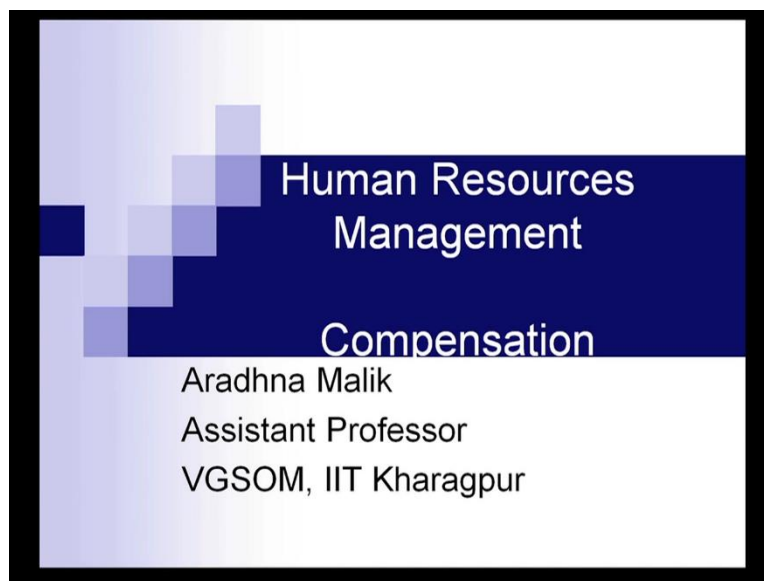


**Principles of Human Resource Management**  
**Prof. Aradhna Malik**  
**Vinod Gupta School of Management**  
**Indian Institute of Technology - Kharagpur**

**Module No. #04**  
**Lecture No. #10**  
**Compensation**

Welcome back, to the course on, Human Resources Management. Today, we will talk about, Compensation.

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We talked about, a whole bunch of things, earlier. Today we will start with the issue of compensation. How do you decide salaries? How do you decide, what to give your employees, in return for the time, effort, energy, they put in, to their work? So, very, very, important topic. Please note down your queries. And, maybe one of these days, I will come online, I will come live. And, we can have a discussion, if you have any questions.

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## Sources

Cascio, W. F. (2003). *Managing Human Resources: Productivity, Quality of Work Life, Profits*. New Delhi: Tata McGraw Hill.

Gomez-Mejia, L. R., Balkin, D. B. & Cardy, R. L. (2012). *Managing human resources (7<sup>th</sup> Ed.)*. New Delhi: PHI Ltd.

So, let us go to the sources, that I have referred to. I have referred to, these two books, *Managing Human Resources: Productivity, Quality of Work Life Profits*, by Cascio. And, I have also refer to this textbook. A book, that is being used, as a textbook in many places, including ours. This is a book called, *Managing Human Resources*, by Gomez-Mejia, Balkin and Cardy. I have the seventh edition, which was published in 2012. If you have a later edition, that will also be helpful.

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## Compensation

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## What is compensation?

(Gomez-Mejia, Balkin & Cardy, 2012)

- Total compensation = Base compensation + pay incentives + benefits
- Base Compensation: "Fixed pay an employee receives on a regular basis, either in the form of a salary or as an hourly wage."
- Pay incentives: "Programs designed to reward employees for good performance."
- Benefits or indirect compensation: Additional programs to enhance the level of comfort of the employee in the non-work aspect of life. These include health insurance, vacations, etc.
  - Perquisites: Type of benefits (also called perks) that are "...available to employees with some special status in the organization."

What is compensation? Let us, first deal with, some of the basic terms. We come across these terms, every day. But, let us see, what these terms are and, what they mean. The first term, we will talk about is, total compensation. Now, total compensation refers to, the base compensation, plus your salary or pay incentives, plus your benefits. Those of you, who work in the government sector, will know, the concept of basic pay. We have all heard, about this term called, basic pay. And, anything additional to that is, a percentage of that.

Now, in some government organizations, we also have the concept of grade pay. And, that is based on, slabs of basic pay. Things like, your house rent allowance, your travel allowance, your telephone allowance; all of these are a percentage of your base pay. Sometimes, it is a percentage. House rent allowance, typically is a percentage of your basic pay. And, it varies from city to city, depending on, how expensive, that city is.

So, for example, the house rent allowance, in a very expensive city, like Delhi, or Bombay, Bangalore, would be much higher than, the house rent allowance for a small town, like Kharagpur, or maybe Purulia in West Bengal, or, in Himachal Pradesh we have towns like, Dharamshala, or Hameerpur, or Bilaspur, or, I mean, some such place. So, these are the added benefits. But, basic pay is, the basic salary on which, everything else is calculated. The second term here is called pay incentives. Pay incentives are programs, designed to reward employees for good performance.

So, for example, you do something. I mean, these things are defined earlier. And say, in academics, in the senior institutes of higher education, like IITs, of course, for IIT Kharagpur we do not have, any such plan, yet. But in IIMs, I have heard, I am not very sure that, if you publish, in a good journal like, Harvard business review, or Sloan management review, or any such top-rated journal in the world. Then, you are given, an additional lump sum of money, as a reward, for your exceptional performance.

So, or, some organizations, I believe in the pharmaceutical industry, and even in the travel industry, they will give you a package. So, this is a pay incentive. They will allot of a certain sum of money, for any additional sales, that you have made, any additional clients, you brought for the organization, may be a percentage of that, will go to you. So, all of these, are the pay incentives. These are calculated, as a percentage of your basic pay. And, these are programs, that are specifically designed, to reward the employees, that perform better than their peers.

The third point here is, benefits or indirect compensation. These are the additional programs, that are developed, to enhance the level of comfort of the employee, in the non-work aspect of life. Now, this is the term, this is a description, that I have come up with myself. And, when you look at this, benefits are additionally things, that make your life outside of work, more comfortable. So, they include health-insurance. They include what are called as LTC, leave travel concession, in government services.

These are the additional things, that make your, that enhance your comfort levels, as an employee of an organization. Because, let us go back to, what we talked about, in the first few lectures. Which is a human being, in an organization, is not only a source of output, a human being is, a human being also. I am a person. I have a family. I have connections. I have health needs. I need to sleep every night, I need to rest, after a certain amount of work is done.

So, I need to have my vacation. So, all of these things, are a part of our lives, of our association with the organization. And, when the organization takes us in, they try and look after us. They compensate for the work, we do. And, they also try and look after, the non-work side of their employees, just to make them more comfortable. So, you have creches. You have schools, you have this, this big hullabaloo going on. The big hullabaloo, about the

management quota of schools in Delhi, which is probably being misused. And so, I mean, so, all of this, these are just incentives.

That, if you are a part of an organization, you will get something a little extra, to take care of you. So, that helps you, look after your other nonwork needs, and the needs of your family. Now, there is something else in this. That are called perquisites, or, commonly known as perks. That are available to employees, with some special status, in the organization.

And, this is directly related to this, management quota business. So, if you are part of the governing body of the school, for example your child or somebody known to you, or somebody, who you have a personal interest in, could get in, without sitting through, without competing with the rest of the crowd.

So, you would have a little handle, there. You would have, some special reservation. They would say, ay. Because, you are doing, such a, so much work for the organization, we will let you, have this benefit, from the organization. For example, in the service industry. If you are working in a hotel, you may be allowed a certain number of lunches or dinners. Some number of meals, free of cost in the hotel.

