ....

   ....

2. What are the different types of employee benefits?

   ....

   ....

6.3 OBJECTIVES OF FRINGE BENEFITS

The objectives of the employee benefits policies and practices of an organisation might be:

- to increase the commitment of employees to the organization;

- to provide for the actual or perceived personal needs of employees, including those concerning security, financial assistance and thus, provision of assets in addition to pay, such as company cars and petrol;
- to demonstrate that the company cars for the needs of its employees;
- to ensure that an attractive and competitive total remuneration package is provided which both attracts and retains high-quality staff;
- to provide a tax-efficient method of remuneration which reduces tax liabilities compared with those related to equivalent cash payments.

Note that these objectives do not include 'to motivate employees'. This is because benefits seldom have a direct and immediate effect on performance unless they are awarded as an incentive; for example, presenting a sales representative with a superior car (e.g. a BMW) for a year if he or she meets a particularly demanding target. Benefits can, however, create more favourable attitudes toward the company leading to increased long-term commitment and better performance.

Why fringe Benefits?

1. Altruistic/Paternalistic consideration
2. Statutory requirements
3. Concern for well being
4. Damage and hazard of industrial working
5. Tax-planning consideration
6. Competitive consideration
7. Concern for quality of work-life
8. Mitigate fatigue and monotony
9. Discourage labour unrest
10. Reduce attrition
11. Build companies image
12. Attract, retain and motivate employees

6.4 TYPES OF INCENTIVES

There are many types of benefits that an employee derives from his employer. Some of the benefits result in tax being paid by the employees, while others, though called fringe, which means marginal, provide an advantage to an employee without having any tax effect. The avowed objective of FBT is to tax in the hands of the employer the benefits usually enjoyed by the employees which cannot be attributed to individual employees. (Budget speech of the Finance Minister) It is these types of benefits that the new law is targeting. However it seems the new law travels beyond what was contemplated by the Finance Minister in his budget speech and attempts to tax in the hands of employer certain expenditure which are directly attributable to the employees.

Examples of such expenditure are: Employers' contribution to superannuation funds and free/concessional tickets to employees or their families for their private journeys in respect of employers engaged in passenger transport.

The Finance Minister argues, "This is not a new tax, although I am obliged to call it by a new name, namely, Fringe Benefit Tax. With due respect to the Hon'ble Finance Minister, no such law ever existed in India. A decade back the law did provide for partial disallowance of certain expenditure with a view to discouraging higher expenditure by businesses, but never before has there been an attempt to tax the expenditure incurred by the assessees.

"The rationale for levying the FBT on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of such benefits and attributing the same directly to the employee. This is especially so where the expenditure incurred by the employer is ostensibly for the purpose of the business but includes, in partial measure, a benefit of a personal nature. (Memorandum explaining the provisions of the Finance Bill, 2005)

The law does not distinguish between the amounts of fringe benefits spent on the employees and the expenditure incurred on non-employees, presumably because the lawmakers thought that if they decided to so segregate the expenditure, though such segregation would be logical, the taxpayers would have a tendency of shifting the expenditure to those heads where FBT is not applicable. This would make the new tax prone to litigations, arising out of the tax payers and the tax gathers trying to interpret the various heads of expenditure in their own way. The law thus covers all possible expenditure where the lawmakers would have presumed that the taxpayer would be hiding his fringe benefits, which has resulted in certain absurd categories of expenditure also being taxed as fringe benefits. But so far as the provisions do not distinguish between amounts which are genuine fringe benefits to the employees, and the amounts which are expenditure not pertaining to the employees, they seem illogical.

6.4.1 Flexible Benefits

In basket benefits/Ala-carte/Flexible system of benefits and services are gaining popularity in multinational companies.

Advantages

1. Employees choose packages that best satisfy their unique needs.
2. Flexible benefits help firms meet the changing needs of a changing workforce.
3. Increased involvement of employees and families improves understanding of benefits.
4. Flexible plans make introduction of new benefits less costly. The new option is added merely as one among a wide variety of elements from which to choose.
5. Cost containment - The organisation sets the dollar maximum. Employee chooses within that constraint.

Disadvantages

1. Employees make bad choices and find themselves not covered for predictable emergencies.
2. Administrative burdens and expenses increase.
3. Adverse selection - employees pick only benefits they will use. The subsequent high benefit utilization increases its cost.
4. Subject to non-discrimination requirements in Section 125 of the Internal Revenue Code.

6.4.2 Administration of Benefits and Services

Organisations fumble while administering employee benefits and services. Yielding to the pressure of unions, employees demand or in deference to social response trends, companies have added newer benefits and services to the list which is already lengthy. Organisations have seldom established objectives, systematic plans and standards to determine the appropriateness of the programmes. This patchwork of benefits and services has caused several problems.

Problems in Administration

The main problem in indirect remuneration is the lack of employee participation. Once a fringe benefit programme is designed by the company, employees have little discretion. For example, the same pension usually is granted to all workers. Younger employees see pensions as distant and largely irrelevant. Older female workers feel that maternity benefits are needed. The uniformity of benefits fails to recognise workforce diversity. Admittedly, uniformity leads to administrative and actuarial economics, but when employees receive benefits they neither want nor need, these economies are questionable.

Managers, too, have little interest in the benefits programmes and trade unions are almost hostile to the schemes. Managers are not even aware of the company's policy towards benefits and their contribution to the quality of corporate life. Trade unions entertain a feeling of alienation as the benefits are likely to erode their base.

Since employees have little choice in their benefit packages, most workers are unaware of all the benefits to which they are entitled. This lack of knowledge often causes employees to request for more benefits to meet their needs. For example, older workers may want improved retirement plans, while younger workers seek improved insurance coverage for dependents. The result is often a proliferation of benefits and increased employer costs. And perhaps even worse, employee confusion can lead to complaints and dissatisfaction about their fringe benefit packages, particularly when employees do not have to contribute financially.

These problems can be avoided if the following lines are taken while administering indirect remuneration. The steps are:

1. Establishing benefit objectives
2. Assessing environmental factors
3. Assessing competitiveness: how should our benefits compare to our competitors
4. Communicating benefit information
5. Controlling benefit costs and evaluation

Benefit Objectives

It is essential for the management to establish objectives for its benefit programmes. In establishing objectives, the management may consider several factors. One such consideration is employee preference for benefits. Personnel/HR outcomes - attendance, length of service, and performance - should also receive due attention in the objective-setting process.

Typically, benefits accomplish four objectives: 1. fostering external competitiveness, 2. increasing cost effectiveness, 3. meeting individual employee's needs and preferences, and 4. complying with legal compulsions. Whatever the objectives, they must reflect the organisation's ability to pay.

Assessing Environment

External as well as internal factors influence a company's indirect remuneration programmes. Among the external factors are included such aspects as government policies and regulations, unions, and economic factors. The major government policies which influence employee benefits and services are wage regulations, tax policies, and specific benefit laws. In addition to government policies, unions are a dominant force to improve benefits and services. When labour unions and the management sit for a wage negotiation, benefits and services figure prominently in their discussion and the settlement reached invariably cover indirect remuneration to the advantage of the employees. Economic factors influence benefit decision in conflicting ways. Struggling to achieve competitive prices for their products and services, managers look to reduce, or at least curtail, increases in labour costs. As indirect remuneration constitutes a major chunk of labour costs. Benefits and services receive top priority in the cost-reduction drive.

On the other hand, competition in the labour market to attract and retain productive employees creates pressure to match the benefits offered by others.

Organisational strategies and objectives, employee preferences and demographic constitute the internal environment of employee benefits and services. A large, well-established employer in a growing or mature industry, for example, may offer a relatively better benefits package. But a smaller, newly formed emerging company may find that the high fixed costs attached to many benefits, particularly pensions, entail too great a financial burden. Instead, such organisations emphasize incentive pay or profit sharing, where costs vary with company's profitability and de-emphasize insurance or other fixed-cost benefits.

The preferences and demographics of a particular employee in an organisation also affect indirect remuneration. Most employee benefits are tax free, and hence are likely to appeal to employees with higher incomes. A vast majority of workers may not be attracted by such tax-free benefits. For them, fewer tax advantages exist, or these employees may have more immediate needs which can be met only by cash benefits. Similarly, employees having college-going children or marriageable daughters have different benefit preferences than those who are newly hired with working spouses and children who have not reached the school-going age.

Competitiveness

More often than not, organisations offer benefits to match or outstrip those offered by competitors. How to ascertain the competitors' benefit packages? These are assessed through market surveys conducted by professional associations and consultants. These surveys provide data on the various benefits offered, their coverage, eligibility and costs. The data allow employers to assess the competitiveness of their benefits and costs, with those offered by others.

Communicating the Benefits

Benefit programmes must be communicated to employees through booklets, brochures, slide presentations, and regular employee meetings. An effective technique is to use employee calendars which communicate the total remuneration components. Each month of the calendar shows a company employee receiving a benefit. For example, one month may feature a photo of an employee building a new home, made possible through the company's savings plan.

Communication helps remove ignorance of employees (and of employers too) about indirect remuneration. Further, employers might be able to increase the productivity and the advantages of good employee benefits by making employees aware of what the company does for them that does not appear on their pay slips.

Evaluation and Control

One way of assessing the usefulness of fringes is to ascertain how far the advantages claimed in favour of indirect monetary schemes have really benefited the employees. The questions relevant in this context are: (i) Have the earnings of employees improved? (ii) Have the benefits been able to attract and retain competent people? (iii) Has the morale of employees gone up? (iv) Have industrial relations improved? The answers to these and other related questions help HR managers to assess the effectiveness of fringe benefits and also to redefine benefit objectives.

Effect on Costs

Cost of fringe benefits is a reliable test of their effectiveness. Employee benefit costs can be computed on the following lines:

1. Total cost of benefits annually for all employees
2. Cost per employee per year
3. Percentage to annual payroll
4. Cost per employee per hour.

The data thus found may be examined in the following manner:

1. Examine the internal cost to the company of all benefits and services by pay roll classification, by profit centre.
2. Compare the company's costs for benefits with external norms. For example, compare its costs, average costs to averages by industry, and so on, for the package as a whole and for each benefit.
3. Prepare a report for the decision-maker, contrasting Steps 1 and 2, and highlighting major variances.
4. Analyse the costs of the programme to employees. Determine what each employee is paying for benefits, totally and by benefit.
5. Compare the data in Step 4 with external survey data.
6. Analyse how satisfied the individual is with the employer's programme as compared to the competitor's programme.

Periodic action on the above lines would not only control benefit costs but would also ensure usefulness of fringe benefits.

Future of Fringe Benefits

Current benefit packages have evolved over the years from plans that addressed the basic needs of the workers and provided minimum benefits to the individuals. Today, we see a much more complex pattern of plans with enhanced flexibility, tailored to meet the needs of individuals and costing public sector and private sector organisations dearly in terms of rupees. Employees in general are more educated, more sophisticated and more demanding of remuneration including fringe benefits. Employers are, therefore, required to devise newer benefit plans to attract and retain competent personnel, keeping a watch on the benefits costs.

Certain guidelines to make benefit programmes more effective are given here.

Guidelines to make Benefit Programmes more Effective

1. Fringe benefit programmes should be looked at as a worthwhile corporate instrument in HRM.
2. Future policy planning in this area will have to keep in view some fresh reference points. Non-unionisation and skills shortage are no more relevant for policy considerations.
3. Any meaningful package of benefits must reflect some perspective planning. Inflexibility brings stagnation.
4. Separate programmes directly beneficial to workers from those that are directed towards community welfare. Clubbing them together adds to their cost. This may not be liked by workers.
5. It is advisable not to have a facility rather than neglecting it in its administration.
6. Poor internal communication hurts the programme in at least three ways: (i) more money is spent for officers' welfare; (ii) excess money spent on corporate image building at the cost of more bonus; (iii) priority to officers' children in admissions to schools. Therefore, make the internal communication system effective.
7. Devise new ways to involve workers and their representatives at all levels of planning and implementation.

International Benefits

For a global corporation, the fringe benefits pose additional problems. Benefit packages must be competitive in the host country if such an organisation were to attract and retain the best people. The belief that people are the same wherever they are, and offer identical benefits irrespective of cultural differences, is not always correct. People may be same biologically but cultures differ and these variations have a strong influence on employee behaviour. Naturally, the benefits offered to the employees in the home country cannot be replicated for the employees in the host country. Cultural differences of the host country must be respected. In South America, for example, a US mining company offered all kinds of benefits to attract workers but lost out to a French company that offered no fringes. After weeks of investigations, the US company discovered that the locals wanted was time-off to come and go on their own terms - which the French were more than willing to give. It is ironic that the US mining company was prepared to offer extravagant fringe benefits at enormous expenses when they were neither needed nor appreciated.

Global companies also must consider employee benefits offered by competitors in host countries. The competition should be targeted and its benefits surveyed. As long as they are reasonable, benefit levels at competing organisations should be matched. Pensions, insurance, time-off and other benefits should meet the needs of the host country's employees.

Employees are getting more educated, sophisticated and more demanding of benefits and services. In order to keep them happy, benefits and services policies have to be taken as strategic HR initiatives. The organizations are going for simpler and flexible benefit packages - more attention on individual needs and greater attention on simplification of benefit policies. Inflexibility means stagnation which breeds frustration. Therefore, flexible, tailor-made and customized services. This requires greater communication among the employees and their improved involvement.

Check Your Progress 2

What are the advantages of flexible benefits?

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6.5 INDIVIDUAL GROUP VARIABLE COMPENSATION

Compensation to Company management consists of basic salary, variable compensation, a long-term incentives program, pension allocations, and other benefits and compensation. In addition there is a share-savings program which includes all employees. The fixed salary is based on each manager's competence and area of responsibility and is revised annually. The outcome of the variable remuneration depends on the level of fulfillment of targets in the relevant year.

For instance, a case, in which the outcome of variable compensation for last year (say 2007), is based on preliminary calculations. Final settlement and any payments will take place during the current year (say 2008). For both the President and other senior executives in the Parent Company, variable compensation for last year is based on a balanced scorecard determine 70 percent of the outcome, while the remaining 30 percent is determined by the development of market capital, human capital and strategic change projects, which represent individual targets. For 2007, variable compensation could amount to at most 50 percent of basic salary for the President and 35 to 60 percent for other senior executives. Of the variable compensation 15 to 40 percentage points is paid cash. The remaining variable salary portion (at most 20 percent) is converted to synthetic shares. Variable compensation does not carry entitlement to a pension. Variable compensation to the President and CEO amounted to an amount corresponding to 34 percent of basic salary. Of variable compensation for the year, one part was in cash, while the remaining was in the form of synthetic shares. The variable compensation for senior executives may amount, corresponding to 40 percent of basic salary. Of variable compensation for the year, one part was paid in cash and the other the form of synthetic shares.

The compensation of Board members is composed of:

1. a fixed yearly salary;
2. an annual variable bonus;
3. stock-based compensation in the form of virtual stock options (hereafter stock options) as a long-term component;
4. non-monetary compensation and other additional compensation in varying amounts; and
5. company pension benefits.

The amount of the annual variable compensation, the value of the options granted and the company pension are largely determined by company performance. This means, in terms of total compensation, significance is attached to company performance.

The compensation components are shown in detail below:

1. The annual fixed compensation is paid in equal monthly payments.
2. The Board member's annual variable compensation (variable bonus) is based on the Return on Assets (ROA). The variable bonus for the prior fiscal year is payable

after the Annual Meeting. For more information on ROA, which is also used to determine the variable compensation of other employees. Board members, as other employee groups, may contribute a portion of their bonus up to a maximum of Rs.30,000 annually into a deferred compensation program. Board members have taken advantage of this offering to varying degrees. (as per policy of the company).

3. Board members may also participate in the stock option program (BOP) for senior executives.

4. Non-monetary compensation and other additional compensation include: delegation allowances, accident insurance premiums and other similar benefits, as well as the personal use of, or benefit from, communication equipment, company cars and security measures made available by the company. The members of the Board did not receive loans or advances from the company.

Variable Pay is compensation linked to individual, team, and organisational performance. Traditionally also known as incentives, variable pay plans attempt to provide tangible rewards to employees for performance beyond normal expectations. The philosophical foundation of variable pay rests on several basic assumptions:

- Some jobs contribute more to organisational success than others.
- Some people perform better than others.
- Employees who perform better should receive more compensation.
- A portion of some employees' total compensation should be contingent on performance.

Contrast the assumptions with a pay system based on seniority or length of service:

- Time spent each day is the primary measure of contribution.
- Length of service with the organisation is the primary differentiating factor among people.
- Contributions to the organisation are recognized through different amounts of base pay.
- Giving rewards to some people but not others is divisive and hampers employees working together.

Types of Variable Pay

Individual incentives are given to reward the effort and performance of individuals. Some of the most common means of providing individuals variable pay includes piece-rate systems, sales commissions, and bonuses. Others include special recognition rewards such as trips or merchandise. Two widely used individual incentives focus on employee safety and attendance. However, individual incentives can present drawbacks. One of the potential difficulties with individual incentives is that an employee may focus on what is best individually and may lock or inhibit performance of other individuals with whom the employee is competing. Competition intensifies if only the top performer or winner receives incentives, which is why team or group incentives have been developed.

When an organisation rewards an entire work group or team for its performance, cooperation among the members usually increases. However, competition among different teams for rewards can lead to decline in overall performance under certain circumstances. The most common team or group incentives are gainsharing plans, where employee teams that meet certain goals share in the gains measured against performance targets.

Often, gainsharing programmes focus on quality improvement, cost reduction, and other measurable results.

Organisational incentives reward people based on the performance results of the entire organisation. This approach assumes that all employees working together can generate greater organisational results that lead to better financial performance. Theses programmes often share some of the financial gains to the firm with employees through payments calculated as a percentage organization each employee's base pay. Also organisational incentives may be given as a lump sum amount to all employees, or different amounts may be given to different levels of employees throughout the organisation. The most prevalent forms of organisation-wide incentives are profit sharing plans and employee stock plans. For senior managers and executives, variable pay plans often are established to provide stock options and other forms of deferred compensation that minimize the tax liabilities of the recipients. Table 6.3 shows some of the programmes under each type of incentive or variable pay plan.

Table 6.3: Types of Variable Pay Plans

Individual	Group/Team	Organisation-Wide
• Piece rate • Sales commissions • Bonuses • Special recognitions (trips, merchandise) • Safety awards • Attendance bonuses	• Gainsharing • Quality improvement • Cost reduction	• Profit sharing • Employee stock options • Executive stock options • Deferred compensation

Successes and Failures of Variable Pay Plans

Even though variable pay has grown in popularity, some attempts to implement it have succeeded and others have not. One study suggests that about 74% of companies have a variable pay plan of some sort. Of those, most feel these plans have been successful in aligning pay with performance for executives (79%), managers (73%), and exempt professionals (60%). However, only 48% felt variable pay was effective for non-exempt/ administrative personnel.

Most employees prefer that performance rewards increase their base pay, rather than be given as a one-time, lump sum payment. Further, employees prefer individual rewards to group/team or organisation incentives. Incentives do work, but they are not a panacea. The enthusiasm that many employers have for variable pay is not shared universally by workers. The success of variable pay plans depends upon the circumstances. The next section discusses several factors that affect successful variable pay plans.

Factors affecting Successful Variable Pay Plans

Most employers adopt variable pay incentives in order to (1) link individual performance to business goals, and (2) reward superior performance. Other goals might include improving productivity or increasing employee retention. Variable pay plans can be considered successful if they meet the goals the organisational had for them when they were initiated. There are a number of different elements that can affect the success of a variable pay plan:

1. Sufficient financial resources available
2. Consistent with organisation culture
3. Clearly separated from base pay
4. Clearly communicated

5. Performance results linked to payouts
6. Current, updated plans
7. Measurable performance
8. Clear, understandable plan details
9. Results in desired behaviours
10. Linked to organisational objectives

These factors have been categorized into three areas for discussion:

- Does the plan fit the organisation?
- Are the behaviours encouraged by the plan desired?
- Is the plan being administered properly?

Benefits

1. ***It encourage team work:*** Because evaluation and reward systems are team based, participants reap immediate incentive benefits from team orientated performance; which in turn provides measurable improvements to company performance over the medium long-term.
2. ***It promotes open lines of communication:*** By focusing on the sharing of information, a variable pay ensures that all employees are able to make informed decisions, which streamlines operation and reduces cost.
3. ***It's all about involvement:*** Employees are regularly updated about progress, expectations, feedback and changes/deviations from the moment programme design begins.

   Result: Employees feel valued for their contributions; and organisation benefits from their motivation and enthusiasm.
4. ***It shows the company is committed to positive change:*** Shared vision and goals replace "us and them" mentality.
5. ***It aligns rewards with key business priorities:*** Variable pay programme is customized to bring about improved performance.

   The more efficient reward system, the more effective reward becomes as a "Positive Reinforcer"
6. ***It links compensation with profitability:*** Variable pay programme allows for a portion of each participant's salary to be performance based – so an organisation doesn't end up paying increasingly high salaries when it can least afford.
7. ***It provides job stability:*** Since variable pay links remuneration with profitability, a company facing tough times can decease the likelihood of retrenchments by reducing variable pay payouts. By doing this the threat to jobs of employees is lessened and they will be more willing to focus on their performance goals.

   Job stability creates trust, thereby increasing employee commitment to achieve those goals.

Prerequisites of a Variable Pay Plan

1. Competitive fixed/base salary
2. Transparent and simple

3. Linked to business objectives
4. Agreed targets – challenging and realistic
5. Quantum must be significant

Catalyst to Variable Pay Plan

1. ***Identify Corporative Objectives:*** CEO/Functional Head should constantly display their commitment to the variable pay plan and this must be perceived by employees.
2. ***Ascertain Employee Readiness:*** Assignment based on survey of all employees in the company will decide whether they are ready or not for the introduction of a variable pay plan.
3. ***Communicate scheme details:*** To ensure the smooth functioning of the scheme, it is crucial that every employee understands why variable pay has been introduced and how the scheme functions.
4. ***Invest in implementation:*** Company should have a realistic idea as to how much time, money and effort will be needed to design and implement the scheme.
5. ***Monitor and Review Scheme:*** Periodic reviews help in fine-tuning a Variable Pay Plan to organisation's ever-changing needs.

Table 6.4: Fixed Pay vs. Variable Pay

Fixed Pay	Variable Pay
• Day to day responsibilities and ongoing performance • Long-term contribution • Skill/competency development and work style	• Special objectives and results • Must be re-earned each year • "Above and Beyond" expected contributions

To amplify this further

- Fixed pay determined by – Market + Inflation + Potential + Performance Rankings
- Variable Pay determined by – Results/Target achieved only

Table 6.5: Fixed vs. Variable Ratio

	2001	2002	2003
Top Mgmt.	78:22	76:24	70:30
Sr. Mgmt.	82:18	79:21	75:25
Middle Mgmt.	86:14	84:16	87:13
Jr. Mgmt.	88:12	86:14	90:10
Others	94:06	94:06	95:05
Overall Average	87:13	84:16	93:17

6.6 PAY FOR PERFORMANCE

Pay for performance (human resources), a system of employee payment that links compensation to measures of work quality or goals. Employee benefit plan that entitles employees to a share in the profits of a company. When the company does well, the employees get a bonus; when the company loses money, employees receive only their regularly established pay. It is sometimes abbreviated as "P4P", is a motivation concept in human resources, in which employees receive increased compensation for their work if their team, department or company reaches certain targets. As of 2005, 75 percent of all U.S. companies connect at least part of an employee's pay to measures of performance.

Undoubtedly, the salaries and tenure of not only of any government employee but of private sector employee must be based on performance to increase the efficiency. But the complexity of the nature of job and the achievement of defined targets in the face of several extraneous variables (e.g. in social schemes) should also be borne in mind.

Pay for performance is also known as variable performance linked pay or contingent pay. Variable performance in the pay is a financially measurable reward paid to an individual based on his overall performance. This measure includes the cumulative performance of the individual, his strategic business unit and that of the organisation. Contingent pay consists of payment related to individual performance, contribution, competence or skill or to the team or organisational performance.

Box 6.1

Performance-based Pay for Government Employees

The performance-based pay package for babus in India may become a reality. If the study being prepared by IIM, Ahmedabad argues well in favour of such a policy, the Sixth Central Pay Commission may recommend target-based variable payment for government employees, sources close to the development told Sunday ET.

Many private sector companies in India pay a part of their employees' salaries according to individual performance and team spirit.

The IIM-A, which is examining the matter now, is likely to submit its report by June, 2007. The specialized study is based on an analysis of the present performance of nine Central government ministries including defense, home company affairs and railways, and how those departments can improve their administrative efficiency if a performance-based payment is offered. In fact, nine ministries are just the samples, and if recommendations are made in favour of performance-based payment, it will be applicable for all ministries.

The management institute is also examining the criteria on which performance-based salaries can be determined for government employees. The study is also looking at how much of one's salary can be earmarked as target variable if such a system is recommended.

The Sixth Pay Commission, which may incorporate the recommendations of the IIM-A study, is scheduled to submit its report before April 5, 2008.

According to initial estimates, the recommendations of the new Pay Commission may entail an extra expenditure of about 25,000 crore per annum. It may have a cascading effect on state governments as state government employees will clamour for a pay rise to maintain parity.

Forms and Types of Performance Linked Reward Scheme/Contingent Pay

There are several types of Performance Linked Reward schemes. Generally, these are designed to share with or distribute among employees as individuals, groups or collectivity, productivity gains, profit improvement, or the financial gains of the organisational performance. Such schemes fall into the following broad categories:

1. Schemes based on individual or small group performance including piece rates, traditional merit pay, and sales commissions.
2. Incentive schemes that relate pay to profit on the basis of pre-determined formula.
3. Bonus schemes based on contribution to productivity and profitability according to a pre-determined formula with gains sometimes being distributed among the individual employees on the basis of merit rating.
4. Productivity bargaining.
5. Long-term incentives, Employees Stock Option Plans – ESOP.
6. Competency based pay.

Main types of contingent pay are:

1. Merit pay or Individual performance related pay.
2. Skill based pay.
3. Shop floor incentive and bonus schemes.
4. Team rewards.
5. Team/Organisation based schemes:
   a) Annual bonus
   b) Gainsharing
   c) Goal sharing
   d) Profit sharing
   e) Economic value added/market value added
   f) Share options/Stock options/EVA
6. Other cash payment.

Merit pay or Individual Performance Related Pay

A common method which has long been in existence is pay increase or bonus payment on the basis of performance rating.

The merit incentive pay scheme provides another method of recognizing and rewarding differential performance. This method could particularly be suitable for office staff. The scheme essentially involves the following steps:

a) The determination of result-oriented merit rating procedures,
b) The identification of job factors and their relative importance,
c) The formulation of a scale of reward, and
d) The communication of the basis of monetary reward.

Illustratively, job factors of salesman can be identified as (a) sales promotion, (b) realization of outstandings, and (c) good-will calls, (d) after-sales service and, (e) investigation of complaints.

These tasks will differ in their degree of importance. This difference can be recognized by imputing numerical values to different job factors. Hypothetically, let us assign weight values of 5, 3, and 2 respectively to the above tasks. In practice, weight values can be ascertained through job analysis.

Suppose it is intended to give an incentive opportunity of 20 per cent. Correspondingly, let there be 20 performance points, each point constituting 1 per cent of basic wage. If each identified job factor has a 4-point scale, then the 20 points will be distributed as follows in Table 6.6.

Table 6.6: Scale of Distributing Incentive Opportunity Points

Job Factors	**Scale Values**			
	1	**2**	**3**	**4**
1. Sales tasks	0	3	6	10
2. Realization of outstandings	0	1.8	3.6	6
3. Goodwill calls, etc.	0	1.2	2.4	4

Each degree will have to be precisely and operationally defined. Take, for example, the job factor of sales task. The four points on the scale can be defined as following Table 6.7.

Table 6.7: Definition of a Point on the Merit Rating Scale

1	2	3	4
Unsatisfactory	Satisfactory	Fair	Good
Sales target not achieved	Sales target achieved	3% above sales achieved	5 per cent above sales achieved

The actual merit rating score will give the percentage of basic wage or basic wage plus D.A. as incentive bonus. Given, a result-oriented merit rating procedure and its objective operation in an organisation, it should not be difficult to install a merit incentive pay system. This is not to minimize the difficulties that are usually encountered in operating a merit rating system. The effectiveness of the performance appraisal system will depend on the soundness of the performance appraisal system.

Sometimes merit increments and merit awards are also given in recognition of superior performance on the part of the individuals. These are poor substitutes for a system of merit incentive pay because of several shortcomings.

Under a system of merit increments, there is not prompt relationship between reward and effort. The quantum of reward at a point of time will be considered inadequate. Additional cost in the form of enhanced allowances is built for the company on permanent basis. Employees continue to benefit from their best performance even if it remains below standard in the future.

Employees getting merit awards cannot visualise a proportionate relationship between their performance and reward. The basis of determining and quantum cannot be explained to employees who are not given such awards. This may evoke jealously and friction and may thus, jeopardize cooperation and goodwill.

Skill Based Pay

Skill based pay links pay to the level of schemes used in the job and sometimes the acquisition and application of additional skills by the persons carrying out the job. The term is sometimes used interchangeably with competence related pay. But skill based pay is usually concerned with the skills used by manual workers. In skill based pay, skills are more likely to be defined in terms of competition of training course, satisfactory performance in a test leading to company accreditation or attainment of national vocational qualification levels. In competency-based pay, the behaviour and attributes of an individual has to be used to perform a role effectively in addition to only the skills.

Skill based pay can take two forms – Conventional job slotting or a progression related to skills. Skill based job slotting is simply a method of locating an individual in a pay and grade structure – unskilled, semiskilled and skilled by reference to their training, qualifications and experience. Skill based pay progression is less conventional method and links a progression to the acquisition of skills.

Shop Floor Incentive and Bonus Schemes

Incentive of bonus schemes relate to the pay or part of the pay received by the employee to the number of items they produce or processes, the time they take to do a certain amount of work and/or some other aspects of their performance. They usually provide for pay to fluctuate with performance in the short-term, but they can, as in major day work, provide for long-term relationship. They are often referred to as payment by result schemes. Such schemes are of the following types:

- The main types of incentive schemes – individual piece work, work measure individual schemes, measure day work and group incentive schemes.
- Alternative approaches – high day rates, performance related pay, productivity bonus and the use of other criteria in the bonus schemes.
- Bonus schemes in different environment.

Individual Piecework: In individual or straight piecework a uniform price is paid per unit of production. Operators are therefore rewarded according to the number of pieces they produce or process, so pay is directly proportionate to results.

Most piecework schemes provide a fallback rate or minimum earning level. It is common for the minimum rate to be set at 70 to 80% of average earnings, although some companies set it as low as 30%. Companies may also provide guaranteed payments for down time due to machine failure, maintenance work or waiting for material.

The advantage to employees of piecework is that the system is easy to operate, simple to understand and can be left to run by itself. Piecework can also enable employers to estimate and control manufacturing cost effectively.

Piecework has become more inappropriate as an incentive method as new technology has changed work arrangements. In larger scale manufacturing, it has largely been replaced by work measure scheme, or some other form of incentive or bonus payment.

Work Measure Schemes: In a work measure scheme, the job or its component task is timed and the incentive payment is related to performance above the standard time allowed for the job. The amount of incentive pay received depends on the difference between the actual time taken to perform the task and the standard time allowed. If a task is done in less than the standard time, then there is a time saving, which means that the operator's output will increase.

Incentive payments are made when performance exceeds the standard. The relationship between pay and performance usually follows either the proportional or progressive pattern. When proportional payments are made, the incentive payment increases in direct proportion to performance. In a regressive payment system (as old Halsey/Rowan schemes) the incentive payment increases less than output.

The proportionate payment method is the most suitable one but the regressive system has the advantage for employers of making mistakes in rate fixing less costly and lowering unit wage costs for output above standard performance. For obvious reasons, however, the latter approach is viewed with suspicion by trade unions and workers. It is usual and advisable to establish a sealing to the amount of incentive pay, which can be earned to avoid excessive amounts being paid out because of loose rates or some other forms of degeneration (this is sometimes called capping).

Measure Day Work: In measure day work, the pay of employees is fixed on the understanding that they will maintain a specified level of performance, but pay does not fluctuate in the short-term with their performance. The arrangement depends on work measurement to define the required level of performance and to monitor the actual level. The fundamental principles of measure day work are that there is an incentive level of performance and that the incentive payment is guaranteed in advance, thereby putting employees under an obligation to perform at the effort level is required. In contrast, a conventional work measure incentive schemes allow employees discretion on their efforts level but relate their pay directly to the result they achieve. Between these two extremes there is a variety of alternatives, including banded incentive, stepping schemes, and various forms of high day rates.

Measure day work seeks to produce an effort – reward bargain in which enhanced and stable earnings are exchanged for an incentive level of performance. It's disadvantage is that the set performance target can become an easily attainable norm and may be difficult to change, even after extensive negotiation.

Check Your Progress 3

What are the steps involved in the system of merit pay?

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6.7 PAY BY SENIORITY

Seniority based pay are used as a motivational device. In general, any deferred compensation scheme implies a contract in which, at some point in the worker's life-cycle, there is a discrepancy between the spot wage and the spot value of the worker's marginal product. The reason being that workers are paid below their productivity during the first few years of their contract, while their wage is above their productivity in the final stage of their career with the firm. If workers do not shirk, they will be allowed to stay with the firm and will be able to recuperate their initial losses. If they shirk, however, they run the risk of being caught and dismissed, and therefore of losing the chance to recover the wages owed to them in the last years of their contract. According to Lazear (1979), workers and firms enter into these long-term implicit contracts to discourage shirking and malfeasance by shifting compensation to the end of the contract.

Incentive theories have been difficult to test empirically due to the lack of available data. This problem is perhaps even more acute with regard to implicit rather than explicit incentives.

In the past, there have been several attempts to test the theory presented in Lazear (1979) with the available data sets. Most of these studies tested the predictions of the theory in terms of worker's earnings and productivity, the incidence of mandatory retirement or pensions, or dismissals and tenure. A common characteristic of the existing labour literature is that it uses survey data at the worker level inferring the existence of a relationship between wages and seniority. However, to our knowledge, there is not yet a study that has used a direct measure of the existence of a seniority-based pay policy at the firm level. Here, we test empirically the theory of implicit incentives using a new data set which allows us to directly observe wether firms decide to set workers' wages according to seniority or not.

We use a unique plant level data set that contains information on several firm's personnel practices for 734 Spanish industrial establishments. All surveyed establishments are involved in production processes within the manufacturing sector. Regarding personnel practices, the survey refers to the blue-collar workers in each plant (that is, workers involved directly in production). Overall, we obtain very homogenous data for every surveyed plant. At the same time, a wide scope of different firms within the manufacturing sector are included in the survey.

The main feature of the data set is that it refers to firms rather than individuals and that it contains a considerable number of firms in the survey. This allows us to measure the presence of seniority-based pay from a different perspective than the one traditionally used in the empirical literature of tenure and wages which concentrates on worker level data.

Similarly, our data allows us to obtain direct measures of monitoring devices, as well as other measures of explicit incentives practices. Moreover, the use of plant level data allows us to get a better understanding of the role that firm and job characteristics play in the diffusion of deferred payment schemes. This is a question that has been scarcely dealt with in the literature using data at the plant level.

India is an interesting case for analyzing seniority-based pay because in this country there is mandatory retirement for almost all workers at the maximum age of 65 (except politicians). Therefore, all establishments in our sample are subject to this mandate. Jobs with delayed payment contracts should be characterized by mandatory retirement. This institution establishes a termination date after which the worker is not entitled to continue receiving a wage that is greater than her productivity. In this context, seniority-based pay can become an optimal contract. Using direct data on firm's personnel practices, we provide empirical support for the theories that are behind the deferred wage schemes as motivation devices. We find that firms that often seniority-based pay are less likely to offer explicit incentives. They are also less likely to invest in monitoring devices. We also find that firms that offer seniority-based pay rather than explicit incentives are more likely to engage in other personnel practices that imply long employment relationships. Finally, since seniority-based pay could be related to other personnel practices, specially training.

6.8 GROUP PIECE RATE

The group piece-rate (e.g., profit-sharing) scheme pays each group member a piece-rate of b > for each unit of group output. Group members not only receive utility from the piece-rate for output but also receive utility from consuming leisure time. Assume that each group member can be paid for this leisure time in an "individual exchange" and receives a payment of a > for each leisure time unit consumed. For expositional simplicity, assume group members produce one output unit for each time unit allocated to work. An individual's total payoff under the group piece-rate scheme equals the sum of the piece-rate payment plus the payoff from leisure time consumption.

6.9 EMPLOYEE PROFIT SHARING

An organization may offer fringe benefits in the form of profit sharing to its employees. It may offer all its employees the opportunity to share in the financial success of the company by becoming shareholders. For instance, in a particular company, the employee's profit sharing shall not be less than 1% of the total of shareholders' dividend and employees' profit sharing. Employee's profit sharing may be allocated in either cash or stocks. Employers provide a variety of benefits to their employees, ranging from free lunch to offering free training. There are also non-standard benefits that some companies give to their employees, privileges that are not mandated by law but can attract employee loyalty and promote a more efficient workforce. An example of these non-standard benefits is Profit Sharing, wherein the employer designates a percentage of annual profits as a pool of money that all employees-or a portion of the workforce, such as executives-would be shared.

The portion of profit that would be shared among employees can either be distributed equally or through a certain grading system where lower-paying jobs get lower shares, while higher-paying jobs are given with bigger compensation. However, profit sharing can only be done if the company has posted gains during the previous fiscal year. It usually occurs annually after the final results for the annual company profitability have been calculated.

Profit sharing has its share of advantages and disadvantages. On a positive note, this type of employee benefit would provide an impression that all employees are working together on the same team. It also reinforces a sense of service to customers, while minimizing the culture of competition between employees. However, profit sharing makes employees unable to see and know the impact of their own work and actions affecting the profitability of the company. It would eventually become more of an entitlement rather than a motivational factor because employees would still get a share of the profit regardless of their performance.

In the end, choosing whether or not offering profit sharing to employees can either inspire employees or would make them less productive. Profit sharing should be balanced out by other employees benefits.

6.10 EMPLOYEE STOCK OWNERSHIP

Employee stock ownership plans can be used to keep plan participants focused on company performance and share price appreciation. By giving plan participants an interest in seeing that the company's stock performs well, these plans are believed to encourage participants to do what's best for shareholders, since the participants themselves are shareholders.

A qualified, defined contribution, employee benefit plan designed to invest primarily in the stock of the sponsoring employer. ESOPs are "qualified" in the sense that the ESOP's sponsoring company, the selling shareholder and participants receive various tax benefits. ESOPs are often used as a corporate finance strategy and are also used to align the interests of a company's employees with those of the company's shareholders.

Check Your Progress 4

State whether the following statements are True or False:

1. Pay for performance is a system of employee payment that links compensation to measures of work quality or goals.
2. Employee benefit plan that entitles employees to a share in the profits of a company.
3. When the company does well, the employees don't get a bonus; when the company loses money, employees don't receive only their regularly established pay.
4. Pay for performance is sometimes abbreviated as "P4P", is a motivation concept in human resources, in which employees receive increased compensation for their work if their team, department or company reaches certain targets.
5. Employee stock ownership plans can be used to keep plan participants focused on company performance and share price appreciation.

6.11 GAIN SHARING

A gain sharing plan offers employees - better cooperation among employees; Improved attention to quality from employees; Better attendance from employees; Better communication among employees. Improved employee involvement. By providing a group based reward system, the an organization is able to improve their work atmosphere, employee earnings, company profits and their performance. Companies today are finally realizing that they need a better way to reward their employees. They need a way to retain and satisfy their talented workers without falling into the trap of giving away annual raises, a practice that has often proven to be a problem in the past. At one time or another, most companies have experienced the predicament of fixed wages. In good times, employees often feel deserving to share in the success since they have made a significant contribution towards it. The employer will normally reciprocate and pass along raises because the profits are fine. Then the day arrives when orders drop off and work is hard to come by. No one is interested in giving anything back and the company is stuck with the high wages of the good old days. This is the dilemma gain sharing addresses.

Employees still need to have a financial motivation to improve, however. But rather than merely following the bumps of the economy, employees need a reason to create more good times for the company and make them last longer. In other words, a pay for performance plan when bonuses are only paid when the productivity warrants it. If their performance doesn't calculate to a bonus payout, nothing is shared. The result is a program, which ties the success of the employees with those of the employer.

6.12 LET US SUM UP

The Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries. Where an employee exchanges (cash) wages for some other form of benefit, this is generally referred to as a 'salary sacrifice' arrangement. In most countries, most kinds of employee benefits are taxable to at least some degree.

Fringe benefits can include, but are not limited to: (employer-provided or employer-paid) housing, group insurance (health, dental, life etc.), disability income protection, retirement benefits, daycare, tuition reimbursement, sick leave, vacation (paid and non-paid), social security, profit sharing, funding of education, and other specialized benefits.

The purpose of the benefits is to increase the economic security of employees.

The term perqs or perks is often used colloquially to refer to those benefits of a more discretionary nature. Often, perks are given to employees who are doing notably well and/or have seniority. Common perks are company cars, hotel stays, free refreshments, leisure activities on work time (golf, etc.), stationery, allowances for lunch, and-when multiple choices exist-first choice of such things as job assignments and vacation scheduling. They may also be given first chance at job promotions when vacancies exist.

6.13 LESSON END ACTIVITY

Write a study note on the Individual group variable compensation.

6.14 KEYWORDS

Pay for Performance: It is a system of employee payment that links compensation to measures of work quality or goals.

General Wage Determinations: It reflects those rates determined by the division to be prevailing in a specific geographic area for the type of construction described.

Fringe Benefits: These include many types of benefits that an employee derives from his employer.

ESOP: Employee Stock Ownership Plans can be used to keep plan participants focused on company performance and share price appreciation.

6.15 QUESTIONS FOR DISCUSSION

1. Discuss the theory of fringe benefits.
2. Attempt a note on the objectives and types of fringe benefits.
3. What do you understand by the concept of the individual group variable compensation?
4. Define the concept of pay for performance.
5. Analyse the concept of pay by seniority.
6. What do you understand the concept of group piece rate?
7. Give a detailed analysis of production sharing plan.
8. Define the scheme of employee profit sharing in the context of employee stock ownership.
9. Describe gain sharing.

Check Your Progress: Model Answers

CYP 1

1. "Fringes embrace a broad range of benefits and services that employees receive as part of their total compensation package—pay or direct compensation—is based on critical job factors and performance.
2. Employee benefits can be further classified under these seven major groups:
   (i) Disability income continuation,
   (ii) Loss-of-job income continuation,
   (iii) Deferred income,
   (iv) Spouse or family income continuation,
   (v) Health and accident protection,
   (vi) Property and liability protection, and
   (vii) A special group of benefits and services called perquisites.

CYP 2

1. Employees choose packages that best satisfy their unique needs.
2. Flexible benefits help firms meet the changing needs of a changing workforce.
3. Increased involvement of employees and families improves understanding of benefits.
4. Flexible plans make introduction of new benefits less costly. The new option is added merely as one among a wide variety of elements from which to choose.
5. Cost containment - The organisation sets the dollar maximum. Employee chooses within that constraint.

Contd....

CYP 3

1. The scheme essentially involves the following steps:
    a) The determination of result-oriented merit rating procedures,
    b) The identification of job factors and their relative importance,
    c) The formulation of a scale of reward, and
    d) The communication of the basis of monetary reward.

CYP 4

1. True
2. True
3. False
4. True
5. True

6.16 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

UNIT IV

LESSON
7

INCENTIVES PLANS

CONTENTS

Contd....

7.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the theories related to incentives plans
- Learn about the concept of basic pay
- Know about different provisions for dearness allowance
- Calculate total compensation package
- Attempt on various methods of compensating
- Know about the concept of living
- Understand about the neutralization factors
- Analyse the executive compensation plan

7.1 INTRODUCTION

Remunerative incentives (or financial incentives) are said to exist where an agent can expect some form of material reward - especially money - in exchange for acting in a particular way. A retirement plan is an arrangement to provide people with an income, possibly a pension, during retirement, when they are no longer earning a steady income from employment, or an asset from which a person may draw an income from as needed. There are significant, though varied and complicated tax advantages for many types of retirement plans. In passing the laws offering those advantages, Congress has expressed a desire to encourage plans that provide retirement security. Plans designed to replace a specific amount of steady income are known as defined benefit plans (though exceptions do apply), and those designed to accumulate as an asset without requiring a specified income are known as defined contribution plans. Retirement plans may be set up by employers, insurance companies, the government or other institutions such as employer associations or trade unions. Retirement plans have increased in importance and in being utilized by more of the US population over the last half century but especially since 1980. Since 1980 and increasingly since 2000, there has been a shift from defined benefit plans to defined contribution plans. Fewer defined benefit plans are being offered because they represent a large and not fully predictable cost to employers. As of 2005, most defined benefit plans are offered by large and/or governmental employers.

Incentive is reward for hard work and it can be financial or non - financial like promotion other benefits. Improper structured and planned incentive schemes can be root of all troubles and disputes.

7.2 TYPES OF INCENTIVE PLANS

7.2.1 Straight Piece Rate System

In the straight piece rate system, a worker is paid straight for the number of pieces which he produces per day. Fresher find hard to survive. In this plan quality may suffer.

7.2.2 Straight Piece Rate with Guarantee Base Wage

A worker is paid straight for output set by management even if worker produces less then the target level output. If worker exceeds this target output, he is given wage in direct proportion to the number of pieces produced by him at the straight piece rate.

7.2.3 Differential Piece Rate System

Difference piece rate system by FW Taylor improved by Merrick suggested separate rate for 70%, 100% and 120 % of target level. In this type of structure fresher could hardly survive.

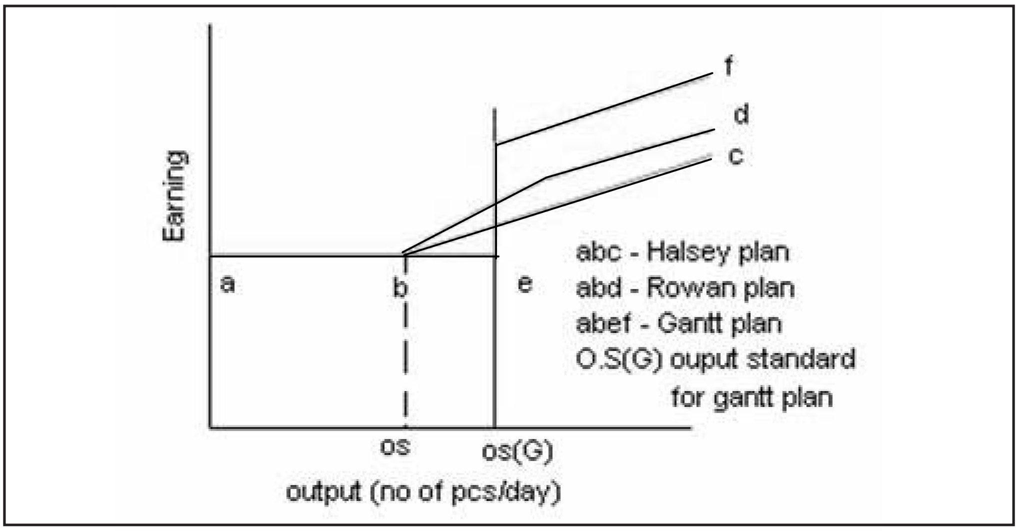

Figure 7.1: P_e Difference Piece Rate System

7.2.4 Halsey Plan

In Halsey Plan, output standards are based upon previous production records available.

W = R.T + (P/100) (S-T).R

W : wage of worker

R : wage rate

T : actual time taken to complete job

P : percentage of profit shared with worker

S : std. time allowed

Here management also shares a percentage of bonus.

7.2.5 Rowan Plan

Unlike Halsey Plan gives bonus on (S-T)/S. Thus it can be employed even if the output standard is not very accurate.

W=R.T + ((S-T)/S).R.T

7.2.6 Gantt Plan

It is improved differential piece rate with minimum base wage guarantee.

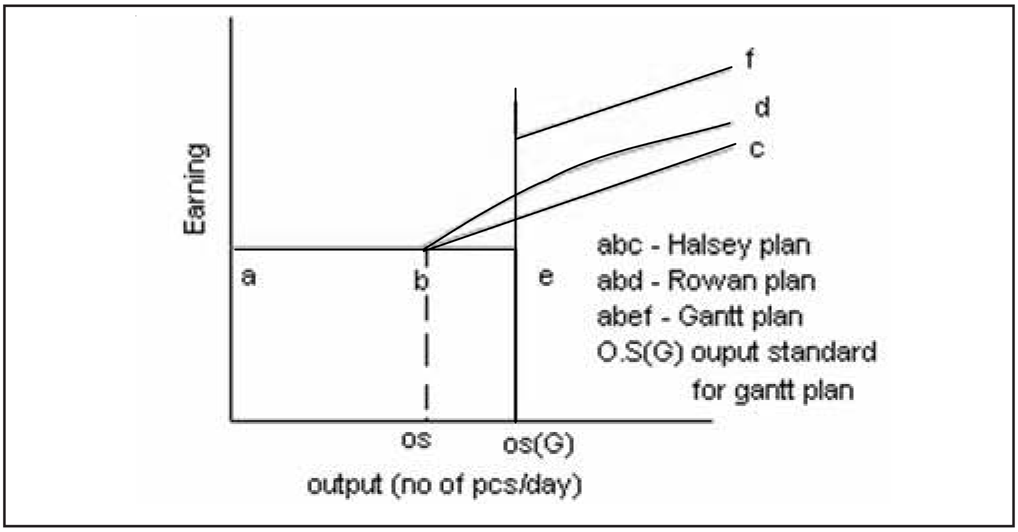

Figure 7.2: Gantt Plan

7.2.7 Bedaux Plan

In Bedaux plan, minimum base wage like other plans is guaranteed.

'B' represents unit of work. 1 B stands for 1 standard work minute and it includes working time as well as time for rest. A worker earning "60 B " per hours reaches 100% of standard output or 100 % efficiency.

A bonus is paid to the worker who earns more than 60 B's in one hour. The bonus as in the original plan is 75% of the number of B's above 60 in one hour.

W= R.T + (Ns- Nt/60) (75/100).R

7.2.8 Emerson's Efficiency Plan

In the Emerson's efficiency plan, the workers with efficiency =67% to 100 % , incentive given is from 0 to 20%. For 1% increase in output 1% increase in incentive.

7.2.9 Group Incentive Plan

Group incentive plan ensures equal distribution of cash or shares between their employees. When a well designed incentive plan is launched in a business today there are many long-term benefits. The first is the ability to change a behaviour or to improve a specific area in the marketing plan. To advance the performance in a positive manner can be one of the most difficult challenges for management. To have employees that display excellence in their work and show accomplishments helps business acquire more or better business. These are traits that deserve praise, recognition and reward. There is a direct correlation in the reaching of a stated objective and the understanding of the program's goals, the system and mechanics of scoring and supporting materials. Incentive programs can build new customers for the business as well as long-term loyalty. This is one of the main reasons that incentive programs are not costly - they are a way of improving your bottom line.

From the employee's point of view, incentive programs are great because they receive recognition and a tangible benefit. Incentive programs make the work environment fun and exciting. Productivity increases and customer problems decrease as a result of a higher quality of service and support. These plans can be established and operated for a short time to improve productivity or a specific work routine. Incentive strategies can improve teamwork or remove bad work habits. The benefit to the worker is improved working conditions and the recognition when the objectives are met. Customers receive better customer service and are contacted more frequently when a sales incentive program is in effect. This sets positive habits for the salesperson and with their new level of excellence they understand the value of customer service.

Check Your Progress 1

What do you understand by 'Rowan Plan' for providing incentives.

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....

7.3 FOCUS OF INCENTIVE PLANS

Some incentive pay plans focus mainly on trying to get the employee to join with management to create a successful company. Incentive pay plans can elicit strong feelings. Opponents variously claim that performance is a function of the organization of work and management practices rather than employee effort; they say that incentives do not work and cause more problems than they solve. Many proponents of incentive pay plans believe that a fair day's work is not normally attainable without some proportion of pay being at risk because time based workers produce only about 50 to 60 percent of the output of incentive pay workers. Although they admit that some incentive pay plans malfunction, they insist that this is usually due to poor installation and maintenance rather than shortcomings of the concept of incentive pay.

To understand why incentive pay plans are so controversial, let's examine incentives and their use before turning to the characteristics of incentive pay plans. We will discuss incentive contributions, compare them with two motivation models, look at the results of incentive pay plans, and assess the prevalence of these plans.

7.3.1 Incentive Contributions

The wage system discussed in this book up to now essentially pays people for the time they contribute. If we assume that the job is the major determinant of the wage, then it is a person's occupancy of that job for which the organization pays. Performance and/or any other factor may also enter into the equation, but the time spent on the job is the primary consideration. To some degree, then, an organization wishing to attain increased performance has a choice of using a pay-for-performance system or some other form of incentive pay. Both may reward performance, but the incentive pay plans discussed in this chapter do so more directly. In addition, the effects of payment by results and payment by time on the organization's cost structure are different. Payment by results leads to variable labour costs, since these attach directly to output. Payment by time makes labour costs fixed, since they are the same in any period, regardless of output.

Our model of the employment exchange specifies that it is contributions that lead to rewards; the question is the units in which performance is determined. Payment on the basis of time allows for a large number of unspecified contributions to be included. Payment for output requires that contributions produce measurable results before they are recognized as contributions.

In practice, however, incentive pay plans often turns out to be payment for one contribution-effort; other contributions required by the organization are often ignored. The measure of distribution does not have to be either output or time. The two can more reasonably be viewed as the two ends of a continuum on which various wage systems can be placed. At the time extreme is a system of automatic rate adjustment. At the other end is a piece-rate system, which pays a set amount for each unit produced. Other systems would fall at various places in between. This continuum is illustrated in Figure 7.3.

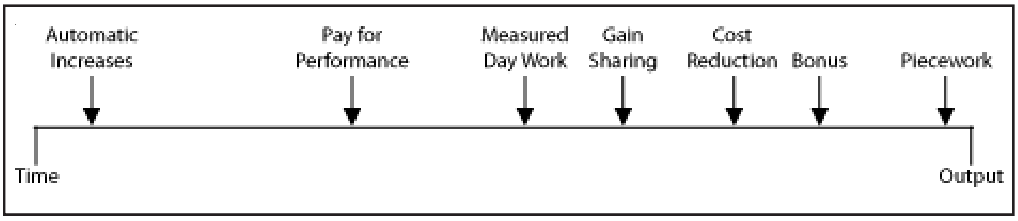

Figure 7.3: A Continuum of Time and Output Systems

Where an organization should fall along this scale is a matter of a large number of factors.

7.4 FACTORS DETERMINING PAY PLANS

The work itself is a major determinant of whether to pay for time or output. The work characteristics to consider include (1) measurability of output; (2) the relationship between effort and output; (3) the degree of standardization; (4) requirements for quality as well as quantity; and (5) competitive conditions, which make it imperative that unit labour costs be definitely known and fixed before production.

General expectations are also very important. Community attitudes and the expectations of employees, both as individuals and as expressed through their union, affect attempts to install an incentive pay plan and certainly its chances of success.

Technological considerations may, of course, enter into the decision. To the degree that machines set the pace for the work, the employee loses control over determining the number of units that will be produced. The ability to change output through increased effort is critical in incentive pay plans. Also, incentive pay plans are more likely to be successful in industries with a stable technology than in those undergoing continual technological change.

The decision to pay for output instead of time is partially based upon the rational factors just discussed and is partially a matter of faith. If an organization is convinced that incentives are the way to go, then a way will be found to apply incentives to the work. The varieties of incentive pay plans and the kinds of contributions are so numerous that desire is more important than a precise fit of job and incentive standards.

7.5 INCENTIVE PAY PLANS AND THE MOTIVATION MODELS

Since organizations believe that incentive pay plans motivate performance, the evidence should be reviewed. Research shows that this belief has a foundation: incentive pay plans can increase performance above that attained in a fixed pay plan. But as noted above, the result is not always higher performance. In fact, numerous studies have shown that incentive pay plans can also result in restriction of output and cause employee-relations problems. Also, it has been shown that the different kinds of incentive pay plans produce different results. Thus it seems useful to examine incentive pay plans in terms of the performance-motivation and membership models.

7.5.1 Performance-Motivation Model

According to this model, for an compensation plan to motivate performance, employees must (1) believe that good performance will lead to more pay, (2) want more pay, (3) not believe that good performance will leads to negative consequences, (4) see that other desired rewards besides pay result from good performance, and (5) believe that their efforts do lead to improved performance. Although the model specifies that the relationship among these variables is multiplicative (anything multiplied by a zero yields a zero), the first variable is clearly the most important.

Incentive pay plans do foster the belief that good performance leads to more pay. But some plans do this better than others. Specifically, plans that relate the individual's pay to his or her output do better than plans applied to groups or other larger units. And plans based on objective standards and measurements create a stronger belief in the performance-pay relationship than plans based on less objective standards. With plans involving less objective standards, the belief is based in part on the employee's confidence that the measurements do reflect his or her performance.

Since people do attach different values to pay, the second condition, desiring more pay, is variable. If employees do want more pay and nothing about the plan serves to reduce its importance to them, this part of the model is met. If, however, an incentive pay plan is applied to employees who don't want more pay or who don't want pay based on performance, it is not.

The belief that negative consequences will result from good performance is quite possible under incentive pay plans. It has been shown that employees can believe that rates will be cut if they produce too much and that social rejection by peers, working themselves out of a job, or even getting fired if they fail to meet the standard can be anticipated. Thus, in some plans it is quite possible that the perceived negative consequences could offset the perceived positive consequences. A major negative consequence is the competitiveness inspired by incentive pay plans. Where cooperation, not competition, is required, an incentive pay plan can lead to many dysfunctional behaviours.

The belief that other desired rewards result from good performance is more likely to appear where the competitive nature of the plan is minimized. In some plans, good performance is likely to result in social acceptance, esteem, respect, and feelings of achievement. If a person feels that he or she benefits from another's good performance and it becomes the norm of the group to perform well, then the possibilities of good performance are increased.