Or, you may be allowed to stay in the hotel, for a certain number of days, in a year. Or, if you are in the travel industry, you may get a certain number of passes or tickets, to travel free of cost say in the airlines or railways. So, all of these are called perquisites. Because, you have a certain special status in the organization. You are an employee. You get things, that others, who are not in the same position, as you, do not get. So, these are the perks or perquisites.

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**Designing a compensation system**  
(Gomez-Mejia, Balkin & Cardy, 2012)

- Challenges of offering a wide variety of pay policies & procedures:
  - Designing a compensation system that is aligned with the strategic objectives of the organization
  - Rooted in and adapted to the "... firm's unique characteristics & environment."

How do you design a compensation system? There are some challenges. When we think about designing a system, to compensate our employees, for the work, they do; there are some challenges, associated with this. Now, these challenges are : we want to give our employees, the best. So, that they can give us, their best output. We want to take care of them, really well. So, that they feel comfortable, being a part of the organization. And, they respond in return, they response to our taking care of them, by doing excellent work, which in turn benefits our organization.

So, we can give them, more benefits. So it is a cycle. You treat them well, they want to work with you. They want to stay with you. They give you their best output. That adds to the value, your organization generates for its clients, that brings in more revenue. You share those revenues with your employees. And, they in turn, feel grateful, or, they in turn, feel satisfied, that they have done good work. So, they have been compensated. So, their commitment increases. So, we want to give our employees, the best. We want to have a base salary.

We want to give them benefits. Whatever, we can afford. We want to take care of their families, their children. These conglomerates like Tata's, for example they have their communities, or, you have these industrial townships, that have their communities in different places. And, they have their own school, their own hospital, their own club, their own community system. We have this thing, even in the Armed Forces, or in the Indian Railways, for example, the civil services.

So, paramilitary forces having have our own clubs. And, so these things, just enhance the, your bonding with the organization. So, when we want to give people, so many things, we want to give them, a wide variety of pay, incentives, and benefits; and that becomes really complicated. So, we also want to align these incentive systems, with the strategic mission, strategic objectives of the organization. So, that we do not go overboard, with provision of these things. We want to compensate our employees. But, we also want to make money. We also want to make profits. We are all hedonistic creatures.

Organizations, when considered as individual entities, are also hedonistic. By hedonistic, I mean, self-servicing, not self-centered. But units, that take care of their own selves, before they take care of somebody else. So, we are all hedonistic. And, we are trying to take care of ourselves. So, we must align, whatever we do, with the strategic objectives of our organization. And, that becomes difficult, if you want to provide a wide variety of things.

For example, there is a training paradox, that we talked about, in one of the earlier lectures. That, we train our employees, especially those that are really bright, that enjoy challenge. So, we train these employees. And, they take that challenge. And then, they become employable, by our competitors. So, where do we draw the line. So, to ensure that, we get the benefit out of their training, as organizations, we have them sign a bond. We say, you can get an MBA. We will give you, so much money, for your fees. You go, you earn your MBA. You perform well.

But, after you get your degree, you either pay the money back, if you want to leave the organization. You pay the money back, or you work with us for five years. So, the profits that are generated, by the good work, that you do, in turn, compensate for the money, we have spent on your education. It is as simple as that. It is just, a plus minus game. So, we need to align, whatever we do, with the strategic objectives of the organization. The other challenge of offering, a wide variety of pay policies and procedures is, they are, they need to be rooted in, and adapted to the firm's unique characteristics and environment.

Now, let us see, when we talk about oil and natural gas companies. Organizations, that deal with oil and natural gas, or mining activities, or manufacturing sector, where their set-ups are away from cities. So, they have unique needs. Their employees have unique needs. Now, miners, for example. People, who actually go into the mines, develop lung problems.

Because, the gases are toxic. , the gases, emanating from the mines are toxic. When there is drilling going on, all of this, the dust that comes in, gets into your lungs, and really damages your health.

So, they need to have a dispensary, or a hospital, that specializes in, dealing with, respiratory disorders, for example. So, , their needs are very specific. So, whatever we give to these people, has to be in line with the environment, that they are supposed to work in. We need to give people, I mean, of course, it is mandatory to wear hard hats, and to give health benefits to people, working in these organization. But, we also want to take care of them. So, maybe, we will spend more on health in a miner.

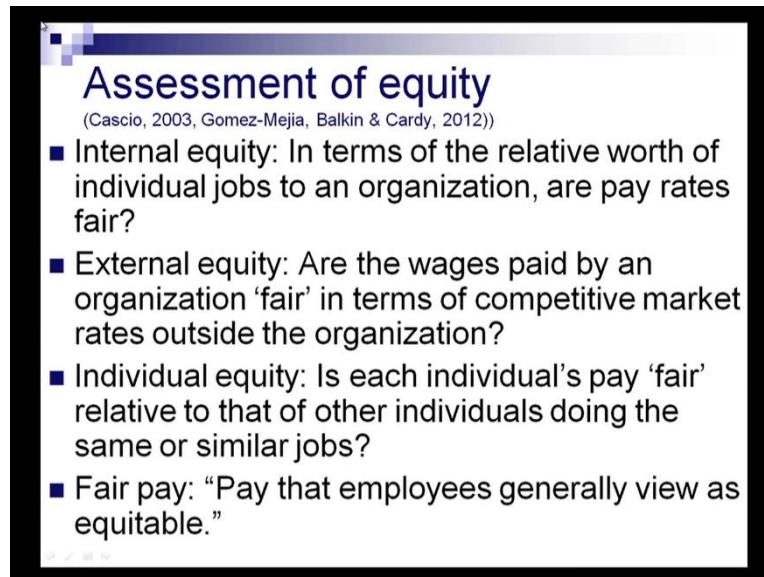
For a mining organization, we may end up spending, much more on health, than on, say, compensating people, for their vacations. We may not give them a vacation, a benefit. But, we will definitely compensate them, for health problems. So, we will also because, these setups are away from main cities. We will also ensure that, good schools are available for their children. We may also ensure that, their spouses have a place to work. Because, these people will again, , the people, who come there, unless, we can have a couple's plan.

We may not want to bring them to the organization. Or, if they come, we need to ensure that, their spouses have something else to do. So, that they decide to stay with us. I have seen this in the armed forces. I am not too sure about other colonies. In the armed forces, specifically, the wives of the officers are, if qualified, if found qualified, they are preferred as teachers in the central schools, located in these armed forces set-ups.

For the simple reason that, they need something to do. They are easily available. So, it is easy to hire them. Provided, they qualify on all other grounds. So again, this is an unwritten rule, not to be quoted. But, it is public information. So, I am sharing it with you, on this portal. So, we have to develop our incentive systems. So, that the they serve the needs of the organization, and the needs of the people, working in the organization.



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### Assessment of equity

(Cascio, 2003, Gomez-Mejia, Balkin & Cardy, 2012))

- Internal equity: In terms of the relative worth of individual jobs to an organization, are pay rates fair?
- External equity: Are the wages paid by an organization 'fair' in terms of competitive market rates outside the organization?
- Individual equity: Is each individual's pay 'fair' relative to that of other individuals doing the same or similar jobs?
- Fair pay: "Pay that employees generally view as equitable."

Now, how do we assess equity? What is equity? Let us first discuss that. Equity means, a sense of fairness. Equity means, being fair to people. Equity means, I feel that, my, the input that I get, from my organization, is equal to, or is fair, in terms of the work, I do. So, various types of the equity. We have internal equity. Internal equity is assessed, in terms of the relative worth of individual jobs, to an organization. And, is assessed, in terms of, whether pay rates are fair.