Employee perceptions that the contributions they believe they are contributing to the organization are in fact those being rewarded may be the weakest link in incentive pay plans. If employees feel that the performance measured is affected by so many things beyond their control that their efforts have little effect, this belief in the contribution-reward connection will be weak. If employees feel that the performance measure does not reflect a number of contributions that they make and that they feel the organization needs, the belief is likewise weak. If the incentive plan is based on such a limited conception of employee contributions that employees believe that it reflects neither the contributions they make nor those that the organization really requires, not only will the incentive pay plan not work, it may weaken membership motivation because of resentment.

If incentive pay plans work by creating or confirming beliefs, they can also affect the beliefs and perceptions that form the basis of membership motivation. If the incentive pay plan signals employees that more of the rewards they want are available in this employment exchange in return for the contributions they want to make, their commitment to the exchange is likely to increase.

If, however, the plan signals that: additional money is the only reward available for increased performance and they don't want more money; other rewards they value will be reduced by good performance; only those contributions resulting in the measured performance result in more rewards but they do not want to provide more of those contributions; or the contributions they wish to increase are not going to result in higher rewards, then their commitment to the employment exchange may be significantly depressed. In fact, the employee may seek an employment exchange that meshes more closely with their contribution-reward desires.

Thus attempts to improve performance motivation may weaken membership motivation. This is an example of the dilemmas faced by organizations in compensation administration. Fortunately, it is usually possible to treat different employee groups differently in matters of pay.

Most reports of experience with incentive pay plans suggest that wage incentives result in greater output per hour worked, lower unit costs, and higher employee earnings. Typically, these reports come from company experience with incentive pay plans and do not attempt to determine the source of change or to compare results of incentive workers with those of a control group. When incentive pay plans are installed, many changes are made in the conditions of work, and if no effort is made to determine the effects of each, the changes observed may be due to something other than the incentive pay plan. It is quite possible, for example, that the results obtained are attributable to changed management practices employed as a prerequisite to installation of an incentive pay plan.

Reports of incentive pay plan results often cite employee earnings increases of 10 to 70 percent and cost decreases of 25 to 65 percent. Although this implies that the observed results are attributable to the incentive pay plan, no attempt was made to determine whether the source of improvement was better management, increased employee effort, or other changes accompanying installation. Evidence that not all the improvement results from the incentive pay plan is available from the experience of a five-plant company. Two plants had incentive plans and three measured day work (production standards but no wage incentive). The most and least efficient plants, their performance separated by a wide margin, were the two incentive plants.

Two authors have reviewed incentive plan results in detail. Lawler conservatively estimates that individual incentive plans result in a productivity increase of 10 to 20 percent. Locke and associates examined experiments that compared the effects of individual incentive plans with those of time-based pay plans. The average increase in performance was 30 percent, with a range of 3 to 49 percent.

Under an incentive pay, increased productivity should result in higher wages for employees. This indeed seems to be the case. In one study of manufacturing organizations, the earnings of those workers under incentive plans were significantly higher than those paid by time plans.

To be effective an incentive pay plan needs to fit the circumstances of the organization. The great variety of incentive pay plans that are possible can be classified by a number of variables, specifically the level of aggregation, the performance definition, and the reward determination method. This section examines these variables, and the following section will look into the necessary considerations in designing an incentive pay.

The level of aggregation defines the unit for which performance or output will be determined. In turn this defines the unit that will receive the organization's reward. Three levels of aggregation are usually defined - the individual, the group, and the organization.

1. ***Individual Level Incentive Pay Plan:*** Individual level incentive pay plan is the most popular form of incentive pay plan. In this type of plan each person's output or performance is measured and the rewards the person receives are based upon this measurement. Clearly this is the type of incentive pay plan most likely to establish a clear performance-reward relationship in the mind of the employee. The purpose of the plan is to increase the pace of work or the effort the individual is willing to contribute in order to receive higher rewards. The classic example of this type of plan is a piecework system, wherein the employee is paid a set amount for each unit of production. The organization expects to receive more output than it would if the employee were paid under a time-based system. In addition, the organization can easily track the labour cost associated with each unit of output.

   One assumption of these plans is that the employee is an independent operator, that he or she alone can carry out all the activities required to achieve the performance measure. In this way performance is a function of the employee's effort. The performance standard must be clearly defined and measurable if such a plan is to be useful. Also, the job must be relatively stable: the output required from the job should be consistent, and the inputs to the job should arrive in such a way that the employee can work continuously.

2. ***Group Level Incentive Pay Plans***: Where it is impossible to relate output to an individual employee's efforts it may be possible to relate it to the efforts of the work group. If, in addition, cooperation is required to produce the desired output, then a group incentive plan may be the best alternative. Interdependence of work, then, is a major reason for choosing a group plan over an individual one. A group incentive plan can reward things that are very different from what an individual plan rewards, in particular: cooperation, teamwork, and coordination of activities. Where these are highly valued, a group plan is most appropriate. As organizations become more complex and the production process more continuous, group incentive pay plans can be expected to become more popular.

   Group plans are also useful where performance standards and measures cannot be defined objectively. In a group setting, variations tend to average out, so no one gets as hurt by random variation or lack of continuity. Almost any individual plan can be adapted to a group setting. Thus the focus in group plans is still higher level of effort.

   The primary disadvantage of the group plan is that it weakens the relationship between the individual's effort and performance. Where there is likely to be wide variation in the efforts of group members, a group incentive may lead to more intra group conflict than cooperation. In group plans it is also more difficult to monitor performance standards and measures. Finally, group norms play an expanded role, both positive and negative, in group plans. They are stronger and more controlling on the individual. Where the group norms are congruent with management's goals, this is a plus; but where the two differ, it can harm the chances of success of the incentive plan.

3. ***Plant and Organization-Wide Incentive Pay Plans***: Organization-wide plans are expanding under the name of gainsharing. These types of plans are both old and new. The Scanlon Plan is one of the oldest incentive pay plans in continuous use in organizations, yet new plans are cropping up.

   Organization-wide plans differ significantly from individual plans by rewarding different things. As indicated, most individual and group plans attempt to increase effort. Most organization-wide plans, however, reward an increase in organization-wide outcomes that directly affect the cost and/or profit picture of the organization. Usually these plans reward increases in productivity of the plant or organization as measured by reduction of organizational costs, in comparison with some measured normal cost. Or they may reward increased output with the same or fewer inputs.

   A major feature of organization-wide incentive pay plans is a change in the relationship between management on the one hand and employees on the other. Rather than the traditional adversarial relationship between the two, most organization-wide plans require a high degree of cooperation. This is because both groups must focus on the desired cost savings and listen to the other party. All this requires a degree of trust that is hard to achieve in American labour relations. Failures of the Scanlon Plan have been attributed most often to the inability of management to take employee input seriously.

7.5.2 Performance Definition

The definition of performance is probably the most important step in establishing any incentive plan. It tells the employee what output or behaviour the organization considers important enough to reward - that is, to spend its money on. The point is that the employee's attention is directed to accomplishing a particular objective or group of objectives at the expense of others that might also be accomplished on the job. So the definition of performance should be complete, or the organization will not obtain the outcomes it needs from its employees. This section will examine the range of factors that is often used as the definition of performance in incentive pay plans.

The most common definition of performance, and in many ways the best, is the intended output of the job. In some situations this can be made an explicitly measurable item, such as the number of electronic assemblies produced. In many jobs in organizations, however, it is hard either to define exactly the output desired or to measure that output. An incentive pay is not well suited to these circumstances.

The most common incentive plan that uses an output measure is piecework. In this plan, a set reward value is attached to each unit of output; the employee's pay is that value times the number of units produced. This plan clearly connects performance and reward and allows the employee to know at all times exactly how much reward he or she is receiving. Since the piecework system emphasizes quantity, quality can be a problem unless it is also built into the determination of units produced.

An alternative to output is time required to complete a task. Amount of production and amount of time are two variables that are always considered together in individual incentive plans. In piecework the amount of production is the measure put before the employee and time is used to determine the value of the output. In time-based rates, the expected production is stated as a function of the time taken to produce that output, so the output is expressed as a function of time and not money.

Check Your Progress 2

What do you understand by plant and organisation-wide incentives pay plans?

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7.5.3 Role of Annual Incentives

The Primary Role of annual incentives is as a Motivator of Behaviour. Of all the compensation elements, the annual management incentive plan has the greatest potential to influence individual behaviour and enhance business results. Unlike base salary, which focuses on core job responsibilities and the relevant external market for those responsibilities, or long-term incentives, which are often stock based and reflect the entire organization's success over a multiple-year period, annual incentives are determined by team and individual performance measures over which the individual manager has the most direct influence or control. The annual timeframe is sufficiently immediate to sustain attention, and the reward is generally paid in a lump sum in the form of cash or a combination of cash and stock. A properly designed annual incentive plan can assist an organization in achieving desired performance on critical tactical success factors—those success factors that can be measured and influenced within a one-year timeframe.

In summary:

- Base salary reflects core job responsibilities.
- Annual incentives recognize team and individual performance.
- Long-term incentives recognize corporate/organization performance.

7.5.4 Annual Incentives Represent a Variable Compensation Cost

In addition to its motivational role in influencing management behaviour, the annual incentive plan is usually the most potentially variable of the compensation elements, with the cost of the plan in a particular year flexing up and down with the aggregate achievement of incentive goals by participants. In fact, as discussed later, one test of a good incentive design is whether the total costs of the plan vary in a meaningful way based on overall organizational performance. In recent years, many organizations have limited base salary increases and moved more of their overall pay opportunities into annual incentive plans in order to have their compensation costs be more variable and affordable. These organizations are prepared to provide their managers with significant compensation opportunities, but only when they achieve the organizational results that support these opportunities.

Annual Incentives Demonstrate Pay-for-Performance Linkage

A final role of the annual incentive plan is to support the belief that management pay, particularly that of senior executives, should vary significantly with the financial results achieved for shareholders over the performance year. Shareholder interest groups and the business press are sharply critical of executive pay that increases in the face of declining earnings. Since base salaries are generally considered fixed, and long-term incentives are by their nature multiple year and often tied to stock price, annual incentives must demonstrate the appropriate relationship between executive pay and the short-term financial performance of the organization.

7.6 INFLUENCING MANAGEMENT BEHAVIOUR: BUILDING A LINE OF STRAIGHT RELATIONSHIP

7.6.1 Performance Measurement Under the Control of Participants

In order for a management incentive plan to influence behaviour, a line-of-sight relationship must exist between the participants and the plan performance measures. Accordingly, the performance measures that determine a participant's award should have the following key characteristics: (1) they must be under the direct control of the participant or of a team of which the participant is a significant member, and (2) they must be achievable within a one-year timeframe.

Let's look at some examples of the line-of-sight concept:

An assistant plant manager participates in a corporate management incentive plan in which the awards to all participants are a function of corporate earnings performance. The corporation has eight manufacturing plants in the United States and two in Europe. There would not be a line-of-sight relationship between an assistant plant manager in this example and corporate earnings. Corporate earnings are not under the control of the assistant plant manager, and the management team would be too large for this position to be considered a significant member to influence behaviour, performance measures would have to be more specific to that particular plant and to the assistant plant manager's area of responsibility.

Corporate and Business Unit Performance Measurement

The manufacturing vice-president participates in the same corporate management incentive plan. The manufacturing vice-president is one of five key officers reporting to the chief executive. This position is a significant member of the management team that collectively impacts earnings. A line-of-sight relationship does exist. The motivational value of the plan may be improved by having a portion of the manufacturing vice-president's award based directly on manufacturing performance (the individual piece) and a portion based on corporate earnings performance (the team piece).

An industrial goods manufacturing company uses return on investment as one of its corporate performance measures in its management incentive plan. Most investments are capital expenditures for new plant and equipment, with the typical payback on such investments over five to seven years. Management incentive participants have little ability to influence return on investment in a one-year timeframe and the plan could be improved by substituting more short-term tactical investment measures such as inventory control.

7.6.2 Difference between a Management Incentive Plan and a Profit-sharing Plan

Occasionally you will see a profit-sharing plan masquerading as a management incentive plan. In its simplest form, a profit sharing plan allocates a percentage of corporate or business unit earnings to plan participants. These allocated dollars are distributed to participants based on salary or a combination of salary and position level. Unlike a management incentive plan, there is a limited line-of-sight relationship for many of the plant participants, since the only performance measure is typically corporate or business unit profitability. Also in a management incentive plan, the performance measures are not constant but will change periodically based on those tactical success factors that are most important in a given year; a profit-sharing arrangement uses the same success measure each year-earnings. There is nothing inherently wrong with a profit-sharing plant. It may have motivational value for senior-level participants, where the line-of-sight relationship does exist. It also represents, a variable compensation cost that fluctuates with earnings. In its simplicity, a profit-sharing plan lacks the differentiating individual and team performance measures required to have the plan function effectively as a tool to influence participant behaviour and help achieve organizational results.

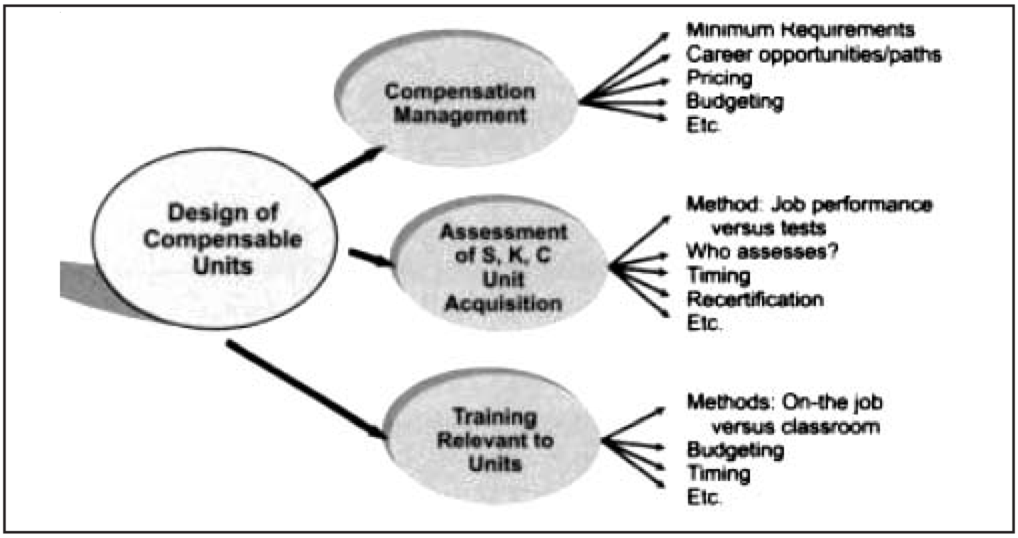

Figure 7.4: Elements of a system paying for skills, knowledge and competencies

An important issue concerns the pricing of plans that pay for skills, knowledge and competencies. Often, it is impossible to price each competency or skill block to the market, in the way that each job in a job-based system can be priced. Rather, the typical procedure is to price the overall system rather than each element of it. The entry rate is set at the level just high enough to entice talented people to join the organization. The top rate is set based on market conditions as well. For example, in skill-based pay plans for semi-skilled factory workers, the top end of the range may be placed appropriately near the bottom of the skilled worker classification. Finally, in some cases an average-rate pay rate is also set to market, based on labour market or industry benchmarks. Within these anchor points, skill blocks or competencies are assigned values based on their relative degree of difficultly. To take a simple example, assume that the entry rate is $10 per your and the top rate is $20 per hour, both determined by the market. If there are 10 skill blocks of equal difficulty (as indicated by learning time or some other metric), each block an employee masters might be given a value of $1 per hour.

Employees need to have some idea of how long it will take to master competencies or skill blocks. The amount of time required to master a block or competency can vary tremendously, from a few months to several years. In general, it is desirable to break very complex blocks or competencies into several pieces so that at least annual advancement is possible within the system. If the blocks or competencies require only a few weeks to master, on the other hand, it is better to group them into a longer and more meaningful grouping or reconsider whether the plan really fits the skill requirements of the organization. The organization does not want too many blocks or competencies because this makes the plan difficult to comply with the satisfaction of the employees.

7.7 BASIC PAY

Also known as Base Pay, this is given to members of the military on a monthly basis and is determined by their rank (or more appropriately their pay grade) and their length of time in military service. Basic Pay is the same for all the services. As a matter of course, over the last several years, basic pay has increased for all ranks effective the first of the year.

The total amount of pay received at a rate fixed by law or administrative action for the position held by an employee, including any special rate, or any locality-based comparability payment, or other similar payment under other legal authority, before any deductions. Basic pay includes night and environmental differentials for prevailing rate employees. Basic pay excludes additional pay of any other kind.

7.7.1 Creating a Base-Pay Compensation Program

It is important for an organization to draw out the principles, design, implementation and evaluation of an employee base pay program. The motive should be to design a pay program that is fair, competitive and supportive of an organization's compensation strategy.

- Identify the relationship between an employee total rewards program and an organization's business strategy
- Discuss the design of base pay programs and necessary considerations
- Discover what it takes to implement and deliver base pay
- Study the key elements in costing base pay and other compensation programs
- Gain an overview of merit pay systems, including development and utilization
- Address the effectiveness and efficiency of pay programs with monitoring and evaluation

The process to create a base pay structure is defined in the steps below:

1. Begin with establishing Objectives for the Program
2. Brief top management on project - Objective and Concept / Secure Buy-in
3. Determine the Job Families in the organization
4. Determine the Job Levels (titles) in each family (entry, intermediate, senior, specialist, etc.)
5. Document job titles using a traditional or "loosely written" job description format.
6. Market Price as many job levels as possible using multiple surveys
7. Create a Pay Structure based on organization's fiscal year / salary review cycle
8. Assign Jobs to grades based on the best fit of consensus market value to salary range midpoints
9. Edit pay grade assignment for internal equity
10. Apply new pay grades with salary ranges to employee data
11. Brief top management - show preliminary work
12. Involve managers/supervisors in the process
13. Analyze results based on Market Index and Compa Ratio for families, departments, and locations
14. Make adjustments
15. Create a Merit Matrix
16. Run Budget

17. Involve managers/supervisors in the process
18. Make adjustments
19. Top management approves plan
20. Communicate concept to all employees during salary reviews / be open to make more adjustments

7.7.2 Accountants

Analyze financial information and prepare financial reports to determine or maintain record of assets, liabilities, profit and loss, tax liability, or other financial activities within an organization.

7.7.3 Human Resources

Plan, direct, and coordinate human resource management activities of an organization to maximize the strategic use of human resources and maintain functions such as employee compensation, recruitment, personnel policies, and regulatory compliance.

7.7.4 Information Systems

Install, configure, and support an organization's Local Area Network (LAN), Wide Area Metwork (WAN), and Internet system or a segment of a network system. Maintain network hardware and software. Monitor network to ensure network availability to all system users and perform necessary maintenance to support network availability. May supervise other network support and client server specialists and plan, coordinate, and implement network security measures.

7.7.5 Software Development

Develop, create, and modify general computer applications software or specialized utility programs. Analyze user needs and develop software solutions. Design software or customize software for client use with the aim of optimizing operational efficiency. May analyze and design databases within an application area, working individually or coordinating database development as part of a team.

7.7.6 Application Engineer

Primary interface between clients and software developers. Assist clients with installation and training on the features and functions of the software. Communicate clients ideas and suggestions for product improvement to software developers. Represent company at trade shows to demo software products.

7.7.7 Chemical Engineer

Design chemical plant equipment and devise processes for manufacturing chemicals and products, such as gasoline, synthetic rubber, plastics, detergents, cement, paper, and pulp, by applying principles and technology of chemistry, physics, and engineering.

7.7.8 Chemist

Conduct qualitative and quantitative chemical analyses or chemical experiments in laboratories for quality or process control or to develop new products or knowledge.

7.7.9 Customer Relations

Interact with customers to provide information in response to inquiries about products and services and to handle and resolve complaints.

Finally, a well-designed system for delivering competitive base salaries to your employees is the foundation of an effective total system of rewards. While some organizations see base pay programs as infrastructure or just a necessary cost of doing business, other companies understand how important these programs are to communicating values and remaining competitive in a complex marketplace for talent.

A focused, streamlined base pay plan can greatly enhance both the organization's operational effectiveness and its ability to attract and retain talent. Sound base pay programs and practices can provide a strong foundation for building a variety of other reward programs, including variable pay, recognition and performance management.

7.7.10 Determining the Right Approach for your Organization

There are many approaches to salary programs - market pricing systems, job or career structured oriented, and competency based systems, and there are combinations of these approaches. Because salaries often represent a significant expense, we want to make sure your program communicates the right messages and is aligned with the other key people management initiatives you have or are developing in your organization. This ensures your salary dollars are invested in a manner that supports your business objectives and desired culture. Its consultants integrate the unique characteristic of your company - its business model, culture, values, core competencies and goals - into the design process and the pay programs. We help you identify your competitive market, desired position, and the best sources for market information, being objective in our recommendations. Our market information is understandable and thorough, to a level detail that provides you with the survey match information and data by job. We also prepare you for and consider processes to maintaining this data after the project is completed. Further, we can develop structures that link your salary program with job profiles, competency and career development programs, and the values you want to promote in an organization. And when we work collaboratively with managers and key individuals, the tools and technology we use become transferred to the organization. This enhances the effectiveness of decisions and builds the capabilities for you to modify the program over time, while strengthening the organization's ability to grow and develop.

7.7.11 What does a Good Organization Offer?

Its client projects usually include the following steps:

1. Assess the current base pay systems and practices in terms of your objectives, structure and total rewards philosophy.
2. Define the "right" salary market and assess your current competitive position.
3. Develop a set of levels that reflects what you value, and a job structure and career paths that support the organization's growth today and well into the future.
4. Create salary ranges that enable you to compete effectively in the market.
5. Define a customized set of salary management policies that are consistent with legal and organizational requirements.
6. Develop a communication plan for the program to builds knowledge and confidence.

7. Assist you in selecting the technology needed to administer the programs over time.

A good organisation's skilled, flexible and collaborative style will yield a salary program that reflects your success factors and enhances your ability to compete for talent while rewarding the performance and development priorities of your organization.

7.8 PROVISIONS FOR DEARNESS ALLOWANCE

In India, Dearness Allowance (D.A.) is part of a person's salary. D.A. is calculated as a percent of the basic salary. This amount is then added to the basic salary along with house rent allowance to get the total salary. Rates vary as per rural/urban areas etc.

7.8.1 All India Services (Dearness Allowance) Rules, 1972

In exercise of the powers conferred by sub-section (1) of the Section 3 of the All India Services Act, 1951 (61 of 1951), the Central Government after consultation with the Governments of the States concerned, hereby makes the following rules, namely :-

1. ***Short title and commencement*:**
   (1) These rules may be called the All-India Services (Dearness Allowance) Rules, 1972.
   (2) They shall come into force on the first day of April, 1972.
2. ***Definition*:** In these rules, unless the context otherwise requires, "a member of the Service" means a member of an All-India Service as defined in Section 2 of the All India Services Act, 1951 (61 of 1951).
3. ***Regulation of Dearness Allowance*:** Every member of the Service and every officer, whose initial pay is fixed in accordance with sub-rule (5) or sub-rule (6A) of rule 4 of the Indian Administrative Service (Pay) Rules, 1954 or sub-rule (5) of rule 4 of the Indian Police Service (Pay) Rules, 1954 or sub-rule (6) of rule 4 of the Indian Forest Service (Pay) Rules, 1968, shall be entitled to draw dearness allowance at such rates, and subject to such conditions, as may be specified by the Central Government, from time to time, in respect of the officers of Central Civil Services, Class I.
4. ***Interpretation*:** If any question arises as to the interpretation of these rules, it shall be referred to the Central Government for decision.

7.8.2 Government of India's Decisions

Government of India's decision under Rule 3

1. Applicability of orders of the Ministry of Finance, Government of India regarding payment of additional installments of dearness allowances to central government employees to the members of All India Services: - Rule 3 of the All India Services (Dearness Allowance) Rules, 1972 stipulates that every member of the All India Services is entitled to draw Dearness Allowance at such rates and subject to such conditions as may be specified by the Central Government from time to time in respect of the officers of Central Civil Services, Group 'A'. This is irrespective of whether the officer concerned is working in the State Government or is outside his cadre.

2. Ministry of Finance, Government of India, have been issuing orders from time to time in regard to payment of additional instalments of Dearness Allowance to the Central Government employees. By virtue of Rule 3 ibid, therefore, these orders are ipso facto applicable to all the members of the All India Services viz., Indian Administrative Service, Indian Police Service and Indian Forest Service. It is only for the sake of convenience and information of all concerned that we have been forwarding the said letters of the Ministry of Finance relating to the grant of additional instalments of Dearness Allowance and the purpose is that such orders are not lost sight of lest the payment of the said additional instalment of Dearness Allowance should get unnecessarily delayed. It has, however, come to notice that some AGs have not been releasing these instalments for want of receipt of our letters whereby, simply, the Ministry of Finance's orders on the subject are forwarded.

3. The provisions of Rule 3 of the All India Services (Dearness Allowance) Rules, 1972 are once again reiterated in this regard whereby all the members of the All India Services-irrespective of their place of postings, are entitled to get Dearness Allowance at the rates and subject to the same conditions which are laid down from time to time in respect of the Group 'A' Central Services Officers. The State Governments and the Accountants General concerned need not therefore wait for our communication, forwarding therewith the Ministry of Finance's orders issued in this regard and are requested to release further instalments of Dearness Allowance as and when the same are announced by the Central Government for its Group 'A' officers.

   (DOPT's letter No. 11014/1/97-AIS(II), dated 2nd July, 1997.)

Dearness Allowance (DA) is a compensatory payment to the employees for the erosion in the real value of their salaries, resulting from price increase. During the Second World War, dearness was paid fully to low paid employees of the Central Government. DA formula has undergone several modifications on account of each of the earlier Pay Commission's suggesting their own formulae.

7.8.3 DA Formula of 1996

The existing formula for grant of DA of Central Government employees is based on the recommendations of the Fourth CPC. At present DA is admissible twice a year as on 1st January and 1st July and is payable with the salary for March and September respectively in the same year. Each installment of DA is calculated with reference to the percentage increase in the 12 monthly average of AICPC (base 1960) over the average index of 608, which is the base for the existing scales of pay as recommended by the Fourth CPC. This percentage increase is taken in whole numbers only.

Thus, the formula for calculating DA is :

12 Monthly Average - 608 of AICPI × 100 = The percentage increase in prices 608

The extent of neutralization admissible to employees against the percentage increase in prices for different pay ranges is as follows:

Pay Range (Basic Pay)	Extent of Neutralization
i) Pay upto Rs.3,500/-p.m.	100%
ii) Pay above Rs.3,500/-p.m.	75% Subject to a minimum and upto Rs.6,000/- p.m. maximum available (i) above.

The yearly expenditure on Dearness Allowance in the case of Central Government employees beginning from 1987-88 is given below. The tentative estimate of expenditure on Dearness Allowance in 1995-96 is of the order of Rs.8154.08 crores.

Year	Rs.Crores
1987-88	602.31
1988-89	1186.00
1989-90	1806.14
1990-91	2300.75
1991-92	3242.14
1992-93	4761.78
1993-94	5908.24
1994-95 (Est.)	6834.70
1995-96 (Est.)	8154.08

The State Government employees as well as the Public Sector employees are getting dearness allowance as a distinct component of the pay packet.

7.8.4 Objections against Dearness Allowance

There are three types of wages, minimum wage, fair wage and living wage. Fifth Central Pay Commission has given living wage to its employees and question of Dearness Allowance does not arise for 38 lacs employees of Central Government. The Fifth Pay Commission in its Report, Vol. III, at page 1753, has observed as under :

Practice of giving D.A. done away in foreign countries: "The practice being followed by the Government and the public sector in India runs contrary to the international experience and the practice in the Private Sector, where Cost of Living Adjustment in (COLA) has been done away with, either partially or completely. In the private sector, inflation neutralization, if paid, does not constitute a distinct component of the pay fixation. In countries abroad, on the other hand, this scheme has been totally abolished. France discontinued its quarterly adjustment of public salaries for inflation in the 80's. Greece has abandoned automatic indexation, while termination of Automatic indexation of police staff in UK is on the cards. In general, countries which have abolished automatic indexation have done this on the assumption that this tends to fuel inflation."

Inspite of above observations and knowing fully well that other countries have dispensed with giving Dearness Allowance on the grounds of inflation, Fifth Pay Commission recommended Dearness Formula as under :

"We therefore, recommend that AICPI (IW) may continue to be the Index that may be used for calculating Dearness Allowance for Government employees. The AICPI (IW) series with base 1982 may however be used henceforth for the purposes of calculating Dearness Allowance, as against the existing practice of using AICPI (IW) series with 1960 as the case, this is not likely to cause any difference to the calculations, as the 1960 series on being discontinued in 1988, is being generated from the 1982 series by using a conversion factor of 4.93."

Increase of Dearness Allowance in January and July and Fifth Central Pay Commission recommended inflation neutralization to make uniform 100% at all levels and observed, inflation neutralization on a graduated scale in present circumstances will be anachronistic and unduly unjust to the senior officers. The Fifth Central Pay Commission even had recommended automatic conversion of dearness allowance to dearness pay when the index increases by 50%. Fifth Pay Commission recommendations were implemented in the year 1998 with 12% D.A. of new scale, increased dearness allowance was announced every year in January and July and now dearness allowance is given @ 59% of basic pay. The Central Government used to make before about 10 years, provision of special allocation for dearness allowance in budget. Since last number of years there is no mention regarding allocation of increase of dearness allowance in the budget. Ultimately, Funds for development are diverted to increase of dearness allowance. Government has to spend about additional Rs.1600 crores towards increase of DA for two installments of increase of DA apart from paying full dearness allowance.

7.8.5 Perverse Recommendations Regarding DA free From Income-Tax

Fifth Central Pay Commission recommended in para 105.12 as under: "Regarding the exemption of Dearness Allowance from tax, we propose that in line with our general recommendation on giving all allowances net of income tax, Dearness Allowance (including Dearness Pay referred to in the last paragraph) should be paid net of tax.

7.8.6 D.A. Increased from 12% to 59% of Basic Pay

The Central Government employees, State Government employees or Local-Self Government employees, where the Fifth Central Pay Commission recommendations are accepted give Dearness Allowance. The Fifth Central Pay Commission recommendations were made applicable in 1998 with retrospective effect from 1996 with 12% Dearness Allowance. The Central Government accepted the report of the Fifth Central Pay Commission recommendations of Dearness Allowance and declared revision of Dearness Allowance twice in a year, January and July. Dearness Allowance rate is increased from 12% to 59% of basic pay. It is unfortunate that none of the authorities including the concerned Hon'ble Minister had read the chapter on D.A. and relevant para as stated above.

7.8.7 Suggestions

The Central Pay Commission had recommended 12% Dearness Allowance on basic pay and directed to give Dearness Allowance on certain formula twice in one year. Today, D.A. has increased within five years from 12% to 59% of basic pay. The following suggestions are made on the following grounds:

- 59% Dearness Allowance which is granted today to the Central Government employees and Pensions should be reduced to fixed 12% of basic pay. D.A. should not be given as it increases inflation in consistent in practice of foreign countries, who have abolished granting of Dearness Allowance. D.A. increases the inflation and so, it should not be granted.
- Living-Wage, which is an ideal wage is already given to the Central Government employees, who work only for 193 days in a year and enjoy 172 holidays in a year, which is the minimum output by the Central Government employees.
- Dearness Allowance should be reduced as Fifth Central Pay Commission had recommended to reduce 30% of staff. The said recommendation has not been carried out. The Central Government can rectify the mistake which they have committed, even now relying on the international practice of not granting increase of D.A. If D.A. is reduced from 59% of basic pay to 12% of basic pay, the Central Government can save about 8,000 crores on Pay and Pension.

7.8.8 Postponing Decision of D.A. Freeze by Central Government

The Hon'ble Prime Minister, Finance Minister and all Chief Ministers of States and also Finance Ministers of States know very well that implementation of the Fifth Central Pay Commission recommendations takes away about 45% to 50% of Revenue Receipts of Central Government and the State Government after payment of interest liability which is the first liability to be discharged by the Centre and the State. There was a meeting called by the Hon'ble Prime Minister of all the Chief Ministers of the States and it is unfortunate that without taking any positive decision to freeze Dearness Allowance, issue has been postponed and declared that revision of D.A. and Bonus will be continued. The writer has pointed out in Part- I of the Book that "The Indians cannot take decisions at the right time." We hope this chapter may be circulated amongst the participants of the meeting, who are to decide regarding freezing D.A. and can decide reductions of D.A. as suggested above.

7.9 CALCULATION OF TOTAL COMPENSATION PACKAGE

As a recruiter who often assists in complex salary negotiations, I'm encountering this issue in many of the searches I'm working on this quarter: The candidate says "I need to make $85,000. Period." Conversely, the employer says "Our compensation for the position is capped at $75,000 + a 10% bonus, take it or leave it."

What each party hears is a seemingly insurmountable $10,000 gap, when the difference is actually much less after the bonus is paid out. This problem is one of communication—and is solved by teaching both parties a little math:

- For the employer to meet the candidate's expectations, the base salary must increase from $75,000 to $77,273 (... because $77,273 + 10% = $85,000).
- For the candidate to meet the employer's expectations, the total compensation must decrease from $85,000 to $82,500 (... because $75,000 + 10% = $82,500).

Once they know the math, both parties will usually split the difference, which makes sense if the candidate is an A-player. To quote Warren Buffett, "Where hiring decisions are concerned, it's better to be vaguely right than precisely wrong."

Here's the formula for the above calculation:

((Total Comp - Base) / Base) = Bonus Percentage

Example: ((82500 - 75000) / 75000) = 10%

You can build this formula in to an Excel spreadsheet and use the "Goal Seek" function in the Tools menu to solve for any of the above variables, or you can use the SOLVE function in any HP-17B or 19-B financial calculator.

In the above case, a good recruiter might convince the employer to pay a 13.33% bonus to an A-player, which would turn a $75K base salary into an $85K package. This same recruiter would be well advised to remind his candidate that all job opportunities must satisfy the 3-F's:

1. ***Fun:*** Will the job be fun? Are the people nice? Would you have them as friends? Are they funny? Forgiving? Will they tolerate Covey's "mistakes of the head" as you ramp up the learning curve?

2. ***Future:*** Where will the industry be in five years? Where will the company be? What about your function and department within the company? (Can your job be outsourced?) Does the company have a sustainable competitive advantage in its current and future markets?

3. ***Finance:*** What's the pay? Base? Bonus? Perks? Benefits? How consistently has the bonus paid out? What are the metrics used to determine your share? Are these metrics truly 1) Measurable, 2) Objective, 3) Relevant to YOU, and 4) Controllable by YOU?

Money is last. (Re-read that.) Sure money matters, but taking a job purely for the pay is like getting married for money. Life's too short. Have fun in a future oriented field and the money will take care of itself – even if it's because you're having too much fun to worry about the fact that you passed up a job you might have hated for a few dollars more somewhere else.

7.9.1 Total Compensation Strategy

Strategy is widely accepted as the most reasonable way to limit retention risk and control shareholder cost while still providing a strong incentive for management to maximize shareholder value. The commitment to competitive compensation levels limits retention risk-that is, the risk that key managers will leave the firm for a better offer elsewhere-because total compensation opportunities are not allowed to fall below competitive levels. The same commitment also limits shareholder cost because total compensation opportunities are not allowed to rise above competitive levels. The commitment to maintaining a substantial proportion of total compensation "at risk"-that is, in the form of bonuses, stock options, and other incentive compensation-is thought to provide a strong incentive to maximize shareholder value-an incentive comparable to that of an owner with a substantial proportion of his wealth in company stock.

This article argues that the dominant total compensation strategy is fundamentally flawed and can never provide incentives comparable to those of an owner/entrepreneur who holds a large proportion of his wealth in company stock. The critical flaw in the strategy is that, even though a very large proportion of the current year's compensation may be "at risk," the commitment to maintaining competitive levels of compensation in all future years effectively ensures that a large proportion of the executive's wealth is not at risk. Incentives that approach entrepreneurial levels can be achieved only by total compensation strategies that make the value of future compensation opportunities sensitive to current performance.

But, strategies that provide strong wealth incentives will always lead to greater retention risk for poor performance or higher shareholder cost for superior performance than the dominant total compensation strategy. And this means that managers and directors who seek stronger wealth incentives must be prepared to make difficult trade-offs between stronger wealth incentives, greater retention risk, and higher potential cost to the shareholders. To help managers and directors in evaluating these trade-offs, the discussion here presents a new analytical framework-one that what is called total wealth incentive analysis.

This analytical framework can be used both to reveal the hidden and ill-considered trade-offs that typically underlie the dominant total compensation strategy, and to design compensation plans that provide strong, sustainable, and cost-effective wealth incentives. These statements from a recent Compensation Committee Report aptly express the dominant total compensation strategy of public companies today. Similarly, if the initial option grant required to provide an expected value of $500K was 20,000 shares based on a stock price of $50 (and a Black-Scholes value of 50%, or $25 per option), and the stock price declines in the second year to $25, the number of option shares granted must be increased to 40,000 to provide an option grant with an expected value of $500K (because new at-the-money options are now worth only $12.50 per share). If performance improves instead of deteriorates, the target operating profit must be increased and the number of option shares reduced to maintain the expected value of the bonus and option grant at the targeted competitive level. These annual adjustments required to maintain the target competitive position have two important consequences. The first, and intended, consequence is that the expected value of the total compensation opportunity remains at a competitive level. The second, unintended but unavoidable, consequence is that poor performance is rewarded by an increase in management's percentage interest in operating profit and stock price appreciation, while superior performance is penalized by a reduction in management's percentage interest in operating profit and stock price appreciation. When performance deteriorates and the target operating profit is reduced from $10 million to $5 million, the target bonus share of operating profit is increased from 2% ($200K/$10 million) to 4% ($200K/$5 million). When the stock price declines from $50 to $25, the number of option shares granted is increased from 20,000 to 40,000. When performance improves and the target operating profit is increased to $20 million, the target bonus share of operating profit is reduced from 2% ($200K/$10 million) to 1% ($200K/$20 million). When the stock price rises from $50 to $100, the number of option shares granted is reduced from 20,000 to 10,000. As I demonstrate later, the "performance penalty" inherent in annual recalibration to competitive

7.9.2 The Dominant Total Compensation Strategy

The foundation of the dominant total compensation strategy is the concept of annual recalibration to a competitive position target. The company adopts a competitive position target-say, the 75th percentile total compensation-and each year recalibrates its salaries, bonus plan targets, and number of option grant shares to provide a total compensation opportunity at the targeted percentile. Base salary and cash compensation can be targeted at the same percentile as total compensation, or, more commonly, at lower percentiles in order to provide higher leverage and a mix of pay that is more attractive to management and the directors than the market mix. For example, the firm has targeted the 50th percentile for salary, the 60th percentile for cash compensation, and the 75th percentile for total compensation. These targeted percentiles provide a targeted pay mix of 30% salary, 20% bonus, and 50% stock options. Despite the fact that these targets put 70% of total compensation at risk, the practice of annual recalibration, as I show below, leaves the company with a weak wealth incentive.

Recalibrating the total compensation program each year to maintain the target competitive percentiles requires adjusting the bonus plan performance target to a new level that represents current expected performance, and changing the number of option shares granted to reflect the current stock price. If, for example, the target operating profit for the first year is $10 million, but performance deteriorates to a level where the expected operating profit for the second year is only $5 million, the target operating profit for the second year must be reduced to $5 compensation levels makes it impossible for the dominant total compensation strategy to provide incentives that approach those of an owner who holds a large portion of his wealth in the form of a fixed percentage interest in the dividends and stock price appreciation of the company. It can also lead, as the compensation history of John Akers at IBM illustrates, to huge discrepancies between management compensation and shareholder gain. In Akers' first year as CEO, the IBM board gave him an option on 19,000 shares exercisable at $145. In subsequent years, as the stock price declined, they gave him larger and larger option share grants to offset the decline in the stock price and maintain the value of his annual compensation package at a competitive level. In 1990, the Board gave him an option on 96,000 shares exercisable at $97. By the end of 1992, the Board had put him in a position where he would have realized an option gain of $17.6 million just for getting the stock price back to the $145 level at which he received his first option grant as CEO!

7.9.3 Objectives of Executive Compensation

The dominant total compensation strategy is, as any total compensation strategy must be if it seeks to maximize the wealth of current shareholders, an attempt to balance four conflicting objectives:

Alignment: giving management an incentive to choose strategies and investments that maximize shareholder value;

Leverage: giving management sufficient incentive compensation to motivate them to work long hours, take risks, and make unpleasant decisions, such as closing a plant or laying off staff, to maximize shareholder value;

Retention: giving managers sufficient total compensation to retain them, particularly during periods of poor performance due to market and industry factors; and

Shareholder cost: limiting the cost of management compensation to levels that will maximize the wealth of current shareholders.

Each of these objectives is critical to the success of total compensation strategy, but every total compensation strategy must make trade-offs between leverage, retention risk, and shareholder cost. A strategy that relies on large stock grants can achieve substantial leverage with minimal retention risk, but only by accepting higher shareholder cost than a strategy that relies on stock option grants. A strategy that relies on large stock option grants can achieve substantial leverage with limited shareholder cost, but only by accepting greater retention risk than a strategy that relies on stock grants. A strategy that relies on a high proportion of guaranteed compensation can achieve limited retention risk and limited shareholder cost, but only by accepting modest leverage.

Most companies and directors believe that the dominant total compensation strategy provides a reasonable balance between the four conflicting objectives of executive compensation. Indeed, the rationale for the dominant corporate compensation practice can be summarized as follows: It provides alignment because bonus and stock compensation is tied to operating and market measures of shareholder value; It provides substantial leverage because a large proportion of pay is at risk and gives the executive incentives comparable to those of an owner who holds a large proportion of his wealth in company stock; It provides retention because it gives the executive competitive compensation opportunities every year; and It controls shareholder cost because compensation opportunities are limited to a given percentile of the competitive pay distribution.

7.10 VARIOUS METHODS OF COMPENSATING

7.10.1 Allowable Methods

Method No. 1: Cost Plus Fixed Fee This is the most common method used by the Department and reimburses the firm for direct and indirect costs attributable to the project plus a negotiated predetermined amount for profit (fixed fee). During the negotiating phase, limits are agreed to on all four cost elements which when totaled are referred to as the contract upset limit or compensation. The four cost elements are direct labour, overhead, profit and direct non-salary expenses.

This method is appropriate when the extent, scope, complexity, character, or duration of the work cannot be reasonably determined at the time of negotiation.

This method is, also, particularly well suited for many projects that are divided into phases where work conducted under one phase defines the scope of services for the next phase. This method has the most flexibility for increasing the amounts payable through the supplemental agreement process for extra work beyond the original defined scope of services.

The major disadvantage is in project management and administration. The Consultant must submit a complete package of backup information with each monthly invoice, including verified payroll records and verification of all direct expenses billed. All of this information must be reviewed, copied and approved by the Project Manager, the Section's fiscal officer, and the Finance Office. Upon project completion, the accumulated records must be audited.

As stated, this method of payment has four basic components, which determine the total compensation to be paid: direct salary costs (labour), overhead, profit and direct non-salary expenses. Direct labour is the cost of salaries for those personnel such as principals, engineers, technicians, drafters, CADD operators, stenographers, survey personnel, and clerks, that are directly chargeable to the project.

A second reimbursable cost is the firm's overhead. This cost represents those allowable costs that are not directly attributable to the project. These costs are quite extensive, and the Project Manager should be aware of exactly which of them are currently eligible for reimbursement. In addition to this manual, a review of recent project pre-award audits or contacting the Audit Section will provide additional information. Overhead costs generally include some or most of the following:

- Provisions for office, light, heat, and related items associated with the working space, depreciation allowances or rental for furniture, drafting equipment, and CADD equipment, automobile expenses, and office and drafting supplies not directly chargeable to the project;
- Taxes and insurance other than those included as salary cost, but excluding state and federal income taxes;
- Library and periodical expense, and other means of keeping current in the profession, such as attendance at technical and professional meetings;
- Those services and expenses essential to the conduct of the business, including preliminary arrangements for new projects and interest on borrowed money; executive, administrative, accounting, legal, stenographic, and clerical salaries and expenses, other than identifiable salaries included in salary costs and expenses

included in reimbursable non-salary expenses, plus salaries of partners and principals, to the extent that they perform general executive and administrative services as distinguished from technical or advisory services directly applicable to the project;

- Business development expenses, including salaries of principals and salary costs of employees so engaged; and
- Provision for loss of productive time of technical employees between assignments and for time of principals and employees on public- interest assignments.

In addition to the above items, included in the overhead are those costs which are related to salaries. These are called payroll burden and fringe benefits. Items usually associated with this part of the overhead include paid sick leave, vacation, holidays, payroll taxes, unemployment taxes, social security taxes, retirement and insurance benefits.

The third component of this payment method is the profit or fixed fee. This fee is negotiable but becomes fixed once agreed upon. This fee is intended to compensate the Consultant for contingencies, interest on invested capital, readiness to serve, disallowed overhead items, and profit. The fixed fee varies with the scope, complexity and duration of the project. The fee is essentially fixed for completion of the services described in the parent agreement for contracts which are within the original scope of service, budget and on schedule. However, the agreement should provide for a means to make appropriate adjustments in the event that there are changes in:

- the costs of the work above those established in the current agreement,
- the character of the work,
- the complexity of the work,
- the duration of the work, or
- the conditions under which the work is required to be performed.

Costs incurred by a firm for unauthorized work, work required to meet schedules due to a firm's inadequate assignment of personnel or planning, work deemed unacceptable, and work required to correct a firm's errors or omissions, may not be eligible for an adjustment in the fixed fee. In fact depending upon the circumstances, all costs incurred may not be reimbursable. This is a Project Manager's decision based upon the firm's presentation of such a request.

The fourth component is direct non-salary expenses.

These costs include:

- Living and traveling expenses of employees, partners and principals when away from the home office on project-related business;
- Directly related communication expenses, such as long-distance telephone, FAX, tele graph, cable, express charges and postage, other than general correspondence;
- Services directly related to the project, such as special legal and accounting fees, sub-consultants, boring contracts, laboratory costs, commercial printing, and other similar charges;
- Cost of materials and supplies directly assignable to the project; and
- Reproduction costs directly chargeable, such as blueprinting, photostating, and printing.

Method No. 2: Lump Sum

This method is used only when the extent, scope, complexity, character and duration of work can be clearly defined and just compensation can be determined. The Consultant agrees to perform the work for a single total price. This price includes all labour, overhead, profit and direct non-salary costs. The project manager should ensure that the lump sum amount is arrived at through the development and evaluation of estimates of each of these cost elements for the work anticipated. Such agreements need to contain provisions for the adjustment of the lump sum amount in the event of a scope change, which should be rare.

The advantage of this method is the ease of administration; progress payments may be made through estimates of percentage of work completed without reviewing payrolls or expenditures and auditing procedures are simplified. The disadvantage of this method is that the contract payment is generally fixed. Because documentation is not as extensive on lump-sum contracts, when this amount is exceeded or work believed to be beyond the original scope is ordered, this method becomes very cumbersome and is usually an unpleasant experience for both parties to resolve.

Method No. 3: Cost per Unit of Work

This method is used when the cost of the work per unit can be determined in advance with reasonable accuracy but the extent of work is indefinite. The Consultant is paid on the basis of a preset price for each unit of work performed. The prices must be supported by cost analyses similar to those required for the lump-sum method. One of the most common areas in which this method is used is in soil investigations, where costs can be based on such items as linear feet of drilling, the installation of observation wells, cost per boring, cost per sample, and cost per type of soils test. Another type of project for which this method may be applicable is materials testing, where the types of tests required, the test procedures, and the number of tests are very well defined by standard specifications.

The advantages and disadvantages of this method are similar to those for the lump-sum method. Administration of the contract is easier, but the potential problem of possible differences in unit costs because of changed conditions still exists.

Method No. 4: Specific Rates of Compensation

This method is considered only for relatively minor items of work of indeterminable extent and only where the Department retains control of the class of employee being used and the extent of such use. The Consultant is paid at an agreed to and supported hourly or daily rate for each class of employee directly engaged in the work. Such rates are all- inclusive and cover the Consultant's direct costs, indirect costs and profit. This method is most appropriate for services of short duration or intermittent duration with a well defined scope of limited complexity. Possible uses would include expert witness testimony, other related legal work, construction inspection, construction site visits, materials inspection, value engineering or peer review by an independent firm, or supplementing in-house staff to meet unusual project needs.

7.10.2 Non-allowable Method of Payment

The consultant industry uses a fifth method of paying for services that involves developing a fee based on a percentage of the cost to the owner for implementing the work product being prepared.

Any method of payment where the amount a firm is paid is based on a percentage of the cost to implement is not allowed. In the past, the most common use of this method was to pay a firm an agreed percentage of the low bid received to perform the work. This practice is not accepted by the Department and is absolutely forbidden on federally sponsored contracts. The major disadvantage of this method is that it provides no incentive for the Consultant to prepare the most cost-effective project. Improvements in the design may increase the Consultant's costs but reduce the potential fee. Because of the many inherent problems with this method of payment, most public agencies no longer consider this a viable pay alternative.

7.11 COST OF LIVING

Cost of living is the cost of maintaining a certain standard of living. Changes in the cost of living over time are often operationalised in a cost of living index. Cost of living calculations are also used to compare the cost of maintaining a certain standard of living in different geographic areas. Geographic differences in cost of living can be measured in terms of purchasing power parity rates.

7.11.1 Cost-of-Living Allowances (COLA)

Employment contracts, pension benefits, and government entitlements (such as Social Security) can be tied to a cost-of-living index, typically to the consumer price index. A cost-of-living allowance (COLA) adjusts salaries based on changes in a cost-of-living index. Salaries are typically adjusted annually. They may also be tied to a cost-of-living index that varies by geographic location if the employee moves.

Annual escalation clauses in employment contracts can specify retroactive or future percentage increases in worker pay which are not tied to any index. These negotiated increases in pay are colloquially referred to as cost-of-living adjustments or cost-of-living increases because of their similarity to increases tied to externally-determined indexes. Most economists and compensation analysts would consider the idea of predetermined future "cost of living increases" to be misleading for two reasons: (1) For most recent periods in the industrialized world, average wages have actually increased faster than most calculated cost-of-living indexes, reflecting the influence of rising productivity and worker bargaining power rather than simply living costs, and (2) most cost-of-living indexes are not forward-looking, but instead compare current or historical data. Additionally, simple arithmetic requires that any increase subject to income tax will necessarily have to exceed the inflation rate to result in an inflation adjusted after-tax salary level. Thus for real purchasing power (or any after-tax income) to merely keep up with inflation, gross income must increase faster than cost-of-living indexes.

Consequently, where using CPI as a proxy for a Cost-of-Living index may fall short is in accounting for subsequent income taxes on COLA increases. As a means for adjusting gross wages/salaries/incomes CPI calculations may fail to gross-up for 'progressive rate marginal taxes'. Indexed increases are generally taxed at the highest marginal tax rate, whereas the consumer expenditure market basket corresponds to the consumer's generally lower average tax rate. The widely recognized problem known as bracket-creep can also occur in countries where the marginal tax brackets themselves are not indexed - COLA increases simply place more dollars into higher tax rate brackets. (Only under a flat-rate tax system would a percentage gain on gross income translate into a comparable inflation-offsetting gain at the after tax level.)

Some salaries and pensions in the U.S. with a COLAs (they vary by type) include:

- Social Security
- Civil Service Retirement System (CSRS)
- Federal Employees Retirement System (FERS)

Pensions in Canada with a COLA include:

- Canadian Auto Workers union (CAW) Local 200 (Ontario)

7.11.2 Other Uses of the Term "Cost-of-Living Allowance"

Stipends or extra pay provided to employees who are being temporarily relocated may also be called cost-of-living adjustments or cost-of-living allowances. Such adjustments are intended to offset changes in welfare due to geographic differences in the cost of living. Such adjustments might more accurately be described as a per diem allowance or tied to a specific item, as with housing allowances. Employees who are being permanently relocated are less likely to receive such allowances, but may receive a base salary adjustment to reflect local market conditions.

A cost-of-living allowance is frequently given to members of the U.S. military stationed at overseas bases. For example, service members stationed in Japan receive a cost of living allowance of between $300 and $700 per month (depending on pay grade), in addition to their base pay.

7.12 NEUTRALISATION FACTORS

Traditional pay scales in companies reflect job characteristics like importance of the work, decision/ responsibility level. The salary has been and will continue to represent the positional level in the organization. The HR community also spends considerable time in collecting market and industry data. The market ultimately decides pay levels, but it also assumes that people occupying similar positions in organizations, or having similar experience or skills, must be on the same salary irrespective of contributions.

The time is now for organizations to re-engineer their salary system. The meaning of pay has to change just like the economic and social orders have undergone a change. The basis to determine pay is gradually shifting from position to performance, status to contribution. This will have some revolutionary consequences. Companies are driven hard to conserve precious human as well as financial capital. The route therefore is not far away from performance and pay cheque linkage. The new mantra must be, "get paid only if there is contribution". That is remuneration according to the expected level of contribution. The guaranteed pay syndrome must now end.

Individual performance as a determinant of pay increase has been identified as the most important internal equity. Companies must then lean towards systems wherein the better performers at least will see the linkage of raises to their contributions. Work cultures are no more authoritarian and encourage constant innovation, risk taking, quick problem solving, the status as basis for Ray also must vanish soon. There is a considerable merit in linking compensation to corporate and individual performance.

Evidence shows that there is positive association between organisation performance and compensation. As the compensation mode moves away from status or position price to contribution and performance, the work culture also undergoes change.

HR practitioners may find following factors useful while designing or reviewing the employee compensation package:

7.12.1 Economic Environmental Factors

- Overall macro-economic environment.
- Neutralization of inflation
- Business potential and growth of the company.
- Cost of living indices.
- Industry wage levels.
- Survey of, campus placement induction level packages.
- Legal and statutory framework relating to compensation.

7.12.2 Organizational Factors

- Capacity of company to pay.
- Identification of key slots.
- Analysis of employee turnover or attrition data.
- Assessment of employee expectations.
- Fixed compensation versus variable compensation.
- Cost to company by monetising various benefits and perquisites.
- Performance linked compensation.
- Incentives and annual increments.
- Employee Stock Options
- Flexibility to employees for structuring their compensation package within overall parameters. General-purpose asset backed secured soft loans and advance by the employer to keep the employee under debt repayable to the organization.
- Attractive handshake package for surplus manpower.
- Effectiveness in acquiring, retaining and motivating the appropriate mix of manpower.
- Issues of consistency, continuity and change.
- Transparency, equity and fairness.
- Positioning of company as model employer.
- In-house entrepreneurial and investment avenues.
- In house execution versus outsourcing cost comparisons of jobs and projects.
- Relativities between induction and top level.
- Relativities between generalists and specialists.

7.12.3 Financial Factors

- Flexibility to regulate the wage cash outflows to match the variations in company's liquidity position e.g. elements of wage package, which can be deferred or curtailed during cash crunch situations.

- Value added per employee.
- Value added per rupee of personnel payment.
- Wage bill to turnover ratio.
- Net of tax value of the package in the hands of employee

7.12.4 Security Factors

- Social security needs.
- Risk coverage.
- Health insurance.
- Professional risk and liability coverage.

Check Your Progress 3

State whether the following statements are True or False:

1. Basic pay, also known as Base Pay, is given to members of an organization on a monthly basis.
2. Basic Pay is the same for all the services. As a matter of course, over the last several years, basic pay has increased for all ranks effective the first of the year.
3. The total amount of pay received at a rate fixed by law or administrative action for the position held by an employee.
4. Basic pay includes night and environmental differentials for prevailing rate employees.
5. A cost-of-living allowance (COLA) adjusts salaries based on changes in a cost-of-living index.

7.13 EXECUTIVE COMPENSATION PLAN

Year after year, we see that executive compensation is overly generous, poorly linked to performance, and poorly controlled by public boards. Nothing has changed in that regard, but now because of events at Enron, WorldCom, and the like, the SEC and the accounting standards board are much more interested in affecting change in this area. Boards are caught in a difficult dilemma. On the one hand, they must assure that they approve a plan that effectively attracts, retains, and motivates the CEO and other top management. On the other hand, they must not appear to be giving away the store and must exercise due diligence in assuring that pay and performance are properly tied to each other. Here's what needs to be done while choking out or designing an executive compensation plan:

1) ***Decide who is covered by the plan.*** Will it be only senior management or will it also include department or functional managers?

2) ***Align your compensation strategy with company goals.*** This key step should build rewards into the plan that march in accord with both your short-term and long-term objectives.

3) ***Benchmark against comp plans of similar companies.*** Today's reality is that you're in a race to acquire and keep the best talent, so your packages must be competitive. You also need this information to avoid overpaying.

4) ***Set a base pay,*** usually through industry surveys or by adding a significant percentage jump from the individual's previous salary.

5) ***Use cash incentives to meet short-term goals.*** Cash is usually used to reward an executive for completion of a specific project or for hitting a specified financial goal within a given time frame of up to a year. Some experts suggest that such short-term incentives make up 15 percent to 40 percent of total pay.

6) ***Use long-term incentives to meet larger goals.*** When the goal is more than a year out, many companies reward top performers with either stock options or other long-term payouts that encourage staying with the organization well into the future.

7) ***Add supplemental benefits,*** including health, life, and disability insurance. "These add extra value to the package," the authors write, "and they're not usually costly to the company."

8) ***Provide deferred compensation options.*** These usually pay out at retirement. They increase in value over time, due to compounding interest, without you having to add more cash.

9) ***Pack in the perks.*** A company car, upgraded air travel, and health or golf club memberships tell executives they're special, without greatly increasing the size of the package. They're also attractive in recruiting efforts.

10) ***Evaluate the program.*** Once a program rolls out, evaluate it yearly. Make sure the executives remain onboard with it, but most important, make sure that it's achieving the primary goal … building success for the company, not just the participants.

7.13.1 A Vital Resource

Just as capable executives are one of the most important resources of your organization, Fundamentals of Executive Compensation is one of our most important HR programs.

7.13.2 Advice for the Executive Compensation Committee

Following is advice for the executive compensation committee when reviewing the salary, bonus, and stock option plans for officers of the company.