Internal equity, in very simple terms, means that, if at a certain level of, in the job, or, if my output is, say A, in one organization. Another person with the same qualification and training, as me, having the same output, should have more or less the same salary and benefits. That is called internal equity. I am an assistant professor here. I get x amount of salary. Another assistant professor, who join at the same time as me, doing the same kind of work as me, gets. x amount of salary, x amount of benefits, just what I get.

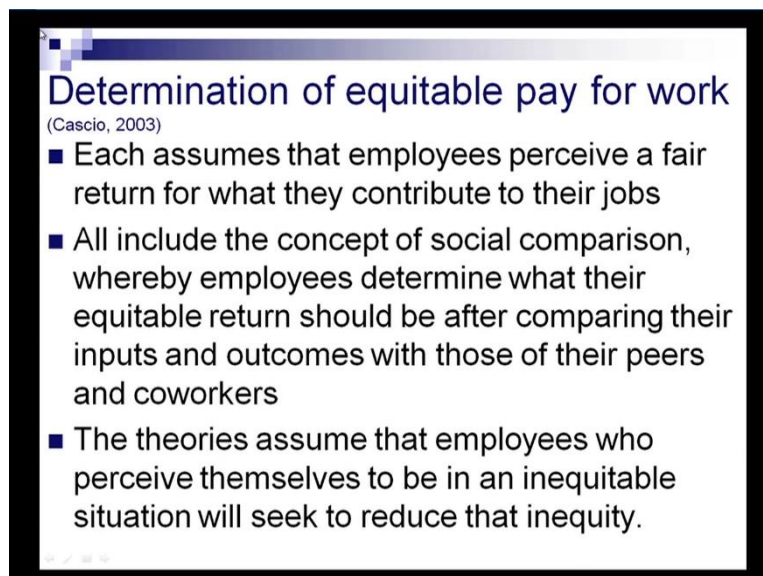
If this person earns lesser than me, then I will feel uncomfortable. If this person earns more than me, then again, I will feel uncomfortable. So, that is internal equity. We compare ourselves to our peers, who have the same kind of characteristics, job-related skills, and output, as we do. The next is external equity. External equity refers to, the sense of fairness, in terms of competitive market rates, outside the organization. Again, I will take the example of academicians. I will not only compare my salary and benefits, with my peers in the same organization.

I will also compare my salary and benefits, with my peers, in another similar organization. I may decide to check, with my peers, with other assistant professors, in other IIT's, to see, how much salary, they are getting. Say, I joined in the year x. This is my salary. These are the perks, I get. These are the benefits, I get. These are the incentives, I get. What do you get. We graduated with the same degree, in the same year. We been employed by a comparable organization. What do you get.? How much work do you do? And, what you get? And then, I will decide whether, I am being paid, fairly or not.

And this is, why a lot of hullabaloo takes place when we go out. A lot of people say, employees of, so and so organization, are getting this. Why are we, not getting it? So, that is what, this is. Individual equity relates to, whether each individual's pay is fair, relative to that of other individuals, doing the same or similar jobs.

Now, individual equity is may be in terms of, internal or external equity. So, these are just some terms, that we will deal with. Fair pay. When we talk about fair pay, fair pay is equity is the assessment. Fair pay is my understanding, my satisfaction, that, whatever i am getting is, whatever i am worth. Pay that, employees, generally view as equitable. These terms are inter-related.

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**Determination of equitable pay for work**  
(Cascio, 2003)

- Each assumes that employees perceive a fair return for what they contribute to their jobs
- All include the concept of social comparison, whereby employees determine what their equitable return should be after comparing their inputs and outcomes with those of their peers and coworkers
- The theories assume that employees who perceive themselves to be in an inequitable situation will seek to reduce that inequity.

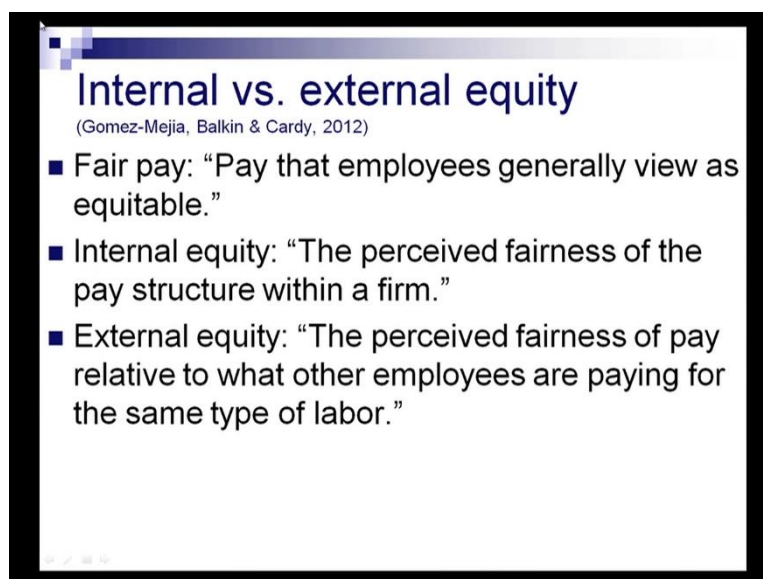
How do you determine, equitable pay for work? Each individual assumes that, if fair return, they should get a fair return, for what, they contribute to their jobs. If I put in a certain number of hours, if my output is a certain amount. Then, I should get, x amount of pay. That

is my understanding of, equitable pay for work. All include the concept of social comparison, where employees determine, what their equitable return should be, after comparing their inputs and outputs, with those of their peers and co-workers. So, I not only have my own standards for assessing, what is fair for me. I also compare myself, with my peers and co-workers.

The theories assume that, employees, who perceive themselves to be in an equitable situation, will seek to reduce that inequity. This is the principle of distributive justice. We will talk about it, in a little while. But, we assume that ,if I feel that, I am either getting paid more for the work, that I put in, or less for the work, that I put in. I will do something at my end, to balance that. So, if I get paid more, then I may decide, to start working less. I will say, I will do the bare minimum.

That is our inherent feeling. Why should I work, so much, when I will still get the same pay. The incremental the difference between, what I will get, if I do the bare minimum. And, what I will get, if I do a little extra, or a lot extra, is not very much, or there is no difference. I should not work more. So, I will cut down on my work. Or, if my pay is less, as compared to the others. Then, I will find out, what more I need to do, in order to, do the same amount of work, or, to get the same amount of salary, as my peers. So, I find out these things, and then, I adjust my working style accordingly.