1. Tie bonus primarily to measures of both profitability and growth. Investors have come to realize companies who have growth without profitability or who have profitability without growth are usually less desirable investments. Stockholders want both profitability and growth.

2. Total compensation should reflect the difficulty of the performance objectives set relative to peers. If objectives are set aggressively high, then compensation should match this aggressive stance. For example, top 25% performance deserves top 25% compensation. If financial objectives are set at industry average, then it is a good practice to set total compensation at a level that is not much more than the industry average. Many companies set objectives that are average for the industry, but set compensation levels which are well above average because of executive attraction and retention concerns. The board must take a realistic look at whether there are special circumstances that might merit this treatment such as attracting key executives to a turnaround situation or labour market conditions that make attraction and retention of desired talent unusually difficult.

3. Analyze expected management compensation level as a percent of expected profits when reviewing bonus formulas. Compare percentages to companies of similar size and industry.

4. The management team should put significant effort into developing or obtaining a database to measure financial performance against peers. This data should be presented to the board to consider in discussions about future objectives for the company. Sources that we use to assist clients in this area include stock analyst reports, trade association surveys, consulting firm surveys, analysis of financial statements for peer public companies, etc.

5. There is a tendency of companies to overweight recent history of the company in setting future financial objectives. The financial objectives should reflect a balance of many factors including:

   - *recent financial history of the company:* desired improvements must be realistic relative to past performance
   - *recent history of peer performance in the industry:* objectives should be set at a level to improve performance relative to peers unless you are already the top performing company.
   - *industry forecast for growth:* objectives should reflect at least the industry average forecast for growth
   - *major changes in business strategy, new products/services, and operations that could significantly impact growth and profitability:* these types of changes can change the model for doing business and make historical financial figures much less relevant in setting future objectives.

6. Avoid canceling and reissuing underwater options at a lower strike price. Management should be in the same boat as the shareholders.

7. Put management stock ownership guidelines in place. In order for management to be in the same boat as the shareholders, management should have a downside financial risk as well as an upside opportunity.

8. When setting the level of stock options analyze both the expected value of options as a percent of the total compensation package as well as in relationship to competitive peer company stock practices. Stock option value which focuses management on both long term and short term results should be balanced with bonus plans which focus only on annual results. There has been a recent trend to increase the emphasis on stock option compensation because of IRS million dollar limits on tax treatment of cash compensation, because of board and management perception that options do not receive as close scrutiny by stockholders as cash compensation, and because of lower impact than bonuses on the P&L statement. This can lead to an imbalance in the executive's perspective on the importance of managing stockholder perceptions versus managing company operations.

9. Cutting heads is often viewed as an easy way to improve profits. Downsizing is a growing trend even in financially health companies. It is difficult to keep the work force energized, positive, and focused when this occurs. Executive bonuses should be consistent with employment and compensation of other employees in the company. It sends the wrong signal to company employees, when top executives receive large bonuses while large numbers of employees are being laid off or when bonuses below the executive level are not being granted. If layoffs are needed or a tightening of the compensation structure for the company overall, then the executive will likely find his/her rewards in the impact of those actions on stock option value. It may be best for the company if the CEO and the top management team forego their bonuses and perhaps even accept a cut in base pay. The long-term rewards

for the executives and the company should outweigh short term compensation loss.

10. It is easy to be generous and complacent when times are good. The board and the compensation designer need to consider what safeguards are in place in the compensation plan should financial results take a quick downturn or should the financials need to be restated in a downward direction.

11. Executive employment contracts are a good idea. They are like premarital agreements and should state the terms for separation from the company in a way that balances the executive's security with the safeguarding of stockholder assets in case of either a voluntary or involuntary termination.

12. Remember that it is always more motivational to pay above average incentive and an average salary, than to pay above average salary and an average incentive. Often it is a good idea to adjust the balance between these elements when they are found to be out of alignment. A competent and confident executive will welcome such a rebalancing because it should result in higher compensation for top performers.

7.14 LET US SUM UP

The components of compensation have to be devised in such a way that, it focuses on the growing demands of employees while retaining the competitiveness and profitability of the company. The human resources managers and tax experts have to evolve proper compensation planning for High end and qualified employees. There are also certain driven factors that are influencing the compensation planning. The compensation Packages of knowledge workers are different from that of manufacturing sector. The employees working in call centers are compensated differently employees of technology driven companies. These refers to the cash component of the wage structure based on which other elements of compensation may be structured. It is normally a fixed amount which is subject to changes based on annual increments or subject to periodical pay hikes. It is structured based on the position of an individual in the organization and differs from grades to grades. The payment of dearness allowance facilitates employees and workers to face the price increase or inflation of prices of goods and services consumed by him. The onslaught of price increase has a major bearing on the living conditions of the labour. The increasing prices reduce the compensation to nothing and the money's worth is coming down based on the level of inflation. The bonus can be paid in different ways. It can be fixed percentage on the basic wage paid annually or in proportion to the profitability. The Government also prescribes a minimum statutory bonus for all employees and workers. The payment of dearness allowance, which may be a fixed percentage on the basic wage, enables the employees to face the increasing prices.

7.15 LESSON END ACTIVITY

Write a study note on the uses of a comprehensive compensation plan for an organization.

7.16 KEYWORDS

Basic Pay: It is also known as Base Pay, and it is given to members of an organization on a monthly basis and is determined by their rank (or more appropriately their pay grade) and their length of time in service.

A Cost-Of-Living Allowance (COLA): It adjusts salaries based on changes in a cost-of-living index.

Cost of Living: Monetary cost of maintaining a particular standard of living, usually measured by calculating the average cost of a number of goods and services.

7.17 QUESTIONS FOR DISCUSSION

1. Discuss the theories related to incentives plans.
2. What do know about the concept of basic pay?
3. Write a note on the different provisions for dearness allowance.
4. How would you calculate total compensation package?
5. Attempt a note on various methods of compensating the employees in an organization.
6. Write a note on the concept of living.
7. What do you understand by the neutralization factors?
8. Analyze the executive compensation plan.

Check Your Progress: Model Answers

CYP 1

Unlike Halsey Plan gives bonus on (S-T)/S. Thus it can be employed even if the output standard is not very accurate.

W=R.T + ((S-T)/S).R.T

CYP 2

Organization-wide plans are expanding under the name of gainsharing. These types of plans are both old and new. The Scanlon Plan is one of the oldest incentive pay plans in continuous use in organizations, yet new plans are cropping up.

CYP 3

1. True
2. True
3. True
4. True
5. True

7.18 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

LESSON

8

RETIREMENT PLAN

CONTENTS

8.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the theories related to retirement plan
- Learn about different types of retirement plans
- Know about pension plan and its types

8.1 INTRODUCTION

A retirement plan is an arrangement to provide people with an income, or pension, during retirement, when they are no longer earning a steady income from employment. Employers, insurance companies, the government or other institutions such as employer associations or trade unions may set up retirement plans. Retirement plans are more commonly known as pension schemes in the UK and Ireland and superannuation plans in Australia.

8.2 TYPES OF RETIREMENT PLANS

Retirement plans may be classified as defined benefit or defined contribution according to how the benefits are determined. A defined benefit plan guarantees a certain payout at retirement, according to a fixed formula which usually depends on the member's salary and the number of years' membership in the plan. A defined contribution plan will provide a payout at retirement that is dependent upon the amount of money contributed and the performance of the investment vehicles utilized.

Some types of retirement plans, such as cash balance plans, combine features of both defined benefit and defined contribution plans. They are often referred to as hybrid plans.

8.3 DEFINED CONTRIBUTION PLANS

In a defined contribution plan, contributions are paid into an individual account for each member. The contributions are invested, for example in the stock market, and the returns on the investment (which may be positive or negative) are credited to the individual's account. On retirement, the member's account is used to provide retirement benefits, often through the purchase of an annuity which provides a regular income. Defined contribution plans have become more widespread all over the world in recent years, and are now the dominant form of plan in the private sector in many countries. For example, the number of DB plans in the US has been steadily declining, as more and more employers see the large pension contributions as a large expense that they can avoid by disbanding the plan and instead offering a defined contribution plan.

Examples of defined contribution plans in the USA include Individual Retirement Accounts (IRAs) and 401(k) plans. In such plans, the employee is responsible, to one degree or another, for selecting the types of investments toward which the funds in the retirement plan are allocated. This may range from choosing one of a small number of pre-determined mutual funds to selecting individual stocks or other securities. Most self-directed retirement plans are characterized by certain tax advantages, and some provide for a portion of the employee's contributions to be matched by the employer. In exchange, the funds in such plans may not be withdrawn by the investor prior to reaching a certain age.

8.4 DEFINED BENEFIT PLANS

Traditionally, retirement plans have been administered by institutions which exist specifically for that purpose, by large businesses, or, for government workers, by the government itself. A traditional form of defined benefit plan is the final salary plan, under which the pension paid is equal to the number of years worked, multiplied by the member's salary at retirement, multiplied by a factor known as the accrual rate.

The final accrued amount is available as a monthly pension or a lump sum.

In addition, many countries offer state-sponsored retirement benefits, beyond those provided by employers, which are funded by payroll or other taxes. In the U.S., this is one role of Social Security.

Defined benefit plans may be either funded or unfunded. In a funded plan, contributions from the employer, and sometimes also from plan members, are invested in a fund towards meeting the benefits. The future returns on the investments, and the future benefits to be paid, are not known in advance, so there is no guarantee that a given level of contributions will be enough to meet the benefits. Typically, the contributions to be paid are regularly reviewed in a valuation of the plan's assets and liabilities, carried out by an actuary. In many countries, such as the USA, the UK and Australia, most private defined benefit plans are funded, because governments there provide tax incentives to funded plans.

In an unfunded plan, no funds are set aside. The benefits to be paid are met immediately by contributions to the plan. Most government run retirement plans, such as the social security system in the USA and most European countries, are unfunded, with benefits being paid directly out of current taxes and social security contributions. In some countries, such as Germany, Austria and Sweden, company run retirement plans are often unfunded.

8.5 HYBRID PLANS

A cash balance plan is a defined benefit plan made by the employer, with the help (some critics say the connivance) of consulting actuaries (like Kwasha Lipton, whom it is said created the cash balance plan) to appear as if they were defined contribution plans. They have notional balances in hypothetical accounts where, typically, each year the plan administrator will contribute an amount equal to a certain percentage of each participant's salary; a second contribution, called interest credit, is made as well. These are not actual contributions and further discussion is beyond the scope of this entry suffice it to say that there is currently much controversy.

Target Benefit plans are defined contribution plans made to match (or look like) defined benefit plans. This would only work if all actuarial assumptions are actually realized.

Check Your Progress 1

What do you understand by:

1. Defined contribution plans

   ....

   ....

2. Defined benefit plans

   ....

   ....

3. Target benefit plans

   ....

   ....

8.6 CONTRASTING TYPES OF RETIREMENT PLANS

Advocates of defined contribution plans point out that each employee has the ability to tailor the investment portfolio to his or her individual needs and financial situation, including the choice of how much to contribute, if anything at all. However, others state that these apparent advantages could also hinder some workers who might not possess the financial savvy to choose the correct investment vehicles or have the discipline to voluntarily contribute money to retirement accounts. This debate parallels the discussion currently going on in the U.S., where many Republican leaders favor transforming the Social Security system, at least in part, to a self-directed investment plan.

8.7 PENSION

A pension is a steady income given to a person (usually after retirement). Pensions are typically payments made in the form of a guaranteed annuity to a retired or disabled employee. Some retirement plan (or superannuation) designs accumulate a cash balance (through a variety of mechanisms) that a retiree can draw upon at retirement, rather than promising annuity payments. These are often also called pensions. In either case, a pension created by an employer for the benefit of an employee is commonly referred to as an occupational or employer pension. Labour unions, the government, or other organizations may also fund pensions.

Occupational pensions are a form of deferred compensation, usually advantageous to employee and employer for tax reasons. Many pensions also contain an insurance aspect, since they often will pay benefits to survivors or disabled beneficiaries, while annuity income insures against the risk of longevity.

While other vehicles (certain lottery payouts, for example, or an annuity) may provide a similar stream of payments, the common use of the term pension is to describe the payments a person receives upon retirement, usually under pre-determined legal and/or contractual terms.

Check Your Progress 2

State whether the following statements are True or False:

1. Retirement plans offer workers various choices to plan for their eventual retirement.
2. A retirement plan is an arrangement to provide people with an income, or pension, during retirement, when they are no longer earning a steady income from employment.
3. Retirement plans may be set up by employers, insurance companies, the government or other institutions such as employer associations or trade unions.
4. Retirement plans are more commonly known as pension schemes in some countries.
5. A retirement plan gives you the choice to remain independent even after retirement.

8.8 TYPES OF PENSIONS

8.8.1 Retirement Pension or Superannuation Plans

By such an arrangement an employer (for example, a corporation, labour union, government agency) provides income to its employees after retirement. Pension plans are a form of "deferred compensation" and became popular in the United States during World War II, when wage freezes prohibited outright increases in workers' pay.

Pension plans can be divided into two broad types: Defined Benefit and Defined Contribution plans.

The defined benefit plan had been the most popular and common type of pension plan in the United States through the 1980s; since that time, defined contribution plans have become the more common type of retirement plan in the United States and many other western countries.

Some plan designs combine characteristics of defined benefit and defined contribution types, and are often known as "hybrid" plans. Such plan designs have become increasingly popular in the US since the 1990s. Examples include Cash Balance and Pension Equity plans.

8.9 LET US SUM UP

Retirement Plans, a relatively new element in the emergence of modern retirement as a social process. Prior to the twentieth century, the concept of mandatory retirement, and therefore the need to plan for such an eventuality, did not exist. For the elderly, retirement in the agrarian society of the colonial and early national periods was essentially a slow transition that led to transferring the property of the head of a household to an heir in return for money or services that might be required by the aged couple. This also assured the continuation of family ownership of the land. In towns and cities before industrialization, the small size of businesses, and the limited numbers of employees they had, meant that the financial burden of creating a pension program of some sort was too great for them to assume. Even with industrialization, most Americans were still engaged in farming as late as 1890, limiting the number of persons who retired. Older Americans tended to stay with their jobs for as long as they could, substituting skills and experience for a loss of strength and stamina in their later years.

Even so, the onset of industrialization and the emergence of larger corporations led to growing concerns about productivity and efficiency on the part of business as well as employee apprehensions regarding their security. These issues helped fuel the move toward mandatory retirement programs. Yet, by 1900, only a few businesses had developed pension plans for their employees, or established programs for mandatory retirement.

In 1935, the Social Security Act established old-age pensions for workers, survivor's benefits for victims of industrial accidents, and aid for dependent mothers and children as well as the blind and disabled. The funds for this program came from taxes paid by employers and employees alike. However, social security did not immediately accelerate the process of retirement. Older workers continued a long-established pattern of delaying retirement until they were physically unable to continue working. This trend continued into the 1950s, although retirement as a social occurrence had begun to increase in this decade. The fixed benefits inherent in the social security program and in private pension plans offered little in the way of financial security for potential retirees, particularly as inflation reduced their spending power.

The ongoing problem of poverty among the elderly led to increases in the benefit levels of social security between 1965 and 1975. To allow adjustments for inflation, benefits were tied to the Consumer Price Index in 1972. At the same time, the private sector began reorganizing its pension plans. The enactment of the Employee Retirement Income Security Act (ERISA) permitted vesting plans, while it also provided workers with some protection against any loss of benefits. Retirement savings became tax-exempt and allowed tax deferments, which lowered the cost of saving for retirement by permitting pretax dollars to be put into a retirement plan and deferring taxation of the gains made from the plan's investments until withdrawal. Private insurance companies had begun offering programs in the 1950s to help individuals prepare for retirement; now they began to expand those programs to offer more options geared to take advantage of these new retirement savings opportunities.

Retirement plans offer workers various choices to plan for their eventual retirement. Often, employers and employees both contribute to these plans, although some may be funded entirely by either an employer or a firm's workers. In general, withdrawals made before age fifty-nine and a half are subject to a 10 percent penalty. Withdrawals normally have to begin no later than one year after a person turns seventy and a half. Income taxes usually become payable once withdrawal begins; taxes are paid on the amounts withdrawn and not on the entire sum in the plan.

8.10 LESSON END ACTIVITY

Write a study note on the retirement plan of a limited company of your area.

8.11 KEYWORDS

Retirement Plan: A retirement plan is an arrangement to provide people with an income, or pension, during retirement, when they are no longer earning a steady income from employment.

Pension: A pension is a steady income given to a person (usually after retirement).

Defined Contribution Plans: In a defined contribution plan, contributions are paid into an individual account for each member.

8.12 QUESTIONS FOR DISCUSSION

1. Discuss the theories related to retirement plan.
2. What do you know about different types of retirement plans?
3. Write a note on the pension plan and its types.

Check Your Progress: Model Answers

CYP 1

1. ***Defined Contribution Plan:*** A defined contribution plan will provide a payout at retirement that is dependent upon the amount of money contributed and the performance of the investment vehicles utilized.
2. ***Defined Benefit Plan:*** A defined benefit plan guarantees a certain payout at retirement, according to a fixed formula which usually depends on the member's salary and the number of years' membership in the plan.
3. ***Target Benefit Plans:*** Target Benefit plans are defined contribution plans made to match (or look like) defined benefit plans. This would only work if all actuarial assumptions are actually realized.

CYP 2

1. True
2. True
3. True
4. True
5. True

8.13 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

UNIT V

LESSON 9

SOCIAL SECURITY LAWS

CONTENTS

9.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the social security laws
- Attempt on the laws relating to workmen's compensation
- Describe the provisions and policies mentioned in the Employees State Insurance Act
- Learn about the incentives like, Provident Fund, Gratuity and Maternity Relief

9.1 INTRODUCTION

Here are some amenities that are necessary to be provided to the employees under different labour legislations. The important legislations which call for these welfare provisions include The Factories Act, 1948, the Plantation Labour Act, 1951, Mines Act, 1952, Motor Transport Workers Act, 1961, and the Contract Labour (Regulation and Abolition) Act, 1970.

9.2 LAWS RELATING TO WORKMEN'S COMPENSATION

Factories Act, 1948

The Act covers areas including health, welfare, safety, working hours, annual leave with wages and employment of women and children.

The Act is applicable to premises including precincts thereof where ten or more workers are employed with the aid of power, or where 20 or more workers are employed without power.

The welfare amenities provided under the Act include:

1. Washing facilities.
2. Facilities for storing and dry clothing.
3. Sitting facilities for occasional rest for workers who are obliged to work standing.
4. First-aid boxes for cup boards - one for every 150 workers, and ambulance facilities if there are more than 500 workers.
5. Canteens if employing more than 250 workers.
6. Shelters, rest rooms and lunch rooms, if employing over 150 workers.
7. Crèche, if employing more than 30 women.
8. Welfare officer, if employing more than 500 workers.

Mines Act, 1952

The mine owners should make provisions for:

1. Maintenance of crèches where 50 or more women workers are employed.
2. Shelters for taking food and rest if 150 or more workers are employed.
3. A canteen in mines employing 250 or more workers.
4. Maintenance of first-aid boxes and first-aid rooms in mines employing more than 150 workers.
5. (i) Pit-head baths equipped with shower baths, (ii) sanitary latrines, and (iii) lockers, separately for men and women workers.
6. Appointment of welfare officer in mines employing more than 500 persons to look after the matters relating to the welfare of the workers.

Plantation Labour Act, 1951

The following welfare measures are to be provided to the plantation workers:

1. A canteen in plantations employing 150 or more workers.
2. Crèche in plantations employing 50 or more women workers.
3. Recreational facilities for the workers and their children.
4. Educational arrangements in the estate for the children of workers, where there are 25 workers' children between the age of 6 and 12.
5. Housing facilities for every worker and his family residing on the plantation. The standards and specifications of the accommodation, procedure for allotment and rent chargeable from workers etc., are to be prescribed in the rules by the State Government.

6. Medical aid to workers and their families. The workers are also entitled, subject to any rules framed by the State Governments, to sickness allowance and maternity allowance.
7. The State Government may make rules requiring every plantation employer to provide the workers with such number and type of umbrellas, blankets, raincoats, or other such amenities for protection from rain or cold as may be prescribed.
8. Appointment of a welfare officer in plantations employing 300 or more workers.

Motor Transport Workers Act, 1961

The motor transport undertakings are required to make the following provisions in the areas of health and welfare:

1. Canteens of prescribed standard, if employing 100 or more workers.
2. Clean, ventilated, well-lighted and comfortable rest rooms at every place where motor transport workers are required to halt at night.
3. Uniforms, raincoats to drivers, conductors and line checkers for protection against rain and cold. A prescribed amount of washing allowance is to be given to the above-mentioned categories of staff.
4. Medical facilities are to be provided to the motor transport workers at the operating centres and at halting station as may be prescribed by the State Governments.
5. First-aid facilities equipped with the prescribed contents are to be provided in every transport vehicle.

Contract Labour (Regulation & Abolition) Act, 1970

The contractor is required to provide the following welfare and health measures to the contract workers:

1. A canteen in every establishment employing 100 or more workers.
2. Rest rooms or other suitable alternative accommodation where the contract labour is required to halt at night in connection with work of an establishment.
3. Provision for washing facilities.
4. Provision for first-aid box equipped with the prescribed contents.

Canteen

The Royal Commission on Labour and the Labour Investigation Committee have laid considerable emphasis on the provision of a canteen inside the workplace. The ILO, in its Recommendation 102, mentioned this facility and felt that a competent authority in each country should guide establishments with regard to nutrition, hygiene, finance, etc. In India, the factories Act places the responsibility on State Governments of making rules to ensure provisions of a canteen in any specified factory with more than 250 workers. Workers should be provided representation in the management of canteens. The Commission on Labour Welfare has suggested that canteens should be run on cooperative basis and that legislation should be amended to empower State Governments to make rules to meet the objective of nutrition.

Crèches

The need for setting up crèches in industrial establishments was stressed by the Royal Commission on Labour in its report way back in 1931. The Factories Act lays down that in any factory with more than 50 women workers a crèche should be provided and maintained for children under 6 years in clean and sanitary conditions. The crèche should be under the care of women trained in child care. The crèche should have adequate accommodation, should be properly lighted and ventilated. You must note that the State Government is empowered to make rules in respect of standards, equipment and facilities. Mothers should also be given time to feed their children at necessary intervals.

Labour Officer

The Factories Act, 1948, provides for the statutory appointment of welfare officer in a factory in which 500 or more workers are employed. The State Government may prescribe the duties, qualifications and conditions of service of officers employed. The functions of a welfare officer include the broad areas of (i) labour welfare (welfare function), (ii) labour administration (personnel function), and (iii) labour relations (conciliation function).

The labour welfare function includes advice and assistance in implementing legislative and non-legislative provisions relating to health, safety and welfare, hours of work, leave, formation of welfare committees, etc.

The labour administration covers organizational discipline, safety and medical administration, liaison, wage and salary administration, education of workers, etc. the labour relation consists of settlement of disputes, promotion of harmonious labour-management relations, etc.

9.2.1 Social Security: Concept and Evolution

The concept of social security is essentially related to the high ideals of human dignity and social justice. It is in away, one of the pillars of the Welfare State. Social security measures have introduced an element of stability and protection in the midst of the stress and strains of modern life.

Social security programmes are increasingly being accepted as useful and necessary instruments for the protection and stability of the labour force. It is primarily an instrument of social and economic justice. It is a dynamic concept. Its content changes with the social and economic system obtaining in a given time and space. The ILO defines social security as "the protection which society provides for its members through a series of public measures, against the economic and social distress that otherwise would be caused by the stoppage or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment, invalidity, old age, and death, the provision of medical care; and the provision of subsidies for families with children".

The term social security came into popularity after the US Government passed the Social Security Act in 1935, introducing the old age pension system. The formation of ILO in 1919 to promote social justice thorough (i) international standards; (ii) providing information; (iii) technical assistance and guidance; and (iv) cooperation with other international organizational organization, provided the impetus and direction needed by most countries. In India over the years, a number of legislative measures have been adopted to ensure benefits to employees of industrial undertakings under the scheme of social security. Let us have a look at some of these important rules and regulations.

Workmens' Compensation Act, 1923

India's first social security legislation was passed in 1923. The Workmens' Compensation Act was to provide injury compensation to industrial workers. The Act imposes obligation on the employer to pay compensation for accidents arising out of and in course of employment. The Act was amended in 1962 raising the wage limit to per month and a later amendment raised the wage limit to Rs. 1,000 per month, and a later amendment raised it to Rs. 1,600 per month.

The compensation limits in case of death were raised from Rs. 10,000 to 30,000 and for permanent and total disablement from Rs. 14,000 to 40,000 by the same amendment. The term "workmen" in the Act refers to those employed in factories mines, plantations, construction work and other hazardous occupations, except those covered by Employees' State Insurance Act, 1948, and clerical employees.

The compensation is related to the extent of the injury of circumstances of death. However, the employee cannot claim any compensation if he sustains injuries under the influence of drugs, alcohol, etc. The Act provides for half the monthly wages. The Act is administered by a Commissioner appointed by the Government. The employer is required to file annual return giving details of the compensation paid, number of injuries and other particulars.

If the workman contacts any occupational disease due to the employment in that particular job, it would be deemed an injury by accident arising out of and in the course of his employment for purpose of the Act. In this case, the compensation will be payable only if the workman has been in service of the employer for more than six months.

If the employer does not pay the compensation within one month from the date it fell due, the commissioner may order recovery of not only the amount of arrears but also a simple interest at the rate of six per cent per annum on the amount due. If there is no justification for the delay in the opinion of the Commissioner, an additional sum not exceeding 50 per cent of such amount may be recovered from the employer by way of penalty.

Check Your Progress 1

What do you understand by social security?

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9.3 EMPLOYEES' STATE INSURANCE ACT, 1948

This is a pioneering attempt to provide medical facilities and unemployment insurance during illness to industrial workers. The subject of health insurance for industrial workers was first discussed in 1927 by the Indian Legislature when the applicability of the convention adopted by the International Conference was considered by the Government of India. The Royal Commission on Labour in its Report (1931) stressed the need for health insurance for workers in India.

The Act covers smaller factories using power and employing 10 or more persons and those not using power but employing 20 or more people. The Act has also been extended to the new classes of establishments, shops, hotels, restaurants, cinemas, theatres, motor transport, building construction, and newspaper establishments employing 20 or more persons. It covers all employees, manual, clerical and supervisory and employees engaged by or through contractors, whose remuneration does not exceed Rs. 1,600 per month. The definition of "employee" includes administrative staff and persons engaged in connection with purchase of raw materials or sale or distribution of products and related functions. The State Government is empowered to exceed the Act to cover other establishments or class of establishments.

The scheme is administered by an autonomous corporation with the Minister of Labour at the Centre as its Chairman, the Union Health Minister as the Vice-Chairman, and representatives of State government, employers and the medical profession nominated by the Central Government.

The scheme is financed by contribution from employers and employees, with the State Governments sharing one-eighth of the cost of medical care. The employer pays 4.7% of the wage bill, a maximum of Rs. 7.50 per week on the highest wage scale, and the insured person pays about 2.3% of his wage, around Rs. 4 per week. The maximum corresponding daily benefit rate for the insured person is Rs. 15. The State Government which implements the scheme is reimbursed to the extent of 7/8 of the expenses incurred on workers' families and 3/4 of the expenses incurred in the case of workers. In order to qualify for the benefit the worker should have contributed to the scheme for a minimum period of 12 weeks.

The benefits provided under the scheme include: (i) Sickness and extended sickness benefit (ii) Maternity benefit (iii) Disablement benefit (iv) Dependent's benefit, (v) Funeral benefit and (vi) Medical benefit.

(i) ***Sickness and extended sickness benefit:*** For sickness occurring during any benefit period, an insured person is entitled to receive sickness cash benefits at the standard benefits are subject to contributory conditions. An insured person suffering from long-term ailments like tuberculosis, leprosy, mental diseases, is eligible for extended sickness benefit at a rate of 25 per cent more than the sickness benefit rate rounded to the next higher multiple of 5 paise, for period of 124/309 days. Contributions are calculated with reference to average daily wages and wages have been classified into 9 groups for the purpose of fixing the contribution.

(ii) ***Maternity benefit:*** An insured woman is entitled to maternity benefit at double the standard benefit rate. This is practically equal to full wages for a period of 12 weeks.

(iii) ***Disablement benefit:*** If a member of the scheme suffers an injury in the course of his employment, he will receive free medical treatment and temporary disablement benefit in cash. The temporary disablement benefit is about 70 per cent of the wages as long as the temporary disablement lasts, provided that it lasted for not less than 3 days, excluding the day of accident. In case of permanent disablement, the insured person will be given life pension at full rate, i.e. about 70 per cent of his wages.

(iv) ***Dependents' benefits:*** This provides timely help to the eligible dependents of an insured person who dies as a result of an accident or an occupational disease arising out of and in the course of employment. Pension at the rate of 40 per cent more than the standard rate will be paid periodically to widow and children in accordance with the prescribed share. The benefit also accrues to parents and grandparents and any other dependent up to the age of 18, where the deceased has no surviving widow or child.