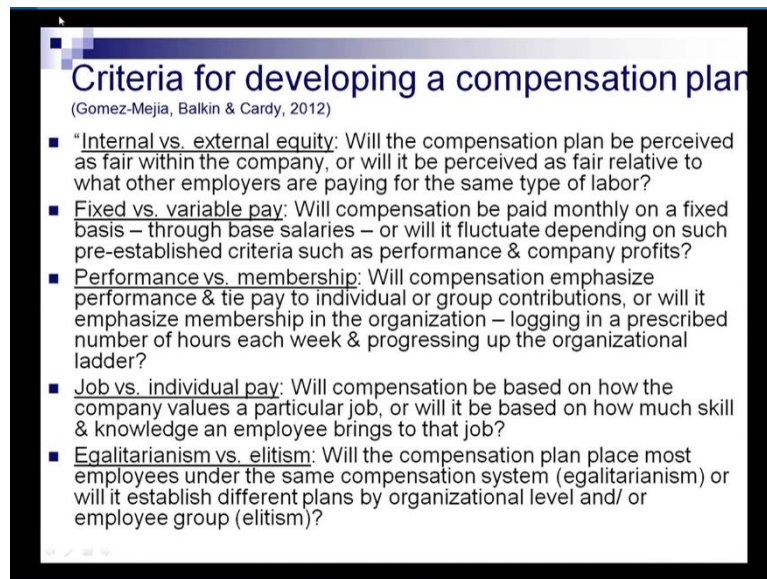
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**Internal vs. external equity**  
(Gomez-Mejia, Balkin & Cardy, 2012)

- Fair pay: “Pay that employees generally view as equitable.”
- Internal equity: “The perceived fairness of the pay structure within a firm.”
- External equity: “The perceived fairness of pay relative to what other employees are paying for the same type of labor.”

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**Criteria for developing a compensation plan**  
(Gomez-Mejia, Balkin & Cardy, 2012)

- **Internal vs. external equity:** Will the compensation plan be perceived as fair within the company, or will it be perceived as fair relative to what other employers are paying for the same type of labor?
- **Fixed vs. variable pay:** Will compensation be paid monthly on a fixed basis – through base salaries – or will it fluctuate depending on such pre-established criteria such as performance & company profits?
- **Performance vs. membership:** Will compensation emphasize performance & tie pay to individual or group contributions, or will it emphasize membership in the organization – logging in a prescribed number of hours each week & progressing up the organizational ladder?
- **Job vs. individual pay:** Will compensation be based on how the company values a particular job, or will it be based on how much skill & knowledge an employee brings to that job?
- **Egalitarianism vs. elitism:** Will the compensation plan place most employees under the same compensation system (egalitarianism) or will it establish different plans by organizational level and/ or employee group (elitism)?

Criteria for developing, a compensation plan. How do we develop a compensation plan? We have internal and external equity. We have fixed and variable pay. We have various ways, in which, we develop a compensation plan. We find out, whether, we are getting, , whether, we want to establish, internal and external equity. Whether, we want to. How we want to balance, the notion of equity? How? What we should do? So, that our employees feel that, they are being treated fairly.

We also want to find out, how much of fixed pay, we want to give them. And, how much of variable pay, we want to give them. So, will the compensation be paid monthly, or, will it be, will it fluctuate on things, pre-established criteria such as, performance and company profits. Are we going to give them, commissions, on the number of clients, they bring in. So, we need to decide, on these things. So, we need to keep, all these factors, into account.

Then, we have performance versus membership. Will the progression occur, as a result of, the stage of the organization, they are in. Or, will it occur, because of the performance. So, if you achieve a certain number of things, you will get this much pay. Or, you spent, so many years in the organization, you get your promotion. You move ahead, and your salary, automatically increases. So, that is another issue. The other is, job versus individual pay. Will compensation be based on, how the company values a particular job, or, will it be based on, how much skill and knowledge, an employee brings to that job.

Now, when we talk about, job related pay, we say for example, this particular activity is very important for the organization. So, anyone, who is able to do this, will get a higher pay, than the others. The other way of assessing things is, anyone, who performs better than, his or her peers, or, who has a better skill set, than his or her peers, will get a higher salary. So, one is the relative importance of the job. The other is, the relative importance of the skill set, the person brings. What do I have, my ability to contribute to the organization, is what, determines my salary.

The other one is, egalitarianism versus elitism. Will the compensation plan, place most employees, under the same compensation system? Will everybody get compensated, in the exact same way, or, will it establish, different plans by organizational level, and/or employee group. So, you will have a different pay scale, for different groups of people. People coming from this region, will get a higher pay. People doing this work, will get a higher pay. People doing this work, will not get, so much of money.

So, how will you decide? You have to decide, where you draw these levels. How, you calculate these levels? What do you do? And, how you communicate, all of this, to your employees. That is the biggest challenge. Equity is about, it is not about the sense of fairness, an organization has. Equity is the sense of fairness, employees have, as regards, the treatment of their work, by their organization. So, that is what, we need to be careful about.

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**Criteria for developing a compensation plan (Contd.)** (Gomez-Mejia, Balkin & Cardy, 2012)

- **Below-market vs. above-market compensation:** Will employees be compensated at below-market levels, at market-levels, or at above-market levels?
- **Monetary vs. nonmonetary awards:** Will the compensation plan emphasize motivating employees through monetary rewards like pay & stock options, or will it stress nonmonetary rewards such as interesting work & job security?
- **Open vs. secret pay:** Will employees have access to information about other workers' compensation levels & how compensation decisions are made (open pay) or will this knowledge be withheld from employees (secret pay)?
- **Centralization vs. decentralization of pay decisions:** Will compensation decisions be made in a tightly controlled central location, or will they be delegated to managers of the firm's units?

Then, we also need to decide, whether our employees will be compensated, at the market price. Or, whether they will be compensated at, whether we will give them less money, than what our competitors are giving them. Because, we can afford, to do so. Or, we will give them more money, than our competitors, are giving them. Again, I will take some, an example, that may not appeal, to a lot of people. But, anyway, even if IIT paid us less salaries, many of us, would still stay here.

The amount of money, we get as salaries, through the IIT system, does not compare, with the market rate for people, with the same skill set, as ours, people with the same kind of output, as ours. Honest input. Everybody knows this. But, many of us, I think, most of us are here, because of the large number of opportunities, we get. This is not a salary-based choice. I am here, because of the freedom of thought, I get. So, even if IIT decides, and again, I do not want this to start a wave out there. But, still, we already know that, we are not getting, as much salary, as our peers, in the private sector are getting. But, we are still here.

So, IIT says, we have a name. We will give them opportunities. We will give them a comfortable working environment. We will give them independence of thought. We let them be, as creative with their teaching, as possible. And, even if we do not give them, so much of money, people will come. And, that is working. IIT raises our salary. Our salaries go up, as and when, the government raises, the salaries of other employees. But, our inputs are not tied, exclusively to the salaries.

Newer private colleges may decide, to give their employees, a higher range of salary, till they establish a reputation. So, in order to attract, newer, qualified employees, new institutes of higher education, new universities, will say, oh, we will give you, so much money, so much salary, so many benefits. We will give you a house. We will give you a driver. We will give you a car etc. Once their reputation starts, being stabilize; become money it attracts, a lot of people.

So, once their reputation is stabilized, then, they will say, ay, now, we can start investing in improving the quality of the work, our employees do. And, we may not increase their salaries, so much. But, we will enhance the quality of life, that they have on campus. Monetary versus non-monetary awards. Will the compensation plan, emphasize motivating

employees, through monetary rewards like, pay and stock options? Or, will it stress, non-monetary rewards, such as interesting work, and job security. Very important, very close to my heart.

At IIT, and institutes of higher education like the IIMS, and possibly IISC also. I have experienced IIM, and I have experienced IIT. And, I am telling you that, I mean, it is amazing. How great, the work environment here is. Because, even though, there is very little monetary award, associated with certain things, if at all. But, the non-monetary rewards, in terms of, freedom of thought, opportunities to grow, opportunities to learn, from our mistakes, are, so many, that we say, east or west, IIT is the best. That is my institute is the best.

Because, we have so many, non-monetary rewards, coming our way. We have a fantastic campus. We have, such camaraderie, between ourselves. We say, wherever I go, this is my family. This is where, I will come back to. I will go. I will teach in another college. So, three-month, six-month, eight months, one year, but I will still come back, to my home, which is IIT. Why because, of these non-monetary rewards. In some other organizations, they will say, you will do x, you will get this much money. So, you keep doing x and y. And, you stay with the organization. Because, its bringing you, so much of money.

So, the interesting work, that we have, I am an academician. Because, I like learning, every day. I will not call myself, an expert, ever. I am always going to be a student. And, it is that learning, that keeps me going. So, whatever is of value to you, will need to be decided by the organization. , a lot of institutes of higher education, that promote research, it is this, need to learn, this craving that people, who join that organization, have to learn and to contribute to the knowledge base, that keeps them growing. So, as long as you give those opportunities to them, they will be happy.

So, you have to decide, what your organization does. And, what the employees coming in, will want to do. Open versus secret pay. Will the employees have, access to information, about other worker's compensation levels. And, how compensation decisions are made. Or, will this knowledge, be withheld from employees. We are a government organization. We are subject to, the right to information. Our salaries are publicly available. What we earn, is publicly available, through public records. There is no hiding.

But, I have heard, in certain private organizations, your salaries are not disclosed to anyone. We are nothing to hide. Single source of income. Get the salary, and it is up. Anyone, any public, any person, can ask the organization, what our salary scales are. And, the organization can, is bound by law, to tell them. So, you have to decide, whether one, whether the law permits you, to keep your salary secret. Should the employees know. Now, if you are compensating people for exceptional performance it would help, if you defined, what exceptional performance was. If you want people to know, what the other person is earning.

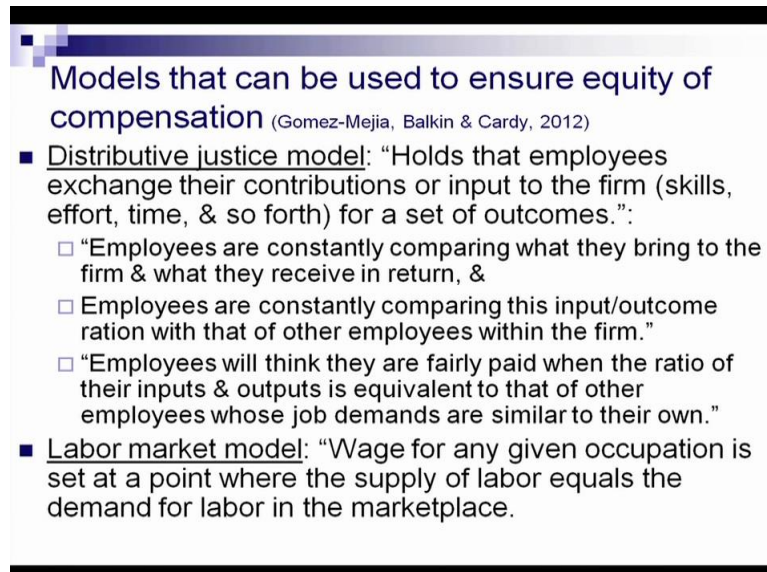
If on the other hand, people know, what the others are doing. But, they do not know, why somebody salaries, higher than theirs. That could result, in a lot of discomfort and discontent, among employees. And, that could be detrimental, to the progress, to the productivity, of the organization. So, it is a very important. It is to tell people, or to share the information, on specific information, on how to go to the next level, of earning more money, or getting more benefits, or whatever. And then, of course, this open pay system, can work.

Centralization versus decentralization of pay decisions. Who makes the pay decisions? Are they made in a tightly controlled central location? Or, will they be delegated to managers, of the firm's units. Again, for contractual work, if I want to take on a research assistant, for one of my research projects. I have been given the authority, to make that decision, based on. And the, my organization trusts me, that I will make the right decision, and compensate somebody adequately for the work, they put in, for my research project. There is a bare minimum, that we have to adhere to. But, if somebody deserve more than that, up to a certain limit, we can compensate them.

But, decisions, any higher than that, are made by a central organization. In our case, they are made by the government.. So, which pay bracket to put somebody into, is the decision of the organization. But the pay brackets, are decided by the central government, by experts in the central governments. So, your organization has to decide, how it wants to do certain things. And, these decisions, will in turn determine, how the compensation plan for your organization develops. Very, very, important to keep, each of these factors in mind, while determining your compensation plan.



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**Models that can be used to ensure equity of compensation** (Gomez-Mejia, Balkin & Cardy, 2012)

- **Distributive justice model:** “Holds that employees exchange their contributions or input to the firm (skills, effort, time, & so forth) for a set of outcomes.”:
  - “Employees are constantly comparing what they bring to the firm & what they receive in return, &
  - Employees are constantly comparing this input/outcome ration with that of other employees within the firm.”
  - “Employees will think they are fairly paid when the ratio of their inputs & outputs is equivalent to that of other employees whose job demands are similar to their own.”
- **Labor market model:** “Wage for any given occupation is set at a point where the supply of labor equals the demand for labor in the marketplace.

Two models, that we will talk about. That can be used, to ensure equity of compensation. One is called, the distributive justice model. Now, according to this model, we exchange, our contributions or input, to the firm, for a set of outcomes. I put an x amount of work. I should get y amount of pay. That is my own internal, individual equity. I should get fair pay. If I am doing this much of work, I should get this much of money for it, or these many benefits, or this much compensation for it. That is my sense of fairness.

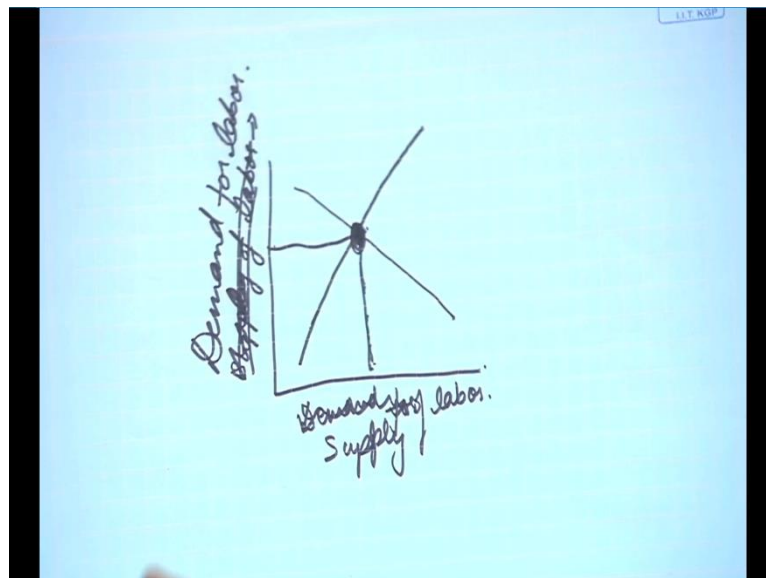
We are constantly also, comparing ourselves with others, within our organization, who come with the same set of skills, we do, and create or, do the same kind of work, we do. So, we say, so and so is getting, this much money, why am I not getting it? So-and-so is getting, this benefit, why not me? That is one thing, that is constantly happening. And the other thing, that is constantly happening is, I am constantly comparing myself, to forces outside my organization. So, so-and-so is in another organization, is getting, this much money, for this much of effort put, in this much of skill, these many challenges, these many days of work.