(v) ***Funeral benefit:*** This benefit was introduced in 1968. An amount of not exceeding Rs. 100 is payable as funeral benefit to the eldest surviving member of the family of the deceased insured person. If the insured person did not have a family or was not living with his family at the time of death, it is payable to the person who actually incurs the expenditure on the funeral of the deceased insured person.

(vi) ***Medical benefit:*** The major attraction of the ESI scheme is medical benefit. Medical benefit has been divided into three parts:

(a) *Restricted medical care:* It consists of out-patient medical care at dispensaries or panel clinics. Facilities of consultation with medical officers, supply of drugs, pre-natal and post-natal care, family planning and immunization services are available in these institutions. The beneficiaries are also entitled to call a doctor to their house to see a serious case.

(b) *Expanded medical care:* This consists of consultation with specialists and supply of special medicines and drugs as may be prescribed by them. Facilities for special laboratory tests and X-ray examinations are also available under this scheme.

(c) *Full medical care:* Hospitalization facilities, services of specialists and drugs and diet as are required for in-patients are available under this scheme.

When a person is entitled to any of the benefits provided by the ESI Act, he shall not be entitled to receive any similar benefit under any other enactment.

An insured person will not be entitled to receive for the same period (a) both sickness benefit and maternity benefit or (b) both sickness benefit and disablement benefit for temporary disablement or (c) both maternity benefit and disablement benefit for temporary disablement. When a person is entitled to more than one benefit, he has an option to select any one of them.

A dispute arising under the provisions of the ESI Act has to be settled by the Employees' Insurance Court, not by a Civil Court.

Check Your Progress 2

Describe, in brief, the provision regarding maternity benefit provided under the Employees' State Insurance Act, 1948.

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9.4 EMPLOYEES' PROVIDENT FUNDS AND MISCELLANEOUS ACT, 1952

The Act was passed in 1952 with the objective of making some provisions for the future of the industrial worker after he retires, for the dependents in case of his early death and to cultivate a spirit of saving among the workers.

The Act applies to all factories and other establishments falling under any notified industry and employing 20 or more workers. Once the Act is applied it does not cease to be applicable even if the number of employees falls below 20. The Act extends to the whole of India except Jammu & Kashmir and the Assam tea Plantations both of which had a separate Act and Scheme.

The Central Government is empowered to apply the provision of the Act to any establishment employing less than 20 persons after giving not less than two months' notice of its intention to do so by a notification in the Official Gazette. Provided, persons and units are working without the aid of power.

Workers in establishments employing 20-20 persons pay 6.25 per cent of their earnings and those with a larger strength pay 8 per cent. Employers make an equal contribution. The Provident Fund is refunded with interest in the event of death, permanent disability, superannuation, retrenchment, migration or on leaving service. On retirement, or after

15 years of service a worker receives his own share and the employer's contribution. For shorter periods of membership, the proportion of employer's contribution varies according to the length of service.

Employees' Deposit-linked Insured Scheme, 1976

The Act is applicable to all factories/establishment to which the Employees' Provident Funds Act applies. Where the monthly pay of an employee exceeds Rs. 1,600 per month, the contribution payable in respect of him by the employer and the State Government will be limited to the amount payable on a monthly pay of Rs. 1,600. The special feature of the scheme and not the employee himself. The Employer is required to contribute to the Insurance Fund at the rate of 0.5 per cent of the pay of the employees who are provident fund subscribers. The Central Government also contributes to the Insurance Fund an amount representing one-half of the amount contributed by the employer.

The above three schemes, namely, the Employees' Provident Funds Scheme, the Employees' Family Pension Scheme, and the Employees' Deposit-linked Insurance Scheme are administered by the Employees' Provident fund Organization. The administration of these schemes is in the hands of the Central Board of Trustees, a tripartite body consisting of a Chairman, nominees of the Central & State Governments and employers' and employees' organizations.

9.5 MATERNITY BENEFIT ACT, 1961

The Act is applicable to all establishments not covered under the ESI scheme. The Act was amended in 1976 to extend the benefits to all women workers earning more than Rs. 1,600 per month in establishments covered by the ESI Act.

Under the Act, a woman can get maternity leave up to 12 weeks. Of this, 6 weeks must be taken prior to the delivery of the child and 6 weeks immediately following that date. During the period of leave the employee is entitled to full wages/salary. The employee is also entitled to a medical bonus of Rs. 25 if not pre-natal confinement and post-natal care has been provided by the employer free of charge. To avail of the leave and benefits, the employee should have put in 160 working days of service in the 12 months immediately preceding the date of expected delivery.

9.6 PAYMENT OF GRATUITY ACT, 1972

Gratuity is an additional retirement benefit. The Act is applicable to all factories mines, oil-fields, plantations, ports, railways, shops or establishments in which 10 or more workers are employed. The Central Government can bring in any establishment by notification under the provisions of the Act.

According to the Act, an employee is entitled to 15 days wages for every continuance in service. Seasonal workers should be paid gratuity at the rate of 7 days wages per season. The total gratuity payable shall not exceed more than 20 months wages. The Act applies to workers who do not have any managerial or administrative capacity or are employed under the government and do not draw wages of more than Rs. 1,600 per month. Gratuity is payable on termination of employment after the completion of at least five years of continuous service. This is relaxable in the case of death or disablement.

Table 9.1: Characteristics of Major Retirement Benefit Schemes

	Employees' Provident Fund (EPF)	**Employees' Pension Scheme (EPS)**	**Government Employees' Pension Scheme (GEPS)**
Characteristics	Defined-contribution and fully funded.	Defined-benefit and pay-as-you-go	Defined-benefit and pay-as-you-go.
Coverage	The scheme covers workers in the private organized sector.	EPF members with monthly earnings not exceeding Rs. 5,000	The scheme covers government employees.
Contribution	Employees contribute 10% or 12% of monthly wage. Employer also provides a matching contribution, out of which an amount in excess of the EPS contribution is credited into the worker's EPF account.	Out of employer's contribution into the EPF, 8.33% of earnings is diverted into EPS. Maximum earnings for EPS contribution is Rs.5000 per month. The government also makes 1.16% contribution	Participants make no explicit contribution but they forego the employer's contribution into their provident fund accounts.
Pension Formula		Pension = wage x t/70 Where t is the service period. 2 years service credit is granted for 20 years or more service.	Pension = 0.5 x wage × max (6,33)/33 Where t is the service period.
Vesting Period	Nil	10 years	10 years
Benefit Payout Pattern	Paid in lumpsum at the time of retirement	Monthly annuity	Monthly annuity
Minimum and Maximum Benefits	EPF has neither uppr nor lower limits on benefits.	EPS has a floor and ceiling in its benefit formula. The minimum monthly pension is Rs.250 and the maximum is Rs.5000 adjusted by the length of service	The minimum monthly pension floor for GEPS is Rs.1250. There is no explicit cap on maximum pension amount.
Indexation	Since EPF offers lump sum benefits, there is no scope for indexation.	EPS does not have any guaranteed indexation benefit.	GEPS is indexed to CPI. The indexation benefit, known as dearness relief, is revised twice a year. Greater indexations are provided to the low income groups.
Commutation	Since benefit is paid in lumpsum, there is no question of commutation. EPF, however, offers liberal non-refundable withdrawal options during working life.	Commutation up to one-third amount of the pension is permissible under EPS	Maximum commutation of 40% is permissible.
Risk Coverage	Does not cover longevity and inflation risk.	Partially covers longevity risk but not inflation	Covers longevity and inflation risk

Check Your Progress 3

State whether the following statements are True or False:

1. The Factories Act, 1948 covers areas including health, welfare, safety, working hours, annual leave with wages and employment of women and children.
2. India's first social security legislation was passed in 1923.
3. The Workmen's Compensation Act was to provide injury compensation to industrial workers.
4. The subject of health insurance was first discussed in 1927 by Indian Legislature.
5. The Factory Act, 1948 is applicable to all premises where 20 or more workers are employed at any time of a year.

9.6.1 Voluntary Welfare Amenities in India

There are employers who have taken the lead and provided a wide variety of welfare amenities to their employees.

Educational Facilities

Economic and social progress is dependent on the quality of workforce. Education plays a crucial role in motivating and preparing the workers for constant change and development that should necessarily happen in industry. The need for imparting necessary education to workers in India had been emphasized by the Indian Industrial Commission (1918) and the Royal Commission on Labour (1931). The educated worker is naturally more receptive and responsible.

Educating the worker's family, especially his children, is essential. It is an investment in training your future workforce. The Central Workers Education Board conducts classes for industrial workers. The National Commission on Labour and the interest in educating workers and running schools for workers' children. However there is no statutory obligation on any industry to impart education to workers' children except in plantations.

Housing Facilities

Both the Indian Industrial Commission (1918) and the Royal Commission realized the importance and necessity of improving housing conditions of industrial workers and suggested various measures. In 1948 the Government of India put forth the Industrial Housing scheme. The committee on Labour Welfare emphasized the importance of the role of the State Government in acquiring land near industrial areas and renting houses at reasonable rates. The National Commission on Labour recommended that the Government should take the major responsibility for housing. The Government should also use all the help that employers can provide and that fiscal and monetary incentives should be provided to employers to make it a viable proposition for them.

Transport Facilities

The growth and expansion of industries has also increased the distance for the worker from his place of residence to his place of work. Transport facilities for workers residing far from the workplace is essential to relieve strain and anxiety. Such facilities will, no doubt also provide greater opportunity for relaxation and reduce the rate of absenteeism.

The Committee on Labour Welfare recommended the provision of adequate transport facilities to workers to enable them to reach their workplace without loss of much time and without fatigue. The Committee also recommended that in industrial undertakings where transport services are not provided, some conveyance allowance mutually agreed upon between the employer and the employees, should be paid to the employees. To encourage the employees to have their own conveyance the Committee recommended that the employer should advance loans for purchase of bicycles, scooters, etc.

Recreational Facilities

Recreation in the form of music, art, theatre, sports and games can play an important role in the mental and physical development of your employees. The importance of recreation in creating a healthy climate for industrial peace and progress has been emphasized by several study teams, committees and commissions.

The ILO Recommendation on Welfare Facilities adopted in 1956 urged upon the member countries to take appropriate measures to encourage the provision of recreational facilities for the workers in or near the undertaking in which they are employed. These measures should, preferably, be taken in such a way as to stimulate and support action by the public authorities so that the community is able to meet the demand for recreational facilities.

In India; provision of recreational facilities has been made obligatory on employers in plantations. The committee on labour Welfare recommended that small units could be lent a helping hand by the State in organizing recreational facilities for its workers in industrial housing colonies. Trade unions could also take the initiative and different agencies could combine their efforts to provide a minimum number of sports and recreational activities to keep the labour force fit and healthy. Excursions can be organized, youths clubs can be formed and holidays homes can be provided for the employees.

Consumer Cooperative Societies

The importance of opening Consumer Cooperative Societies/Fair Price Shops for the workers was first realized during the second World War. During this period a large number of Consumer Cooperative Societies were organized by the Government for the distribution of controlled commodities. A committee was set up in 1961 by the National Cooperative Movement.

The Committee felt that it should be made obligatory for employers and industrial undertakings to introduce consumer cooperative activities in their labour welfare programmes. The Indian Labour Conference in 1962 adopted a scheme for setting up consumer cooperative stores in all industrial establishments including plantations and mines employing 300 or more workers. The employer was to give assistance in the form of share capital working capital, loan, free accommodation and other amenities. The Industrial Truce Resolution, 1962, aimed to keep prices of essential commodities low by opening a sufficient number of fair price shops and cooperative stores so that workers were assured of a regular supply of essential items.

9.7 LET US SUM UP

There are a number of Employment, Labour and social security laws in India, which prescribe different mandatory standards to be observed by corporate bodies and factory owners on various issues of labour, employment, social security and factory/labour conditions. All such statutes assume importance for the corporate sector, more particular for standards on working hours, safety, special conditions for women, minimum wages, night shifts, compensatory holidays, disposal of waste & effluents, ventilation and temperature, lighting, overcrowding, fencing of machinery, settlement of disputes, maternity leave, social security, liability, compensation claims etc. The Factories Act, 1948 is a very comprehensive Statute, covering a wide ambit of specific areas of labour and employment law.

- Factories Act, 1948
- Employees’ State Insurance Act, 1948
- Minimum Wages Act, 1948
- Workmen's Compensation Act, 1923
- Industrial Disputes Act, 1947
- Payment of Wages Act, 1936
- Payment of Bonus Act, 1965
- Maternity Benefit Act, 1961
- Fatal Accidents Act, 1955
- Industries (Development and Regulation) Act, 1951
- The Employees' Provident Funds and Miscellaneous Provisions Act, 1952
- The Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948
- The Seamen's Provident Fund Act, 1966
- The Public Provident Fund Act, 1968
- The Mines Act, 1952

An HR manager dealing with employment, social security & labour issues across any industry segment should have knowledge about the issues relating to labour, social security and employment and thus encompass the following:

- Consultancy knowledge for both Public and Private Sector
- Vetting, drafting Labour and Employment Agreements
- Registration of business set-ups under labour enactments like the Shops and Establishments Acts in various states of India
- Professional assistance in regulatory compliance under various labour, employment, industrial and social security laws
- Labour, Social Security & Employment Due Diligence & Verification Exercises
- Interacting with Regulatory Offices/Authorities
- Professional Assistance in obtaining Regulatory Licences and statutory approvals from concerned Labour Authorities
- Consultancy services on necessary regulatory requirements for recruitment for employment outside India and immigration laws
- Drafting, vetting social security Treaties/Agreements like Totalization Agreements

He should have the experience of working on various labour, employment and social security related issues for a wide range of multinational companies/organizations. He should acquire substantial experience with employment documentation, workforce hiring contracts, labour & employment dispute resolution, disciplinary matters, dismissal and redundancy procedures, Transfer of Undertakings, Protection of Employment (TUPE), compliance and statutory requirements, labour Tribunal claims etc.

9.8 LESSON END ACTIVITY

Write a study note on the social security laws relating to workmen's compensation, in India.

9.9 KEYWORDS

Workmens' Compensation Act, 1923: It is India's first social security legislation and it was passed in 1923.

Employees' State Insurance Act, 1948: This is a pioneering attempt to provide medical facilities and unemployment insurance during illness to industrial workers.

Sickness and extended sickness benefit: For sickness occurring during any benefit period, an insured person is entitled to receive sickness cash benefits at the standard benefits are subject to contributory conditions.

Maternity benefit: An insured woman is entitled to maternity benefit at double the standard benefit rate. This is practically equal to full wages for a period of 12 weeks.

Disablement benefit: If a member of the scheme suffers an injury in the course of his employment, he will receive free medical treatment and temporary disablement benefit in cash.

Dependents' benefits: This provides timely help to the eligible dependents of an insured person who dies as a result of an accident or an occupational disease arising out of and in the course of employment.

Funeral benefit: This benefit was introduced in 1968. An amount of not exceeding Rs. 100 is payable as funeral benefit to the eldest surviving member of the family of the deceased insured person.

Medical benefit: The major attraction of the ESI scheme is medical benefit. Medical benefit has been divided into three parts:

Restricted medical care: It consists of out-patient medical care at dispensaries or panel clinics.

Expanded medical care: This consists of consultation with specialists and supply of special medicines and drugs as may be prescribed by them.

Full medical care: Hospitalization facilities, services of specialists and drugs and diet as are required for in-patients are available under this scheme.

9.10 QUESTIONS FOR DISCUSSION

1. Discuss the provisions of various laws relating to workmen's compensation in India.
2. What do you mean by social security laws?
3. Define Employees State Insurance and provisions of this statute.
4. Write a note on the Provident Fund and the related legislation in India.
5. Discuss various provisions of the Gratuity and Maternity Relief.

Check Your Progress: Model Answers

CYP 1

Social Security: The concept of social security is essentially related to the high ideals of human dignity and social justice. It is in away, one of the pillars of the Welfare State. Social security measures have introduced an element of stability and protection in the midst of the stress and strains of modern life.

CYP 2

Maternity Benefit under ESI: An insured woman is entitled to maternity benefit at double the standard benefit rate. This is practically equal to full wages for a period of 12 weeks.

CYP 3

1. True
2. True
3. True
4. True
5. True

9.11 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

R.S. Dwivedi, *Managing Human Resource and P.M. in Indian Enterprise*, Galgotia Publishing Company, New Delhi.

Wayne Cascio, *Managing Human Resource*, Tata McGraw Hill, New Delhi.

Memoria and Gankar, *Personnel Management*, Himalaya Publication

S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

Aswathappa, *Human Resource Management and Personnel Management*, Tata McGraw Hill, New Delhi.

LESSON 10

WAGES AND BONUS LAWS

CONTENTS

10.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the theories related to wage and bonus laws in India
- Know about various provisions of the law of minimum wages
- Speak about the provisions relating to the payment of wages
- Discuss different provision of the payment of bonus
- Learn about the objectives and scope of these laws
- Understand the Equal Remuneration Act
- Know about the working of different Institutions related to Reward system like Wage Boards, Pay Commissions
- Analyze the impact of the fifth pay scale on Central and State Government

10.1 INTRODUCTION

The conception of minimum wages is based on the principles of equity and social justice. Its underlying idea is that "he who works is entitled to a fair remuneration which may enable him to live a life consistent with human dignity". Wages are not an economic abstraction but an important price in society. Economically speaking, wages may be the price of labour, just as interest is the price of capital and profit, the price of risk carrying but from social point of view they are unique in that they not only constitute payment for this effort but also provide the means of subsistence for those who supply the effort.

Problems of minimum wages: The problem of minimum wages is not as simple as it appears to be on the face of it. It really consists of so many problems. The first of these problems is to know what minimum wage implies. Should it be subsistence wage which may enable a worker to stay alive and maintain his working capacity or should it be a living wage which may also provide for the maintenance of health and efficiency, a measure of frugal comfort and some insurance against the more important misfortunes, or should it be a fair wage somewhere between the levels of subsistence and living wage, as permitted by country's economy. In considering these questions, one can hardly overlook the fact that minimum wage is essentially a relative term and may mean differently in different countries according to their state of social and economic development. Again, it will also have to be considered whether there should be adopted a national system of minimum wages providing for a uniform wage for all covered workers subject only to regional variations, or a sectoral system of fixing different minimum wage rates for different sectors or industries, or a combination of both these systems.

After these questions are settled, another problem that will require serious consideration is as to what methods and machinery should be used for fixing minimum wages. The Government can use both direct and indirect methods. The indirect methods may take the form of extending existing collective agreements to third parties, and regulation of wages in public employment and public contracts by inserting fair wage clause in all public contracts. The direct methods may take the form of fixation of minimum wages by statute or by order, regulation or decree of the Government without any consultation with the interests concerned; or fixing minimum wages on the recommendations of wage boards and wage councils on which the workers and employers may be equally represented; or by the award of arbitration or industrial courts. In case wage boards or wage councils are to be set up, it will have to be decided what should be their composition, functions and powers.

Another important question that will have to be considered is whether the minimum wage fixing machinery should be required to follow any criteria in determining and recommending minimum wages. Criteria which are generally followed for minimum wage fixing are the needs of workers, capacity of the industry or employment to pay, wages paid for comparable work elsewhere in the economy, standards of living of other social groups and requirements of economic development. All these factors are too important to be overlooked by any minimum wage fixing machinery. It is their consideration in a coordinated manner that may help to work out an acceptable minimum wage. Minimum wage fixers will have to see that minimum wages determined by them are neither too high nor too low, as that will not serve the cause of economic growth. They will have to exercise their judgement on this question by weighing the gains to workers who will benefit from higher wages against the various kinds of costs which higher wages may impose on the industry and the economy on the whole. They will also have to bear in mind the fact that raising of minimum wages is more likely to benefit the workers, and will also avoid serious economic dislocation, if it proceeds rather gradually and experimentally, probing to see how far wages can be raised without adverse repercussion on markets and employment, and giving employers time to absorb the effects of higher wage costs through higher productivity, than if large increases in minimum wages are imposed suddenly.

Another important point closely connected with the minimum wage fixing machinery is whether it should be statutory or backed by any law, and if so, what should be the type of legislation or regulations that the Government may enact.

The last but not the least important problem is that of the administration and implementation of minimum wage regulation and enforcement of minimum rates of wages that might be fixed. Mere enactment of minimum wage legislation and fixation of statutory minimum wages will hardly serve any purpose unless they are implemented and enforced effectively. The need for strict enforcement is still greater in the case of minimum wage laws as these are largely applicable to small sweated employments and have works, which present problems of their own. The difficulties of enforcement are greater in the case of such establishments as generally they do not maintain any record or accounts. It is to these establishments that much attention has to be paid. Their employers will have to be trained and made to keep proper records.

10.1.1 Minimum Wages and ILO

The need for regulating minimum wages has been gaining increasing attention not only of the governments of developing and developed countries but also of the International Labour Organisation (ILO) at Geneva, which is formulating International Labour Standards for its member countries since its very inception after the First World War. The ILO attached much importance to the question of fixing minimum wages as far back as 1921, and the result of its enquiry led to the adoption of a Convention No. 20 and a Recommendation No. 30 on Minimum Wage Fixing Machinery, 1928, covering only non-agriculture sector of employments. After 23 years, that is, 1951 the ILO Conference at its 34th Session adopted a Minimum Wage Fixing Convention No. 99 and a recommendation No. 83 for agricultural employments. Since then, a number of conventions and recommendations have been adopted, having important bearings on the question of minimum wages.

Government of India

The Committee on Fair Wages (1948) and the 15th session of the Indian Labour Conference (1957) propounded certain wage concepts such as minimum wage, living wage, fair wage and the need-based minimum wage. The Committee on Fair Wages defined the first three (distinct) levels of wages while the need-based minimum wage was defined by the 15th session of the Indian Labour Conference. These concepts are considered here.

Minimum wage: A minimum wage must provide not merely for the bare sustenance of life but for the preservation of the efficiency of the worker by providing some measure of education, medical requirements and amenities.

Need-based Minimum wage: The minimum wage should be need-based as following: (i) The standard working-class family should be taken to consist of three consumption units for one earner; the earnings of women, children and adolescents should be disregarded; (ii) minimum food requirements should be calculated on the basis of a net intake of 2,7000 calories, as recommended by Dr. Aykroyd, for an average Indian adult of moderate activity; (iii) clothing requirements should be estimated at a per capita consumption of 18 yards per annum which would give for the average worker's family of four, a total of 72 yards; (iv) in respect of housing, the norm should be the minimum rent charged by the government in any area for houses provided under the subsidized Industrial Housing Scheme for low-income groups; and, (v) fuel, lighting and other miscellaneous items of expenditure should constitute 20% of the total minimum wage. The Minimum Wages Act, 1948, did not define the minimum wage. Courts and employers go by the definition given by the Committee on Fair Wages while trade unions would like to consider the need-based minimum wage concept.

The Pay Commissions appointed by the Government of India to consider the question of revision of wages/salaries of Central Government employees did not accept the need-based minimum wage formula because of budgetary implications, unemployment and low wage levels in agriculture, etc. The Third and the Fourth Pay Commissions conceded, directly or otherwise, that except in large organized private and public sector enterprises the actual wage levels fall short of the need-based minimum wage as per the formula recommended by the 15th Indian Labour Conference.

Fair Wage: For fair wage lower limit is the minimum wage; and the upper limit is set by the capacity of the industry to pay.

Between the two, actual wage will depend on the following factors:

- Productivity of labour.
- Prevailing rates of wages in the same or similar occupations in the same or neighbouring localities.
- Place of industry in the economy.
- National income and its distribution.

Living Wage: It represents a standard of living which is provided not merely for a bare physical sustenance but decency, protection against ill-health, requirements of essential social needs and some insurance against the more important misfortunes including old age.

Broadly accepted definition of living wage is contained in Universal Declaration of Human Rights, which states –

"Everyone who works has the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity, and supplemented, if necessary, by other means of social protection."

This definition, however, does not provide factors which workers can utilize to bargain with their employer. More specifically –

"A living wage enables workers to meet their needs for nutritious food and clean water, shelter, clothes, education, health care and transport, as well as allowing for a discretionary income. It should be enough to provide for the basic needs of workers and their families, to allow them to participate fully in society and live with dignity. It should take into account the cost of living, social security benefits and the relative standards of other groups."

The moral imperative on employers to pay workers a living wage has long been acknowledged by the world community. Workers must not only be able to meet their basic needs but to steadily improve their living conditions. All human beings have certain economic rights: to food, shelter, medicine, education. Thus the primary justification for a living wage should be to allow workers to meet their basic needs and improve their standards of living as a moral and economic right.

In India, the Committee on Fair Wage set up in 1948 to provides guidelines for wage structures in the country. The report of this Committee was a major landmark in the history of formulation of wage policy in India. Besides setting out guidelines for wage fixation the Committee on Fair Wages defined three different levels of wages viz; living wage, fair wage and minimum wage.

The Committee felt that living wage should enable the worker to provide for himself and his family not merely the basic essentials of food, clothing and shelter but a measure of frugal comfort including education for children, protection against ill health, requirements of essential social needs and a measure of insurance against more important misfortunes including old age. The concept of a living wage is based on the principle that anyone who works full-time should be able to support a family above the poverty line.

Further more, the Directive Principles of State Policy in the Constitution have specifically referred to 'living wages' in Article 43 which reads as under:

"The State shall endeavour to secure, by suitable legislation or economic organisation or in any other way, to all workers, agricultural, industrial or otherwise, work, a living wage, a condition of work ensuring a decent standard of life and full employment of leisure and social and cultural opportunities and, in particular, the state shall endeavour to promote cottage industries on an individual or co-operative basis in rural area."

The concept of living wages is finding increasing support across various USA states. In the context of Americans, the Living Wage is a concept that measures the level of income required for a family of four to live independent of monthly public assistance, food stamps, child care subsidies, and rent subsidies. It's a measure of self-sufficiency.

More than two dozen USA cities have already implemented the living wage ordinance while dozen more are debating such a proposal. Living-wage ordinances provide for varying pay rates. These pay levels are typically set at a rate needed for a full-time, year-round worker in those localities to earn enough to bring a family of four out of poverty. In USA, the calculation of living wages would include seven components, which are as follows:

1. Housing & Utilities
2. Child Care
3. Food
4. Transportation
5. Medical Care
6. Clothing and Personal Care
7. Taxes

While it provides for basic self-sufficiency it leaves out a lot. It does not include any funds for entertainment. Also, it excludes money for tobacco and alcohol consumption.

The concept is a dynamic one and each society tries to meet the requirements of living wage. The requirements vary from economy to economy. In a developed economy, the requirements of living wages are higher than those of developing economies. In India also, we have enshrined this concept in the Directive Principles of State Policies of our Constitution and try to achieve it as our economy progresses.

Some other related concepts:

(i) ***Nominal/Money Wage:*** The earnings in cash or its equivalence.

(ii) ***Real Wage:*** Money wages discounted by the cost of living index to denote the purchasing power of the wages.

Since the Second World War the gap between nominal wages and real wage has started declining. Where the rate of neutralization for rise in cost of living is less than 100%, the real wages tend to decline. A steep decline usually leads to industrial unrest, particularly when the affected workers are unionized.

(iii) ***National Minimum Wage:*** A uniform minimum wage for the country as a whole. The National Commission Labour (1969) and the Study Group on Wages, Incomes and Prices (1978) considered among other things, the question of a national minimum wage. The former found it neither feasible nor desirable while the latter recommended but it was not endorsed by the Government. It is generally recognized that fixation of minimum wage by the State may be impracticable and also not in the interest of the workers.

From time to time, there have been demands for a national wage policy. However, the efforts in this direction did not bear fruits because it usually meant some regulation and without a check on prices and incomes it was considered infeasible to check wages.

10.1.2 Five Year Plans and Wage Policy

The First Plan (1951 to 1956) suggested that pre-war levels of real wages should be restored as a first step towards "living wage" through increased productivity. It further suggested various measures for making wage adjustments. These measures included: reduction of disparities in income, reduction of gap between the existing and living wages, standardization and maintenance of wage differentials to provide incentives.

The Second Plan (1956 to 1961) stressed improvement in wages through increased productivity stemming from efficiency on the part of the workers, improved layout of plants and improvement in management practices. It suggested a wide application of the system of payment by results with due safeguards such as protection against fatigue and undue speed-up. Specifically, the plan recommended settlement of industry-wise wage disputes through tripartite wage boards. Significant development during this period relates to the recommendation of the fifteenth Indian Labour Conference with respect to the need-based minimum wage. Another major development was the report of the Second Pay Commission for Central Government employees. The concept of need-based minimum wage generated public controversy.

The Third Plan (1961 to 1966) reinforced the wage policy of the preceding two plans with respect to minimum wage fixation, reduction of disparities and wage differentials and stressed the role of productivity in raising the living standard of the workers.

The Fourth Plan (1969 to 1974) did not provide a fresh direction or any shift of the government's wage policy.