I should also get, at least, that much money, or more, if possible. All of us want, more money. And, we want to, sort of, want to get the maximum benefit, that we can, by putting in the required amount of work, that we can put in. So, we all try and compare ourselves, and find out, what is going on, around us. Employees will think that, they are fairly paid, when the ratio of their inputs and outputs, is equivalent to that of other employees, whose job demands are similar, to their own.

So, employees will think that, once we feel that, we are getting paid fairly, if the amount of input and output, are a certain ratio. And, this ratio compares with people, who have the same kind of work, that we do.

Now, the other model, that we can use. This is called, the distributive justice model, where we compare ourselves to others. Labor market model is, where the wage for any given occupation, is set at a point, where the supply of labor, equals the demand for labor, in the marketplace. So, in economics, you have the demand and supply curve. So, let me just draw this, for you.

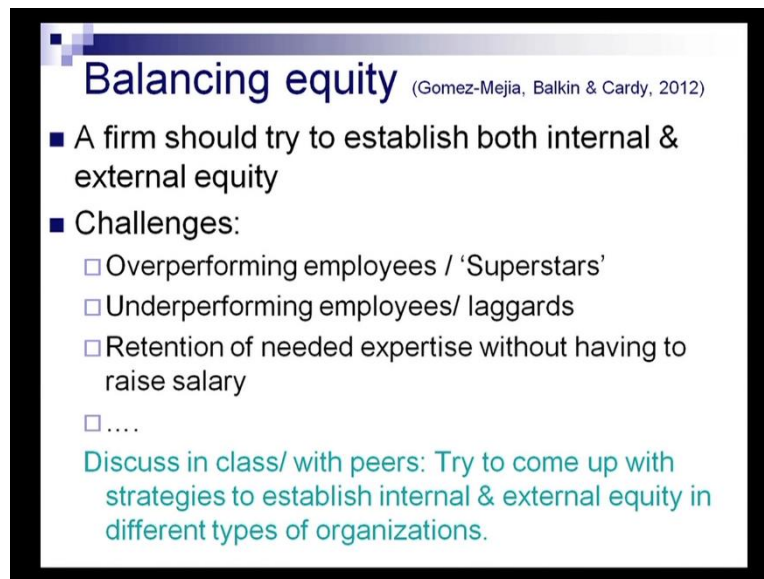
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So, you have the supply of labor, that is going up. People are getting, more and more training, and the demand for labor, is going down. And, the middle point, at which, these two balance out. As the supply of labor increases, the demand for labor goes down. And, the middle point is where they balance out.

So, at this point, what should the wage be? Anything more, if we have more labor coming in, their wages are likely to come down. If we have less labor coming in, from this, , at this point, if we do not have enough labor, their wages are likely to go up, to a point. And then, they are likely to come down. So, this is the labor market model.

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**Balancing equity** (Gomez-Mejia, Balkin & Cardy, 2012)

- A firm should try to establish both internal & external equity
- Challenges:
  - Overperforming employees / 'Superstars'
  - Underperforming employees/ laggards
  - Retention of needed expertise without having to raise salary
  - ...

Discuss in class/ with peers: Try to come up with strategies to establish internal & external equity in different types of organizations.

Then, we try and balance the equity. We try and establish, both internal and external equity, for a firm. When we talk about compensation plans, we try and establish both internal and external equity, for a firm. We try and give the employees, a sense of fairness, regarding, what they are earning, and what others in their positions, within the same organization, and in other organizations, are earning. And, we give them a sense of fairness.

The challenges to this are, one is the, over performing employees or superstars. Think people, who do a lot more than, they are expected to. The other is, underperforming employees or laggards. So, we have people, who just sit there, they look busy and take it easy. The other laggards. What do we do, with these people? How do we compensate them? How do we deduct their salaries? Do we throw them out? I mean, but the larger challenge, lies in dealing with your superstars.

The third challenges, retention of needed expertise, without having to raise salary. This again relates back, to the training paradox. I educate my employees. I teach my employees. I invest in their training. And then, they leave me, and go away. What do I do? So, I have an exercise for you, that you can have in class, that I will not be evaluating. But, it will help you, get some sense of, where we are going with this. So, the exercise is, it will be nice, if you can try and come up with strategies, to establish internal and external equity, in different types of organizations.

Knowledge-based organizations versus service industry. Service industry versus the manufacturing sector. So, have these discussions, and get a feel for, where one would balance these things out. Where, at which point, would employees feel comfortable. There is no right or wrong answer. It is the thought process, that counts. So, please try and do this with your peers, with your friends. Just discuss this, with your friends, and see what comes out. And, feel free to write to me. And, I will respond to you, if you have any questions. (Refer Slide Time: 42:15)



**Strategic integration of compensation plans and business plans** (Cascio, 2003)

- Recognition of compensation as a pivotal control and incentive mechanism that can be used flexibly by management to attain business objectives
- Integration of pay systems and business strategy formulation
- Integration of pay considerations into strategic decision making processes
- Viewing organization's performance as the ultimate criterion of the success of strategic pay decisions and operational compensation programs

The other thing, that we will talk about today is, strategic integration of compensation plans and business plans. We need to strategically integrate, our compensation plans, with our business plans, like I told you earlier. We need to compensate our employees. We need to give them money. We need to give them incentives. We need to give them benefits. We also need to make sure that, we make profits. And, that employees stay committed enough, to stay with us.

So, in order to do this, we need to recognize that, compensation is going to be a pivotal control. And, incentive mechanism, that can be used flexibly by management, to attain business objectives. Compensation is going to help us, move towards our strategic objectives. And, we need to pay a lot of attention to this. The other thing is, integration of pay systems and business strategy formulation. We should inter-twine the two. I would not say, business strategy should be dependent on pay systems, or the other way around.

But, they need to be inter-twined. How we decide, how much money is going to, go into the different stages of our business. When we talk about our business, we need to know, what stage our business is at. And, we talked about this, when we are talking about training. When the business is just being set up, you need entrepreneurs. You need risk takers. You may need to invest a lot of money, in experimentation. When the business stabilizes a little bit, when it becomes mature, a larger amount of money, will go into maintenance.

And, when the business is on a decline, then again, you will have to invest, a large amount of money, in reviving the business, and bring it up to speed with its competitors. So, and how do you find people, who can do that? What do you need to give them? What will drive them? You need to figure out those things. So, maybe, when your just setting up a business, the compensation plans could involve programs, that help the employees think.

So, you may need to spend a lot of money, on training and development. Training of employees, and research & development, when you are, just setting up the organization. You get in people, who are independent thinkers. Do not impose, too many restrictions on them. And, give them a chance to think independently. And, give them a lot of money, to explore their options. May be, invest more money in the training benefits. For example, let them go, and get some extra education. Call people over. I am just giving an example of how, you can integrate these things.