The Fifth Plan (1974 to 1979) recommended that the reward structure of the industrial employees in terms of wage and non-wage benefits must be related to performance records in industrial enterprises. The plan suggested that it was necessary to build over a period of time a national wage structure to narrow down disparities within the organized sector itself, including both public and private sectors. Committee on Wage Policy released its report at the end of 1975. The report relates to the problems of wage policy in the organized sector of the economy including the government sector. The committee felt that the objectives of a wage policy cannot be accomplished if wage fixation is left to the forces in the labour market. According to the committee, the objectives of wage policy include provision of minimum wages not below the poverty line to ensure health and efficiency of workers, distribution of due share in the fruits of growth, rationalization of wage differentials and minimization of disparities, removal of unjustified wage differentials between the organized and the unorganized sector, provision of compensation for health and life hazards and other disadvantages, provision of compensation for rising cost of living, provision of incentives for productivity and skills, reduction of wage disputes, removal of malpractices in wage payments, etc.

The Sixth Plan (1980 to 1985) pointed out that there were marked disparities with respect to wages between the organized and unorganized, and urban and rural sectors. Specifically, it observed that wage levels in the organized sector varied not only between regions and industries but even among units in the same industry. These levels were related neither to the nature of occupations nor to the level of skills. The anomalies and disparities have resulted in social tensions and industrial unrest. Therefore, the plan stressed the need for bringing about a greater rationalization of wage structure and linking of wages at least in some measure to labour productivity. The plan also realized an urgent need to generate a climate conducive to modernization in industry, and adoption of new techniques which help increase in productivity without being detrimental to employment.

The Seventh Plan (1985 to 1990) asserted that an important aspect of labour policy related to the formulation of an appropriate wage policy. The basic objectives of the wage policy as visualized by the plan were a rise in the levels of real income in consonance with increases in productivity, promotion and productive employment improvement in skills, sectoral shifts in the desired directions and reduction in disparities.

The Eighth Plan (1992 to 1997) laid focus on formulation of wage policy relating to child labour, bonded labour, rural labour, women labour and inter-state migrant labour.

The new wage policy for public enterprise should generate their own resources to meet wage revision and enhanced liabilities. Justice Mohan Committee's Report reviewed the wage structure of PSUs and has given an entirely different angle.

Check Your Progress 1

1. Define minimum wage.

   ....

   ....

2. What do you understand by living wage?

   ....

   ....

10.2 LAW OF MINIMUM WAGES

Minimum Wages Act, 1948: This Act requires the appropriate government, Central or State, as the case may be, to fix minimum rates of wages payable to employees in any employment specified in Part I or Part II of the Schedules appended to the Act and any employment subsequently added to either part of the Schedule.

Act does not define minimum wages: The definition given by the Fair Wages Committee, 1948 is considered for legal interpretation. The appropriate government notifies the industries/trades covered by the Act, set up a tripartite machinery (including representatives of employers, unions and government) to prescribe rates for different classes/categories/trades/employments/localities/adults, adolescents, children and apprentices. The minimum wages can be fixed by hour, day, month or such other large period.

The Act symbolizes the fulfillment of 1928 ILO convention on the subject. Courts held that minimum wages be paid irrespective of the employer's capacity to pay.

The real purpose of the Act is to prevent exploitation of labour through the payment of unduly low wages. However, the minimum wages prescribed does not enable the person to come even up to the poverty level, officially determined from time to time. Even so, the employers grouse that often the wage rates bear little relation to the rule of the market and the law of demand and supply. There is widespread criticism about several inadequacies in the implementation of the legislation.

10.3 PAYMENT OF WAGES

The legal framework for the payment of wages/salaries is governed mainly by four legislations besides the guidelines for managerial remuneration. These are briefly discussed here.

Payment of Wages Act, 1936: The main purpose of the Act is to ensure regular and prompt payment of wages and to prevent the exploitation of the wage earner by prohibiting arbitrary fines and deductions from his wages. It also stipulates the rate of payment for overtime work and penal deductions for participation in illegal strikes (eight days' wages can be deduced for one day's participation in illegal strike). The Act is applicable to all those who are employed in factories/establishments declared as factories under Section 85 of the Factories Act, 1948, etc. and drawing less that Rs. 1,600 per month.

10.4 PAYMENT OF BONUS

Payment of Bonus Act, 1965: The main purpose of the Act is to provide for the payment of bonus to persons employed in certain establishments and or matters connected therewith. The Act extends to all factories as defined in Section 2(m) of the Factories Act, 1948 and to all other establishments in which 20 or more persons are employed on any day during an accounting year.

The Act provides for a minimum (81/3% of pay) and maximum (20% of pay) bonus and for negotiations on bonus. The minimum bonus is payable, subject to certain exemptions specified in the Act, irrespective of profit/loss.

The Act is supposed to reduce industrial conflict on account of bonus but this objective has not generally been achieved in most years since 1965.

Check Your Progress 2

What is the main purpose of:

1. The payment of Wages Act, 1936?

   ....

   ....

2. Payments of Bonus Act, 1965.

   ....

   ....

10.5 OBJECTIVES AND SCOPE OF THESE LAWS

The regulation of managerial remuneration is a special feature of company law in India. Section 198 of the Companies Act provides for an overall ceiling of 11% of the net profits as the maximum managerial remuneration that can be paid by a company in any financial year. Within the ceiling there are sub-ceilings as per Section 309, on remuneration payable to managing direction or wholetime director (up to 5% of profits if one, and 10% if more than one managing director and/or wholetime directors). Ceilings are prescribed for directors etc. under different situations. Section 637AA inserted by the Companies (Amendment) Act, 1974, further empowered the Central Government to adopt administrative guidelines and ceilings within statutory limits in respect of salary, commission and perquisites.

A comparative statement of these ceilings from 1969 to date is shown in Table 10.1. It is seen that the remuneration (particularly pay and commission) was steeply reduced during 1978-83, and considerably stepped up since 1987.

Several arguments have been made in support of the regulation of managerial remuneration. Some of these include the following:

(i) The per capita income is low and a large proportion of India's population has remained poor over time.

(ii) High salaries encourage conspicuous consumption which have undesirable socio-economic effects.

(iii) The public policy seeks to reduce income disparities. Several committees noted that the differences in chief executive's remuneration between public sector (including nationalized banks) and private sector is 1:3 and between civil servants and private sector chiefs is 1:4.

(iv) Safeguard the interest of consumers and public, including minority shareholders; and

(v) Avoid unfair competition in managerial remuneration to attract talent which may have undesirable impact on the social welfare sectors of the economy.

The 1969 guidelines were challenged before the Gujarat High Court in Citibank's case. The High Court held that the guidelines were illegal and ultra vires the statutory provisions. The 1978 guidelines, as modified in 1979 were also struck down by the Delhi High Court in case of M/s. Mahindra & Mahindra Co. Ltd. vs. Union of India. On an appeal filed by the Government, the Supreme Court granted interim stay and liberty to the Central Government to operate these guidelines only in respect of those companies, which consent to the fixation of remuneration as per these guidelines and to keep in abeyance proposals of those who object to such fixation. The same ruling holds good for 1983 and 1987 guidelines also. Whatever be the rationale and extent of regulation, in actual practice ironically it appears that there is no statutory limit for managerial remuneration. If companies are willing to bear the tax on the disallowed portion of the pay, it is not necessary to have any government approval, unless the executive desires a seat on the board of directors. A change in designation from Director to Vice-President was enough to come out of statutory restrains on remuneration. In the process, however, company boards may be deprived of professionals. The fact that the remuneration of the chief executives in public sector continues to be only a third of that of their counterparts in private sector has implications for flow of talent from one sector to another, though at that level, remuneration alone may not be the driving force.

Table 10.1: Ceilings on Managerial Remuneration

	Prior to 1969 Rs.	1969-78 Rs.	1978-83 Rs.	1983-87 Rs.	1987 Rs
Salary	1,80,000	90,000	60,000	90,000	1,80,000
Commission		45,000	12,000	45,000	90,000
Perks		30,000	60,000	88,000	1,35,000
	1,80,000 + Perks	1,65,000	1,32,000	2,23,000	4,05,000

10.5.1 Institutional Mechanism for Wage Determination

Public policy and legislative framework provides the basis for wage determination. Within the framework of public policy and legislative framework, wages are determined through one or more of the following methods: (a) unilaterally by employers, (b) through collective bargaining between employer (or employers association in an industry or industry-cum-region) and union (or federation of unions in a sector or sector-cum-region), and (c) Pay Commissions for civil service, (d) wage boards for select industries, and (e) adjudication by a third party where wage disputes remain unsolved through negotiation and conciliation.

10.5.2 Unilateral Pay Fixation

In India, 92 per cent of the labour force is unorganised. Though a significant portion of the unorganised labour force is covered by minimum wage legislation, given the high unemployment and underemployment there are little incentives for employers to comply with the legislation (for every person who does not work below the minimum wage, there could be many more who are willing to work for less than the minimum wage) and many practical difficulties in effective enforcement. It is not only anecdotal accounts by workers and trade union activists, but also field study reports by researchers, both Indian and foreign, which confirm the problems with actual implementation of minimum wage legislation. Majority of the unorganised sector workforce is not unionised and hence, the possibility for determining wages and working conditions through collective bargaining is virtually ruled out. In a few cases, collective bargaining in the unorganised and sick industries in the private sector has actually led to agreeing for less than the benefits and protection afforded by legislation.

Given the above scenario, in respect of a vast majority of the workforce in the unorganized sector wages are unilaterally determined. This often results in not only workers getting less than the minimum wages and benefits stipulated under law, but also discrimination in wages and benefits between one (set of) workers, and another. In a large number of private sector establishments, for the non-unionised supervisors and executives wages are unilaterally determined by their employers. In this case, however, usually employers tend to base the salary levels at or around, if not above, the market rates in view of the difficulties in attracting, retaining and motivating skilled and experienced personnel.

Unilateral wage fixation by employer can be unfair to the individual employees because the latter will have lesser bargaining power vis-a-vis their employers, often tend to encourage arbitrariness and raise questions about fairness and equity.

10.5.3 Collective Bargaining

Collective bargaining is a process whereby standards are created to govern labour relations – including, particularly, wages and working conditions. ILO Conventions No. 87 and 98 establish the right of workers to organise and bargain collectively. In India, union density is about 6 per cent of the labour force in the country. Of them nearly two thirds are in government and quasi-governmental organisations, including defence and are covered by collective bargaining.

Trade Union Act does not provide for statutory recognition of collective bargaining (though some state government legislations provide for it) and legislation puts a premium on adjudication rather than collective bargaining. Refusal to bargain collectively, in good faith, with recognized trade unions is, however, made an “unfair labour practice” under section 2(ra)/Schedule V of the Industrial Disputes Act and is punishable under section 25(u) with imprisonment for a term which may extend to six months or with fine which may extend to Rs. 1000 or with both.

10.5.4 Levels of Bargaining

Sectoral Bargaining at National Level: Prior to 1970s wage boards appointed by government were given awards on wages and working conditions. The number of wage boards had declined from 19 in the later 1960s to one (for journalists) in late 1990s. Since early 1970s sectoral bargaining is occurring at national level mainly in industries where the government is a dominant player. These include banks and coal (approximately 8,00,000 workers each), steel, ports and docks (2,50,000 workers each). 58 private/public/ multinational banks are members of the Indian Banks Associations. They negotiate long-term settlements with the all-India federations of bank employees. Over 200 coking and non-coking mines were nationalized in the early 1970s. They are spread all over the country, with some owned by state governments and many by the Central Government. There is one national agreement for the entire coal industry. In steel, there is a permanent bipartite committee for the integrated steel mills in the public and the private sectors.

Since 1969, this committee, which is called the National Joint Consultative Committee for Steel (NJCCS) Industry has signed six long-term settlements. The 11 major ports in the country have formed the Indian Ports' Association. They hold negotiations with the industrial federations of major national trade union centres in the country.

A peculiar feature of sectoral bargaining at the national level is the presence of a single employer body and the involvement of concerned administrative ministry from the employer's side. In many sectors, two to five major national centres of trade unions, which have a major presence through respective industry federations of workers' organisations, negotiate. In banks, coal, ports and docks, invariably all agreements were preceded by strikes or strikes threats. Only in the steel industry this did not happen during the past 29 years. Even through industry-wide bargaining is not extended to the oil sector, which was nationalized in the late 1970s, the Oil Coordination Committees accomplish a great deal of standardization in pay and service conditions even if collective bargaining occurs at firm and/or plant (for instance, Hindustan Petroleum Corporation Limited). The agreements in banking and coal covered 8,00,000 workers each while that in steel and ports and docks covered 2,50,000 workers each.

Industry-cum-Region-wide Agreements: These are common in cotton/jute textiles, engineering and tea, which are dominated by the private sector. But such agreements are not binding on enterprise managements in the respective industries/regions unless they authorize the respective employer associations in writing, to bargain on their behalf. The employment in the four regional agreements in textile, jute and plantations was around 1,200,000, 3,00,000 and 2,50,000 respectively.

Decentralised Firm/Plant Level Agreements: In the rest of the private sector while employers generally press for decentralisation at plant level, unions insist on bargaining at least at the company level where the employees are formed into federations (combining several plants/locations). In 1998 there was a 39-day strike in Escorts, a private sector automobile and engineering conglomerate with over 14 factories and 35,000 workers, in an industrial centre close to New Delhi on this issue of decentralised bargaining. It does not mean, however, that employers in multi-unit private sector enterprise do not bargain with trade union federations at company level. One example relates to Brooke-Bond till it was merged with Lipton and became a part of Hindustan Lever in one of the recent mega mergers in the country. Plant level bargaining is believed to reduce the bargaining power of unions, particularly during periods of crisis. In juxtaposition, there is a general tendency on the part of particularly the unions and the government to think of public sector as a whole. With the result, uniformity is sought at the highest level and the concept of capacity to pay is altogether ignored in public sector wage negotiations. If a public enterprise's coffers are empty, the exchequer used to raise the money. There is a no corresponding tendency, even among the trade unions to consider the private sector as a whole, and capacity to pay continues to be reckoned for the purpose of wage negotiations in the private sector.

Duration: Till the 1970s, the collective agreements were for a period of two to three years. During the 70s and the 80s, the duration of agreements increased to three to four years. During the 1990s, over four-fifths of the central public sector agreements' were signed for a duration of five years each. For the sixth round of Wage negotiations due from 1.1.1997, but serious negotiations, are still to commence even at the beginning of the year 2000, the government's proposal to extend wage agreements for 10 years is meeting with stiff resistance from the unions and sympathetic consideration from the Group of Ministers appointed for the purpose. Collective agreements in most private sector agreements continue to be valid for a period of three or in some rare cases four years.

Emerging Trends: Till the 1970s, collective bargaining meant two things: As far as possible, considering the adversarial relationship in most situations, the attitude of both the managements and the trade unions has been to bar the gain to the other party. A second trend during the period was for the workers unions to serve charter of demands on the managements. Managements used to bargain that it is not possible to give so much. After some negotiations, agreements were reached and workers used to collect some additional benefits. It were the managements, reluctantly giving in and workers collecting. In the 1980s, managements began to serve counter-proposals before or after they receive charter of demands from the trade unions. The idea was to give and take in the name of 'productivity bargaining.' Trade unions used to agree to give up restrictive and wasteful practices in return for higher wage and benefits. In some cases there were general (honeymoon promises which say something without meaning much) or specific, actionable clauses. Since the late 1990s, the scope was widened to cover assertion of managerial rights to concession bargaining in crisis. Over all, in the public sector, however, the trend is, "something (to workers) for nothing (to management)" while in the private sector the usual pattern has been "Something (to workers) in return for anything (for managements)". The emerging trend, particularly in the private sector is something akin to what Ian McGregor of British Steel averred during Thatcher's era in the UK: Something for something, nothing for nothing. Overall, the difficult conditions in product markets and near recessionary and/or jobless growth situation in several crucial sectors of the economy collective bargaining is barring the gains to the workers.

Even in cases where they seem to gain significantly higher wage increases, it is as Ramaswamy and Holmstorm observe, management's way of meeting union's head on reducing complex issues of rights and career prospects and industrial relations to a straight bargain between two corporate groups. The managements get control over work allocation, and the unions get more money for their members. Managements emphasize that manning standards are fixed not arbitrarily but 'scientifically', by Taylorist industrial engineers; an argument that middle-class union leaders can accept. The company and the union become mirror images of each other – hierarchically structured, under hardheaded leaders who believe they are competent to take decisions on behalf of the "less qualified people below them" (Holmstorm, 1990; 7-8; Also see: Ramaswamy, 1990,160-173).

Very few empirical studies looked at the trends in collective agreements over the past half a century. Two surveys undertaken by the Employers' Federation of India during 1956-60 and 1961-69 revealed that: (a) during 1956-60 one-third to one-half of the industrial disputes in large firms were settled through collective bargaining. The second survey covering 111 agreements during 1961-69 revealed that over fifty per cent of the agreements were for periods ranging from three to five years. Wages is the dominant issue in almost all agreements. Nearly 50 per cent of the agreements during the 1960s dealt with retirement benefits. There was no evidence, at that time of management proposals or managerial rights. This is a post mid-1980s phenomenon as studies of 60 and 200 firms respectively by Venkata Ratnam (1990 and 1997b).

The sad reality is that: (a) workers can decide which union can represent them without ever belonging to a union; (b) workers can enjoy the benefits of collective bargaining as 'free riders' without joining union/paying union dues; (c) unions can have collective bargaining rights without the support of the rank and file; (d) even where it is mandatory to bargain with managements, it is possible to strike deals with minority unions; and (e) through collective bargaining, workers' interests can be divided further by offering more to the shrinking 'core' workers who do less and leaving less to the growing workers in the unorganized 'peripheries' who do more.

Check Your Progress 3

1. Mention the institutional mechanism for wage determination.

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2. Define collective bargaining.

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10.6 EQUAL REMUNERATION ACT

Equal Remuneration Act, 1976: The main object of this Act is to provide for the payment of equal remuneration to men and women workers engaged in same or similar work. The Act stipulates stringent punishments for contravention of the provisions of the Act.

10.6.1 Part I: A Critical Evaluation of the Relevance of the Act

The Equal Remuneration Act in India was enacted to prevent discrimination between workers on grounds of gender. The preamble to the Act describes it as:

An Act to provide for the payment of equal remuneration to men and women workers and for the prevention of discrimination, on the ground of sex, against women in the matter of employment and for matters connected therewith or incidental thereto.

The purpose of the Act is to make sure that employers do not discriminate on the basis of gender, in matters of wage fixing, transfers, training and promotion. It provides for payment of equal remuneration to men and women workers, for same work or work of similar nature and for the prevention of discrimination against women in the matters of employment.

Discrimination is nothing more than the expression of a preference. In this neutral sense, without assessing either the consequences of such behaviour, or the "social justice" aspect, the right to discriminate is a desirable feature of any free society.

Individual Acts of choice may sometimes result in a preference that might exclude or inconvenience a certain group. However, how valid or just is it to make such a choice illegal? Even more significant, how many profit-maximising, and efficiency--enhancing entrepreneurs would make such a choice?

Except in rare circumstance, people's preferences are not absolute, but vary depending on other factors, main among them being the cost, or benefit of making such a choice. Under normal circumstances, the higher the cost (the lower the benefit), the less likely the choice will be made. Discrimination has a price, and the existence of this price will limit the existence of discrimination prevalent in the market.

1. ***Prohibition of discrimination during recruitment***: Section 5 of the Equal Remuneration Act specifically forbids employers from discriminating against women during recruitment. It states:

   On and from the commencement of this Act, no employer shall, while making recruitment for the same work or work of a similar nature, or in any condition of service subsequent to recruitment such as promotions, training or transfer, make any discrimination against women.

In a competitive world such legislation has no bearing at all. All discrimination in the market costs money, and any profit-maximising entrepreneur would realise the costs of discrimination and do his best to remove it. During recruitment, if employers discriminate against women, and refuse to hire them, they are doing this at their own detriment. An employer would only want to hire a woman if she can display herself to be amply able to perform the task at hand. If this is so, by judging applicants on grounds other than efficiency, an employer is hiring those who are potentially less productive, or less suited to the job. Such a policy would definitely cause profits to decrease.

Profit seekers would begin employing women, and as such employment would increase. As demand for women workers increases, their wages also get bid up.

An employer hiring on bases other than an employer's ability to contribute to firm's productivity wouldn't be able to persist since his willingness to operate with discrimination would confer an advantage on his competitors. If all entrepreneurs aren't actively practising discrimination, then one who is doing so is operating under a comparative disadvantage. He must either bear these losses, or change his hiring policy.

Furthermore, during recruitment, in a world of incomplete information, employers must guess at employees' productivity using some proxies, and gender might prove to be a possible proxy. Factors such as maternity leave, inability to work late hours, inability to work night shifts etc. are reflections of the worker's productivity, and would go towards establishing gender as a proxy. Using such proxies economises in information, if employers later find that such proxies are wrong, they will find they are hiring workers with low productivity, and principles of profit maximisation would force them to choose new proxies.

2. ***Prohibition of discrimination during wage fixing:*** The Equal Remuneration Act also seeks to address the issue of payment of unequal wages to men and women. It makes it compulsory for employers to pay women wages equal to those paid to men for performance of the same work. Section 4(1) states:

No employer shall pay to any worker, employed by him in an establishment or employment, remuneration, whether payable in cash or in kind, at rates less favourable than those at which remuneration is paid by him to the workers of the opposite sex in such establishment or employment for performing the same work or work of a similar nature.

This law also has no relevance in a competitive world, where the employer's primary concern is to make a profit. Perhaps, earlier when Indian industry was protected and sheltered, employers could afford to follow such potentially profit reducing policies, and still stay afloat, however, this is no longer the case today.

Productivity is defined in terms of profit statement; employers reward workers proportionate to the amount they add to revenues. When an employer estimates wages, he takes into account the following factors:

1. Intelligence 5 Leadership ability
2. Efficiency 6 Communication Skills
3. Initiative 7 Perseverance
4. Skill 8 Experience

However, an equal pay legislation such as the Equal Remuneration Act in India, seeks to determine wages on the basis of a politically motivating or social justice related factor, in this case, gender. The mutual incompatibility of the two sets of factors is obvious. While the first set might generate an efficient labour force, the second set has absolutely no relation to productivity, and hence cannot work towards an efficient labour force.

If a firm overpays, it would eventually have to close down since it would run out of money. At the same time, if a firm underpays, it is would still not be a profit yielding practise since it would lose employees to competitors. To add to it, it would suffer from over optimal quit-rates, and have to invest additionally in hiring, firing, and other training expenses.

While clearly, the search for profit would cause some entrepreneurs to set aside their taste for discrimination, it is nevertheless true that others would be willing to incur the cost. These employers would then be paying the price of discrimination in the form of decreased profits.

The extent to which the most discriminatory employers can continue this practice would be largely determined by factors beyond their control, namely, by the competitive pressures exerted by other employers. An employer's willingness to operate under the competitive disadvantage of discrimination would confer an advantage on his competitors. So, even if some employers were willing to pay the price of discrimination, failure to respond to the continuous challenge of the market would mean eventual displacement by a more cost-effective firm.

There are several other reasons that cause unequal pay between sexes that are unconnected to any bias or prejudice on the part of the employer, known as non-discriminatory reality. Women may receive different wages because they bear children, and are hence separated from the labour force for a period, which could range between a few months and a few years. Data in Canada and the USA have found a negative correlation between female-male wage-ratios and birth rates.

To add to the problem, the Equal Remuneration Act does employers further injustice by forcing them to obliviate any difference in wages by increasing the wages of the woman. Section 4, sub-sections (2), and (3) state:

(2) No employer shall, for the purpose of complying with the provisions of sub-section (1), reduce the rate of remuneration of any worker.

(3) Where, in an establishment or employment, the rates of remuneration payable before the commencement of this Act for men and women workers for the same work or work of a similar nature are different only on the ground of sex, then the higher (in cases where there are only two rates), or, as the case may be, the highest (in cases where there are more than two rates), of such rates shall be the rate at which remuneration shall be payable, on and from such commencement, to such men and women workers.

Hence, not only must an employer make sure that he pays the workers equal wages, he may not decrease wages to this purpose.

3. ***The injurious nature of the act with respect to entrepreneurs***: Consider the situation in light of the numerous labour laws that make it very difficult to fire any worker. An employer who hires a woman must pay her equal wages as the male worker although, she may prove to be less efficient. Furthermore, he may not decrease the male worker's wages to fulfil this condition. Given that following such a policy might later prove to be harmful and bankrupting to the employer, one might expect him to be reluctant to hire a woman in the first place. However, the law prevents him from doing that too!! In the attempt to protect women workers from

some perceived injustice, the act is exploiting the entrepreneur who is simply trying to run an honest business.

The applicability of the act does not depend upon the financial viability of the employer to pay equal remuneration as provided by it, nor does it take into account the employers' cost constraints. And such an act has overriding effect with respect to implementation. Section 3 of the Act states:

The provisions of this act shall have effect notwithstanding anything inconsistent therewith contained in any other law or in the terms of any award, agreement or contract of service, whether made before or after the commencement of this Act, or in any instrument having effect under any law for the time being in force.

Such an act serves only to create an extremely restrictive and confining atmosphere for entrepreneurs and is in no way encouraging for industry as a whole.

It's redundancy in a liberalised, competitive and free labour market is apparent. Given that India has entered the era of liberalisation and has begun the process of deregulation in other fields, elimination of the act is but a natural, logical, and obvious step.

10.6.2 Part II: A Study into the Enforcement of the Law

Following an understanding of the Equal Remuneration Act, its various clauses, and the implications of having such a law, a study into the actual enforcement of the law would give a clearer picture of the impact of such restrictive legislation. Comprehension of how the act really works might give a more lucid idea of how useful or dispensable the act is:

a. Implementation of the law is not efficient enough. The law enforcement agencies are either inactive, or corrupt.

b. The source of wage discrimination is in the nature of demand and supply of labour. Discrimination against women exists in terms of availability of job opportunities: occupations and organisations where women could find work is very limited compared to those of men. This lack may be result of socio-historical reasons, and not differences in real economic value of contribution of female labour.

Hence to determine the causal factors behind such difference in wages, it would be useful to examine the implementation of the law.

The law is mainly maintained via labour inspectors. Section 9, clauses 3 and 4 lay down their functions as:

Clause (3): An Inspector may, at any place within the local limits of his jurisdiction:

(a) Enter, at any reasonable time, with such assistance, as he thinks fit, any building, factory, premises, or vessel;

(b) Require any employer to produce any register, muster-roll or other documents relating to the employment of workers, and examine such documents;

(c) Take on the spot or otherwise, the evidence of any person for the purpose of ascertaining whether the provisions of this Act are being, or have been, complied with;

(d) Examine the employer, his agent or servant or any other person found in charge of the establishment or any premises connected therewith or any person whom the Inspector has reasonable cause to believe to be, or to have been a worker in the establishment;

(e) Make copies, or take extracts from, any register, or other document maintained in relation to the establishment under this Act.

Clause (4): Any person required by an Inspector to produce any register or other document or to give any information shall comply with such requisition.

To conclude, the enforcement of the Equal Remuneration Act leaves much to be desired. There are numerous stages where the implementation of the act could be and is mishandled. Discrimination in the market could take place through three main devices: discrimination during recruitment of workers, discrimination at the time of giving remuneration, and discrimination while allotting benefits such as pension, provident fund, gratuity, annual increments.

Discrimination in cases where two employees are clearly identified as those performing same work, or work of similar nature, is easy to identify, and perhaps could be checked through frequent and thorough checks by a labour inspector. However, in cases where it occurs at the recruitment stage, or where it is not evident that two workers are performing workers of similar nature, or when the employer discriminates by withholding pension and other benefits, enforcement isn't so elementary and uncomplicated.

If discriminatory tendencies exist in the employers' mind, these can only be eliminated by exposing the factory to competitive forces, following which the employer will no longer find such practices viable if his goal truly is profit maximisation. If, despite competitive pressures, the employer still continues to follow discriminatory practices, it can only be because he is willing to undergo losses caused by his practise; i.e. he is paying the price of discrimination. In this scenario: if the employer is inclined to have lower profits, and follow a restrictive hiring, and wages policy, there can be no decrees or statutes that can effectively prevent him from doing so.

1. ***The Gendarme: labour inspectors***: Labour Departments as mentioned before, are overburdened with work. There are 30 labour laws in India presently, including the Sick Industries Act, and the responsibility of enforcing all of these lies with labour inspectors. These inspectors' activities range from conducting regular checks on factories: where they must take tours of the factories, inspect pay registers, check the facilities, dimensions of the rooms, toilets, and entertain any complaints that may arise. Inspectors must also conduct surprise visits on factories. Furthermore, they are charged with the job of making inquiries into all complaints/ violations, for which they may have to subpoena workers, employers, or documents.

2. ***Scrooge and his cronies: the employers***: As could be guessed, employers are not in favour of the act. An employer feels it is restrictive, and creates unnecessary barriers to his aim of profit maximisation. There has been a lot of talk about laws governing an employers' freedom to hire and fire, and they are all in agreement about the fact that such laws will only reduce the employer's incentive to hire more workers. If an employer knows he will be saddled with a worker once hired, and the wages, benefits, working conditions, leave etc. are all regulated, he would avoid hiring them until he reaches the point where another worker is absolutely inescapable.

   Manmohan Singh, Hon. Prime Minister, has said, " …by denying flexibility in deploying labour, government policies have unwittingly impeded the use of labour in the economy … Measures are therefore urgently needed to reduce the rigidities in the labour force." One can quote B V Talwar, an industrialist and exporter, who has written in an article titled "Special Economic Zones-Chinese Style", " if there is no law that can even persuade, let alone compel an employer to employ even one more worker, even though it can be conclusively proved that his enterprise can well afford such an addition. As against all the labour laws prohibit him, or at least make it extremely difficult to fire even one worker."