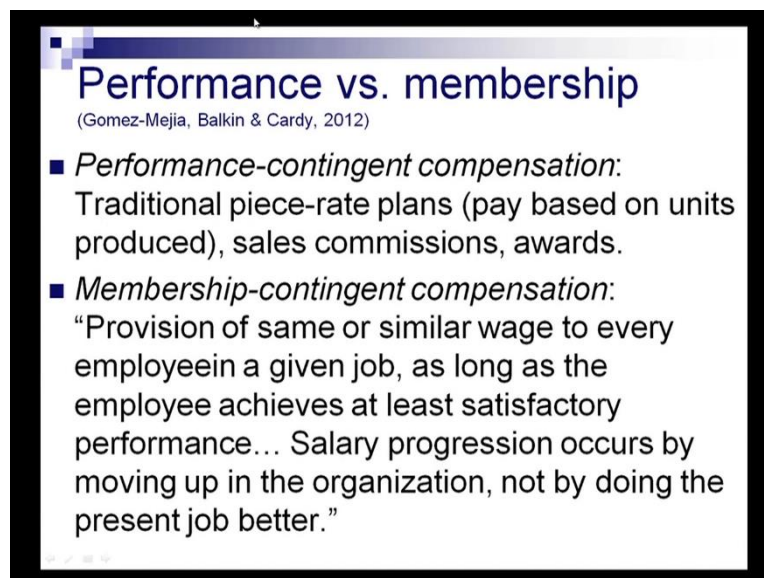
When your organization is at a stable mature stage, maybe, you need to spend money, you need to keep these people, who have taken it to that stage. So, you can give them, vacations and benefits. And, give them enough money and compensate them, enough. So, that they keep contributing, as much as, they have been to keep the organization, where it is. And, help it grow at a steady pace. So, you need senior employees. So, we need to find out, what they want. Maybe, have school benefits. Maybe, have health benefits. So, they do not go away.

So, I mean, all of these things, are very complex. You need to keep, the age of employees in mind. You need to keep, their life stage in mind. You need to keep, their needs in mind. You need to keep, so many things in mind. The next is integration of pay considerations into strategic decision-making processes. So, how do you compensate your employees? And, how much money do you give? And, how do you strategize with this decision-making processes, is something that, you really need to take care of.

The next one is, viewing the organization's performance, as the ultimate criterion of success of strategic pay decisions and operational compensation programs. At the end of the day, it is all about making money. At the end of the day, it is all about profits. The organization needs money to survive. So, at the end of the day, it is all about profits. It is all about strategizing. And, we need to calculate our output, in terms of the profits, we made. The input, that went into it.

And then, maybe, revise things, according to the feedback, we receive from, different stages of, how, we have implemented these programs. So, this is how, you strategically integrate the compensation plans, with your business plans. And, just like you evaluate your business plan, you also need to see, how these two, inter-twined. And, how they feed into each other. How much of impact, they are having, on each other. What you get out of them. And, how you need to keep them, strategically aligned. So, that you get, the maximum amount of benefit from, what you do.

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**Performance vs. membership**  
(Gomez-Mejia, Balkin & Cardy, 2012)

- **Performance-contingent compensation:**  
Traditional piece-rate plans (pay based on units produced), sales commissions, awards.
- **Membership-contingent compensation:**  
“Provision of same or similar wage to every employee in a given job, as long as the employee achieves at least satisfactory performance... Salary progression occurs by moving up in the organization, not by doing the present job better.”

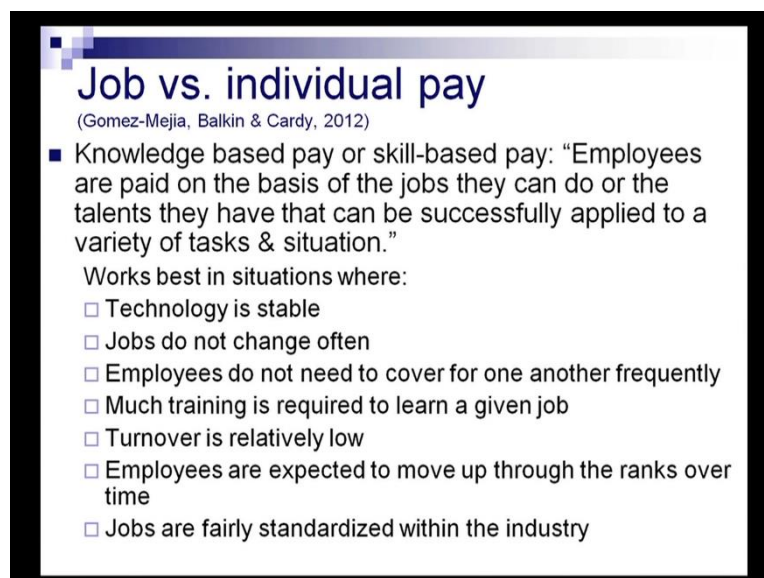
Some clarifications. When we talk about, performance versus membership. Performance, is a measure of your output. Membership, it means, the stage that, you are at, in your organization. So, when we talk about, performance versus membership related compensation. Performance contingent compensation, depends on, or it relates to, or it refers to, the traditional piece rate plans, could be based on. The piece rate plans are, pay based on, units produced. So, this is the number of, things that, you make. So, this is, here is your money. And, you have sales commission. You have rewards.

So, in the manufacturing sector, you will say, if your machine produces, these many things, this is the amount of money, you will get. If your unit produces, say 500 cars in a month. This is what, you will get. And, sales commissions, if you bring in, these many customers. If you sell our product or service, to these many customers, then this is the amount of money, you will get. And, if you go above and beyond the call of duty, and do y, then this is the amount of money, you will get. So, that is performance contingent compensation.

Membership contingent compensation means that, you provide the same or similar wage, to every employee, in a given job. As long as the employee achieves, at least satisfactory performance. So, you have a basic pay, basic salary. People do the bare minimum required. The salary progression occurs by moving up in the organization, not by doing the present job, better. You can be a great employee, but you do not get a raise.

You only get a promotion, when opportunities open up. That is traditionally, what happens in typical government organizations. You get your increments, every year, and unless do something, drastically wrong ; your increment comes in. And then, when you move up to the next rank, it really does not make a difference. But. They have done something good or not, your salary depends on the rank, you are at. And, that is called membership contingent compensation.

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**Job vs. individual pay**  
(Gomez-Mejia, Balkin & Cardy, 2012)

- Knowledge based pay or skill-based pay: “Employees are paid on the basis of the jobs they can do or the talents they have that can be successfully applied to a variety of tasks & situation.”  
Works best in situations where:
  - Technology is stable
  - Jobs do not change often
  - Employees do not need to cover for one another frequently
  - Much training is required to learn a given job
  - Turnover is relatively low
  - Employees are expected to move up through the ranks over time
  - Jobs are fairly standardized within the industry

We have job versus individual pay. Knowledge-based pay or skill-based pay, refers to the fact that, employees are, or the salary that employees are paid, on the basis of the jobs, they

can do, or the talents, they have, that can be successfully applied, to a variety of tasks and situations. So, that is, the job versus or knowledge-based pay. It works best in situations, where technology is stable. Where the jobs, do not change often. So, you do a certain kind of work, all the time. And, you do it really well. And, you get that much money, because of the output, your skills are contributing to.

So, that is the job-based pay. Your skills become the resource. When we talk about human resources management, the skills that you have, become the resource. And, these skills, in turn, result in output, which is measurable, which is tangible. And, the tangibility of, or the quantification of this tangible output, is what, determines your pay. So, this works best in situations, where the technology is stable. Where, you are doing the same thing you know, what you are working with. Where jobs, do not change often. Where the job description, does not change often.

Where employees, do not need to cover for, one another, frequently. Where, you do the same job, day after day, week after week, month after month. And, where, much training is required, to learn a given job. So, may be, you are coding. May be, you are writing, you are doing something physical, so, you learn, how to do it. And then, you keep doing it, again and again, and, again and again. The turnover is relatively low. So, you have been in that job, for a long period of time.