In fact, we have the word of a factory manager himself. The Personnel Manager, Pee Embro Exports Limited has said that if laws such as the Equal Remuneration Act did not exist, he would, in all probability, hire more workers in his enterprise.

Hence, all employers are, as can be anticipated not appreciative of the Equal Remuneration Act, and feel that the removal of the act would make running a factory or a business much easier and efficient.

3. ***The Motley crew: the workers***: Lastly, one must of course, consider the views of the worker himself, or in this case, herself, since the female workers are the true `beneficiaries' of the Act.

   Of course, most female workers are in favour of the act, and do view it as the only deliverance from the employers' restrictive and discriminatory tendencies. This attitude is understandable since, if the act works to the benefit of the women workers, it would only be logical for them to support it. However, there is a certain small proportion of female workers who feel that the lower wages that accrue to them are justifiable, and warranted. In any analysis of the utility of the act, it would be very interesting to analyse their motives and reasons for having such an outlook.

   Finally, there are factors that deal with biases and mindsets inherent in Indian society, which cause an employer to follow a restrictive policy. These of course, cannot be justified in economic terms, and seem quite frightening when one looks at the issue from the outlook of justice. However, what one does not understand is that an employer following such policies despite competition in his trade, is doing so at his own cost. The employer is now paying the cost for the sake of his `beliefs' or `biases'. The only way in which it would be possible for an employer to follow policies that are potentially profit reducing: which hamper his running of a business; and still survive would be if he received certain benefits from the government in the form of a subsidy or protection. In this case, the easier solution to the problem is to remove this protection. Once the employer is exposed to market forces, and he can no longer afford to follow policies which put him in danger of having to close down, he will automatically let go of such non-economic techniques and follow an equitable wage policy.

10.7 WORKING OF DIFFERENT INSTITUTIONS RELATED TO REWARD SYSTEM LIKE WAGE BOARDS

The Wage Boards have a long history in the Indian Industrial Relations Systems. As early as 1931 the Royal Commission on Labour recommended the setting up of Wage Boards for determination of wages. It was envisaged in the First Five Year Plan that permanent Wage Boards with a tripartite composition should be set up in each state and at the Centre to deal comprehensively with all aspects regarding the question of wages. The above recommendation, however, did not receive adequate attention and the wage disputes continued to be settled through Industrial Tribunals. The Second Plan also considered the Wage Board to be a more acceptable machinery as it gives the parties a more responsible role in reaching decisions.

The Fair Wages Committee, the real authors of the Wage Board Scheme, said that fair wages should be fixed on an industry-cum-region basis. But the Government has consistently set up single industry-wide Wage Boards throughout the country.

The first Wage Board to be set up by the Government was in 1957 in the cotton textile industry. Since then more and more industries have been brought within the scope of Wage Boards. The Wage Boards were set up: to provide better climate for industrial relations; to represent consumers/public interests; to standardize wage structure throughout the industry concerned; and to align the wage settlements with the social and economic policies of the Government.

Constitution of Wage Boards: Wage Board is tripartite in nature, which consists of a chairperson, an equal number of representatives of employers and employees (two members each), and two other independent members (an economist and a consumer's representative) nominated to the Board. The chairman shall be appointed by the appropriate Government in consultation with the Chief Justice of the High Court concerned or Supreme Court of India, as the case may be. Any person who is or has been or is eligible to be appointee as a Judge of the High Court shall be qualified for appointment as the Chairman. It has been the practice to nominate a Member of the Parliament to represent the interests of the consumer/public.

The members representing the employers shall be appointed by the appropriate Government on the recommendation of the most representative organisations of the employers in the activity. The members representing the employees shall be appointed by the appropriate Government on the recommendation of the most representative organisations of the employees in the activity.

Functions of the Wage Board: The primary function of the Wage Board shall be to determine the wages payable to the employees of the activity. The appropriate Government or the recognised organisations of employers and employees, by mutual agreement, may refer to the Wage Board any other matter for determination.

Procedure of the Wage Board: The Wage Board shall follow such procedure as may be prescribed; provided that, wherever the appropriate government has not prescribed any procedure, the Wage Board may evolve its own procedure.

Criteria for Award of the Wage Board: In evolving a wage structure, a Wage Board is required to take into consideration the needs of the industry, the system of payment by results, prevalent rates of wages for comparable employments, the categories of workers to be covered, capacity to pay, level of employment and other relevant factors including public interest in making its award. Wage Boards may have been assigned additional tasks such as consideration of the grant of bonus and framing of gratuity schemes.

Award of the Wage Board: The award of the Wage Board: (a) Shall be based on the majority opinion and shall be in writing and signed by the members including the chairman. (b) Shall be final and shall not be called in question by any court in any manner whatsoever but an appeal may be filed against the award before the National Labour Relations Commission. (c) Shall come into force with effect from such date as may be specified therein and if no date is specified it shall come into force on and from the date on which it is signed. (d) Shall be binding on all persons who were employed in the activity on the date on which it is signed and all persons who subsequently become employed therein and all their employees including the heirs or successors and assigns of the employers. (e) Shall remain in operation for a period of three years and it may be extended for such further period as may be decided by mutual agreement between the parties.

Enforcement of the Award: After the award of the Wage Board comes into force, every employee of the activity shall be entitled to be paid wages in terms of the award and every employer of the activity shall be able to pay wages at rates which shall in no case be less than the rates of the award, provided that if the wages of an employee are higher than the wages due as per the award, he shall be entitled to continue to draw higher wages, at his option.

The Wage Boards are non-statutory, except the one for working journalists. In some states, however, there are statutory wage boards for certain industries. As a rule, the wage boards have been functioning with a flexible approach. Each board collects information by issuing a detailed questionnaire and holds sittings to record the views of the concerned interests. After an assessment of these views, the board makes its recommendations to the Government. The procedures adopted by the boards have evoked sharp criticism. The recommendations of the wage boards are examined by the Government and the unanimous recommendations are accepted by the parties. In a few cases the recommendations have been modified, leading to apprehensions about the government adopting a partisan stand towards employer or employees as the case may be.

The major criticism levelled against the Wage Boards has been that: (1) Single machinery for wage fixation in all types of industries will not be suitable and therefore depending upon the nature of the industry, wage boards. Collective bargaining or adjudication could be utilised for wage determination. (2) Non-implemented or even unanimous recommendations. (3) The question of linking wages with productivity has not been considered seriously by any of the Wage Boards. (4) Serious procedural delays. Bipartite Committee was set up on the advice of the 27th Session of the Standing Labour Committee to examine the problems of delays in the working of the Wage Boards and securing fuller implementation. One of the suggestions that emerged was, after the constitution of a Wage Board for a particular industry disputes relating to matters before the board, should not be referred to adjudication.

The National Commission of Labour (1969) also recommended: there need be no independent persons on the Wage Board, the chairman should preferably be appointed by the common consent of both employers and employees, the Wage Boards should be required to submit their recommendations within one year of their appointment, the recommendations of a Wage Board should remain in force for a period of five years, unanimous recommendations of the Wage Boards should be made statutorily binding. Central Wage Board Division should be set up on a permanent basis to service all the wage boards.

Wage Boards Recommendations: In pursuance of the recommendations of the Planning Commission, the Wage Board System was introduced in March, 1957 with the appointment of a Wage Board for the Cotton Textile Industry by the Government of India. Since then 30 Wage Boards have so far been set up by the Government of India. As of April 2000, the Fifth Wage Board was set up only for working journalists and other newspaper employees under the Working Journalists and Other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955.

Check Your Progress 4

What are the functions of wage bonds?

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10.8 PAY COMMISSIONS

The pay structure of the Central Government employees is based on the recommendations of Pay Commissions set up by the Central Government. While some state governments also broadly follow the recommendations of the Central Pay Commissions for their employees, also a few other state governments set up their own pay commissions. During the past 50 years, Government of India has set up five pay commissions. The recommendations of the Fifth Pay Commission, which submitted its report in 1997, as accepted by the Government are currently in force. Pay Commissions also cover a wide range of employees in the public sector.

There are significant differences between the methods of settlement of wage disputes available to workers in the private sector and those concerned with the Government employees. The latter are at a disadvantageous position as none of the wage settlement methods such as collective bargaining, conciliation, adjudication or arbitration is available to these employees to settle wage claims and disputes.

A Joint Consultative Machinery was set up by the Central Government to discuss matters relating to the welfare of the employees and improvement of efficiency and standards of work. The scheme provides for a limited extent of compulsory arbitration on the following subjects: (i) pay and allowances, (ii) weekly hours of work, and (iii) leave of a class or grade of employees. The Government, however, becomes the final authority in deciding whether an issue can or cannot go for arbitration.

Despite these arrangements, the effective method available to Government employees is that of enquiry by a Pay Commission. The Central Government has so far set up five Pay Commissions which reported in 1947, 1959, 1973, 1984, 1996 respectively. Most State Governments have also set up Pay Commissions from time to time.

Pay Commissions which were set up at regular intervals function non-statutorily, study the problems, establishing their own procedures for the collection of data and information and make recommendations to the Government. Though these recommendations are given much weightage, the ultimate responsibility lies with the Government whether to accept or modify or reject some of them.

The First Central Pay Commission recognised that the influence of the law of demand and supply cannot be wholly ignored in fixing the salaries of public servants. The fairness and adequacy of the salary proposed must be judged balancing the interests of the employee, employer and the public. The Commission stated that an employee must be paid a 'living wage'. However, with the Fair Wages Committee's clarification of the concept of living wage it becomes clear that the living wage which was recommended by the Commission should actually be the minimum wage.

The Second Pay Commission also referred to the principle that as a matter of social policy, the lowest rate of remuneration should not be lower than a 'living wage' and the highest salaries also should be kept down, consistent with the essential requirements of recruitment and efficiency. The Commission reached the conclusion that the minimum wage or salary should not be determined merely on economic considerations, but should satisfy also a social test -both because of its intrinsic validity and because of its bearing on efficiency. Even above the minimum level Government should remunerate their employees fairly; for those who serve the State, as well as others, are entitled to fair wages (Second Central Pay Commission Report).

The first two Central Pay Commissions stressed that the minimum wage must satisfy a social test and that wages above the minimum should be 'fair'.

The major requirements of a sound pay system quoted by the Third Pay Commission included inclusiveness, comprehensibility and adequacy.

(a) ***Inclusiveness:*** The pay structure and career pattern adopted for the civil service should broadly be adopted by autonomous quasi-governmental organisations also.

Secondly, the large-scale appointment of casual, contingency, and work-charged employees should be discouraged and kept to the minimum.

(b) ***Comprehensibility:*** The pay scale proper should provide a true and comprehensible picture of the total remuneration given to the government employee.

(c) ***Adequacy:*** The pay structure should be adequate both internally and externally. Individual attributes such as education, training and skill should be taken into account for internal adequacy. For being externally adequate, the pay structure should provide for some measure of protection of living standards.

None of the above pay commissions viewed that the Government should be assigned the role of 'model employer' by paying higher wages and salaries. However, it was observed that the Government must be guided by the objectives and principles prescribed by the Pay Commission.

Though the feasibility of need-based minimum wage as examined by the two Pay Commissions, differed in their views on the 15th session of the Indian Labour Conference specifications on the minimum wage, the Third Pay Commission viewed that the minimum wage fixed should be realistic and should match the conditions prevailing in the economy. The Commission concluded "the adoption of the minimum remuneration based on the 15th ILC norms at this stage would be tantamount 10 a misdirection of resources" (Report of the Third Central Pay Commission (1973), Vol. 1, p. 58).

An important criteria in wage determination in industry is that of comparison. The First Pay Commission considered that a 'fair relativity' should be maintained between the government employees and outside rates. The Second Pay Commission felt that though fair comparison between rates of remuneration for comparable work could be adopted, it involves practical difficulties in the application of the principle. The Third Pay Commission paid considerable attention to fair comparison under the principle of 'equal pay for equal work'. However, there can be no fair comparison between establishment with a profit motive and a public service motive. The Fourth Central Pay Commission dealt with the criteria of comparability on how it is not satisfactory as an absolute factor for fixing the governmental pay structure by comparison with that prevailing in the private sector. A market price cannot be assigned to the value of work in the public services. The Commission viewed that comparisons should be used in determining pay of government employees. As far as possible, the effort should be to provide comparable emoluments for comparable work.

Capacity to pay is another significant criterion applicable to the remuneration of government employees but the method of assessment of Government's capacity is entirely different from that in the private sector. Since the Government's capacity to pay cannot be measured precisely, the Government could pay 'fair wages' to its employees. The Fourth Central Pay Commission observed that the capacity of the employer to pay its employee is a factor to reckon and be given due consideration. The Commission said that the fairness of the payments has to satisfy a double test in the sense it has to be fair from the point of employees as well as the people they serve.

The Fourth Central Pay Commission (1984; p. 84) disagreed with the First and Second Pay Commissions, which rejected the 'model employer principle'. The Commission expressed that a model employer need not necessarily pay higher wages than other good employers. "A 'model' is above the ordinary or above that which is the minimum, or higher than what others are content with or what is good enough to serve their purpose".

Another important factor in wage determination is the cost of living. The approach of most Pay Commissions has been to devise a salary structure with reference to a certain consumer price index at which the Commission believes that prices may eventually get stabilized or, at any rate, below which prices are unlikely to fall and to provide for neutralisation of any rise in the cost of living thereafter through dearness allowance linked to, and generally varying with the consumer price index.

The various commissions expressed different views on the subject of dearness allowance payable to Government employees. The First Central Pay Commission observed that the dearness allowance is relevant not only to the needs of the most vulnerable section of the employees but some of the upper grade employees also require a measure of relief. The quantum of dearness allowance will be raised, lowered, or discontinued for a rise or fall in the Consumer Price Index. The same principles would apply to all classes of employees except that when the Consumer Price Index fell considerably below the existing level, DA was to be discontinued at different index levels for employees on different pay scales. The Commission recommended DA to all employees drawing a salary up to Rs. 100.

The Second Central Pay Commission considered DA as a device to protect the real income of wage earners and salaried employees from the effects of rise in prices. The Commission, however, limited payment of dearness allowance to those drawing a salary of less than Rs. 300 per month. The Third Pay Commission observed that dearness allowance should be treated as compensation to the wage earners and salaried employees against rise in prices over the index level to which the pay structure was related.

After examining the consumption pattern of employees in the higher pay range the Commission recommended extending payment of dearness allowance to all employees getting pay not exceeding Rs. 2,250 per month.

The Fourth Central Pay Commission also viewed that the compensation should provide full neutralisation of price rise to employees drawing basic pay up to Rs. 3,500, 75 per cent to those getting basic pay between Rs. 3,501 and Rs. 6,000 and 65 per cent to those getting basic pay above Rs. 6,000, subject to marginal adjustments. This compensation may continue to be shown as a distinct element of remuneration.

Doubts were expressed regarding the suitability of the Consumer Price Index for Industrial workers presently being used for purposes of grant of DA to Central Government employees. It has been argued that this index does not truly represent the consumption pattern of all Central Government employees and should be replaced by an index specially prepared for the purpose.

Check Your Progress 5

State whether the following statements are True or False:

1. The Equal Remuneration Act in India was enacted to prevent discrimination between workers on grounds of gender.
2. The purpose of the equal remuneration Act is to make sure that employers do not discriminate on the basis of gender, in matters of wage fixing, transfers, training and promotion.
3. The Equal Remuneration Act provides for payment of equal remuneration to men and women workers, for same work or work of similar nature and for the prevention of discrimination against women in the matters of employment.

Contd....

4. Discrimination is nothing more than the expression of a preference.
5. Individual acts of choice may sometimes result in a preference that might exclude or inconvenience a certain group.

10.9 THE IMPACT OF THE FIFTH PAY COMMISSION OF CENTRAL AND STATE GOVERNMENTS

The Fifth Central Pay Commission, which submitted its report in 1996, made some proposals linking pay revision with work organisation and manpower planning. It recommended 40 per cent increase in pay and 30 per cent reduction in manpower over a three year period, new modes of recruitment, including contract employment, and innovative suggestions on training, performance appraisal, career progression, transfer policies and accountability. The government accepted the first part of the recommendations and not the second part.

The problem with pay commissions is twofold: first, they are not able to relate recommendations with the principles they enunciate, second, governments usually tend to take economic decisions on political considerations.

When Pay Commissions and Wage Boards submit the reports, the Government accepts the recommendations with or without modifications. When collective bargaining and conciliation fail to accomplish resolution of dispute between labour and management, the cases may be decided through voluntary arbitration or compulsory adjudication. During the 1970s and 1980s, wages in the cement industry were decided through arbitration. Not any longer, when wage disputes persist, government refers them for adjudication. Though the adjudicators award is normally binding on labour and management, it is not uncommon for parties to move the courts over the award of the adjudicator. In such cases, the Supreme Court is the final arbiter. There have been, however, instances where even Supreme Court verdicts had problems in implementation/enforcement due to ground realities. In such instances either labour or management, usually the former, makes amends and agrees with the latter for something less than what the Supreme Court mandated. The dearness allowance dispute in Raptokas Bret (1992-93) is one such case. While the Supreme Court ordered the company to pay double indexed dearness allowance, the company found it difficult and instead wanted to sell the unit. The union then gave up its demand for double indexed dearness allowance and entered into an agreement with the management.

In most industrialized countries, it is realised that interest issues (wages, allowances, etc.) cannot be adjudicated, but rights issues (right to unionise, right to bargain, right to prior notice, right to consultation, etc.) can be. In India, however no such distinction is made and both interest issues and rights issues are subject to bargaining and adjudication. This creates avoidable difficulties in the running of enterprises.

10.9.1 An Approach to Public Sector Pay Revision

Justice Mohan Committee, appointed by the Government of India on 31 August 1996 to recommend revised pay structure, allowances, perquisites and benefits for the board level functionaries, below board level executives and non-unionised supervisory staff submitted its report in December 1998. It had to contend with three issues:

1. The capacity to pay of the public sector. Till 1991, capacity to pay was not reckoned. There was broad uniformity in pay structure and some allowances, even though most profit-making companies tended to pay higher gross emoluments to their employees than the others. In the post-liberalisation (1991 to date) pay revision

was deferred in loss-making companies. The historical circumstances and constraints and continued administrative hurdles make it impossible for many public sector companies to earn profits without substantial financial restructuring and considerable autonomy in decision-making. Therefore, the union's argument is that capacity to pay cannot be considered in isolation.

2. The relativity between the emoluments paid in the public sector enterprises and other similarly situated employees in the Government sector, and in the private sector. Historically, the Government tended to decide pay structure in public sector having regard to corresponding pay scales in the government departments. Government has revised the pay and benefits of civil servants without regard to its financial situation. This created problem for some state governments whose financial situation was even worse because their own employees expect the state government to pay at par with Central Government. When the Government, as owner, is now asking the public sector to revise pay only if they earn profits without increasing unit labour costs and price revision, the unions in public sector are genuinely asking questions on the legitimacy and morality of such instructions from the Government.

3. The need for autonomy for public sector enterprises in determination of employee compensation. Without civil service reforms, both reforms and autonomy in the public sector remain a wishful indulgence. Without autonomy and market mechanism, insistence on capacity to pay is considered arbitrary by the unions and even by most managers.

   Additionally, the pay revision, due from 1 January 1997 is saddled with the following other issues:

   (i) *Duration:* In the past civil service pay was revised once in 10 to 12 years and public sector pay once in three to five years. In the private sector, pay revision continues to take place usually once in three years and in rare cases once in four to five years. The government now insists on pay revision once in 10 years for the employees in public sector units. The unions have been resisting. While a few public sector firms revised pay for officers on a 10-year commitment, the Group of Ministers appointed by the Government is inclined to rollback the Government instructions and recommend a pay revision once in five years. This might result in reopening of the already concluded pay revisions executives in some public sector units. If five-year agreements continue to be the norm, the agreements signed now (April 2000 or thereafter) will expire by December 2001.

   (ii) *Parity between officers and workers:* The parity between the lowest paid worker and the highest paid executive was reduced from about 20 in early 1970s to less than 6 at the end of 1999. Justice Mohan Committee recommended that the parity should be raised to 10. But if one were to go by the scales, it recommended for the executives in the public sector undertakings, without reducing the existing pay scales of unionized workers – at a time when the existing wage agreements expired and became overdue for revision – it would not be possible to increase the parity to 10.

   (iii) *Parity between the public sector and private sector.* This is a tricky issue. At the worker level, emoluments in the public sector were estimated to be 1.5 times higher than their counterparts in the private sector. From senior manager onwards, emoluments in the public sector could be at least 5 to 10 times less than counterparts in the private sector.

(iv) *Parity at the worker level between the permanent and the casual contract worker.* For far too long collective bargaining distorted wage differential at similar skill level at the lowest rungs based on whether the job is permanent or not. In many companies, permanent workers doing similar jobs with more or less similar skills get up to 8 to 10 times more pay than the casual and contract workers working on similar jobs at the same site. While successive pay commissions and collective agreements in most cases scuttled the issue, it is frequently raised by a few unions and some non-governmental organisations. A few collective agreements and some court judgments now insist that there should be no such discrimination.

(v) *Performance-linked pay:* Public sector does not generally have either the concept or the culture of performance-linked pay. In the public sector units where performance-linked payments exist, the proportion of such payments in the total pay never exceeded 8 per cent till 1999. Justice Mohan Committee recommended that perquisites and allowances should not exceed 50 per cent of the pay. Payments above this should be linked to performance and not exceed another 50 per cent of the pay and gross ceiling of 5 per cent of distributable profits for all the employees of the company. In the private sector, Companies Act allows payment of 11 per cent of distributable profits among the full time directors whose number would be usually less than 10. In the public sector, as per Justice Mohan Committee recommendation, 5 per cent of the distributable profits should be distributed among all the employees whose number usually ranges from over 3,000 to over 100,000. The per employee share of distributable profits would, in several cases be so low that they may not be adequate to inspire, induce or motivate people for aspiring to get the paltry extra emoluments to performance.

Finally to conclude the impact of the fifth pay commission was such that after its implemented in 1997 at a cost of Rs. 17,000 crore, the consequent results were that a need for growing demand in perks and salary was demanded from some quarters and the government brought out the recommendations of the sixth pay commission for implementation in the interest of the employees, especially of the government sector. In July 2006, the Cabinet approved setting up of the sixth pay commission. This commission has been setup under Justice B.N. Srikrishna with a timeframe of 18 months. The cost of hikes in salaries is anticipated to be about Rs. 20,000 crore for a total of 5.5 million government employees as per media speculation on the 6th Pay Commission, the report of which is expected to be handed over in late March/early April 2008. The employees had threatened to go on a nationwide strike if the government failed to hike their salaries. Reasons for the demand of hikes include rising inflation and rising pay in the private sector due to the forces of globalization.

10.10 LET US SUM UP

A company must formulate its wage and salary policy in an integrated manner by taking into account the overall objectives of setting up the business. This is because a remunerative wage structure helps the organisation in obtaining and retaining a healthy, competent and devoted work force, which in turn affects its productivity and profitability. Such a wage policy acts as a dominating force in motivating the employees to contribute their maximum worth to the enterprise.

Wages refers to all remuneration (whether by way of salary, allowances, or otherwise) expressed in terms of money which would (if the terms of employment, express or implied, are fulfilled) be payable to a person employed in respect of his employment or of work done in such employment. It includes:- (i) any remuneration payable under any award or settlement between the parties or order of a Court; (ii) any remuneration to which the person employed is entitled in respect of overtime work or holidays or any leave period; (iii) any sum which by reason of the termination of employment of the person employed is payable under any law, contract or instrument which provides for the payment of such sum, whether with or without deductions, but does not provide for the time within which the payment is to be made; (iv) any sum to which the person employed is entitled under any scheme framed under any law for the time being in force.

There are three main legislations governing wages.

The payment of wages may also include the provision of extra lump-sum income which is awarded by an organisation to its employees usually on an annual basis. Such income is known as bonus and may be provided to the employees on special occasions like festivals, new year and other important celebrations. This enables an employee to buy goods and services which can improve his way of life. Some firms even distribute bonus to its employees as a token for their contribution in the high performance of the firm. All such gestures by an enterprise help in boosting the confidence of the employees in their efforts as well as in the organisation.

As per the 'Committee on Fair wages', there are three distinct levels of wages:- (i) Living wage represents a standard of living which provides not merely for a bare physical subsistence, but for the maintenance of health and decency, a measure of frugal comfort including education for children, protection against ill-health, requirements of essential social needs and some insurance against the more important misfortunes; (ii) Minimum wage ensures not merely the bare sustenance of life, but the preservation of the efficiency of the worker by providing some measure of education, medical requirements and amenities. Thus, the minimum wage prescribes the lower limit while the upper limit is set by the capacity of the industry to pay; (iii) Fair wage is the wage which is above the minimum wage but below the living wage.

The laws and matters relating to wages and bonus come under the purview of the Ministry of Labour and Employment. Within the Ministry, Central Industrial Relations Machinery (CIRM) enforces all the labour legislations and the rules framed thereunder. CIRM is an attached office of the Ministry and is also known as the Chief Labour Commissioner (Central) [CLC(C)] Organisation. The CIRM is headed by the Chief Labour Commissioner (Central). Also, wage cell and wage board have been set up for the purpose.

10.11 LESSON END ACTIVITY

Write a study note on the wages and bonus laws in India.

10.12 KEYWORDS

Minimum Wages Act, 1948: This Act requires the appropriate government, Central or State, as the case may be, to fix minimum rates of wages payable to employees in any employment specified in Part I or Part II of the Schedules appended to the Act and any employment subsequently added to either part of the Schedule.

Payment of Bonus Act, 1965: The main purpose of the Act is to provide for the payment of bonus to persons employed in certain establishments and or matters connected therewith.

Equal Remuneration Act, 1976: The main object of this Act is to provide for the payment of equal remuneration to men and women workers engaged in same or similar work.

Collective Bargaining: Collective bargaining is a process whereby standards are created to govern labour relations – including, particularly, wages and working conditions.

Functions of the Wage Board: The primary function of the Wage Board shall be to determine the wages payable to the employees of the activity.

Procedure of the Wage Board: The Wage Board shall follow such procedure as may be prescribed; provided that, wherever the appropriate government has not prescribed any procedure, the Wage Board may evolve its own procedure.

Duration: In the past civil service pay was revised once in 10 to 12 years and public sector pay once in three to five years.

Performance-linked pay: In the public sector units where performance-linked payments exist, the proportion of such payments in the total pay never exceeded 8 per cent till 1999.

10.13 QUESTIONS FOR DISCUSSION

1. Discuss the theories related to wage and bonus laws in India.
2. What do you know about various provisions of the Law of Minimum Wages?
3. Write a note about the provisions relating to the payment of wages.
4. Discuss different provision regarding the payment of bonus, in India.
5. Analyze the objectives and scope of the wages and labour laws in India.
6. What do you understand by the Equal Remuneration Act?
7. Write an appraisal on the working of different Institutions related to Reward system like Wage Boards, in India.
8. Write a note on the Pay Commissions and their recommendations in India.
9. Analyze the impact of the fifth pay scale on Central and State Government.

Check Your Progress: Model Answers

CYP 1

1. ***Minimum Wage:*** A minimum wage must provide not merely for the bare sustenance of life but for the preservation of the efficiency of the worker by providing some measure of education, medical requirements and amenities.
2. ***Living Wage:*** It represents a standard of living which is provided not merely for a bare physical sustenance but decency, protection against ill-health, requirements of essential social needs and some insurance against the more important misfortunes including old age.

CYP 2

1. ***Purpose of the Payment & Wages Act, 1936:*** The main purpose of the Act is to ensure regular and prompt payment of wages and to prevent the exploitation of the wage earner by prohibiting arbitrary fines and deductions from his wages.

Contd...

2. ***Purpose of the Bonus Act, 1965:*** The main purpose of the Act is to provide for the payment of bonus to persons employed in certain establishments and or matters connected therewith.

CYP 3

1. ***Institutional Mechanism for Wage Determination:*** Public policy and legislative framework provides the basis for wage determination. Within the framework of public policy and legislative framework, wages are determined through one or more of the following methods: (a) unilaterally by employers, (b) through collective bargaining between employer (or employers association in an industry or industry-cum-region) and union (or federation of unions in a sector or sector-cum-region), and (c) Pay Commissions for civil service, (d) wage boards for select industries, and (e) adjudication by a third party where wage disputes remain unsolved through negotiation and conciliation.
2. ***Collective Bargaining:*** Collective bargaining is a process whereby standards are created to govern labour relations – including, particularly, wages and working conditions.

CYP 4

Functions of Wage Bonds: The primary function of the Wage Board shall be to determine the wages payable to the employees of the activity. The appropriate Government or the recognised organisations of employers and employees, by mutual agreement, may refer to the Wage Board any other matter for determination.

CYP 5

1. True
2. True
3. True
4. True
5. True

10.14 SUGGESTED READINGS

B.D. Singh, *Compensation and Reward Management,* Excel Books, New Delhi.

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S.S. Khanka, *Human Resource Management*, S.Chand & Company Ltd., New Delhi.

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