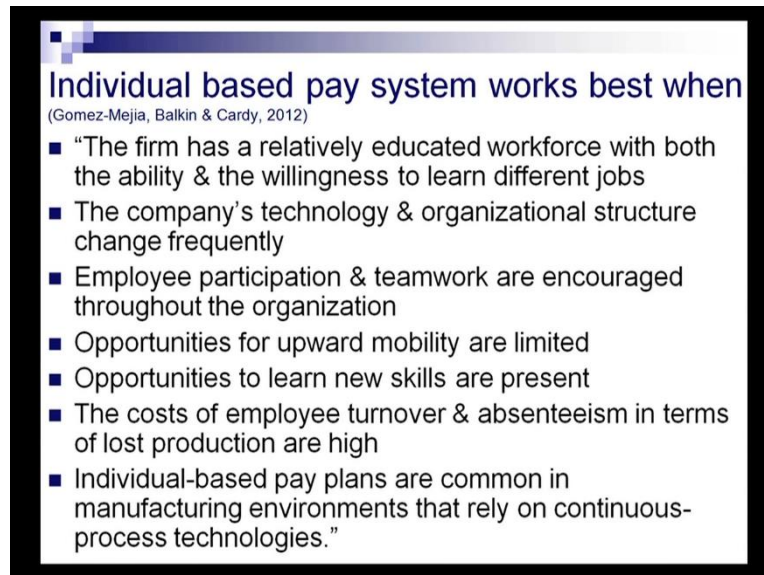
Employees are expected to move up, through the ranks, over time. Jobs are fairly standardized within the industry. The same kind of work, needs to be done. And, after the next position opens up, you go up in rank. You learn something new. And, you keep doing it, again and again and again. And then, you move up, and you do the same thing. So, in this kind of a set-up, this job-based pay is more applicable. It works best at that time. Now, you will say, how is this different from, what we just discussed earlier, which is the membership contingent compensation.

Membership contingent compensation is not related, to the output, that you have. Even, if the demands of your current rank change, you will still get the same pay. In this case, when we talk about, job-based pay. If the demands of the job descriptions changes, then the pay will change. The pay is tied, to the job description. And, the job description could to be identified, by the rank, that you get, or the designation, you have.



So, in the membership contingent compensation, the rank could, change shape. Here, the rank, the name of the rank, remains the same, or, the designation remains the same. The job description could change. Here, additional job descriptions, could be added. So, some difference here.

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**Individual based pay system works best when**  
(Gomez-Mejia, Balkin & Cardy, 2012)

- “The firm has a relatively educated workforce with both the ability & the willingness to learn different jobs
- The company’s technology & organizational structure change frequently
- Employee participation & teamwork are encouraged throughout the organization
- Opportunities for upward mobility are limited
- Opportunities to learn new skills are present
- The costs of employee turnover & absenteeism in terms of lost production are high
- Individual-based pay plans are common in manufacturing environments that rely on continuous-process technologies.”

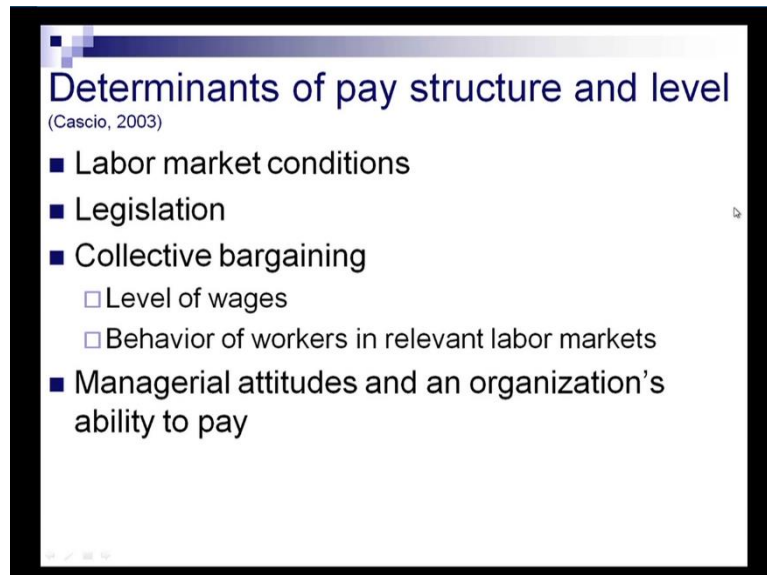
Individual-based pay system, works best, when the firm has a relatively educated workforce, with both the ability and willingness, to learn different jobs. So, you come with the set of skills. And then, you learn different things. And, you move up the ranks. So, you are well educated, and you adapt to the situation. That is the individual-based pay system. The company's technology, and organization structure, change frequently. So, that is another place, where the individual-based pay system, works best.

Then, the employee participation and teamwork are encouraged, throughout the organization. The opportunities for, upward mobility, are limited. You do not have, very many opportunities, for upward mobility. But, you are able to do, a lot of things, within your current job. So, that is another place, this kind of individual-based pay system, is very helpful. Then, the opportunities, to learn new skills, are present. So, you keep doing, whatever you are doing. And, you do the best, you can. But, the progression up, is not there. It just depends on, what you can learn, and what you can contribute.

The costs of employee turnover and absenteeism, in terms of lost production, are high. The job is complex. The demands of the job are, so high, that not many people, want to change.

If people are absent, then it has a negative impact, on the quality of the output. Individual-based pay plans, are common in manufacturing environments, that rely on continuous process technologies; a factory. You are doing the same thing, again, and again, and again, and again, and again. So, that is where, this works best.

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Some determinants of pay structure and level. Some things, that determine, how you create a pay structure are, number one. Labor market conditions. What is going on, in the world around you? How many people are there, with the same skill set, as you? How many people are there, who can do the same thing, that you are doing? And, what is required by the organization? Legislation. What does the law say? The law will tell you that, the minimum wage, that has to be given to an employee, in the manufacturing sector is x. So, you are, the salary, you determine for your employees, cannot be less than that. That is legislation.

Collective bargaining, happens all the time. A lot of time, students do this. They will get a certain offer, from somewhere. And then, they will take their, that offer letter. And, lot of them, will get together. If organization decides to take in students, from a particular college or a school. They take all these employees. They give them, a certain offer. And, they are all, so great. They all have, is a specified, very specific skills set. And, they will say, we will not join you, till all of us get a salary, that is x percent higher than, what you have offered us.

So, it is collective bargaining. All of us, will not, we will not come to work, till you raise our salaries, by this much. And, that is called collective bargaining. It is a result, of the level of

wages. It is also a result of, behavior of workers, in relevant labor market. So, we will see, what our competitors are doing. And then, we will all say, ay. No pilots are coming into work, today. Let us see, what happens. No doctors are coming into work, today. Let us see, what happens. No safaai karam charis are work, are coming to work in Delhi. Let us see, what happens. Let us all, go on strike. Let us all, try and convince people, who are deciding our salaries.

So, that is the collective bargaining. Managerial attitudes, and an organization's ability, to pay. So, these are all determinants of the pay structure, and the level of salary, that we give to our employees. Now, that ends this particular lecture. In the next lecture, we will discuss, incentive and reward systems. So, thank you very much, for listening. Please note down, any confusions, you may have. And, I will continue with this, in the next lecture. Thank you.